

COVANTA HOLDING CORP

Form 10-Q

October 20, 2010

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

**Form 10-Q**

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

**For the quarterly period ended September 30, 2010**

**or**

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

**For the transition period from to**

**Commission file number 1-06732**

**COVANTA HOLDING CORPORATION**  
*(Exact name of registrant as specified in its charter)*

**Delaware**  
*(State or Other Jurisdiction of  
Incorporation or Organization)*

**95-6021257**  
*(I.R.S. Employer  
Identification Number)*

**40 Lane Road, Fairfield, NJ**  
*(Address of Principal Executive Office)*

**07004**  
*(Zip Code)*

**(973) 882-9000**  
**(Registrant's telephone number including area code)**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

**Applicable Only to Corporate Issuers:**

The number of shares of the registrant's Common Stock outstanding as of the last practicable date.

| <b>Class</b>                   | <b>Outstanding at October 14, 2010</b> |
|--------------------------------|--|
| Common Stock, \$0.10 par value | 153,406,403 shares                     |

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**FORM 10-Q QUARTERLY REPORT**  
**For the Quarter Ended September 30, 2010**

**PART I. FINANCIAL INFORMATION**

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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Certain statements in this Quarterly Report on Form 10-Q may constitute forward-looking statements as defined in Section 27A of the Securities Act of 1933 (the Securities Act ), Section 21E of the Securities Exchange Act of 1934 (the Exchange Act ), the Private Securities Litigation Reform Act of 1995 (the PSLRA ) or in releases made by the Securities and Exchange Commission ( SEC ), all as may be amended from time to time. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of Covanta Holding Corporation and its subsidiaries ( Covanta ) or industry results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Statements that are not historical fact are forward-looking statements. Forward-looking statements can be identified by, among other things, the use of forward-looking language, such as the words plan, believe, expect, anticipate, intend, estimate, project, may, will, would, could, should, seeks, similar words, or the negative of these terms or other variations of these terms or comparable language, or by discussion of strategy or intentions. These cautionary statements are being made pursuant to the Securities Act, the Exchange Act and the PSLRA with the intention of obtaining the benefits of the safe harbor provisions of such laws. Covanta cautions investors that any forward-looking statements made by Covanta are not guarantees or indicative of future performance. Important assumptions and other important factors that could cause actual results to differ materially from those forward-looking statements with respect to Covanta include, but are not limited to, the risks and uncertainties affecting their businesses described in Item 1A. Risk Factors of Covanta s Annual Report on Form 10-K for the year ended December 31, 2009 and in other filings by Covanta with the SEC.

Although Covanta believes that its plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, actual results could differ materially from a projection or assumption in any of its forward-looking statements. Covanta s future financial condition and results of operations, as well as any forward-looking statements, are subject to change and inherent risks and uncertainties. The forward-looking statements contained in this Quarterly Report on Form 10-Q are made only as of the date hereof and Covanta does not have or undertake any obligation to update or revise any forward-looking statements whether as a result of new information, subsequent events or otherwise, unless otherwise required by law.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

|   | <b>Three Months Ended<br/>September 30,</b>     |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2010</b>                                     | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
|   | <b>(Unaudited)</b>                              |             |  |             |
|   | <b>(In thousands, except per share amounts)</b> |             |  |             |
| <b>OPERATING REVENUES:</b>                                |   |             |  |             |
| Waste and service revenues                                | \$ 257,878                                      | \$ 233,187  | \$ 768,433                                 | \$ 667,298  |
| Electricity and steam sales                               | 148,051   | 161,342     | 438,005                                    | 439,751     |
| Other operating revenues                                  | 31,048  | 14,180      | 82,545                                     | 36,206      |
| Total operating revenues                                  | 436,977   | 408,709     | 1,288,983                                  | 1,143,255   |
| <b>OPERATING EXPENSES:</b>                                |   |             |  |             |
| Plant operating expenses                                  | 242,069   | 233,290     | 813,086                                    | 703,888     |
| Other operating expenses                                  | 28,707  | 14,804      | 77,568                                     | 34,270      |
| General and administrative expenses                       | 23,014  | 28,945      | 77,401                                     | 81,366      |
| Depreciation and amortization expense                     | 48,622  | 48,057      | 146,527                                    | 150,717     |
| Net interest expense on project debt                      | 9,880   | 12,634      | 31,266                                     | 37,511      |
| Write-down of assets                                      | 32,321  |             | 32,321                                     |             |
| Total operating expenses                                  | 384,613   | 337,730     | 1,178,169                                  | 1,007,752   |
| Operating income  | 52,364  | 70,979      | 110,814                                    | 135,503     |
| <b>Other income (expense):</b>                            |   |             |  |             |
| Investment income   | 574   | 952         | 1,669                                      | 3,136       |
| Interest expense  | (10,970)  | (10,843)    | (32,250)                                   | (27,291)    |
| Non-cash convertible debt related expense                 | (9,779)   | (3,465)     | (29,760)                                   | (14,562)    |
| Total other expenses                                      | (20,175)  | (13,356)    | (60,341)                                   | (38,717)    |
| Income before income tax expense and equity in net income |   |             |  |             |
| from unconsolidated investments                           | 32,189  | 57,623      | 50,473                                     | 96,786      |
| Income tax expense  | (16,414)  | (19,614)    | (23,348)                                   | (34,197)    |
| Equity in net income from unconsolidated investments      | 6,833   | 5,611       | 18,024                                     | 17,091      |

