PEPCO HOLDINGS INC
Form 10-K/A
May 21, 2003

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

FORM 10-K/A

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

For the fiscal year ended December 31, 2002

Commission File Number	Name of Registrant, State of Incorporation, Address of Principal Executive Offices, and Telephone Number	I.R.S. Employer Identification Number
001-31403	PEPCO HOLDINGS, INC.	52-2297449
	("Pepco Holdings," a Delaware corporation) 701 Ninth Street, N.W. Washington, D.C. 20068 Telephone: (202)872-2000	

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

Registrant	Title of Each Class	Name of Each Exchange on Which Registered
Pepco Holdings	Common Stock, $.01 par value	New York Stock Exchange

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

None.

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

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

Indicate by check mark whether Pepco Holdings is an accelerated filer (as defined in Rule 12b-2 of the

Act). Yes _X_. No ___.

Registrant	Aggregate Market Value of Voting and Non-Voting Common Equity Held by Non-Affiliates of the Registrant at June 28, 2002	Number of Shares of Common Stock of the Registrant Outstanding at June 28, 2002
Pepco Holdings	$2.3 billion	($.01 par value)

Pepco Holdings, Inc. (the "Registrant") is hereby amending its Annual Report on Form 10-K for the year ended December 31, 2002 (the "Form 10-K") to delete from the Form 10-K certain non-GAAP financial measures presented under the caption "Additional Supplemental Pro Forma Information" in Note 2 to the Registrant's Consolidated Financial Statements.

The Form 10-K and the Consolidated Financial Statements of the Registrant included therein were prepared in accordance with and complied with the rules and regulations of the Securities and Exchange Commission (the "Commission") in effect at the time of the filing of the Form 10-K. However, the Commission recently adopted new paragraph (e) of Item 10 of Regulation S-K concerning the use of non-GAAP measures in Commission filings. This new requirement is applicable to annual and quarterly reports filed under the Securities Exchange Act of 1934, as amended, with respect to fiscal periods ending after March 28, 2003, and annual and quarterly reports for periods prior to the effective time of the new rule if they are incorporated by reference in a registration statement on Form S-3 filed after March 28, 2003.

This amendment is being made solely for purposes of conforming the information presented in Note 2 to the requirements of paragraph (e) of Item 10 of Regulation S-K in order to enable the Company to incorporate the Form 10-K in Form S-3 registration statements filed after March 28, 2003. No changes are being made to the Registrant's Consolidated Financial Statements other than the deletion of the information presented under the caption "Additional Supplemental Pro Forma Information" in Note 2.

Part II

Item 8.

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Item 8 is hereby amended to read in its entirety as follows:

Report of Independent Accountants

To the Shareholders and Board of Directors
of Pepco Holdings, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of earnings and shareholders' equity and comprehensive income, and of cash flows present fairly, in all material respects, the financial position of Pepco Holdings, Inc. and its subsidiaries at December 31, 2002 and 2001, and the results of their operations and their cash flows for the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP
Washington, DC
February 10, 2003, except as to the twelfth and thirteenth paragraphs of Note 14 for which the date is March 4, 2003

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS

For the Year Ended December 31,	2002	2001	2000
(Millions, except $ per share data)			
Operating Revenue			
Pepco	$ 1,533.5	$ 1,723.5	$ 2,220.6
Conectiv Power Delivery	996.2	-	-
Conectiv Energy	850.2	-	-
Pepco Energy Services	826.7	541.5	212.4
Other Non-Regulated	117.9	106.2	132.5
Gain on divestiture of generation assets	-	29.3	423.8
Total Operating Revenue	4,324.5	2,400.5	2,989.3
Operating Expenses			
Fuel and purchased energy	2,538.4	1,238.1	1,183.7
Other operation and maintenance	775.1	373.4	409.8
Depreciation and amortization	239.8	170.6	247.6
Other taxes	225.6	186.5	207.4
Impairment losses	-	65.5	45.7

Total Operating Expenses	3,778.9	2,034.1	2,094.2
Operating Income	545.6	366.4	895.1
Other Income (Expenses)			
Interest and dividend income	24.8	62.0	27.7
Interest expense	(213.3)	(148.7)	(211.5)
Loss from Equity Investments	(9.7)	(23.9)	(17.1)
Other income	7.8	5.3	8.2
Total Other (Expenses)	(190.4)	(105.3)	(192.7)
Preferred Stock Dividend Requirements of Subsidiaries	20.6	14.2	14.7
Income Tax Expense	124.1	83.5	341.2
Net Income	$ 210.5	$ 163.4	$ 346.5
Earnings Per Share of Common Stock			
Basic	$ 1.61	$ 1.51	$ 3.02
Diluted	$ 1.61	$ 1.50	$ 2.96

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

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31,	2002	2001	2000
(Millions of Dollars)			
Net income	$ 210.5	$ 163.4	$ 346.5
Other comprehensive (loss)/income, net of taxes			
Energy commodity derivative instruments designated as cash flow hedges			
Unrealized gain from cash flow hedges net of reclassification adjustments and net of taxes of $11	17.2	-	-

million for the year ended December 31, 2002			
Marketable Securities			
Unrealized gain/(loss) on marketable securities net of reclassification adjustments and net of taxes (benefit) of $2.3 million, $1.6 million and $(3.1) million for the years ended December 31, 2002, 2001, and 2000, respectively	4.3	2.9	(5.7)
Treasury lock			
Unrealized loss from treasury lock net of reclassification adjustments and net of taxes of $42.7 million for the year ended December 31, 2002	(59.7)	-	-
Interest rate swap agreement designated as cash flow hedge			
Unrealized loss from cash flow hedge net of reclassification adjustments and net of taxes (benefit) of $4.3 million, $(1.2) million, and zero for the years ended December 31, 2002, 2001, and 2000	(8.0)	(2.1)	-
Other comprehensive (loss)/income, net of taxes	(46.2)	.8	(5.7)
Comprehensive income	$ 164.3	$ 164.2	$ 340.8

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

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS

(Millions of Dollars)	December 31, 2002	December 31, 2001
CURRENT ASSETS		
Cash and cash equivalents, including $16.3 million in restricted cash in 2002	$ 98.8	$ 515.5
Marketable securities	175.3	161.2
Accounts receivable, less allowance for uncollectible accounts of $37.3 million and $9.5 million	1,118.5	401.2
Fuel, materials and supplies-at average cost	254.9	37.8
Prepaid expenses and other	54.4	24.2
Total Current Assets	1,701.9	1,139.9
INVESTMENTS AND OTHER ASSETS		
Goodwill	1,431.8	-
Regulatory assets, net	1,175.5	14.3
Investment in finance leases	1,091.6	736.0
Prepaid pension expense	124.9	152.4
Other	538.0	489.9
Total Investments and Other Assets	4,361.8	1,392.6
PROPERTY, PLANT AND EQUIPMENT		
Property, plant and equipment	10,625.0	4,361.9
Accumulated depreciation	(3,827.0)	(1,608.5)
Net Property, Plant and Equipment	6,798.0	2,753.4

TOTAL ASSETS	$	12,861.7	$	5,285.9

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

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

LIABILITIES AND SHAREHOLDERS' EQUITY		December 31, 2002		December 31, 2001
(Millions of Dollars)				
CURRENT LIABILITIES				
Short-term debt	$	1,377.4	$	458.2
Accounts payable and accrued payroll		638.8		224.1
Capital lease obligations due within one year		15.8		15.2
Interest and taxes accrued		63.4		92.6
Other		501.2		175.3
Total Current Liabilities		2,596.6		965.4
DEFERRED CREDITS				
Income taxes		1,535.2		501.6
Investment tax credits		69.0		24.7
Other		432.0		38.8
Total Deferred Credits		2,036.2		565.1
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS				

Long-term debt	4,712.8	1,602.1
Capital lease obligations	119.6	120.3
Total Long-Term Debt and Capital Lease Obligations	4,832.4	1,722.4
COMPANY OBLIGATED MANDATORILY REDEEMABLE PREFERRED SECURITIES OF SUBSIDIARY TRUST WHICH HOLDS SOLELY PARENT JUNIOR SUBORDINATED DEBENTURES	290.0	125.0
PREFERRED STOCK		
Serial preferred stock	35.3	35.3
Redeemable serial preferred stock	75.4	49.5
Total Preferred Stock	110.7	84.8
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY		
Common stock, $.01 and $1 par value, respectively-authorized 400,000,000 and 200,000,000 shares, respectively-issued 169,982,361 shares and 118,544,883 shares, respectively	1.7	118.5
Premium on stock and other capital contributions	2,212.0	1,028.3
Capital stock expense	(3.2)	(12.9)
Accumulated other comprehensive loss	(52.9)	(6.7)
Retained income	838.2	974.1
	2,995.8	2,101.3
Less cost of shares of common stock in treasury (none and 11,323,707 shares, respectively)	-	(278.1)

Total Shareholders' Equity		2,995.8		1,823.2
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$	12,861.7	$	5,285.9

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

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

For the Year Ended December 31,	2002	2001	2000
(Millions of Dollars)			
OPERATING ACTIVITIES			
Net income	$ 210.5	$ 163.4	$ 346.5
Adjustments to reconcile net income to net cash from (used by) operating activities:			
Depreciation and amortization	239.8	170.6	247.6
Gain on divestiture of generation assets	-	(29.3)	(423.8)
Impairment losses	-	65.5	45.7
Changes in:			
Accounts receivable	(75.3)	80.0	(184.5)
Regulatory assets, net	34.8	(152.2)	(227.0)
Prepaid expenses	74.1	389.4	(377.7)
Accounts payable and accrued payroll	165.9	(52.7)	34.8
	(57.1)	(721.8)	727.8

Interest and taxes accrued, including Federal income tax refund of $135.4 million in 2002			
Net other operating activities, including divestiture related items in 2001 and 2000	212.8	(11.0)	(216.3)
Net Cash From (Used By) Operating Activities	805.5	(98.1)	(26.9)
INVESTING ACTIVITIES			
Acquisition of Conectiv, net of cash acquired	(1,075.6)	-	-
Net investment in property, plant and equipment	(503.8)	(245.3)	(225.5)
Proceeds from/changes in:			
Divestiture of generation assets	-	156.2	2,741.0
Purchase of leveraged leases	(319.6)	(157.7)	-
Sales of marketable securities, net of purchases	1.4	75.4	(38.2)
Purchases of other investments, net of sales	(17.7)	(56.9)	(78.5)
Sale of aircraft	4.0	22.9	87.1
Net other investing activities	(9.1)	(8.0)	(90.5)
Net Cash (Used By) From Investing Activities	(1,920.4)	(213.4)	2,395.4
FINANCING ACTIVITIES			
Dividends paid on preferred and common stock	(135.3)	(126.5)	(190.4)
Redemption of preferred stock	(9.9)	(5.6)	(9.7)

Issuance of common stock	105.7	-	-
Reacquisition of the Company's common stock	(2.2)	(78.1)	(200.0)
Issuances of long-term debt	1,974.2	92.4	-
Reacquisitions of long-term debt	(415.2)	(1,059.9)	(216.4)
Repayments of short-term debt, net of issuances	(684.8)	138.5	12.1
Cost of issuances and financings	(130.4)	-	-
Net other financing activities	(3.9)	1.6	1.8
Net Cash From (Used By) Financing Activities	698.2	(1,037.6)	(602.6)
Net (Decrease) Increase In Cash and Cash Equivalents	(416.7)	(1,349.1)	1,765.9
Cash and Cash Equivalents at Beginning of Period	515.5	1,864.6	98.7
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 98.8	$ 515.5	$ 1,864.6
Supplemental Disclosure of Cash Flow Information			
Cash paid (received) for interest (net of capitalized interest of $10.6 million, $2.6 million and $3.4 million) and income taxes:			
Interest	$ 139.6	$ 172.0	$ 108.4
Income taxes	$ (271.0)	$ 781.2	$ 45.8
Supplemental Disclosure of Non-Cash Investing Activity			
Transfer of Benning and Buzzard Stations to Pepco	$ -	$ -	$ 53.6

Energy Services

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

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock				
(Dollar Amounts in Millions)	Shares	Par Value	Premium on Stock	Accumulated Other Comprehensive Income (Loss)	Retained Income
BALANCE, DECEMBER 31, 1999	118,530,802	$ 118.5	$ 1,025.4	$ (1.8)	$ 781.1
Net Income	-	-	-	-	346.5
Other comprehensive loss	-	-	-	(5.7)	-
Dividends on common stock	-	-	-	-	(190.4)
Conversion of stock options	13,934	-	0.3	-	-
Gain on acquisition of preferred stock	-	-	1.6	-	-
BALANCE, DECEMBER 31, 2000	118,544,736	$ 118.5	$ 1,027.3	$ (7.5)	$ 937.2
Net Income	-	-	-	-	163.4

Other comprehensive income	-	-	-	.8	-
Dividends on common stock	-	-	-	-	(126.5)
Conversion of stock options	147	-	-	-	-
Gain on acquisition of preferred stock	-	-	.7	-	-
Release of restricted stock	-	-	.3	-	-
BALANCE, DECEMBER 31, 2001	118,544,883	$ 118.5	$ 1,028.3	$ (6.7)	$ 974.1
Net Income	-	-	-	-	210.5
Other comprehensive income	-	-	-	(46.2)	-
Dividends on common stock	-	-	-	-	(130.6)
Issuance of common stock:					
Related to Conectiv acquisition	163,602,584	1.7	2,095.6	-	-
Original issue shares	5,750,000	-	105.7	-	-
DRP original shares	629,777	-	12.4	-	-
Cancellation of Pepco outstanding stock	(107,221,176)	(107.2)	(963.8)	-	-
Cancellation of Pepco Treasury	(11,323,707)	(11.3)	(64.5)	-	(215.8)

Stock					
Reacquired Conectiv and Pepco PARS	-	-	(3.2)	-	-
Vested options converted to Pepco Holdings options	-	-	1.5	-	-
BALANCE, DECEMBER 31, 2002	169,982,361	$ 1.7	$ 2,212.0	$ (52.9)	$ 838.2

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

PEPCO HOLDINGS, INC.

(1) ORGANIZATION

Pepco Holdings, Inc. (Pepco Holdings or the Company, formerly New RC, Inc.), a registered holding company under the Public Utility Holding Company Act of 1935 (PUHCA), was incorporated under the laws of Delaware on February 9, 2001 for the purpose of effecting Potomac Electric Power Company's (Pepco) acquisition of Conectiv. In accordance with the terms of the merger agreement, upon the consummation of the merger on August 1, 2002, Pepco and Conectiv became wholly owned subsidiaries of Pepco Holdings. Additionally, Pepco, through a series of transactions, transferred its ownership interests in its pre-merger subsidiaries Potomac Capital Investment Corporation (PCI) and Pepco Energy Services, Inc. (Pepco Energy Services) to Pepco Holdings and PCI transferred its ownership interest in its pre-merger subsidiary Pepco Communications, Inc. (Pepcom) to Pepco Holdings. These transactions resulted in PCI, Pepco Energy Services, and Pepcom becoming wholly owned subsidiaries of Pepco Holdings. Additionally, PUHCA imposes certain restrictions on the operations of registered holding companies and their subsidiaries; therefore, Pepco Holdings has a subsidiary service company that provides a variety of support services to Pepco Holdings and its subsidiaries. The costs of the service company are directly assigned or allocated to Pepco Holdings' or its subsidiaries based on prescribed allocation factors listed in the service agreement filed with, and approved by, the Securities and Exchange Commission (SEC). Pepco Holdings manages its operations as described below.

