

PEPCO HOLDINGS INC  
Form 10-Q/A  
March 14, 2005

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

FORM 10-Q/A

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended March 31, 2004

| <u>Commission<br/>File Number</u> | <u>Name of Registrant, State of<br/>Incorporation, Address of Principal<br/>Executive Offices,<br/>and Telephone Number</u>   | <u>I.R.S. Employer<br/>Identification Number</u> |
|-----------------------------------|---|--|
| 001-31403                         | PEPCO HOLDINGS, INC.<br><br>(Pepco Holdings or PHI), a<br>Delaware corporation<br>701 Ninth Street, N.W.<br>Washington, D.C. 20068<br>Telephone: (202)872-2000                          | 52-2297449                                       |
| 001-01072                         | POTOMAC ELECTRIC POWER<br>COMPANY<br><br>(Pepco), a District of<br>Columbia and Virginia<br>corporation<br>701 Ninth Street, N.W.<br>Washington, D.C. 20068<br>Telephone: (202)872-2000 | 53-0127880                                       |
| 001-01405                         | DELMARVA POWER & LIGHT<br>COMPANY<br><br>(DPL), a Delaware and<br>Virginia corporation<br>800 King Street, P.O. Box 231<br>Wilmington, Delaware 19899<br>Telephone: (202)872-2000       | 51-0084283                                       |

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001-03559 ATLANTIC CITY ELECTRIC COMPANY 21-0398280

(ACE), a New Jersey corporation  
800 King Street, P.O. Box 231  
Wilmington, Delaware 19899  
Telephone: (202)872-2000

333-59558 ATLANTIC CITY ELECTRIC TRANSITION FUNDING LLC 51-0408521

(ACE Funding), a Delaware limited liability company  
P.O. Box 15597  
Wilmington, Delaware 19850  
Telephone: (202)872-2000

Continued

Securities registered pursuant to Section 12(b) of the Act:

| <u>Registrant</u> | <u>Title of Each Class</u>   | <u>Name of Each Exchange on Which Registered</u> |
|-------------------|--|--|
| Pepco Holdings    | Common Stock, \$.01 par value  | New York Stock Exchange                          |
| DPL               | Guarantee by DPL of the 8.125% Cumulative Trust Preferred Capital Securities of Delmarva Power Financing I | New York Stock Exchange                          |

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

Pepco Serial Preferred Stock, \$50 par value

Indicate by check mark whether each of the registrants (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 and (2) has been subject to such filing requirements for the past 90 days. Yes X. No   .

Indicate by check mark whether Pepco Holdings is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes X. No   .

Pepco, DPL, ACE, and ACE Funding are not accelerated filers.

DPL, ACE and ACE Funding

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meet the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q and are therefore filing this Form 10-Q/A with reduced disclosure format specified in General Instruction H(2) of Form 10-Q.

| <u>Registrant</u> | <u>Number of Shares of Common Stock of the Registrant Outstanding at March 31, 2004</u> |
|-------------------|---|
| Pepco Holdings    | 172,171,604 (\$.01 par value)   |
| Pepco             | 100 (\$.01 par value) (a)   |
| DPL               | 1,000 (\$2.25 par value) (b)  |
| ACE               | 12,886,853 (\$3 par value)(b)   |
| ACE Funding       | None (c)  |

- (a) All voting and non-voting common equity is owned by Pepco Holdings.
- (b) All voting and non-voting common equity is owned by Conectiv, a wholly owned subsidiary of Pepco Holdings.
- (c) All voting and non-voting common equity is owned by ACE.

### EXPLANATORY NOTE

This Form 10-Q/A of Pepco Holdings, Inc. ("PHI"), Potomac Electric Power Company ("Pepco"), Delmarva Power & Light Company ("DPL"), Atlantic City Electric Company ("ACE") and Atlantic City Electric Transition Funding LLC ("ACE Funding" and, together with PHI, Pepco, DPL and ACE, the "Reporting Companies") amends the Quarterly Reports on Form 10-Q for the quarter ended March 31, 2004, of the Reporting Companies. This Form 10-Q/A is being filed to make changes requested by the staff of the Securities and Exchange Commission based on its review of the prior filings.

The amendments contained herein consist of:

- 
- In Part I, Item 4 Controls and Procedures of each of PHI, Pepco, DPL and ACE, a change to the wording used to disclose the conclusions of its chief executive officer and chief financial officer regarding the effectiveness of each company's disclosure controls and procedures. This wording change does not, in the view of each of PHI, Pepco, DPL and ACE, reflect a substantive change in the conclusions of its chief executive officer and chief financial officer regarding the effectiveness of its disclosure controls and procedures from that which was stated in the prior filing;
  - The replacement of the certifications of PHI, Pepco, DPL and ACE required by Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended, and filed as Exhibits 31.1 through 31.8, with new certifications amended solely to delete the title of the respective company's chief executive officer and chief financial officer from the introductory paragraph of their respective certifications; and
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The replacement of the certification of ACE Funding required by Rule 15d-14(d) under the Securities Exchange Act of 1934, as amended, and filed as Exhibit 31.9, with a new certification amended solely to delete the title of ACE Funding's chairman from the introductory paragraph of his certification.

The chief executive officer and chief financial officer of each of PHI, Pepco, DPL and ACE have determined that the filing of this Form 10-Q/A to make these changes to such company's prior disclosures has not altered their conclusions with regard the effectiveness of such company's disclosure controls and procedures as set forth in Part I, Item 4 of PHI's, Pepco's, DPL's and ACE's Form 10-Q for the quarter ended March 31, 2004.

\* \* \*

Except for the foregoing amendments, no other information in each Reporting Company's Form 10-Q has been modified, supplemented or updated.

THIS COMBINED FORM 10-Q/A IS SEPARATELY FILED BY PEPCO HOLDINGS, PEPCO, DPL, ACE, AND ACE FUNDING. INFORMATION CONTAINED HEREIN RELATING TO ANY INDIVIDUAL REGISTRANT IS FILED BY SUCH REGISTRANT ON ITS OWN BEHALF. EACH REGISTRANT MAKES NO REPRESENTATION AS TO INFORMATION RELATING TO THE OTHER REGISTRANTS.

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|-------------|-------------|---|-----|

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## **GLOSSARY OF TERMS**

| <b><u>Term</u></b>                | <b><u>Definition</u></b>  |
|-----------------------------------|---|
| ABO                               | Accumulated benefit obligation  |
| ACE                               | Atlantic City Electric Company  |
| ACE Funding                       | Atlantic City Electric Transition Funding LLC   |
| Ancillary services                | Generally, electricity generation reserves and reliability services   |
| APCA                              | New Jersey Air Pollution Control Act  |
| Act                               | Medicare Prescription Drug, Improvement and Modernization Act of 2003   |
| APB                               | Accounting Principles Board Opinion   |
| APBO                              | Accumulated Post-retirement Benefit Obligation  |
| Asset Purchase and Sale Agreement | Asset Purchase and Sale Agreement, dated as of June 7, 2000 and subsequently amended, between Pepco and Mirant (formerly Southern Energy, Inc.) relating to the sale of Pepco's generation assets |
| Bankruptcy Court                  | Bankruptcy Court for the Northern District of Texas   |
| BGS                               | Basic generation service (the supply of energy to customers in New Jersey who have not chosen a competitive supplier)   |
| BTP                               | Bondable Transition Property  |

|                               |   |
|-------------------------------|---|
| CAA                           | Clean Air Act   |
| Competitive Energy Business   | Consists of the business operations of Conectiv Energy and Pepco Energy Services  |
| Conectiv                      | A wholly owned subsidiary of PHI which is a PUHCA holding company and the parent of DPL and ACE   |
| Conectiv Energy               | Conectiv Energy Holding Company and its subsidiaries  |
| Conectiv Power Delivery (CPD) | The tradename under which DPL and ACE conduct their power delivery operations   |
| CT                            | Combustion turbine  |
| DCPSC                         | District of Columbia Public Service Commission  |
| Debentures                    | Junior Subordinated Debentures  |
| Delivery revenue              | Revenue Pepco receives for delivering energy to its customers   |
| District Court                | U.S. District Court for the Northern District of Texas  |
| DMEC                          | Delaware Municipal Electric Corporation   |
| DPL                           | Delmarva Power & Light Company  |
| DPSC                          | Delaware Public Service Commission  |
| EDECA                         | New Jersey Electric Discount and Energy Competition Act   |
| EITF                          | Emerging Issues Task Force  |
| EITF 03-11                    | Emerging Issues Task Force 03-11 entitled "Reporting Realized Gains and Losses on Derivative Instruments that are Subject to FASB Statement No. 133, 'Accounting for Derivative Instruments and Hedging Activities,' and not 'Held for Trading Purposes'" |
| EPA                           | Environmental Protection Agency   |
| ERISA                         | Employment Retirement Income Security Act of 1974   |
| Exchange Act                  | Securities Exchange Act of 1934, as amended   |
| FASB                          | Financial Accounting Standards Board  |
| FERC                          | Federal Energy Regulatory Commission  |
| FIN 45                        | FASB Interpretation No. 45, entitled "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others"   |

|             |  |
|-------------|--|
| FIN 46      | FASB Interpretation No. 46, entitled "Consolidation of Variable Interest Entities"                         |
| FIN 46R     | FASB Interpretation No. 46 (revised December 2003), entitled "Consolidation of Variable Interest Entities" |
| FirstEnergy | FirstEnergy Corp., formerly Ohio Edison  |

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| <u>Term</u>                     | <u>Definition</u>   |
|---------------------------------|---|
| FirstEnergy PPA                 | PPAs between Pepco and FirstEnergy Corp. and Allegheny Energy, Inc.   |
| FSP                             | FASB Staff Position   |
| FSP 106-1                       | FASB Staff Position 106-1, entitled "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003"                         |
| GAAP                            | Accounting principles generally accepted in the United States of America  |
| GCR                             | Gas Cost Recovery   |
| GPC                             | Generation Procurement Credit   |
| LTIP                            | Long-Term Incentive Plan  |
| Mirant                          | Mirant Corporation and certain of its subsidiaries  |
| Mirant Pre-Petition Obligations | Unpaid obligations of Mirant to Pepco existing at the time of filing of Mirant's bankruptcy petition consisting primarily of payments due Pepco in respect of the PPA-Related Obligations |
| MPSC                            | Maryland Public Service Commission  |
| NERC                            | North American Electric Reliability Counsel   |
| NJBPU                           | New Jersey Board of Public Utilities  |
| NJBPU Financing Orders          | Bondable stranded costs rate orders issued by the NJBPU   |
| NJDEP                           | New Jersey Department of Environmental Protection   |
| NOx                             | Nitrogen oxide emissions  |
| OCI                             | Other Comprehensive Income  |
| OPC                             | Maryland Office of the People's Counsel   |

|                             |   |
|-----------------------------|---|
| Panda                       | Panda-Brandywine, L.P.  |
| Panda PPA                   | PPA between Pepco and Panda   |
| PCI                         | Potomac Capital Investment Corporation and its subsidiaries   |
| Pepco                       | Potomac Electric Power Company  |
| Pepco Energy Services       | Pepco Energy Services, Inc. and its subsidiaries  |
| Pepco Holdings or PHI       | Pepco Holdings, Inc.  |
| Pepco TPA Claim             | Pepco's \$105 million allowed, pre-petition general unsecured claim against Mirant  |
| Pepcom                      | Pepco Communications, Inc.  |
| PJM                         | PJM Interconnection, LLC  |
| PPA                         | Power Purchase Agreement  |
| PPA-Related Obligations     | Mirant's obligations to purchase from Pepco the capacity and energy that Pepco is obligated to purchase under the FirstEnergy PPA and the Panda PPA |
| PSD                         | Prevention of Significant Deterioration provisions of the CAA   |
| PUHCA                       | Public Utility Holding Company Act of 1935  |
| RARC                        | Regulatory Asset Recovery Charge  |
| RCN                         | RCN Corporation   |
| Recoverable stranded costs  | The portion of stranded costs that is recoverable from ratepayers as approved by regulatory authorities   |
| Regulated electric revenues | Revenues for delivery (transmission and distribution) service and electricity supply service  |
| SEC                         | Securities and Exchange Commission  |
| Settlement Agreement        | Amended Settlement Agreement and Release, dated as of October 24, 2003 between Pepco and the Mirant Parties   |
| SFAS                        | Statement of Financial Accounting Standards   |
| SFAS No. 106                | Statement of Financial Accounting Standards No. 106, entitled "Employers Accounting for Post-retirement Benefits Other than Pensions"               |

| <u>Term</u>                                   | <u>Definition</u>   |
|---|---|
| SFAS No. 123                                  | Statement of Financial Accounting Standards No. 123, entitled "Accounting for Stock-Based Compensation"   |
| SFAS No. 131                                  | Statement of Financial Accounting Standards No. 131, entitled "Disclosures About Segments of an Enterprise and Related Information"   |
| SFAS No. 132                                  | Statement of Financial Accounting Standards No. 132, entitled "Employers Disclosures about Pensions and Other Post-retirement Benefits"   |
| SFAS No. 133                                  | Statement of Financial Accounting Standards No. 133, entitled "Accounting for Derivative Instruments and Hedging Activities"  |
| SFAS No. 148                                  | Statement of Financial Accounting Standards No. 148 entitled "Accounting For Stock-Based Compensation - Transition and Disclosure"  |
| SFAS No. 150                                  | Statement of Financial Accounting Standards No. 150, entitled "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity"  |
| SMECO   | Southern Maryland Electric Cooperative, Inc.  |
| SMECO Agreement                               | Capacity purchase agreement between Pepco and SMECO   |
| SO <sub>2</sub>                               | Sulfur dioxide emissions  |
| SOS   | Standard Offer Service (the supply of energy to customers in Maryland and the District of Columbia who have not chosen a competitive supplier)  |
| Standard Offer Service revenue or SOS revenue | Revenue Pepco receives for the procurement of energy by Pepco for its SOS customers   |
| Starpower                                     | Starpower Communications, LLC   |
| Stranded costs                                | Costs incurred by a utility in connection with providing service which would otherwise be unrecoverable in a competitive or restructured market. Such costs may include costs for generation assets, purchased power costs, and regulatory assets and liabilities, such as accumulated deferred income taxes. |
| TBC   | Transition bond charge  |
| TPAs  | Transition Power Agreements for Maryland and the District of Columbia between Pepco and Mirant  |
| Transition Bonds                              | Transition bonds issued by ACE Funding  |
| Treasury lock                                 | A hedging transaction that allows a company to "lock-in" a specific interest rate corresponding to the rate of a designated Treasury bond for a determined period of time   |

VaR

Value at Risk

VSCC

Virginia State Corporation Commission

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PART I FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS

Listed below is a table that sets forth, for each registrant, the page number where the information is contained herein.

| <u>Item</u>                                     | <u>Registrants</u>    |              |            |            |                    |
|---|-----------------------|--------------|------------|------------|--------------------|
|   | <u>Pepco Holdings</u> | <u>Pepco</u> | <u>DPL</u> | <u>ACE</u> | <u>ACE Funding</u> |
| Consolidated Statements of Earnings             | 3                     | 28           | 42         | 52         | 63                 |
| Consolidated Statements of Comprehensive Income | 4                     | N/A          | N/A        | N/A        | N/A                |
| Consolidated Balance Sheets                     | 5                     | 29           | 43         | 53         | 64                 |
| Consolidated Statements of Cash Flows           | 7                     | 31           | 45         | 55         | 65                 |
| Notes to Consolidated Financial Statements      | 8                     | 32           | 46         | 56         | 66                 |

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PEPCO HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)  
(Unaudited)

|                                 | Three Months Ended<br>March 31,         |          |
|---------------------------------|---|----------|
|                                 | 2004                                    | 2003     |
|                                 | (Millions, except<br>\$ per share data) |          |
| Operating Revenue               |   |          |
| Power Delivery                  | \$1,039.6                               | \$ 974.3 |
| Conectiv Energy                 | 391.8                                   | 611.2    |
| Pepco Energy Services           | 310.2                                   | 314.3    |
| Other Non-Regulated             | 22.5                                    | 28.9     |
| Total Operating Revenue         | 1,764.1                                 | 1,928.7  |
| Operating Expenses              |   |          |
| Fuel and purchased energy       | 1,067.0                                 | 1,300.4  |
| Other operation and maintenance | 358.9                                   | 370.4    |
| Depreciation and amortization   | 112.8                                   | 104.0    |
| Other taxes                     | 72.0                                    | 62.0     |
| Deferred electric service costs | 15.0                                    | -        |

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|   |          |          |
|---|----------|----------|
| Impairment losses                                     | -        | 52.8     |
| Gain on sale of assets                                | (12.1)   | -        |
| Total Operating Expenses                              | 1,613.6  | 1,889.6  |
| Operating Income                                      | 150.5    | 39.1     |
| Other Income (Expenses)                               |          |          |
| Interest and dividend income                          | 1.2      | 7.2      |
| Interest expense                                      | (92.6)   | (89.1)   |
| Loss from equity investments                          | (.4)     | (3.4)    |
| Other income  | 5.3      | 8.0      |
| Other expenses  | (.7)     | (2.1)    |
| Total Other Expenses                                  | (87.2)   | (79.4)   |
| Preferred Stock Dividend Requirements of Subsidiaries | .7       | 6.6      |
| Income (Loss) Before Income Tax Expense (Benefit)     | 62.6     | (46.9)   |
| Income Tax Expense (Benefit)                          | 11.4     | (22.0)   |
| Net Income (Loss)                                     | 51.2     | (24.9)   |
| Retained Income at Beginning of Period                | 781.0    | 838.2    |
| Dividends on Common Stock                             | (42.9)   | (42.7)   |
| Retained Income at End of Period                      | \$ 789.3 | \$ 770.6 |
| Basic and Diluted Share Information                   |          |          |
| Weighted average shares outstanding                   | 171.8    | 170.0    |
| Earnings (loss) per share of common stock             | \$.30    | \$(.15)  |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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(Unaudited)

|  | Three Months Ended<br>March 31, |          |
|--|---------------------------------|----------|
|  | 2004                            | 2003     |
|  | (Millions of Dollars)           |          |
| Net income (loss)  | \$51.2                          | \$(24.9) |
| Other comprehensive income, net of taxes   |                                 |          |
| Unrealized gains on commodity<br>derivatives designated as cash flow hedges                  |                                 |          |
| Unrealized holding gains arising during period   | 21.9                            | 20.8     |
| Less: reclassification adjustment for<br>gains included in net earnings                      | 1.5                             | 9.9      |
| Net unrealized gains on commodity derivatives  | 20.4                            | 10.9     |
| Realized gain on Treasury lock   | 2.9                             | 3.0      |
| Unrealized (losses) gain on interest rate swap<br>agreements designated as cash flow hedges: |                                 |          |
| Unrealized holding losses arising during period  | (9.0)                           | (.4)     |
| Less: reclassification adjustment for (loss) gain<br>included in net earnings                | (.4)                            | 1.5      |
| Net unrealized (losses) on interest rate swaps   | (8.6)                           | (1.9)    |
| Unrealized gains on marketable securities:   |                                 |          |
| Unrealized holding gains arising during period   | .3                              | .6       |
| Less: reclassification adjustment for gains<br>included in net earnings                      | -                               | -        |
| Net unrealized gains on marketable securities  | .3                              | .6       |
| Other comprehensive income, before taxes   | 15.0                            | 12.6     |
| Income tax expense   | 6.6                             | 6.9      |
| Other comprehensive income, net of taxes   | 8.4                             | 5.7      |

|                             |        |          |
|-----------------------------|--------|----------|
| Comprehensive income (loss) | \$59.6 | \$(19.2) |
|-----------------------------|--------|----------|

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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PEPCO HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)

|   | March 31,<br>2004     | December 31,<br>2003 |
|---|-----------------------|----------------------|
| ASSETS  |                       |                      |
|   | (Millions of Dollars) |                      |
| CURRENT ASSETS  |                       |                      |
| Cash and cash equivalents   | \$ 302.9              | \$ 100.3             |
| Restricted cash   | .2                    | .5                   |
| Restricted funds held by trustee  | 11.4                  | 8.3                  |
| Marketable securities   | 26.3                  | 28.7                 |
| Accounts receivable, less allowance for<br>uncollectible accounts of \$44.8 million<br>and \$43.5 million, respectively | 1,155.0               | 1,136.3              |
| Fuel, materials and supplies-at average cost  | 252.4                 | 281.2                |
| Prepaid expenses and other  | 59.9                  | 73.6                 |
| Total Current Assets  | 1,808.1               | 1,628.9              |
| INVESTMENTS AND OTHER ASSETS  |                       |                      |
| Goodwill  | 1,434.3               | 1,434.3              |
| Regulatory assets   | 1,459.2               | 1,506.6              |

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|  |            |            |
|--|------------|------------|
| Investment in finance leases held in trust | 1,162.0    | 1,143.1    |
| Investment in financing trusts             | 2.2        | 2.9        |
| Prepaid pension expense                    | 158.9      | 166.6      |
| Other                                      | 580.4      | 539.0      |
| Total Investments and Other Assets         | 4,797.0    | 4,792.5    |
| PROPERTY, PLANT AND EQUIPMENT              |            |            |
| Property, plant and equipment              | 10,696.0   | 10,747.2   |
| Accumulated depreciation                   | (3,751.3)  | (3,782.3)  |
| Net Property, Plant and Equipment          | 6,944.7    | 6,964.9    |
| TOTAL ASSETS                               | \$13,549.8 | \$13,386.3 |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

PEPCO HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)

|                                      | March 31,<br>2004     | December 31,<br>2003 |
|--------------------------------------|-----------------------|----------------------|
| LIABILITIES AND SHAREHOLDERS' EQUITY |                       |                      |
|                                      | (Millions of Dollars) |                      |

CURRENT LIABILITIES

|  |            |          |
|--|------------|----------|
| Short-term debt                          | \$ 1,044.7 | \$ 898.3 |
| Accounts payable and accrued liabilities | 602.4      | 699.6    |
| Debentures issued to financing trust     | 72.2       | 25.8     |

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|   |         |         |
|---|---------|---------|
| Capital lease obligations due within one year | 15.8    | 15.8    |
| Interest and taxes accrued                    | 79.5    | 96.8    |
| Other   | 361.6   | 354.1   |
| Total Current Liabilities                     | 2,176.2 | 2,090.4 |

DEFERRED CREDITS

|  |         |         |
|--|---------|---------|
| Regulatory liabilities                   | 459.7   | 479.9   |
| Income taxes                             | 1,831.9 | 1,777.0 |
| Investment tax credits                   | 62.3    | 63.7    |
| Other post-retirement benefit obligation | 285.6   | 276.9   |
| Other                                    | 298.6   | 259.1   |
| Total Deferred Credits                   | 2,938.1 | 2,856.6 |

LONG-TERM LIABILITIES

|   |         |         |
|---|---------|---------|
| Long-term debt                                | 4,641.3 | 4,588.9 |
| Transition Bonds issued by ACE Funding        | 544.2   | 551.3   |
| Debentures issued to financing trust          | -       | 72.2    |
| Mandatorily redeemable serial preferred stock | 45.0    | 45.0    |
| Capital lease obligations                     | 114.4   | 115.4   |
| Total Long-Term Liabilities                   | 5,344.9 | 5,372.8 |

COMMITMENTS AND CONTINGENCIES

PREFERRED STOCK OF SUBSIDIARIES

|                                   |      |      |
|-----------------------------------|------|------|
| Serial preferred stock            | 35.3 | 35.3 |
| Redeemable serial preferred stock | 27.9 | 27.9 |
| Total preferred stock             | 63.2 | 63.2 |

SHAREHOLDERS' EQUITY

|  |         |         |
|--|---------|---------|
| Common stock, \$.01 par value, - authorized 400,000,000 shares and 200,000,000 shares, respectively - issued 172,171,604 shares and 171,769,448 shares, respectively | 1.7     | 1.7     |
| Premium on stock and other capital contributions   | 2,254.0 | 2,246.6 |
| Capital stock expense  | (3.3)   | (3.3)   |

|  |                |                |
|--|----------------|----------------|
| Accumulated other comprehensive loss           | (14.3)         | (22.7)         |
| Retained income                                | 789.3          | 781.0          |
| Total Shareholders' Equity                     | 3,027.4        | 3,003.3        |
| <br>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | <br>\$13,549.8 | <br>\$13,386.3 |

The accompanying Notes are an integral part of these Consolidated Financial Statements

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PEPCO HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

Three Months Ended  
March 31,  
2004 2003  
(Millions of Dollars)

OPERATING ACTIVITIES

|  |         |           |
|--|---------|-----------|
| Net income (loss)  | \$ 51.2 | \$ (24.9) |
| Adjustments to reconcile net income to net cash from operating activities: |         |           |
| Gain on sale of assets   | (12.1)  | -         |
| Net (gain) loss on derivative contracts                                    | (1.9)   | 66.5      |
| Depreciation and amortization  | 112.8   | 104.0     |
| Impairment loss  | -       | 52.8      |
| Rents received from leveraged leases under income earned                   | (21.3)  | (16.1)    |
| Deferred income taxes  | (3.9)   | (5.1)     |
| Investment tax credit adjustments, net                                     | (1.3)   | (1.3)     |
| Changes in:  |         |           |
| Accounts receivable  | 48.0    | (42.3)    |
| Regulatory assets and liabilities  | 12.6    | (22.1)    |
| Other deferred charges   | 2.7     | 1.7       |

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|  |         |         |
|--|---------|---------|
| Prepaid expenses                                       | 24.9    | (32.2)  |
| Prepaid pension costs                                  | 7.7     | 3.1     |
| Fuel, materials and supplies                           | 28.9    | 30.4    |
| Accounts payable and accrued liabilities               | (72.4)  | (80.9)  |
| Interest and taxes accrued                             | (37.8)  | 12.6    |
| Net Cash from Operating Activities                     | 138.1   | 46.2    |
| INVESTING ACTIVITIES                                   |         |         |
| Net investment in property, plant and equipment        | (94.3)  | (149.1) |
| Proceeds from sale of assets                           | 28.5    | -       |
| Proceeds from sales of marketable securities           | 11.5    | 106.0   |
| Purchases of marketable securities                     | (8.8)   | (97.8)  |
| Proceeds from sales of other investments               | -       | 11.5    |
| Purchases of other investments                         | (0.2)   | (1.3)   |
| Changes in restricted cash                             | 0.3     | 2.0     |
| Net other investing activities                         | 1.1     | 3.3     |
| Net Cash Used By Investing Activities                  | (61.9)  | (125.4) |
| FINANCING ACTIVITIES                                   |         |         |
| Dividends paid on preferred and common stock           | (43.6)  | (44.3)  |
| Common stock issued for the Dividend Reinvestment Plan | 7.4     | 6.6     |
| Redemption of debentures issued to financing trust     | (25.0)  | -       |
| Redemption of Trust Preferred Stock                    | -       | (70.0)  |
| Issuances of long-term debt                            | 275.0   | 300.0   |
| Reacquisition of long-term debt                        | (43.4)  | (112.5) |
| (Repayment) Issuances of short-term debt, net          | (39.4)  | 15.5    |
| Cost of issuances and financings                       | (3.4)   | (3.1)   |
| Net other financing activities                         | (1.2)   | (1.1)   |
| Net Cash from Financing Activities                     | 126.4   | 91.1    |
| Net Increase in Cash and Cash Equivalents              | 202.6   | 11.9    |
| Cash and Cash Equivalents at Beginning of Period       | 100.3   | 82.5    |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD             | \$302.9 | \$ 94.4 |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

PEPCO HOLDINGS, INC.

### (1) ORGANIZATION

Pepco Holdings, Inc. (Pepco Holdings or PHI) is a diversified energy company that, through its operating subsidiaries, is engaged in three principal areas of business operations:

- regulated power delivery,
- non-regulated competitive energy generation, marketing and supply, and
- other non-regulated activities consisting primarily of investments in energy-related assets.

PHI is a public utility holding company registered under the Public Utility Holding Company Act of 1935 (PUHCA) and is subject to the regulatory oversight of the Securities and Exchange Commission (SEC) under PUHCA. As a registered public utility holding company, PHI requires SEC approval to, among other things, issue securities, acquire or dispose of utility assets or securities of utility companies and acquire other businesses. In addition, under PUHCA, transactions among PHI and its subsidiaries generally must be performed at cost and subsidiaries are prohibited from paying dividends out of an accumulated deficit or paid-in capital without SEC approval.

PHI was incorporated in Delaware on February 9, 2001, for the purpose of effecting the acquisition of Conectiv by Potomac Electric Power Company (Pepco). The acquisition was completed on August 1, 2002, at which time Pepco and Conectiv became wholly owned subsidiaries of PHI. Conectiv was formed in 1998 to be the holding company for Delmarva Power & Light Company (DPL) and Atlantic City Electric Company (ACE) in connection with a merger between DPL and ACE. As a result, DPL and ACE are wholly owned subsidiaries of Conectiv. Conectiv also is a registered public utility holding company under PUHCA.

PHI Service Company, a subsidiary service company of PHI, provides a variety of support services, including legal, treasury, accounting, tax, purchasing and information technology services to Pepco Holdings and its operating subsidiaries. These services are provided pursuant to a service agreement among PHI, PHI Service Company, and the participating operating subsidiaries that has been filed with, and approved by, the SEC under PUHCA. The expenses of the service company are charged to PHI and the participating operating subsidiaries in accordance with costing methodologies set forth in the service agreement.

The following is a description of each of PHI's areas of operation.

Power Delivery

The largest component of PHI's business is power delivery, which consists of the transmission and distribution of electricity and the distribution of natural gas. PHI's power delivery business is conducted by its subsidiaries Pepco, DPL and ACE, each of which is a regulated public utility in the jurisdictions in which it serves customers. DPL and ACE conduct their power delivery operations under the trade name Conectiv Power Delivery.

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### Competitive Energy

PHI's competitive energy business provides non-regulated generation, marketing and supply of electricity and gas, and related energy management services, in the mid-Atlantic region. PHI's competitive energy operations are conducted through subsidiaries of Conectiv Energy Holding Company (collectively, Conectiv Energy) and Pepco Energy Services, Inc. and its subsidiaries (collectively, Pepco Energy Services).

### Other Non-Regulated

This component of PHI's business is conducted through its subsidiaries Potomac Capital Investment Corporation (PCI) and Pepco Communications, Inc. (Pepcom). PCI manages a portfolio of financial investments, which primarily includes energy leveraged leases. During the second quarter of 2003, PHI announced the discontinuation of further new investment activity by PCI. Pepcom through a subsidiary currently owns a 50% interest in Starpower Communications, LLC (Starpower), a joint venture with RCN Corporation (RCN), which provides cable and telecommunication services to households in the Washington, D.C. area. As part of PHI's strategy of focusing on energy-related investments, PHI in January 2004 announced that Pepcom intends to sell its interest in Starpower. PHI cannot predict whether Pepcom's efforts to sell its interest in Starpower will be successful or, if successful, when a sale would be completed or what the sale proceeds would be. As of December 31, 2003, PHI determined that its investment in Starpower was impaired and therefore recorded a non-cash charge of \$102.6 million during the fourth quarter of 2003.

## (2) ACCOUNTING POLICY AND PRONOUNCEMENTS DISCLOSURES

### Financial Statement Presentation

Pepco Holdings' unaudited consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Pursuant to the rules and regulations of the SEC, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted. Therefore, these financial statements should be read along with the annual financial statements included in PHI's Annual Report on Form 10-K/A for the year ended December 31, 2003. In the opinion of PHI's management, the consolidated financial statements contain all adjustments (which all are of a normal recurring nature) necessary to present fairly Pepco Holdings' financial condition as of March 31, 2004, in accordance with GAAP. Interim results for the three months ended March 31, 2004 may not be indicative of results that will be realized for the full year ending December 31, 2004. Additionally, certain prior period balances have been reclassified in order to conform to current period presentation.

### FIN 45

Pepco Holdings applied the provisions of FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45), commencing in 2003 to its agreements that contain guarantee and indemnification clauses. These provisions expand those required by FASB Statement No. 5, "Accounting for Contingencies," by requiring a guarantor to recognize a liability on its balance sheet for the fair value of obligations it assumes under certain guarantees issued or modified after December 31, 2002 and to disclose certain

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types of guarantees, even if the likelihood of requiring the guarantor's performance under the guarantee is remote.

As of March 31, 2004, Pepco Holdings did not have material obligations under guarantees or indemnifications issued or modified after December 31, 2002, which are required to be recognized as a liability on its consolidated balance sheets, however, certain energy marketing obligations of Conectiv Energy were recorded.

#### FIN 46

On December 31, 2003, FIN 46 was implemented by Pepco Holdings. FIN 46 was revised and superseded by FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (FIN 46R) which clarified some of the provisions of FIN 46 and exempted certain entities from its requirements. FIN 46R is applicable to Pepco Holdings' financial statements for the quarter ended March 31, 2004. The implementation of FIN 46R (including the evaluation of interests in purchase power arrangements) did not impact Pepco Holdings' financial condition or results of operations for the three months ended March 31, 2004.

As part of the FIN 46R evaluation, Pepco Holdings reviewed its subsidiaries' power purchase agreements (PPAs), including its Non-Utility Generation (NUG) contracts, to determine (i) if the subsidiary's interest in each entity that is a counterparty to a PPA agreement was a variable interest, (ii) whether the entity was a variable interest entity and (iii) if so, whether Pepco Holdings' subsidiary was the primary beneficiary. Due to a variable element in the pricing structure of PPAs with four entities, including Pepco's agreement with Panda-Brandywine, L.P. (Panda), Pepco Holdings' subsidiaries potentially assume the variability in the operations of the plants of these entities and therefore have a variable interest in the entities. However, due to Pepco Holdings' inability to obtain information from certain of these entities considered to be confidential and proprietary by the entities or the certain entities' own determination that they qualified for exemption as a business, Pepco Holdings was unable to obtain sufficient information to conduct the analysis required under FIN 46R to determine whether these four entities were variable interest entities or if Pepco Holdings' subsidiaries were the primary beneficiary. As a result, Pepco Holdings has applied the scope exemption from the application of FIN 46R for enterprises that have conducted exhaustive efforts to obtain the necessary information.

Power purchases related to the PPAs with these four entities in the quarters ended March 31, 2004 and 2003 were approximately \$77 million and \$79 million, respectively. Power purchases related to the PPAs in the years ended December 31, 2003, 2002 and 2001 were approximately \$302 million, \$295 million and \$302 million, respectively. Pepco Holdings' exposure to loss under the Panda PPA is discussed in Note (4) Commitments And Contingencies, under "Relationship with Mirant Corporation." Pepco Holdings does not have loss exposure under the remaining three PPAs since cost recovery will be achieved from its customers

through regulated rates.

#### EITF 03-11

On January 1, 2004, Pepco Holdings implemented EITF Issue No. 03-11 (EITF 03-11), "Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133, 'Accounting for Derivative Instruments and Hedging Activities,' and not 'Held for Trading Purposes' as Defined in EITF Issue No. 02-3" "Issues Involved in Accounting for Derivative

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Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities." As a result of the implementation of this EITF, \$37.4 million of operating revenues and operating expenses related to certain of Conectiv Energy's energy contracts are reported on a net basis in the accompanying consolidated statements of earnings for the three months ended March 31, 2004, as these energy contracts did not physically settle. Had EITF 03-11 been effective for the first quarter of 2003, Pepco Holdings' operating revenues and operating expenses would have been reduced by \$37.1 million. The implementation of EITF 03-11, including the associated reclassification of certain operating revenues and operating expenses, did not have an impact on Pepco Holdings' financial condition or earnings.

#### Components of Net Periodic Benefit Cost

The following Pepco Holdings information is for the three months ended March 31,

|                                    | <u>Pension Benefits</u> |               | <u>Other Post-Retirement Benefits</u> |               |
|------------------------------------|-------------------------|---------------|---------------------------------------|---------------|
|                                    | <u>2004</u>             | <u>2003</u>   | <u>2004</u>                           | <u>2003</u>   |
|                                    | (In Millions)           |               |                                       |               |
| Service cost                       | \$ 9.6                  | \$ 8.1        | \$ 2.4                                | \$ 2.3        |
| Interest cost                      | 23.8                    | 23.0          | 8.3                                   | 7.9           |
| Expected return on plan assets     | (29.8)                  | (26.1)        | (2.8)                                 | (2.0)         |
| Amortization of prior service cost | .3                      | .3            | -                                     | -             |
| Amortization of net loss           | <u>4.5</u>              | <u>3.4</u>    | <u>3.1</u>                            | <u>1.9</u>    |
| Net periodic benefit cost          | <u>\$ 8.4</u>           | <u>\$ 8.7</u> | <u>\$11.0</u>                         | <u>\$10.1</u> |

The actual components of net periodic benefit cost for the 2003 interim period are not available. The component amounts presented above for the 2003 interim period were calculated in proportion to the annual

amounts presented in Pepco Holdings' financial statements for the year ended December 31, 2003. These component amounts are presented for comparison purposes only.

### *Pension*

The 2004 pension net periodic benefit cost of \$8.4 million includes \$3.6 million for Pepco, \$2.1 million for ACE, and \$(.5) million for DPL. The remaining pension net periodic benefit cost is for other PHI subsidiaries. The 2003 pension net periodic benefit cost of \$8.7 million includes \$5.2 million for Pepco, \$3.2 million for ACE, and \$(1.4) million for DPL. The remaining pension net periodic benefit cost is for other PHI subsidiaries.

### *Pension Contributions*

Pepco Holdings funding policy with regard to the pension plan is to maintain a funding level in excess of 100% of its accumulated benefit obligation (ABO). PHI's defined benefit plan currently meets the minimum funding requirements of the Employment Retirement Income Security Act of 1974 (ERISA) without any additional funding. In 2003 and 2002 PHI made discretionary tax-deductible cash contributions to the plan of \$50 million and \$35 million, respectively. Assuming no changes to the current pension plan assumptions, PHI projects no funding will be required in 2004; however PHI may elect to make a discretionary tax-deductible contribution, if required to maintain its assets in excess of its ABO. As of March 31, 2004, no contributions have been made.

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### *Other Post-Retirement Benefits*

The 2004 Other Post-Retirement net periodic benefit cost of \$11.0 million includes \$4.5 million for Pepco, \$2.5 million for ACE, and \$2.3 million for DPL. The remaining Other Post-Retirement net periodic benefit cost is for other PHI subsidiaries. The 2003 Other Post-Retirement net periodic benefit cost of \$10.1 million includes \$4.2 million for Pepco, \$2.6 million for ACE, and \$1.7 million for DPL. The remaining Other Post-Retirement net periodic benefit cost is for other PHI subsidiaries.