|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| <b>NET INCOME</b>   | 22,608    | 43,620    | 45,149    | 79,680    |
| Less: Net income attributable to noncontrolling interests in subsidiaries | (2,451)   | (2,768)   | (6,436)   | (6,312)   |
| <b>NET INCOME ATTRIBUTABLE TO COVANTA HOLDING CORPORATION</b>             | \$ 20,157 | \$ 40,852 | \$ 38,713 | \$ 73,368 |
| <b>Weighted Average Common Shares Outstanding:</b>                        |           |           |           |           |
| Basic   | 153,443   | 153,779   | 153,907   | 153,660   |
| Diluted   | 154,312   | 155,110   | 154,639   | 154,935   |
| <b>Earnings Per Share:</b>  |           |           |           |           |
| Basic   | \$ 0.13   | \$ 0.27   | \$ 0.25   | \$ 0.48   |
| Diluted   | \$ 0.13   | \$ 0.26   | \$ 0.25   | \$ 0.47   |
| <b>Cash Dividend Declared Per Share:</b>                                  | \$        | \$        | \$ 1.50   | \$        |

The accompanying notes are an integral part of the condensed consolidated financial statements.



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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

|   | As of                                       |                      |
|---|---|----------------------|
|   | September 30,<br>2010                       | December 31,<br>2009 |
|   | (Unaudited)                                 |                      |
|   | (In thousands, except per<br>share amounts) |                      |
| <b>ASSETS</b>   |   |                      |
| <b>Current:</b>   |   |                      |
| Cash and cash equivalents   | \$ 76,507                                   | \$ 433,683           |
| Restricted funds held in trust  | 228,070                                     | 131,223              |
| Receivables (less allowances of \$2,469 and \$2,978, respectively)                    | 273,321                                     | 306,631              |
| Unbilled service receivables  | 22,377                                      | 37,692               |
| Deferred income taxes   | 1,348                                       | 9,509                |
| Prepaid expenses and other current assets   | 139,023                                     | 126,139              |
| <b>Total Current Assets</b>   | <b>740,646</b>                              | <b>1,044,877</b>     |
| Property, plant and equipment, net  | 2,526,291                                   | 2,582,841            |
| Investments in fixed maturities at market (cost: \$25,713 and \$27,500, respectively) | 26,659                                      | 28,142               |
| Restricted funds held in trust  | 109,651                                     | 146,529              |
| Unbilled service receivables  | 32,316                                      | 37,389               |
| Waste, service and energy contracts, net  | 480,731                                     | 380,359              |
| Other intangible assets, net  | 80,720                                      | 84,610               |
| Goodwill  | 230,020                                     | 202,996              |
| Investments in investees and joint ventures   | 128,873                                     | 120,173              |
| Other assets  | 296,807                                     | 306,366              |
| <b>Total Assets</b>   | <b>\$ 4,652,714</b>                         | <b>\$ 4,934,282</b>  |
| <b>LIABILITIES AND EQUITY</b>   |   |                      |
| <b>Current:</b>   |   |                      |
| Current portion of long-term debt   | \$ 6,821                                    | \$ 7,027             |
| Current portion of project debt   | 174,528                                     | 191,993              |
| Accounts payable  | 36,259                                      | 27,831               |
| Deferred revenue  | 73,892                                      | 60,256               |
| Accrued expenses and other current liabilities  | 201,940                                     | 217,721              |
| <b>Total Current Liabilities</b>  | <b>493,440</b>                              | <b>504,828</b>       |
| Long-term debt  | 1,421,798                                   | 1,430,679            |
| Project debt  | 716,505                                     | 767,371              |
| Deferred income taxes   | 583,954                                     | 571,122              |
| Waste and service contracts   | 91,827                                      | 101,353              |
| Other liabilities   | 144,654                                     | 141,760              |