Power Delivery

The largest component of Pepco Holdings' business is power delivery, which is conducted through its subsidiaries Pepco, Delmarva Power & Light Company (DPL), and Atlantic City Electric Company (ACE).

Pepco, DPL and ACE are all regulated public utilities in the jurisdictions in which they serve customers. The operations of DPL and ACE collectively are referred to as "Conectiv Power Delivery."

Pepco

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. Under settlements entered into with regulatory authorities, Pepco is required to provide electricity supply at specified rates (referred to as "default service") to customers in Maryland until July 2004 and to customers in Washington, D.C. until February 2005. Under a full requirements contract entered into in 2000 in connection with the purchase by Mirant Corporation of substantially all of Pepco's electricity generation assets, Mirant is obligated to supply Pepco with all of the capacity and energy needed to fulfill these default service obligations at fixed prices that are lower than currently approved tariff rates that Pepco charges for providing such service. If Mirant were to fail to fulfill its supply obligations, Pepco would have to find alternative sources of supply at rates then prevailing.

Conectiv Power Delivery

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. Under regulatory settlements, DPL is required to provide default electricity service in Maryland until July 2003 for non-residential customers and until July 2004 for residential customers, to customers in Delaware until May 2006 and to customers in Virginia until January 2004 (which may be extended to July 2007). Conectiv Energy (described below) supplies all of DPL's default service load requirements under a supply agreement that ends May 31, 2006. The terms of the supply agreement are structured to coincide with DPL's load requirements under each of its regulatory settlements. Conectiv Energy's resources for supplying DPL's default service load include electricity generated by Conectiv Energy's plants and electricity purchased under long-term agreements. DPL purchases gas supplies for its customers from marketers and producers in the spot market and under short-term and long-term agreements.

ACE is engaged in the generation, transmission, and distribution of electricity in southern New Jersey. ACE has default service obligations, known as Basic Generation Service (BGS), for approximately 20 percent of the electricity supply to its customers. ACE expects to fulfill these obligations through the generation output from its fossil fuel-fired generating plants and through existing purchase power agreements with non-utility generators (NUG). As discussed in Note 14. Commitments and Contingencies herein, in January 2003, ACE terminated its competitive bidding process to sell these generation assets.

ACE formed Atlantic City Electric Transition Funding LLC (ACE Transition Funding) during 2001. ACE Transition Funding, which is discussed in Note 14. Commitments and Contingencies, herein, is a wholly owned subsidiary of ACE.

Competitive Energy

This component of the Company's business is conducted through subsidiaries of Conectiv Energy Holding Company (collectively referred to herein as Conectiv Energy) and Pepco Energy Services. Conectiv Energy Holding Company and Pepco Energy Services are subsidiaries of Pepco Holdings.

Conectiv Energy

Conectiv Energy supplies power to DPL and provides wholesale power and ancillary services to the

Pennsylvania/New Jersey/Maryland (PJM) power pool. Conectiv Energy's generation asset strategy focuses on mid-merit plants with operating flexibility, multi-fuel capability and low capital requirements that can quickly change their output level on an economic basis. Mid-merit plants generally are operated during times when demand for electricity rises and prices are higher. Through December 31, 2002, Conectiv Energy also engaged in energy trading to take advantage of price fluctuations and arbitrage opportunities.

As of December 31, 2002, Conectiv Energy owned and operated electric generating plants with 2,600 MW of capacity. In January 2002, Conectiv Energy began construction of a 1,100 MW combined cycle plant with six combustion turbines at a site in Bethlehem, Pennsylvania that is expected to become fully operational in stages adding 360 MW in 2002 and an additional 740 MW of capacity in 2003. In addition, Conectiv Energy has ordered seven combustion turbines which, with additional equipment, could be configured into up to three combined cycle plants with approximately 550 MW of capacity each. Through December 31, 2002 a total of $192.3 million has been paid for these turbines. The total cost to purchase the combustion turbines is approximately $235 million. In August of 2002, as part of the acquisition of Conectiv by Pepco, the book value of these combustion turbines was adjusted down to the then fair market value of $153 million (approximately 35% lower than the purchase cost). Construction of these additional plants is subject to market and other conditions but is currently scheduled to occur in phases to be completed in 2007 and 2008. In light of continuing declines in wholesale energy prices, further analysis of energy markets and projections of future demand for electricity, among other factors, Conectiv Energy is considering all of its options including delaying delivery of equipment, delaying construction, selling the equipment and canceling equipment orders.

Pepco Energy Services

Pepco Energy Services provides retail electricity and natural gas to residential, commercial, industrial and governmental customers in the District of Columbia and states in the mid-Atlantic region. Pepco Energy Services also provides integrated energy management solutions to commercial, industrial and governmental customers, including energy-efficiency contracting, development and construction of "green power" facilities, equipment operation and maintenance, fuel management, and appliance service agreements. In addition, Pepco Energy Services owns electricity generation plants with approximately 800 MW of peaking capacity, the output of which is sold in the wholesale market. Pepco Energy Services also purchases and sells electricity and natural gas in the wholesale markets to support its commitments to its retail customers.

Other Non-Regulated

This component of Pepco Holdings' business is conducted through its subsidiaries PCI and Pepcom.

PCI

PCI manages a portfolio of financial investments and strategic operating businesses that are designed to provide supplemental earnings and cash flow. PCI has been redirecting its investment operations to focus on investments that are related to the energy industry, such as energy leveraged leases. These transactions involve PCI's purchase and leaseback of utility assets, located outside of the United States, that provide a long-term, stable stream of cash flow and earnings. PCI has reduced its previous concentration of investments in the aircraft industry from 33 aircraft in 1995 to three aircraft currently. PCI also owns a ten-story, 360,000 square foot office building in downtown Washington, D.C., which is leased to Pepco and serves as Pepco Holdings' and Pepco's corporate headquarters.

PCI's utility industry products and services are provided through various operating companies. Its underground electric services company, W.A. Chester, provides high voltage construction and maintenance services to utilities and to other customers throughout the United States. PCI also owns Severn Cable, which provides low voltage electric and telecommunication construction and maintenance services in the Washington, D.C. area.

Pepcom

Pepcom owns a 50% interest in Starpower Communications, LLC, a joint venture with RCN Corporation, which provides cable and telecommunication services to households in the Washington, D.C. area.

(2) MERGER TRANSACTION

General

On August 1, 2002, Pepco's acquisition of Conectiv was consummated through a series of merger transactions and an exchange of cash and Pepco Holdings' common stock. In accordance with the terms of the merger agreement, existing holders of Conectiv common stock and Class A common stock, outstanding immediately prior to the merger, received cash in the aggregate amount of $1.1 billion and approximately 56.2 million shares of Pepco Holdings common stock. The number of Pepco Holdings shares issued to Conectiv shareholders was determined based on a formula outlined in the merger agreement, which is included in the Company's Registration Statement on Form S-4 (Number 333-57042). The stock was valued at $18.26 per share, resulting in stock consideration paid to existing Conectiv shareholders of approximately $1 billion. The valuation of Pepco Holdings shares was determined based on the closing market prices on the New York Stock Exchange of Pepco's common stock 3 days before and 3 days after the date that the amount of Pepco Holdings common shares to be issued to Conectiv shareholders became fixed (July 25, 2002). Additionally, Pepco incurred approximately $35.6 million in direct acquisition costs which are treated as consideration paid for Conectiv. Also, under the terms of the merger agreement approximately $1.7 million in existing Conectiv stock options and performance accelerated restricted stock (PARS) were converted to PHI options and PARS. Accordingly, as illustrated in the table below, total consideration paid for Conectiv was approximately $2.2 billion.

The merger was accounted for using the purchase method of accounting, with Pepco as the acquirer of Conectiv. In accordance with the provisions of the purchase method of accounting, Pepco compared the total cost to acquire Conectiv to the estimated fair values (on August 1, 2002, the date of acquisition) of the Conectiv assets acquired and liabilities assumed. The excess of cost over the fair value of Conectiv's assets and liabilities acquired was recorded as goodwill.

The following table presents (in millions of dollars) (1) the estimated fair value of Conectiv's assets and liabilities at August 1, 2002, the acquisition date, (2) the goodwill balance resulting from the acquisition of Conectiv by Pepco and (3) the total consolidated Pepco Holdings goodwill balance at December 31, 2002. Goodwill may be subject to refinement during 2003.

Total Consideration Paid for Conectiv:		
Cash paid to existing Conectiv shareholders	$	1,095.2
Stock issued to existing Conectiv shareholders		1,029.7
Conversion of Conectiv options/PARS		1.7

Pepco direct merger costs		35.6		
			$	2,162.2
Fair Value of Conectiv's Assets/Liabilities:				
Assets				
Property, Plant and Equipment, Net		3,629.7		
Investments and Other Assets		1,461.5		
Current Assets		873.5		
Total Assets	$	5,964.7		
Liabilities				
Preferred Stock and Securities		200.8		
Long-Term Debt		1,489.9		
Current Liabilities		2,234.3		
Deferred Credits and Other		1,428.4		
Total Liabilities	$	5,353.4		
Less: Fair Value of Net Assets Acquired				611.3
Deferred Income Tax Liability				209.6
Add: Liabilities Assumed				73.0
Goodwill Resulting Directly from the			$	1,414.3
Goodwill on Pepco Energy Services' Books				17.5
Consolidated Pepco Holdings' Goodwill at December 31, 2002			$	1,431.8

Goodwill generated by the acquisition of Conectiv is attributable to Pepco Holdings' power delivery business.

Pro Forma Information (unaudited)

Pro forma unaudited financial information for Pepco Holdings on a consolidated basis, giving effect to the merger as if it had occurred at the beginning of each year presented, is presented below. This pro forma information is not necessarily indicative of the results that would have occurred, or that will occur in the future. Amounts, except earnings per share, are in millions.

	For the Year Ended December 31,	
	2002	2001

Operating Revenue	$	6,777.3	$	6,361.8
Income from Continuing Operations (a)	$	231.5	$	511.0
Average Shares Outstanding		163.4		167.0
Basic and Diluted Earnings Per Share (a)	$	1.42	$	3.06

(a) This amount reflects the pro forma impact of $700 million in debt issued in September 2002 at 7.15%, the proceeds of which were used to fund the acquisition. Total debt issued in September 2002 was $1.5 billion. The remaining $800 million in debt was used to repay outstanding debt.

(3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Statement Presentation

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Pepco Holdings and its wholly owned subsidiaries. All intercompany balances and transactions between subsidiaries have been eliminated. Investments in entities in which Pepco Holdings has a 20% to 50% interest are accounted for using the equity method. Under the equity method, investments are initially carried at cost and subsequently adjusted for the Company's proportionate share of the investees' undistributed earnings or losses and dividends. Certain prior period amounts have been reclassified in order to conform to the current period presentation.

Consolidated Financial Statement Composition

As a result of the merger transaction on August 1, 2002, Pepco Holdings' accompanying consolidated balance sheet and consolidated statements of shareholders' equity as of December 31, 2002 include the accounts of Pepco Holdings and its subsidiaries (discussed in Note (1) Organization, herein), after giving effect to the merger transaction and resulting purchase accounting entries discussed in Note (2) Merger Transaction, herein. Since Pepco was the acquiring company, in accordance with the purchase method of accounting, Pepco represents the "predecessor" company. Accordingly, the accompanying consolidated balance sheet as of December 31, 2001, and the consolidated statements of shareholders' equity as of December 31, 2001 and 2000, respectively, as previously reported by Pepco, include only the consolidated accounts of Pepco and its pre-merger subsidiaries, PCI and Pepco Energy Services.

The accompanying consolidated statements of earnings, consolidated statements of comprehensive income, and consolidated statements of cash flows for the year ended December 31, 2002 include Pepco's and its pre-merger subsidiaries' operating results for the full year consolidated with Conectiv and its subsidiaries operating results for the five months of August 1, 2002, the date the merger was consummated, through December 31, 2002. The accompanying consolidated statements of earnings, consolidated statements of comprehensive income, and consolidated statements of cash flows for the years ended December 31, 2001 and 2000, as previously reported by Pepco, include only the consolidated operations of Pepco and its pre-merger subsidiaries.

Accordingly, due to the application of the purchase method of accounting that was used to record the merger transaction, the consolidated balances included in the accompanying consolidated financial statements as of and for the years ended December 31, 2002, 2001, and 2000 are not comparable.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, such as Statement of Position 94-6 "Disclosure of Certain Significant Risks and Uncertainties," requires management to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. Examples of estimates used by the Company include the calculation of the allowance for uncollectible accounts, environmental remediation costs and anticipated collections, unbilled revenue, pension assumptions, and fair values used in the purchase method of accounting and the resulting goodwill balance. Although Pepco Holdings believes that its estimates and assumptions are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates.

Regulation of Power Delivery Operations

Pepco is regulated by the Maryland Public Service Commission (Maryland Commission), the District of Columbia Public Service Commission (D.C. Commission), and its wholesale business is regulated by the Federal Energy Regulatory Commission (FERC). Conectiv Power Delivery is subject to regulation by the Delaware Public Service Commission (Delaware Commission), the Maryland Commission, the New Jersey Board of Public Utilities (NJBPU), the Virginia State Corporation Commission (Virginia Commission), and FERC.

Revenue Recognition

Power Delivery revenues primarily include revenues from the supply and delivery of electricity to the customers of Pepco, DPL, and ACE. Revenues from the supply and delivery of natural gas to DPL's customers are also included in Power Delivery. Competitive Energy revenues are primarily derived from electricity and natural gas trading activities and generation, which are the sale of electricity, capacity, and ancillary services from deregulated electric generating plants. It also includes revenues from wholesale and retail sales of electricity and natural gas to customers that are supplied by purchases in wholesale markets and revenues from energy management products and services. Other Non-Regulated revenues are provided by Pepco Holdings' non-regulated subsidiary PCI.

The Power Delivery and Competitive Energy businesses recognize revenues for the supply and delivery of electricity and gas upon delivery to the customer, including amounts for services rendered, but not yet billed. Conectiv Energy recognizes revenue when delivery is substantially complete for non-trading activities, and on a mark-to-market basis for trading activities. Pepco Energy Services recognizes revenue for its wholesale and retail commodity business upon delivery to customers. Revenues for Pepco Energy Services' energy efficiency construction business is recognized using the percentage-of-completion method of revenue recognition and revenues from its operation and maintenance and other products and services contracts are recognized when earned. Revenues from the Other Non-Regulated business lines are principally recognized when services are performed or products are delivered; however, revenue from PCI's utility industry services contracts is recognized using the percentage-of-completion method of revenue recognition, which recognizes revenue as work progresses on the contract.

Accounting For the Effects of Certain Types of Regulation

The requirements of Statement of Financial Accounting Standards (SFAS) No. 71 "Accounting for the Effects of Certain Types of Regulation" apply to the Power Delivery businesses of Pepco, DPL, and ACE. SFAS No. 71 allows regulated entities, in appropriate circumstances, to establish regulatory assets and to defer the income statement impact of certain costs that are expected to be recovered in future rates. Management's assessment of the probability of recovery of regulatory assets requires judgment and interpretation of laws, regulatory commission orders, and other factors. Should existing facts or circumstances change in the future to indicate that a regulatory asset is not probable of recovery, then the regulatory asset would be charged to earnings.