### *FASB Staff Position (FSP 106-1), Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act)*

The Act became effective on December 8, 2003. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D.

SFAS No. 106 "Employers Accounting for Post-retirement Benefits Other than Pensions" requires presently enacted changes in relevant laws to be considered in current period measurements of post-retirement benefit costs and the Accumulated Post-Retirement Benefit Obligation (APBO). Therefore, under that guidance, measures of the APBO and net periodic post-retirement benefit costs on or after the date of enactment should reflect the effects of the Act.

However, due to certain accounting issues raised by the Act that are not explicitly addressed by SFAS No. 106 and uncertainties that may exist as to reliable information available on which to measure the effects of the Act, the FSP 106-1 allows a plan sponsor to elect to defer recognizing the effects of the Act in the

accounting for its plan under SFAS No. 106 and in providing disclosures related to the plan required by SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Post-retirement Benefits," until authoritative guidance on the accounting for the federal subsidy is issued, or until certain other events occur.

Pepco Holdings sponsors post-retirement health care plans that provide prescription drug benefits. Pepco Holdings did not elect the deferral provided by the FSP 106-1. The APBO as of December 31, 2003 was reduced by \$28 million to reflect the effects of the Act. For the current quarter and all of 2003, Pepco Holdings' net periodic postretirement benefit expense has not been reduced to reflect the Act. It is estimated that the annual postretirement benefit cost will be reduced by approximately \$4 million due to effects of the Act. This reduction includes both the decrease in the cost of future benefits being earned and an amortization of the APBO reduction over the future average working lifetime of the participants, or 13.5 years. The anticipated claims costs expected to be incurred have been adjusted to reflect the cost sharing between Medicare and Pepco Holdings. Participation rates have not been changed. In reflecting the effects of the Act, Pepco Holdings has determined which plans are eligible for Medicare cost sharing by analyzing the terms of each of its plans. It has recognized Medicare cost sharing for a plan only if Pepco Holdings' projected prescription drug coverage is expected to be at least as generous as the expected contribution by Medicare to a prescription drug plan not provided by Pepco Holdings.

Specific authoritative guidance on the accounting for the federal subsidy under the Act is pending and that guidance, when issued, could require Pepco Holdings to change previously reported information. When

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issued, the guidance on accounting for the federal subsidy will include transition guidance, as applicable, for entities that elected to defer accounting for the effects of the Act and those that did not.

The effect of the subsidy on the current period Other Post-Retirement net periodic benefit cost of \$11.0 million would be approximately a \$1 million reduction due to the subsidy. Approximately \$.5 million would be related to the amortization of the actuarial gain, \$.1 million would be a subsidy-related reduction in current period service cost and approximately \$.4 million would be a subsidy-related reduction in interest cost on the APBO.

#### Severance Costs

During 2002, Pepco Holdings' management approved initiatives by Pepco and Conectiv to streamline their operating structures by reducing the number of employees at each company. These initiatives met the criteria for the accounting treatment provided under EITF No. 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." A roll forward of the severance accrual balance is as follows. (Amounts in millions)

|                            |              |
|----------------------------|--------------|
| Balance, December 31, 2003 | \$ 7.9       |
| Accrued during 2004        | -            |
| Payments during 2004       | <u>(4.3)</u> |
| Balance, March 31, 2004    | \$ 3.6       |

Substantially all of the severance liability accrued at March 31, 2004 will be paid through mid 2005. Employees have the option of taking severance payments in a lump sum or over a period of time.

Summarized Income Statement Information for Starpower

Pepco Holdings, through a subsidiary of Pepcom, owns a 50% interest in Starpower. Unaudited summarized financial information for Starpower for the three months ended March 31, 2004, is as follows:

|                               | (Millions of Dollars) |
|-------------------------------|-----------------------|
| Total Revenue                 | \$ 20.5               |
| Cost of Sales                 | <u>5.7</u>            |
| Gross Margin                  | 14.8                  |
| Operating Expenses            | 10.6                  |
| Depreciation and Amortization | <u>6.5</u>            |
| Loss                          | \$(2.3)               |

Stock-Based Compensation

The objective of Pepco Holdings' Long-Term Incentive Plan (the LTIP) is to increase shareholder value by providing a long-term incentive to reward officers, key employees, and directors of Pepco Holdings and its subsidiaries and to increase the ownership of Pepco Holdings' common stock by such individuals. Any officer or key employee of Pepco Holdings or its subsidiaries may be designated by PHI's Board of Directors as a participant in the LTIP. Under the LTIP, awards to officers and key employees may be in the form of restricted stock, options, performance units, stock appreciation rights, or dividend equivalents. No awards were granted during the quarter ended March 31, 2004.

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Pepco Holdings recognizes compensation costs for the LTIP based on the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." In accordance with FASB Statement No. 123, Accounting for Stock-Based Compensation ("SFAS No. 123"), as amended by FASB Statement No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," the following table illustrates the effect on net income and basic and diluted earnings per share if Pepco Holdings had applied the fair value based method of expense recognition and measurement provisions of SFAS No. 123 to stock-based employee compensation.

For the Three Months Ended March 31,

2004

2003

(Millions, except Per Share Data)

|  |                |                  |
|--|----------------|------------------|
| Net Income (Loss), as reported   | \$51.2         | \$(24.9)         |
| Add: Total stock-based employee compensation cost, net of related tax effects, included in net income as reported                            | .8             | .1               |
| Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of related tax effects | <u>(1.1)</u>   | <u>(.4)</u>      |
|  | )              | )                |
| Pro forma net income   | \$ <u>50.9</u> | \$ <u>(25.2)</u> |
| Basic and diluted earnings per share as reported   | \$ .30         | \$ (.15)         |
| Pro forma basic and diluted earnings per share   | \$ .30         | \$ (.15)         |

(3) SEGMENT INFORMATION

Based on the provisions of Statement of Financial Accounting Standards (SFAS) No. 131 "Disclosures about Segments of an Enterprise and Related Information," Pepco Holdings' management has identified its reportable segments at March 31, 2004 as Power Delivery, Conectiv Energy, Pepco Energy Services, and Other Non-Regulated. Prior to the three months ended March 31, 2004, Pepco Holdings' Power Delivery business consisted of two reportable segments, Pepco and Conectiv Power Delivery. However, with the continued integration of the Power Delivery businesses, effective January 1, 2004 these two businesses represent a single segment. Additionally, during the quarter ended March 31, 2004, Pepco Holdings transferred several operating businesses from one reportable segment to another in order to better align their operations going forward. In accordance with the provisions of SFAS No. 131, results for the quarter ended March 31, 2003 have been reclassified to conform to the current period segment presentation. Intercompany (intersegment) revenues and expenses are not eliminated at the segment level for purposes of presenting segment financial results. Elimination of these intercompany amounts is accomplished for Pepco Holdings' consolidated results through the "Corporate and Other" column. Segment financial information for the three months ended March 31, 2004 and 2003, is as follows.

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For the Three Months Ended March 31, 2004

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(In Millions)

Competitive

Energy Segments

|                         | <u>Power<br/>Delivery</u> |     | <u>Conectiv<br/>Energy</u> |     | <u>Pepco<br/>Energy<br/>Services</u> | <u>Other<br/>Non-<br/>Regulated</u> | <u>(a)<br/>Corp.<br/>&amp; Other</u> | <u>PHI<br/>Cons.</u> |
|-------------------------|---------------------------|-----|----------------------------|-----|--------------------------------------|-------------------------------------|--------------------------------------|----------------------|
| Operating Revenue       | \$1,039.2                 |     | \$ 587.8                   | (b) | \$310.7                              | \$ 21.1                             | \$ (194.7)                           | \$ 1,764.1           |
| Operating Expense       | 930.7                     | (b) | 572.3                      |     | 308.2                                | (3.3)                               | (194.3)                              | 1,613.6              |
| Operating Income (loss) | 108.5                     |     | 15.5                       |     | 2.5                                  | 24.4                                | (.4)                                 | 150.5                |
| Interest Expense        | 46.3                      |     | 6.6                        |     | .5                                   | 10.0                                | 29.2                                 | 92.6                 |
| Income Taxes (c)        | 27.2                      |     | 3.4                        |     | (.6)                                 | (5.8)                               | (12.8)                               | 11.4                 |
| Net Income (loss)       | \$ 40.8                   |     | \$ 5.0                     |     | \$ 3.1                               | \$ 20.1                             | \$ (17.8)                            | \$ 51.2              |
| Total Assets            | \$8,514.3                 |     | \$2,048.8                  |     | \$555.2                              | \$1,336.2                           | \$1,095.3                            | \$13,549.8           |

- (a) Includes unallocated Pepco Holdings (parent company) capital costs, such as acquisition financing costs, and the depreciation and amortization related to purchase accounting adjustments for the fair value of non-regulated Conectiv assets and liabilities as of August 1, 2002. Intercompany transactions are also included in this line item. Additionally, this line item for "total assets" also includes Pepco Holdings' goodwill balance.
- (b) Power Delivery purchased electric energy, electric capacity and natural gas from Conectiv Energy in the amount of \$148.4 million for the three months ended March 31, 2004.
- (c) In February 2004, a local jurisdiction issued final consolidated tax return regulations, which were retroactive to 2001. Under these regulations, Pepco Holdings (parent) and other affiliated companies doing business in this location, now have the necessary guidance to file a consolidated income tax return. This allows Pepco Holdings' subsidiaries with taxable losses to utilize those losses against tax liabilities of Pepco Holdings' companies with taxable income. During the first quarter of 2004, Pepco Holdings and its subsidiaries recorded the impact of the new regulations of \$13.1 million for the period of 2001 through 2003.

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For the Three Months Ended March 31, 2003

(In Millions)

Competitive  
Energy Segments

|                         | <u>Power<br/>Delivery</u> |     | <u>Conectiv<br/>Energy</u> |             | <u>Pepco<br/>Energy<br/>Services</u> | <u>Other<br/>Non-<br/>Regulated</u> | <u>(a)<br/>Corp.<br/>&amp; Other</u> |     | <u>PHI<br/>Cons.</u> |
|-------------------------|---------------------------|-----|----------------------------|-------------|--------------------------------------|-------------------------------------|--------------------------------------|-----|----------------------|
| Operating Revenue       | \$ 969.1                  |     | \$ 828.2                   | (b),<br>(d) | \$332.4                              | \$ 26.3                             | \$(227.3)                            |     | \$ 1,928.7           |
| Operating Expense       | 842.8                     | (b) | 980.2                      | (c)         | 337.6                                | 4.1                                 | (275.1)                              | (c) | 1,889.6              |
| Operating Income (loss) | 126.3                     |     | (152.0)                    |             | (5.2)                                | 22.2                                | 47.8                                 |     | 39.1                 |
| Interest Expense        | 46.7                      |     | 2.9                        |             | 2.1                                  | 13.8                                | 23.6                                 |     | 89.1                 |
| Income Taxes            | 34.5                      |     | (63.3)                     |             | (2.6)                                | .7                                  | 8.7                                  |     | (22.0)               |
| Net Income (loss)       | 49.0                      |     | (90.5)                     |             | (4.4)                                | 8.4                                 | 12.6                                 |     | (24.9)               |
| Total Assets            | \$8,539.7                 |     | \$2,066.4                  |             | \$484.5                              | \$1,611.8                           | \$892.6                              |     | \$13,595.0           |

- (a) Includes unallocated Pepco Holdings (parent company) capital costs, such as acquisition financing costs, and the depreciation and amortization related to purchase accounting adjustments for the fair value of non-regulated Conectiv assets and liabilities as of August 1, 2002. Intercompany transactions are also included in this line item. Additionally, this line item for "total assets" also includes Pepco Holdings' goodwill balance.
- (b) Power Delivery purchased electric energy, electric capacity and natural gas from Conectiv Energy in the amount of \$158.0 million for the three months ended March 31, 2003.
- (c) Conectiv Energy's results include a charge of \$110.7 million related to a combustion turbine (CT) cancellation. This unfavorable impact at Conectiv Energy is partially offset by \$57.9 million in Corp. & Other related to the reversal of a purchase accounting fair value adjustment made on the date of the merger.
- (d) This amount includes the unfavorable impact resulting from net trading losses of approximately \$44 million incurred prior to the cessation of proprietary trading.

(4) COMMITMENTS AND CONTINGENCIES

Relationship with Mirant Corporation

In 2000, Pepco sold substantially all of its electricity generation assets to Mirant Corporation, formerly Southern Energy, Inc. As part of the sale, Pepco entered into several ongoing contractual arrangements with Mirant and certain of its subsidiaries (collectively, Mirant). On July 14, 2003, Mirant Corporation and most of its subsidiaries filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Northern District of Texas (the Bankruptcy Court). Under bankruptcy law, a debtor generally may, with authorization from a bankruptcy court, assume or reject executory contracts. A rejection of an executory contract entitles the counterparty to file a claim as an unsecured creditor against the bankruptcy estate for damages incurred due to the rejection of the contract. In a bankruptcy proceeding, a debtor can normally restructure some or all of its pre-petition liabilities.

Depending on the outcome of the matters discussed below, the Mirant bankruptcy could have a material adverse effect on the results of operations of Pepco Holdings and Pepco. However, management currently believes that Pepco Holdings and Pepco currently have sufficient cash, cash flow and borrowing capacity under their credit facilities and in the capital markets to be able to satisfy the additional cash requirements that are expected to arise due to the Mirant bankruptcy. Accordingly, management does not anticipate that the Mirant bankruptcy will impair the ability of Pepco Holdings or Pepco to fulfill their contractual obligations or to fund projected capital expenditures. On this basis, management currently does not believe that the Mirant bankruptcy will have a material adverse effect on the financial condition of either company.

Transition Power Agreements

As part of the asset purchase and sale agreement for the Pepco generation assets (the Asset Purchase and Sale Agreement), Pepco and Mirant entered into Transition Power Agreements for Maryland and the District of Columbia, respectively (collectively, the TPAs). Under these agreements, Mirant was obligated to supply Pepco with all of the capacity and energy needed to fulfill its standard offer service obligations in Maryland through June 2004 and its standard offer service obligations in the District of Columbia into January 2005.

To avoid the potential rejection of the TPAs, Pepco and Mirant entered into an Amended Settlement Agreement and Release dated as of October 24, 2003 (the Settlement Agreement) pursuant to which Mirant has assumed both of the TPAs and the terms of the TPAs were modified. The Settlement Agreement also provides that Pepco has an allowed, pre-petition general unsecured claim against Mirant in the amount of \$105 million (the Pepco TPA Claim).

The amount, if any, that Pepco will be able to recover from the Mirant bankruptcy estate in respect of the Pepco TPA Claim will depend on the amount of assets available for distribution to creditors. At the current stage of the bankruptcy proceeding, there is insufficient information to determine the amount, if any, that Pepco might be able to recover from the Mirant bankruptcy estate.

### Power Purchase Agreements

Under agreements with FirstEnergy Corp., formerly Ohio Edison (FirstEnergy), and Allegheny Energy, Inc., both entered into in 1987, Pepco is obligated to purchase from FirstEnergy 450 megawatts of capacity and energy annually through December 2005 (the FirstEnergy PPA). Under an agreement with Panda-Brandywine L.P. (Panda), entered into in 1991, Pepco is obligated to purchase from Panda 230 megawatts of capacity and energy annually through 2021 (the Panda PPA). In each case, the purchase price is substantially in excess of current market prices. As a part of the Asset Purchase and Sale Agreement, Pepco entered into a "back-to-back" arrangement with Mirant. Under this arrangement, Mirant is obligated, among other things, to purchase from Pepco the capacity and energy that Pepco is obligated to purchase under the FirstEnergy PPA and the Panda PPA at a price equal to the price Pepco is obligated to pay under the PPAs (the PPA-Related Obligations).

### Pepco Pre-Petition Claims

When Mirant filed its bankruptcy petition on July 14, 2003, Mirant had unpaid obligations to Pepco of approximately \$29 million, consisting primarily of payments due to Pepco in respect of the PPA-Related Obligations (the Mirant Pre-Petition Obligations). The Mirant Pre-Petition Obligations constitute part of the indebtedness for which Mirant is seeking relief in its bankruptcy proceeding. Pepco has filed Proofs of Claim in the Mirant bankruptcy proceeding in the amount of approximately \$26 million to recover this indebtedness; however, the amount of Pepco's recovery, if any, is uncertain. The \$3 million difference between Mirant's unpaid obligation to Pepco and the \$26 million Proofs of Claim filed by Pepco primarily represents a TPA settlement adjustment which is included in the \$105 million Proofs of Claim filed by Pepco against the Mirant debtors in respect of the Pepco TPA Claim. In view of this uncertainty, Pepco, in the third quarter of 2003, expensed \$14.5 million to establish a reserve against the \$29 million receivable from Mirant. In January 2004, Pepco paid approximately \$2.5 million to Panda in settlement of certain billing disputes under the Panda PPA that related to periods after the sale of Pepco's generation assets to Mirant. Pepco believes that under the terms of the Asset Purchase and Sale Agreement, Mirant is obligated to reimburse Pepco for the settlement payment. Accordingly, in the first quarter of 2004 Pepco increased the amount of the receivable due from Mirant by approximately \$2.5 million, and Pepco intends to file Proofs of Claim for this amount against Mirant. Pepco currently estimates that the \$14.5 million expensed in the third quarter of 2003 represents the portion of the entire \$31.5 million receivable unlikely to be recovered in bankruptcy, and no additional reserve has been established for the \$2.5 million increase in the receivable. The amount expensed represents Pepco's estimate of the possible outcome in bankruptcy, although the amount ultimately recoverable could be higher or lower.

### Mirant's Attempt to Reject the PPA-Related Obligations

On August 28, 2003, Mirant filed with the Bankruptcy Court a motion seeking authorization to reject its PPA-Related Obligations.

Upon motions filed by Pepco and the Federal Energy Regulatory Commission (FERC), on October 9, 2003, the U.S. District Court for the Northern District of Texas (the District Court) withdrew jurisdiction over the rejection proceedings from the Bankruptcy Court. On December 23, 2003, the District Court denied Mirant's motion to reject the PPA-Related Obligations. The District Court's decision is being appealed by Mirant and The Official

Committee of Unsecured Creditors of Mirant Corporation in the U.S. Court of Appeals for the Fifth Circuit. Oral argument on the appeal was heard on May 5, 2004.

Pepco is exercising all available legal remedies and vigorously opposing Mirant's continued attempts to reject the PPA-Related Obligations in order to protect the interests of its customers and shareholders. While Pepco believes that it has substantial legal bases to oppose the attempt to reject the agreements, the outcome of Mirant's efforts to reject the PPA-Related Obligations is uncertain.

In accordance with the Bankruptcy Court's order, Mirant is continuing to perform the PPA-Related Obligations pending the resolution of the ongoing proceedings. However, if Mirant ultimately is successful in rejecting, and is otherwise permitted to stop performing the PPA-Related Obligations, Pepco could be required to repay to Mirant, for the period beginning on the effective date of the rejection (which date could be prior to the date of the court's order and possibly as early as September 18, 2003) and ending on the date Mirant is entitled to cease its purchases of energy and capacity from Pepco, all amounts paid by Mirant to Pepco in respect of the PPA-Related Obligations, less an amount equal to the price at which Mirant resold the purchased energy and capacity. Pepco estimates that the amount it could be required to repay to Mirant in the unlikely event September 18, 2003, is determined to be the effective date of rejection, is approximately \$69.2 million as of May 1, 2004. This repayment would entitle Pepco to file a claim against the bankruptcy estate in an amount equal to the amount repaid. Mirant has also asked the Bankruptcy Court to require Pepco to disgorge all amounts paid by Mirant to Pepco in respect of the PPA-Related Obligations, less an amount equal to the price at which Mirant resold the purchased energy and capacity, for the period July 14, 2003 (the date on which Mirant filed its bankruptcy petition) to September 18, 2003, on the theory that Mirant did not receive value for those payments. Pepco estimates that the amount it would be required to repay to Mirant on the disgorgement theory is approximately \$22.5 million. Pepco believes a claim based on this theory should be entitled to administrative expense status for which complete recovery could be expected. If Pepco were required to repay any such amounts for either period, the payment would be expensed at the time the payment is made.

The following are estimates prepared by Pepco of its potential future exposure if Mirant's motion to reject its PPA-Related Obligations ultimately is successful. These estimates are based in part on current market prices and forward price estimates for energy and capacity, and do not include financing costs, all of which could be subject to significant fluctuation. The estimates assume no recovery from the Mirant bankruptcy estate and no regulatory recovery, either of which would mitigate the effect of the estimated loss. Pepco does not consider it realistic to assume that there will be no such recoveries. Based on these assumptions, Pepco estimates that its pre-tax exposure as of May 1, 2004, representing the loss of the future benefit of the PPA-Related Obligations to Pepco, is as follows:

- If Pepco were required to purchase capacity and energy from FirstEnergy commencing as of May 1, 2004, at the rates provided in the PPA (with an average price per kilowatt hour of approximately 6.1 cents) and resold the capacity and energy at market rates projected, given the characteristics of the FirstEnergy PPA, to be approximately 4.5 cents per kilowatt hour, Pepco estimates that it would cost approximately \$41.0 million for the remainder of 2004, and \$57 million in 2005, the last year of the FirstEnergy PPA.

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- If Pepco were required to purchase capacity and energy from Panda commencing as of May 1, 2004, at the rates provided in the PPA (with an average price per kilowatt hour of approximately

15.6 cents), and resold the capacity and energy at market rates projected, given the characteristics of the Panda PPA, to be approximately 6.9 cents per kilowatt hour, Pepco estimates that it would cost approximately \$26 million for the remainder of 2004, \$38 million in 2005, and \$36 million in 2006 and approximately \$35 million to \$43 million annually thereafter through the 2021 contract termination date.

The ability of Pepco to recover from the Mirant bankruptcy estate in respect of the Mirant Pre-Petition Obligations and damages if the PPA-Related Obligations are successfully rejected will depend on whether Pepco's claims are allowed, the amount of assets available for distribution to creditors and Pepco's priority relative to other creditors. At the current stage of the bankruptcy proceeding, there is insufficient information to determine the amount, if any, that Pepco might be able to recover from the Mirant bankruptcy estate, whether the recovery would be in cash or another form of payment, or the timing of any recovery.

If Mirant ultimately is successful in rejecting the PPA-Related Obligations and Pepco's full claim is not recovered from the Mirant bankruptcy estate, Pepco may seek authority from the Maryland Public Service Commission (MPSC) and the District of Columbia Public Service Commission (DCPSC) to recover its additional costs. Pepco is committed to working with its regulatory authorities to achieve a result that is appropriate for its shareholders and customers. Under the provisions of the settlement agreements approved by the MPSC and the DCPSC in the deregulation proceedings in which Pepco agreed to divest its generation assets under certain conditions, the PPAs were to become assets of Pepco's distribution business if they could not be sold. Pepco believes that, if Mirant ultimately is successful in rejecting the PPA-Related Obligations, these provisions would allow the stranded costs of the PPAs that are not recovered from the Mirant bankruptcy estate to be recovered through Pepco's distribution rates. If Pepco's interpretation of the settlement agreements is confirmed, Pepco expects to be able to establish the amount of its anticipated recovery as a regulatory asset. However, there is no assurance that Pepco's interpretation of the settlement agreements would be confirmed by the respective public service commissions.

If the PPA-Related Obligations are successfully rejected, and there is no regulatory recovery, Pepco will incur a loss. However, the accounting treatment of such a loss depends on a number of legal and regulatory factors, and is not determinable at this time.

#### The SMECO Agreement

As a term of the Asset Purchase and Sale Agreement, Pepco assigned to Mirant a facility and capacity agreement with Southern Maryland Electric Cooperative, Inc. (SMECO) under which Pepco was obligated to purchase the capacity of an 84-megawatt combustion turbine installed and owned by SMECO at a former Pepco generating station (the SMECO Agreement). The SMECO Agreement expires in 2015 and contemplates a monthly payment to SMECO of approximately \$.5 million. Pepco is responsible to SMECO for the performance of the SMECO Agreement if Mirant fails to perform its obligations thereunder. At this time, Mirant continues to make post-petition payments due to SMECO.

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However, on March 15, 2004, Mirant filed a complaint with the Bankruptcy Court seeking a declaratory judgment that the facility and capacity credit agreement is an unexpired lease of non-residential real property rather than an executory contract and that if Mirant were to successfully reject the agreement, any claim against the bankruptcy estate for damages made by SMECO (or by Pepco as subrogee) would be

subject to the provisions of the Bankruptcy Code that limit the recovery of rejection damages by lessors. Pepco believes that there is no reasonable factual or legal basis to support Mirant's contention that the SMECO Agreement is a lease of real property and has filed a motion to dismiss the complaint. However, the outcome of this proceeding cannot be predicted.

#### Proposed Federal Tax Legislation Affecting Cross-border=0 Leases

The assets of PCI include a cross-border=0 energy lease portfolio with a book value of approximately \$1.2 billion at March 31, 2004. Currently, there is pending legislation in the U.S. House of Representatives (HR3967), that would apply new passive loss limitation rules prospectively to any new leases (including cross-border=0 leases) entered into on or after February 11, 2004 with tax indifferent parties (i.e., municipalities, tax exempt or governmental entities). Cross-border=0 leases are leases by a U.S. taxpayer of property located in a foreign country. All of PCI's cross-border=0 leases are with tax indifferent parties but were entered into prior to 2004. Legislation is also pending in the Senate (S1637) that may jeopardize the tax benefits received by leaseholders, including PCI, from existing cross-border=0 leases. The legislation, if adopted as proposed, would enact new passive loss limitation rules that would be applied retroactively to all existing lease agreements, for taxable years beginning after May 31, 2004, for all cross-border=0 leaseholders, including PCI. The outcome of these legislative proposals is unknown at this time. However, if the Senate's version were to be adopted in its current form, the amount of income tax benefits that PHI would receive in connection with PCI's cross-border=0 leases could decrease materially. If this occurred, PHI may be required to write down the book value of PCI's portfolio of cross-border=0 leases by taking a charge against earnings. Any of these circumstances could have a material adverse effect on PHI's financial condition and results of operations.

#### Preliminary Settlement Agreement with NJDEP

On April 26, 2004, PHI, Conectiv and ACE entered into a preliminary settlement agreement with the New Jersey Department of Environmental Protection (NJDEP) and the Attorney General of New Jersey that addresses various environmental issues at ACE and Conectiv Energy facilities in New Jersey. Among other things, the preliminary settlement agreement provides that:

- contingent upon the receipt of necessary approvals from the New Jersey Board of Public Utilities (NJBPU), PJM Interconnection, LLC (PJM), North American Electric Reliability Council (NERC)/FERC and other regulatory authorities and the receipt of permits to construct certain transmission facilities in southern New Jersey described more fully below, ACE will permanently cease operation of the B.L. England generating facility by December 15, 2007. In the event that ACE is unable to shut down the B.L. England facility by December 15, 2007 through no fault of its own (e.g., because of failure to obtain the required regulatory approvals), B.L. England Unit 1 would be required to comply with stringent sulfur dioxide (SO<sub>2</sub>), nitrogen oxide (NO<sub>x</sub>) and particulate matter emissions limits set forth in the preliminary settlement agreement by October 1, 2008, and B.L. England Unit 2 would

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be required to comply with the emissions limits by May 1, 2009. If ACE does not either shut down the B.L. England facility by December 15, 2007 or satisfy the emissions limits applicable in the event shut down is not so completed, ACE will be required to pay significant monetary penalties.

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ACE will be permitted to combust coal with a sulfur content of greater than 1% at the B.L. England facility in compliance with the terms of B.L. England's current permit until December 15, 2007 and NJDEP will not impose new, more stringent short-term SO<sub>2</sub> emissions limits on the B.L. England facility.

- to resolve any possible civil liability (and without admitting liability) for violations of the permit provisions of the New Jersey Air Pollution Control Act (APCA) and the Prevention of Significant Deterioration (PSD) provisions of the federal Clean Air Act (CAA) relating to modifications that may have been undertaken at the B.L. England facility, ACE will pay a \$750,000 civil penalty to NJDEP by June 1, 2004.
- to compensate New Jersey for other alleged violations of the APCA and/or the CAA, ACE will undertake environmental projects beneficial to the state of New Jersey and approved by the NJDEP in a consent order or other final settlement document valued at \$2 million.
- ACE will submit all federally required studies and complete construction of facilities necessary to satisfy the Environmental Protection Agency's (EPA) new cooling water intake structure regulations in accordance with a schedule that NJDEP will establish in the renewal New Jersey Pollutant Discharge Elimination System (NJPDES) permit for the B.L. England facility. The schedule will take into account ACE's agreement, provided that all regulatory approvals are obtained, to shut down the B.L. England facility by December 15, 2007.
- to resolve any possible civil liability (and without admitting liability) for natural resource damages resulting from groundwater contamination at the B.L. England facility, Conectiv Energy's Deepwater generating facility and ACE's operations center near Pleasantville, New Jersey, ACE and Conectiv will pay NJDEP \$647,162 in cash or property and will remediate the groundwater contamination at all three sites. If subsequent data indicate that groundwater contamination is more extensive than indicated in NJDEP's preliminary analysis, NJDEP may seek additional compensation for natural resource damages.

The preliminary settlement agreement also provides that the parties will work toward a consent order or other final settlement document that reflects the terms of the preliminary settlement agreement.

Pursuant to a NJBPU order issued on September 25, 2003, ACE on April 30, 2004, filed a report with the NJBPU recommending that the B.L. England facility be shut down in accordance with the terms of the preliminary settlement agreement. The report stated that the operation of the B.L. England facility is necessary at the present time to satisfy reliability standards, but that those reliability standards could also be satisfied in other ways. The report concludes that, based on B.L. England's current and projected operating costs resulting from compliance with more restrictive environmental requirements, the most cost-effective way in which to meet reliability standards is to shut down the B.L. England facility and construct additional transmission lines into southern New Jersey. ACE cannot predict

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whether the NJBPU will approve the construction of the additional transmission lines.

#### Rate Proceedings

On February 3, 2003, ACE filed a petition with the NJBPU to increase its electric distribution rates and its Regulatory Asset Recovery Charge (RARC) in New Jersey. In its most recent submission, made on February 20, 2004, ACE proposed an overall rate increase of approximately \$35.1 million, consisting of a \$30.6 million

increase in distribution rates and a \$4.5 million increase in RARC. Hearings were held before an Administrative Law Judge in late March and early April 2004. At the hearing held on April 6, 2004, the Ratepayer Advocate proposed an annual rate decrease of \$4.5 million, modifying its earlier proposal that rates be decreased by \$11.7 million annually. The Staff of the NJBPU is expected to submit its recommendations in briefs to be filed in June. ACE cannot predict the outcome of this proceeding.

In December 2003, the Delaware Public Service Commission (DPSC) approved a settlement agreement that provided for an annual increase of \$7.75 million in DPL's gas base rate. In accordance with the terms of the settlement agreement, on February 13, 2004, DPL filed for an Environmental Surcharge of approximately \$522,000 amortized over five years to recover out-of-pocket costs associated with gas environmental issues. The DPSC approved this surcharge on April 20, 2004. The surcharge will be adjusted year-to-year to reflect DPL's actual costs.

DPL filed on February 13, 2004 for a change in electric ancillary service rates that has an aggregate effect of increasing annual revenues by \$13.1 million or 2.4%. This filing was prompted by the increasing ancillary service costs charged to DPL by PJM. On February 24, 2004, the DPSC accepted the filing and placed the increase into effect on March 15, 2004, subject to refund. Intervention by another party has been filed. Unless the proceeding is settled, evidentiary hearings will be held in late August with a decision expected before the end of 2004.

On August 29, 2003, DPL submitted its annual Gas Cost Recovery (GCR) rate filing to the DPSC. In its filing, DPL sought to increase its GCR rate by approximately 15.8% in anticipation of increasing natural gas commodity costs. The GCR rate, which permits DPL to recover its procurement gas costs through customer rates, became effective November 1, 2003 and was subject to refund pending evidentiary hearings that were held on April 19, 2004. No party has proposed to modify DPL's proposed GCR rate, thus no refund is required. However, DPSC Staff has suggested prospective modifications to the program by which DPL hedges price risk for its gas purchases.

In compliance with the merger settlement approved by the MPSC in connection with the merger of Pepco and Conectiv, on December 4, 2003, DPL and Pepco submitted testimony and supporting schedules to establish electric distribution rates in Maryland effective July 1, 2004, when the current distribution rate freeze/caps end. The filings of each company demonstrate that it is in an under-earning situation. As provided in the terms of the merger settlement, DPL requested it be allowed to put into effect July 1, 2004, a rate increase for non-residential customers to offset the nuclear decommissioning equivalent decrease that was effective July 1, 2003. The merger settlement provides that Pepco's distribution rates can only decrease or remain unchanged after July 1, 2004. With limited exceptions, the merger settlement does not permit either company to increase distribution rates until after December 31, 2006. The MPSC Staff has filed testimony stating that no distribution rate reductions are justified and that DPL should be authorized to

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increase its non-residential customers' distribution rates by approximately \$1.1 million. The Office of the People's Counsel (OPC) agrees that no distribution rate reduction is warranted for DPL or Pepco if the respective DPL and Pepco capital structures are used in determining whether existing rates should be reduced. However, OPC argues that the Pepco Holdings' consolidated capital structure and capital costs should be used to determine whether distribution rate reductions for Pepco and DPL are warranted. Based on PHI's consolidated capital structure, OPC recommended that DPL's and Pepco's distribution rates be reduced. Hearings in the Pepco case concluded April 27, 2004. Hearings in the DPL case will be held on May 11 and 12, 2004. Separate MPSC decisions in the DPL and Pepco cases are expected to be issued in early July 2004. Neither Pepco nor DPL can predict the outcome of the proceedings.

### District of Columbia

On March 1, 2004, the DCPSC issued an order adopting the "wholesale" model for Standard Offer Service (SOS) in the District of Columbia after fixed rate SOS ends February 7, 2005. Under the wholesale model, Pepco will continue as the SOS provider after February 7, 2005. Several parties have filed applications for reconsideration of the order adopting the wholesale model that are pending before the DCPSC. PHI cannot predict the outcome of this proceeding.

In December 2003, the DCPSC issued an order adopting terms and conditions that would apply if the wholesale SOS model were adopted. Pepco and most of the other parties in the case filed applications for reconsideration and/or clarification of various parts of this order, and on March 1, 2004, the DCPSC granted in part and denied in part the applications for reconsideration and/or clarification. Because the DCPSC changed certain rules in its order granting in part and denying in part applications for reconsideration of the wholesale SOS terms and conditions, several parties filed for reconsideration of the March 1, 2004 order. Those applications for reconsideration are pending decision by the DCPSC. The DCPSC has also instituted an evidentiary proceeding to consider the amount of the administrative charge which Pepco may collect for providing SOS on and after February 8, 2005. The DCPSC intends to issue a decision by August 10, 2004.

### Virginia

In March 2004, Virginia amended its Electric Utility Restructuring Act to extend the rate freeze provisions applicable to DPL's rates for both provider of last resort (POLR) supply and distribution. The rate freezes, previously scheduled to expire on July 1, 2007, were extended to December 31, 2010, except that one change in base rates can be proposed by DPL prior to July 1, 2007, and one additional change in base rates can be proposed by DPL between that date and December 31, 2010. Additionally, rates may be increased to reflect increased purchased power costs, increased taxes, or increased costs to comply with environmental or reliability requirements.

The Virginia Electric Utility Restructuring Act obligates DPL to offer POLR service during the period that rates are frozen and thereafter, until relieved of that obligation by the Virginia State Corporation Commission (VSCC).

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On December 3, 2003, DPL and Conectiv Energy filed with the VSCC an amendment to extend their power supply agreement for one year, i.e., through December 31, 2004, and on a month-to-month basis thereafter, as it applies to power supply for DPL's Virginia POLR customers. The VSCC approved the amendment in an order issued on March 1, 2004. After December 31, 2004 either DPL or Conectiv Energy can terminate Conectiv Energy's obligation to provide supplies to meet DPL's Virginia POLR obligations by giving 30 days written notice to the other party.

### Third Party Guarantees, Indemnifications, and Off-Balance Sheet Arrangements

Pepco Holdings and certain of its subsidiaries have various financial and performance guarantees and indemnification obligations which are entered into in the normal course of business to facilitate commercial transactions with third parties as discussed below.

As of March 31, 2004, Pepco Holdings and its subsidiaries were parties to a variety of agreements

pursuant to which they were guarantors for standby letters of credit, performance residual value, and other commitments and obligations. The fair value of these commitments and obligations was not required to be recorded in Pepco Holdings' Consolidated Balance Sheets; however, certain energy marketing obligations of Conectiv Energy were recorded. The commitments and obligations, in millions of dollars, were as follows:

|   | <u>Guarantor</u> |                 |            |              |
|---|------------------|-----------------|------------|--------------|
|   | <u>PHI</u>       | <u>Conectiv</u> | <u>PCI</u> | <u>Total</u> |
| Energy marketing obligations of Conectiv Energy (1)         | \$119.3          | \$12.2          | \$ -       | \$131.5      |
| Energy procurement obligations of Pepco Energy Services (1) | 17.3             | -               | -          | 17.3         |
| Standby letters of credit of Pepco Holdings (2)             | 5.5              | -               | -          | 5.5          |
| Guaranteed lease residual values (3)                        | -                | 5.5             | -          | 5.5          |
| Loan agreement (4)  | 13.1             | -               | -          | 13.1         |
| Construction performance guarantees (5)                     | -                | 4.2             | -          | 4.2          |
| Other (6)   | <u>14.9</u>      | <u>4.2</u>      | <u>5.7</u> | <u>24.8</u>  |
| Total   | \$170.1          | \$26.1          | \$5.7      | \$201.9      |

1. Pepco Holdings and Conectiv have contractual commitments for performance and related payments of Conectiv Energy and Pepco Energy Services to counterparties related to routine energy sales and procurement obligations, including requirements under Basic Generation Service contracts for ACE.
2. Pepco Holdings has issued standby letters of credit of \$5.5 million on behalf of subsidiaries' operations related to Conectiv Energy's competitive energy activities and third party construction performance. These standby letters of credit were put into place in order to allow the subsidiaries the flexibility needed to conduct business with counterparties without having to post substantial cash collateral. While the exposure under these standby letters of credit is \$5.5 million, Pepco Holdings does not expect to fund the full amount.
3. Subsidiaries of Conectiv have guaranteed residual values in excess of fair value related to certain equipment and fleet vehicles held through lease agreements. As of March 31, 2004, obligations under the guarantees were approximately \$5.5 million. Assets leased under

agreements subject to residual value guarantees are typically for periods ranging from 2 years to 10 years. Historically, payments under the guarantees have not been made by the guarantor as, under normal conditions, the contract runs to full term at which time the residual value is minimal. As such, Pepco Holdings believes the likelihood of requiring payment under the guarantee is remote.