|   |                     |                     |
|---|---------------------|---------------------|
| <b>Total Liabilities</b>  | 3,452,178           | 3,517,113           |
| <b>Commitments and Contingencies (Note 14)</b>  |                     |                     |
| <b>Equity:</b>  |                     |                     |
| Covanta Holding Corporation stockholders' equity:   |                     |                     |
| Preferred stock (\$0.10 par value; authorized 10,000 shares; none issued and outstanding)   |                     |                     |
| Common stock (\$0.10 par value; authorized 250,000 shares; issued 156,723 and 155,615 shares; outstanding 153,407 and 154,936 shares) | 15,672              | 15,562              |
| Additional paid-in capital  | 885,563             | 909,205             |
| Accumulated other comprehensive income  | 8,903               | 7,443               |
| Accumulated earnings  | 256,906             | 450,864             |
| Treasury stock, at par  | (332)               | (68)                |
| <b>Total Covanta Holding Corporation stockholders' equity</b>   | <b>1,166,712</b>    | <b>1,383,006</b>    |
| Noncontrolling interests in subsidiaries  | 33,824              | 34,163              |
| <b>Total Equity</b>   | <b>1,200,536</b>    | <b>1,417,169</b>    |
| <b>Total Liabilities and Equity</b>   | <b>\$ 4,652,714</b> | <b>\$ 4,934,282</b> |

The accompanying notes are an integral part of the condensed consolidated financial statements.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

|  | <b>For the Nine Months Ended</b> |             |
|--|----------------------------------|-------------|
|  | <b>September 30,</b>             |             |
|  | <b>2010</b>                      | <b>2009</b> |
|  | <b>(Unaudited)</b>               |             |
|  | <b>(In thousands)</b>            |             |
| <b>OPERATING ACTIVITIES:</b>   |                                  |             |
| Net income   | \$ 45,149                        | \$ 79,680   |
| Adjustments to reconcile net income to net cash provided by operating activities:                    |                                  |             |
| Depreciation and amortization expense  | 146,527                          | 150,717     |
| Amortization of long-term debt deferred financing costs  | 5,044                            | 3,591       |
| Amortization of debt premium and discount  | (5,620)                          | (6,382)     |
| Write-down of assets   | 32,321                           |             |
| Non-cash convertible debt related expense  | 29,760                           | 14,562      |
| Stock-based compensation expense   | 13,279                           | 10,724      |
| Equity in net income from unconsolidated investments   | (18,024)                         | (17,091)    |
| Dividends from unconsolidated investments  | 10,910                           | 2,941       |
| Deferred income taxes  | 20,763                           | 14,612      |
| Other, net   | 7,436                            | 5,544       |
| Increase in restricted funds held in trust   | (12,881)                         | (2,824)     |
| Change in working capital, net of effects of acquisitions  | 53,443                           | (8,341)     |
| Net cash provided by operating activities  | 328,107                          | 247,733     |
| <b>INVESTING ACTIVITIES:</b>   |                                  |             |
| Proceeds from the sale of investment securities  | 9,759                            | 5,467       |
| Purchase of investment securities  | (10,080)                         | (6,053)     |
| Purchase of property, plant and equipment  | (83,101)                         | (59,109)    |
| Purchase of equity interest  |                                  | (8,938)     |
| Acquisition of noncontrolling interests in subsidiaries  | (2,000)                          |             |
| Acquisition of businesses, net of cash acquired  | (128,254)                        | (251,734)   |
| Loan issued for the Harrisburg EfW facility to fund certain facility improvements, net of repayments | (400)                            | (8,605)     |
| Acquisition of land use rights   | (18,545)                         |             |
| Other, net   | (14,952)                         | (652)       |
| Net cash used in investing activities  | (247,573)                        | (329,624)   |
| <b>FINANCING ACTIVITIES:</b>   |                                  |             |
| Proceeds from borrowings on long-term debt   |                                  | 460,000     |
| Proceeds from issuance of warrants   |                                  | 53,958      |
| Purchase of convertible note hedge   |                                  | (112,378)   |
| Payment of deferred financing costs  |                                  | (15,648)    |
| Payment of interest rate swap termination costs  |                                  | (9,760)     |
| Principal payments on long-term debt   | (4,999)                          | (5,009)     |

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|   |           |            |
|---|-----------|------------|
| Principal payments on project debt                                    | (123,268) | (193,619)  |
| Payments of borrowings on revolving credit facility                   | (56,000)  |            |
| Proceeds from borrowings on project debt                              | 14,178    | 72,046     |
| Proceeds from borrowings on revolving credit facility                 | 56,000    |            |
| Change in restricted funds held in trust                              | (37,544)  | 30,977     |
| Proceeds from the exercise of options for common stock, net           | 917       | 374        |
| Cash dividends paid to shareholders                                   | (232,671) |            |
| Common stock repurchased  | (36,708)  |            |
| Financings of insurance premiums, net                                 | (9,787)   | (9,443)    |
| Distributions to partners of noncontrolling interests in subsidiaries | (7,098)   | (9,596)    |
| Other financing   | (415)     |            |
| Net cash (used in) provided by financing activities                   | (437,395) | 261,902    |
| Effect of exchange rate changes on cash and cash equivalents          | (315)     | 196        |
| Net (decrease) increase in cash and cash equivalents                  | (357,176) | 180,207    |
| Cash and cash equivalents at beginning of period                      | 433,683   | 192,393    |
| Cash and cash equivalents at end of period                            | \$ 76,507 | \$ 372,600 |

The accompanying notes are an integral part of the condensed consolidated financial statements.