The components of Pepco Holdings' regulatory asset balances at December 31, 2002 and 2001, are as follows:

	2002	2001
	(Millions of Dollars)	
Recoverable stranded costs	$ 920.8	$ -
Deferred energy supply costs	136.2	(13.4)
Deferred recoverable income taxes	116.5	55.6
Deferred debt extinguishment costs	56.8	25.7
Regulatory liability for New Jersey income tax benefit	(51.2)	-
Deferred other post retirement benefit costs	25.0	-
Unrecovered purchase power costs	10.5	-
Generation Procurement Credit, customer sharing commitment, and other	(39.1)	(53.6)
Net Regulatory Assets	$ 1,175.5	$ 14.3

Accounting For Derivatives

Changes in the fair value of derivatives that are not hedges, under SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities", are recognized in earnings. The gain or loss on a derivative that hedges exposure to variable cash flow of a forecasted transaction is initially recorded in other comprehensive income (a separate component of common stockholders' equity) and is subsequently reclassified into earnings when the forecasted transaction occurs. If a forecasted transaction is no longer probable, the deferred gain or loss in accumulated other comprehensive income is immediately reclassified to earnings. Changes in the fair value of other hedging derivatives result in a change in the value of the asset, liability, or firm commitment being hedged to the extent the hedge is effective. Any ineffective portion of a hedge is recognized in earnings immediately.

In June 2002, Pepco Holdings entered into several treasury lock transactions in anticipation of the issuance of several series of fixed rate debt by the end of September 2002. These treasury lock transactions, which were designated as qualified cash flow hedges in accordance with the provisions of SFAS 133, were intended to offset the changes in future cash flows attributable to fluctuations in interest rates. Upon the closing of the sale of the debt on September 6, 2002, the net loss on the settlement of the treasury lock transactions of $63.4 million (after-tax) was recorded as accumulated other comprehensive loss and began to be amortized into interest expense over the life of the related debt. Additionally, the fair value of the liability of $106.1 million (pre-tax) was paid by Pepco Holdings on September 4, 2002, the hedge settlement date.

Conectiv Energy engages in commodity hedging activities to minimize the risk of market fluctuations associated with the purchase and sale of energy commodities (natural gas, petroleum, coal and electricity). The majority of these hedges relate to the procurement of fuel for the power plants, fixing the cash flows from the plant output, and securing power for electric load service. Conectiv Energy's hedging activities are conducted using derivative instruments designated as cash flow hedges, which are designed to reduce the variability in future cash flows. Conectiv Energy's commodity hedging objectives, in accordance with its risk management policy, are primarily the assurance of stable and known cash flows and the fixing of favorable prices and margins when they become available.

Conectiv Bethlehem, LLC (CBI), a subsidiary of Conectiv Energy, entered into an interest rate swap agreement for the purpose of managing its overall borrowing rate and limiting its interest rate risk associated with debt it has incurred. CBI currently hedges 75% of the interest rate payments for its variable rate debt. CBI formally designated its interest rate swap agreements as a cash flow hedge.

Pepco Energy Services purchases natural gas futures and electricity forward contracts to hedge price risk in connection with the purchase of physical natural gas and electricity for delivery to customers in future months. Pepco Energy Services accounts for its natural gas futures and electricity forward contracts as cash flow hedges of forecasted transactions.

PCI has entered into interest rate swap agreements for the purpose of managing its overall borrowing rate and limiting its interest rate risk associated with debt it has issued. PCI currently hedges 100% of its variable rate debt and approximately 24% of its fixed rate debt for the Medium Term Note program. PCI formally designated its interest rate swap agreements as both cash flow hedge and fair value hedge instruments, as appropriate.

On October 25, 2002, the Emerging Issues Task Force (EITF) rescinded Issue No. 98-10 (EITF 98-10), "Accounting for Contracts Involved in Energy Trading and Risk Management Activities." The Company's interpretation of EITF 98-10 is consistent with the current rules that are being applied under SFAS No. 133 and therefore management does not believe that rescinding EITF 98-10 will impact its financial position or results of operations.

Energy Trading Activities

In 2002, a pronouncement was issued by the EITF entitled EITF Issue No. 02-3 (EITF 02-3) "Accounting for Contracts Involved in Energy Trading and Risk Management Activities," which addresses the presentation of revenue and expense associated with "energy trading book" contracts on a gross vs. net basis. Previously the EITF concluded that gross presentation was acceptable, but with the issuance of EITF 02-3 and the subsequent guidance provided by the EITF in June and September 2002, net presentation is required. Conectiv Energy and Pepco Energy Services enter into trading activities that are subject to the provisions of this pronouncement and both historically have classified these contracts on a gross basis.

Conectiv Energy and Pepco Energy Services have completed their evaluation of the financial statement reclassification required by EITF 02-3. Beginning with July 2002, all of their trades were recorded net and therefore no reclassification was required for activities after July 2002. Accordingly, since Conectiv Energy's operating results that are included in Pepco Holdings' results herein consist only of the post-merger months of August 2002 through December 2002, no revenue or expense reclassifications are required for Conectiv Energy's portion of Pepco Holdings' results. However, based on the provisions of EITF 02-3, Pepco Energy Services' results during the period January 2002 through June 2002 required a reclassification adjustment that reduced its revenues by $22.6 million. Additionally, Pepco Energy Services' revenues decreased from $643.9 million to $541.5 million and from $234.9 million to $212.4 million, for the years ended December 31, 2001 and 2000, respectively. There is no impact on Conectiv Energy's or Pepco Energy Services' overall financial position or net results of operations as a result of the implementation of EITF 02-3.

Accounting For Marketable Securities

The Company, through its subsidiaries, holds marketable equity securities and investment grade commercial paper investments which are classified as available-for-sale securities under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Unrealized holding gains and losses on available-for-sale securities are excluded from earnings and are reported in accumulated other comprehensive income on the accompanying consolidated balance sheets. However, if a decline in fair value of an available-for-sale security is determined to be other than temporary, then the cost basis of the security is written down to fair value and the decline in fair value is included in earnings.

Included in net unrealized losses are gross unrealized losses of $2.3 million and gross unrealized gains of $1.1 million at December 31, 2002 and gross unrealized losses of $8.7 million and gross unrealized losses of $1.7 million at December 31, 2001.

In determining gross realized gains and losses on sales or maturities of securities, specific identification is used. Gross realized gains were $.6 million, $.6 million, and $1.1 million, in 2002, 2001, and 2000, respectively. Gross realized losses were $.7 million, $.7 million, and $1.4 million, in 2002, 2001, and 2000, respectively.

At December 31, 2002, the contractual maturities for mandatorily redeemable preferred stock held by PCI are $83.1 million within one year, $34.9 million from one to five years, $50.7 million from five to 10 years and $5.8 million for over 10 years.

Short-Term Debt

Short-term financing requirements have been principally satisfied through the sale of commercial promissory notes. Interest rates for the short-term financing during 2002 ranged from 1.45% to 2.57% and during 2001 ranged from 2.06% to 6.61%. Additionally, a minimum 100% line of credit back-up for outstanding commercial promissory notes is maintained.

A detail of the components of Pepco Holdings' short-term debt at December 31, 2002 and 2001 is as follows:

		2002		2001
				(Millions of Dollars)
Commercial paper	$	450.9	$	350.2
Short-term borrowings		361.8		-
Current portion of long-term debt		406.3		108.0
Variable rate demand bonds		158.4		-
Total	$	1,377.4	$	458.2

Accounting for Goodwill and Certain Other Intangibles

Effective January 1, 2002, Pepco Holdings and its subsidiaries adopted the full provisions of SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting and broadens the criteria for recording intangible assets apart from goodwill. SFAS 142 requires that purchased goodwill and certain indefinite-lived intangibles no longer be amortized, but instead be tested for impairment at least annually. Additionally, because Pepco Holdings completed the net asset valuation and determination of goodwill process in August 2002, the Company did not test for impairment in 2002 and therefore intends to test for impairment during 2003.

Environmental Remediation Costs

Environmental remediation costs are accrued at the time that management determines that it is probable that an asset has been impaired or that a liability has been incurred and the amount of the loss can be reasonably estimated. Environmental remediation costs are charged as an operating expense unless the costs extend the life of an asset or prevent environmental contamination that has yet to occur, in which case the costs are capitalized. Amounts that the Company has determined are probable of recovery from third parties, such as insurance carriers, are netted against the operating expense line item. The amount that is probable of recovery from third parties and the anticipated liability for environmental remediation costs are separately recorded. Amounts accrued for probable environmental remediation costs that may be incurred in the future are not measured on a discounted basis.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, money market funds, and commercial paper with original maturities of three months or less. Cash and cash equivalents includes $16.3 million in 2002 that is restricted for costs incurred on the CBI Project.

Other Assets

The other assets balance principally consists of real estate under development, equity and other investments, and deferred compensation trust assets.

Other Current Liabilities

The other current liability balance principally consists of customer deposits, accrued vacation liability, other postretirement/postemployment benefits, and the current portion of deferred income taxes.

Other Deferred Credits

The other deferred credits balance principally consists of accrued Conectiv other post employment benefit liabilities and miscellaneous deferred revenue.

Accounts Receivable and Allowance for Uncollectible Accounts

Pepco Holdings' subsidiaries accounts receivable balances primarily consist of customer account receivable, other accounts receivable, and accrued unbilled revenue. Accrued unbilled revenue represents revenue earned in the current period but not billed to the customer until a future date, usually within one month. The Company uses the allowance method to account for uncollectible accounts receivable.

Capitalized Interest and Allowance for Funds Used During Construction

In accordance with the provisions of SFAS No. 34, "Capitalization of Interest Cost," the cost of financing the construction of Pepco Holdings' subsidiaries electric generating plants is capitalized. Other non-utility construction projects also include financing costs in accordance with SFAS No. 34. In regards to the Company's regulated utility operations, the cost of additions to, and replacements or betterments of, retirement units of property and plant is capitalized. Such costs include material, labor, the capitalization of an Allowance for Funds Used During Construction (AFUDC) and applicable indirect costs, including engineering, supervision, payroll taxes and employee benefits. The original cost of depreciable units of plant retired, together with the cost of removal, net of salvage, is charged to accumulated depreciation.

Leasing Activities

Pepco Holdings accounts for leases entered into by its subsidiaries in accordance with the provisions of SFAS No. 13, "Accounting for Leases." Income from investments in direct financing leases and leveraged lease transactions, in which PCI is an equity participant, is accounted for using the financing method. In accordance with the financing method, investments in leased property are recorded as a receivable from the lessee to be recovered through the collection of future rentals. For direct financing leases, unearned income is amortized to income over the lease term at a constant rate of return on the net investment. Income including investment tax credits, on leveraged equipment leases, is recognized over the life of the lease at a constant rate of return on the positive net investment. Investments in equipment under operating leases are stated at cost, less accumulated depreciation. Depreciation is recorded on a straight-line basis over the equipment's estimated useful life.

Amortization of Debt Issuance and Reacquisition Costs

Expenses incurred in connection with the issuance of long-term debt, including premiums and discounts associated with such debt, are deferred and amortized over the lives of the respective issues. Costs associated with the reacquisition of debt are also deferred and amortized over the lives of the new issues.

Treasury Stock

The Company uses the cost method of accounting for treasury stock. Under the cost method, the Company records the total cost of the treasury stock as a reduction to its shareholders' equity on the face of its consolidated balance sheets. Additionally, stock held in treasury is not considered outstanding for the purposes of computing the Company's earnings per share.

Severance Costs

Through December 31, 2002, Pepco Holdings accounted for its subsidiaries' severance costs in accordance with the provisions of EITF No. 94-3 (EITF 94-3) "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." For any activities after January 1, 2003, the Company will apply the provisions of newly issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities."

During 2002, Pepco Holdings' management approved initiatives by Pepco and Conectiv to streamline their operating structure by reducing the number of employees at each company. These initiatives met the criteria for the accounting treatment provided under EITF 94-3. As of December 31, 2002, Pepco Holdings accrued $25.4 million of severance costs in connection with the plan. These costs relate to 274 employees, who primarily work in the Company's power delivery business. Management intends to pay the severance costs by the end of 2003.

Pension and Other Post Employment Benefit Plans

Pepco Holdings has a noncontributory retirement plan (the Plan) that covers substantially all employees of Pepco, DPL, ACE, and certain employees of other Pepco Holdings' subsidiaries. Following the consummation of the acquisition of Conectiv by Pepco on August 1, 2002, the Pepco General Retirement Plan and the Conectiv Retirement Plan were merged into the Plan on December 31, 2002. The provisions and benefits of the merged plan for Pepco employees are identical to those of the original Pepco plan and for DPL and ACE employees the provisions and benefits are identical to the original Conectiv plan. In addition to providing pension benefits, Pepco Holdings also provides certain health care and life insurance benefits for eligible employees (OPEBS).

The Company accounts for the Plan in accordance with SFAS No. 87, "Employers' Accounting for Pensions" and its OPEBS in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." The Company's financial statement disclosures were prepared in accordance with SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits."

Pepco and Conectiv's pension assets did not achieve the level of returns assumed in the determination of their pension expense accruals during 2002. As a result, Pepco contributed $35 million to its pension plan in December 2002 to exceed a funding level of 100% with respect to its accrued benefit obligation. Conectiv's pension plan did not require a contribution to exceed 100% of its accrued benefit obligation.

New Accounting Standards

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143 entitled "Accounting for Asset Retirement Obligations," which is required to be adopted for financial statements issued for fiscal years beginning after June 15, 2002 (the Company's first quarter 2003 financial statements). This Statement establishes the accounting and reporting standards for measuring and recording asset retirement obligations. The Company has completed its assessment of the provisions of SFAS No. 143 and believes that although the implementation of the Statement will result in certain account reclassifications, it will not have a material impact on the Company's financial position or results of operations.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145 rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt (an amendment of APB Opinion No. 30)." SFAS No. 4 had required that material gains and losses on extinguishment of debt be classified as an extraordinary item. Under SFAS No. 145, SFAS No. 4 is rescinded effective for fiscal years beginning after May 15, 2002. Due to the rescission of SFAS No. 4, it is less likely that a gain or loss on extinguishment of debt would be classified as an extraordinary item in Pepco Holdings' Consolidated Statements of Income.

In July 2002, the FASB issued SFAS No. 146, which requires companies to recognize costs associated with exit or disposal activities when the costs are incurred rather than at the date of a commitment to an exit or disposal plan. The primary effect of applying SFAS No. 146 will be on the timing of recognition of costs associated with exit or disposal activities. In many cases, those costs will be recognized as liabilities in periods following a commitment to a plan, not at the date of the commitment. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure, which amends FASB Statement No. 123, Accounting for Stock-Based Compensation," which is effective for interim periods ending after December 15, 2002 (the Company's first quarter 2003 financial statements). This statement provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS No. 123 "Accounting for Stock Based Compensation" to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. Pepco Holdings currently accounts for its stock based compensation plan using the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." The Company believes that the implementation of SFAS 148 will not have a material impact on its financial position or results of operations.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 requires that upon issuance of a guarantee, a guarantor must recognize a liability for the fair value of an obligation assumed under a guarantee. Additional disclosures are also prescribed for certain guarantee contracts. The initial recognition and initial measurement provisions of FIN 45 are effective for any guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002 (the Company's first quarter 2003 financial statements). The Company is in the process of assessing the provisions of FIN 45 in order to determine its impact on the Company's financial position and results of operations.

In January 2003, FASB issued Interpretation No. 46 "Consolidation of Variable Interest Entities" (Fin 46). Pepco Holdings is in the process of assessing the provisions of Fin 46 in order to determine its impact on the Company's financial position or results of operations.

(4) SEGMENT INFORMATION

Based on the provisions of SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information," Pepco Holdings' management has identified the following reportable segments: Pepco, Conectiv Power Delivery, Conectiv Energy, Pepco Energy Services, and Other Non-Regulated. 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 years ended December 31, 2002, 2001, and 2000, is as follows.