4. Pepco Holdings has issued a guarantee on the behalf of a subsidiary's 50% unconsolidated investment in a limited liability company for repayment borrowings under a loan agreement of approximately \$13.1 million.
5. Conectiv has performance obligations of \$4.2 million relating to obligations to third party suppliers of equipment.
6. Other guarantees comprise:
  - Pepco Holdings has guaranteed payment of a bond issued by a subsidiary of \$14.9 million. Pepco Holdings does not expect to fund the full amount of the exposure under the guarantee.
  - Conectiv has guaranteed a subsidiary building lease of \$4.2 million. Pepco Holdings does not expect to fund the full amount of the exposure under the guarantee.
  - PCI has guaranteed facility rental obligations related to contracts entered into by Starpower Communications LLC. In addition, PCI has agreed to indemnify RCN for 50% of any payments RCN makes under the Starpower franchise and construction performance bonds. As of March 31, 2004, the guarantees cover the remaining \$3.6 million in rental obligations and \$2.1 million in franchise and construction performance bonds issued.

In addition, in connection with the Conectiv Bethlehem revolving credit agreement, Conectiv provides a guarantee associated with Conectiv Energy's agreement to purchase energy and capacity from Conectiv Bethlehem and other guarantees related to obligations of Pepco Holdings subsidiaries under agreements related to constructing and operating the Conectiv Bethlehem mid-merit plant. Generally, Conectiv's guarantee obligations do not exceed the amount of the debt outstanding under the credit agreement and do not guarantee Conectiv Bethlehem's obligation to repay the debt. As of March 31, 2004, the outstanding balance under the Conectiv Bethlehem credit facility was \$320.6 million.

Pepco Holdings and certain of its subsidiaries have entered into various indemnification agreements related to purchase and sale agreements and other types of contractual agreements with vendors and other third parties. These indemnification agreements typically cover environmental, tax, litigation and other matters, as well as breaches of representations, warranties and covenants set forth in these agreements. Typically, claims may be made by third parties under these indemnification agreements over various periods of time depending on the nature of the claim. The maximum potential exposure under these indemnification agreements can range from a specified dollar amount to an unlimited amount depending on the nature of the claim and the particular transaction. The total maximum potential amount of future payments under these indemnification agreements is not estimable due to several factors, including uncertainty as to whether or when claims may be made under these indemnities.

#### Dividends

On April 22, 2004, Pepco Holdings' Board of Directors declared a dividend on common stock of 25 cents per share payable June 30, 2004, to shareholders of record on June 10, 2004.

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POTOMAC ELECTRIC POWER COMPANY  
STATEMENTS OF EARNINGS  
(Unaudited)

Three Months Ended  
March 31,  
2004                      2003  
(Millions of Dollars)

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|  |         |         |
|--|---------|---------|
| Operating Revenue  | \$369.6 | \$333.4 |
| Operating Expenses   |         |         |
| Fuel and purchased energy                                    | 173.7   | 134.2   |
| Other operation and maintenance                              | 67.1    | 59.7    |
| Depreciation and amortization                                | 43.9    | 41.3    |
| Other taxes  | 56.5    | 45.0    |
| Gain on sale of asset  | (6.6)   | -       |
| Total Operating Expenses                                     | 334.6   | 280.2   |
| Operating Income   | 35.0    | 53.2    |
| Other Income (Expenses)                                      |         |         |
| Interest and dividend income                                 | -       | 1.2     |
| Interest expense   | (20.2)  | (19.3)  |
| Other income   | 1.4     | 1.4     |
| Other expenses   | (.5)    | (1.6)   |
| Total Other Expenses   | (19.3)  | (18.3)  |
| Distributions on Preferred Securities<br>of Subsidiary Trust | -       | 2.3     |
| Income Before Income Tax Expense                             | 15.7    | 32.6    |
| Income Tax Expense   | 6.2     | 12.6    |
| Net Income   | 9.5     | 20.0    |
| Dividends on Redeemable Serial Preferred Stock               | .4      | 1.2     |
| Earnings Available for Common Stock                          | 9.1     | 18.8    |
| Retained Income at Beginning of Period                       | 505.3   | 468.9   |
| Dividends paid to Pepco Holdings                             | (11.8)  | (15.7)  |

|                                  |         |         |
|----------------------------------|---------|---------|
| Retained Income at End of Period | \$502.6 | \$472.0 |
|----------------------------------|---------|---------|

The accompanying Notes are an integral part of these Financial Statements.

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POTOMAC ELECTRIC POWER COMPANY  
BALANCE SHEETS  
(Unaudited)

|   | March 31,<br>2004     | December 31,<br>2003 |
|---|-----------------------|----------------------|
| ASSETS  |                       |                      |
|   | (Millions of Dollars) |                      |
| CURRENT ASSETS  |                       |                      |
| Cash and cash equivalents   | \$209.2               | \$ 6.8               |
| Accounts receivable, less allowance for<br>uncollectible accounts of \$18.2 million<br>and \$18.4 million | 243.8                 | 269.8                |
| Materials and supplies - at average cost  | 44.1                  | 44.9                 |
| Prepaid expenses and other  | 17.4                  | 26.0                 |
| Total Current Assets  | 514.5                 | 347.5                |

INVESTMENTS AND OTHER ASSETS

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|                                    |       |       |
|------------------------------------|-------|-------|
| Regulatory assets                  | 157.6 | 168.3 |
| Prepaid pension expense            | 164.7 | 168.1 |
| Other                              | 115.2 | 108.6 |
| Total Investments and Other Assets | 437.5 | 445.0 |

PROPERTY, PLANT AND EQUIPMENT

|                                   |                  |                  |
|-----------------------------------|------------------|------------------|
| Property, plant and equipment     | 4,738.5          | 4,694.5          |
| Accumulated depreciation          | (1,836.8)        | (1,769.6)        |
| Net Property, Plant and Equipment | 2,901.7          | 2,924.9          |
| <b>TOTAL ASSETS</b>               | <b>\$3,853.7</b> | <b>\$3,717.4</b> |

The accompanying Notes are an integral part of these Financial Statements.

POTOMAC ELECTRIC POWER COMPANY  
BALANCE SHEETS  
(Unaudited)

|  | March 31,<br>2004     | December 31,<br>2003 |
|--|-----------------------|----------------------|
| LIABILITIES AND SHAREHOLDER'S EQUITY     |                       |                      |
|  | (Millions of Dollars) |                      |
| CURRENT LIABILITIES                      |                       |                      |
| Short-term debt                          | \$ 210.0              | \$ 107.5             |
| Accounts payable and accrued liabilities | 124.7                 | 159.9                |

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|  |                  |                  |
|--|------------------|------------------|
| Capital lease obligations due within one year                                      | 15.6             | 15.6             |
| Interest and taxes accrued   | 45.4             | 43.5             |
| Other  | 67.5             | 105.5            |
| Total Current Liabilities  | 463.2            | 432.0            |
| DEFERRED CREDITS   |                  |                  |
| Regulatory liabilities   | 186.4            | 200.1            |
| Income taxes   | 704.0            | 644.9            |
| Investment tax credits   | 20.1             | 20.6             |
| Other post-retirement benefit obligation   | 48.9             | 44.4             |
| Other  | 32.7             | 38.2             |
| Total Deferred Credits   | 992.1            | 948.2            |
| LONG-TERM LIABILITIES  |                  |                  |
| Long-term debt   | 1,195.3          | 1,130.4          |
| Mandatorily redeemable serial preferred stock                                      | 45.0             | 45.0             |
| Capital lease obligations  | 113.7            | 114.7            |
| Total Long-Term Liabilities  | 1,354.0          | 1,290.1          |
| COMMITMENTS AND CONTINGENCIES  |                  |                  |
| REDEEMABLE SERIAL PREFERRED STOCK  | 35.3             | 35.3             |
| SHAREHOLDER'S EQUITY   |                  |                  |
| Common stock, \$.01 par value, authorized<br>400,000,000 shares, issued 100 shares | -                | -                |
| Premium on stock and other capital contributions                                   | 507.6            | 507.6            |
| Capital stock expense  | (1.1)            | (1.1)            |
| Retained income  | 502.6            | 505.3            |
| Total Shareholder's Equity   | 1,009.1          | 1,011.8          |
| <b>TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY</b>                                  | <b>\$3,853.7</b> | <b>\$3,717.4</b> |

The accompanying Notes are an integral part of these Financial Statements.

POTOMAC ELECTRIC POWER COMPANY  
STATEMENTS OF CASH FLOWS  
(Unaudited)

Three Months Ended  
March 31,  
2004                      2003  
(Millions of Dollars)

OPERATING ACTIVITIES

|   |        |         |
|---|--------|---------|
| Net income  | \$ 9.5 | \$ 20.0 |
| Adjustments to reconcile net income to net cash<br>from operating activities: |        |         |
| Depreciation and amortization   | 43.9   | 41.3    |
| Deferred income taxes   | (6.8)  | 6.7     |
| Investment tax credit adjustments   | (.5)   | (.5)    |
| Gain on sale of asset   | (6.6)  | -       |
| Changes in:   |        |         |
| Accounts receivable   | 26.0   | (13.3)  |
| Regulatory assets and liabilities   | (3.5)  | (17.6)  |
| Prepaid expenses  | 17.4   | (14.2)  |
| Accounts payable and accrued liabilities                                      | (17.0) | 27.6    |
| Prepaid pension costs   | 3.4    | 4.9     |
| Other deferred charges and other  | 3.8    | (5.9)   |
| Other deferred credits  | (1.0)  | 7.1     |
| Interest and taxes accrued  | 1.9    | 9.8     |
| Net Cash From Operating Activities  | 70.5   | 65.9    |

INVESTING ACTIVITIES

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|  |         |         |
|--|---------|---------|
| Net investment in property, plant and equipment  | (42.4)  | (41.4)  |
| Proceeds from sale of asset                      | 22.0    | -       |
| Net Cash Used By Investing Activities            | (20.4)  | (41.4)  |
| FINANCING ACTIVITIES                             |         |         |
| Dividend to Pepco Holdings                       | (11.8)  | (15.7)  |
| Dividends paid on preferred stock                | (.4)    | (1.2)   |
| Issuances of long-term debt                      | 275.0   | -       |
| Repayment of short-term debt, net                | (107.6) | (3.9)   |
| Net other financing activities                   | (2.9)   | -       |
| Net Cash From (Used By) Financing Activities     | 152.3   | (20.8)  |
| Net Increase In Cash and Cash Equivalents        | 202.4   | 3.7     |
| Cash and Cash Equivalents at Beginning of Period | 6.8     | 13.9    |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD       | \$209.2 | \$ 17.6 |

The accompanying Notes are an integral part of these Financial Statements.

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**NOTES TO FINANCIAL STATEMENTS**

**POTOMAC ELECTRIC POWER COMPANY**

**(1) ORGANIZATION**

Potomac Electric Power Company (Pepco) is engaged in the transmission and distribution of electricity in Washington, D.C. and major portions of Prince George's and Montgomery Counties in suburban Maryland. Pepco's service territory covers approximately 640 square miles and has a population of approximately 2 million. On August 1, 2002 Pepco completed its acquisition of Conectiv, at which time Pepco and Conectiv became wholly owned subsidiaries of Pepco Holdings, Inc. (Pepco Holdings or PHI). PHI is a public utility holding company registered under the Public Utility Holding Company Act of 1935 (PUHCA) and is subject to the regulatory oversight of the Securities and Exchange Commission (SEC) under PUHCA.

**(2) ACCOUNTING POLICY AND PRONOUNCEMENTS DISCLOSURES**

### Financial Statement Presentation

Pepco's unaudited consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Pursuant to the rules and regulations of the SEC, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted. Therefore, these financial statements should be read along with the annual financial statements included in Pepco's Annual Report on Form 10-K/A for the year ended December 31, 2003. In the opinion of Pepco's management, the consolidated financial statements contain all adjustments (which all are of a normal recurring nature) necessary to present fairly Pepco's financial condition as of March 31, 2004, in accordance with GAAP. Interim results for the three months ended March 31, 2004 may not be indicative of results that will be realized for the full year ending December 31, 2004. Additionally, certain prior period balances have been reclassified in order to conform to current period presentation.

#### FIN 45

Pepco applied the provisions of FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45), commencing in 2003 to its agreements that contain guarantee and indemnification clauses. These provisions expand those required by FASB Statement No. 5, "Accounting for Contingencies," by requiring a guarantor to recognize a liability on its balance sheet for the fair value of obligations it assumes under certain guarantees issued or modified after December 31, 2002 and to disclose certain types of guarantees, even if the likelihood of requiring the guarantor's performance under the guarantee is remote.

As of March 31, 2004, Pepco did not have material obligations under guarantees or indemnifications issued or modified after December 31, 2002, which are required to be recognized as a liability on its consolidated balance sheets.

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#### FIN 46

On December 31, 2003, FIN 46 was implemented by Pepco. FIN 46 was revised and superseded by FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (FIN 46R) which clarified some of the provisions of FIN 46 and exempted certain entities from its requirements. FIN 46R is applicable to Pepco's financial statements for the quarter ended March 31, 2004. The implementation of FIN 46R (including the evaluation of interests in purchase power arrangements) did not impact Pepco's financial condition or results of operations for the three months ended March 31, 2004.

As part of the FIN 46R evaluation, Pepco reviewed its power purchase agreements (PPAs), including its Non-Utility Generation (NUG) contracts, to determine (i) if its interest in each entity that is a counterparty to a PPA agreement was a variable interest, (ii) whether the entity was a variable interest entity and (iii) if so, whether Pepco was the primary beneficiary. Due to a variable element in the pricing structure of its PPA with one entity, Panda-Brandywine, L.P. (Panda), Pepco potentially assumes the variability in the operations of the plant of this entity and therefore has a variable interest in the entity. However, due to Pepco's inability to obtain information from the entity considered to be confidential and proprietary by the entity, Pepco was unable to obtain sufficient information to conduct the analysis required under FIN 46R to

determine whether the entity was a variable interest entity or if Pepco was the primary beneficiary. As a result, Pepco has applied the scope exemption from the application of FIN 46R for enterprises that have conducted exhaustive efforts to obtain the necessary information.

Power purchases related to the Panda PPA in the quarters ended March 31, 2004 and 2003 were approximately \$20 million and \$23 million, respectively. Power purchases related to the Panda PPA in the years ended December 31, 2003, 2002 and 2001 were approximately \$80 million, \$74 million and \$75 million, respectively. Pepco's exposure to loss under the Panda PPA is discussed in Note (4) Commitments And Contingencies, under "Relationship with Mirant Corporation."

#### Components of Net Periodic Benefit Cost

The following Pepco Holdings information is for the three months ended March 31,

|                                    | <u>Pension Benefits</u> |               | <u>Other Post-Retirement Benefits</u> |               |
|------------------------------------|-------------------------|---------------|---------------------------------------|---------------|
|                                    | <u>2004</u>             | <u>2003</u>   | <u>2004</u>                           | <u>2003</u>   |
|                                    | (In Millions)           |               |                                       |               |
| Service cost                       | \$ 9.6                  | \$ 8.1        | \$ 2.4                                | \$ 2.3        |
| Interest cost                      | 23.8                    | 23.0          | 8.3                                   | 7.9           |
| Expected return on plan assets     | (29.8)                  | (26.1)        | (2.8)                                 | (2.0)         |
| Amortization of prior service cost | .3                      | .3            | -                                     | -             |
| Amortization of net loss           | <u>4.5</u>              | <u>3.4</u>    | <u>3.1</u>                            | <u>1.9</u>    |
| Net periodic benefit cost          | <u>\$ 8.4</u>           | <u>\$ 8.7</u> | <u>\$11.0</u>                         | <u>\$10.1</u> |

The actual components of net periodic benefit cost for the 2003 interim period are not available. The component amounts presented above for the 2003 interim period were calculated in proportion to the annual amounts presented

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in Pepco Holdings' financial statements for the year ended December 31, 2003. These component amounts are presented for comparison purposes only.

#### *Pension*

The 2004 pension net periodic benefit cost of \$8.4 million includes \$3.6 million for Pepco. The 2003 pension net periodic benefit cost of \$8.7 million includes \$5.2 million for Pepco.

#### Pension Contributions

Pepco Holdings funding policy with regard to the pension plan is to maintain a funding level in excess of 100% of its accumulated benefit obligation (ABO). PHI's defined benefit plan currently meets the minimum funding requirements of the Employment Retirement Income Security Act of 1974 (ERISA) without any additional funding. In 2003 and 2002 PHI made discretionary tax-deductible cash contributions to the plan of \$50 million and \$35 million, respectively. Assuming no changes to the current pension plan assumptions, PHI projects no funding will be required in 2004; however PHI may elect to make a discretionary tax-deductible contribution, if required to maintain its assets in excess of its ABO. As of March 31, 2004, no contributions have been made.

#### *Other Post-Retirement Benefits*

The 2004 Other Post-Retirement net periodic benefit cost of \$11.0 million includes \$4.5 million for Pepco. The 2003 Other Post-Retirement net periodic benefit cost of \$10.1 million includes \$4.2 million for Pepco.

#### *FASB Staff Position (FSP 106-1), Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act)*

The Act became effective on December 8, 2003. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D.

SFAS No. 106 "Employers Accounting for Post-retirement Benefits Other than Pensions" requires presently enacted changes in relevant laws to be considered in current period measurements of post-retirement benefit costs and the Accumulated Post-Retirement Benefit Obligation (APBO). Therefore, under that guidance, measures of the APBO and net periodic post-retirement benefit costs on or after the date of enactment should reflect the effects of the Act.

However, due to certain accounting issues raised by the Act that are not explicitly addressed by SFAS No. 106 and uncertainties that may exist as to reliable information available on which to measure the effects of the Act, the FSP 106-1 allows a plan sponsor to elect to defer recognizing the effects of the Act in the accounting for its plan under SFAS No. 106 and in providing disclosures related to the plan required by SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Post-retirement Benefits," until authoritative guidance on the accounting for the federal subsidy is issued, or until certain other events occur.

Pepco Holdings sponsors post-retirement health care plans that provide prescription drug benefits. Pepco Holdings did not elect the deferral provided by the FSP 106-1. The APBO as of December 31, 2003 was reduced by

\$28 million to reflect the effects of the Act. For the current quarter and all of 2003, Pepco Holdings' net periodic postretirement benefit expense has not been reduced to reflect the Act. It is estimated that the annual postretirement benefit cost will be reduced by approximately \$4 million due to effects of the Act. This reduction includes both the decrease in the cost of future benefits being earned and an amortization of the APBO reduction over the future average working lifetime of the participants, or 13.5 years. The anticipated claims costs expected to be incurred have been adjusted to reflect the cost sharing between Medicare and Pepco Holdings. Participation rates have not been changed. In reflecting the effects of the Act, Pepco Holdings has determined which plans are eligible for Medicare cost sharing by analyzing the terms of each of its plans. It has recognized Medicare cost sharing for a plan only if Pepco Holdings' projected prescription drug coverage is expected to be at least as generous as the expected contribution by Medicare to a prescription drug plan not provided by Pepco Holdings.

Specific authoritative guidance on the accounting for the federal subsidy under the Act is pending and that guidance, when issued, could require Pepco Holdings to change previously reported information. When issued, the guidance on accounting for the federal subsidy will include transition guidance, as applicable, for entities that elected to defer accounting for the effects of the Act and those that did not.

The effect of the subsidy on the current period Other Post-Retirement net periodic benefit cost of \$11.0 million would be approximately a \$1 million reduction due to the subsidy. Approximately \$.5 million would be related to the amortization of the actuarial gain, \$.1 million would be a subsidy-related reduction in current period service cost and approximately \$.4 million would be a subsidy-related reduction in interest cost on the APBO.

### Severance Costs

During 2002, Pepco Holdings' management approved initiatives by Pepco to streamline its operating structure by reducing its number of employees. These initiatives met the criteria for the accounting treatment provided under EITF No. 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." A roll forward of the severance balance is as follows. (Amounts in millions)

|                            |              |
|----------------------------|--------------|
| Balance, December 31, 2003 | \$ 3.3       |
| Accrued during 2004        | -            |
| Payments during 2004       | <u>(1.5)</u> |
|                            | )            |
| Balance, March 31, 2004    | \$ 1.8       |

Substantially all of the severance liability accrued at March 31, 2004 will be paid through mid 2005. Employees have the option of taking severance payments in a lump sum or over a period of time.

### (3) SEGMENT INFORMATION

In accordance with SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information," Pepco has one segment, its regulated utility business.

(4) COMMITMENTS AND CONTINGENCIES

Relationship with Mirant Corporation

In 2000, Pepco sold substantially all of its electricity generation assets to Mirant Corporation, formerly Southern Energy, Inc. As part of the sale, Pepco entered into several ongoing contractual arrangements with Mirant and certain of its subsidiaries (collectively, Mirant). On July 14, 2003, Mirant Corporation and most of its subsidiaries filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Northern District of Texas (the Bankruptcy Court). Under bankruptcy law, a debtor generally may, with authorization from a bankruptcy court, assume or reject executory contracts. A rejection of an executory contract entitles the counterparty to file a claim as an unsecured creditor against the bankruptcy estate for damages incurred due to the rejection of the contract. In a bankruptcy proceeding, a debtor can normally restructure some or all of its pre-petition liabilities.

Depending on the outcome of the matters discussed below, the Mirant bankruptcy could have a material adverse effect on the results of operations of Pepco. However, management currently believes that Pepco currently has sufficient cash, cash flow and borrowing capacity under its credit facilities and in the capital markets to be able to satisfy the additional cash requirements that are expected to arise due to the Mirant bankruptcy. Accordingly, management does not anticipate that the Mirant bankruptcy will impair the ability of Pepco to fulfill its contractual obligations or to fund projected capital expenditures. On this basis, management currently does not believe that the Mirant bankruptcy will have a material adverse effect on the financial condition of Pepco.

Transition Power Agreements

As part of the asset purchase and sale agreement for the Pepco generation assets (the Asset Purchase and Sale Agreement), Pepco and Mirant entered into Transition Power Agreements for Maryland and the District of Columbia, respectively (collectively, the TPAs). Under these agreements, Mirant was obligated to supply Pepco with all of the capacity and energy needed to fulfill its standard offer service obligations in Maryland through June 2004 and its standard offer service obligations in the District of Columbia into January 2005.

To avoid the potential rejection of the TPAs, Pepco and Mirant entered into an Amended Settlement Agreement and Release dated as of October 24, 2003 (the Settlement Agreement) pursuant to which Mirant has assumed both of the TPAs and the terms of the TPAs were modified. The Settlement Agreement also provides that Pepco has an allowed, pre-petition general unsecured claim against Mirant in the amount of \$105 million (the Pepco TPA Claim).

The amount, if any, that Pepco will be able to recover from the Mirant bankruptcy estate in respect of the Pepco TPA Claim will depend on the amount of assets available for distribution to creditors. At the current stage of the bankruptcy proceeding, there is insufficient information to determine the amount, if any, that Pepco might be able to recover from the Mirant bankruptcy estate.

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Power Purchase Agreements

Under agreements with FirstEnergy Corp., formerly Ohio Edison (FirstEnergy), and Allegheny Energy, Inc., both entered into in 1987, Pepco is obligated to purchase from FirstEnergy 450 megawatts of capacity and energy annually through December 2005 (the FirstEnergy PPA). Under an agreement with Panda-Brandywine L.P. (Panda), entered into in 1991, Pepco is obligated to purchase from Panda 230 megawatts of capacity and energy annually through 2021 (the Panda PPA). In each case, the purchase price is substantially in excess of current market prices. As a part of the Asset Purchase and Sale Agreement, Pepco entered into a "back-to-back" arrangement with Mirant. Under this arrangement, Mirant is obligated, among other things, to purchase from Pepco the capacity and energy that Pepco is obligated to purchase under the FirstEnergy PPA and the Panda PPA at a price equal to the price Pepco is obligated to pay under the PPAs (the PPA-Related Obligations).

#### Pepco Pre-Petition Claims

When Mirant filed its bankruptcy petition on July 14, 2003, Mirant had unpaid obligations to Pepco of approximately \$29 million, consisting primarily of payments due to Pepco in respect of the PPA-Related Obligations (the Mirant Pre-Petition Obligations). The Mirant Pre-Petition Obligations constitute part of the indebtedness for which Mirant is seeking relief in its bankruptcy proceeding. Pepco has filed Proofs of Claim in the Mirant bankruptcy proceeding in the amount of approximately \$26 million to recover this indebtedness; however, the amount of Pepco's recovery, if any, is uncertain. The \$3 million difference between Mirant's unpaid obligation to Pepco and the \$26 million Proofs of Claim filed by Pepco primarily represents a TPA settlement adjustment which is included in the \$105 million Proofs of Claim filed by Pepco against the Mirant debtors in respect of the Pepco TPA Claim. In view of this uncertainty, Pepco, in the third quarter of 2003, expensed \$14.5 million to establish a reserve against the \$29 million receivable from Mirant. In January 2004, Pepco paid approximately \$2.5 million to Panda in settlement of certain billing disputes under the Panda PPA that related to periods after the sale of Pepco's generation assets to Mirant. Pepco believes that under the terms of the Asset Purchase and Sale Agreement, Mirant is obligated to reimburse Pepco for the settlement payment. Accordingly, in the first quarter of 2004 Pepco increased the amount of the receivable due from Mirant by approximately \$2.5 million, and Pepco intends to file Proofs of Claim for this amount against Mirant. Pepco currently estimates that the \$14.5 million expensed in the third quarter of 2003 represents the portion of the entire \$31.5 million receivable unlikely to be recovered in bankruptcy, and no additional reserve has been established for the \$2.5 million increase in the receivable. The amount expensed represents Pepco's estimate of the possible outcome in bankruptcy, although the amount ultimately recoverable could be higher or lower.

#### Mirant's Attempt to Reject the PPA-Related Obligations

On August 28, 2003, Mirant filed with the Bankruptcy Court a motion seeking authorization to reject its PPA-Related Obligations.

Upon motions filed by Pepco and the Federal Energy Regulatory Commission (FERC), on October 9, 2003, the U.S. District Court for the Northern District of Texas (the District Court) withdrew jurisdiction over the rejection proceedings from the Bankruptcy Court. On December 23, 2003, the District Court denied Mirant's motion to reject the PPA-Related Obligations. The District Court's decision is being appealed by Mirant and The Official

Oral argument on the appeal was heard on May 5, 2004.

Pepco is exercising all available legal remedies and vigorously opposing Mirant's continued attempts to reject the PPA-Related Obligations in order to protect the interests of its customers and shareholders. While Pepco believes that it has substantial legal bases to oppose the attempt to reject the agreements, the outcome of Mirant's efforts to reject the PPA-Related Obligations is uncertain.

In accordance with the Bankruptcy Court's order, Mirant is continuing to perform the PPA-Related Obligations pending the resolution of the ongoing proceedings. However, if Mirant ultimately is successful in rejecting, and is otherwise permitted to stop performing the PPA-Related Obligations, Pepco could be required to repay to Mirant, for the period beginning on the effective date of the rejection (which date could be prior to the date of the court's order and possibly as early as September 18, 2003) and ending on the date Mirant is entitled to cease its purchases of energy and capacity from Pepco, all amounts paid by Mirant to Pepco in respect of the PPA-Related Obligations, less an amount equal to the price at which Mirant resold the purchased energy and capacity. Pepco estimates that the amount it could be required to repay to Mirant in the unlikely event September 18, 2003, is determined to be the effective date of rejection, is approximately \$69.2 million as of May 1, 2004. This repayment would entitle Pepco to file a claim against the bankruptcy estate in an amount equal to the amount repaid. Mirant has also asked the Bankruptcy Court to require Pepco to disgorge all amounts paid by Mirant to Pepco in respect of the PPA-Related Obligations, less an amount equal to the price at which Mirant resold the purchased energy and capacity, for the period July 14, 2003 (the date on which Mirant filed its bankruptcy petition) to September 18, 2003, on the theory that Mirant did not receive value for those payments. Pepco estimates that the amount it would be required to repay to Mirant on the disgorgement theory is approximately \$22.5 million. Pepco believes a claim based on this theory should be entitled to administrative expense status for which complete recovery could be expected. If Pepco were required to repay any such amounts for either period, the payment would be expensed at the time the payment is made.

The following are estimates prepared by Pepco of its potential future exposure if Mirant's motion to reject its PPA-Related Obligations ultimately is successful. These estimates are based in part on current market prices and forward price estimates for energy and capacity, and do not include financing costs, all of which could be subject to significant fluctuation. The estimates assume no recovery from the Mirant bankruptcy estate and no regulatory recovery, either of which would mitigate the effect of the estimated loss. Pepco does not consider it realistic to assume that there will be no such recoveries. Based on these assumptions, Pepco estimates that its pre-tax exposure as of May 1, 2004, representing the loss of the future benefit of the PPA-Related Obligations to Pepco, is as follows:

- If Pepco were required to purchase capacity and energy from FirstEnergy commencing as of May 1, 2004, at the rates provided in the PPA (with an average price per kilowatt hour of approximately 6.1 cents) and resold the capacity and energy at market rates projected, given the characteristics of the FirstEnergy PPA, to be approximately 4.5 cents per kilowatt hour, Pepco estimates that it would cost approximately \$41.0 million for the remainder of 2004, and \$57 million in 2005, the last year of the FirstEnergy PPA.

- 
- If Pepco were required to purchase capacity and energy from Panda commencing as of May 1,

2004, at the rates provided in the PPA (with an average price per kilowatt hour of approximately 15.6 cents), and resold the capacity and energy at market rates projected, given the characteristics of the Panda PPA, to be approximately 6.9 cents per kilowatt hour, Pepco estimates that it would cost approximately \$26 million for the remainder of 2004, \$38 million in 2005, and \$36 million in 2006 and approximately \$35 million to \$43 million annually thereafter through the 2021 contract termination date.

The ability of Pepco to recover from the Mirant bankruptcy estate in respect of the Mirant Pre-Petition Obligations and damages if the PPA-Related Obligations are successfully rejected will depend on whether Pepco's claims are allowed, the amount of assets available for distribution to creditors and Pepco's priority relative to other creditors. At the current stage of the bankruptcy proceeding, there is insufficient information to determine the amount, if any, that Pepco might be able to recover from the Mirant bankruptcy estate, whether the recovery would be in cash or another form of payment, or the timing of any recovery.

If Mirant ultimately is successful in rejecting the PPA-Related Obligations and Pepco's full claim is not recovered from the Mirant bankruptcy estate, Pepco may seek authority from the Maryland Public Service Commission (MPSC) and the District of Columbia Public Service Commission (DCPSC) to recover its additional costs. Pepco is committed to working with its regulatory authorities to achieve a result that is appropriate for its shareholders and customers. Under the provisions of the settlement agreements approved by the MPSC and the DCPSC in the deregulation proceedings in which Pepco agreed to divest its generation assets under certain conditions, the PPAs were to become assets of Pepco's distribution business if they could not be sold. Pepco believes that, if Mirant ultimately is successful in rejecting the PPA-Related Obligations, these provisions would allow the stranded costs of the PPAs that are not recovered from the Mirant bankruptcy estate to be recovered through Pepco's distribution rates. If Pepco's interpretation of the settlement agreements is confirmed, Pepco expects to be able to establish the amount of its anticipated recovery as a regulatory asset. However, there is no assurance that Pepco's interpretation of the settlement agreements would be confirmed by the respective public service commissions.

If the PPA-Related Obligations are successfully rejected, and there is no regulatory recovery, Pepco will incur a loss. However, the accounting treatment of such a loss depends on a number of legal and regulatory factors, and is not determinable at this time.

#### The SMECO Agreement

As a term of the Asset Purchase and Sale Agreement, Pepco assigned to Mirant a facility and capacity agreement with Southern Maryland Electric Cooperative, Inc. (SMECO) under which Pepco was obligated to purchase the capacity of an 84-megawatt combustion turbine installed and owned by SMECO at a former Pepco generating station (the SMECO Agreement). The SMECO Agreement expires in 2015 and contemplates a monthly payment to SMECO of approximately \$.5 million. Pepco is responsible to SMECO for the performance of the SMECO Agreement if Mirant fails to perform its obligations thereunder. At this time, Mirant continues to make post-petition payments due to SMECO.

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However, on March 15, 2004, Mirant filed a complaint with the Bankruptcy Court seeking a declaratory

judgment that the facility and capacity credit agreement is an unexpired lease of non-residential real property rather than an executory contract and that if Mirant were to successfully reject the agreement, any claim against the bankruptcy estate for damages made by SMECO (or by Pepco as subrogee) would be subject to the provisions of the Bankruptcy Code that limit the recovery of rejection damages by lessors. Pepco believes that there is no reasonable factual or legal basis to support Mirant's contention that the SMECO Agreement is a lease of real property and has filed a motion to dismiss the complaint. However, the outcome of this proceeding cannot be predicted.

#### Rate Proceedings

In compliance with the merger settlement approved by the MPSC in connection with the merger of Pepco and Conectiv, on December 4, 2003, Pepco submitted testimony and supporting schedules to establish electric distribution rates in Maryland effective July 1, 2004, when the current distribution rate freeze/caps end. Pepco's filing demonstrates that it is in an under-earning situation. The merger settlement provides that Pepco's distribution rates can only decrease or remain unchanged after July 1, 2004. With limited exceptions, the merger settlement does not permit Pepco to increase distribution rates until after December 31, 2006. The MPSC Staff has filed testimony stating that no distribution rate reductions are justified. The Office of the People's Counsel (OPC) agrees that no distribution rate reduction is warranted for Pepco if the Pepco capital structure is used in determining whether existing rates should be reduced. However, OPC argues that the Pepco Holdings' consolidated capital structure and capital costs should be used to determine whether distribution rate reductions for Pepco are warranted. Based on PHI's consolidated capital structure, OPC recommended that Pepco's distribution rates be reduced. Hearings in the Pepco case concluded April 27, 2004. The MPSC decision is expected to be issued in early July 2004. Pepco cannot predict the outcome of the proceeding.

#### SOS Proceedings

##### District of Columbia

On March 1, 2004, the DCPSC issued an order adopting the "wholesale" model for Standard Offer Service (SOS) in the District of Columbia after fixed rate SOS ends February 7, 2005. Under the wholesale model, Pepco will continue as the SOS provider after February 7, 2005. Several parties have filed applications for reconsideration of the order adopting the wholesale model that are pending before the DCPSC. PHI cannot predict the outcome of this proceeding.

In December 2003, the DCPSC issued an order adopting terms and conditions that would apply if the wholesale SOS model were adopted. Pepco and most of the other parties in the case filed applications for reconsideration and/or clarification of various parts of this order, and on March 1, 2004, the DCPSC granted in part and denied in part the applications for reconsideration and/or clarification. Because the DCPSC changed certain rules in its order granting in part and denying in part applications for reconsideration of the wholesale SOS terms and conditions, several parties filed for reconsideration of the March 1, 2004 order. Those applications for reconsideration are pending decision by the DCPSC. The DCPSC has also instituted an evidentiary proceeding to consider the amount of the administrative charge which Pepco may collect for providing SOS on and after February 8, 2005. The DCPSC intends to issue a decision by August 10, 2004.