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY**

|   | Covanta Holding Corporation Stockholders' Equity |                     |                            |                            |                      |                       | Noncontrolling Interests |                 | Total          |
|---|--|---------------------|----------------------------|----------------------------|----------------------|-----------------------|--------------------------|-----------------|----------------|
|   | Common Stock Shares                              | Common Stock Amount | Additional Paid-In Capital | Other Comprehensive Income | Accumulated Earnings | Treasury Stock Shares | Treasury Stock Amount    | in Subsidiaries |                |
| Balance as of December 31, 2009                                       | 155,615  | \$ 15,562           | \$ 909,205                 | \$ 7,443                   | \$ 450,864           | 679                   | \$ (68)                  | \$ 34,163       | \$ 1,417,169   |
| Stock-based compensation expense                                      |  |                     | 13,279                     |                            |                      |                       |                          |                 | 13,279         |
| Cash dividend declared  |  |                     |                            |                            | (232,671)            |                       |                          |                 | (232,671)      |
| Unvested restricted shares forfeited                                  |  |                     | 14                         |                            |                      | 137                   | (14)                     |                 |                |
| Common stock repurchased  |  |                     | (36,458)                   |                            |                      | 2,500                 | (250)                    |                 | (36,708)       |
| Exercise of options to purchase common stock                          | 165  | 17                  | 900                        |                            |                      |                       |                          |                 | 917            |
| Shares issued in non-vested stock award                               | 943  | 93                  | (93)                       |                            |                      |                       |                          |                 |                |
| Acquisition of noncontrolling interests in subsidiaries               |  |                     | (1,284)                    |                            |                      |                       |                          | (716)           | (2,000)        |
| Distributions to partners of noncontrolling interests in subsidiaries |  |                     |                            |                            |                      |                       |                          | (7,098)         | (7,098)        |
| Comprehensive income, net of income taxes:                            |  |                     |                            |                            |                      |                       |                          |                 |                |
| Net income  |  |                     |                            |                            | 38,713               |                       |                          | 6,436           | 45,149         |
| Foreign currency translation  |  |                     |                            | 560<br>(221)               |                      |                       |                          | 1,039           | 1,599<br>(221) |

|  |         |           |            |          |            |       |          |           |              |
|--|---------|-----------|------------|----------|------------|-------|----------|-----------|--------------|
| Pension and other postretirement plan unrecognized net loss, net of income tax benefit of \$88 |         |           |            |          |            |       |          |           |              |
| Net unrealized gain on derivatives, net of income tax expense of \$335                         |         |           |            | 512      |            |       |          |           | 512          |
| Net unrealized gain on securities, net of income tax expense of \$244                          |         |           |            | 609      |            |       |          |           | 609          |
| Total comprehensive income   |         |           |            | 1,460    | 38,713     |       |          | 7,475     | 47,648       |
| Balance as of September 30, 2010   | 156,723 | \$ 15,672 | \$ 885,563 | \$ 8,903 | \$ 256,906 | 3,316 | \$ (332) | \$ 33,824 | \$ 1,200,536 |

**Covanta Holding Corporation Stockholders Equity**

|                                      | <b>Common Stock</b> |               | <b>Additional</b> | <b>Other</b>                     | <b>Accumulated</b> | <b>Treasury</b> | <b>Noncontrolling</b> |                     | <b>Total</b> |
|--------------------------------------|---------------------|---------------|-------------------|----------------------------------|--------------------|-----------------|-----------------------|---------------------|--------------|
|                                      | <b>Shares</b>       | <b>Amount</b> | <b>Paid-In</b>    | <b>Comprehensive</b>             | <b>Earnings</b>    | <b>Stock</b>    | <b>Interests</b>      | <b>in</b>           |              |
|                                      |                     |               | <b>Capital</b>    | <b>Loss</b>                      |                    | <b>Shares</b>   | <b>Amount</b>         | <b>Subsidiaries</b> |              |
|                                      |                     |               |                   | <b>(Unaudited, in thousands)</b> |                    |                 |                       |                     |              |
| Balance as of December 31, 2008      | 154,797             | \$ 15,480     | \$ 832,595        | \$ (8,205)                       | \$ 349,219         | 517             | \$ (52)               | \$ 35,014           | \$ 1,224,051 |
| Stock-based compensation expense     |                     |               | 10,724            |                                  |                    |                 |                       |                     | 10,724       |
| Issuance of warrants                 |                     |               | 53,846            |                                  |                    |                 |                       |                     | 53,846       |
| Unvested restricted shares forfeited |                     |               | 2                 |                                  |                    | 19              | (2)                   |                     |              |
| Shares repurchased for               |                     |               | (1,909)           |                                  |                    | 140             | (14)                  |                     | (1,923)      |