	December 31, 2002 (In Millions)						
	Power Delivery Segments		Competitive Energy Segments				
	Pepco	Conectiv Power Delivery	Conectiv Energy	Pepco Energy Services	Other Non-Regulated	(a) Corp. & Other	PHI Cons.
Operating Revenue	$ 1,533.9	$ 997.3	$ 1,214.3	$ 827.5	$ 115.5	$ (364.0)	$ 4,324.5
Operating Expense	1,219.7	890.5	1,157.6	815.9	43.4	(348.2)	3,778.9
Operating Income	314.2	106.8	56.7	11.6	72.1	(15.8)	545.6
Net Income	136.3	46.4	30.5	6.8	29.0	(38.5)	210.5
Total Assets	3,536.4	4,569.4	2,111.6	296.9	1,754.9	592.5	12,861.7

(a) "Corp. and Other" for 2002 includes primarily severance costs, as well as 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.

Note: The condensed segment statements of earnings information for the year ended December 31, 2002 presented above includes Pepco and its pre-merger subsidiaries (PCI and Pepco Energy Services) results for the entire periods presented consolidated with Conectiv and its subsidiaries results starting on August 1, 2002, the date the merger was consummated. The 2001 and 2000 operating amounts included herein reflect only the operations of Pepco and its pre-merger subsidiaries, as previously reported by Pepco. Accordingly, the amounts between years are not comparable.

December 31, 2001
(In Millions)

	Power Delivery Segments		Competitive Energy Segments				
	Pepco	Conectiv Power Delivery	Conectiv Energy	Pepco Energy Services	Other Non-Regulated	(a) Corp. & Other	PHI Cons.
Operating Revenue	$ 1,752.8	-	-	$ 541.5	$ 112.2	$ (6.0)	$ 2,400.5
Operating Expense	1,369.7	-	-	524.1	146.3	(6.0)	2,034.1
Operating Income (loss)	383.1	-	-	17.4	(34.1)	-	366.4
Net Income (loss)	189.2	-	-	10.3	(36.1)	-	163.4
Total Assets	5,010.0	-	-	211.8	1,289.9	(1,225.8)	5,285.9

December 31, 2000
(In Millions)

	Power Delivery Segments		Competitive Energy Segments				
	Pepco	Conectiv Power Delivery	Conectiv Energy	Pepco Energy Services	Other Non-Regulated	(a) Corp. & Other	PHI Cons.
Operating Revenue	$ 2,644.4	-	-	$ 212.4	$ 132.5	-	$ 2,989.3
Operating Expense	1,794.8	-	-	228.9	70.5	-	2,094.2
Operating Income (loss)	849.6	-	-	(16.5)	62.0	-	895.1
Net	343.4	-	-	(8.8)	11.9	-	346.5

Income (loss)							
Total Assets	7,967.4	-	-	176.6	-	(2,348.9)	7,027.3

(a) "Corp. and Other" for 2001 and 2000 represents the elimination of intercompany rent paid by Pepco to PCI for lease of office space in PCI's office building. This line item for "total assets" also represents the elimination of intercompany transactions.

(5) LEASING ACTIVITIES

The investment in financing leases was comprised of the following at December 31:

	2002	2001
	(Millions of Dollars)	
Energy leveraged leases	$ 1,022.0	$ 658.8
Aircraft leases	18.3	22.7
Other	51.3	54.5
Total	$ 1,091.6	$ 736.0

Pepco Holdings' $1,022.0 million equity investment in energy leveraged leases at December 31, 2002, consists of electric power plants and natural gas transmission and distribution networks located outside of the United States. Of this amount, $367.4 million of equity is attributable to facilities located in The Netherlands, $497.5 million in Austria and $157.1 million in Australia.

The components of the net investment in finance leases at December 31, 2002 and 2001 are summarized below:

At December 31, 2002:	Leveraged Leases	Direct Finance Leases	Total Finance Leases
		(Millions of Dollars)	
Rents receivable, net of recourse debt	$ 2,324.4	$ 60.9	$ 2,385.3
Residual value	-	22.6	22.6
Less: Unearned and deferred income	(1,298.6)	(17.7)	(1,316.3)
Investment in finance leases	1,025.8	65.8	1,091.6
Less: Deferred taxes	(278.5)	(43.9)	(322.4)
Net Investment in Finance Leases	$ 747.3	$ 21.9	$ 769.2
At December 31, 2001:			
Rents receivable, net of recourse debt	$ 1,435.5	$ 70.5	$ 1,506.0
Residual value	-	22.6	22.6
Less: Unearned and deferred income	(772.7)	(19.9)	(792.6)

Investment in finance leases		662.8		73.2		736.0
Less: Deferred taxes		(210.2)		(43.2)		(253.4)
Net Investment in Finance Leases	$	452.6	$	30.0	$	482.6

Income recognized from leveraged leases was comprised of the following:

For the Year Ended December 31,	2002	2001	2000
		(Millions of Dollars)	
Pre-tax earnings from leveraged leases	$ 64.1	$ 9.0	$ 37.5
Investment tax credit recognized	-	.3	.8
Income from leveraged leases, including investment tax credit	64.1	9.3	38.3
Income tax expense (benefit)	14.2	(9.9)	7.5
Net Income from Leveraged Leases	$ 49.9	$ 19.2	$ 30.8

In June 2002, PCI entered into a $609 million leveraged lease transaction with an Austrian municipal-owned entity. This transaction involved PCI's purchase and leaseback of hydroelectric facilities, over a base term of approximately 28 to 35 years. The transaction was financed with approximately $503 million of third party, non-recourse debt over the base term. PCI's equity investment in this leveraged lease was approximately $113 million.

In September 2002, PCI entered into a $766 million leveraged lease transaction with an Austrian municipal-owned entity. This transaction involved PCI's purchase and leaseback of 14 hydroelectric facilities, over a base term ranging from approximately 31 to 39 years. The transaction was financed with approximately $634 million of third party, non-recourse debt over the base term. PCI's equity investment in this leveraged lease was approximately $153 million.

In November 2002, PCI entered into a $309 million leveraged lease transaction with an Austrian municipal-owned entity. This transaction involved PCI's purchase and lease back of three hydroelectric facilities, over a base term of approximately 36 years. The transaction was financed with approximately $259 million of third party, non-recourse debt over the base term. PCI's equity investment in this leveraged lease was approximately $55 million.

In December 2001, PCI entered into an $850.0 million leveraged lease transaction with an Austrian municipal-owned entity. This transaction involved PCI's purchase and leaseback of a 56% undivided interest in a hydroelectric facility, over a base term of approximately 33 years. The transaction was financed with approximately $692.0 million of third party, non-recourse debt at commercial rates for a period of approximately 33 years. PCI's equity investment in this leveraged lease was approximately $164.6 million.

Rents receivable from leveraged leases are net of non-recourse debt. Minimum lease payments receivable from PCI's finance leases for each of the years 2003 through 2007 and thereafter are $10.4 million, $10.5 million, $3.4 million, $34.2 million, and $5.3 million, and $1,027.8 million, respectively.

The approximate annual commitments under all capital and operating leases are $37.7 million for 2003, $34.3 million for 2004, $34.5 million for 2005, $34.3 million for 2006, $34.1 million for 2007, and

$174.3 million thereafter.

(6) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is comprised of the following.

At December 31, 2002	Original Cost	Accumulated Depreciation	Net Book Value
		(Millions of Dollars)	
Generation	$ 1,672.1	$ 678.2	$ 993.9
Distribution	5,373.3	2,104.3	3,269.0
Transmission	1,584.7	609.3	975.4
Gas	304.4	107.8	196.6
General	868.3	301.1	567.2
Construction work in progress	644.9	-	644.9
Nonoperating and other property	177.3	26.3	151.0
Total	$ 10,625.0	$ 3,827.0	$ 6,798.0
At December 31, 2001			
Distribution	$ 3,163.0	$ 1,213.2	$ 1,949.8
Transmission	701.3	239.0	462.3
General	359.3	155.7	203.6
Construction work in progress	115.2	-	115.2
Nonoperating and other property	23.1	.6	22.5
Total	$ 4,361.9	$ 1,608.5	$ 2,753.4

The nonoperating and other property amounts include balances for distribution and transmission plant held for future use as well as other property held by non-utility subsidiaries.

Pepco Holdings' utility subsidiaries use separate depreciation rates for each electric plant account. The rates, which vary from jurisdiction to jurisdiction, were equivalent to a system-wide composite depreciation rate of approximately 3.5% for Pepco's transmission and distribution system property in 2002, 2001 and 2000. The composite depreciation rate in 2002 for DPL was approximately 3.2% and for ACE was 3.3%.

Property, plant and equipment includes regulatory assets of $53 million and $47 million at December 31, 2002 and 2001, respectively, which are accounted for pursuant to SFAS No. 71.

(7) PENSIONS AND OTHER POSTRETIREMENT AND POSTEMPLOYMENT BENEFITS (OPEB)

Pension Benefits

The Pepco Holdings Retirement Plan (Plan) is a noncontributory plan that covers substantially all employees of Pepco, DPL, ACE and certain employees of other Pepco Holdings subsidiaries. Effective

December 31, 2002, following the August 1, 2002 Pepco and Conectiv merger, the Pepco General Retirement Plan and the Conectiv Retirement Plan were merged into the Plan. The provisions and benefits of the merged plan for Pepco employees are identical to those of the original Pepco plan and for DPL and ACE employees the provisions and benefits are identical to the original Conectiv plan.

The acquisition of Conectiv by Pepco in August 2002 resulted in purchase accounting requirements that are reflected in the net periodic pension cost. Under such accounting, Conectiv's accrued pension liability was adjusted on August 1, 2002 through consolidation to recognize all previously unrecognized gains and losses arising from past experience different from that assumed, all unrecognized prior service costs, and the remainder of any unrecognized obligation or asset existing at the date of the initial application of SFAS No.87, "Employers' Accounting for Pensions." The Conectiv Plan transferred a projected benefit obligation of $804 million and plan assets of $744 million on August 1, 2002.

As a result of the divestiture of Pepco's Generation Assets to Mirant, in December 2000 Pepco recognized a curtailment charge of approximately $8.7 million. Since this charge is the direct result of the divestiture, it was considered to be a transaction cost and was netted against the gain on divestiture of Generation Assets on the Company's accompanying statements of earnings for the year ended December 31, 2000. Additionally, in accordance with the terms of the divestiture, with respect to generation employees transferred from the Company to Mirant, the Company is only responsible for the portion of transferred employees' pensions that relate to service with the Company.

Pension expense/(income) included in net period benefit cost was $9.0 million in 2002, $(3) million in 2001, and $3 million in 2000. The 2002 net period benefit cost amount of $9.0 million includes $2.9 million of Conectiv net benefit cost for the period August 1, 2002 through December 31, 2002. The components of net periodic benefit cost were computed as follows.

	Pension Benefits		
	2002	2001	2000
		(Millions of Dollars)	
Components of Net Periodic Benefit Cost			
Service cost	$ 16.0	$ 9.7	$ 12.8
Interest cost	54.1	36.3	37.2
Expected return on plan assets	(69.0)	(50.9)	(48.7)
Amortization of prior service cost	1.0	1.0	1.4
Recognized actuarial loss	6.9	.9	.3
Net Period Benefit Cost	$ 9.0	$ (3.0)	$ 3.0

Pension program assets are stated at fair value and are composed of approximately 42% and 45% of fixed income investments (including cash equivalents) with the balance in equity investments at December 31, 2002 and 2001, respectively. No Pepco Holdings stock is included in the pension program assets.

The changes in benefit obligation and fair value of plan assets are presented in the following table.

	Pension Benefits	
	2002	2001
	(Millions of Dollars)	
Change in Benefit Obligation		
Projected Benefit obligation at beginning of year	$ 548.3	$ 532.3
Service cost	16.0	9.7
Interest cost	54.1	36.3
Acquisition	804.1	-
Actuarial loss	40.7	3.2
Benefits paid	(64.3)	(33.2)
Projected Benefit Obligation at End of Year	$ 1,398.9	$ 548.3
Accumulated Benefit Obligation at December 31	$ 1,228.2	$ 489.0
Change in Fair Value of Plan Assets		
Fair value of plan assets at beginning of year	$ 555.0	$ 576.9
Actual return on plan assets	(37.2)	(14.6)
Company contributions	35.0	25.0
Acquisition	744.3	-
Benefits paid	(56.5)	(32.3)
Fair Value of Plan Assets at End of Year	$ 1,240.6	$ 555.0

The following table sets forth the Program's prepaid benefit cost.

	Pension Benefits	
	2002	2001
	(Millions of Dollars)	
Funded status	$ (158.3)	$ 6.7
Unrecognized actuarial loss	278.1	139.6
Unrecognized prior service cost	5.1	6.1
Prepaid Benefit Cost	$ 124.9	$ 152.4

The actuarial assumptions for Pepco and Conectiv at December 31, 2002, and 2001 are:

	2002	2001
Discount rate	6.75 %	7.0 %

Expected return on plan assets		
Pepco	9.0 %	9.0 %
Conectiv	9.5 %	-
Rate of compensation increase		
Pepco	4.0 %	4.0 %
Conectiv	4.5 %	-

As of January 1, 2002, Pepco and Conectiv's individual plan actuarial valuations incorporated different assumptions for the 2002 year net periodic expense determination. The Company expects to review, and may change the actuarial assumptions of the plan for 2003.

Other Post-Employment Benefits

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for eligible employees (OPEBS). The Company is amortizing the Pepco plan related unrecognized transition obligation measured at January 1, 1993, over a 20-year period.

The acquisition of Conectiv by Pepco in August 2002 resulted in purchase accounting requirements that are reflected in the net periodic benefit cost. Under such accounting Conectiv's accrued postretirement liability was adjusted on August 1, 2002 through consolidation to recognize all previously unrecognized actuarial gains and losses, all unrecognized prior service costs, and the remainder of any unrecognized obligation or asset existing at the date of the initial application of SFAS No.106. The Conectiv Plan transferred a projected benefit obligation of $320 million and plan assets of $100 million on August 1, 2002.

Postemployment benefit expense included in net income was $28.1 million, $15.9 million, and $18 million in 2002, 2001, and 2000, respectively. The 2002 net period benefit cost amount of $28.1 million includes $9.7 million of Conectiv net benefit cost for the period August 1, 2002 through December 31, 2002.

	Other Post Employment Benefits		
	2002	2001	2000
		(Millions of Dollars)	
Components of Net Periodic Benefit Cost			
Service cost	$ 7.2	$ 4.6	$ 5.8
Interest cost	20.0	8.2	8.2
Expected return on plan assets	(5.2)	(1.9	(1.9)
Recognized actuarial loss	6.1	5.0	5.9
Net Period Benefit Cost	$ 28.1	$ 15.9	$ 18.0

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. The assumed health care cost trend rate used to measure the expected cost benefits covered by the plan is 10% for the both the Pepco and Conectiv plans. These rates are expected to decline to 5.0% over the next four-year period. A one percentage point change in the assumed health care cost trend rate would have the following effects for fiscal year 2002.

	1 Percentage-Point Increase	1 Percentage-Point Decrease
	(Millions of Dollars)	
Effect on total of service and interest cost components	$ 1.6	$ (1.4)
Effect on postretirement benefit obligation	$ 21.4	$ (20.2)

The changes in benefit obligation and fair value of plan assets are presented in the following table.