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DELMARVA POWER & LIGHT COMPANY  
CONSOLIDATED STATEMENTS OF EARNINGS  
(Unaudited)

|  | Three Months Ended<br>March 31, |         |
|--|---------------------------------|---------|
|  | 2004                            | 2003    |
|  | (Millions of Dollars)           |         |
| Operating Revenue  |                                 |         |
| Electric   | \$249.4                         | \$263.1 |
| Gas  | 99.9                            | 77.2    |
| Other services   | 1.4                             | 3.0     |
| Total Operating Revenue                                      | \$350.7                         | 343.3   |
| Operating Expenses   |                                 |         |
| Fuel and purchased energy                                    | 158.2                           | 169.9   |
| Gas purchased  | 73.3                            | 52.3    |
| Other operation and maintenance                              | 46.1                            | 45.9    |
| Depreciation and amortization                                | 18.1                            | 18.7    |
| Other taxes  | 9.0                             | 9.4     |
| Total Operating Expenses                                     | 304.7                           | 296.2   |
| Operating Income   | 46.0                            | 47.1    |
| Other Income (Expenses)                                      |                                 |         |
| Interest and dividend income                                 | .1                              | .5      |
| Interest expense   | (9.0)                           | (9.5)   |
| Other income   | 1.0                             | .9      |
| Total Other Expenses   | (7.9)                           | (8.1)   |
| Distributions on Preferred Securities of<br>Subsidiary Trust | -                               | 1.4     |
| Income Before Income Tax Expense                             | 38.1                            | 37.6    |

|  |         |         |
|--|---------|---------|
| Income Tax Expense                             | 15.7    | 15.0    |
| Net Income                                     | 22.4    | 22.6    |
| Dividends on Redeemable Serial Preferred Stock | .2      | .2      |
| Earnings Available for Common Stock            | 22.2    | 22.4    |
| Retained Income at Beginning of Period         | 367.4   | 364.4   |
| Dividends paid to Pepco Holdings               | (22.1)  | (18.5)  |
| Retained Income at End of Period               | \$367.5 | \$368.3 |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

DELMARVA POWER & LIGHT COMPANY  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)

| ASSETS  | March 31,<br>2004     | December 31,<br>2003 |
|---|-----------------------|----------------------|
|   | (Millions of Dollars) |                      |
| CURRENT ASSETS  |                       |                      |
| Cash and cash equivalents   | \$ 6.9                | \$ 4.9               |
| Accounts receivable, less allowance for uncollectible accounts of \$10.2 million and \$10.1 million | 163.6                 | 163.2                |
| Fuel, materials and supplies - at average cost  | 20.5                  | 34.2                 |

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|                            |       |       |
|----------------------------|-------|-------|
| Prepaid expenses and other | 7.0   | 14.4  |
| Total Current Assets       | 198.0 | 216.7 |

INVESTMENTS AND OTHER ASSETS

|                                    |       |       |
|------------------------------------|-------|-------|
| Goodwill                           | 48.5  | 48.5  |
| Regulatory assets                  | 143.6 | 150.3 |
| Prepaid pension costs              | 196.1 | 195.4 |
| Other                              | 30.6  | 33.5  |
| Total Investments and Other Assets | 418.8 | 427.7 |

PROPERTY, PLANT AND EQUIPMENT

|                                   |                  |                  |
|-----------------------------------|------------------|------------------|
| Property, plant and equipment     | 2,213.8          | 2,195.0          |
| Accumulated depreciation          | (708.7)          | (687.0)          |
| Net Property, Plant and Equipment | 1,505.1          | 1,508.0          |
| <b>TOTAL ASSETS</b>               | <b>\$2,121.9</b> | <b>\$2,152.4</b> |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

DELMARVA POWER & LIGHT COMPANY  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)

| LIABILITIES AND SHAREHOLDER'S EQUITY  | March 31,<br>2004     | December 31,<br>2003 |
|---|-----------------------|----------------------|
|   | (Millions of Dollars) |                      |
| <b>CURRENT LIABILITIES</b>  |                       |                      |
| Short-term debt   | \$ 160.0              | \$ 174.4             |
| Debentures issued to financing trust  | 72.2                  | -                    |
| Accounts payable and accrued liabilities  | 46.3                  | 52.7                 |
| Accounts payable to associated companies  | 23.5                  | 36.9                 |
| Capital lease obligations due within one year   | .2                    | .2                   |
| Interest and taxes accrued  | 44.3                  | 23.0                 |
| Other   | 56.0                  | 56.7                 |
| Total Current Liabilities   | 402.5                 | 343.9                |
| <b>DEFERRED CREDITS</b>   |                       |                      |
| Regulatory liabilities  | 211.1                 | 219.9                |
| Income taxes  | 394.2                 | 397.3                |
| Investment tax credits  | 12.4                  | 12.6                 |
| Above-market purchased energy contracts and other<br>electric restructuring liabilities | 38.7                  | 42.7                 |
| Other   | 17.1                  | 18.1                 |
| Total Deferred Credits  | 673.5                 | 690.6                |
| <b>LONG-TERM LIABILITIES</b>  |                       |                      |
| Long-term debt  | 442.8                 | 442.7                |
| Debentures issued to financing trust  | -                     | 72.2                 |
| Capital lease obligations   | .4                    | .4                   |
| Total Long-Term Liabilities   | 443.2                 | 515.3                |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |                       |                      |
| REDEEMABLE SERIAL PREFERRED STOCK   | 21.7                  | 21.7                 |

## SHAREHOLDER'S EQUITY

|   |                  |                  |
|---|------------------|------------------|
| Common stock, \$2.25 par value, authorized 1,000,000 shares - issued 1,000 shares | -                | -                |
| Premium on stock and other capital contributions                                  | 223.5            | 223.5            |
| Capital stock expense   | (10.0)           | (10.0)           |
| Retained income   | 367.5            | 367.4            |
| Total Shareholder's Equity  | 581.0            | 580.9            |
| <b>TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY</b>                                 | <b>\$2,121.9</b> | <b>\$2,152.4</b> |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

DELMARVA POWER & LIGHT COMPANY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|  | Three Months Ended<br>March 31, |         |
|--|---------------------------------|---------|
|  | 2004                            | 2003    |
|  | (Millions of Dollars)           |         |
| <b>OPERATING ACTIVITIES</b>  |                                 |         |
| Net income   | \$22.4                          | \$ 22.6 |
| Adjustments to reconcile net income to net cash from operating activities: |                                 |         |
| Depreciation and amortization  | 18.1                            | 18.7    |
| Deferred income taxes  | 1.7                             | (3.9)   |
| Investment tax credit adjustments, net                                     | (.2)                            | (.2)    |
| Changes in:  |                                 |         |

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|   |               |                |
|---|---------------|----------------|
| Accounts receivable                               | (.4)          | (30.2)         |
| Regulatory assets and liabilities                 | 4.5           | (.5)           |
| Fuel, materials and supplies                      | 13.7          | 7.3            |
| Derivative and energy trading contracts           | (4.1)         | (4.7)          |
| Other deferred charges                            | 6.5           | (2.8)          |
| Accounts payable and accrued liabilities          | (22.3)        | 19.5           |
| Interest and taxes accrued                        | 21.3          | 18.5           |
| Net Cash From Operating Activities                | 61.2          | 44.3           |
| <b>INVESTING ACTIVITIES</b>                       |               |                |
| Net investment in property, plant and equipment   | (23.3)        | (18.3)         |
| Net other investing activities                    | .9            | .1             |
| Net Cash Used By Investing Activities             | (22.4)        | (18.2)         |
| <b>FINANCING ACTIVITIES</b>                       |               |                |
| Dividends paid to Pepco Holdings                  | (22.1)        | (18.5)         |
| Preferred dividends paid                          | (.2)          | (.2)           |
| Repayment of short-term debt, net                 | (14.4)        | -              |
| Principal portion of capital lease payments       | (.1)          | (.2)           |
| Net Cash Used By Financing Activities             | (36.8)        | (18.9)         |
| Net Change In Cash and Cash Equivalents           | 2.0           | 7.2            |
| Cash and Cash Equivalents at Beginning of Period  | 4.9           | 109.7          |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b> | <b>\$ 6.9</b> | <b>\$116.9</b> |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### DELMARVA POWER & LIGHT COMPANY

#### (1) ORGANIZATION

Delmarva Power & Light Company (DPL) is engaged in the transmission and distribution of electricity in Delaware and portions of Maryland and Virginia and provides gas distribution service in northern Delaware. DPL's electricity distribution service territory covers approximately 6,000 square miles and has a population of approximately 1.25 million. DPL's natural gas distribution service territory covers approximately 275 square miles and has a population of approximately 523,000. DPL is a wholly owned subsidiary of Conectiv. On August 1, 2002, Pepco completed its acquisition of Conectiv, at which time Pepco and Conectiv became wholly owned subsidiaries of Pepco Holdings, Inc. (Pepco Holdings or PHI). PHI is a public utility holding company registered under the Public Utility Holding Company Act of 1935 (PUHCA) and is subject to the regulatory oversight of the Securities and Exchange Commission (SEC) under PUHCA.

#### (2) ACCOUNTING POLICY AND PRONOUNCEMENTS DISCLOSURES

##### Financial Statement Presentation

DPL's unaudited consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Pursuant to the rules and regulations of the SEC, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted. Therefore, these financial statements should be read along with the annual financial statements included in DPL's Annual Report on Form 10-K/A for the year ended December 31, 2003. In the opinion of DPL's management, the consolidated financial statements contain all adjustments (which all are of a normal recurring nature) necessary to present fairly DPL's financial condition as of March 31, 2004, in accordance with GAAP. Interim results for the three months ended March 31, 2004 may not be indicative of results that will be realized for the full year ending December 31, 2004. Additionally, certain prior period balances have been reclassified in order to conform to current period presentation.

##### FIN 45

DPL applied the provisions of FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45), commencing in 2003 to its agreements that contain guarantee and indemnification clauses. These provisions expand those required by FASB Statement No. 5, "Accounting for Contingencies," by requiring a guarantor to recognize a liability on its balance sheet for the fair value of obligations it assumes under certain guarantees issued or modified after December 31, 2002 and to disclose certain types of guarantees, even if the likelihood of requiring the guarantor's performance under the guarantee is remote.

As of March 31, 2004, DPL did not have material obligations under guarantees or indemnifications issued or modified after December 31, 2002, which are required to be recognized as a liability on its consolidated balance sheets.

FIN 46

On December 31, 2003, FIN 46 was implemented by DPL. FIN 46 was revised and superseded by FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (FIN 46R) which clarified some of the provisions of FIN 46 and exempted certain entities from its requirements. FIN 46R is applicable to DPL's financial statements for the quarter ended March 31, 2004. The implementation of FIN 46R did not materially impact DPL's financial condition or results of operations for the three months ended March 31, 2004.

Components of Net Periodic Benefit Cost

The following Pepco Holdings information is for the three months ended March 31,

|                                    | <u>Pension Benefits</u> |               | <u>Other Post-Retirement Benefits</u> |               |
|------------------------------------|-------------------------|---------------|---------------------------------------|---------------|
|                                    | <u>2004</u>             | <u>2003</u>   | <u>2004</u>                           | <u>2003</u>   |
|                                    | (In Millions)           |               |                                       |               |
| Service cost                       | \$ 9.6                  | \$ 8.1        | \$ 2.4                                | \$ 2.3        |
| Interest cost                      | 23.8                    | 23.0          | 8.3                                   | 7.9           |
| Expected return on plan assets     | (29.8)                  | (26.1)        | (2.8)                                 | (2.0)         |
| Amortization of prior service cost | .3                      | .3            | -                                     | -             |
| Amortization of net loss           | <u>4.5</u>              | <u>3.4</u>    | <u>3.1</u>                            | <u>1.9</u>    |
| Net periodic benefit cost          | <u>\$ 8.4</u>           | <u>\$ 8.7</u> | <u>\$11.0</u>                         | <u>\$10.1</u> |

The actual components of net periodic benefit cost for the 2003 interim period are not available. The component amounts presented above for the 2003 interim period were calculated in proportion to the annual amounts presented in Pepco Holdings' financial statements for the year ended December 31, 2003. These component amounts are presented for comparison purposes only.

*Pension*

The 2004 pension net periodic benefit cost of \$8.4 million includes \$(.5) million for DPL. The 2003 pension net periodic benefit cost of \$8.7 million includes \$(1.4) million for DPL.

*Pension Contributions*

Pepco Holdings funding policy with regard to the pension plan is to maintain a funding level in excess of 100% of its accumulated benefit obligation (ABO). PHI's defined benefit plan currently meets the minimum

funding requirements of the Employment Retirement Income Security Act of 1974 (ERISA) without any additional funding. In 2003 and 2002 PHI made discretionary tax-deductible cash contributions to the plan of \$50 million and \$35 million, respectively. Assuming no changes to the current pension plan assumptions, PHI projects no funding will be required in 2004; however PHI may elect to make a discretionary tax-deductible contribution, if required to maintain its assets in excess of its ABO. As of March 31, 2004, no contributions have been made.

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### *Other Post-Retirement Benefits*

The 2004 Other Post-Retirement net periodic benefit cost of \$11.0 million includes \$2.3 million for DPL. The 2003 Other Post-Retirement net periodic benefit cost of \$10.1 million includes \$1.7 million for DPL.

### *FASB Staff Position (FSP 106-1), Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act)*

The Act became effective on December 8, 2003. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D.

SFAS No. 106 "Employers Accounting for Post-retirement Benefits Other than Pensions" requires presently enacted changes in relevant laws to be considered in current period measurements of post-retirement benefit costs and the Accumulated Post-Retirement Benefit Obligation (APBO). Therefore, under that guidance, measures of the APBO and net periodic post-retirement benefit costs on or after the date of enactment should reflect the effects of the Act.

However, due to certain accounting issues raised by the Act that are not explicitly addressed by SFAS No. 106 and uncertainties that may exist as to reliable information available on which to measure the effects of the Act, the FSP 106-1 allows a plan sponsor to elect to defer recognizing the effects of the Act in the accounting for its plan under SFAS No. 106 and in providing disclosures related to the plan required by SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Post-retirement Benefits," until authoritative guidance on the accounting for the federal subsidy is issued, or until certain other events occur.

Pepco Holdings sponsors post-retirement health care plans that provide prescription drug benefits. Pepco Holdings did not elect the deferral provided by the FSP 106-1. The APBO as of December 31, 2003 was reduced by \$28 million to reflect the effects of the Act. For the current quarter and all of 2003, Pepco Holdings' net periodic postretirement benefit expense has not been reduced to reflect the Act. It is estimated that the annual postretirement benefit cost will be reduced by approximately \$4 million due to effects of the Act. This reduction includes both the decrease in the cost of future benefits being earned and an amortization of the APBO reduction over the future average working lifetime of the participants, or 13.5 years. The anticipated claims costs expected to be incurred have been adjusted to reflect the cost sharing between Medicare and Pepco Holdings. Participation rates have not been changed. In reflecting the effects of the Act, Pepco Holdings has determined which plans are eligible for Medicare cost sharing by analyzing

the terms of each of its plans. It has recognized Medicare cost sharing for a plan only if Pepco Holdings' projected prescription drug coverage is expected to be at least as generous as the expected contribution by Medicare to a prescription drug plan not provided by Pepco Holdings.

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Specific authoritative guidance on the accounting for the federal subsidy under the Act is pending and that guidance, when issued, could require Pepco Holdings to change previously reported information. When issued, the guidance on accounting for the federal subsidy will include transition guidance, as applicable, for entities that elected to defer accounting for the effects of the Act and those that did not.

The effect of the subsidy on the current period Other Post-Retirement net periodic benefit cost of \$11.0 million would be approximately a \$1 million reduction due to the subsidy. Approximately \$.5 million would be related to the amortization of the actuarial gain, \$.1 million would be a subsidy-related reduction in current period service cost and approximately \$.4 million would be a subsidy-related reduction in interest cost on the APBO.

### (3) SEGMENT INFORMATION

In accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," DPL has one segment, its regulated utility business.

DPL's operating expenses and revenues include amounts for transactions with other PHI subsidiaries. DPL purchased electric energy, electric capacity and natural gas from PHI subsidiaries in the amounts of \$148.4 million for the three months ended March 31, 2004 and \$158.0 million for the three months ended March 31, 2003. DPL also sold natural gas and electricity and leased certain assets to other Conectiv and PHI subsidiaries.

### (4) COMMITMENTS AND CONTINGENCIES

#### Rate Proceedings

In December 2003, the Delaware Public Service Commission (DPSC) approved a settlement agreement that provided for an annual increase of \$7.75 million in DPL's gas base rate. In accordance with the terms of the settlement agreement, on February 13, 2004, DPL filed for an Environmental Surcharge of approximately \$522,000 amortized over five years to recover out-of-pocket costs associated with gas environmental issues. The DPSC approved this surcharge on April 20, 2004. The surcharge will be adjusted year-to-year to reflect DPL's actual costs.

DPL filed on February 13, 2004 for a change in electric ancillary service rates that has an aggregate effect of increasing annual revenues by \$13.1 million or 2.4%. This filing was prompted by the increasing ancillary service costs charged to DPL by PJM Interconnection, LLC (PJM). On February 24, 2004, the DPSC accepted the filing and placed the increase into effect on March 15, 2004, subject to refund. Intervention by another party has been filed. Unless the proceeding is settled, evidentiary hearings will be held in late August with a decision expected before the end of 2004.

On August 29, 2003, DPL submitted its annual Gas Cost Recovery (GCR) rate filing to the DPSC. In its filing, DPL sought to increase its GCR rate by approximately 15.8% in anticipation of increasing natural gas commodity costs. The GCR rate, which permits DPL to recover its procurement gas costs through customer rates, became effective November 1, 2003 and was subject to refund pending evidentiary hearings that were held on April 19, 2004. No party has proposed to modify DPL's proposed GCR rate, thus no refund is required. However, DPSC Staff has suggested prospective modifications to the program by which DPL hedges price risk for its gas purchases.

In compliance with the merger settlement approved by the MPSC in connection with the merger of Pepco and Conectiv, on December 4, 2003, DPL submitted testimony and supporting schedules to establish electric distribution rates in Maryland effective July 1, 2004, when the current distribution rate freeze/caps end. DPL's filing demonstrates that it is in an under-earning situation. As provided in the terms of the merger settlement, DPL requested it

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be allowed to put into effect July 1, 2004, a rate increase for non-residential customers to offset the nuclear decommissioning equivalent decrease that was effective July 1, 2003. With limited exceptions, the merger settlement does not permit DPL to increase distribution rates until after December 31, 2006. The MPSC Staff has filed testimony stating that no distribution rate reductions are justified and that DPL should be authorized to increase its non-residential customers' distribution rates by approximately \$1.1 million. The Office of the People's Counsel (OPC) agrees that no distribution rate reduction is warranted for DPL if the DPL capital structure is used in determining whether existing rates should be reduced. However, OPC argues that the Pepco Holdings' consolidated capital structure and capital costs should be used to determine whether distribution rate reductions for DPL are warranted. Based on PHI's consolidated capital structure, OPC recommended that DPL's distribution rates be reduced. Hearings will be held on May 11 and 12, 2004. The MPSC decision is expected to be issued in early July 2004. DPL cannot predict the outcome of the proceeding.

#### POLR Proceedings

##### Virginia

In March 2004, Virginia amended its Electric Utility Restructuring Act to extend the rate freeze provisions applicable to DPL's rates for both provider of last resort (POLR) supply and distribution. The rate freezes, previously scheduled to expire on July 1, 2007, were extended to December 31, 2010, except that one change in base rates can be proposed by DPL prior to July 1, 2007, and one additional change in base rates can be proposed by DPL between that date and December 31, 2010. Additionally, rates may be increased to reflect increased purchased power costs, increased taxes, or increased costs to comply with environmental or reliability requirements.

The Virginia Electric Utility Restructuring Act obligates DPL to offer POLR service during the period that rates are frozen and thereafter, until relieved of that obligation by the Virginia State Corporation Commission (VSCC).

On December 3, 2003, DPL and Conectiv Energy filed with the VSCC an amendment to extend their power supply agreement for one year, i.e., through December 31, 2004, and on a month-to-month basis thereafter, as it applies to power supply for DPL's Virginia POLR customers. The VSCC approved the amendment in an order issued on March 1, 2004. After December 31, 2004 either DPL or Conectiv Energy can terminate Conectiv Energy's obligation to provide supplies to meet DPL's Virginia POLR obligations by giving 30 days written notice to the other party.



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ATLANTIC CITY ELECTRIC COMPANY  
CONSOLIDATED STATEMENTS OF EARNINGS  
(Unaudited)

|                                 | Three Months Ended<br>March 31, |         |
|---------------------------------|---------------------------------|---------|
|                                 | 2004                            | 2003    |
|                                 | (Millions of Dollars)           |         |
| Operating Revenue               | \$322.4                         | \$301.2 |
| Operating Expenses              |                                 |         |
| Fuel and purchased energy       | 193.4                           | 187.6   |
| Other operation and maintenance | 52.0                            | 52.8    |

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|  |         |         |
|--|---------|---------|
| Depreciation and amortization                                | 33.9    | 28.7    |
| Other taxes  | 4.0     | 6.5     |
| Deferred electric service costs                              | 15.0    | -       |
| Total Operating Expenses                                     | 298.3   | 275.6   |
| Operating Income   | 24.1    | 25.6    |
| Other Income (Expenses)                                      |         |         |
| Interest and dividend income                                 | .5      | 3.0     |
| Interest expense   | (15.4)  | (16.2)  |
| Other income   | 2.4     | 2.2     |
| Total Other Expenses   | (12.5)  | (11.0)  |
| Distributions on Preferred Securities of<br>Subsidiary Trust | -       | 1.4     |
| Income Before Income Tax Expense                             | 11.6    | 13.2    |
| Income Tax Expense   | 4.8     | 5.1     |
| Net Income   | 6.8     | 8.1     |
| Dividends on Redeemable Serial<br>Preferred Stock            | .1      | .1      |
| Earnings Available for Common Stock                          | 6.7     | 8.0     |
| Retained Income at Beginning of Period                       | 159.6   | 153.9   |
| Dividends paid to Pepco Holdings                             | (5.7)   | (8.2)   |
| Retained Income at End of Period                             | \$160.6 | \$153.7 |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

ATLANTIC CITY ELECTRIC COMPANY  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)

| ASSETS   | March 31,<br>2004     | December 31,<br>2003 |
|--|-----------------------|----------------------|
|  | (Millions of Dollars) |                      |
| CURRENT ASSETS   |                       |                      |
| Cash and cash equivalents  | \$ 89.7               | \$ 114.1             |
| Restricted funds held by trustee   | 11.4                  | 8.3                  |
| Accounts receivable, less allowance for uncollectible<br>accounts of \$5.3 million for each period | 163.8                 | 167.7                |
| Fuel, materials and supplies - at average cost   | 36.5                  | 34.3                 |
| Prepaid taxes and other  | 2.1                   | 5.3                  |
| Total Current Assets   | 303.5                 | 329.7                |
| INVESTMENTS AND OTHER ASSETS   |                       |                      |
| Regulatory assets  | 1,158.0               | 1,188.1              |
| Other  | 24.7                  | 26.2                 |
| Total Investments and Other Assets   | 1,182.7               | 1,214.3              |

**PROPERTY, PLANT AND EQUIPMENT**

|                                   |                  |                  |
|-----------------------------------|------------------|------------------|
| Property, plant and equipment     | 1,705.5          | 1,831.6          |
| Accumulated depreciation          | (653.0)          | (790.1)          |
| Net Property, Plant and Equipment | 1,052.5          | 1,041.5          |
| <b>TOTAL ASSETS</b>               | <b>\$2,538.7</b> | <b>\$2,585.5</b> |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

ATLANTIC CITY ELECTRIC COMPANY  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)

|   | March 31,<br>2004 | December 31,<br>2003 |
|---|-------------------|----------------------|
| (Millions of Dollars)                       |                   |                      |
| <b>LIABILITIES AND SHAREHOLDER'S EQUITY</b> |                   |                      |
| <b>CURRENT LIABILITIES</b>                  |                   |                      |
| Short-term debt                             | \$ 71.3           | \$ 59.5              |
| Debentures issued to financing trust        | -                 | 25.8                 |
| Accounts payable and accrued liabilities    | 75.8              | 81.9                 |
| Accounts payable to associated companies    | 3.6               | 12.6                 |
| Interest and taxes accrued                  | 47.9              | 38.5                 |
| Other                                       | 43.3              | 50.3                 |
| Total Current Liabilities                   | 241.9             | 268.6                |
| <b>DEFERRED CREDITS</b>                     |                   |                      |
| Regulatory liabilities                      | 62.1              | 60.0                 |
| Income taxes                                | 507.0             | 514.7                |
| Investment tax credits                      | 23.9              | 24.4                 |
| Pension benefit obligation                  | 39.1              | 37.1                 |
| Other postretirement benefit obligation     | 45.9              | 43.6                 |

|  |                  |                  |
|--|------------------|------------------|
| Other  | 41.5             | 41.6             |
| Total Deferred Credits   | 719.5            | 721.4            |
| LONG-TERM LIABILITIES  |                  |                  |
| Long-Term Debt   | 485.4            | 497.5            |
| Transition Bonds issued by ACE Funding   | 544.2            | 551.3            |
| Total Long-Term Liabilities  | 1,029.6          | 1,048.8          |
| COMMITMENTS AND CONTINGENCIES  |                  |                  |
| REDEEMABLE SERIAL PREFERRED STOCK  | 6.2              | 6.2              |
| SHAREHOLDER'S EQUITY   |                  |                  |
| Common stock, \$3.00 par value, authorized 25,000,000 shares, issued 12,886,853 shares | 38.7             | 38.7             |
| Premium on stock and other capital contributions                                       | 343.0            | 343.0            |
| Capital stock expense  | (.8)             | (.8)             |
| Retained income  | 160.6            | 159.6            |
| Total Shareholder's Equity   | 541.5            | 540.5            |
| <b>TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY</b>                                      | <b>\$2,538.7</b> | <b>\$2,585.5</b> |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

ATLANTIC CITY ELECTRIC COMPANY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

Three Months Ended  
March 31,  
2004                      2003  
(Millions of Dollars)

## OPERATING ACTIVITIES

|  |        |        |
|--|--------|--------|
| Net income   | \$ 6.8 | \$ 8.1 |
| Adjustments to reconcile net income to net cash from operating activities: |        |        |
| Depreciation and amortization  | 33.9   | 28.7   |
| Investment tax credit adjustments  | (.5)   | (.5)   |
| Deferred income taxes  | (9.9)  | (1.2)  |
| Changes in:  |        |        |
| Accounts receivable  | .8     | (15.1) |
| Regulatory assets and liabilities  | 11.6   | (1.5)  |
| Fuel, materials and supplies   | (2.2)  | 3.1    |
| Accounts payable   | (19.9) | (9.9)  |
| Interest and taxes accrued   | 9.4    | 36.9   |
| Derivative and energy trading contracts                                    | (.1)   | 16.7   |
| Other deferred charges   | 8.4    | (1.3)  |
| Net Cash From Operating Activities   | 38.3   | 64.0   |

## INVESTING ACTIVITIES

|   |        |        |
|---|--------|--------|
| Net investment in property, plant and equipment | (25.2) | (16.5) |
| Other investing activities                      | .7     | -      |
| Net Cash Used By Investing Activities           | (24.5) | (16.5) |

## FINANCING ACTIVITIES

|  |        |         |
|--|--------|---------|
| Dividends paid to Pepco Holdings                   | (5.7)  | (8.2)   |
| Preferred dividends paid                           | (.1)   | (.1)    |
| Redemption of debentures issued to financing trust | (25.0) | -       |
| Redemption of trust preferred stock                | -      | (70.0)  |
| Reacquisition of long-term debt                    | (7.4)  | (98.0)  |
| Costs of issuances and refinancings                | -      | (1.3)   |
| Net Cash Used By Financing Activities              | (38.2) | (177.6) |

|  |        |         |
|--|--------|---------|
| Net Change In Cash and Cash Equivalents          | (24.4) | (130.1) |
| Cash and Cash Equivalents at Beginning of Period | 114.1  | 247.1   |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD       | \$89.7 | \$117.0 |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

### **ATLANTIC CITY ELECTRIC COMPANY**

(1)

#### **ORGANIZATION**

Atlantic City Electric Company (ACE) is engaged in the generation, transmission and distribution of electricity in southern New Jersey. ACE's service territory covers approximately 2,700 square miles and has a population of approximately 995,000. ACE is a wholly owned subsidiary of Conectiv. On August 1, 2002 Pepco completed its acquisition of Conectiv, at which time Pepco and Conectiv became wholly owned subsidiaries of Pepco Holdings, Inc. (Pepco Holdings or PHI). PHI is a public utility holding company registered under the Public Utility Holding Company Act of 1935 (PUHCA) and is subject to the regulatory oversight of the Securities and Exchange Commission (SEC) under PUHCA.

#### **(2) ACCOUNTING POLICY AND PRONOUNCEMENTS DISCLOSURES**

##### **Financial Statement Presentation**

ACE's unaudited consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Pursuant to the rules and regulations of the SEC, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted. Therefore, these financial statements should be read along with the annual financial statements included in ACE's Annual Report on Form 10-K/A for the year ended December 31, 2003. In the opinion of ACE's management, the consolidated financial statements contain all adjustments (which all are of a normal recurring nature) necessary to present fairly ACE's financial condition as of March 31, 2004, in accordance with GAAP. Interim results for the three months ended March 31, 2004 may not be indicative of results that will be realized for the full year ending December 31, 2004. Additionally, certain prior period balances have been reclassified in order to conform to current period presentation.

##### **FIN 45**

ACE applied the provisions of FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45), commencing in 2003 to its agreements that contain guarantee and indemnification clauses. These provisions expand those required by FASB Statement No. 5, "Accounting for Contingencies," by requiring a guarantor to recognize a liability on its balance sheet for the fair value of obligations it assumes under certain

guarantees issued or modified after December 31, 2002 and to disclose certain types of guarantees, even if the likelihood of requiring the guarantor's performance under the guarantee is remote.

As of March 31, 2004, ACE did not have material obligations under guarantees or indemnifications issued or modified after December 31, 2002, which are required to be recognized as a liability on its consolidated balance sheets.

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#### Fin 46

On December 31, 2003, FIN 46 was implemented by ACE. FIN 46 was revised and superseded by FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (FIN 46R) which clarified some of the provisions of FIN 46 and exempted certain entities from its requirements. FIN 46R is applicable to ACE's financial statements for the quarter ended March 31, 2004. The implementation of FIN 46R (including the evaluation of interests in purchase power arrangements) did not impact ACE's financial condition or results of operations for the three months ended March 31, 2004.

As part of the FIN 46R evaluation, ACE reviewed its power purchase agreements (PPAs), including its Non-Utility Generation (NUG) contracts, to determine (i) if its interest in each entity that is a counterparty to a PPA agreement was a variable interest, (ii) whether the entity was a variable interest entity and (iii) if so, whether ACE was the primary beneficiary. Due to a variable element in the pricing structure of PPAs with three entities, ACE potentially assumes the variability in the operations of the plants of these entities and therefore has a variable interest in the entities. However, due to ACE's inability to obtain information from certain of these entities considered to be confidential and proprietary by the entities or the certain entities' own determination that they qualified for exemption as a business, ACE was unable to obtain sufficient information to conduct the analysis required under FIN 46R to determine whether these three entities were was a variable interest entities or if ACE was the primary beneficiary. As a result, ACE has applied the scope exemption from the application of FIN 46R for enterprises that have conducted exhaustive efforts to obtain the necessary information.

Power purchases related to the PPAs with these three entities in the quarters ended March 31, 2004 and 2003 were approximately \$57 million each quarter. Power purchases related to the PPAs in the years ended December 31, 2003, 2002 and 2001 were approximately \$222 million, \$221 million and \$227 million, respectively. ACE does not have exposure to loss under these contracts since cost recovery will be achieved from its customers through regulated rates.

#### Components of Net Periodic Benefit Cost

The following Pepco Holdings information is for the three months ended March 31,

| <u>Pension Benefits</u> |             | <u>Other Post-Retirement Benefits</u> |             |
|-------------------------|-------------|---------------------------------------|-------------|
| <u>2004</u>             | <u>2003</u> | <u>2004</u>                           | <u>2003</u> |

(In Millions)

|                                    |               |               |               |               |
|------------------------------------|---------------|---------------|---------------|---------------|
| Service cost                       | \$ 9.6        | \$ 8.1        | \$ 2.4        | \$ 2.3        |
| Interest cost                      | 23.8          | 23.0          | 8.3           | 7.9           |
| Expected return on plan assets     | (29.8)        | (26.1)        | (2.8)         | (2.0)         |
| Amortization of prior service cost | .3            | .3            | -             | -             |
| Amortization of net loss           | <u>4.5</u>    | <u>3.4</u>    | <u>3.1</u>    | <u>1.9</u>    |
| Net periodic benefit cost          | <u>\$ 8.4</u> | <u>\$ 8.7</u> | <u>\$11.0</u> | <u>\$10.1</u> |

The actual components of net periodic benefit cost for the 2003 interim period are not available. The component amounts presented above for the 2003 interim period were calculated in proportion to the annual amounts presented

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in Pepco Holdings' financial statements for the year ended December 31, 2003. These component amounts are presented for comparison purposes only.

#### *Pension*

The 2004 pension net periodic benefit cost of \$8.4 million includes \$2.1 million for ACE. The 2003 pension net periodic benefit cost of \$8.7 million includes \$3.2 million for ACE.

#### *Pension Contributions*

Pepco Holdings funding policy with regard to the pension plan is to maintain a funding level in excess of 100% of its accumulated benefit obligation (ABO). PHI's defined benefit plan currently meets the minimum funding requirements of the Employment Retirement Income Security Act of 1974 (ERISA) without any additional funding. In 2003 and 2002 PHI made discretionary tax-deductible cash contributions to the plan of \$50 million and \$35 million, respectively. Assuming no changes to the current pension plan assumptions, PHI projects no funding will be required in 2004; however PHI may elect to make a discretionary tax-deductible contribution, if required to maintain its assets in excess of its ABO. As of March 31, 2004, no contributions have been made.

#### *Other Post-Retirement Benefits*

The 2004 Other Post-Retirement net periodic benefit cost of \$11.0 million includes \$2.5 million for ACE. The 2003 Other Post-Retirement net periodic benefit cost of \$10.1 million includes \$2.6 million for ACE.

*FASB Staff Position (FSP 106-1), Accounting and Disclosure  
Requirements Related to the Medicare Prescription Drug, Improvement  
and Modernization Act of 2003 (the Act)*

The Act became effective on December 8, 2003. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D.

SFAS No. 106 "Employers Accounting for Post-retirement Benefits Other than Pensions" requires presently enacted changes in relevant laws to be considered in current period measurements of post-retirement benefit costs and the Accumulated Post-Retirement Benefit Obligation (APBO). Therefore, under that guidance, measures of the APBO and net periodic post-retirement benefit costs on or after the date of enactment should reflect the effects of the Act.

However, due to certain accounting issues raised by the Act that are not explicitly addressed by SFAS No. 106 and uncertainties that may exist as to reliable information available on which to measure the effects of the Act, the FSP 106-1 allows a plan sponsor to elect to defer recognizing the effects of the Act in the accounting for its plan under SFAS No. 106 and in providing disclosures related to the plan required by SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Post-retirement Benefits," until authoritative guidance on the accounting for the federal subsidy is issued, or until certain other events occur.

Pepco Holdings sponsors post-retirement health care plans that provide prescription drug benefits. Pepco Holdings did not elect the deferral provided by the FSP 106-1. The APBO as of December 31, 2003 was reduced by

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\$28 million to reflect the effects of the Act. For the current quarter and all of 2003, Pepco Holdings' net periodic postretirement benefit expense has not been reduced to reflect the Act. It is estimated that the annual postretirement benefit cost will be reduced by approximately \$4 million due to effects of the Act. This reduction includes both the decrease in the cost of future benefits being earned and an amortization of the APBO reduction over the future average working lifetime of the participants, or 13.5 years. The anticipated claims costs expected to be incurred have been adjusted to reflect the cost sharing between Medicare and Pepco Holdings. Participation rates have not been changed. In reflecting the effects of the Act, Pepco Holdings has determined which plans are eligible for Medicare cost sharing by analyzing the terms of each of its plans. It has recognized Medicare cost sharing for a plan only if Pepco Holdings' projected prescription drug coverage is expected to be at least as generous as the expected contribution by Medicare to a prescription drug plan not provided by Pepco Holdings.

Specific authoritative guidance on the accounting for the federal subsidy under the Act is pending and that guidance, when issued, could require Pepco Holdings to change previously reported information. When issued, the guidance on accounting for the federal subsidy will include transition guidance, as applicable, for entities that elected to defer accounting for the effects of the Act and those that did not.

The effect of the subsidy on the current period Other Post-Retirement net periodic benefit cost of \$11.0 million would be approximately a \$1 million reduction due to the subsidy. Approximately \$.5 million would

be related to the amortization of the actuarial gain, \$.1 million would be a subsidy-related reduction in current period service cost and approximately \$.4 million would be a subsidy-related reduction in interest cost on the APBO.

(3) SEGMENT INFORMATION

In accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," ACE has one segment, its regulated utility business.

(4) COMMITMENTS AND CONTINGENCIES

Rate Proceedings

On February 3, 2003, ACE filed a petition with the NJBPU to increase its electric distribution rates and its Regulatory Asset Recovery Charge (RARC) in New Jersey. In its most recent submission, made on February 20, 2004, ACE proposed an overall rate increase of approximately \$35.1 million, consisting of a \$30.6 million increase in distribution rates and a \$4.5 million increase in RARC. Hearings were held before an Administrative Law Judge in late March and early April 2004. At the hearing held on April 6, 2004, the Ratepayer Advocate proposed an annual rate decrease of \$4.5 million, modifying its earlier proposal that rates be decreased by \$11.7 million annually. The Staff of the NJBPU is expected to submit its recommendations in briefs to be filed in June. ACE cannot predict the outcome of this proceeding.

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Preliminary Settlement Agreement with NJDEP

On April 26, 2004, PHI, Conectiv and ACE entered into a preliminary settlement agreement with the New Jersey Department of Environmental Protection (NJDEP) and the Attorney General of New Jersey that addresses various environmental issues at ACE and Conectiv Energy facilities in New Jersey. Among other things, the preliminary settlement agreement provides that:

- contingent upon the receipt of necessary approvals from the New Jersey Board of Public Utilities (NJBPU), PJM Interconnection, LLC (PJM), North American Electric Reliability Council (NERC)/Federal Energy Regulatory Commission (FERC) and other regulatory authorities and the receipt of permits to construct certain transmission facilities in southern New Jersey described more fully below, ACE will permanently cease operation of the B.L. England generating facility by December 15, 2007. In the event that ACE is unable to shut down the B.L. England facility by December 15, 2007 through no fault of its own (e.g., because of failure to obtain the required regulatory approvals), B.L. England Unit 1 would be required to comply with stringent sulfur dioxide (SO<sub>2</sub>), nitrogen oxide (NO<sub>x</sub>) and particulate matter emissions limits set forth in the preliminary settlement agreement by October 1, 2008, and B.L. England Unit 2 would be required to comply with the emissions limits by May 1, 2009. If ACE does not either shut down the B.L. England facility by December 15, 2007 or satisfy the emissions limits applicable in the event shut down is not so completed, ACE will be required to pay significant monetary penalties.
- ACE will be permitted to combust coal with a sulfur content of greater than 1% at the B.L. England facility in compliance with the terms of B.L. England's current permit until December 15,

2007 and NJDEP will not impose new, more stringent short-term SO<sub>2</sub> emissions limits on the B.L. England facility.

- to resolve any possible civil liability (and without admitting liability) for violations of the permit provisions of the New Jersey Air Pollution Control Act (APCA) and the Prevention of Significant Deterioration (PSD) provisions of the federal Clean Air Act (CAA) relating to modifications that may have been undertaken at the B.L. England facility, ACE will pay a \$750,000 civil penalty to NJDEP by June 1, 2004.
- to compensate New Jersey for other alleged violations of the APCA and/or the CAA, ACE will undertake environmental projects beneficial to the state of New Jersey and approved by the NJDEP in a consent order or other final settlement document valued at \$2 million.
- ACE will submit all federally required studies and complete construction of facilities necessary to satisfy the Environmental Protection Agency's (EPA) new cooling water intake structure regulations in accordance with a schedule that NJDEP will establish in the renewal New Jersey Pollutant Discharge Elimination System (NJPDES) permit for the B.L. England facility. The schedule will take into account ACE's agreement, provided that all regulatory approvals are obtained, to shut down the B.L. England facility by December 15, 2007.

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- to resolve any possible civil liability (and without admitting liability) for natural resource damages resulting from groundwater contamination at the B.L. England facility, Conectiv Energy's Deepwater generating facility and ACE's operations center near Pleasantville, New Jersey, ACE and Conectiv will pay NJDEP \$647,162 in cash or property and will remediate the groundwater contamination at all three sites. If subsequent data indicate that groundwater contamination is more extensive than indicated in NJDEP's preliminary analysis, NJDEP may seek additional compensation for natural resource damages.