|  |         |           |            |            |            |     |         |           |              |
|--|---------|-----------|------------|------------|------------|-----|---------|-----------|--------------|
| tax withholdings for vested stock awards   |         |           |            |            |            |     |         |           |              |
| Exercise of options to purchase common stock   | 61      | 6         | 367        |            |            |     |         |           | 373          |
| Shares issued in non-vested stock award  | 740     | 74        | (74)       |            |            |     |         |           |              |
| Purchase price allocation for noncontrolling interests   |         |           |            |            |            |     |         | 33,428    | 33,428       |
| Distributions to partners of noncontrolling interests in subsidiaries                          |         |           |            |            |            |     |         | (9,596)   | (9,596)      |
| Comprehensive income, net of income taxes:   |         |           |            |            |            |     |         |           |              |
| Net income   |         |           |            |            | 73,368     |     |         | 6,312     | 79,680       |
| Foreign currency translation   |         |           |            | 3,478      |            |     |         | 741       | 4,219        |
| Pension and other postretirement plan unrecognized net loss, net of income tax benefit of \$50 |         |           |            | (126)      |            |     |         |           | (126)        |
| Net unrealized gain on securities, net of income tax expense of \$379                          |         |           |            | 947        |            |     |         |           | 947          |
| Total comprehensive income   |         |           |            | 4,299      | 73,368     |     |         | 7,053     | 84,720       |
| Balance as of September 30, 2009   | 155,598 | \$ 15,560 | \$ 895,551 | \$ (3,906) | \$ 422,587 | 676 | \$ (68) | \$ 65,899 | \$ 1,395,623 |

The accompanying notes are an integral part of the condensed consolidated financial statements.





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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION**

The terms we, our, ours, us and Company refer to Covanta Holding Corporation and its subsidiaries; the term Energy refers to our subsidiary Covanta Energy Corporation and its subsidiaries.

**Organization**

We are a leading developer, owner and operator of infrastructure for the conversion of waste to energy (known as energy-from-waste ), as well as other waste disposal and renewable energy production businesses in the Americas, Europe and Asia. We conduct all of our operations through subsidiaries which are engaged predominantly in the businesses of waste and energy services. We also engage in the independent power production business outside the Americas.

We own, have equity investments in, and/or operate 65 energy generation facilities, 57 of which are in the Americas and eight of which are located outside the Americas. Our energy generation facilities use a variety of fuels, including municipal solid waste, wood waste (biomass), landfill gas, water (hydroelectric), natural gas, coal, and heavy fuel-oil. We also own or operate several businesses that are associated with our energy-from-waste business, including a waste procurement business, four landfills, which we use primarily for ash disposal, and several waste transfer stations. We have two reportable segments, Americas and International. The Americas segment is comprised of waste and energy services operations primarily in the United States and Canada. The International segment is comprised of international waste and energy services.

**Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ( GAAP ) and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for fair presentation have been included in our financial statements. All intra-entity accounts and transactions have been eliminated. Operating results for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ended December 31, 2010. This Form 10-Q should be read in conjunction with the Audited Consolidated Financial Statements and accompanying Notes in our Annual Report on Form 10-K for the year ended December 31, 2009 ( Form 10-K ).

We use the equity method to account for our investments for which we have the ability to exercise significant influence over the operating and financial policies of the investee. Consolidated net income includes our proportionate share of the net income or loss of these companies. Such amounts are classified as equity in net income from unconsolidated investments in our condensed consolidated financial statements. Investments in companies in which we do not have the ability to exercise significant influence are carried at the lower of cost or estimated realizable value. We monitor investments for other than temporary declines in value and make reductions when appropriate.

**NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS**

In July 2010, the Financial Accounting Standards Board ( FASB ) issued an accounting standard related to disclosures about the credit quality of financing receivables and the allowance for credit losses. The standard requires greater transparency about an entity s financing receivables, which include loans, long-term receivables, lease receivables, and

other long-term receivables. We are required to adopt this standard effective January 1, 2011 and do not expect this accounting standard to have a material impact on our condensed consolidated financial statements.

In October 2009, the FASB issued an accounting standard related to multiple-deliverable revenue arrangements which we are required to adopt by January 1, 2011, although earlier application is permitted. The standard provides amendments to criteria for separating consideration in multiple element arrangements. As a result, multiple deliverable arrangements generally will be separated in more circumstances than under existing U.S. GAAP. We are currently evaluating the potential effects of this standard (which may be adopted either on a prospective or retrospective basis) on our condensed consolidated financial statements.