	Other Post- Employment Benefits	
	2002	2001
	(Millions of Dollars)	
Change in Benefit Obligation		
Benefit obligation at beginning of year	$ 122.3	$ 113.4
Service cost	7.2	4.7
Interest cost	20.0	8.2
Acquisition	319.8	-
Actuarial loss	22.4	6.0
Benefits paid	(19.3)	(10.0)
Benefit Obligation at End of Year	$ 472.4	$ 122.3
Change in Fair Value of Plan Assets		
Fair value of plan assets at beginning of year	$ 18.7	$ 21.0
Actual return on plan assets	(.4)	(.3)
Company contributions	20.4	5.0
Acquisition	100.2	-
Benefits paid	(15.9)	(7.0)
Fair Value of Plan Assets at End of Year	$ 123.0	$ 18.7

The following table sets forth the Program's accrued benefit cost.

	Other Post- Employment Benefits	
	2002	2001
	(Millions of Dollars)	
Funded status	$ (349.4)	$ (103.6)
Unrecognized actuarial loss	82.5	55.2
Unrecognized initial net obligation	12.0	17.4

Accrued Benefit Cost	$ (254.9)	$ (31.0)

Actuarial assumptions as of December 31, 2002, and 2001 are:

	2002	2001
Discount rate	6.75 %	7.0 %
Expected return on plan assets		
Pepco	9.0 %	9.0 %
Conectiv	9.5 %	-
Rate of compensation increase		
Pepco	4.0 %	4.0 %
Conectiv	4.5 %	-

As of January 1, 2002, Pepco and Conectiv's individual plan actuarial valuations incorporated different assumptions for 2002 net periodic expense determination. The Company expects to review, and may change the actuarial assumptions of the plans for 2003.

Pepco funded the 2002 and 2001 portions of its estimated liability for Pepco postretirement medical and life insurance costs through the use of an Internal Revenue Code (IRC) 401 (h) account, within the Company's pension plan, and an IRC 501 (c) (9) Voluntary Employee Beneficiary Association (VEBA). Conectiv also annually funds a portion of its estimated postretirement liability through its VEBAs. Assets are composed of cash equivalents, fixed income investments and equity investments.

The Company also sponsors defined contribution savings plans covering all eligible employees. Under these plans, the Company makes contributions on behalf of participants. Company contributions to the plans totaled approximately $9.0 million in 2002, $4.3 million in 2001, and $5 million in 2000.

(8) LONG-TERM DEBT

The components of long-term debt are shown below.

		At December 31	
Interest Rate	Maturity	2002	2001
		(Millions of Dollars)	
First Mortgage Bonds			
Pepco:			
5.625%	2003	50.0	50.0
6.50%	2005	100.0	100.0
6.25%	2007	175.0	175.0
6.50%	2008	78.0	78.0
5.875%	2008	50.0	50.0
5.75%	2010	16.0	16.0
6.00%	2022	30.0	30.0
6.375%	2023	37.0	37.0
7.25%	2023	100.0	100.0

6.875%	2023	100.0	100.0
5.375%	2024	42.5	42.5
5.375%	2024	38.3	38.3
6.875%	2024	75.0	75.0
7.375%	2025	75.0	75.0
8.50%	2027	-	66.2
7.50%	2028	40.0	40.0
DPL:			
6.40%	2003	85.0	-
7.15% - 8.15%	2011 - 2015	33.0	-
5.90%	2021	18.2	-
7.71%	2025	100.0	-
6.05%	2032	15.0	-
ACE:			
6.63%	2013	68.6	-
7.00%	2023	62.5	-
7.00%	2028	75.0	-
6.38%	2003 - 2006	2.0	-
6.80%	2021	38.9	-
5.60%	2025	4.0	-
6.15% - 7.20%	2028 - 2029	54.7	-
Amortizing First Mortgage Bonds			
DPL:			
6.95%	2003 - 2008	17.9	-
Total First Mortgage Bonds		$ 1,581.6	1,073.0

NOTE: Schedule is continued on next page.

Interest Rate	Maturity	At December 31, 2002	2001
		(Millions of Dollars)	
First Mortgage Bonds			
5.20%	2019	$ 31.0	$ -
5.50%	2025	15.0	-
4.90%	2026	34.5	-
5.65%	2028 - 2029	16.2	-
Variable	2030 - 2032	78.4	-

Total Unsecured Tax-Exempt Bonds		175.1	-
Medium-Term Notes (secured)			
ACE:			
6.00% - 7.20%	2003	40.0	-
6.18% - 7.98%	2004 - 2008	223.0	-
7.25% - 7.63%	2010 - 2014	8.0	-
7.68%	2015 - 2016	17.0	-
Total Medium-Term Notes (secured)		288.0	-
Medium-Term Notes (unsecured)			
Pepco:			
7.46% - 7.60%	2002	-	40.0
7.64%	2007	35.0	35.0
6.25%	2009	50.0	50.0
7.00%	2024	50.0	50.0
DPL:			
8.30%	2004	4.5	-
6.75%	2006	20.0	-
7.06% - 8.13%	2007	61.5	-
7.56% - 7.58%	2017	14.0	-
6.81%	2018	4.0	-
7.61%	2019	12.0	-
7.72%	2027	10.0	-
ACE:			
6.63%	2003	30.0	-
7.50% - 7.52%	2007	15.0	-
CIV:			
6.73%	2003	50.0	-
6.73%	2004	50.0	-
5.30% - 6.73%	2005	280.0	-
6.73%	2006	20.0	-
Total Medium-Term Notes (unsecured)		$ 706.0	$ 175.0

NOTE: Schedule is continued on next page.

Interest Rate	Maturity	At December 31, 2002	2001
		(Millions of Dollars)	
First Mortgage Bonds			
2.89%	2010	$ 109.0	$ -
4.21%	2013	66.0	-
4.91%	2017	118.0	-
5.50%	2023	147.0	-
Total Asset Backed Bonds		440.0	-
Recourse Debt			
PCI:			
4.00% - 5.99%	2008	92.0	92.0
6.00% - 6.99%	2003 - 2005	213.2	228.1
7.00% - 8.99%	2003 - 2004	107.1	125.7
Total Recourse Debt		412.3	445.8
Notes (unsecured)			
PHI:			
5.50% - 7.45%	2007 - 2032	1,500.0	-
Nonrecourse debt			
PCI:			
6.57% - 9.66%		25.3	26.6
Acquisition fair value adjustment		2.4	-
Total Long-Term Debt		5,130.7	1,720.4

Net unamortized discount	(11.6)	(10.3)
Current portion	(406.3)	(108.0)
Total Net Long-Term Debt	$ 4,712.8	$ 1,602.1

The outstanding First Mortgage Bonds at Pepco, DPL and ACE are secured by a lien on substantially all of the respective Company's property, plants, and equipment.

The aggregate amount of maturities for long-term debt outstanding at December 31, 2002, are $406.3 million in 2003, $229.3 million in 2004, $502.8 million in 2005, $130.4 million in 2006, $846.4 million in 2007, and $3,003.9 million thereafter.

(9) INCOME TAXES

The provision for income taxes, reconciliation of consolidated income tax expense, and components of consolidated deferred tax liabilities (assets) are shown below.

Provision for Income Taxes

	For the Year Ended December 31,		
	2002	2001	2000
	(Millions of Dollars)		
Current Tax Expense			
Federal	$ (305.0)	$ (0.8)	$ 465.8
State and local	(17.2)	11.0	114.9
Total Current Tax (Benefit) Expense	(322.2)	10.2	580.7
Deferred Tax Expense			
Federal	400.5	58.0	(198.3)
State and local	49.2	18.9	(19.5)
Investment tax credits	(3.4)	(3.6)	(21.7)
Total Deferred Tax Expense (Benefit)	446.3	73.3	(239.5)
Total Income Tax Expense	$ 124.1	$ 83.5	$ 341.2

Reconciliation of Consolidated Income Tax Expense

	For the Year Ended December 31,					
	2002		2001		2000	
	Amount	Rate	Amount	Rate	Amount	Rate
	(Millions of Dollars)					
	$ 340.3		$ 251.9		$ 693.2	

Income Before Income Taxes								
Income tax at federal statutory rate	$	119.1	.35	$	88.2	.35	$	242.6	.35
Increases (decreases) resulting from									
Depreciation		6.6	.02		3.0	.01		11.7	.02
Removal costs		(2.4)	(.01)		(3.0)	(.01		(5.6)	(.01)
Allowance for funds used during construction		(.1)	-		0.4	-		0.9	-
State income taxes, net of federal effect		20.7	.06		19.4	.08		63.3	.09
Tax credits		(4.0)	(.01)		(3.0)	(.01		(4.8)	(.01)
Dividends received deduction		(1.8)	(.01)		(2.3)	(.01		(3.4)	-
Reversal of previously accrued deferred taxes		-	-		(7.3)	(.03		(2.1)	-
Taxes related to divestiture at non-statutory rates		-	-		6.1	.02		48.3	.07
Leveraged leases		(8.3)	(.02)		(14.4)	(.06		(4.3)	(.01)
Other		(5.7)	(.02)		(3.6)	(.01		(5.4)	(.01)
Total Income Tax Expense	$	124.1	.36	$	83.5	.33	$	341.2	.49

Components of Consolidated Deferred Tax Liabilities (Assets)

	At December 31			
		2002		2001
		(Millions of Dollars		
Deferred Tax Liabilities (Assets)				
Depreciation and other book to tax basis differences	$	1,484.4	$	511.9
Rapid amortization of certified pollution control facilities and prepayment premium on debt retirement		97.0		-

Deferred taxes on amounts to be collected through future rates	57.2	22.4
Deferred investment tax credit	(38.8)	(17.3)
Contributions in aid of construction	(57.2)	(48.1)
Goodwill, accumulated other comprehensive income, and valuation adjustments	(195.1)	-
Deferred electric service and electric restructuring liabilities	8.2	-
Finance and operating leases	246.0	123.2
Assets with a tax basis greater than book basis	(25.1)	(26.4)
Customer sharing	(3.7)	(4.7)
Transition costs	(14.3)	(14.3)
Property taxes, contributions to pension plan, and other	29.1	(6.3)
Total Deferred Tax Liabilities, Net	1,587.7	540.4
Deferred tax liabilities included in Other Current Liabilities	52.5	38.8
Total Deferred Tax Liabilities, Net-Non-Current	$ 1,535.2	$ 501.6

The net deferred tax liability represents the tax effect, at presently enacted tax rates, of temporary differences between the financial statement and tax bases of assets and liabilities. The portion of the net deferred tax liability applicable to Pepco's operations, which has not been reflected in current service rates, represents income taxes recoverable through future rates, net and is recorded as a regulatory asset on the balance sheet.

The Tax Reform Act of 1986 repealed the Investment Tax Credit (ITC) for property placed in service after December 31, 1985, except for certain transition property. ITC previously earned on Pepco's, DPL's and ACE's property continues to be normalized over the remaining service lives of the related assets.

The Company files a consolidated federal income tax return. The Company's federal income tax liabilities for all years through 1997 have been determined. The Company is of the opinion that the final settlement of its federal income tax liabilities for subsequent years will not have a material adverse effect on its financial position or results of operations.

(10) SERIAL PREFERRED STOCK AND REDEEMABLE PREFERRED STOCK

The amounts outstanding for Pepco, DPL, and ACE Serial Preferred Stock and Redeemable Serial Preferred Stock are as follows. Pre-merger (2001) amounts for DPL and ACE are not included.

			Shares Outstanding		December 31	
Issuer	Series	Redemption Price	2002	2001 (3)	2002	2001 (3)
					(Millions of Dollars)	
Pepco	$2.44 Series of 1957	$51.00	239,641	239,641	$ 12.0	$ 12.0
Pepco	$2.46 Series of 1958	$51.00	173,892	173,912	8.7	8.7

Pepco	$2.28 Series of 1965	$51.00	291,759	291,759	14.6	14.6
					$ 35.3	$ 35.3
Pepco	$3.40 Series of 1992	(1)	950,000	990,000	$ 47.5	$ 49.5
ACE	$100 per share par value, 4.00% - 5.00%	$100 - $105.5	62,305	-	6.2	-
DPL	$100 per share par value,			-	18.2	
	3.70% - 5.00%	$103 - $105	181,698			-
	6-3/4%	(2)	35,000	-	3.5	-
					$ 75.4	$ 49.5

(1) The shares of the $3.40 (6.80%) Series are subject to mandatory redemption, at par, through the operation of a sinking fund that began redeeming 50,000 shares annually, on September 1, 2002, with the remaining shares to be redeemed on September 1, 2007. The shares were not redeemable prior to September 1, 2002; thereafter, the shares are redeemable at par. The sinking fund requirements through 2006 with respect to the Redeemable Serial Preferred Stock are $2.5 million in 2004, 2005, and 2006. In the event of default with respect to dividends, or sinking fund or other redemption requirements relating to the serial preferred stock, no dividends may be paid, nor any other distribution made, on common stock. Payments of dividends on all series of serial preferred or preference stock, including series that are redeemable, must be made concurrently.

(2) Redeemable beginning November 1, 2003 at $100 per share.

(3) The 2001 amounts for ACE and DPL are pre-acquisition and therefore not included.

On September 3, 2002, Pepco redeemed $2 million or 40,000 shares of its $3.40 Serial Preferred Stock Series of 1992, pursuant to mandatory sinking fund provisions.

On December 30, 2002, DPL redeemed at par 316,500 shares of its $25 par preferred stock with an annual dividend rate of 7.75%.

(11) COMPANY OBLIGATED MANDATORILY REDEEMABLE PREFERRED SECURITIES OF SUBSIDIARY TRUST

Pepco, DPL, and ACE have wholly owned financing subsidiary trusts shown in the table below. The financing subsidiary trusts have common and preferred trust securities outstanding and hold Junior Subordinated Debentures (the Debentures) of Pepco, DPL, and ACE. Pepco, DPL, and ACE own all of the common securities of the trusts, which constitute approximately 3% of the liquidation amount of all of the trust securities issued by the trusts. The trusts use interest payments received on the Debentures, which are the trusts' only assets, to make cash distributions on the trust securities. The obligations of Pepco, DPL, and ACE pursuant to the Debentures and guarantees of distributions with respect to the trusts' securities, to the extent the trusts have funds available therefore, constitute full and unconditional guarantees of the obligations of the trusts under the trust securities the trusts have issued.

For Pepco Holdings' consolidated financial reporting purposes, the Debentures are eliminated in consolidation against the trust's investment in the Debentures. The preferred trust securities are subject to mandatory redemption upon payment of the Debentures at maturity or upon redemption. The Debentures mature in 2026 to 2038. The Debentures are subject to redemption, in whole or in part, at the option of Pepco, DPL, and/or ACE, at 100% of their principal amount plus accrued interest, after an initial period during which they may not be redeemed and at any time upon the occurrence of certain events.

Issuer	Series	Shares Outstanding 2002	Shares Outstanding 2001	Amount 2002	Amount 2001
				Millions of Dollars)	
Pepco financing trust	$25 per share, 7.375%	5,000,000	5,000,000	$ 125.0	$ 125.0
DPL financing trust	$25 per share, 8.125%	2,800,000	2,800,000	70.0	-
ACE financing trust	$25 per share, 8.25%	2,800,000	2,800,000	70.0	-
ACE financing trust	$25 per share, 7.375%	1,000,000	1,000,000	25.0	-
				$ 290.0	$ 125.0

Note: The 2001 amounts for DPL and ACE are pre-acquisition and therefore are not included.

(12) STOCK BASED COMPENSATION AND CALCULATIONS OF EARNINGS PER SHARE OF COMMON STOCK

Stock Based Compensation

The objective of the Company's long-term incentive plan (the Plan) is to increase shareholder value by providing a long-term incentive to reward officers, key employees, and directors of the Company and its subsidiaries and to increase the ownership of the Company's Common Stock by such individuals. Any officer or key employee of the Company or its subsidiaries may be designated by the Board as a participant in the Plan. Under the Plan, awards to officers and key employees may be in the form of restricted stock, options, performance units, stock appreciation rights, and dividend equivalents. Non-employee directors are entitled to a grant on May 1 of each year of a non-qualified stock option for 1,000 shares of common stock. The Board of Directors has determined that these grants will not be made. Up to 10,000,000 shares of common stock may be issued under the Plan for a period of 10 years after August 1, 2002.