The preliminary settlement agreement also provides that the parties will work toward a consent order or other final settlement document that reflects the terms of the preliminary settlement agreement.

Pursuant to a NJBPU order issued on September 25, 2003, ACE on April 30, 2004, filed a report with the NJBPU recommending that the B.L. England facility be shut down in accordance with the terms of the preliminary settlement agreement. The report stated that the operation of the B.L. England facility is necessary at the present time to satisfy reliability standards, but that those reliability standards could also be satisfied in other ways. The report concludes that, based on B.L. England's current and projected operating costs resulting from compliance with more restrictive environmental requirements, the most cost-effective way in which to meet reliability standards is to shut down the B.L. England facility and construct additional transmission lines into southern New Jersey. ACE cannot predict whether the NJBPU will approve the construction of the additional transmission lines.

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ATLANTIC CITY ELECTRIC TRANSITION FUNDING, LLC  
STATEMENTS OF EARNINGS AND MEMBER'S EQUITY

(Unaudited)

|  | Three Months Ended<br>March 31, |        |
|--|---------------------------------|--------|
|  | 2004                            | 2003   |
|  | (Millions of Dollars)           |        |
| Operating Revenue                            |                                 |        |
| Utility                                      | \$16.4                          | \$11.5 |
| Operating Expenses                           |                                 |        |
| Amortization of bondable transition property | 9.8                             | 6.3    |
| Interest expense                             | 6.6                             | 5.1    |
| Servicing and administrative expenses        | -                               | .1     |
| Total Operating Expenses                     | 16.4                            | 11.5   |
| Operating Income                             | -                               | -      |
| Other Income                                 |                                 |        |
| Interest and dividend income                 | -                               | -      |

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|                                      |        |        |
|--------------------------------------|--------|--------|
| Total Other Income                   | -      | -      |
| Income Before Income Tax Expense     | -      | -      |
| Income Tax Expense                   | -      | -      |
| Net Income                           | \$ -   | \$ -   |
| Member's equity, beginning of period | \$ 3.0 | \$ 2.2 |
| Net Income                           | -      | -      |
| Member's equity, end of period       | \$ 3.0 | \$ 2.2 |

The accompanying Notes are an integral part of these Financial Statements.

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ATLANTIC CITY ELECTRIC TRANSITION FUNDING, LLC  
BALANCE SHEETS  
(Unaudited)

|  | March 31, 2004        | December 31,<br>2003 |
|--|-----------------------|----------------------|
|  | (Millions of Dollars) |                      |
| CURRENT ASSETS                                 |                       |                      |
| Restricted funds held by trustee               | \$ 12.8               | \$ 9.9               |
| Transition bond charge receivable for Servicer | 12.1                  | 18.1                 |

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|  |                |                |
|--|----------------|----------------|
| Total Current Assets                         | 24.9           | 28.0           |
| <b>OTHER ASSETS</b>                          |                |                |
| Bondable transition property (net)           | 555.6          | 556.8          |
| <b>TOTAL ASSETS</b>                          | <b>\$580.5</b> | <b>\$584.8</b> |
| <b>LIABILITIES AND MEMBER'S EQUITY</b>       |                |                |
| <b>CURRENT LIABILITIES</b>                   |                |                |
| Interest accrued                             | \$ 5.5         | \$ 4.0         |
| Payable to PHI Service Company               | .1             | .6             |
| Short term debt                              | 27.7           | 25.9           |
| Total Current Liabilities                    | 33.3           | 30.5           |
| <b>CAPITALIZATION</b>                        |                |                |
| Member's equity                              | 3.0            | 3.0            |
| Long-term debt                               | 544.2          | 551.3          |
| Total capitalization                         | 547.2          | 554.3          |
| <b>TOTAL LIABILITIES AND MEMBER'S EQUITY</b> | <b>\$580.5</b> | <b>\$584.8</b> |

The accompanying Notes are an integral part of these Financial Statements.

Three Months Ended  
March 31,

2004                      2003

(Millions of Dollars)

## OPERATING ACTIVITIES

|  |       |       |
|--|-------|-------|
| Net income   | \$ -  | \$ -  |
| Adjustments to reconcile net income to net cash from operating activities: |       |       |
| Amortization of bondable transition property                               | 9.8   | 6.3   |
| Transition bond charge receivable from Servicer                            | (2.6) | (5.8) |
| Accrued interest and other   | 1.7   | 5.1   |
| Net Cash From Operating Activities   | 8.9   | 5.6   |

## INVESTING ACTIVITIES

|   |       |       |
|---|-------|-------|
| Deposit of restricted funds held by trustee | (2.9) | (4.3) |
| Net Cash Used by Investing Activities       | (2.9) | (4.3) |

## FINANCING ACTIVITIES

|  |       |       |
|--|-------|-------|
| Long-term debt redeemed                          | (5.4) | -     |
| Debt issuance costs                              | (.6)  | (1.2) |
| Other financing activities                       | -     | (0.1) |
| Net Cash Used By Financing Activities            | (6.0) | (1.3) |
| Net Increase in Cash and Cash Equivalents        | -     | -     |
| Cash and Cash Equivalents at Beginning of Period | -     | -     |

|  |      |      |
|--|------|------|
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ - | \$ - |
|--|------|------|

The accompanying Notes are an integral part of these Financial Statements.

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## NOTES TO FINANCIAL STATEMENTS

### ATLANTIC CITY ELECTRIC TRANSITION FUNDING LLC

#### (1) ORGANIZATION

Atlantic City Electric Transition Funding LLC (ACE Funding), a limited liability company established by Atlantic City Electric Company (ACE) under the laws of the State of Delaware, was formed on March 28, 2001 pursuant to a limited liability company agreement with ACE dated April 11, 2001 as amended, as sole member of ACE Funding. ACE is a wholly owned subsidiary of Conectiv, which is a wholly owned subsidiary of Pepco Holdings, Inc., a registered holding company under the Public Utility Holding Company Act of 1935. ACE is a public utility, which supplies and delivers electricity to its customers under the trade name Conectiv Power Delivery.

ACE Funding was organized for the sole purpose of purchasing and owning Bondable Transition Property (BTP), issuing transition bonds (Transition Bonds) to fund the purchasing of BTP, pledging its interest in BTP and other collateral to the Trustee to collateralize the Transition Bonds, and performing activities that are necessary, suitable or convenient to accomplish these purposes. BTP represents the irrevocable right of ACE or its successor or assignee to collect a non-bypassable transition bond charge (TBC) from customers pursuant to bondable stranded costs rate orders (NJBPU Financing Orders), issued by the New Jersey Board of Public Utilities (NJBPU) in accordance with the Electric Discount and Energy Competition Act enacted by the state of New Jersey in February 1999.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIESFinancial Statement Presentation

ACE Funding's unaudited financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Pursuant to the rules and regulations of the SEC, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted. Therefore, these financial statements should be read along with the annual financial statements included in ACE Funding's Annual Report on Form 10-K/A for the year ended December 31, 2003. In the opinion of ACE Funding's management, the financial statements contain all adjustments (which all are of a normal recurring nature) necessary to present fairly ACE Funding's financial condition as of March 31, 2004, in accordance with GAAP. Interim results for the three months ended March 31, 2004 may not be indicative of results that will be realized for the full year ending December 31, 2004.

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**

**AND RESULTS OF OPERATIONS**

PEPCO HOLDINGS

OVERVIEW

Pepco Holdings is a diversified energy company that, through its operating subsidiaries, is engaged in three principal areas of business operations:

- regulated power delivery,
- non-regulated competitive energy generation, marketing and supply, and
- other non-regulated activities consisting primarily of investments in energy-related assets.

The following is a description of each of PHI's areas of operation.

Power Delivery

The largest component of PHI's business is power delivery, which consists of the transmission and distribution of electricity and the distribution of natural gas. PHI's power delivery business is conducted by

its subsidiaries Potomac Electric Power Company (Pepco), Delmarva Power & Light Company (DPL) and Atlantic City Electric Company (ACE), each of which is a regulated public utility in the jurisdictions in which it serves customers. DPL and ACE conduct their power delivery operations under the trade name Conectiv Power Delivery.

### Competitive Energy

PHI's competitive energy business provides non-regulated generation, marketing and supply of electricity and gas, and related energy management services, in the mid-Atlantic region. PHI's competitive energy operations are conducted through subsidiaries of Conectiv Energy Holding Company (collectively, Conectiv Energy) and Pepco Energy Services and its subsidiaries (collectively, Pepco Energy Services).

### Other Non-Regulated

This component of PHI's business is conducted through its subsidiaries Potomac Capital Investment Corporation (PCI) and Pepco Communications, Inc. (Pepcom). PCI manages a portfolio of financial investments, which primarily includes energy leveraged leases. During the second quarter of 2003, PHI announced the discontinuation of further new investment activity by PCI. Pepcom currently owns through a subsidiary a 50% interest in Starpower Communications, LLC (Starpower), a joint venture with RCN Corporation (RCN), which provides cable and telecommunication services to households in the Washington, D.C. area. As discussed in the 2003 Pepco Holdings' Form 10-K/A, as part of PHI's strategy of focusing on energy-related investments, PHI in January 2004 announced that Pepcom intends to sell its interest in Starpower.

For additional information, refer to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of PHI's 2003 Form 10-K/A.

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## EARNINGS OVERVIEW

The earnings of Pepco Holdings for the quarter ended March 31, 2004, were \$51.2 million compared to a loss of \$24.9 million for the corresponding quarter in 2003. Earnings for the quarter ended March 31, 2004 included the favorable impact of \$13.1 million related to a local tax benefit. Excluding the effect of this benefit, earnings for the first quarter of 2004 would have been \$38.1 million. Earnings for the quarter ended March 31, 2003 included the unfavorable impacts of \$26.7 million net trading losses incurred by Conectiv Energy and the \$31.1 million net unfavorable impact of the cancellation of the combustion turbine purchase contract and a corresponding purchase accounting adjustment reversal. Excluding the effect of the 2003 trading losses and the contract termination, earnings for the first quarter of 2003 would have been \$32.9 million. The variances in earnings between quarters are shown in the following table:

| For the<br>Quarter<br>Ended | Power           | Conectiv      | Pepco           | Other                | Corp. &      | PHI                 |
|-----------------------------|-----------------|---------------|-----------------|----------------------|--------------|---------------------|
| <u>March 31,</u>            | <u>Delivery</u> | <u>Energy</u> | <u>Services</u> | <u>Non-Regulated</u> | <u>Other</u> | <u>Consolidated</u> |

(In Millions)

|   |         |        |     |        |        |          |     |        |
|---|---------|--------|-----|--------|--------|----------|-----|--------|
| 2004 Net<br>Income/(Loss)   | \$40.8  | \$ 5.0 |     | \$ 3.1 | \$20.1 | \$(17.8) |     | \$51.2 |
| 2004<br>Supplemental<br>Adjustment<br>(a):                        |         |        |     |        |        |          |     |        |
| Local<br>Tax Benefit<br>(b)                                       | (.8)    | -      |     | (1.5)  | (8.8)  | (2.0)    |     | (13.1) |
| 2004<br>Adjusted  | 40.0    | 5.0    |     | 1.6    | 11.3   | (19.8)   |     | 38.1   |
| 2003 Net<br>Income/(Loss)   | 49.0    | (90.5) |     | (4.4)  | 8.4    | 12.6     |     | (24.9) |
| 2003<br>Supplemental<br>Adjustments<br>(a):                       |         |        |     |        |        |          |     |        |
| Trading<br>Losses   | -       | 26.7   | (c) | -      | -      | -        |     | 26.7   |
| CT<br>Cancellation  | -       | 65.7   | (d) | -      | -      | (34.6)   | (d) | 31.1   |
| 2003<br>Adjusted  | 49.0    | 1.9    |     | (4.4)  | 8.4    | (22.0)   |     | 32.9   |
| \$ Variance<br>for<br>2004<br>Adjusted<br>vs.<br>2003<br>Adjusted | \$(9.0) | \$ 3.1 |     | \$ 6.0 | \$ 2.9 | \$ 2.2   |     | \$ 5.2 |

- (a) The adjustments represent non-GAAP financial information. The adjustments are net of tax. Management believes that the adjusted earnings amounts may be useful to investors because they show results before giving effect to the adjustment items.
- (b) In February 2004, a local jurisdiction issued final consolidated tax return regulations, which were retroactive to 2001. Under these regulations, Pepco Holdings (parent) and other affiliated companies doing business in this location, now have the necessary guidance to file a consolidated income tax return. This allows Pepco Holdings' subsidiaries with taxable losses to utilize those losses against tax liabilities of

Pepco Holdings' companies with taxable income. Pepco Holdings and its impacted subsidiaries recorded the impact of the new regulations of \$13.1 million in the first quarter of 2004 for the period 2001 through 2003.

- (c) This amount represents the unfavorable impact resulting from net trading losses prior to the cessation of proprietary trading.
- (d) This amount represents the unfavorable impact related to the cancellation of a CT contract. The Corp. & Other amount represents the reversal of a purchase accounting fair value adjustment made on the merger date.

## CONSOLIDATED RESULTS OF OPERATIONS

### Operating Revenue

Total consolidated operating revenue for the three months ended March 31, 2004, was \$1,764.1 million compared to \$1,928.7 million for the comparable period in 2003. Intercompany revenue has been eliminated for purposes of this analysis. A detail of these amounts is as follows:

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|                       | <u>2004</u> | <u>2003</u> | <u>Change</u> |
|-----------------------|-------------|-------------|---------------|
| Power Delivery        | \$1,039.6   | \$ 974.3    | \$ 65.3       |
| Conectiv Energy       | 391.8       | 611.2       | (219.4)       |
| Pepco Energy Services | 310.2       | 314.3       | (4.1)         |
| Other Non-Regulated   | <u>22.5</u> | <u>28.9</u> | (6.4)         |
| Total                 | \$1,764.1   | \$1,928.7   |               |

The increase in Power Delivery's operating revenue during the first quarter of 2004 primarily resulted from increases in regulated electric and gas revenues of \$64.9 million. Non-regulated revenues increased by \$.4 million.

For the three months ended March 31, 2004, electric delivery sales were 12,710,000 Mwh, an increase of approximately 1% as compared to 12,600,000 Mwh for the comparable period in 2003. For the three months ended March 31, 2004, gas sales were 10,034,000 dth, a decrease of 6% as compared to 10,670,000 dth for the comparable period in 2003.

The \$64.9 million increase in regulated electric and gas revenues was due to the following: (i) a \$38.1 million increase in delivery revenue (revenue Power Delivery receives for delivering energy to its customers) caused by a \$28.2 million increase in rates for electricity distribution and gas, \$11.8 million increase from growth in customer demand, a \$9.4 million increase from the pass through of increased energy taxes, offset by an \$11.3 million decrease in weather related sales, of which \$7.5 million of the weather related decrease comes from electricity sales and \$3.8 million comes from gas sales; (ii) an \$11.3 million increase in Standard Offer Service revenue (revenue Power Delivery receives for the procurement of energy by Power Delivery for its customers) resulting from more customers being on Standard Offer Service in 2004 than in 2003, and (iii) a \$15.5 million increase in sales into the PJM market.

The decrease in Conectiv Energy's operating revenue during the first quarter of 2004 resulted from a reduction in energy sales totaling \$53 million primarily caused by the expiration of two high-quantity, low-margin contracts that ended in 2003 partially offset by new sales, and a \$37 million decrease from the implementation of EITF 03-11 on January 1, 2004. EITF 03-11 requires that revenues and expenses on physically settled derivative contracts not "held for trading purposes" that did not result in physical settlement be reported on a net basis. EITF 03-11 does not require that prior periods be reclassified from gross to net presentation. Additionally, a change in power scheduling procedures by Conectiv Energy to schedule power directly to DPL led to a reduction of \$130 million in revenues and expenses from PJM.

The decrease in Pepco Energy Services' operating revenue during the first quarter of 2004 was primarily due to a decrease in wholesale commodity transactions.

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The decrease in Other Non-Regulated operating revenue during the first quarter of 2004 was primarily due to revenue of \$6.7 million which was recorded in 2003, but not in 2004 from a PCI subsidiary that was transferred to Pepco Energy Services in August 2003.

#### Operating Expenses

Total consolidated operating expenses for the three months ended March 31, 2004, were \$1,613.6 million compared to \$1,889.6 million for 2003. Intercompany expenses have been eliminated for purposes of this analysis. A detail of these amounts is as follows:

|                       | <u>2004</u> | <u>2003</u> | <u>Change</u> |
|-----------------------|-------------|-------------|---------------|
| Power Delivery        | \$ 788.2    | 698.1       | \$ 90.1       |
| Conectiv Energy       | 524.0       | 921.8       | (397.8)       |
| Pepco Energy Services | 308.1       | 320.0       | (11.9)        |
| Other Non-Regulated   | (3.4)       | 13.1        | (16.5)        |

|                     |              |               |      |
|---------------------|--------------|---------------|------|
| Corporate and Other | <u>(3.3)</u> | <u>(63.4)</u> | 60.1 |
|                     | )            | )             |      |
| Total               | \$1,613.6    | \$1,889.6     |      |

The \$90.1 million increase in Power Delivery's operating expenses during the 2004 quarter primarily resulted from a \$64.2 million increase in fuel and purchased energy, and a \$25.9 million increase in other operating expenses. These changes are discussed below in greater detail.

Fuel and energy costs increased by \$64.2 million to \$450.2 million for the three months ended March 31, 2004, from \$386.0 million for the corresponding period in 2003. The increase was primarily due to (i) a \$27.0 million increase in energy procurement costs to provide Standard Offer Service due to the TPA Settlement with Mirant, (ii) a \$10.6 million increase in net energy procurement due to higher Standard Offer Service sales, (iii) a \$21.0 million increase in gas costs from increased off-system sales and higher fuel costs than experienced in 2003, (iv) \$2.6 million for increased sales into the PJM market, and (v) \$3.0 million for various other cost increases.

Other operation and maintenance expenses increased by \$1.7 million to \$164.2 million for the three months ended March 31, 2004 from \$162.5 million for the corresponding period in 2003. The increase was primarily due to \$1.7 million in various miscellaneous expenses.

Depreciation and amortization expenses increased by \$7.3 million to \$96.0 million for the three months ended March 31, 2004 from \$88.7 million for the corresponding period in 2003. The increase is primarily due to increases in utility plant and regulatory assets.

Other taxes increased by \$8.5 million to \$69.4 million for the three months ended March 31, 2004 from \$60.9 million for the corresponding period in 2003. The increase was primarily due to \$9.3 million in higher fuel taxes which are passed through rates to customers.

Gain on sale of assets during the three months ended March 31, 2004 reflects the sale of land in the first quarter of 2004 for a gain of \$6.6 million which reduced operating expenses.

Deferred electric service costs represent a \$15.0 million increase in the net costs of providing Basic Generation Service. As of March 31, 2004, the balance for deferred electric service costs was \$170.6 million. Rates were reset as of August 1, 2003 so that there will be no under-recovery of costs embedded in the rates on or after that date.

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The decrease in Conectiv Energy's operating expenses during the first quarter of 2004 resulted from a reduction in operating expenses of approximately \$120 million primarily due to the expiration of two high quantity, low margin contracts during 2003, a \$37 million decrease from the implementation of EITF 03-11,

and a loss of \$110.7 million recognized in 2003 from the cancellation of a CT order. Additionally, in 2003, Conectiv Energy scheduled DPL POLR requirements directly with PJM and its 2003 revenues included these POLR sales. In 2004, POLR requirements were partially scheduled by Conectiv Energy and partially by DPL to better utilize PHI's working capital. The result of this change was a \$130 million reduction in Conectiv Energy revenue, and a corresponding reduction in operating expense.

The decrease in Pepco Energy Services' operating expense during the first quarter of 2004 was primarily due to a decrease in wholesale commodity transactions.

The decrease in Other Non-Regulated operating expenses during the first quarter of 2004 results from the fact that PCI recorded a pre-tax gain of \$5.5 million on the sale of two aircraft, which is reflected in the gain on sale of assets on the consolidated statement of earnings. Also, PCI's operating expenses decreased due to the disposition of assets held in PCI's investment portfolio.

The decrease in "Corporate and Other" primarily results from the fact that the 2003 period includes a purchase accounting adjustment of \$57.9 million related to the CT write-off by Conectiv Energy.

#### Other Income (Expenses)

Total consolidated other (expenses), which primarily consist of dividend and interest income and interest expense, for the three months ended March 31, 2004, were \$(87.2) million compared to \$(79.4) million for 2003. A detail of these amounts is as follows:

|                       | <u>2004</u>   | <u>2003</u>   | <u>Change</u> |
|-----------------------|---------------|---------------|---------------|
| Power Delivery        | \$(39.7)      | \$(36.1)      | \$ (3.6)      |
| Conectiv Energy       | (7.0)         | (3.9)         | (3.1)         |
| Pepco Energy Services | -             | .1            | (.1)          |
| Other Non-Regulated   | (10.1)        | (13.4)        | 3.3           |
| Corporate and Other   | <u>(30.4)</u> | <u>(26.1)</u> | (4.3)         |
|                       | )             | )             |               |
| Total                 | \$(87.2)      | \$(79.4)      |               |

The increase in Power Delivery's other expense during the 2004 quarter primarily resulted from lower interest income and an increase in interest expense mainly due to the distributions on mandatorily redeemable preferred securities being classified as interest expense during the 2004 quarter in accordance with SFAS No. 150.

The increase in Conectiv Energy's other expenses for the 2004 first quarter primarily resulted from a decrease in income recognized from an equity investment and the reduction of capitalized interest in 2004.

The decrease in Other Non-Regulated other expenses during the 2004 quarter resulted from decreased

losses from Pepcom's investment in Starpower of approximately \$1.3 million and decreased capital costs of approximately \$3.7 million offset by reduced income from investments of \$1.9 million related to the sell down of PCI's security portfolio.

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The increase in "Corporate and Other" primarily resulted from an increase in interest expense at the PHI parent level primarily due to an increase in debt outstanding during the 2004 quarter partially offset by lower interest rates during the 2004 quarter.

#### Income Tax Expense (Benefit)

Total consolidated income tax expense for the three months ended March 31, 2004, was \$11.4 million compared to an income tax benefit of \$(22.0) million for 2003. A detail of these amounts is as follows:

|                       | <u>2004</u>   | <u>2003</u> | <u>Change</u> |
|-----------------------|---------------|-------------|---------------|
| Power Delivery        | \$ 26.7       | \$ 32.7     | \$ (6.0)      |
| Conectiv Energy       | 3.2           | (63.4)      | 66.6          |
| Pepco Energy Services | (.8)          | (2.7)       | 1.9           |
| Other Non-Regulated   | (5.8)         | .9          | (6.7)         |
| Corporate and Other   | <u>(11.9)</u> | <u>10.5</u> | (22.4)        |
|                       | )             |             |               |
| Total                 | \$ 11.4       | \$(22.0)    |               |

Pepco Holdings effective tax rate for the first quarter ended March 31, 2004 was 18.0% as compared to the federal statutory rate of 35%. The major reasons for this difference were state income taxes (net of federal benefit, including the benefit associated with the retroactive adjustment for the issuance of final consolidated tax return regulations by a local taxing authority), the flow-through of Deferred Investment Tax Credits and the tax benefits related to certain leveraged leases partially offset by the flow-through of certain book tax depreciation differences.

The effective tax rate on the loss for the quarter ended March 31, 2003 was 46.9% (i.e., PHI reported an aggregate tax benefit in an amount equal to 46.9% of its consolidated loss before income taxes for such period) as compared to a statutory rate of 35%. The major reasons for this difference are the state tax benefits associated with PHI's first quarter loss, tax benefits associated with certain leveraged leases and the flow through of deferred investment and other tax credits (all of which have the effect of increasing the effective rate where there is a pre-tax loss) partially offset by the flow through of certain book tax depreciation

differences.

## CAPITAL RESOURCES AND LIQUIDITY

### Capital Structure

The components of Pepco Holdings' capital structure, expressed as a percentage of total capitalization (including short-term debt and current maturities of long-term debt) is shown below as of March 31, 2004 and December 31, 2003 (Dollars in Millions). For a discussion of long-term financing activity subsequent to March 31, 2004, please refer to the "Financing Activity Subsequent to March 31, 2004" section below.

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|  | <u>March 31, 2004</u> |            | <u>December 31, 2003</u> |            |
|--|-----------------------|------------|--------------------------|------------|
| Common Shareholders' Equity              | \$3,027.4             | 34.1%      | \$3,003.3                | 34.7%      |
| Preferred Stock (a)                      | 108.2                 | 1.2%       | 108.2                    | 1.2%       |
| Debentures Issued to Financing Trust (b) | 72.2                  | .9%        | 98.0                     | 1.1%       |
| Long-Term Debt (c)                       | 5,337.8               | 60.2%      | 5,101.3                  | 58.8%      |
| Short-Term Debt (d)                      |                       | <u>3.6</u> | <u>360.0</u>             | <u>4.2</u> |
|  | <u>320.6</u>          | %          |                          | %          |
| Total                                    | <u>\$8,866.2</u>      | 100.0%     | <u>\$8,670.8</u>         | 100.0%     |

- (a) Represents Mandatorily Redeemable Serial Preferred Stock, Serial Preferred Stock, and Redeemable Serial Preferred Stock.
- (b) Represents debentures issued pursuant to financing trusts, including the current portion.
- (c) Excludes capital lease obligations and transition bonds issued by ACE Funding. Includes first mortgage bonds, medium term notes, other long-term debt (other than debt issued by ACE Funding), current maturities of long-term debt (other than debt issued by ACE Funding), and Variable Rate Demand Bonds.
- (d) Excludes current maturities of long-term debt, capital lease obligations due within one year, and Variable Rate Demand Bonds.

### Financing Activity During the Three Months Ended March 31, 2004

Set forth below is a summary of long-term financing activity during the quarter ended March 31, 2004.

In January 2004, ACE Funding redeemed at maturity \$5.4 million of 2.89% Transition Bonds.

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In March 2004, ACE redeemed its \$1.975 million 6.375% Tax Exempt Bonds due 2006 at par and \$25.773 million of 7.375% Junior Subordinated Debentures due 2028 at par.

In March 2004, Pepco issued \$175 million of 4.65% Senior Notes due 2014 and \$100 million of 5.75% Senior Notes due 2034. The notes are secured by a like amount of First Mortgage Bonds.

In March 2004, PCI redeemed at maturity \$26 million of 6.59% Medium-Term Notes and \$10 million of 6.36% Medium-Term Notes.

### Financing Activity Subsequent to March 31, 2004

Set forth below is a summary of long-term financing activity subsequent to March 31, 2004.

In April 2004, Pepco redeemed \$100 million of 6.875% First Mortgage Bonds due 2023 at 102.66%, \$75 million of 6.875% First Mortgage Bond due 2024 at 103.10%, and \$35 million of 7% Medium Term Notes due 2024 at 102.747%.

In April 2004, ACE issued \$120 million of 5.80% Senior Notes due 2034. The notes are secured by a like amount of First Mortgage Bonds.

In April 2004, ACE Funding redeemed at maturity \$4.2 million of 2.89% Transition Bonds.

ACE has called for redemption on May 13, 2004 its \$62.5 million of 7% First Mortgage Bonds due 2023 at 102.88% and its \$75 million of 7% First Mortgage Bonds due 2028 at 102.91%.

DPL has called for redemption on May 17, 2004 its \$72.2 million of 8.125% Junior Subordinated Debentures due 2036 at par. DPL intends to initially fund the redemption using short-term debt. The \$72.2 million redemption amount has

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been classified as a current liability in the accompanying consolidated balance sheet at March 31, 2004.

### Working Capital

At March 31, 2004, Pepco Holdings' current assets on a consolidated basis totaled \$1.8 billion, whereas current liabilities totaled \$2.2 billion. At December 31, 2003, current assets on a consolidated basis totaled \$1.6 billion, whereas current liabilities totaled \$2.1 billion. At March 31, 2004, approximately \$1 billion of the \$2.2 billion total current liabilities balance represents short-term debt. An analysis of Pepco Holdings' \$1.0 billion of short-term debt as of March 31, 2004 is as follows:

As of March 31, 2004

(\$ in Millions)

| <u>Type</u> | <u>PHI</u> | <u>Pepco</u> | <u>DPL</u> | <u>ACE</u> | <u>PES</u> | <u>PCI</u> | <u>Conectiv</u> |
|-------------|------------|--------------|------------|------------|------------|------------|-----------------|
|-------------|------------|--------------|------------|------------|------------|------------|-----------------|

|   | ACE<br><u>Funding</u> |                |                |               | Conectiv<br><u>Energy</u> |                |               |               | Pepco<br>Holdings<br><u>Consolidated</u> |                  |
|---|-----------------------|----------------|----------------|---------------|---------------------------|----------------|---------------|---------------|--|------------------|
| Variable<br>Rate<br>Demand<br>Bonds           | \$ -                  | \$ -           | \$104.8        | \$22.6        | \$ -                      | \$ -           | \$31.0        | \$ -          | \$ -                                     | \$158.4          |
| Current<br>Portion<br>of<br>Long-Term<br>Debt | 200.0                 | 210.0          | 7.0            | 21.0          | 27.6                      | -              | .1            | 50.0          | 50.0                                     | 565.7            |
|   |                       |                |                |               |                           |                |               |               |  | <u>320.6</u>     |
| Construction<br>Loan                          | —                     | —              | —              | —             | —                         | <u>320.6</u>   | —             | —             | —  |                  |
|   |                       |                |                |               |                           |                |               |               |  | <u>\$1,044.7</u> |
| Total   | <u>\$200.0</u>        | <u>\$210.0</u> | <u>\$111.8</u> | <u>\$43.6</u> | <u>\$27.6</u>             | <u>\$320.6</u> | <u>\$31.1</u> | <u>\$50.0</u> | <u>\$50.0</u>                            |                  |

#### Capital Requirements

##### Construction Expenditures

Pepco Holdings' construction expenditures for the quarter ended March 31, 2004 totaled approximately \$95 million of which \$90 million was related to its power delivery businesses and the remainder related to Conectiv Energy.

##### Third Party Guarantees, Indemnifications and Off-Balance Sheet Arrangements

Pepco Holdings and certain of its subsidiaries have various financial and performance guarantees and indemnification obligations which are entered into in the normal course of business to facilitate commercial transactions with third parties as discussed below.

As of March 31, 2004, Pepco Holdings and its subsidiaries were parties to a variety of agreements pursuant to which they were guarantors for standby letters of credit, performance residual value, and other commitments and obligations. The fair value of these commitments and obligations was not required to be recorded in Pepco Holdings' Consolidated Balance Sheets; however, certain energy marketing obligations of Conectiv Energy were recorded. The commitments and obligations, in millions of dollars, were as follows:

|   | <u>Guarantor</u> |                 |            |              |
|---|------------------|-----------------|------------|--------------|
|   | <u>PHI</u>       | <u>Conectiv</u> | <u>PCI</u> | <u>Total</u> |
| Energy marketing obligations of Conectiv Energy (1)         | \$119.3          | \$12.2          | \$ -       | \$131.5      |
| Energy procurement obligations of Pepco Energy Services (1) | 17.3             | -               | -          | 17.3         |
| Standby letters of credit of Pepco Holdings (2)             | 5.5              | -               | -          | 5.5          |
| Guaranteed lease residual values (3)                        | -                | 5.5             | -          | 5.5          |
| Loan agreement (4)  | 13.1             | -               | -          | 13.1         |
| Construction performance guarantees (5)                     | -                | 4.2             | -          | 4.2          |
| Other (6)   | <u>14.9</u>      | <u>4.2</u>      | <u>5.7</u> | <u>24.8</u>  |
| Total   | \$170.1          | \$26.1          | \$5.7      | \$201.9      |

1. Pepco Holdings and Conectiv have contractual commitments for performance and related payments of Conectiv Energy and Pepco Energy Services to counterparties related to routine energy sales and procurement obligations, including requirements under Basic Generation Service contracts for ACE.
2. Pepco Holdings has issued standby letters of credit of \$5.5 million on behalf of subsidiaries' operations related to Conectiv Energy's competitive energy activities and third party construction performance. These standby letters of credit were put into place in order to allow the subsidiaries the flexibility needed to conduct business with counterparties without having to post substantial cash collateral. While the exposure under these standby letters of credit is \$5.5 million, Pepco Holdings does not expect to fund the full amount.
3. Subsidiaries of Conectiv have guaranteed residual values in excess of fair value related to certain equipment and fleet vehicles held through lease agreements. As of March 31, 2004, obligations under the guarantees were approximately \$5.5 million. Assets leased under agreements subject to residual value guarantees are typically for periods ranging from 2 years to 10 years. Historically, payments under the guarantees have not been made by the guarantor as, under normal conditions, the contract runs to full term at which time the residual value is minimal. As such, Pepco Holdings believes the likelihood of requiring payment under the guarantee is remote.
4. Pepco Holdings has issued a guarantee on the behalf of a subsidiary's 50% unconsolidated investment in a limited liability company for repayment borrowings under a loan agreement of approximately \$13.1 million.
5. Conectiv has performance obligations of \$4.2 million relating to obligations to third party suppliers of equipment.

6. Other guarantees comprise:

- Pepco Holdings has guaranteed payment of a bond issued by a subsidiary of \$14.9 million. Pepco Holdings does not expect to fund the full amount of the exposure under the guarantee.
- Conectiv has guaranteed a subsidiary building lease of \$4.2 million. Pepco Holdings does not expect to fund the full amount of the exposure under the guarantee.

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- PCI has guaranteed facility rental obligations related to contracts entered into by Starpower Communications LLC. In addition, PCI has agreed to indemnify RCN for 50% of any payments RCN makes under the Starpower franchise and construction performance bonds. As of March 31, 2004, the guarantees cover the remaining \$3.6 million in rental obligations and \$2.1 million in franchise and construction performance bonds issued.

In addition, in connection with the Conectiv Bethlehem revolving credit agreement, Conectiv provides a guarantee associated with Conectiv Energy's agreement to purchase energy and capacity from Conectiv Bethlehem and other guarantees related to obligations of Pepco Holdings subsidiaries under agreements related to constructing and operating the Conectiv Bethlehem mid-merit plant. Generally, Conectiv's guarantee obligations do not exceed the amount of the debt outstanding under the credit agreement and do not guarantee Conectiv Bethlehem's obligation to repay the debt. As of March 31, 2004, the outstanding balance under the Conectiv Bethlehem credit facility was \$320.6 million.

Pepco Holdings and certain of its subsidiaries have entered into various indemnification agreements related to purchase and sale agreements and other types of contractual agreements with vendors and other third parties. These indemnification agreements typically cover environmental, tax, litigation and other matters, as well as breaches of representations, warranties and covenants set forth in these agreements. Typically, claims may be made by third parties under these indemnification agreements over various periods of time depending on the nature of the claim. The maximum potential exposure under these indemnification agreements can range from a specified dollar amount to an unlimited amount depending on the nature of the claim and the particular transaction. The total maximum potential amount of future payments under these indemnification agreements is not estimable due to several factors, including uncertainty as to whether or when claims may be made under these indemnities.

#### Contractual Arrangements with Credit Rating Triggers or Margining Rights

Under certain contractual arrangements entered into by PHI's subsidiaries in connection with competitive energy and other transactions, the affected company may be required to provide cash collateral or letters of credit as security for its contractual obligations if the credit ratings of the applicable company are downgraded one or more levels. In the event of a downgrade, the amount required to be posted would depend on the amount of the underlying contractual obligation existing at the time of the downgrade. As of March 31, 2004, a one-level downgrade in the credit rating of PHI and all of its affected subsidiaries would have required PHI and such subsidiaries to provide aggregate cash collateral or letters of credit of approximately up to \$86 million. An additional amount of approximately \$244 million of aggregate cash

collateral or letters of credit would have been required in the event of subsequent downgrades to below investment grade.

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Many of the contractual arrangements entered into by PHI's subsidiaries in connection with competitive energy activities include margining rights pursuant to which the PHI subsidiary or a counterparty may request collateral if the market value of the contractual obligations reaches levels that are in excess of the credit thresholds established in the applicable arrangements. Pursuant to these margining rights, the affected PHI subsidiary may receive, or be required to post, collateral due to energy price movements. As of March 31, 2004, Pepco Holdings' subsidiaries engaged in competitive energy activities were in receipt of (a net holder of) cash collateral in the amount of \$14.6 million in connection with their competitive energy activities.

#### Dividends

On April 22, 2004, Pepco Holdings' Board of Directors declared a dividend on common stock of 25 cents per share payable June 30, 2004, to shareholders of record on June 10, 2004.

### REGULATORY AND OTHER MATTERS

#### Relationship with Mirant Corporation

In 2000, Pepco sold substantially all of its electricity generation assets to Mirant Corporation, formerly Southern Energy, Inc. As part of the sale, Pepco entered into several ongoing contractual arrangements with Mirant and certain of its subsidiaries (collectively, Mirant). On July 14, 2003, Mirant Corporation and most of its subsidiaries filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Northern District of Texas (the Bankruptcy Court). Under bankruptcy law, a debtor generally may, with authorization from a bankruptcy court, assume or reject executory contracts. A rejection of an executory contract entitles the counterparty to file a claim as an unsecured creditor against the bankruptcy estate for damages incurred due to the rejection of the contract. In a bankruptcy proceeding, a debtor can normally restructure some or all of its pre-petition liabilities.

Depending on the outcome of the matters discussed below, the Mirant bankruptcy could have a material adverse effect on the results of operations of Pepco Holdings and Pepco. However, management currently believes that Pepco Holdings and Pepco currently have sufficient cash, cash flow and borrowing capacity under their credit facilities and in the capital markets to be able to satisfy the additional cash requirements that are expected to arise due to the Mirant bankruptcy. Accordingly, management does not anticipate that the Mirant bankruptcy will impair the ability of Pepco Holdings or Pepco to fulfill their contractual obligations or to fund projected capital expenditures. On this basis, management currently does not believe that the Mirant bankruptcy will have a material adverse effect on the financial condition of either company.

#### Transition Power Agreements

As part of the asset purchase and sale agreement for the Pepco generation assets (the Asset Purchase and Sale Agreement), Pepco and Mirant entered into Transition Power Agreements for Maryland and the District of Columbia, respectively (collectively, the TPAs). Under these agreements, Mirant was obligated

to supply Pepco with all of the capacity and energy needed to fulfill its standard offer service obligations in Maryland through June 2004 and its standard offer service obligations in the District of Columbia into January 2005.