**NOTE 3. ACQUISITIONS, BUSINESS DEVELOPMENT AND DISPOSITIONS**

Our growth strategy includes the acquisition of waste and energy related businesses located in markets with significant growth opportunities and the development of new projects and expansion of existing projects. We will also consider acquiring or developing new technologies and businesses that are complementary with our existing renewable energy and waste services business. The results of operations reflect the period of ownership of the acquired businesses and business development projects. The acquisitions in the section below are not material to our condensed consolidated financial statements individually or in the aggregate and therefore, disclosures of pro forma financial information have not been presented.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Acquisitions and Business Development**

*Americas*

Wallingford Energy-from-Waste Facility

We entered into new tip fee contracts for the delivery of waste to our Wallingford, Connecticut energy-from-waste facility, which commenced upon expiration of the existing service fee contract in June 2010. These contracts in total are expected to supply waste utilizing most or all of the facility's capacity through 2020.

Covanta Huntington Limited Partnership

In March 2010, for cash consideration of \$2.0 million, we acquired a nominal limited partnership interest held by a third party in Covanta Huntington Limited Partnership, our subsidiary which owns and operates an energy-from-waste facility in Huntington, New York.

Honolulu Energy-from-Waste Facility

We operate and maintain the energy-from-waste facility located in and owned by the City and County of Honolulu, Hawaii. In December 2009, we entered into agreements with the City and County of Honolulu to expand the facility's waste processing capacity from 2,160 tons per day ( tpd ) to 3,060 tpd and to increase gross electricity capacity from 57 megawatts ( MW ) to 90 MW. The agreements also extend the contract term by 20 years. The \$302 million expansion project is a fixed-price construction contract which will be funded and owned by the City and County of Honolulu. Construction commenced at the end of 2009.

Veolia Energy-from-Waste Businesses

We completed the following transactions with Veolia Environmental Services North America Corp. (collectively referred to as the Veolia EfW Acquisition ). The acquired businesses have a combined capacity of 9,600 tpd. Each of the operations acquired includes a long-term operating contract with their respective municipal client.

Between August 2009 and February 2010, we acquired one transfer station business and seven energy-from-waste businesses located in New York, Pennsylvania, California, Florida and British Columbia. Six of the energy-from-waste facilities and the transfer station are publicly-owned facilities. We paid cash consideration of \$259.3 million in August 2009 for six energy-from-waste businesses and one transfer station, and in February 2010, we paid \$128.3 million for the seventh energy-from-waste business.

The businesses acquired in August 2009 included a majority ownership stake in one energy-from-waste facility and in November 2009, we acquired the remaining ownership stake in that facility for cash consideration of \$23.7 million.

During the three months ended September 30, 2010, a post-closing purchase price adjustment of \$2 million was recorded which is expected to be paid during the fourth quarter of 2010, pending final settlement. The final purchase price allocation included \$139.8 million of property, plant and equipment, \$329.2 million of intangible assets related to long-term operating contracts at each acquired Veolia business except for the facility which we own, \$27.0 million related to goodwill and \$113.9 million of assumed debt. The acquired intangible assets will be amortized over an

average remaining useful facility life of 31 years.

*Philadelphia Transfer Stations*

In May 2009, we acquired two waste transfer stations with combined capacity of 4,500 tpd in Philadelphia, Pennsylvania for cash consideration of \$17.5 million, inclusive of final working capital adjustments. The final purchase price allocation included \$5.9 million of identifiable intangible assets related primarily to customer relationships and goodwill of \$1.3 million.

*Alternative Energy Technology Development*

We have entered into various agreements with multiple partners to invest in the development, testing or licensing of new technologies related to the transformation of waste materials into renewable fuels or the generation of energy. Licensing fees and demonstration unit purchases aggregated \$4.4 million during the nine months ended September 30, 2010 and, \$4.7 million and \$6.5 million during the years ended December 31, 2009 and 2008, respectively.

*Hillsborough Energy-from-Waste Facility*

In 2005, we entered into agreements with Hillsborough County, Florida to implement a 600 tpd expansion of this energy-from-waste facility, and to extend the agreement under which we operate the facility through 2027. During the third quarter of 2009, construction of the expansion was successfully completed and commercial operation commenced.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***International***

**Dublin Joint Venture**

In 2007, we entered into agreements to build, own, and operate a 1,700 metric tpd energy-from-waste project serving the City of Dublin, Ireland and surrounding communities at an estimated cost of \$350 million. Dublin Waste to Energy Limited, which we control and co-own with DONG Energy Generation A/S, developed the project and has a 25 year tip fee type contract to provide disposal service for 320,000 metric tons of waste annually, representing approximately 50% of the facility's processing capacity. The project is expected to sell electricity into the local electricity grid, at rates partially supported by a preferential renewable tariff. While the primary approvals and licenses for the project have been obtained, the longstop date for acquiring necessary property rights and achieving certain other conditions precedent under the project agreement expired on September 4, 2010, without the satisfaction of all the conditions precedent. The parties will need to agree to proceed and are currently working toward addressing the current project issues. See discussion in Note 8. Supplementary Information for accounting information for the Dublin project.