Prior to the merger, Pepco and Conectiv each had a Long-Term Incentive Plan under which stock options were granted. At the time of the merger, Pepco options were exchanged on a one-for-one basis for Company stock options granted under the Company's Long-Term Incentive Plan. At the time of the merger, certain Conectiv options vested and were canceled in exchange for a cash payment. Certain other Conectiv options were exchanged on a 1 for 1.28205 basis for Company stock options under the Company's Long-Term Incentive Plan. Options were granted under Pepco's plan in May 1998 and additional options were granted in May 1999, January 2000, May 2000, January 2001, May 2001, January 2002, and May 2002. The exercise prices of the options are $24.3125, $29.78125, $22.4375, $23.15625, $24.59, $21.825, $22.57 and $22.685, respectively, which represents the market prices (fair values) of the common stock on their grant dates. Fifty percent of the options granted in 1998 became exercisable on October 9, 1998 and the remaining 50% became exercisable on June 11, 1999. Twenty-five percent of the options granted on January 1, 2000 became exercisable on January 1, 2001. The remaining options for the January 1, 2000 grant will become exercisable at the rate of twenty-five percent on January 1 of each year until January 1, 2004. Twenty-five percent of the options granted on May 1, 2000 became exercisable on May 1, 2001. The remaining options for the May 1, 2000 grant will become exercisable at the rate of twenty-five percent on May 1 of each year until May 1, 2004. Twenty-five percent of the options granted on January 1, 2001 became exercisable on January 1, 2002. The remaining options for the January 1, 2001 grant will become exercisable at the rate of twenty-five percent on January 1 of each year until January 1, 2005. Twenty-five percent of the options granted on May 1, 2001 will become exercisable on May 1, 2002. The remaining options for the May 1, 2001 grant will become exercisable at the rate of twenty-five percent on May 1 of each year until May 1,

2005. Twenty-five percent of the options granted on January 1, 2002 became exercisable on January 1, 2003. The remaining options for the January 1, 2002 grant will become exercisable at the rate of twenty-five percent on January 1 of each year until January 1, 2006. Twenty-five percent of the options granted on May 1, 2002 will become exercisable on May 1, 2003. The remaining options for the May 1, 2002 grant will become exercisable at the rate of twenty-five percent on May 1 of each year until May 1, 2006.

At the date of merger with Conectiv, 590,198 shares of Conectiv Stock Options were converted into 756,660 shares of Pepco Holdings Stock Options. These stock options were originally granted on January 1, 1998, January 1, 1999, July 1, 1999, October 18, 2000, and January 1, 2002. The exercise prices of these options, after conversion, are $17.81, $18.91, $19.30, $13.08 and $19.03, respectively, which represent the adjusted market price (fair values) of Conectiv common stock on their grant dates. All of the options granted in 1998, 1999 and 2000 are exercisable. Fifty percent of the options granted in 2002 are exercisable on January 1, 2004. The remaining options for the 2002 grant will become exercisable on January 1, 2005.

Stock option activity for the three years ended December 31 is summarized below.

	2002			2001			2000		
	Number of Shares		Weighted Average Price	Number of Shares		Weighted Average Price	Number of Shares		Weighted Average Price
Beginning-of-year balance	970,741	$	23.7810	594,341	$	22.9083	253,675	$	24.5281
Options granted	1,151,860	$	20.1363	389,600	$	24.5261	366,500	$	22.4571
Options exercised	0	$	0	-		-	13,934	$	24.3125
Options forfeited	0	$	0	13,200	$	24.0220	11,900	$	22.4375
End-of-year balance	2,122,601	$	21.8031	970,741	$	23.7810	594,341	$	22.9083
Exercisable	508,247	$	20.3969	87,125	$	22.4044	-		-

For options outstanding as of December 31, 2002, the range of exercise prices was $13.08 to $29.7813, and the weighted average remaining contractual life was approximately 8 years.

The Company recognizes compensation costs for the Plan based on the accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." There were no stock-based employee compensation costs charged to expense in 2002 and 2001, and approximately $9 thousand charged in 2000. The Company's pro forma net income and pro forma earnings per share are not substantially impacted based on the application of SFAS No. 123, "Accounting for Stock-Based Compensation" or SFAS No. 148. The after tax compensation expense that would have been recorded under SFAS No. 123 for 2002 and 2001 would have been approximately $570 thousand and $240 thousand, respectively.

Stock-based employee compensation costs, net of taxes, in respect of share awards charged to expense in 2002 was approximately $1.1 million. No amounts were expensed in 2001 or 2000.

The fair values of each option granted in 2002 and 2001, estimated on the date of grant using the Black Scholes option pricing model, and related valuation assumptions are as follows:

	2002	2001
Weighted average fair value per option	$ 3.59	$ 2.47
Expected option term (years)	8	8
Expected volatility	27.43 %	16.58 %
Expected dividend yield	5.40 %	4.74 %
Risk-free interest rate	5.20	4.92 %

The number of share award opportunities granted under Pepco's Performance Restricted Stock Program, a component of the Company's Long-Term Incentive Plan, during 2002, 2001, and 2000 were 57,000, 58,250, and 52,750, respectively. In addition, 287,800 shares award opportunities were approved under the Program for grants to be made in 2003. The fair value per share on grant date for the performance restricted stock was $22.51 for the 2002 grant, $24.43 for the 2001 grant, and $22.44 for the 2000 grant. Performance criteria are selected and measured over a three-year period. Depending on the extent to which the performance criteria are satisfied, the executives will earn some or all of the maximum award of common stock.

The number of shares and share award opportunities granted under the Merger Success Integration Program established under the Company's Long-Term Incentive Plan during 2002 was 241,075. The fair value per share on grant date was $19.73. Of those shares, 96,427 are restricted and have time based vesting over three years, with vesting of 20% in 2003, 30% in 2004, and 50% in 2005. The remaining 144,648 shares may be earned based on performance during the years 2003 and 2004. Performance criteria are selected and measured over the two-year period. Depending on the extent to which the performance criteria are satisfied, the executives will earn some or all of the maximum award of common stock. The number of shares eligible for award in 2004 for 2003 performance is 72,331 and the number of shares eligible for award for in 2005 for 2004 performance is 72,317.

On August 1, 2002, the date of the consummation of the merger with Conectiv, in accordance with the terms of the merger agreement, 80,602 shares of Conectiv performance accelerated restricted stock (PARS) were converted to 103,336 shares of Pepco Holdings restricted stock. The PARS were originally granted on January 1, 2002 at a fair market price of $24.40. All of the converted restricted stock has time based vesting over periods ranging from 5 to 7 years from the original grant date.

Calculations of Earnings Per Share of Common Stock

Reconciliations of the numerator and denominator for basic and diluted earnings per common share are shown below.

For the Year Ended December 31,

	2002	2001	2000
(Millions, except Per Share Data)			
Income (Numerator):			
Net Income	$ 210.5	$ 163.4	$ 346.5
Add: Interest paid or accrued on Convertible Debentures, net of related taxes	-	0.3	3.6
Earnings Applicable to Common Stock, Assuming Conversion of Convertible Securities	$ 210.5	$ 163.7	$ 350.1
Shares (Denominator):			
Average shares outstanding for computation of basic earnings per share of common stock	131.1 (a)	108.5	114.9
Average shares outstanding for diluted computation:			
Average shares outstanding	131.1	108.5	114.9
Additional shares resulting from the conversion of convertible debentures	-	0.3	3.4
Average Shares Outstanding for Computation of Diluted Earnings Per Share of Common Stock	131.1	108.8	118.3
Basic earnings per share of common stock	$ 1.61	$ 1.51	$ 3.02
Diluted earnings per share of common stock	$ 1.61	$ 1.50	$ 2.96

(a) Amount includes weighted average impact of 56.2 million Pepco Holdings shares issued to Conectiv shareholders on August 1, 2002 in connection with the acquisition of Conectiv.

The Company's Shareholder Dividend Reinvestment Plan (DRP) provides that shares of common stock purchased through the plan may be original issue shares or, at the option of the Company, shares purchased in the open market. The DRP permits additional cash investments by plan participants of not less than $25 each calendar month or more than $200,000 each calendar year. There were 629,777 original issue shares issued under the DRP in 2002. No original issue shares were issued under the DRP in 2001 or 2000.

The following table presents the Company's common stock reserved:

Name of Plan	Number of Shares
DRP	10,000,000
Conectiv Incentive Compensation Plan	1,800,000
Potomac Electric Power Company Long-Term Incentive Plan	1,400,000
Pepco Holdings, Inc. Long-Term Incentive Plan	10,000,000
Pepco Holdings, Inc. Stock Compensation Plan for Directors	100,000
Potomac Electric Power Company Savings Plans consisting of (i) the Savings Plan for Exempt Employees, (ii) the Savings Plan for Bargaining Unit Employees, and (iii) the Savings Plan for Non-Exempt, Non-Bargaining Unit Employees	3,000,000
Conectiv Savings and Investment Plan	20,000

Atlantic Electric Savings and Investment Plan-B	25,000
Total	26,345,000

(13) FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair values of the Company's financial instruments at December 31, 2002 and 2001 are shown below.

	At December 31,					
	2002			2001		
	(Millions of Dollars)					
		Carrying Amount	Fair Value		Carrying Amount	Fair Value
Assets						
Marketable securities	$	175.3	175.3	$	161.2	161.2
Liabilities and Capitalization						
Long-Term Debt	$	4,712.8	5,015.9	$	1,602.1	1,591.2
Company Obligated Mandatorily Redeemable Preferred Securities of Subsidiary Trust which holds Solely Parent Junior Subordinated Debentures	$	290.0	291.5	$	125.0	124.6
Serial Preferred Stock	$	35.3	26.7	$	35.3	26.1
Redeemable Serial Preferred Stock	$	75.4	69.1	$	49.5	49.4

The methods and assumptions below were used to estimate, at December 31, 2002 and 2001, the fair value of each class of financial instruments shown above for which it is practicable to estimate that value.

The fair value of the Marketable Securities was derived based on quoted market prices.

The fair values of the Long-term Debt, which includes First Mortgage Bonds and Medium-Term Notes, excluding amounts due within one year, were derived based on current market prices, or for issues with no market price available, were based on discounted cash flows using current rates for similar issues with similar terms and remaining maturities. The fair values of the Recourse and the Non-Recourse Debt held by PCI, excluding amounts due within one year, were based on current rates offered to similar companies for debt with similar remaining maturities.

The fair values of the Serial Preferred Stock, Redeemable Serial Preferred Stock, and Company Obligated Mandatorily Redeemable Preferred Securities of Subsidiary Trust, excluding amounts due within one year, were derived based on quoted market prices or discounted cash flows using current rates of preferred stock with similar terms.

The carrying amounts of all other financial instruments in Pepco Holdings' accompanying financial statements approximate fair value.

(14) COMMITMENTS AND CONTINGENCIES

Termination of Agreements for Sale of ACE Electric Generating Plants

Under the terms of agreements between ACE and NRG Energy, Inc. (NRG) for the sale of ACE's fossil fuel-fired electric generating plants (Deepwater Station, Conemaugh and Keystone Stations and B.L. England Station) the agreements were subject to termination by either party after February 28, 2002. NRG delivered notice to Conectiv on April 1, 2002 terminating these agreements. On January 13, 2003, the Company announced the termination of a second competitive bidding process initiated on May 23, 2002 to sell these ACE-owned fossil fuel-fired electric generating plants. The Company noted that while the competitive bidding process identified a number of interested parties, current conditions in the electric energy market prevented ACE from reaching agreements for the sale of these generating assets. The Company remains interested in selling these assets on acceptable terms, but cannot predict whether or not any or all of the plants will be sold, whether the New Jersey Board of Public Utilities (NJBPU) will grant the required approval of any sales agreements, or any related impacts upon recoverable stranded costs.

Basic Generation Service

Under the provisions of New Jersey's 1999 Electric Discount and Energy Competition Act (the New Jersey Act) and the NJBPU's Final Decision and Order concerning restructuring ACE's electric utility business, ACE was obligated to provide Basic Generation Service (BGS) through July 31, 2002, which entailed supplying electricity to customers in ACE's service area who do not choose an alternative supplier. The Final Decision and Order provides for the recovery through customer rates of the costs incurred by ACE in providing BGS, including an allowed return on certain electric generating plants, the above-market portion of the cost of power purchased from NUGs, and the above-market portion of costs associated with generating power for BGS customers. In recognition of this cost-based, rate-recovery mechanism, when the costs incurred by ACE in providing BGS exceed the revenues from billings to ACE's customers for BGS, the under-recovered costs are deferred as a regulatory asset. Pursuant to the terms of the 1999 restructuring of ACE's electric generation business, during 2000-2002, the under-recovered costs were first applied to a deferred energy cost liability that was eliminated and then a regulatory asset was established ($153.0 million as of December 31, 2002). After the initial four-year transition period ends July 31, 2003, customer rates are to be adjusted to recover the under-recovered cost balance over a reasonable period of time to be determined by the NJBPU. ACE's recovery of the deferred costs is subject to review by the NJBPU.

On August 1, 2002, in accordance with the provisions of the New Jersey Act and the NJBPU's Final Decision and Order, ACE petitioned the NJBPU for a $71.6 million, or 8.4%, annualized increase in electric rates, effective August 1, 2003. This proposed rate increase is intended to recover ACE's deferred cost balance as of August 1, 2003 over a four-year period and reset Power Delivery rates such that an under-recovery of certain costs is no longer embedded in rates. ACE's recovery of the deferred costs is subject to review by the NJBPU, which will determine the amount of cost recovery in accordance with the New Jersey Act. The outside auditing firm selected by the NJBPU has completed its review and audit of the deferral balance of ACE. A draft report has been provided to ACE, and ACE has responded to the NJBPU and the auditors with factual comments.

BGS electricity supply beyond July 31, 2002 was provided for by a BGS auction held in February 2002, which awarded about 1,900 MW, or 80% of ACE's BGS load to four suppliers for the period from August 1, 2002 to July 31, 2003. The remaining 20% of ACE's BGS load is supplied utilizing ACE's electric supply, consisting of its fossil fuel-fired electric generating plants (excluding Deepwater), which are used first to meet such BGS load, and its NUG contracts, to the extent such electric generating plants are not sufficient to satisfy such load.

Any portion of ACE's electric supply that exceeds the load requirement of the BGS customers is sold in the wholesale market. In addition, if any of the four suppliers awarded 80% of ACE's BGS load default on performance, ACE will offer the defaulted load to the other winning bidders. If they are not interested, ACE will then procure the needed supply from the wholesale market. Any costs related to this new supply that are not covered by remuneration from the supplier in default will be included in the calculation of deferred electric service costs, which are subject to NJBPU review and future recovery in customer rate increases.

By Decision and Order dated December 18, 2002, the NJBPU approved the process for the procurement of BGS supply for the period starting August 1, 2003. The decision included holding two separate but simultaneous auctions to procure BGS supply. The first auction will be for the supply needed to serve large commercial and industrial customers who will be paying an hourly energy price. There are approximately 50 customers in this group for ACE. The auction will determine the capacity price to be paid by these customers. The period covered by this auction is August 1, 2003 through May 31, 2004. The second auction will be for the supply needs of the remainder of the BGS customers, and would be for full requirements service (energy, capacity, transmission, and ancillary services) for these customers. In this auction, two-thirds of the needs will be procured for the same period as the first auction, while the remaining one-third of the needs will be procured for a period of 34 months. The results of these auctions will be used to set the rates paid by the customers in each group. The decision also established working groups to deal with metering issues and customer education. The auctions were conducted February 3 and 4, 2003. The NJBPU approved the results of the auctions on February 5, 2003. ACE has entered into BGS Supplier Agreements with the winning bidders. If any of the winning bidders were to default on their commitments, ACE will offer the defaulted load to other winning bidders, or will make arrangements to purchase the needed supply from PJM-administered markets.