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To avoid the potential rejection of the TPAs, Pepco and Mirant entered into an Amended Settlement Agreement and Release dated as of October 24, 2003 (the Settlement Agreement) pursuant to which Mirant has assumed both of the TPAs and the terms of the TPAs were modified. The Settlement Agreement also provides that Pepco has an allowed, pre-petition general unsecured claim against Mirant in the amount of \$105 million (the Pepco TPA Claim).

The amount, if any, that Pepco will be able to recover from the Mirant bankruptcy estate in respect of the Pepco TPA Claim will depend on the amount of assets available for distribution to creditors. At the current stage of the bankruptcy proceeding, there is insufficient information to determine the amount, if any, that Pepco might be able to recover from the Mirant bankruptcy estate.

#### Power Purchase Agreements

Under agreements with FirstEnergy Corp., formerly Ohio Edison (FirstEnergy), and Allegheny Energy, Inc., both entered into in 1987, Pepco is obligated to purchase from FirstEnergy 450 megawatts of capacity and energy annually through December 2005 (the FirstEnergy PPA). Under an agreement with Panda-Brandywine L.P. (Panda), entered into in 1991, Pepco is obligated to purchase from Panda 230 megawatts of capacity and energy annually through 2021 (the Panda PPA). In each case, the purchase price is substantially in excess of current market prices. As a part of the Asset Purchase and Sale Agreement, Pepco entered into a "back-to-back" arrangement with Mirant. Under this arrangement, Mirant is obligated, among other things, to purchase from Pepco the capacity and energy that Pepco is obligated to purchase under the FirstEnergy PPA and the Panda PPA at a price equal to the price Pepco is obligated to pay under the PPAs (the PPA-Related Obligations).

#### Pepco Pre-Petition Claims

When Mirant filed its bankruptcy petition on July 14, 2003, Mirant had unpaid obligations to Pepco of approximately \$29 million, consisting primarily of payments due to Pepco in respect of the PPA-Related Obligations (the Mirant Pre-Petition Obligations). The Mirant Pre-Petition Obligations constitute part of the indebtedness for which Mirant is seeking relief in its bankruptcy proceeding. Pepco has filed Proofs of Claim in the Mirant bankruptcy proceeding in the amount of approximately \$26 million to recover this indebtedness; however, the amount of Pepco's recovery, if any, is uncertain. The \$3 million difference between Mirant's unpaid obligation to Pepco and the \$26 million Proofs of Claim filed by Pepco primarily represents a TPA settlement adjustment which is included in the \$105 million Proofs of Claim filed by Pepco against the Mirant debtors in respect of the Pepco TPA Claim. In view of this uncertainty, Pepco, in the third quarter of 2003, expensed \$14.5 million to establish a reserve against the \$29 million receivable from Mirant. In January 2004, Pepco paid approximately \$2.5 million to Panda in settlement of certain billing disputes under the Panda PPA that related to periods after the sale of Pepco's generation assets to Mirant. Pepco believes that under the terms of the Asset Purchase and Sale Agreement, Mirant is obligated to reimburse Pepco for the settlement payment. Accordingly, in the first quarter of 2004 Pepco increased

the amount of the receivable due from Mirant by approximately \$2.5 million, and Pepco intends to file Proofs of Claim for this amount against Mirant. Pepco currently estimates that the \$14.5 million expensed in the third quarter of 2003 represents the portion of the entire \$31.5 million receivable unlikely to be recovered in bankruptcy, and no additional reserve has been established for the \$2.5 million increase in the receivable. The amount expensed represents

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Pepco's estimate of the possible outcome in bankruptcy, although the amount ultimately recoverable could be higher or lower.

#### Mirant's Attempt to Reject the PPA-Related Obligations

On August 28, 2003, Mirant filed with the Bankruptcy Court a motion seeking authorization to reject its PPA-Related Obligations.

Upon motions filed by Pepco and the Federal Energy Regulatory Commission (FERC), on October 9, 2003, the U.S. District Court for the Northern District of Texas (the District Court) withdrew jurisdiction over the rejection proceedings from the Bankruptcy Court. On December 23, 2003, the District Court denied Mirant's motion to reject the PPA-Related Obligations. The District Court's decision is being appealed by Mirant and The Official Committee of Unsecured Creditors of Mirant Corporation in the U.S. Court of Appeals for the Fifth Circuit. Oral argument on the appeal was heard on May 5, 2004.

Pepco is exercising all available legal remedies and vigorously opposing Mirant's continued attempts to reject the PPA-Related Obligations in order to protect the interests of its customers and shareholders. While Pepco believes that it has substantial legal bases to oppose the attempt to reject the agreements, the outcome of Mirant's efforts to reject the PPA-Related Obligations is uncertain.

In accordance with the Bankruptcy Court's order, Mirant is continuing to perform the PPA-Related Obligations pending the resolution of the ongoing proceedings. However, if Mirant ultimately is successful in rejecting, and is otherwise permitted to stop performing the PPA-Related Obligations, Pepco could be required to repay to Mirant, for the period beginning on the effective date of the rejection (which date could be prior to the date of the court's order and possibly as early as September 18, 2003) and ending on the date Mirant is entitled to cease its purchases of energy and capacity from Pepco, all amounts paid by Mirant to Pepco in respect of the PPA-Related Obligations, less an amount equal to the price at which Mirant resold the purchased energy and capacity. Pepco estimates that the amount it could be required to repay to Mirant in the unlikely event September 18, 2003, is determined to be the effective date of rejection, is approximately \$69.2 million as of May 1, 2004. This repayment would entitle Pepco to file a claim against the bankruptcy estate in an amount equal to the amount repaid. Mirant has also asked the Bankruptcy Court to require Pepco to disgorge all amounts paid by Mirant to Pepco in respect of the PPA-Related Obligations, less an amount equal to the price at which Mirant resold the purchased energy and capacity, for the period July 14, 2003 (the date on which Mirant filed its bankruptcy petition) to September 18, 2003, on the theory that Mirant did not receive value for those payments. Pepco estimates that the amount it would be required to repay to Mirant on the disgorgement theory is approximately \$22.5 million. Pepco believes a claim based on this theory should be entitled to administrative expense status for which complete recovery could be expected. If Pepco were required to repay any such amounts for either period, the payment would

be expensed at the time the payment is made.

The following are estimates prepared by Pepco of its potential future exposure if Mirant's motion to reject its PPA-Related Obligations ultimately is successful. These estimates are based in part on current market prices and forward price estimates for energy and capacity, and do not include financing costs, all of which could be subject to significant fluctuation. The estimates assume no recovery from the Mirant bankruptcy estate and no

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regulatory recovery, either of which would mitigate the effect of the estimated loss. Pepco does not consider it realistic to assume that there will be no such recoveries. Based on these assumptions, Pepco estimates that its pre-tax exposure as of May 1, 2004, representing the loss of the future benefit of the PPA-Related Obligations to Pepco, is as follows:

- If Pepco were required to purchase capacity and energy from FirstEnergy commencing as of May 1, 2004, at the rates provided in the PPA (with an average price per kilowatt hour of approximately 6.1 cents) and resold the capacity and energy at market rates projected, given the characteristics of the FirstEnergy PPA, to be approximately 4.5 cents per kilowatt hour, Pepco estimates that it would cost approximately \$41.0 million for the remainder of 2004, and \$57 million in 2005, the last year of the FirstEnergy PPA.
- If Pepco were required to purchase capacity and energy from Panda commencing as of May 1, 2004, at the rates provided in the PPA (with an average price per kilowatt hour of approximately 15.6 cents), and resold the capacity and energy at market rates projected, given the characteristics of the Panda PPA, to be approximately 6.9 cents per kilowatt hour, Pepco estimates that it would cost approximately \$26 million for the remainder of 2004, \$38 million in 2005, and \$36 million in 2006 and approximately \$35 million to \$43 million annually thereafter through the 2021 contract termination date.

The ability of Pepco to recover from the Mirant bankruptcy estate in respect of the Mirant Pre-Petition Obligations and damages if the PPA-Related Obligations are successfully rejected will depend on whether Pepco's claims are allowed, the amount of assets available for distribution to creditors and Pepco's priority relative to other creditors. At the current stage of the bankruptcy proceeding, there is insufficient information to determine the amount, if any, that Pepco might be able to recover from the Mirant bankruptcy estate, whether the recovery would be in cash or another form of payment, or the timing of any recovery.

If Mirant ultimately is successful in rejecting the PPA-Related Obligations and Pepco's full claim is not recovered from the Mirant bankruptcy estate, Pepco may seek authority from the Maryland Public Service Commission (MPSC) and the District of Columbia Public Service Commission (DCPSC) to recover its additional costs. Pepco is committed to working with its regulatory authorities to achieve a result that is appropriate for its shareholders and customers. Under the provisions of the settlement agreements approved by the MPSC and the DCPSC in the deregulation proceedings in which Pepco agreed to divest its generation assets under certain conditions, the PPAs were to become assets of Pepco's distribution business if they could not be sold. Pepco believes that, if Mirant ultimately is successful in rejecting the PPA-Related

Obligations, these provisions would allow the stranded costs of the PPAs that are not recovered from the Mirant bankruptcy estate to be recovered through Pepco's distribution rates. If Pepco's interpretation of the settlement agreements is confirmed, Pepco expects to be able to establish the amount of its anticipated recovery as a regulatory asset. However, there is no assurance that Pepco's interpretation of the settlement agreements would be confirmed by the respective public service commissions.

If the PPA-Related Obligations are successfully rejected, and there is no regulatory recovery, Pepco will incur a loss. However, the accounting treatment of such a loss depends on a number of legal and regulatory factors, and is not determinable at this time.

### The SMECO Agreement

As a term of the Asset Purchase and Sale Agreement, Pepco assigned to Mirant a facility and capacity agreement with Southern Maryland Electric Cooperative, Inc. (SMECO) under which Pepco was obligated to purchase the capacity of an 84-megawatt combustion turbine installed and owned by SMECO at a former Pepco generating station (the SMECO Agreement). The SMECO Agreement expires in 2015 and contemplates a monthly payment to SMECO of approximately \$.5 million. Pepco is responsible to SMECO for the performance of the SMECO Agreement if Mirant fails to perform its obligations thereunder. At this time, Mirant continues to make post-petition payments due to SMECO.

However, on March 15, 2004, Mirant filed a complaint with the Bankruptcy Court seeking a declaratory judgment that the facility and capacity credit agreement is an unexpired lease of non-residential real property rather than an executory contract and that if Mirant were to successfully reject the agreement, any claim against the bankruptcy estate for damages made by SMECO (or by Pepco as subrogee) would be subject to the provisions of the Bankruptcy Code that limit the recovery of rejection damages by lessors. Pepco believes that there is no reasonable factual or legal basis to support Mirant's contention that the SMECO Agreement is a lease of real property and has filed a motion to dismiss the complaint. However, the outcome of this proceeding cannot be predicted.

### Preliminary Settlement Agreement with NJDEP

On April 26, 2004, PHI, Conectiv and ACE entered into a preliminary settlement agreement with the New Jersey Department of Environmental Protection (NJDEP) and the Attorney General of New Jersey that addresses various environmental issues at ACE and Conectiv Energy facilities in New Jersey. Among other things, the preliminary settlement agreement provides that:

- contingent upon the receipt of necessary approvals from the New Jersey Board of Public Utilities (NJBP), PJM Interconnection, LLC (PJM), North American Electric Reliability Council (NERC)/FERC and other regulatory authorities and the receipt of permits to construct certain transmission facilities in southern New Jersey described more fully below, ACE will permanently cease operation of the B.L. England generating facility by December 15, 2007. In the event that ACE is unable to shut down the B.L. England facility by December 15, 2007 through no fault of its own (e.g., because of failure to obtain the required regulatory approvals), B.L. England Unit 1 would be required to comply with stringent sulfur dioxide (SO<sub>2</sub>), nitrogen oxide (NO<sub>x</sub>) and particulate matter emissions limits set forth in the preliminary settlement agreement by October 1, 2008, and B.L. England Unit 2 would be required to comply with the emissions limits by May 1, 2009. If ACE does not either shut down the B.L. England facility by December 15, 2007 or satisfy

the emissions limits applicable in the event shut down is not so completed, ACE will be required to pay significant monetary penalties.

- ACE will be permitted to combust coal with a sulfur content of greater than 1% at the B.L. England facility in compliance with the terms of B.L. England's current permit until December 15, 2007 and NJDEP will not impose new, more stringent short-term SO<sub>2</sub> emissions limits on the B.L. England facility.

to resolve any possible civil liability (and without admitting liability) for violations of the permit provisions of the New Jersey

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- Air Pollution Control Act (APCA) and the Prevention of Significant Deterioration (PSD) provisions of the federal Clean Air Act (CAA) relating to modifications that may have been undertaken at the B.L. England facility, ACE will pay a \$750,000 civil penalty to NJDEP by June 1, 2004.
  - to compensate New Jersey for other alleged violations of the APCA and/or the CAA, ACE will undertake environmental projects beneficial to the state of New Jersey and approved by the NJDEP in a consent order or other final settlement document valued at \$2 million.
  - ACE will submit all federally required studies and complete construction of facilities necessary to satisfy the Environmental Protection Agency's (EPA) new cooling water intake structure regulations in accordance with a schedule that NJDEP will establish in the renewal New Jersey Pollutant Discharge Elimination System (NJPDES) permit for the B.L. England facility. The schedule will take into account ACE's agreement, provided that all regulatory approvals are obtained, to shut down the B.L. England facility by December 15, 2007.
  - to resolve any possible civil liability (and without admitting liability) for natural resource damages resulting from groundwater contamination at the B.L. England facility, Conectiv Energy's Deepwater generating facility and ACE's operations center near Pleasantville, New Jersey, ACE and Conectiv will pay NJDEP \$647,162 in cash or property and will remediate the groundwater contamination at all three sites. If subsequent data indicate that groundwater contamination is more extensive than indicated in NJDEP's preliminary analysis, NJDEP may seek additional compensation for natural resource damages.

The preliminary settlement agreement also provides that the parties will work toward a consent order or other final settlement document that reflects the terms of the preliminary settlement agreement.

Pursuant to a NJBPU order issued on September 25, 2003, ACE on April 30, 2004, filed a report with the NJBPU recommending that the B.L. England facility be shut down in accordance with the terms of the preliminary settlement agreement. The report stated that the operation of the B.L. England facility is necessary at the present time to satisfy reliability standards, but that those reliability standards could also be satisfied in other ways. The report concludes that, based on B.L. England's current and projected operating costs resulting from compliance with more restrictive environmental requirements, the most cost-effective way in which to meet reliability standards is to shut down the B.L. England facility and construct additional

transmission lines into southern New Jersey. ACE cannot predict whether the NJBPU will approve the construction of the additional transmission lines.

#### Rate Proceedings

On February 3, 2003, ACE filed a petition with the NJBPU to increase its electric distribution rates and its Regulatory Asset Recovery Charge (RARC) in New Jersey. In its most recent submission, made on February 20, 2004, ACE proposed an overall rate increase of approximately \$35.1 million, consisting of a \$30.6 million increase in distribution rates and a \$4.5 million increase in RARC. Hearings were held before an Administrative Law Judge in late March and early April 2004. At the hearing held on April 6, 2004, the Ratepayer Advocate proposed an annual rate decrease of \$4.5 million, modifying its earlier proposal that rates be decreased by \$11.7 million annually. The Staff of the

NJBPU is expected to submit its recommendations in briefs to be filed in June. ACE cannot predict the outcome of this proceeding.

In December 2003, the Delaware Public Service Commission (DPSC) approved a settlement agreement that provided for an annual increase of \$7.75 million in DPL's gas base rate. In accordance with the terms of the settlement agreement, on February 13, 2004, DPL filed for an Environmental Surcharge of approximately \$522,000 amortized over five years to recover out-of-pocket costs associated with gas environmental issues. The DPSC approved this surcharge on April 20, 2004. The surcharge will be adjusted year-to-year to reflect DPL's actual costs.

DPL filed on February 13, 2004 for a change in electric ancillary service rates that has an aggregate effect of increasing annual revenues by \$13.1 million or 2.4%. This filing was prompted by the increasing ancillary service costs charged to DPL by PJM. On February 24, 2004, the DPSC accepted the filing and placed the increase into effect on March 15, 2004, subject to refund. Intervention by another party has been filed. Unless the proceeding is settled, evidentiary hearings will be held in late August with a decision expected before the end of 2004.

On August 29, 2003, DPL submitted its annual Gas Cost Recovery (GCR) rate filing to the DPSC. In its filing, DPL sought to increase its GCR rate by approximately 15.8% in anticipation of increasing natural gas commodity costs. The GCR rate, which permits DPL to recover its procurement gas costs through customer rates, became effective November 1, 2003 and was subject to refund pending evidentiary hearings that were held on April 19, 2004. No party has proposed to modify DPL's proposed GCR rate, thus no refund is required. However, DPSC Staff has suggested prospective modifications to the program by which DPL hedges price risk for its gas purchases.

In compliance with the merger settlement approved by the MPSC in connection with the merger of Pepco and Conectiv, on December 4, 2003, DPL and Pepco submitted testimony and supporting schedules to establish electric distribution rates in Maryland effective July 1, 2004, when the current distribution rate freeze/caps end. The filings of each company demonstrate that it is in an under-earning situation. As provided in the terms of the merger settlement, DPL requested it be allowed to put into effect July 1, 2004, a rate increase for non-residential customers to offset the nuclear decommissioning equivalent decrease that was effective July 1, 2003. The merger settlement provides that Pepco's distribution rates can only decrease or remain unchanged after July 1, 2004. With limited exceptions, the merger settlement does not permit either company to increase distribution rates until after December 31, 2006. The MPSC Staff has filed testimony stating that no distribution rate reductions are justified and that DPL should be authorized to increase its

non-residential customers' distribution rates by approximately \$1.1 million. The Office of the People's Counsel (OPC) agrees that no distribution rate reduction is warranted for DPL or Pepco if the respective DPL and Pepco capital structures are used in determining whether existing rates should be reduced. However, OPC argues that the Pepco Holdings' consolidated capital structure and capital costs should be used to determine whether distribution rate reductions for Pepco and DPL are warranted. Based on PHI's consolidated capital structure, OPC recommended that DPL's and Pepco's distribution rates be reduced. Hearings in the Pepco case concluded April 27, 2004. Hearings in the DPL case will be held on May 11 and 12, 2004. Separate MPSC decisions in the DPL and Pepco cases are expected to be issued in early July 2004. Neither Pepco nor DPL can predict the outcome of the proceedings.

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## SOS and POLR Proceedings

### District of Columbia

On March 1, 2004, the DCPSC issued an order adopting the "wholesale" model for Standard Offer Service (SOS) in the District of Columbia after fixed rate SOS ends February 7, 2005. Under the wholesale model, Pepco will continue as the SOS provider after February 7, 2005. Several parties have filed applications for reconsideration of the order adopting the wholesale model that are pending before the DCPSC. PHI cannot predict the outcome of this proceeding.

In December 2003, the DCPSC issued an order adopting terms and conditions that would apply if the wholesale SOS model were adopted. Pepco and most of the other parties in the case filed applications for reconsideration and/or clarification of various parts of this order, and on March 1, 2004, the DCPSC granted in part and denied in part the applications for reconsideration and/or clarification. Because the DCPSC changed certain rules in its order granting in part and denying in part applications for reconsideration of the wholesale SOS terms and conditions, several parties filed for reconsideration of the March 1, 2004 order. Those applications for reconsideration are pending decision by the DCPSC. The DCPSC has also instituted an evidentiary proceeding to consider the amount of the administrative charge which Pepco may collect for providing SOS on and after February 8, 2005. The DCPSC intends to issue a decision by August 10, 2004.

### Virginia

In March 2004, Virginia amended its Electric Utility Restructuring Act to extend the rate freeze provisions applicable to DPL's rates for both provider of last resort (POLR) supply and distribution. The rate freezes, previously scheduled to expire on July 1, 2007, were extended to December 31, 2010, except that one change in base rates can be proposed by DPL prior to July 1, 2007, and one additional change in base rates can be proposed by DPL between that date and December 31, 2010. Additionally, rates may be increased to reflect increased purchased power costs, increased taxes, or increased costs to comply with environmental or reliability requirements.

The Virginia Electric Utility Restructuring Act obligates DPL to offer POLR service during the period that rates are frozen and thereafter, until relieved of that obligation by the Virginia State Corporation

Commission (VSCC).

On December 3, 2003, DPL and Conectiv Energy filed with the VSCC an amendment to extend their power supply agreement for one year, i.e., through December 31, 2004, and on a month-to-month basis thereafter, as it applies to power supply for DPL's Virginia POLR customers. The VSCC approved the amendment in an order issued on March 1, 2004. After December 31, 2004 either DPL or Conectiv Energy can terminate Conectiv Energy's obligation to provide supplies to meet DPL's Virginia POLR obligations by giving 30 days written notice to the other party.

## CRITICAL ACCOUNTING POLICIES

No material changes have occurred to Pepco Holdings' Critical Accounting Policies during the first quarter of 2004. Accordingly, for a discussion of these policies, please refer to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of Pepco Holdings' 2003 Form 10-K/A.

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## RISK FACTORS

Proposed tax legislation may have a material adverse effect on PHI's financial condition and results of operations.

The assets of PCI include a cross-border=0 energy lease portfolio with a book value of approximately \$1.2 billion at March 31, 2004. Currently, there is pending legislation in the U.S. House of Representatives (HR3967), that would apply new passive loss limitation rules prospectively to any new leases (including cross-border=0 leases) entered into on or after February 11, 2004 with tax indifferent parties (i.e., municipalities, tax exempt or governmental entities). Cross-border=0 leases are leases by a U.S. taxpayer of property located in a foreign country. All of PCI's cross-border=0 leases are with tax indifferent parties but were entered into prior to 2004. Legislation is also pending in the Senate (S1637) that may jeopardize the tax benefits received by leaseholders, including PCI, from existing cross-border=0 leases. The legislation, if adopted as proposed, would enact new passive loss limitation rules that would be applied retroactively to all existing lease agreements, for taxable years beginning after May 31, 2004, for all cross-border=0 leaseholders, including PCI. The outcome of these legislative proposals is unknown at this time. However, if the Senate's version were to be adopted in its current form, the amount of income tax benefits that PHI would receive in connection with PCI's cross-border=0 leases could decrease materially. If this occurred, PHI may be required to write down the book value of PCI's portfolio of cross-border=0 leases by taking a charge against earnings. Any of these circumstances could have a material adverse effect on PHI's financial condition and results of operations.

For additional information concerning risk factors, please refer to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in Pepco Holdings' Form 10-K/A for the year ended December 31, 2003.

## FORWARD LOOKING STATEMENTS

Some of the statements contained in this Quarterly Report on Form 10-Q/A are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. These statements include declarations regarding Pepco Holdings' intents, beliefs and current expectations. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of such terms or other comparable terminology. Any forward-looking statements are not guarantees of future performance, and actual results could differ materially from those indicated by the forward-looking statements. Forward-looking statements involve estimates, assumptions, known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements.

The forward-looking statements contained herein are qualified in their entirety by reference to the following important factors, which are difficult to predict, contain uncertainties, are beyond Pepco Holdings' control and may cause actual results to differ materially from those contained in forward-looking statements:

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- Prevailing governmental policies and regulatory actions affecting the energy industry, including with respect to allowed rates of return, industry and rate structure, acquisition and disposal of assets and facilities, operation and construction of plant facilities, recovery of purchased power expenses, and present or prospective wholesale and retail competition;
  - Changes in and compliance with environmental and safety laws and policies;
  - Weather conditions;
  - Population growth rates and demographic patterns;
  - Competition for retail and wholesale customers;
  - General economic conditions, including potential negative impacts resulting from an economic downturn;
  - Growth in demand, sales and capacity to fulfill demand;
  - Changes in tax rates or policies or in rates of inflation;
  - Changes in project costs;
  - Unanticipated changes in operating expenses and capital expenditures;
  - The ability to obtain funding in the capital markets on favorable terms;
  - Restrictions imposed by PUHCA;

- Legal and administrative proceedings (whether civil or criminal) and settlements that influence our business and profitability;
- Pace of entry into new markets;
- Volatility in market demand and prices for energy, capacity and fuel;
- Interest rate fluctuations and credit market concerns; and
- Effects of geopolitical events, including the threat of domestic terrorism.

Any forward-looking statements speak only as to the date of this Quarterly Report and Pepco Holdings undertakes no obligation to update any forward-looking statements to reflect events or circumstances after the date on which such statements are made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for Pepco Holdings to predict all of such factors, nor can Pepco Holdings assess the impact of any such factor on our business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement.

Pepco Holdings undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The foregoing review of factors should not be construed as exhaustive.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**

**AND RESULTS OF OPERATIONS**

**POTOMAC ELECTRIC POWER COMPANY**

**OVERVIEW**

Potomac Electric Power Company (Pepco) is engaged in the transmission and distribution of electricity in Washington, D.C. and major portions of Prince George's and Montgomery Counties in suburban Maryland. Pepco's service territory covers approximately 640 square miles and has a population of approximately 2 million. On August 1, 2002 Pepco completed its acquisition of Conectiv, at which time Pepco and Conectiv became wholly owned subsidiaries of Pepco Holdings, Inc. (Pepco Holdings or PHI). PHI is a public utility holding company registered under the Public Utility Holding Company Act of 1935 (PUHCA) and is subject to the regulatory oversight of the Securities and Exchange Commission (SEC) under PUHCA.

For additional information, refer to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of Pepco's 2003 Form 10-K/A.

**CONSOLIDATED RESULTS OF OPERATIONS**

The accompanying results of operations are for the three months ended March 31, 2004 vs. March 31, 2003. All amounts in the tables below are in millions.

Operating Revenue

|                                | <u>2004</u> | <u>2003</u> | <u>Change</u> |
|--------------------------------|-------------|-------------|---------------|
| Regulated electric revenue     | \$360.2     | \$327.9     | \$32.3        |
| Non-regulated electric revenue | <u>9.4</u>  | <u>5.5</u>  | 3.9           |
| Total                          | \$369.6     | \$333.4     |               |

The table above shows the amount of electric revenue earned that are subject to price regulation (regulated) and that are not subject to price regulation (non-regulated). Regulated electric revenues include revenues for delivery (transmission and distribution) service and electricity supply service within the service areas of Pepco.

Regulated revenue, which includes delivery revenue (revenue Pepco receives for delivering energy to its customers) and SOS revenue (revenue Pepco receives for the procurement of energy by Pepco for its customers) increased by \$32.3 million. Delivery revenue increased by \$11.5 million for the three months ended March 31, 2004 due to a \$9.4 million increase from an energy tax pass through and a \$3.9 million increase that results from a 1.3% increase in delivered kilowatt-hour sales, partially offset by a \$1.8 million decrease in weather-related sales. SOS revenue increased by \$20.8 million for the three months ended March 31, 2004 due to a 14.1% increase in sales.

Pepco's retail access to a competitive market for generation services was made available to all Maryland customers on July 1, 2000 and to D.C. customers on January 1, 2001. At March 31, 2004, 13% of Pepco's Maryland customers and 10% of its D.C. customers have chosen alternate suppliers. These customers accounted for 742 megawatts of load in Maryland (of Pepco's total load of 3,322) and 786 megawatts of load in D.C. (of Pepco's total load of 2,161). At

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March 31, 2003, 17% of Pepco's Maryland customers and 12% of its D.C. customers had chosen alternate suppliers. These customers accounted for 987 megawatts of load in Maryland (of Pepco's total load of 3,537) and 960 megawatts of load in D.C. (of Pepco's total load of 2,310).

For the three months ended March 31, 2004, delivery sales were 6,679,000 MWh, an increase of 1.3% as compared to 6,592,000 MWh for the comparable period in 2003.

Non-regulated electric revenue increased \$3.9 million primarily due to higher property claims and billed rents during the 2004 quarter.

Operating Expenses

#### Fuel and Purchased Energy

Electric fuel and purchased energy increased by \$39.5 million to \$173.7 million for the three months ended March 31, 2004, from \$134.2 million for the corresponding period in 2003. The increase was primarily due to \$27.0 million higher costs as a result of the Transition Power Agreements (TPA) settlement with Mirant that increased the price of energy purchased from Mirant, \$20.0 million higher SOS costs resulting from a 14.1% increase in SOS sales, and \$1.8 million higher transmission services. These increases were partially offset by a \$9.4 million reduction in the Generation Procurement Credit (GPC) which resulted from the lower SOS margin, which in turn provided less customer sharing.

#### Other Operation and Maintenance

Other operation and maintenance expenses increased by \$7.4 million to \$67.1 million for the three months ended March 31, 2004, from \$59.7 million for the corresponding period in 2003. The increase was primarily due to \$3.0 million higher field labor costs not associated with capital projects, \$1.9 million for increased outside legal counsel and professional fees and \$1.2 million for PJM charges and other expenses.

#### Depreciation and Amortization

Depreciation and amortization expenses increased by \$2.6 million to \$43.9 million for the three months ended March 31, 2004, from \$41.3 million for the corresponding period in 2003. This increase results from \$1.0 million for additions to depreciable plant, \$.9 million for non-utility depreciation, and \$.7 million for higher software amortization.

#### Other Taxes

Other taxes increased by \$11.5 million to \$56.5 million for the three months ended March 31, 2004, from \$45.0 million for the corresponding period in 2003. The increase was primarily due to \$9.3 million higher fuel taxes which is a pass through, and \$1.0 million higher DC delivery tax.

#### Gain on Sale of Asset

Gain on sale of asset during the first quarter of 2004 reflects a sale of land in the first quarter of 2004 for a gain of \$6.6 million which reduced operating expenses.

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## Other Income (Expenses)

Other expenses increased by \$1.0 million to a net expense of \$19.3 million for the three months ended March 31, 2004, from a net expense of \$18.3 million for the corresponding period in 2003 primarily due to an increase in interest expense resulting from the reclassification of distributions on mandatorily redeemable preferred securities to interest expense in accordance with SFAS No. 150.

## Income Tax Expense

Pepco's effective tax rate for the three months ended March 31, 2004 and 2003 was 37.6% and 38.7% respectively, as compared to the federal statutory rate of 35%. The major reasons for this difference are state income taxes (net of federal benefit) and the flow-through of certain book tax depreciation differences partially offset by the flow through of Deferred Investment Tax Credits.

## CAPITAL RESOURCES AND LIQUIDITY

### Financing Activity

In March 2004, Pepco issued \$175 million of 4.65% Senior Notes due 2014 and \$100 million of 5.75% Senior Notes due 2034. The notes are secured by a like amount of First Mortgage Bonds.

### Financing Activity Subsequent to March 31, 2004

In April 2004, Pepco redeemed \$100 million of 6.875% First Mortgage Bonds due 2023 at 102.66%, \$75 million of 6.875% First Mortgage Bond due 2024 at 103.10%, and \$35 million of 7% Medium Term Notes due 2024 at 102.747%.

### Capital Requirements

#### Construction Expenditures

Pepco's construction expenditures for the quarter ended March 31, 2004 totaled approximately \$42 million.

## REGULATORY AND OTHER MATTERS

### Relationship with Mirant Corporation

In 2000, Pepco sold substantially all of its electricity generation assets to Mirant Corporation, formerly Southern Energy, Inc. As part of the sale, Pepco entered into several ongoing contractual arrangements with Mirant and certain of its subsidiaries (collectively, Mirant). On July 14, 2003, Mirant Corporation and most of its subsidiaries filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Northern District of Texas (the Bankruptcy Court). Under bankruptcy law, a debtor generally may, with authorization from a bankruptcy court, assume or reject executory contracts. A rejection of an executory contract entitles the counterparty to file a claim as an unsecured creditor against the bankruptcy estate for damages incurred due to the rejection of the contract. In a bankruptcy proceeding, a debtor can normally restructure some or all of its pre-petition liabilities.

Depending on the outcome of the matters discussed below, the Mirant bankruptcy could have a material adverse effect on the results of operations of Pepco. However, management currently believes that Pepco currently has sufficient cash, cash flow and borrowing capacity under its credit facilities and in the capital markets to be able to satisfy the additional cash requirements that are expected to arise due to the Mirant bankruptcy. Accordingly, management does not anticipate that the Mirant bankruptcy will impair the ability of Pepco to fulfill its contractual obligations or to fund projected capital expenditures. On this basis, management currently does not believe that the Mirant bankruptcy will have a material adverse effect on the financial condition of Pepco.

#### Transition Power Agreements

As part of the asset purchase and sale agreement for the Pepco generation assets (the Asset Purchase and Sale Agreement), Pepco and Mirant entered into Transition Power Agreements for Maryland and the District of Columbia, respectively (collectively, the TPAs). Under these agreements, Mirant was obligated to supply Pepco with all of the capacity and energy needed to fulfill its standard offer service obligations in Maryland through June 2004 and its standard offer service obligations in the District of Columbia into January 2005.

To avoid the potential rejection of the TPAs, Pepco and Mirant entered into an Amended Settlement Agreement and Release dated as of October 24, 2003 (the Settlement Agreement) pursuant to which Mirant has assumed both of the TPAs and the terms of the TPAs were modified. The Settlement Agreement also provides that Pepco has an allowed, pre-petition general unsecured claim against Mirant in the amount of \$105 million (the Pepco TPA Claim).

The amount, if any, that Pepco will be able to recover from the Mirant bankruptcy estate in respect of the Pepco TPA Claim will depend on the amount of assets available for distribution to creditors. At the current stage of the bankruptcy proceeding, there is insufficient information to determine the amount, if any, that Pepco might be able to recover from the Mirant bankruptcy estate.

#### Power Purchase Agreements

Under agreements with FirstEnergy Corp., formerly Ohio Edison (FirstEnergy), and Allegheny Energy, Inc., both entered into in 1987, Pepco is obligated to purchase from FirstEnergy 450 megawatts of capacity and energy annually through December 2005 (the FirstEnergy PPA). Under an agreement with Panda-Brandywine L.P. (Panda), entered into in 1991, Pepco is obligated to purchase from Panda 230

megawatts of capacity and energy annually through 2021 (the Panda PPA). In each case, the purchase price is substantially in excess of current market prices. As a part of the Asset Purchase and Sale Agreement, Pepco entered into a "back-to-back" arrangement with Mirant. Under this arrangement, Mirant is obligated, among other things, to purchase from Pepco the capacity and energy that Pepco is obligated to purchase under the FirstEnergy PPA and the Panda PPA at a price equal to the price Pepco is obligated to pay under the PPAs (the PPA-Related Obligations).

### Pepco Pre-Petition Claims

When Mirant filed its bankruptcy petition on July 14, 2003, Mirant had unpaid obligations to Pepco of approximately \$29 million, consisting primarily of payments due to Pepco in respect of the PPA-Related Obligations (the Mirant Pre-Petition Obligations). The Mirant Pre-Petition Obligations constitute part of the indebtedness for which Mirant is seeking relief in its bankruptcy proceeding. Pepco has filed Proofs of Claim in the Mirant bankruptcy proceeding in the amount of approximately \$26 million to recover this indebtedness; however, the amount of Pepco's recovery, if any, is uncertain. The \$3 million difference between Mirant's unpaid obligation to Pepco and the \$26 million Proofs of Claim filed by Pepco primarily represents a TPA settlement adjustment which is included in the \$105 million Proofs of Claim filed by Pepco against the Mirant debtors in respect of the Pepco TPA Claim. In view of this uncertainty, Pepco, in the third quarter of 2003, expensed \$14.5 million to establish a reserve against the \$29 million receivable from Mirant. In January 2004, Pepco paid approximately \$2.5 million to Panda in settlement of certain billing disputes under the Panda PPA that related to periods after the sale of Pepco's generation assets to Mirant. Pepco believes that under the terms of the Asset Purchase and Sale Agreement, Mirant is obligated to reimburse Pepco for the settlement payment. Accordingly, in the first quarter of 2004 Pepco increased the amount of the receivable due from Mirant by approximately \$2.5 million, and Pepco intends to file Proofs of Claim for this amount against Mirant. Pepco currently estimates that the \$14.5 million expensed in the third quarter of 2003 represents the portion of the entire \$31.5 million receivable unlikely to be recovered in bankruptcy, and no additional reserve has been established for the \$2.5 million increase in the receivable. The amount expensed represents Pepco's estimate of the possible outcome in bankruptcy, although the amount ultimately recoverable could be higher or lower.

### Mirant's Attempt to Reject the PPA-Related Obligations

On August 28, 2003, Mirant filed with the Bankruptcy Court a motion seeking authorization to reject its PPA-Related Obligations.

Upon motions filed by Pepco and the Federal Energy Regulatory Commission (FERC), on October 9, 2003, the U.S. District Court for the Northern District of Texas (the District Court) withdrew jurisdiction over the rejection proceedings from the Bankruptcy Court. On December 23, 2003, the District Court denied Mirant's motion to reject the PPA-Related Obligations. The District Court's decision is being appealed by Mirant and The Official Committee of Unsecured Creditors of Mirant Corporation in the U.S. Court of Appeals for the Fifth Circuit. Oral argument on the appeal was heard on May 5, 2004.

Pepco is exercising all available legal remedies and vigorously opposing Mirant's continued attempts to reject the PPA-Related Obligations in order to protect the interests of its customers and shareholders. While

Pepco believes that it has substantial legal bases to oppose the attempt to reject the agreements, the outcome of Mirant's efforts to reject the PPA-Related Obligations is uncertain.

In accordance with the Bankruptcy Court's order, Mirant is continuing to perform the PPA-Related Obligations pending the resolution of the ongoing proceedings. However, if Mirant ultimately is successful in rejecting, and is otherwise permitted to stop performing the PPA-Related Obligations, Pepco could be required to repay to Mirant, for the period beginning on the effective date of the rejection (which date could be prior to the date of the

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court's order and possibly as early as September 18, 2003) and ending on the date Mirant is entitled to cease its purchases of energy and capacity from Pepco, all amounts paid by Mirant to Pepco in respect of the PPA-Related Obligations, less an amount equal to the price at which Mirant resold the purchased energy and capacity. Pepco estimates that the amount it could be required to repay to Mirant in the unlikely event September 18, 2003, is determined to be the effective date of rejection, is approximately \$69.2 million as of May 1, 2004. This repayment would entitle Pepco to file a claim against the bankruptcy estate in an amount equal to the amount repaid. Mirant has also asked the Bankruptcy Court to require Pepco to disgorge all amounts paid by Mirant to Pepco in respect of the PPA-Related Obligations, less an amount equal to the price at which Mirant resold the purchased energy and capacity, for the period July 14, 2003 (the date on which Mirant filed its bankruptcy petition) to September 18, 2003, on the theory that Mirant did not receive value for those payments. Pepco estimates that the amount it would be required to repay to Mirant on the disgorgement theory is approximately \$22.5 million. Pepco believes a claim based on this theory should be entitled to administrative expense status for which complete recovery could be expected. If Pepco were required to repay any such amounts for either period, the payment would be expensed at the time the payment is made.