**China Joint Ventures and Energy-from-Waste Facilities**

In March 2009, Taixing Covanta Yanjiang Cogeneration Co., Ltd. of which we own 85%, entered into a 25 year concession agreement and waste supply agreements to build, own and operate a 350 metric tpd energy-from-waste facility for Taixing Municipality, in Jiangsu Province, People's Republic of China. The project, which will be built on the site of our existing coal-fired facility in Taixing, will supply steam to an adjacent industrial park under short-term arrangements. We will continue to operate our existing coal-fired facility. The Taixing project commenced construction in late 2009 and the project company has obtained Rmb 165 million in project financing which, together with available cash from existing operations, will fund construction costs.

In 2008, our project joint venture with Chongqing Iron & Steel Company (Group) Limited received an award to build, own, and operate an 1,800 metric tpd energy-from-waste facility for Chengdu Municipality, in Sichuan Province, People's Republic of China and the project's 25 year waste concession agreement was executed. Construction of the facility has commenced and the project company has obtained financing for Rmb 480 million for the project, of which 49% is guaranteed by us and 51% is guaranteed by Chongqing Iron & Steel Company (Group) Limited until the project has been constructed and for one year after operations commence.

**Dispositions - Americas**

**Detroit Energy-from-Waste Facility**

On June 30, 2009, our long-term operating contract with the Greater Detroit Resource Recovery Authority (GDRRA) to operate the 2,832 tpd energy-from-waste facility located in Detroit, Michigan (the Detroit Facility) expired.

Effective June 30, 2009, we purchased an undivided 30% owner-participant interest in the Detroit Facility for total cash consideration of approximately \$7.9 million and entered into certain agreements for continued operation of the Detroit Facility for a term expiring June 30, 2010. During this one-year period, we were unable to secure an acceptable steam off-take arrangement.

Effective June 30, 2010, we agreed to sell our entire interest in the Detroit Facility, subject to the buyer's due diligence and any required regulatory approvals, and to continue operating the Detroit Facility under commercial arrangements

until the earlier of the closing of the sale transaction or September 30, 2010. The sale agreement did not close or extend on September 30, 2010, and the commercial arrangements expired on that date at which time we decided that it was in our best interest to shut down. Regardless if the Detroit Facility is permanently shut down, re-started or sold, we do not expect it to have a material effect on our condensed consolidated financial statements.

**NOTE 4. EARNINGS PER SHARE**

Per share data is based on the weighted average number of outstanding shares of our common stock, par value \$0.10 per share, during the relevant period. Basic earnings per share are calculated using only the weighted average number of outstanding shares of common stock. Diluted earnings per share computations, as calculated under the treasury stock method, include the weighted average number of shares of additional outstanding common stock issuable for stock options, restricted stock, rights and warrants whether or not currently exercisable.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Diluted earnings per share for all the periods presented does not include securities if their effect was anti-dilutive (in thousands, except per share amounts).

|  | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|--|---------------------------|-------------|--------------------------|-------------|
|  | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|  | <b>2010</b>               | <b>2009</b> | <b>2010</b>              | <b>2009</b> |
| Net income attributable to Covanta Holding Corporation   | \$ 20,157                 | \$ 40,852   | \$ 38,713                | \$ 73,368   |
| <b>Basic earnings per share:</b>   |                           |             |                          |             |
| Weighted average basic common shares outstanding   | 153,443                   | 153,779     | 153,907                  | 153,660     |
| Basic earnings per share   | \$ 0.13                   | \$ 0.27     | \$ 0.25                  | \$ 0.48     |
| <b>Diluted earnings per share:</b>   |                           |             |                          |             |
| Weighted average basic common shares outstanding   | 153,443                   | 153,779     | 153,907                  | 153,660     |
| Dilutive effect of stock options   | 395                       | 434         | 403                      | 434         |
| Dilutive effect of restricted stock  | 474                       | 897         | 329                      | 841         |
| Dilutive effect of convertible debentures  |                           |             |                          |             |
| Dilutive effect of warrants  |                           |             |                          |             |
| Weighted average diluted common shares outstanding   | 154,312                   | 155,110     | 154,639                  | 154,935     |
| Diluted earnings per share   | \$ 0.13                   | \$ 0.26     | \$ 0.25                  | \$ 0.47     |
| Securities excluded from the weighted average dilutive common shares outstanding because their inclusion would have been antidilutive: |                           |             |                          |             |
| Stock options  | 1,850                     | 1,981       | 1,883                    | 1,981       |
| Restricted stock   |                           |             |                          |             |
| Warrants   | 27,226                    | 24,803      | 27,226                   | 24,803      |

On May 22, 2009, we entered into privately negotiated warrant transactions in connection with the issuance of 3.25% Cash Convertible Senior Notes due 2014 ( Notes ). As of September 30, 2010, the warrants did not have a dilutive effect on earnings per share because the average market price during the periods presented was below the strike price. These warrants could have a dilutive effect to the extent that the price of our common stock exceeds the applicable strike price (\$25.74 in any of the periods presented) of the warrants. In connection with the special cash dividend declared on June 17, 2010, the conversion rate for the warrants was adjusted to \$23.45 effective on July 8, 2010. For additional information related to the special cash dividend, see Note 6. Changes in Capitalization - Equity.