Securitization

Under the New Jersey Act, up to 100% of recovery-eligible stranded costs related to electric generating plants and the costs to affect buyouts or buy downs of NUG contracts may be recovered through customer rates. On September 9, 2002, New Jersey enacted an amendment (Amendment) to the New Jersey Act. The Amendment permits the NJBPU to authorize the securitization of deferred balances of electric public utilities resulting from the provisions of the New Jersey Act. The NJBPU may authorize the issuance of transition bonds by an electric public utility or other financing entity in order to (i) recover stranded costs deemed eligible for rate recovery in a stranded cost recovery order; (ii) recover rate reduction requirements determined by the NJBPU to be necessary under the provisions of the New Jersey Act; or (iii) recover basic generation service transition costs. The NJBPU may approve transition bonds with scheduled amortization of up to fifteen years if related to stranded cost recoveries or recoveries of basic generation service transition costs, or the remaining term of a purchase power agreement if related to the buyout or buy down of long-term purchase power contracts with NUGs.

On September 20, 2002, the NJBPU issued a Bondable Stranded Costs Rate Order (Financing Order) to ACE authorizing the issuance of $440 million of Transition Bonds. ACE issued Transition Bonds totaling $440 million on December 19, 2002, in accordance with this Financing Order. The proceeds of these bonds will be used to recover the stranded costs associated with the divestiture of the ACE nuclear assets, the buyout of the Pedricktown NUG contract and the buy down of the American Ref-Fuel NUG contract. Also included in the amount authorized was $20 million of transaction costs and capital reduction costs.

ACE formed ACE Transition Funding during 2001 as a special purpose entity (SPE) for the sole purpose of purchasing and owning the bondable transition property (BTP), issuing transition bonds (Bonds), pledging ACE Transition Funding's interest in BTP and other collateral to the bond trustee to collateralize the Bonds, and performing activities that are necessary, suitable or convenient to accomplish these purposes. Proceeds from the sale of Bonds were transferred to ACE in consideration for the BTP, and ACE will repurchase debt and/or equity related to the stranded costs and NUG contracts noted above. The Bonds of

ACE Transition Funding are included in the accompanying Consolidated Balance Sheets.

On January 31, 2003, ACE filed a petition seeking from the NJBPU an administrative valuation of a portion of the B.L. England Station stranded costs and a finding that such costs may be included as part of the principal amount of transition bonds for which ACE may seek approval under the New Jersey Act. Management anticipates that the necessary approvals will be received from the NJBPU and that a bondable stranded costs rate petition will ultimately be approved, leading to the issuance of additional transition bonds.

Rate Increase

On February 3, 2003, ACE filed a petition with the NJBPU to increase its electric distribution rates and the Regulatory Asset Recovery Charge in New Jersey. The request, if approved, will increase ACE's annual revenues by approximately $68.4 million. The petition was filed in accordance with the NJBPU's Final Order in restructuring, which mandated that ACE file a plan to set rates that will be in place when the New Jersey Act's transition period ends July 31, 2003.

Pepco Regulatory Contingencies

Final briefs on Pepco's District of Columbia divestiture proceeds sharing application were filed on July 31, 2002 following an evidentiary hearing in June 2002. That application was filed to implement a provision of Pepco's D.C. Commission approved divestiture settlement that provided for a sharing of any net proceeds from the sale of its generation related assets. A principal issue in the case is whether a sharing between customers and shareholders of the excess deferred income taxes and accumulated deferred investment tax credits associated with the sold assets would violate the normalization provisions of the Internal Revenue Code and implementing regulations. On March 4, 2003, the Internal Revenue Service (IRS) issued a notice of proposed rulemaking (NOPR) that could be relevant to that principal issue. Comments on the NOPR must be filed by June 2, 2003, and the IRS will hold a public hearing on June 2, 2003. Pepco cannot predict whether the IRS will adopt the regulations as proposed, make changes before issuing final regulations or decide not to adopt regulations. Other issues deal with the inclusion of internal costs and cost allocations. Pepco believes that its calculation of the customers' share of divestiture proceeds is correct. However, the potential exists that Pepco could be required to make additional gain sharing payments to D.C. customers. Such additional payments, which cannot be estimated, would be charged to expense and could have a material adverse effect on results of operations in the quarter and year in which a decision is rendered; however, Pepco does not believe that additional payments, if any, will have a material adverse impact on its financial position. It is impossible to predict when the D.C. Commission will issue a decision.

Pepco filed its divestiture proceeds plan application in Maryland in April 2001. Reply briefs were filed in May 2002 and Pepco is awaiting a Proposed Order from the Hearing Examiner. It is a certainty that some party or parties will appeal the Hearing Examiner's Proposed Order to the Maryland Commission. The principal issue in the case is the same normalization issue that was raised in the D.C. case. On March 4, 2003, the IRS issued a NOPR that could be relevant to that principal issue. Comments on the NOPR must be filed by June 2, 2003, and the IRS will hold a public hearing on June 2, 2003. Pepco cannot predict whether the IRS will adopt the regulations as proposed, make changes before issuing final regulations or decide not to adopt regulations. Other issues deal with the inclusion of internal costs and cost allocations. Pepco believes that its calculation of the customers' share of divestiture proceeds is correct. The potential also exists that Pepco would be required to make additional gain sharing payments to Maryland customers. Such additional payments, which cannot be estimated, would be charged to expense and could have a material adverse effect on results of operations in the quarter and year in which a decision is rendered; however, Pepco does not believe that additional payments, if any, will have a material adverse impact on its financial position. It is impossible to predict when the Hearing Examiner or the Maryland Commission will issue their decisions.

In Maryland, in accordance with the terms of an agreement approved by the Maryland Commission, customers who are unable to receive generation services from another supplier, or who do not select another supplier, are entitled to receive services from Pepco until July 1, 2004 (Standard Offer Service or SOS). Pepco has entered into a settlement in Phase I of Maryland Case No. 8908 to extend its provision of SOS services in Maryland. The Settlement is awaiting approval from the Maryland Commission. The Settlement provides for an extension of SOS for four years for residential and small commercial customers, an extension of two years for medium sized commercial customers, and an extension of one year for large commercial customers. The settlement provides for a policy review by the Commission to consider how SOS will be provided after the current extension expires. The settlement provides for SOS to be procured from the wholesale marketplace and that Pepco will be able to recover its costs of procurement and a return.

Full Requirements Contract with Mirant

Under a full requirements contract entered into in 2000 in connection with the purchase by Mirant Corporation of substantially all of Pepco's electricity generation assets, Mirant is obligated to supply Pepco with all of the capacity and energy needed to fulfill these default service obligations at fixed prices that are lower than currently approved tariff rates that Pepco charges for providing such service. If Mirant were to fail to fulfill its supply obligations, Pepco would have to find alternative sources of supply at rates then prevailing.

Environmental Matters

The Company through its subsidiaries is subject to regulation with respect to the environmental effects of their operations, including air and water quality control, solid and hazardous waste disposal, and limitations on land use by various federal, regional, state, and local authorities. Federal and state statutes authorize governmental agencies to compel responsible parties to clean up certain abandoned or uncontrolled hazardous waste sites. The Company's subsidiaries may incur costs to clean up facilities found to be contaminated due to current and past disposal practices. The Company's subsidiaries' liability for clean-up costs is affected by the activities of these governmental agencies and private land-owners, the nature of past disposal practices, the activities of others (including whether they are able to contribute to clean-up costs), and the scientific and other complexities involved in resolving clean up-related issues (including whether a Pepco Holdings subsidiary or a corporate predecessor is responsible for conditions on a particular parcel). The Company's current liabilities include approximately $22.7 million as of December 31, 2002, for potential clean-up and other costs related to sites at which a Conectiv subsidiary is a potentially responsible party, alleged to be a third-party contributor, or has made a decision to clean up contamination on its own property. The accrued liability as of December 31, 2002, included $11.2 million for remediation and other costs associated with environmental contamination that resulted from an oil release at the Indian River power plant (which was sold on June 22, 2001) and reflects the terms of a related consent agreement reached with the Delaware Department of Natural Resources and Environmental Control during 2001. As a result of discontinuing the second competitive bidding process for ACE's fossil fuel-fired generating stations and management's decision to clean up contamination on its own property, ACE's anticipated $7 million costs to clean up the Deepwater generating station is included in the previously stated $22.7 million liability. The costs of cleaning up ACE's B.L. England generating station have not yet been quantified. The Company does not expect such future costs to have a material effect on the Company's financial position or results of operations.

In April 2002, EPA proposed regulations addressing best technology available for minimizing environmental impact from existing power production cooling water intake structures. The ACE Deepwater electric generating station's New Jersey Pollution Discharge Elimination System (NJPDES) renewal permit, effective through September 30, 2007 will require a study to evaluate the efficiency of recent changes to the intake structure and other biological impact studies that will be submitted with a permit renewal application in 2007. The NJPDES permit for the B.L. England Station expired in December 1999, but has been administratively extended, through submittal of a renewal application, and the plant continues to operate under the conditions of the existing permit until a renewal permit is issued by the New Jersey Department of Environmental Protection (NJDEP).

A Conectiv subsidiary holds a National Pollution Discharge Elimination System (NPDES) permit for the Edge Moor Power Plant. Studies to determine impacts on aquatic organisms by the plant's intake structures, required by the existing permit which expires in October 2003, were completed in 2002. The results of these studies and additional site specific studies on alternative technologies are expected to determine whether changes to intake structures are required to comply with any final rule that EPA adopts.

On May 4, 2002, ACE, Conectiv Atlantic Generation, LLC (CAG), and the NJDEP entered into an Administrative Consent Order (ACO) to address ACE's and CAG's inability to procure Discrete Emission Reductions (DER) credits to comply with New Jersey's NO_x Reasonable Available Control Technology (RACT) requirements and NJDEP's allegations that ACE had failed to comply with DER credit use restrictions from 1996 to 2001. The ACO eliminates requirements for ACE and CAG to purchase DER credits for certain ACE and CAG electric generating units through May 1, 2005 and provides, among other things, for installation of new controls on CAG's electric generating units ($7 million estimated cost), a $1.0 million penalty, a $1.0 million contribution to promote, develop and enhance an urban airshed reforestation project, and operating hour limits at ACE's Deepwater Unit No. 4.

On July 11, 2001, the NJDEP denied ACE's request to renew a permit variance, effective through July 30, 2001, that authorized Unit 1 at the B.L. England station to burn coal containing greater than 1% sulfur. ACE has appealed the denial. The NJDEP has issued a number of stays of the denial to authorize ACE to operate Unit 1 with the current fuel until May 29, 2003. NJDEP also issued addendums to the permit/certificate to operate for Unit 1 authorizing trial burns of coal with a sulfur content less than 2.6%. ACE is requesting an extension of the current stay of the denial and submitted final wrap-up reports on the results of its test burns to NJDEP on January 28, 2003. Management is not able to predict the outcome of ACE's appeal, including the effects, if any, of trial burn results on NJDEP's position with regard to the denial or the appeal.

In February 2000, the United States Environmental Protection Agency (USEPA) and NJDEP requested information from ACE regarding the operation of coal-fired boilers at ACE's B.L. England and Deepwater generating stations. As of December 2002, in responding to this request and numerous subsequent requests, ACE has provided more than 24,000 pages of documents covering activities at B.L. England and Deepwater since 1978 to USEPA and NJDEP. USEPA has sought this information pursuant to its authority under Clean Air Act Section 114, and the ACE requests are similar to those that USEPA has made of other electric utilities to determine compliance with New Source Review (NSR) Prevention of Significant Deterioration (PSD) and non-attainment NSR requirements. Similar inquiries have resulted in the filing of federal lawsuits against utilities in the South and Midwest. A number of settlements of litigation brought as a result of such inquiries alleging violations of NSR standards have been announced. In January 2002, the Department of Justice completed its review of the USEPA's enforcement actions and concluded that the USEPA has a reasonable basis on which to pursue NSR enforcement. On December 31, 2002, EPA published an NSR reform package including both proposed and final rules. The proposed rule offers options for clarifying the routine maintenance, repair and replacement exclusion to the NSR rules. It is unclear how EPA's proposed reform rules will ultimately impact the on-going NSR enforcement actions; however, EPA officials have indicated their intention to continue with the NSR enforcement initiative targeting alleged past violations under the current rules. ACE met with EPA and NJDEP in May 2002 to discuss NSR issues. Since then, ACE entered into a confidentiality agreement with the government agencies. The Company does not believe that it has violated NSR requirements. Management cannot predict the impact of the USEPA/NJDEP inquiries or proposal on B.L England or Deepwater operations.

In October 1995, Pepco received notice from the EPA that it, along with several hundred other companies, may be a potentially responsible party (PRP) in connection with the Spectron Superfund Site located in Elkton, Maryland. The site was operated as a hazardous waste disposal, recycling, and processing facility from 1961 to 1988. In August 2001, Pepco entered into a Consent Decree for de minimis parties with EPA to resolve its liability at this site. Pursuant to the consent decree, in return for a de minimis payment by Pepco to the United States and a group of PRPs, those parties covenant not to sue Pepco for past and future costs of remediation at the site and the United States will also provide contribution protection against third party claims related to response actions at the site. Natural resource damages, if any, are not covered by the Consent Decree. Court approval of the Consent Decree is pending. Pepco believes that its liability at this site, pursuant to the terms of the Consent Decree, will not have a material adverse effect on its financial position or results of operations.

In June 1992, EPA identified ACE as a PRP at the Bridgeport Rental and Oil Services (BROS) superfund site in Logan Township, New Jersey. In September 1996, ACE along with other PRPs signed a consent decree with EPA and NJDEP to address remediation of the Site. ACE's liability is limited to 0.232 percent and ACE has made contributions of approximately $105,000. The Phase 2 Remedial Investigation/Feasibility Study (RI/FS) to address groundwater and wetlands contamination is scheduled to be completed in September 2003. ACE believes that its liability at this site will not have a material adverse effect on its financial position or results of operations.

In November 1991, NJDEP identified ACE as a PRP at the Delilah Road Landfill site in Egg Harbor Township, New Jersey. In 1993, ACE, along with other PRPs, signed an Administrative Consent Order (ACO) with NJDEP to remediate the Site. The soil cap remedy for the Site has been completed and the NJDEP conditionally approved the Remedial Action Report in January 2003. The results of groundwater monitoring over the next year will help to determine the extent of post-remedy operation and maintenance costs.

In December 1987, Pepco was notified by the EPA that it, along with several other utilities and nonutilities, is a PRP in connection with the polychlorinated biphenyl compounds (PCBs) contamination of a Philadelphia, Pennsylvania, site owned by a nonaffiliated company. In the early 1970s, Pepco sold scrap transformers, some of which may have contained some level of PCBs, to a metal reclaimer operating at the site. In October 1994, a Remedial Investigation/Feasibility Study (RI/FS) including a number of possible remedies was submitted to the EPA. In December 1997, the EPA signed a ROD that set forth a selected remedial action plan with estimated implementation costs of approximately $17 million. In June 1998, the EPA issued a unilateral Administrative Order to Pepco and 12 other PRPs to conduct the design and actions called for in the ROD. At December 31, 2002, Pepco has accrued $1.7 million for its share of these costs. Pepco believes that its liability at this site will not have a material adverse effect on its financial position or results of operations.