The following are estimates prepared by Pepco of its potential future exposure if Mirant's motion to reject its PPA-Related Obligations ultimately is successful. These estimates are based in part on current market prices and forward price estimates for energy and capacity, and do not include financing costs, all of which could be subject to significant fluctuation. The estimates assume no recovery from the Mirant bankruptcy estate and no regulatory recovery, either of which would mitigate the effect of the estimated loss. Pepco does not consider it realistic to assume that there will be no such recoveries. Based on these assumptions, Pepco estimates that its pre-tax exposure as of May 1, 2004, representing the loss of the future benefit of the PPA-Related Obligations to Pepco, is as follows:

- If Pepco were required to purchase capacity and energy from FirstEnergy commencing as of May 1, 2004, at the rates provided in the PPA (with an average price per kilowatt hour of approximately 6.1 cents) and resold the capacity and energy at market rates projected, given the characteristics of the FirstEnergy PPA, to be approximately 4.5 cents per kilowatt hour, Pepco estimates that it would cost approximately \$41.0 million for the remainder of 2004, and \$57 million in 2005, the last year of the FirstEnergy PPA.
- If Pepco were required to purchase capacity and energy from Panda commencing as of May 1, 2004, at the rates provided in the PPA (with an average price per kilowatt hour of approximately 15.6 cents), and resold the capacity and energy at market rates projected, given the characteristics

of the Panda PPA, to be approximately 6.9 cents per kilowatt hour, Pepco estimates that it would cost approximately \$26 million for the remainder of 2004, \$38 million in 2005, and \$36 million in 2006 and approximately \$35 million to \$43 million annually thereafter through the 2021 contract termination date.

The ability of Pepco to recover from the Mirant bankruptcy estate in respect of the Mirant Pre-Petition Obligations and damages if the PPA-Related Obligations are successfully rejected will depend on whether Pepco's claims are allowed, the amount of assets available for distribution to creditors and Pepco's priority relative to other creditors. At the current stage of the bankruptcy proceeding, there is insufficient information to determine the amount, if any, that Pepco might be able to recover from the Mirant

bankruptcy estate, whether the recovery would be in cash or another form of payment, or the timing of any recovery.

If Mirant ultimately is successful in rejecting the PPA-Related Obligations and Pepco's full claim is not recovered from the Mirant bankruptcy estate, Pepco may seek authority from the Maryland Public Service Commission (MPSC) and the District of Columbia Public Service Commission (DCPSC) to recover its additional costs. Pepco is committed to working with its regulatory authorities to achieve a result that is appropriate for its shareholders and customers. Under the provisions of the settlement agreements approved by the MPSC and the DCPSC in the deregulation proceedings in which Pepco agreed to divest its generation assets under certain conditions, the PPAs were to become assets of Pepco's distribution business if they could not be sold. Pepco believes that, if Mirant ultimately is successful in rejecting the PPA-Related Obligations, these provisions would allow the stranded costs of the PPAs that are not recovered from the Mirant bankruptcy estate to be recovered through Pepco's distribution rates. If Pepco's interpretation of the settlement agreements is confirmed, Pepco expects to be able to establish the amount of its anticipated recovery as a regulatory asset. However, there is no assurance that Pepco's interpretation of the settlement agreements would be confirmed by the respective public service commissions.

If the PPA-Related Obligations are successfully rejected, and there is no regulatory recovery, Pepco will incur a loss. However, the accounting treatment of such a loss depends on a number of legal and regulatory factors, and is not determinable at this time.

#### The SMECO Agreement

As a term of the Asset Purchase and Sale Agreement, Pepco assigned to Mirant a facility and capacity agreement with Southern Maryland Electric Cooperative, Inc. (SMECO) under which Pepco was obligated to purchase the capacity of an 84-megawatt combustion turbine installed and owned by SMECO at a former Pepco generating station (the SMECO Agreement). The SMECO Agreement expires in 2015 and contemplates a monthly payment to SMECO of approximately \$.5 million. Pepco is responsible to SMECO for the performance of the SMECO Agreement if Mirant fails to perform its obligations thereunder. At this time, Mirant continues to make post-petition payments due to SMECO.

However, on March 15, 2004, Mirant filed a complaint with the Bankruptcy Court seeking a declaratory judgment that the facility and capacity credit agreement is an unexpired lease of non-residential real property rather than an executory contract and that if Mirant were to successfully reject the agreement, any

claim against the bankruptcy estate for damages made by SMECO (or by Pepco as subrogee) would be subject to the provisions of the Bankruptcy Code that limit the recovery of rejection damages by lessors. Pepco believes that there is no reasonable factual or legal basis to support Mirant's contention that the SMECO Agreement is a lease of real property and has filed a motion to dismiss the complaint. However, the outcome of this proceeding cannot be predicted.

#### Rate Proceedings

In compliance with the merger settlement approved by the MPSC in connection with the merger of Pepco and Conectiv, on December 4, 2003, Pepco submitted testimony and supporting schedules to establish electric distribution rates in Maryland effective July 1, 2004, when the current distribution rate freeze/caps end. Pepco's filing demonstrates that it is in an under-earning situation. The merger settlement provides that Pepco's distribution rates can only decrease or remain unchanged after July 1, 2004. With limited exceptions, the merger settlement does not permit Pepco to increase distribution rates until after December 31, 2006. The MPSC Staff has filed testimony stating that no distribution rate reductions are justified. The Office of the People's Counsel (OPC) agrees that no distribution rate reduction is warranted for Pepco if the Pepco capital structure is used in determining whether existing rates should be reduced. However, OPC argues that the Pepco Holdings' consolidated capital structure and capital costs should be used to determine whether distribution rate reductions for Pepco are warranted. Based on PHI's consolidated capital structure, OPC recommended that Pepco's distribution rates be reduced. Hearings in the Pepco case concluded April 27, 2004. The MPSC decision is expected to be issued in early July 2004. Pepco cannot predict the outcome of the proceeding.

#### SOS Proceedings

##### District of Columbia

On March 1, 2004, the DCPSC issued an order adopting the "wholesale" model for Standard Offer Service (SOS) in the District of Columbia after fixed rate SOS ends February 7, 2005. Under the wholesale model, Pepco will continue as the SOS provider after February 7, 2005. Several parties have filed applications for reconsideration of the order adopting the wholesale model that are pending before the DCPSC. PHI cannot predict the outcome of this proceeding.

In December 2003, the DCPSC issued an order adopting terms and conditions that would apply if the wholesale SOS model were adopted. Pepco and most of the other parties in the case filed applications for

reconsideration and/or clarification of various parts of this order, and on March 1, 2004, the DCPSC granted in part and denied in part the applications for reconsideration and/or clarification. Because the DCPSC changed certain rules in its order granting in part and denying in part applications for reconsideration of the wholesale SOS terms and conditions, several parties filed for reconsideration of the March 1, 2004 order. Those applications for reconsideration are pending decision by the DCPSC. The DCPSC has also instituted an evidentiary proceeding to consider the amount of the administrative charge which Pepco may collect for providing SOS on and after February 8, 2005. The DCPSC intends to issue a decision by August 10, 2004.

## CRITICAL ACCOUNTING POLICIES

No material changes have occurred to Pepco's Critical Accounting Policies during the first quarter of 2004. Accordingly, for a discussion of these policies, please refer to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of Pepco's 2003 Form 10-K/A.

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## FORWARD LOOKING STATEMENTS

Some of the statements contained in this Quarterly Report on Form 10-Q/A are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. These statements include declarations regarding Pepco's intents, beliefs and current expectations. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of such terms or other comparable terminology. Any forward-looking statements are not guarantees of future performance, and actual results could differ materially from those indicated by the forward-looking statements. Forward-looking statements involve estimates, assumptions, known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements.

The forward-looking statements contained herein are qualified in their entirety by reference to the following important factors, which are difficult to predict, contain uncertainties, are beyond Pepco's control and may cause actual results to differ materially from those contained in forward-looking statements:

- Prevailing governmental policies and regulatory actions affecting the energy industry, including with respect to allowed rates of return, industry and rate structure, acquisition and disposal of assets and facilities, operation and construction of plant facilities, recovery of purchased power expenses, and present or prospective wholesale and retail competition;
- Changes in and compliance with environmental and safety laws and policies;
- Weather conditions;
- Population growth rates and demographic patterns;
- Competition for retail and wholesale customers;

- General economic conditions, including potential negative impacts resulting from an economic downturn;
- Growth in demand, sales and capacity to fulfill demand;
- Changes in tax rates or policies or in rates of inflation;
- Changes in project costs;
- Unanticipated changes in operating expenses and capital expenditures;
- The ability to obtain funding in the capital markets on favorable terms;
- Restrictions imposed by PUHCA;
- Legal and administrative proceedings (whether civil or criminal) and settlements that influence our business and profitability;

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- Pace of entry into new markets;
  - Volatility in market demand and prices for energy, capacity and fuel;
  - Interest rate fluctuations and credit market concerns; and
  - Effects of geopolitical events, including the threat of domestic terrorism.

Any forward-looking statements speak only as to the date of this Quarterly Report and Pepco undertakes no obligation to update any forward-looking statements to reflect events or circumstances after the date on which such statements are made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for Pepco to predict all of such factors, nor can Pepco assess the impact of any such factor on our business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement.

Pepco undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The foregoing review of factors should not be construed as exhaustive.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND**

**RESULTS OF OPERATIONS**

**DELMARVA POWER & LIGHT COMPANY**

**OVERVIEW**

Delmarva Power & Light Company (DPL) is engaged in the transmission and distribution of electricity in Delaware and portions of Maryland and Virginia and provides gas distribution service in northern Delaware. DPL's electricity distribution service territory covers approximately 6,000 square miles and has a population of approximately 1.25 million. DPL's natural gas distribution service territory covers approximately 275 square miles and has a population of approximately 523,000. DPL is a wholly owned subsidiary of Conectiv. On August 1, 2002 Pepco completed its acquisition of Conectiv, at which time Pepco and Conectiv became wholly owned subsidiaries of Pepco Holdings, Inc. (Pepco Holdings or PHI). PHI is a public utility holding company registered under the Public Utility Holding Company Act of 1935 (PUHCA) and is subject to the regulatory oversight of the Securities and Exchange Commission (SEC) under PUHCA.

In March 2004, Virginia amended its Electric Utility Restructuring Act to extend the rate freeze provisions applicable to DPL's rates for both provider of last resort (POLR) supply and distribution. The rate freezes, previously scheduled to expire on July 1, 2007, were extended to December 31, 2010, except that one change in base rates can be proposed by DPL prior to July 1, 2007, and one additional change in base rates can be proposed by DPL between that date and December 31, 2010. Additionally, rates may be

increased to reflect increased purchased power costs, increased taxes, or increased costs to comply with environmental or reliability requirements.

The Virginia Electric Utility Restructuring Act obligates DPL to offer POLR service during the period that rates are frozen and thereafter, until relieved of that obligation by the Virginia State Corporation Commission (VSCC).

For additional information, refer to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of DPL's 2003 Form 10-K/A.

## RESULTS OF OPERATIONS

The Results of Operations discussion section below is presented only for the three months ended March 31, 2004 and 2003, in accordance with General Instruction H(2)(a). Other than the disclosures below, information under this item has been omitted in accordance with General Instruction H to the Form 10-Q.

### Operating Revenue

#### Electric Revenues

|                                 | Three Months Ended<br>March 31, |                |               |
|---------------------------------|---------------------------------|----------------|---------------|
|                                 | <u>2004</u>                     | <u>2003</u>    | <u>Change</u> |
|                                 | (Dollars in Millions)           |                |               |
| Regulated electric revenues     | \$249.4                         | \$251.0        | \$(1.6)       |
| Non-regulated electric revenues | <u>-</u>                        | <u>12.1</u>    | (12.1)        |
| Total electric revenues         | <u>\$249.4</u>                  | <u>\$263.1</u> |               |

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The table above shows the amounts of electric revenues earned that are subject to price regulation (regulated) and that are not subject to price regulation (non-regulated). Regulated electric revenues include revenues for delivery (transmission and distribution) service and electricity supply service within the service areas of DPL.

#### Regulated Electric Revenues

The \$1.6 million decrease in Regulated electric revenues was primarily due to the following: (i) a \$1.9 million decrease in weather related sales and (ii) a \$.3 million decrease from more customers choosing alternate suppliers. The decreases were partially offset by a \$.6 million increase in other variances.

Customers who have chosen alternate suppliers accounted for 11% of billed sales for both the three months ended March 31, 2004 and 2003. For the three months ended March 31, 2004, delivery sales were 3,661,000 Mwh as compared to 3,673,000 Mwh for the comparable period in 2003.

### Non-Regulated Electric Revenues

The \$12.1 million decrease in non-regulated electric revenues was primarily due to an \$11.7 million decrease in sales to Delaware Municipal Electric Corporation (DMEC) due to DPL's contract with DMEC expiring at year-end 2003.

### Gas Revenues

|                            | Three Months Ended<br>March 31, |               |               |
|----------------------------|---------------------------------|---------------|---------------|
|                            | <u>2004</u>                     | <u>2003</u>   | <u>Change</u> |
|                            | (Dollars in Millions)           |               |               |
| Regulated gas revenues     | \$81.9                          | \$72.1        | \$ 9.8        |
| Non-regulated gas revenues | <u>18.0</u>                     | <u>5.1</u>    | 12.9          |
| Total gas revenues         | <u>\$99.9</u>                   | <u>\$77.2</u> |               |

DPL has gas revenues from on-system natural gas sales, which generally are subject to price regulation, and from the transportation of natural gas for customers. The table above shows the amounts of gas revenues from sources that were subject to price regulation (regulated) and that were not subject to price regulation (non-regulated).

### Regulated Gas Revenues

The \$9.8 million increase in Regulated gas revenues primarily resulted from an \$11.9 million increase in the Gas Cost Rate effective November 1, 2003, and a \$3.1 million increase in Gas base rates effective December 9, 2003. The increases were partially offset by a \$3.8 million decrease in weather related sales and \$1.4 million decrease in other variances. Heating degree days decreased by 4.1% for the three months ended March 31, 2004 compared to the same period in 2003. For the three months ended March 31, 2004, gas sales were 10,034,000 dth as compared to 10,670,000 dth for the comparable period in 2003.

### Non-Regulated Gas Revenues

The \$12.9 million increase in Non-regulated gas revenues is primarily due to the following: (i) a \$12.4 million increase due to bundled off-system sales revenues partially offset by a decrease in capacity release revenues, and (ii) a \$5.0 million increase due to off-system sales associated with a storage optimization program which began in November of 2003. The revenue increases were partially offset by a decrease of \$4.3 million due to lower market prices in 2004 than in 2003.

#### Operating Expenses

##### Fuel and Purchased Energy

Fuel and purchased energy decreased by \$11.7 million to \$158.2 million for the three months ended March 31, 2004, from \$169.9 million for the three months ended March 31, 2003. The decrease was primarily due to an \$11.7 million decrease in power purchased for the DMEC contract which expired at year-end 2003.

##### Gas Purchased

Gas purchased increased by \$21.0 million to \$73.3 million for the three months ended March 31, 2004, from \$52.3 million for the three months ended March 31, 2003. Overall, the increase was due to (i) higher regulated fuel costs; (ii) cost related to increased non-regulated off-system sales, and (iii) cost associated with the implementation of a storage optimization program, which began in November of 2003. The cost increases were partially offset by lower prices in 2004 vs. 2003.

##### Other Income (Expenses)

Other expenses decreased by \$.2 million to a net expense of \$7.9 million for the three months ended March 31, 2004, from a net expense of \$8.1 million for the three months ended March 31, 2003. The decrease was primarily due to a \$.9 million decrease in interest charges attributed to the reduction in long term debt from prior year, which was partially offset by a \$.7 million increase in money pool interest expense.

##### Income Tax Expense

DPL's effective tax rate for the first quarter of 2004 and 2003 was 41% and 40%, respectively, as compared to the federal statutory rate of 35%. In both quarters, the major reason for this difference is state income taxes (net of federal benefit).

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND

**RESULTS OF OPERATIONS**

ATLANTIC CITY ELECTRIC COMPANY

OVERVIEW

Atlantic City Electric Company (ACE) is engaged in the generation, transmission and distribution of electricity in southern New Jersey. ACE's service territory covers approximately 2,700 square miles and has a population of approximately 995,000. ACE is a wholly owned subsidiary of Conectiv. On August 1, 2002 Pepco completed its acquisition of Conectiv, at which time Pepco and Conectiv became wholly owned subsidiaries of Pepco Holdings, Inc. (Pepco Holdings or PHI). PHI is a public utility holding company registered under the Public Utility Holding Company Act of 1935 (PUHCA) and is subject to the regulatory oversight of the Securities and Exchange Commission (SEC) under PUHCA.

For additional information, refer to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of ACE's 2003 Form 10-K/A.

## RESULTS OF OPERATIONS

The Results of Operations discussion section below is presented only for the three months ended March 31, 2004 and 2003, in accordance with General Instruction H(2)(a). Other than the disclosures below, information under this item has been omitted in accordance with General Instruction H to the Form 10-Q.

### Operating Revenues

#### Electric Revenues

|                                 | Three Months Ended<br><u>March 31,</u> |                |               |
|---------------------------------|--|----------------|---------------|
|                                 | <u>2004</u>                            |                | <u>Change</u> |
|                                 | <u>2003</u>                            |                |               |
| (Dollars in Millions)           |  |                |               |
| Regulated electric revenues     | \$320.0                                | \$295.5        | \$24.5        |
| Non-regulated electric revenues | <u>2.4</u>                             | <u>5.7</u>     | (3.3)         |
| Total electric revenues         | <u>\$322.4</u>                         | <u>\$301.2</u> |               |

The table above shows the amounts of electric revenues earned that are subject to price regulation (regulated) and that are not subject to price regulation (non-regulated). Regulated electric revenues include revenues for delivery (transmission and distribution) service and electricity supply service within the service areas of ACE.

#### Regulated Electric Revenues

The \$24.5 million increase in Regulated electric revenues was due to the following: (i) a \$7.9 million increase from residential and small commercial business growth; (ii) a \$13.2 million increase from higher retail rates across all classes effective August 1, 2003; (iii) a \$15.5 million increase in PJM Interconnection sales revenues, (iv) a \$9.2 million decrease from more

customers choosing alternate suppliers; (v) a \$3.8 million retail revenue decrease from lower retail sales due to warmer winter weather, and (vi) a \$0.9 million increase from other variances. Customers who have chosen alternate suppliers accounted for 18% of billed sales for the 2004 period compared to 10% for the corresponding 2003 period. Delivered sales for the three months ended March 31, 2004 were 2,370,000 MWh as compared to 2,334,000 MWh for the comparable period in 2003.

Sales, resulting primarily from the sale of electricity to the Pennsylvania-New Jersey-Maryland (PJM) Interconnection (an electric power pool), increased due to the New Jersey BPU mandate that each New Jersey utility participate in an auction to allow third-party energy suppliers to provide Basic Generation Service (BGS) to the customers in its territory. As of December 31, 2003, 100% of the ACE customer BGS MWh load was being supplied by other suppliers through the auction process, so now all ACE generation is sold to PJM markets as per the NJBPU mandated order.

#### Non-Regulated Electric Revenues

The \$3.3 million decrease in non-regulated electric revenues was primarily due to a \$3.2 million fuel oil sale in the first quarter of 2003.

#### Operating Expenses

##### Fuel and Purchased Energy

Fuel and purchased energy increased by \$5.8 million to \$193.4 million for the three months ended March 31, 2004, from \$187.6 million for the three months ended March 31, 2003. The increase is primarily due to the annual adjustment in the NJBPU approved rates paid to the providers of Basic Generation Service.

##### Depreciation and Amortization

Depreciation and amortization expenses increased by \$5.2 million to \$33.9 million for the three months ended March 31, 2004, from \$28.7 million for the three months ended March 31, 2003 primarily due to a \$3.5 million increase for amortization of bondable transition property as result of additional transition bonds issued in December 2003 and due to a \$1.7 million increase for amortization of a regulatory tax asset related to New Jersey stranded costs.

##### Other Taxes

Other taxes decreased by \$2.5 million to \$4.0 million for the three months ended March 31, 2004, from \$6.5 million for the three months ended March 31, 2003. The decrease was mainly due to a tax expense true-up in March, 2004 for the Transitional Energy Facility Assessment, which is based on kilowatt-hour sales.

##### Deferred Electric Service Costs

This item represents a \$15 million over-recovery of the cost incurred in providing Basic Generation Service.

ACE's rates were reset as of August 1, 2003 so that there will be no under-recovery of costs embedded in the rates on or after that date. The balance for ACE's deferred electric service costs was \$170.6 million as of March 31, 2004. On July 31, 2003, the

NJBPU issued its Summary Order permitting ACE to begin collecting a portion of the deferred costs that were incurred as a result of the New Jersey Electric

Discount and Energy Competition Act (EDECA) and to reset rates to recover on-going costs incurred as a result of EDECA.

#### Other Income (Expenses)

Other expenses increased by \$1.5 million to a net expense of \$12.5 million for the three months ended March 31, 2004, from a net expense of \$11.0 million for the three months ended March 31, 2003. This increase is primarily due to (i) \$1.4 million decrease in interest income accrued on the balance for ACE's deferred electric service costs due to a lower interest rate used, effective August 1, 2003; (ii) \$1.9 million decrease in long-term debt interest expense due to lower outstanding long-term debt balances for ACE; (iii) \$1.5 million increase in interest expense on Transition Bonds issued by ACE Transition Funding due to additional transition bonds issued in December, 2003; (iv) \$0.2 million increase in interest expense due to the implementation of FAS 150, which required a change in designation for trust preferred securities and (v) \$0.3 million increase from other variances.

#### Income Tax Expense

ACE's effective tax rate for the first quarter of 2004 and 2003 was 42% and 38%, respectively, as compared to the federal statutory rate of 35%. For the 2004 quarter the major reason for this difference is state income taxes (net of federal benefit). The 2004 difference was also attributable to plant flow through and other book to tax differences. For the 2003 quarter the major reason for this difference is state income taxes (net of federal benefit) and other book to tax differences.

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**AND RESULTS OF OPERATIONS**

ATLANTIC CITY ELECTRIC TRANSITION FUNDING LLC

For the information required by this item refer to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of ACE Funding's 2003 Form 10-K/A.

Operating Revenues

Utility revenue increased by \$4.9 million as a result of the \$152 million of Transition Bonds issued in December 2003.

Operating Expenses

Operating expenses, comprised of amortization of Bondable Transition Property, interest expense and servicing and administrative expenses increased by \$4.9 million as a result of the \$152 million of Transition Bonds issued in December 2003.

. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

PEPCO HOLDINGS

COMMITTEE OF CHIEF RISK OFFICERS RECOMMENDED RISK MANAGEMENT DISCLOSURES

The following tables present the combined risk management disclosures of Conectiv Energy and Pepco Energy Services for the quarter ended March 31, 2004. Forward-looking data represents 100% of the combined positions of Conectiv Energy and Pepco Energy Services. The tables typically identify three business categories for the competitive energy segment defined as follows:

Proprietary trading

- Standardized contracts entered into to take a view of market direction, capture market price changes, and/or put capital at risk. These activities are generally accounted for on a mark-to-market basis under SFAS No. 133. Conectiv Energy's proprietary trading activities were discontinued in March 2003; however, the market exposure under certain contracts associated with proprietary trading was not eliminated due to the illiquid market environment available to execute such elimination. These illiquid contracts will remain in place until they are terminated and their values are realized. Contracts where the market exposure has been eliminated will remain on Pepco Holdings' balance sheet until their maturity through the year 2005.

Other energy commodity

- Contracts associated with energy assets, retail energy marketing activities and the arbitrage activities related to interpool and intrapool short-term transactions of a 24-hour power desk. Purchases and sales supporting the hedging of such activities including the POLR services supported by Conectiv Energy.

Non-commodity energy

- Other activities for the competitive energy segment provided for reconciliation to segment reporting (includes thermal, power plant operating services, energy-efficiency and other services business).

Table 1

This table identifies the components of gross margin by type of activity (proprietary trading, other energy commodity, and non-commodity energy). Further delineation of gross margin by type of accounting treatment is also presented (mark-to market vs. accrual accounting treatment).

Statement of Competitive Energy Gross Margin  
For the Three Months Ended March 31, 2004  
(Dollars in Millions)

|  | Proprietary<br>Trading<br>(1) | Other<br>Energy<br>Commodity<br>(2) | Non-Commodity<br>Energy (3) | <u>Total</u> |
|--|-------------------------------|-------------------------------------|-----------------------------|--------------|
| <u>Mark to Market Activities</u>                             |                               |                                     |                             |              |
| Unrealized Marked-to-market (MTM)<br>Gain (Loss)             |                               |                                     |                             |              |
| Unrealized gain (loss) at inception                          | \$ -                          | \$ -                                | \$ -                        | \$ -         |
| Changes in unrealized fair value prior<br>to settlements     | (0.2)                         | 3.1                                 | -                           | 2.9          |
| Changes in valuation techniques and<br>assumptions           | -                             | -                                   | -                           | -            |
|  | <u>(2.3)</u>                  | <u>(3.9)</u>                        | <u>-</u>                    | <u>(6.2)</u> |
| Reclassification to realized at<br>settlement of contracts   | )                             | )                                   | )                           |              |
| Total changes in unrealized fair value                       | (2.5)                         | (0.8)                               | -                           | (3.3)        |
|  | <u>2.3</u>                    | <u>3.9</u>                          | <u>-</u>                    | <u>6.2</u>   |
| Realized Net Settlement of Transactions<br>Subject to MTM    |                               |                                     |                             |              |
| Total (Loss) Gain on MTM activities                          | (0.2)                         | 3.1                                 | -                           | 2.9          |
|  | <u>-</u>                      | <u>(1.9)</u>                        | <u>-</u>                    | <u>(1.9)</u> |
| Transaction-related expenses associated<br>with MTM activity | )                             | )                                   | )                           |              |
|  | <u>(0.2)</u>                  | <u>1.2</u>                          | <u>-</u>                    | <u>1.0</u>   |
| Total MTM activities gross margin                            | )                             |                                     |                             |              |
| <u>Accrual Activities</u>                                    |                               |                                     |                             |              |

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|   |                 |                |                |                |
|---|-----------------|----------------|----------------|----------------|
| Accrual activities revenues                                     | N/A             | 847.8          | 44.5           | 892.3          |
| Hedge losses reclassified from Other Comprehensive Income (OCI) | N/A             | 6.1            | -              | 6.1            |
|   | <u>N/A</u>      | <u>(2.8)</u>   | <u>-</u>       | <u>(2.8)</u>   |
| Cash flow hedge ineffectiveness recorded in income statement    | )               | )              |                |                |
|   | <u>N/A</u>      | <u>851.1</u>   | <u>44.5</u>    | <u>895.6</u>   |
| Total revenue-accrual activities revenues                       |                 |                |                |                |
| Fuel and Purchased Power  | N/A             | (787.2)        | (2.0)          | (789.2)        |
| Hedges of fuel and purchased power reclassified from OCI        | N/A             | (3.2)          | -              | (3.2)          |
| Cash flow hedge ineffectiveness recorded in income statement    | N/A             | (1.7)          | -              | (1.7)          |
|   | <u>N/A</u>      | <u>-</u>       | <u>(29.0)</u>  | <u>(29.0)</u>  |
| Other transaction-related expenses                              | )               | )              |                |                |
|   | <u>N/A</u>      | <u>59.0</u>    | <u>13.5</u>    | <u>72.5</u>    |
| Total accrual activities gross margin                           |                 |                |                |                |
|   | <u>\$ (0.2)</u> | <u>\$ 60.2</u> | <u>\$ 13.5</u> | <u>\$ 73.5</u> |
| Total Gross Margin  | )               |                |                |                |

Notes

:

- (1) Includes all contracts held for trading. Contracts that are marked-to-market through earnings under SFAS No. 133 have been reclassified to "Other Energy Commodity" if their purpose was not speculative. Proprietary trading was discontinued in March 2003; however, the market exposure under certain contracts associated with proprietary trading was not eliminated due to the illiquid market environment available to execute such elimination. These illiquid contracts will remain in place until they are terminated and their values are realized.
- (2) Includes Generation line of business (LOB), POLR services, origination business, and miscellaneous wholesale and retail commodity sales. As of the second quarter of 2003, this category also includes the arbitrage activities of the 24-Hour Power Desk and any other activities marked-to-market through the Income Statement under SFAS No. 133 that are not proprietary trading but are deemed to be ineffective hedges.

- (3) Includes Conectiv Thermal Systems, Inc. (Conectiv Thermal), Conectiv Operating Services Company, and Pepco Energy Services' energy-efficiency and other services business.

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Table 2

This table provides detail on changes in the competitive energy segment's net asset or liability balance sheet position with respect to energy contracts from one period to the next.

Roll-forward of Mark-to-Market Energy Contract Net Assets  
For the Three Months Ended March 31, 2004  
(Dollars are Pre-Tax and in Millions)

|   | Proprietary <u>Trading</u> (1) | Other<br>Energy<br><u>Commodity</u><br>(2) | <u>Total</u>   |
|---|--------------------------------|--|----------------|
| Total Marked-to-market (MTM) Energy Contract Net Assets at December 31, 2003                            | \$ 10.8                        | \$ 59.6                                    | \$ 70.4        |
| Total change in unrealized fair value excluding reclassification to realized at settlement of contracts | (0.2)                          | 3.1  | 2.9            |
| Reclassification to realized at settlement of contracts   | (2.3)                          | (1.0)                                      | (3.3)          |
| Effective portion of changes in fair value - recorded in OCI  | -                              | 15.4                                       | 15.4           |
| Ineffective portion of charges in fair value - recorded in earnings                                     | -                              | (4.5)                                      | (4.5)          |
| Net option premium payments   | -                              | -  | -              |
| Purchase/sale of existing contracts or portfolios subject to MTM  | <u>-</u>                       | <u>-</u>                                   | <u>-</u>       |
|   | <u>\$ 8.3</u>                  | <u>\$72.6</u>                              | <u>\$ 80.9</u> |

Total MTM Energy Contract Net Assets at  
March 31, 2004 (a)

| (a)  | <u>Total</u>   |
|--|----------------|
| Detail of MTM Energy Contract Net Assets at March 31, 2004 (above) |                |
| Current Assets   | \$153.6        |
|  | <u>65.3</u>    |
| Non-current Assets   |                |
|  | <u>218.9</u>   |
| Total MTM Energy Assets  |                |
| Current Liabilities  | (88.5)         |
|  | <u>(49.5)</u>  |
| Non-current Liabilities  | )              |
|  | <u>(138.0)</u> |
| Total MTM Energy Contract Liabilities                              | )              |
|  | <u>\$ 80.9</u> |
| Total MTM Energy Contract Net Assets                               |                |

Notes:

- (1) Includes all contracts held for trading. Proprietary trading was discontinued in March 2003; however, the market exposure under certain contracts associated with proprietary trading was not eliminated due to the illiquid market environment available to execute such elimination. These illiquid contracts will remain in place until they are terminated and their values are realized. Contracts where the market exposure has been eliminated will remain on Pepco Holdings' balance sheet until their maturity through 2005.
- (2) Includes all SFAS No. 133 hedge activity and non-trading activities marked-to-market through the Income Statement under SFAS No. 133. As of the second quarter of 2003, this category also includes the activities of the 24-Hour Power Desk.

Table 3

This table provides the source used to determine the carrying amount of the competitive energy segment's total mark-to-market asset or liability (exchange-traded, provided by other external sources, or modeled internally) and is further delineated by maturities.

Maturity and Source of Fair Value of Mark-to-Market  
Energy Contract Net Assets  
As of March 31, 2004  
(Dollars are Pre-Tax and in Millions)

| <u>Fair Value of Contracts at March 31, 2004</u>        |               |               |                   |                        |                         |
|---|---------------|---------------|-------------------|------------------------|-------------------------|
|   |               |               | <u>Maturities</u> |                        |                         |
| <u>Source of Fair Value</u>                             | <u>2004</u>   | <u>2005</u>   | <u>2006</u>       | <u>2007 and Beyond</u> | <u>Total Fair Value</u> |
| <u>Proprietary Trading</u>                              |               |               |                   |                        |                         |
| (1)   |               |               |                   |                        |                         |
| Actively Quoted ( <u>i.e.</u> , exchange-traded) prices | \$ 5.8        | \$ 0.8        | \$ -              | \$ -                   | \$ 6.6                  |
| Prices provided by other external sources (2)           | 1.7           | -             | -                 | -                      | 1.7                     |
|   | <u>—</u>      | <u>—</u>      | <u>—</u>          | <u>—</u>               | <u>—</u>                |
| Modeled   |               |               |                   |                        |                         |
|   | <u>\$ 7.5</u> | <u>\$ 0.8</u> | <u>\$ -</u>       | <u>\$ -</u>            | <u>\$ 8.3</u>           |
| Total   |               |               |                   |                        |                         |
| <u>Other Unregulated</u>                                |               |               |                   |                        |                         |
| (3)   |               |               |                   |                        |                         |
| Actively Quoted ( <u>i.e.</u> , exchange-traded) prices | \$41.6        | \$24.6        | \$ 0.2            | -                      | \$66.4                  |
| Prices provided by other external sources (2)           | (18.8)        | (33.3)        | (14.3)            | 0.1                    | (66.3)                  |
| Modeled (4)   | <u>25.0</u>   | <u>31.9</u>   | <u>15.6</u>       | <u>—</u>               | <u>72.5</u>             |

\$47.8      \$23.2      \$ 1.5      \$0.1      \$72.6

Total

- (1) Includes all contracts held for trading. Proprietary trading was discontinued in March 2003; however, contracts where the market exposure has been eliminated will remain on Pepco Holdings' balance sheet until their maturity through the year 2005.
- (2) Prices provided by other external sources reflect information obtained from over-the-counter brokers, industry services, or multiple-party on-line platforms. Proprietary trading was discontinued in March 2003; however, the market exposure under certain contracts associated with proprietary trading was not eliminated due to the illiquid market environment available to execute such elimination. These illiquid contracts will remain in place until they are terminated and their values are realized.
- (3) Includes all SFAS No. 133 hedge activity and non-trading activities marked-to-market through AOCI or on the Income Statement as required. As of the second quarter of 2003, this category also includes the activities of the 24-Hour Power Desk.
- (4) The modeled hedge position is a power swap for 50% of Conectiv Energy's POLR obligation in the DPL territory. The model is used to approximate the forward load quantities. Pricing is derived from the broker market.

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Table 4

This table presents details of merchant energy cash flows from gross margin, adjusted for cash provided or used by option premiums. This is not intended to present a statement of cash flows in accordance with Generally Accepted Accounting Principles.

Selected Competitive Energy Gross Margin Information  
For the Three Months Ended March 31, 2004  
(Dollars in Millions)

| <u>Proprietary</u> | <u>Other Energy</u>  | <u>Non-</u>       |              |
|--------------------|----------------------|-------------------|--------------|
| <u>Trading (1)</u> | <u>Commodity (2)</u> | <u>Commodity</u>  |              |
|                    |                      | <u>Energy (3)</u> | <u>Total</u> |

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|   |               |               |               |            |
|---|---------------|---------------|---------------|------------|
| Total Gross Margin (4)  | \$(0.2)       | \$60.2        | \$13.5        | \$73.5     |
| Less: Total Change in Unrealized Fair Value                           | <u>2.5</u>    | <u>0.8</u>    | <u>-</u>      | <u>3.3</u> |
| Gross Margin Adjusted for Unrealized Marked-to-market (MTM) Gain/Loss | <u>\$ 2.3</u> | <u>\$61.0</u> | <u>\$13.5</u> | \$76.8     |
| Add/Deduct Non-cash Realized Amortization                             |               |               |               | <u>0.6</u> |
| Cash Component of Gross Margin (Accrual Basis)                        |               |               |               | \$77.4     |
| Net Change in Cash Collateral   |               |               |               | \$ 1.5     |

- (1) Includes all contracts held for trading. Proprietary trading was discontinued in March 2003; however, the market exposure under certain contracts associated with proprietary trading was not eliminated due to the illiquid market environment available to execute such elimination. These illiquid contracts will remain in place until they are terminated and their values are realized. Contracts that are marked-to-market through earnings under SFAS No. 133 are included in "Other Energy Commodity" if their purpose was not speculative.
- (2) Includes Generation LOB, POLR services, origination business, and miscellaneous wholesale and retail commodity sales. As of the second quarter of 2003, this category also includes the arbitrage activities of the 24-Hour Power Desk and any other activities marked-to-market through the Income Statement under SFAS No. 133 that are not proprietary trading.
- (3) Includes Conectiv Thermal, Conectiv Operating Services Company, and Pepco Energy Services' energy-efficiency and other services business.
- (4) The gross margin on this line ties to the "Total Gross Margin" on Table 1.

Table 5

This table provides detail on effective cash flow hedges under SFAS No. 133 included in the balance sheet. The data in the table indicates the magnitude of the SFAS No. 133 hedges the competitive energy segment has in place and the changes in fair value associated with the hedges. The effective cash flow hedges presented in this table are further delineated by hedge type (commodity, interest rate, and currency), maximum term, and portion expected to be reclassified to earnings during the next 12 months.