Pepco's Benning Service Center facility operates under a National Pollutant Discharge Elimination System (NPDES) permit. The EPA issued an NPDES permit for this facility in November 2000. Pepco has filed a petition with the EPA Environmental Appeals Board seeking review and reconsideration of certain provisions of the EPA's permit determination. In May 2001, Pepco and the EPA reached a settlement on Pepco's petition, pursuant to which the EPA withdrew certain contested provisions of the permit and agreed to issue a revised draft permit for public comment. As of December 31, 2002, the EPA has not issued a revised permit and Pepco is operating pursuant to the November 2000 permit absent the withdrawn conditions in accordance with the settlement agreement.

In the late 1980's DPL was identified by EPA as a PRP at the Spectron Superfund Site located in Elkton, Maryland. The site was operated as a hazardous waste disposal, recycling, and processing facility from 1961 to 1988. The PRP Group determined that in 1987 and 1988 DPL sent 440 gallons of waste paint to the site. DPL paid $290.40 in connection with a Consent Agreement as a Non-Performing Settling Party to resolve its liability for Phase I activities at the site. In September 1991 DPL made an additional $500 payment pursuant to a second Administrative Consent Order initiating Phase II activities. The site was added to the National Priorities List in 1994. In February 2003, the PRP Group informed DPL that DPL was a de micromis party at the Site because its 440 gallon contribution to the Site was less than EPA's 890 gallon threshold for de minimis status and that DPL has no further liability for contribution to the Site's remediation fund.

In the late 1980's, DPL was notified by the EPA that it, along with several other utilities and nonutilities was a PRP in connection with the polychlorinated biphenyl compounds (PCBs) contamination at the Metal Bank/Cottman Avenue site located in Philadelphia, Pennsylvania at which the Site owner, from 1968 to 1972, drained oil from used transformers to reclaim copper. Based on the PRP group's determination that DPL sent 102 transformers to the Site, DPL was allocated responsibility for 0.24 percent of remediation costs. In October 1994, a Remedial Investigation/Feasibility Study (RI/FS) including a number of possible remedies was submitted to the EPA. In December 1997, the EPA signed a Record of Decision (ROD) that set forth a selected remedial action plan with estimated implementation costs of approximately $17 million. In 1999, DPL entered into a de minimis settlement with EPA and paid approximately $107,000 to resolve its liability for cleanup costs at the Site. The de minimis settlement did not resolve DPL's responsibility for natural resource damages, if any, at the Site. DPL believes that its liability at this site will not have a material adverse effect on its financial position or results of operations.

Litigation

During 1993, Pepco was served with Amended Complaints filed in three jurisdictions (Prince George's County, Baltimore City and Baltimore County), in separate ongoing, consolidated proceedings each denominated, "In re: Personal Injury Asbestos Case." Pepco (and other defendants) were brought into these cases on a theory of premises liability under which plaintiffs argue that Pepco was negligent in not providing a safe work environment for employees or its contractors who allegedly were exposed to asbestos while working on Pepco's property. Initially, a total of approximately 448 individual plaintiffs added Pepco to their Complaints. While the pleadings are not entirely clear, it appears that each plaintiff seeks $2 million in compensatory damages and $4 million in punitive damages from each defendant. In a related proceeding in the Baltimore City case, Pepco was served, in September 1993, with a third-party complaint by Owens Corning Fiberglass, Inc. (Owens Corning) alleging that Owens Corning was in the process of settling approximately 700 individual asbestos-related cases and seeking a judgment for contribution against Pepco on the same theory of alleged negligence set forth above in the plaintiffs' case. Subsequently, Pittsburgh Corning Corp. (Pittsburgh Corning) filed a third-party complaint against Pepco, seeking contribution for the same plaintiffs involved in the Owens Corning third-party complaint. Since the initial filings in 1993, approximately 90 additional individual suits have been filed against Pepco. The third-party complaints involving Pittsburgh Corning and Owens Corning were dismissed by the Baltimore City Court during 1994 without any payment by Pepco. As of December 31, 2002, approximately 200 cases were pending against Pepco. Of the 200 remaining asbestos cases pending against Pepco, approximately 35 of those cases have been tendered to Mirant for defense and indemnification pursuant to the Asset Purchase and Sale Agreement which was executed in December 2000. While the aggregate amount specified in the remaining suits would exceed $400 million, Pepco believes the amounts are greatly exaggerated, as were the claims already disposed of. The amount of total liability, if any, and any related insurance recovery cannot be precisely determined at this time; however, based on information and relevant circumstances known at this time, Pepco does not believe these suits will have a material adverse effect on its financial position. However, an unfavorable decision rendered against Pepco could have a material adverse effect on results of operations in the year in which a decision is rendered.

On April 7, 2000, approximately 139,000 gallons of oil leaked from a pipeline at a generation station that was owned by Pepco at Chalk Point in Aquasco, Maryland. The pipeline was operated by Support Terminals Services Operating Partnership LP, an unaffiliated pipeline management company. The oil spread from Swanson Creek to the Patuxent River and several of its tributaries. The area affected covers portions of 17 miles of shoreline along the Patuxent River and approximately 45 acres of marshland adjacent to the Chalk Point property. As a result of the oil spill, eleven class action lawsuits and two additional lawsuits on behalf of a number of Southern Maryland residents, businesses and watermen were filed against Pepco. On November 27, 2001, Pepco and ST Services entered into a Settlement Agreement with the various plaintiffs to settle all pending class action litigation stemming from the oil spill. Under the Settlement Agreement, a total of $2.25 million was placed in an escrow account to be distributed to watermen and property owner class members pursuant to a Plan of Distribution filed with the Court. On December 27, 2001, the Court entered an "Order Certifying Settlement Classes and Preliminarily Approving Proposed Settlement," which was approved in April 2002. In April 2002, the Claims Administrator provided the Court with a list of those members of the Settlement Classes which had timely excluded themselves from the Settlement Agreement. Approximately 80 class members elected to exclude themselves from the terms of the November 27, 2001 Settlement Agreement.

On December 2, 2001, Enron North America Corp. and several of its affiliates filed for protection under the United States Bankruptcy Code. In December 2001, DPL and Conectiv Energy Supply, Inc. (CESI) terminated all transactions under various agreements with Enron North America Corp. and Enron Power Marketing, Inc. (EPMI and, together with Enron North America Corp., Enron). In late January 2003, after several months of discussions attempting to arrive at a settlement with Enron concerning the amount owed by Delmarva and CESI, EPMI filed an adversary complaint (the Complaint) against CESI in the Bankruptcy Court for the Southern District of New York. The Complaint seeks an order from the Bankruptcy Court that, among other things, (1) awards damages in the amount of approximately $11.7 million, plus interest and attorney's fees and additional damages (in an amount to be determined at trial), (2) declares unenforceable the provisions of the master power purchase and sale agreement (MPPSA) between CESI and EPMI that permitted CESI to set off against any amounts CESI owes EPMI under the MPPSA any amounts due by EPMI or any of its affiliates to CESI or any of its affiliates under any agreements among EPMI or any of its affiliates and CESI and any of its affiliates, and (3) declares that the arbitration provision in the MPPSA should not be enforced. CESI disagrees with Enron's calculation of the amount due (CESI's calculations result in an amount due of approximately $3.8 million) and believes that Enron's other claims are without merit. CESI's response to the Complaint is due on April 7, 2003. At the present time, it is not possible to predict the outcome of this suit or to estimate with specificity the amount that CESI will ultimately pay Enron; however, based on, among other factors, the specific provisions in the applicable contracts of the Conectiv subsidiaries with Enron and applicable legal principles, Management does not believe that the Company has material financial exposure related to the Enron bankruptcy.

The Company, through its subsidiaries, is involved in other legal and administrative (including environmental) proceedings before various courts and agencies with respect to matters arising in the ordinary course of business. Management is of the opinion that the final disposition of these proceedings will not have a material adverse effect on the Company's financial position or results of operations.

Third Party Guarantees

At December 31, 2002, Pepco Holdings and its subsidiaries guaranteed $416.5 million of third party obligations. The detail of these guarantees is summarized below.

	Guarantor			
	PHI	Conectiv	PCI	Total
	(Dollars in Millions)			
Energy trading obligations of Conectiv Energy	$ 80.7	$ 136.3	-	$ 217.0
Energy trading obligations of Pepco Energy Services	36.9	-	-	36.9
Construction performance guarantees	85.3	36.6	-	121.9
Other	-	28.2	12.5	40.7
Total	$ 202.9	$ 201.1	$ 12.5	$ 416.5

Pepco Holdings and the above referenced significant subsidiaries guarantee payments to counter-parties related to routine energy trading obligations, including requirements under BGS contracts for ACE. A portion of Conectiv's Mid-merit plant program and the energy management programs of Pepco Energy Services contains construction payment guarantees. Pepco Holdings also has investments in partnerships and joint ventures, which are accounted for under the equity method of accounting. Pepco Holdings and its subsidiaries guarantee certain payment and performance obligations associated with these unconsolidated entities.

Dividends Declared

Pepco Holdings' Board of Directors has declared a quarterly dividend on common stock of $.25 per share to be paid March 31, 2003, to shareholders of record on March 10, 2003.

(15) QUARTERLY FINANCIAL SUMMARY (UNAUDITED)

		1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
		(Millions of Dollars, except Per Share Data)				
2002						
Total Operating Revenue	$	489.2	581.2	1,641.2	1,607.5	4,324.5
Total Operating Expenses	$	426.3	481.8	1,383.4	1,484.7	3,778.9
Operating Income	$	62.9	99.4	257.8	122.8	545.6
Other (Expenses)	$	(24.9)	(25.0)	(62.2)	(75.5)	(190.4)
Preferred Stock Dividend Requirements of Subsidiaries	$	3.6	3.6	6.1	7.4	20.6
Income Tax Expense	$	11.1	25.1	74.3	13.6	124.1
Net Income	$	23.3	45.7	115.2	26.3	210.5
	$	.22	.43	.80	.16	1.61

Basic Earnings Per Share of Common Stock						
Diluted Earnings Per Share of Common Stock	$	.22	.43	.80	.16	1.61
Cash Dividends Per Common Share	$	.25	.25	.25	.25	1.00
2001						
Total Operating Revenue	$	607.0	592.0	720.0	481.9	2,400.5
Total Operating Expenses	$	474.7	492.5	586.8	489.3	2,034.1
Operating Income	$	132.8	99.5	133.2	(7.4)	366.4
Other (Expenses)	$	(19.0)	(28.4)	(25.1)	(32.4)	(105.3)
Preferred Stock Dividend Requirements of Subsidiaries	$	3.5	3.6	3.6	3.6	14.2
Income Tax Expense (Benefit)	$	46.6	19.3	35.8	(26.2)	83.5
Net Income (Loss)	$	63.7	48.2	68.7	(17.2)	163.4
Basic Earnings (Loss) Per Share of Common Stock	$	.58	.45	.64	(.16)	1.51
Diluted Earnings (Loss) Per Share of Common Stock	$	.57	.45	.64	(.16)	1.50
Cash Dividends Per Common Share	$	.415	.25	.25	.25	1.165

NOTES: As a result of the merger transaction that was completed on August 1, 2002, the third and fourth quarter 2002 results are not comparable with the prior years presented. For additional information, refer to the Management's Discussion and Analysis of Financial Condition and Results of Operations "Overview" and "Lack of Comparability of Operating Results with Prior Years" sections, herein.

The Company's subsidiaries' sales of electric energy are seasonal and, accordingly, comparisons by quarter within a year are not meaningful. The totals of the four quarterly basic earnings per common share and diluted earnings per common share may not equal the basic earnings per common share and diluted earnings per common share for the year due to changes in the number of common shares outstanding during the year and, with respect to the diluted earnings per common share, changes in the amount of dilutive securities.

All periods presented include the reclassification of revenues and expenses required by EITF 02-3.

Part IV

Item 15.

EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

EXHIBITS

Item 15, Exhibits, Financial Statement Schedules and Reports on Form 8-K is hereby amended to include the following additional exhibit:

Exhibit No.	Registrant(s)	Description of Exhibit	Reference
23.7	PHI	Consent of Independent Accountants	Filed herewith.

(c) Exhibits

Exhibit 23.7

Consent of Independent Accountants

We hereby consent to the incorporation by reference in the Registration Statement on Form S-4 (Number 333-103408), the Registration Statements on Forms S-3 (Numbers 333-89938, 333-100478 and 333-104350) and the Registration Statements on Forms S-8 (Numbers 333-96673, 333-96675 and 333-96687) of Pepco Holdings, Inc. of our report dated February 10, 2003, except as to the twelfth and thirteenth paragraphs of Note 14 for which the date is March 4, 2003, relating to the consolidated financial statements of Pepco Holdings, Inc., which appears in this Form 10-K/A. We also consent to the incorporation by reference of our report dated February 10, 2003, relating to the consolidated financial statement schedule of Pepco Holdings, Inc., which appears in this Form 10-K/A.

PRICEWATERHOUSECOOPERS LLP
Washington, DC
May 20, 2003

SIGNATURES

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

PEPCO HOLDINGS, INC. ("Pepco Holdings")
(Registrant)

By /s/ JOHN M. DERRICK, JR.

May 20, 2003

John M. Derrick, Jr.,
Chairman of the Board and
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the above named registrant and in the capacities and on the dates indicated:

/s/ JOHN M. DERRICK, JR. John M. Derrick, Jr.	Chairman, Chief Executive Officer and Director of Pepco Holdings, Inc. **(Principal Executive Officer of Pepco Holdings, Inc.)**	May 20, 2003
/s/ A. W. WILLIAMS Andrew W. Williams	Senior Vice President and Chief Financial Officer of Pepco Holdings, Inc. **(Principal Financial Officer of Pepco Holdings, Inc.)**	May 20, 2003
/s/ JAMES P. LAVIN James P. Lavin	Vice President and Controller of Pepco Holdings, Inc. **(Principal Accounting Officer of Pepco Holdings, Inc.)**	May 20, 2003

Signature	Title	Date
Edmund B. Cronin, Jr.* Edmund B. Cronin, Jr.	Director, Pepco Holdings, Inc.	May 20, 2003
Terence C. Golden	Director, Pepco Holdings, Inc.	
George F. MacCormack* George F. MacCormack	Director, Pepco Holdings, Inc.	May 20, 2003
Richard B. McGlynn* Richard B. McGlynn	Director, Pepco Holdings, Inc.	May 20, 2003
Judith A. McHale* Judith A. McHale	Director, Pepco Holdings, Inc.	May 20, 2003
Floretta D. McKenzie*	Director, Pepco Holdings, Inc.	May 20, 2003

Floretta D. McKenzie

Lawrence C. Nussdorf*	Director, Pepco Holdings, Inc.	May 20, 2003
Lawrence C. Nussdorf		
Peter F. O'Malley*	Director, Pepco Holdings, Inc.	May 20, 2003
Peter F. O'Malley		
Pauline A. Schneider*	Director, Pepco Holdings, Inc.	May 20, 2003
Pauline A. Schneider		
/s/ D. R. WRAASE	Director, Pepco Holdings, Inc.	May 20, 2003
Dennis R. Wraase		
____________	Director, Pepco Holdings, Inc.	
A. Thomas Young		

*By: /s/ ELLEN SHERIFF ROGERS May 20, 2003
Ellen Sheriff Rogers
Attorney-in-Fact

INDEX TO EXHIBITS FILED HEREWITH

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23.7	PHI	Consent of Independent Accountants