Cash Flow Hedges Included in Accumulated Other Comprehensive Loss  
As of March 31, 2004  
(Dollars in Millions)

| <u>Contracts</u>                 | Accumulated Other<br>Comprehensive<br>Income (OCI)<br><u>(Loss) After Tax</u> | Portion Expected<br>to be Reclassified<br>to Earnings during<br>the Next<br><u>12 Months</u> | <u>Maximum<br/>Term</u> |
|----------------------------------|---|--|-------------------------|
| Merchant Energy<br>(Non-Trading) | \$ 39.8   | \$ 32.0  | 57 months               |
| Interest Rate                    | (68.1)  | (5.7)  | 25 months               |
| Foreign Currency                 | -   | -  |                         |
| Other                            | <u>—</u>  | <u>—</u>   |                         |
| Total                            | <u>\$(28.3)</u>   | <u>\$ 26.3</u>   |                         |

)

Total Other Comprehensive Loss Activity  
For the Three Months Ended March 31, 2004  
(After-Tax)

|                                    | Merchant<br>Hedge<br><u>Contracts</u> | Non-Merchant<br><u>Hedges</u> | <u>Total</u> |
|------------------------------------|---------------------------------------|-------------------------------|--------------|
| Accumulated OCI, December 31, 2003 | \$ 20.2                               | \$(56.9)                      | \$(36.7)     |
| Changes in fair value              | 14.6                                  | (4.7)                         | 9.9          |
| Reclasses from OCI to net income   | <u>(3.3)</u>                          | <u>1.8</u>                    | <u>(1.5)</u> |

)

)

|  |                |                 |                 |
|--|----------------|-----------------|-----------------|
| Accumulated OCI derivative loss,<br>March 31, 2004 | <u>\$ 31.5</u> | <u>\$(59.8)</u> | <u>\$(28.3)</u> |
|  | )              | )               |                 |

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Table 6

This table provides information on the competitive energy segment's credit exposure, net of collateral, to wholesale counterparties.

Schedule of Credit Risk Exposure on Competitive Wholesale Energy Contracts  
(Dollars in Millions)

March 31, 2004

| Rating (1)                               | Exposure<br>Before<br>Credit<br>Collateral<br>(2) | Credit<br>Collateral<br>(3) | Net<br>Exposure | Number of<br>Counterparties<br>Greater Than<br>10% * | Net Exposure<br>of<br>Counterparties<br>Greater Than<br>10% |
|--|---|-----------------------------|-----------------|--|---|
| Investment Grade                         | \$293.3   | \$ 9.4                      | \$283.9         | 4  | \$180.8   |
| Non-Investment Grade                     | 22.6  | 13.0                        | 9.6             | -  | -   |
| Split rating                             | -   | -                           | -               | -  | -   |
| No External Ratings                      | -   | -                           | -               | -  | -   |
| Internal Rated - Investment<br>Grade     | 25.1  | 1.1                         | 24.0            | -  | -   |
| Internal Rated -<br>Non-Investment Grade | <u>19.2</u>                                       | <u>-</u>                    | <u>19.2</u>     | <u>-</u>   | <u>-</u>  |

|                 |         |        |         |   |         |
|-----------------|---------|--------|---------|---|---------|
| Total           | \$360.2 | \$23.5 | \$336.7 | 4 | \$180.8 |
| Credit reserves |         |        | \$ 7.3  |   |         |

- (1) Investment Grade - primarily determined using publicly available credit ratings of the counterparty. If the counterparty has provided a guarantee by a higher-rated entity (e.g., its parent), it is determined based upon the rating of its guarantor. Included in "Investment Grade" are counterparties with a minimum Standard & Poor's or Moody's rating of BBB- or Baa3, respectively. If it has a split rating (i.e., rating not uniform between major rating agencies), it is presented separately.
- (2) Exposure before credit collateral - includes the MTM energy contract net assets for open/unrealized transactions, the net receivable/payable for realized transactions and net open positions for contracts not subject to MTM. Amounts due from counterparties are offset by liabilities payable to those counterparties to the extent that legally enforceable netting arrangements are in place. Thus, this column presents the net credit exposure to counterparties after reflecting all allowable netting, but before considering collateral held.
- (3) Credit collateral - the face amount of cash deposits, letters of credit and performance bonds received from counterparties, not adjusted for probability of default, and if applicable property interests (including oil and gas reserves).

\* Using a percentage of the total exposure

Note: Pepco Holdings attempts to minimize credit risk exposure from its competitive wholesale energy counterparties through, among other things, formal credit policies, regular assessments of counterparty creditworthiness that result in the establishment of an internal credit quality score with a corresponding credit limit, monitoring procedures that include stress testing, the use of standard agreements which allow for the netting of positive and negative exposures associated with a single counterparty and collateral requirements under certain circumstances, and has established reserves for credit losses.

Table 7

This table provides point-in-time information on the amount of estimated production and fuel requirements hedged for the competitive energy segment's merchant generation facilities (based on economic availability projections).

Merchant Plant Owned Assets Hedging Information  
Estimated Three Calendar Years

|   | <u>2004</u> | <u>2005</u> | <u>2006</u> |
|---|-------------|-------------|-------------|
| Estimated Plant Output Hedged (1)           | 100%        | 100%        | 93%         |
| Estimated Plant Gas Requirements Hedges (2) | 107%        | 108%        | 23%         |

Pepco Holdings' portfolio of electric generating plants includes "mid-merit" assets and peaking assets. Mid-merit electric generating plants are typically combined cycle units that can quickly change their megawatt output level on an economic basis. These plants are generally operated during times when demand for electricity rises and power prices are higher. The above information represents a hedge position for a single point in time and does not reflect the ongoing transactions executed to carry a balanced position. Pepco Holdings dynamically hedges both the estimated plant output and fuel requirements as the projected levels of output and fuel needs change.

The percentages above are based on modeled volumetric requirements using data available at March 31, 2004.

Hedged output is for on-peak periods only.

- (1) While on-peak generation is 100% economically hedged, Pepco Holdings has POLR load requirements that are forecasted to exceed, on average, the dispatch level of generation in the fleet. In total, Pepco Holdings has installed capacity that exceeds the level of POLR. The peaking units are generally not used to meet POLR load requirements.
- (2) Natural gas is the primary fuel for the majority of the mid-merit fleet. Fuel oil is the primary fuel for the majority of the peaking units.

Table 8

Value at Risk Associated with Energy Contracts  
For the Three Months Ended March 31, 2004  
(Dollars in Millions)

Pepco Holdings uses a value-at-risk (VaR) model to assess the market risk of its electricity, gas, coal, and petroleum product commodity activities. The model includes physical forward contracts used for hedging and trading, and commodity derivative instruments. VaR represents a confidence interval of the probability of experiencing a mark-to-market loss of no more than the indicated amount on instruments or portfolios due to changes in market factors, for a specified time period. Pepco Holdings estimates VaR across its power, gas, coal, and petroleum products commodity business using a delta-gamma variance/covariance model with a 95 percent, one-tailed confidence level and assuming a one-day holding period. Since VaR is an estimate, it is not necessarily indicative of actual results that may occur.

This table provides the VaR for all proprietary trading positions of the competitive energy segment. VaR represents the potential gain or loss on energy contracts and/or portfolios due to changes in market prices, for a specified time period and confidence level.

| Proprietary Trading<br><u>VaR (1)</u> | VaR for Energy<br>Derivative<br><u>Contracts (2)</u> |
|---------------------------------------|--|
|---------------------------------------|--|

95% confidence level, one-day holding  
period, one-tailed (3)

|                        |       |        |
|------------------------|-------|--------|
| Period end             | \$ -  | \$ 7.5 |
| Average for the period | \$ -  | \$ 8.3 |
| High                   | \$ .1 | \$10.1 |
| Low                    | \$ -  | \$ 2.9 |

Notes:

- (1) Includes all derivative contracts held for trading and marked-to-market under SFAS No. 133. Proprietary trading was discontinued in March 2003; however, the market exposure under certain contracts associated with proprietary trading was not eliminated due to the illiquid market environment available to execute such elimination. These illiquid contracts will remain in place until they are terminated and their values are realized.
- (2) Includes all derivative contracts under SFAS No. 133, including trading positions and cash flow hedges.
- (3) As VaR calculations are shown in a standard delta or delta/gamma closed form 95% 1-day holding period 1-tail normal distribution form, traditional statistical and financial methods can be employed to reconcile prior 10-K and 10-Q VaRs to the above approach. In this case, 5-day VaRs divided by the square root of 5 equal 1-day VaRs; and 99% 1-tail VaRs divided by 2.326 times 1.645 equal 95% 1-tail VaRs. Note that these methods of conversion are not valid for converting from 5-day or less holding periods to over 1-month holding periods and should not be applied to "non-standard closed form" VaR calculations in any case.

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Pepco Holdings

For additional information concerning market risk, please refer to Item 7A, Quantitative and Qualitative Disclosure About Market Risk in Pepco Holdings' Form 10-K/A for the year ended December 31, 2003.

Pepco

For information concerning market risk, please refer to Item 7A, Quantitative and Qualitative Disclosure About Market Risk in Pepco's Form 10-K/A for the year ended December 31, 2003.

INFORMATION FOR THIS ITEM IS NOT REQUIRED FOR DPL, ACE, AND ACE FUNDING AS THEY MEET THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION H(1)(a) AND (b) OF FORM 10-Q AND THEREFORE ARE FILING THIS FORM WITH A REDUCED FILING FORMAT.

Item 4

. CONTROLS AND PROCEDURES

Pepco Holdings, Inc.

Disclosure controls and procedures are PHI's controls and other procedures that are designed to ensure that information required to be disclosed by PHI in the reports that it files with or submits to the Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized, and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls, and procedures designed to ensure that information required to be disclosed by PHI in the reports that it files or submits under the Exchange Act is accumulated and communicated to management, including the chief executive officer and the chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision, and with the participation of management, including the chief executive officer and the chief financial officer, PHI has evaluated the effectiveness of the design and operation of its disclosure controls and procedures as of March 31, 2004, and, based upon this evaluation, the chief executive officer and the chief financial officer have concluded that these controls and procedures are effective to provide reasonable assurance that material information relating to Pepco Holdings and its subsidiaries that is required to be disclosed in reports filed with, or submitted to, the SEC under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified by the SEC rules and forms and (ii) is accumulated and communicated to management, including its chief executive officer and chief accounting officer, as appropriate to allow timely decisions regarding required disclosure.

During the three months ended March 31, 2004, there was no change in PHI's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, PHI's internal controls over financial reporting.

Potomac Electric Power Company

Disclosure controls and procedures are Pepco's controls and other procedures that are designed to ensure that information required to be disclosed by Pepco in the reports that it files with or submits to the SEC under the Exchange Act is recorded, processed, summarized, and reported,

within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls, and procedures designed to ensure that information required to be disclosed by Pepco in the reports that it files or submits under the Exchange Act is accumulated and communicated to management, including the chief executive officer and the chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision, and with the participation of management, including the chief executive officer and the chief financial officer, Pepco has evaluated the effectiveness of the design and operation of its disclosure controls and procedures as of March 31, 2004, and, based upon this evaluation, the chief executive officer and the chief financial officer have concluded that these controls and procedures are effective to provide reasonable assurance that material information relating to Pepco and its subsidiaries that is required to be disclosed in reports filed with, or submitted to, the SEC under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified by the SEC rules and forms and (ii) is accumulated and communicated to management, including its chief executive officer and chief accounting officer, as appropriate to allow timely decisions regarding required disclosure.

During the three months ended March 31, 2004, there was no change in Pepco's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, Pepco's internal controls over financial reporting.

#### Delmarva Power & Light Company

Disclosure controls and procedures are DPL's controls and other procedures that are designed to ensure that information required to be disclosed by DPL in the reports that it files with or submits to the SEC under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls, and procedures designed to ensure that information required to be disclosed by DPL in the reports that it files or submits under the Exchange Act is accumulated and communicated to management, including the chief executive officer and the chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision, and with the participation of management, including the chief executive officer and the chief financial officer, DPL has evaluated the effectiveness of the design and operation of its disclosure controls and procedures as of March 31, 2004, and, based upon this evaluation, the chief executive officer and the chief financial officer have concluded that these controls and procedures are effective to provide reasonable assurance that material information relating to DPL and its subsidiaries that is required to be disclosed in reports filed with, or submitted to, the SEC under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified by the SEC rules and forms and (ii) is accumulated and communicated to management, including its chief executive officer and chief accounting officer, as appropriate to allow timely decisions regarding required disclosure.

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During the three months ended March 31, 2004, there was no change in DPL's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, DPL's internal controls over financial reporting.

Atlantic City Electric Company

Disclosure controls and procedures are ACE's controls and other procedures that are designed to ensure that information required to be disclosed by ACE in the reports that it files with or submits to the SEC under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls, and procedures designed to ensure that information required to be disclosed by ACE in the reports that it files or submits under the Exchange Act is accumulated and communicated to management, including the chief executive officer and the chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision, and with the participation of management, including the chief executive officer and the chief financial officer, ACE has evaluated the effectiveness of the design and operation of its disclosure controls and procedures as of March 31, 2004, and, based upon this evaluation, the chief executive officer and the chief financial officer have concluded that these controls and procedures are effective to provide reasonable assurance that material information relating to ACE and its subsidiaries that is required to be disclosed in reports filed with, or submitted to, the SEC under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified by the SEC rules and forms and (ii) is accumulated and communicated to management, including its chief executive officer and chief accounting officer, as appropriate to allow timely decisions regarding required disclosure.

During the three months ended March 31, 2004, there was no change in ACE's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, ACE's internal controls over financial reporting.

Atlantic City Electric Transition Funding LLC

ACE Funding is an "asset backed issuer" (as defined by Rule 15d-14(g) under the Exchange Act) and, accordingly, the disclosures required by this Item relate to matters that, as provided in Rule 15d-15 under the Exchange Act, do not apply to ACE Funding.

Part II OTHER INFORMATION

Item 1

. LEGAL PROCEEDINGS

Pepco Holdings

Mirant Bankruptcy

On July 14, 2003, Mirant and most of its subsidiaries filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code. For additional information refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Relationship with Mirant Corporation."

For further information concerning litigation matters, please refer to Item 3, Legal Proceedings, of Pepco Holdings' Form 10-K/A for the year ended December 31, 2003.

Pepco

Mirant Bankruptcy

On July 14, 2003, Mirant and most of its subsidiaries filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code. For additional information refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Relationship with Mirant Corporation."

For further information concerning litigation matters, please refer to Item 3, Legal Proceedings, of Pepco's Form 10-K/A for the year ended December 31, 2003.

Delmarva Power & Light Company

For information concerning litigation matters, please refer to Item 3, Legal Proceedings, of DPL's Form 10-K/A for the year ended December 31, 2003.

Atlantic City Electric Company

For information concerning litigation matters, please refer to Item 3, Legal Proceedings, of ACE's Form 10-K/A for the year ended December 31, 2003.

Atlantic City Electric Transition Funding LLC

None.

Item 2

. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES  
OF EQUITY SECURITIES

Pepco Holdings

None.

Pepco

None.

INFORMATION FOR THIS ITEM IS NOT REQUIRED FOR DPL, ACE, AND ACE FUNDING AS THEY MEET THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION H(1)(a) AND (b) OF FORM 10-Q AND THEREFORE ARE FILING THIS FORM WITH A REDUCED FILING FORMAT.

Item 3

. DEFAULTS UPON SENIOR SECURITIES

Pepco Holdings

None.

Pepco

None.

INFORMATION FOR THIS ITEM IS NOT REQUIRED FOR DPL, ACE, AND ACE FUNDING AS THEY MEET THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION H(1)(a) AND (b) OF FORM 10-Q AND THEREFORE ARE FILING THIS FORM WITH A REDUCED FILING FORMAT.

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Item 4

. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Pepco Holdings

None.

Pepco

None.

INFORMATION FOR THIS ITEM IS NOT REQUIRED FOR DPL, ACE, AND ACE FUNDING AS THEY MEET THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION H(1)(a) AND (b) OF FORM 10-Q AND THEREFORE ARE FILING THIS FORM WITH A REDUCED FILING FORMAT.

Item 5

. OTHER INFORMATION

Pepco Holdings

None.

Pepco

None.

DPL

None.

ACE

None.

ACE Funding

None.

Item 6

. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

The documents listed below are being filed or furnished on behalf of Pepco Holdings, Inc. (PHI), Potomac Electric Power Company (Pepco), Delmarva Power & Light Company (DPL), Atlantic City Electric Company (ACE) and Atlantic City Electric Transition Funding LLC (ACE Funding).

Exhibit

| <u>No.</u> | <u>Registrant(s)</u> | <u>Description of Exhibit</u> | <u>Reference</u> |
|------------|----------------------|-------------------------------|------------------|
|------------|----------------------|-------------------------------|------------------|

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|      |       |   |                 |
|------|-------|---|-----------------|
| 12.1 | PHI   | Statements Re: Computation of Ratios                            | Filed herewith. |
| 12.2 | Pepco | Statements Re: Computation of Ratios                            | Filed herewith. |
| 12.3 | DPL   | Statements Re: Computation of Ratios                            | Filed herewith. |
| 12.4 | ACE   | Statements Re: Computation of Ratios                            | Filed herewith. |
| 31.1 | PHI   | Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer | Filed herewith. |
| 31.2 | PHI   | Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer | Filed herewith. |

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|      |             |   |                     |
|------|-------------|---|---------------------|
| 31.3 | Pepco       | Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer                                       | Filed herewith.     |
| 31.4 | Pepco       | Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer                                       | Filed herewith.     |
| 31.5 | DPL         | Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer                                       | Filed herewith.     |
| 31.6 | DPL         | Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer                                       | Filed herewith.     |
| 31.7 | ACE         | Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer                                       | Filed herewith.     |
| 31.8 | ACE         | Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer                                       | Filed herewith.     |
| 31.9 | ACE Funding | Rule 13a-14(d)/15d-14(d) Certificate of Chief Executive Officer                                       | Filed herewith.     |
| 32.1 | PHI         | Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 | Furnished herewith. |
| 32.2 | Pepco       | Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 | Furnished herewith. |
| 32.3 | DPL         | Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 | Furnished herewith. |
| 32.4 | ACE         |   | Furnished herewith. |

Certificate of Chief Executive Officer and Chief  
Financial Officer pursuant to 18 U.S.C. Section 1350

|      |             |  |                     |
|------|-------------|--|---------------------|
| 32.5 | ACE Funding | Certificate of Chief Executive Officer and Chief<br>Financial Officer pursuant to 18 U.S.C. Section 1350 | Furnished herewith. |
|------|-------------|--|---------------------|

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Exhibit 12.1

Statements Re. Computation of Ratios

PEPCO HOLDINGS

|   | Three Months<br>Ended        | For the Year Ended December 31, |         |         |         |         |
|---|------------------------------|---------------------------------|---------|---------|---------|---------|
|   | March 31, 2004               | 2003                            | 2002    | 2001    | 2000    | 1999    |
|   | (Dollar Amounts in Millions) |                                 |         |         |         |         |
| Income before extraordinary item<br>(a)   | \$51.6                       | \$211.1                         | \$220.2 | \$192.3 | \$369.1 | \$256.7 |
| Income tax expense  | 11.4                         | 65.9                            | 124.1   | 83.5    | 341.2   | 114.5   |
| Fixed charges:  |                              |                                 |         |         |         |         |
| Interest on long-term debt,<br>amortization of discount,<br>premium and expense (b) | 93.1                         | 379.6                           | 224.5   | 157.2   | 221.5   | 200.5   |

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|  |  |         |         |         |         |         |
|--|--|---------|---------|---------|---------|---------|
| Other interest   | 5.0  | 21.7    | 21.0    | 23.8    | 23.6    | 23.8    |
| Preferred dividend requirements of subsidiaries                                    | .7   | 13.9    | 20.6    | 14.2    | 14.7    | 17.1    |
| Total fixed charges  | 98.8   | 415.2   | 266.1   | 195.2   | 259.8   | 241.4   |
| Non-utility capitalized interest   | -  | (10.2)  | (9.9)   | (2.7)   | (3.9)   | (1.8)   |
| Income before extraordinary item, income tax expense, and fixed charges            | \$161.8  | \$682.0 | \$600.5 | \$468.3 | \$966.2 | \$610.8 |
| Total fixed charges, shown above   | 98.8   | 415.2   | 266.1   | 195.2   | 259.8   | 241.4   |
| Increase preferred stock dividend requirements of subsidiaries to a pre-tax amount | .2   | 4.3     | 11.5    | 6.1     | 13.5    | 7.7     |
| Fixed charges for ratio computation  | \$99.0   | \$419.5 | \$277.6 | \$201.3 | \$273.3 | \$249.1 |
| Ratio of earnings to fixed charges and preferred dividends                         | 1.63   | 1.63    | 2.16    | 2.33    | 3.54    | 2.45    |
| (a)  | Excludes income and losses on equity investments.  |         |         |         |         |         |
| (b)  | Includes distributions on mandatorily redeemable preferred securities subsequent to the July 1, 2003 implementation of SFAS No. 150. |         |         |         |         |         |

Exhibit 12.2

Statements Re. Computation of Ratios

PEPCO

| Three Months Ended | For the Year Ended December 31, |      |      |      |      |
|--------------------|---------------------------------|------|------|------|------|
| March 31, 2004     | 2003                            | 2002 | 2001 | 2000 | 1999 |

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(Dollar Amounts in Millions)

|  |        |         |         |         |         |         |
|--|--------|---------|---------|---------|---------|---------|
| Net income (a)   | \$ 9.5 | \$104.6 | \$141.2 | \$192.3 | \$369.1 | \$256.7 |
| Income tax expense   | 6.2    | 69.1    | 79.9    | 83.5    | 341.2   | 114.5   |
| Fixed charges:   |        |         |         |         |         |         |
| Interest on long-term debt, amortization of discount, premium and expense (b)  | 20.2   | 79.6    | 109.5   | 157.2   | 221.5   | 200.5   |
| Other interest   | 3.5    | 16.2    | 17.3    | 23.8    | 23.6    | 23.8    |
| Preferred dividend requirements of a subsidiary trust  | -      | 4.6     | 9.2     | 9.2     | 9.2     | 9.2     |
| Total fixed charges  | 23.7   | 100.4   | 136.0   | 190.2   | 254.3   | 233.5   |
| Non-utility capitalized interest   | -      | -       | (.2)    | (2.7)   | (3.9)   | (1.8)   |
| Income before extraordinary item, income tax expense, and fixed charges  | \$39.4 | \$274.1 | \$356.9 | \$463.3 | \$960.7 | \$602.9 |
| Ratio of earnings to fixed charges   | 1.66   | 2.73    | 2.62    | 2.44    | 3.78    | 2.58    |
| Total fixed charges, shown above   | 23.7   | 100.4   | 136.0   | 190.2   | 254.3   | 233.5   |
| Preferred dividend requirements, excluding mandatorily redeemable preferred securities subsequent to SFAS No. 150 implementation, adjusted to a pre-tax amount | .7     | 5.5     | 7.8     | 7.2     | 10.6    | 11.4    |
| Total Fixed Charges and Preferred Dividends  | \$24.4 | \$105.9 | \$143.8 | \$197.4 | \$264.9 | \$244.9 |
| Ratio of earnings to fixed charges and preferred dividends   | 1.61   | 2.59    | 2.48    | 2.35    | 3.63    | 2.46    |

(a) Excludes losses on equity investments.

(b)

Includes distributions on mandatorily redeemable preferred securities subsequent to the July 1, 2003 implementation of SFAS No. 150.

Exhibit 12.3Statements Re. Computation of RatiosDELMARVA POWER & LIGHT COMPANY

|   | Three Months<br>Ended        | For the Year Ended December 31, |         |         |         |         |
|---|------------------------------|---------------------------------|---------|---------|---------|---------|
|   | March 31, 2004               | 2003                            | 2002    | 2001    | 2000    | 1999    |
|   | (Dollar Amounts in Millions) |                                 |         |         |         |         |
| Net income  | \$22.4                       | \$53.2                          | \$ 49.7 | \$200.6 | \$141.8 | \$142.2 |
| Income tax expense  | 15.7                         | 36.4                            | 33.7    | 139.9   | 81.5    | 95.3    |
| Fixed charges:  |                              |                                 |         |         |         |         |
| Interest on long-term debt,<br>amortization of discount,<br>premium and expense (a) | 9.0                          | 37.0                            | 42.6    | 68.5    | 77.1    | 77.8    |
| Other interest  | .7                           | 2.7                             | 3.6     | 3.4     | 7.5     | 6.1     |
| Preferred dividend requirements<br>of a subsidiary trust                            | -                            | 2.8                             | 5.7     | 5.7     | 5.7     | 5.7     |
| Total fixed charges   | 9.7                          | 42.5                            | 51.9    | 77.6    | 90.3    | 89.6    |
| Income before extraordinary<br>item, income tax expense, and<br>fixed charges       | \$47.8                       | \$132.1                         | \$135.3 | \$418.1 | \$313.6 | \$327.1 |
| Ratio of earnings to fixed charges  | 4.93                         | 3.11                            | 2.61    | 5.39    | 3.47    | 3.65    |

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|  |        |        |         |         |         |         |
|--|--------|--------|---------|---------|---------|---------|
| Total fixed charges, shown above   | \$ 9.7 | \$42.5 | \$ 51.9 | \$ 77.6 | \$ 90.3 | \$ 89.6 |
| Preferred dividend requirements,<br>adjusted to a pre-tax amount   | .3     | 1.7    | 2.9     | 6.3     | 7.7     | 7.4     |
| Total fixed charges and<br>preferred dividends   | \$10.0 | \$44.2 | \$ 54.8 | \$ 83.9 | \$ 98.0 | \$ 97.0 |
| Ratio of earnings to fixed charges<br>and preferred dividends  | 4.78   | 2.99   | 2.47    | 4.98    | 3.20    | 3.37    |
| (a) Includes distributions on mandatorily redeemable preferred securities subsequent to the July 1, 2003 implementation of SFAS No. 150. |        |        |         |         |         |         |

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Exhibit 12.4

Statements Re. Computation of Ratios

ATLANTIC CITY ELECTRIC COMPANY

|                                  | Three Months<br>Ended | For the Year Ended December 31, |         |         |         |         |
|----------------------------------|-----------------------|---------------------------------|---------|---------|---------|---------|
|                                  | March 31, 2004        | 2003                            | 2002    | 2001    | 2000    | 1999    |
| (Dollar Amounts in Millions)     |                       |                                 |         |         |         |         |
| Income before extraordinary item | \$ 6.8                | \$41.5                          | \$ 28.2 | \$ 75.5 | \$ 54.4 | \$ 63.9 |

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|   |  |         |         |         |         |         |
|---|--|---------|---------|---------|---------|---------|
| Income tax expense  | 4.8  | 27.3    | 16.3    | 46.7    | 36.7    | 49.3    |
| Fixed charges:  |  |         |         |         |         |         |
| Interest on long-term debt,<br>amortization of discount,<br>premium and expense (a) | 15.4   | 62.8    | 53.1    | 62.2    | 76.2    | 60.6    |
| Other interest  | .7   | 2.6     | 2.4     | 3.3     | 4.5     | 3.8     |
| Preferred dividend requirements<br>of subsidiary trusts                             | -  | 1.8     | 7.6     | 7.6     | 7.6     | 7.6     |
| Total fixed charges   | 16.1   | 67.2    | 63.1    | 73.1    | 88.3    | 72.0    |
| Income before extraordinary<br>item, income tax expense and<br>fixed charges        | \$27.7   | \$136.0 | \$107.6 | \$195.3 | \$179.4 | \$185.2 |
| Ratio of earnings to fixed charges  | 1.72   | 2.02    | 1.71    | 2.67    | 2.03    | 2.57    |
| Total fixed charges, shown above  | \$16.1   | \$ 67.2 | \$ 63.1 | \$ 73.1 | \$ 88.3 | \$ 72.0 |
| Preferred dividend requirements<br>adjusted to a pre-tax amount                     | .2   | .5      | 1.1     | 2.7     | 3.6     | 3.8     |
| Total fixed charges and<br>preferred dividends                                      | \$16.3   | \$ 67.7 | \$ 64.2 | \$ 75.8 | \$ 91.9 | \$ 75.8 |
| Ratio of earnings to fixed charges<br>and preferred dividends                       | 1.70   | 2.01    | 1.68    | 2.58    | 1.95    | 2.44    |
| (a)   | Includes distributions on mandatorily redeemable preferred securities subsequent to the July 1, 2003 implementation of SFAS No. 150. |         |         |         |         |         |

CERTIFICATION

I, Dennis R. Wraase, certify that:

1. I have reviewed this report on Form 10-Q/A of Pepco Holdings, Inc.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2005

D. R. WRAASE

Dennis R. Wraase  
Chairman of the Board, President  
and Chief Executive Officer

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Exhibit 31.2

CERTIFICATION

I, Joseph M. Rigby, certify that:

1. I have reviewed this report on Form 10-Q/A of Pepco Holdings, Inc.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely

to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2005

JOSEPH M. RIGBY  
Joseph M. Rigby  
Senior Vice President and  
Chief Financial Officer

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Exhibit 31.3

#### CERTIFICATION

I, Dennis R. Wraase, certify that:

- 1. I have reviewed this report on Form 10-Q/A of Potomac Electric Power Company.
- 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchanges Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

- a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2005

D. R. WRAASE  
Dennis R. Wraase  
Chairman of the Board and  
Chief Executive Officer

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Exhibit 31.4

#### CERTIFICATION

I, Joseph M. Rigby, certify that:

1. I have reviewed this report on Form 10-Q/A of Potomac Electric Power Company.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2005

JOSEPH M. RIGBY  
Joseph M. Rigby

Senior Vice President and  
Chief Financial Officer

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Exhibit 31.5

### CERTIFICATION

I, Thomas S. Shaw, certify that:

1. I have reviewed this report on Form 10-Q/A of Delmarva Power & Light Company.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the

audit committee of registrant's board of directors:

- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2005

T. S. SHAW

Thomas S. Shaw  
Chief Executive Officer

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Exhibit 31.6

#### CERTIFICATION

I, Joseph M. Rigby, certify that:

1. I have reviewed this report on Form 10-Q/A of Delmarva Power & Light Company.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in

which this report is being prepared;

- b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:

- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2005

JOSEPH M. RIGBY  
Joseph M. Rigby  
Senior Vice President and  
Chief Financial Officer

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Exhibit 31.7

#### CERTIFICATION

I, William J. Sim, certify that:

- 1. I have reviewed this report on Form 10-Q/A of Atlantic City Electric Company.
- 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which

such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2005

W. J. SIM  
William J. Sim  
President and Chief Executive Officer

# CERTIFICATION

I, Joseph M. Rigby, certify that:

1. I have reviewed this report on Form 10-Q/A of Atlantic City Electric Company.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b)

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2005

JOSEPH M. RIGBY  
Joseph M. Rigby  
Chief Financial Officer

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Exhibit 31.9

CERTIFICATION

I, Thomas S. Shaw, certify that:

1. I have reviewed this report on Form 10-Q/A of Atlantic City Electric Transition Funding LLC and other reports containing distribution information for the period covered by this report.
2. To the best of my knowledge, this report and the other reports I have reviewed do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading.
3. To the best of my knowledge, the financial information required to be provided to the trustee under the governing documents of the issuer is included in these reports.
4. To the best of my knowledge, Atlantic City Electric Company, the Servicer, has complied with its servicing obligations and minimum servicing standards.

T. S. SHAW

Date: March 14, 2005

Thomas S. Shaw  
Chairman

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Exhibit 32.1

Certificate of Chief Executive Officer and Chief Financial Officer

of

Pepco Holdings, Inc.

(pursuant to 18 U.S.C. Section 1350)

I, Dennis R. Wraase, and I, Joseph M. Rigby, certify that, to the best of my knowledge, (i) the Quarterly Report on Form 10-Q/A of Pepco Holdings, Inc. for the quarter ended March 31, 2004, filed with the Securities and Exchange Commission on the date hereof fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Pepco Holdings, Inc.

March 14, 2005

D. R. WRAASE

Dennis R. Wraase  
Chairman of the Board, President  
and Chief Executive Officer

March 14, 2005

JOSEPH M. RIGBY

Joseph M. Rigby  
Senior Vice President and  
Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Pepco Holdings, Inc. and will be retained by Pepco Holdings, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

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Exhibit 32.2

Certificate of Chief Executive Officer and Chief Financial Officer

of

Potomac Electric Power Company

(pursuant to 18 U.S.C. Section 1350)

I, Dennis R. Wraase, and I, Joseph M. Rigby, certify that, to the best of my knowledge, (i) the Quarterly Report on Form 10-Q/A of Potomac Electric Power Company for the quarter ended March 31, 2004, filed with the Securities and Exchange Commission on the date hereof fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Potomac Electric Power Company.

March 14, 2005

D. R. WRAASE

Dennis R. Wraase  
Chairman of the Board and  
Chief Executive Officer

March 14, 2005

JOSEPH M. RIGBY

Joseph M. Rigby  
Senior Vice President and  
Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Potomac Electric Power Company and will be retained by Potomac Electric Power Company and furnished to the Securities and Exchange Commission or its staff upon request.

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Exhibit 32.3

Certificate of Chief Executive Officer and Chief Financial Officer

of

Delmarva Power & Light Company

(pursuant to 18 U.S.C. Section 1350)

I, Thomas S. Shaw, and I, Joseph M. Rigby, certify that, to the best of my knowledge, (i) the Quarterly Report on Form 10-Q/A of Delmarva Power & Light Company for the quarter ended March 31, 2004, filed with the Securities and Exchange Commission on the date hereof fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Delmarva Power & Light Company.

March 14, 2005

T. S. SHAW

Thomas S. Shaw  
Chief Executive Officer

March 14, 2005

JOSEPH M. RIGBY

Joseph M. Rigby  
Senior Vice President and  
Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Delmarva Power & Light Company and will be retained by Delmarva Power & Light Company and furnished to the Securities and Exchange Commission or its staff upon request.

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Exhibit 32.4

Certificate of Chief Executive Officer and Chief Financial Officer

of

Atlantic City Electric Company

(pursuant to 18 U.S.C. Section 1350)

I, William J. Sim, and I, Joseph M. Rigby, certify that, to the best of my knowledge, (i) the Quarterly Report on Form 10-Q/A of Atlantic City Electric Company for the quarter ended March 31, 2004, filed with the Securities and Exchange Commission on the date hereof fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Atlantic City Electric Company.

March 14, 2005

W. J. SIM

William J. Sim  
President and  
Chief Executive Officer

March 14, 2005

JOSEPH M. RIGBY

Joseph M. Rigby  
Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Atlantic City Electric Company and will be retained by Atlantic City Electric Company and furnished to the Securities and Exchange Commission or its staff upon request.

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Exhibit 32.5

Certificate of Chief Executive Officer and Chief Financial Officer

of

Atlantic City Electric Transition Funding, LLC

(pursuant to 18 U.S.C. Section 1350)

I, Thomas S. Shaw, and I, James P. Lavin, certify that, to the best of my knowledge, the (i) Quarterly Report on Form 10-Q/A of Atlantic City Electric Transition Funding, LLC for the quarter ended March 31, 2004, filed with the Securities and Exchange Commission on the date hereof fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Atlantic City Electric Transition Funding, LLC.

March 14, 2005

T. S. SHAW

Thomas S. Shaw  
Chairman

March 14, 2005

JAMES P. LAVIN

James P. Lavin  
Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Atlantic City Electric Transition Funding, LLC and will be retained by Atlantic City Electric Transition Funding, LLC and furnished to the Securities and Exchange Commission or its staff upon request.

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(b) Reports on Form 8-K

Current Reports on Form 8-K were filed or furnished by the following registrants for the quarter ended March 31, 2004:

PEPCO HOLDINGS

A Current Report on Form 8-K was filed on January 16, 2004. The items reported on such Form 8-K were Item 5 (Other Events) and Item 7 (Financial Statements, *Pro Forma* Financial Information and Exhibits).

A Current Report on Form 8-K was filed on January 29, 2004. The items reported on such Form 8-K were Item 5 (Other Events) and Item 7 (Financial Statements, *Pro Forma* Financial Information and Exhibits).

A Current Report on Form 8-K was filed on February 26, 2004. The items reported on such Form 8-K were Item 7 (Financial Statements, *Pro Forma* Financial Information and Exhibits) and Item 12 (Results of Operation and Financial Condition).

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A Current Report on Form 8-K was filed on March 10, 2004. The items reported on such Form 8-K were Item 7 (Financial Statements, *Pro Forma* Financial Information and Exhibits) and Item 9 (Regulation FD Disclosure).

PEPCO

A Current Report on Form 8-K was filed on March 23, 2004. The items reported on such Form 8-K were Item 5 (Other Events) and Item 7 (Financial Statements, *Pro Forma* Financial Information and Exhibits).

DPL

None.

ACE

None.

ACE FUNDING

None.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, each of the registrants has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

March 14, 2005

PEPCO HOLDINGS, INC. (PHI)  
POTOMAC ELECTRIC POWER COMPANY  
(Pepco)  
DELMARVA POWER & LIGHT COMPANY  
(DPL)  
ATLANTIC CITY ELECTRIC COMPANY (ACE)  
(Registrants)

By JOSEPH M. RIGBY  
Joseph M. Rigby  
Senior Vice President and  
Chief Financial Officer,  
PHI, Pepco and DPL  
Chief Financial Officer, ACE

ATLANTIC CITY ELECTRIC TRANSITION  
FUNDING LLC  
(Registrant)

March 14, 2005

By JAMES P. LAVIN  
James P. Lavin  
Chief Financial Officer

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INDEX TO EXHIBITS FILED HEREWITH

| <u>Exhibit No.</u> | <u>Registrant(s)</u> | <u>Description of Exhibit</u>                                   |
|--------------------|----------------------|---|
| 12.1               | PHI                  | Statements Re: Computation of Ratios                            |
| 12.2               | Pepco                | Statements Re: Computation of Ratios                            |
| 12.3               | DPL                  | Statements Re: Computation of Ratios                            |
| 12.4               | ACE                  | Statements Re: Computation of Ratios                            |
| 31.1               | PHI                  | Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer |
| 31.2               | PHI                  | Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer |
| 31.3               | Pepco                | Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer |
| 31.4               | Pepco                | Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer |
| 31.5               | DPL                  | Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer |
| 31.6               | DPL                  | Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer |

|      |             |   |
|------|-------------|---|
| 31.7 | ACE         | Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer |
| 31.8 | ACE         | Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer |
| 31.9 | ACE Funding | Rule 13a-14(d)/15d-14(d) Certificate of Chief Executive Officer |

INDEX TO EXHIBITS FURNISHED HERewith

| <u>Exhibit No.</u> | <u>Registrant(s)</u> | <u>Description of Exhibit</u>   |
|--------------------|----------------------|---|
| 32.1               | PHI                  | Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 |
| 32.2               | Pepco                | Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 |
| 32.3               | DPL                  | Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 |
| 32.4               | ACE                  | Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 |
| 32.5               | ACE Funding          | Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 |