On January 31, 2007, we issued 1.00% Senior Convertible Debentures due 2027 ( Debentures ). The Debentures are convertible under certain circumstances if the closing sale price of our common stock exceeds a specified conversion price (\$28.20 in any of the periods presented) before February 1, 2025. As of September 30, 2010, the Debentures did not have a dilutive effect on earnings per share because the average market price during the periods presented exceeded the strike price. In connection with the special cash dividend declared on June 17, 2010, the conversion rate for the Debentures was adjusted to 38.9883 shares of our common stock per \$1,000 principal amount of Debentures. The adjusted conversion rate is equivalent to an adjusted conversion price of \$25.65 per share and became effective on July 13, 2010. For additional information related to the special cash dividend, see Note 6. Changes in Capitalization - Equity.



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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 5. FINANCIAL INFORMATION BY BUSINESS SEGMENTS**

Our reportable segments are Americas and International. The Americas segment is comprised of waste and energy services operations primarily in the United States and Canada. The International segment is comprised of waste and energy services operations in other markets, currently the United Kingdom, Ireland, Italy, China, the Philippines, India, and Bangladesh. The results of our reportable segments are as follows (in thousands):

|   | Reportable Segments |               |              | Total        |
|---|---------------------|---------------|--------------|--------------|
|   | Americas            | International | All Other(1) |              |
| <b>Three Months Ended September 30, 2010:</b> |                     |               |              |              |
| Operating revenues                            | \$ 393,779          | \$ 38,296     | \$ 4,902     | \$ 436,977   |
| Operating income (loss)                       | 79,652              | (24,760)      | (2,528)      | 52,364       |
| <b>Three Months Ended September 30, 2009:</b> |                     |               |              |              |
| Operating revenues                            | \$ 345,643          | \$ 57,745     | \$ 5,321     | \$ 408,709   |
| Operating income (loss)                       | 68,731              | 4,601         | (2,353)      | 70,979       |
| <b>Nine Months Ended September 30, 2010:</b>  |                     |               |              |              |
| Operating revenues                            | \$ 1,133,703        | \$ 140,807    | \$ 14,473    | \$ 1,288,983 |
| Operating income (loss)                       | 140,783             | (27,456)      | (2,513)      | 110,814      |
| <b>Nine Months Ended September 30, 2009:</b>  |                     |               |              |              |
| Operating revenues                            | \$ 988,271          | \$ 140,788    | \$ 14,196    | \$ 1,143,255 |
| Operating income (loss)                       | 132,970             | 5,781         | (3,248)      | 135,503      |

(1) All other is comprised of our insurance subsidiaries operations.

**NOTE 6. CHANGES IN CAPITALIZATION****Short-Term Liquidity**

The credit facilities are comprised of a \$300 million revolving credit facility (the Revolving Loan Facility), a \$320 million funded letter of credit facility (the Funded L/C Facility), and a \$650 million term loan (the Term Loan Facility) (collectively referred to as the Credit Facilities). As of September 30, 2010, we were in compliance with all required covenants and had available credit for liquidity as follows (in thousands):

|                             | Total<br>Available<br>Under Facility | Maturing | Outstanding Letters<br>of Credit as of<br>September 30, 2010 | Available as of<br>September 30, 2010 |
|-----------------------------|--------------------------------------|----------|--|---------------------------------------|
| Revolving Loan Facility (1) | \$ 300,000                           | 2013     | \$   | \$ 300,000                            |
| Funded L/C Facility         | \$ 320,000                           | 2014     | \$ 294,471   | \$ 25,529                             |

(1) Up to \$200 million of which may be utilized for letters of credit.

### Long-Term Debt

Long-term debt is as follows (in thousands):

|  | As of                 |                      |
|--|-----------------------|----------------------|
|  | September 30,<br>2010 | December 31,<br>2009 |
| 3.25% Cash Convertible Senior Notes due 2014           | \$ 460,000            | \$ 460,000           |
| Debt discount related to Cash Convertible Senior Notes | (96,730)              | (112,475)            |
| Cash conversion option derivative at fair value        | 93,331                | 128,603              |
| 3.25% Cash Convertible Senior Notes, net               | 456,601               | 476,128              |
| 1.00% Senior Convertible Debentures due 2027           | 373,750               | 373,750              |
| Debt discount related to Convertible Debentures        | (29,603)              | (45,042)             |
| 1.00% Senior Convertible Debentures, net               | 344,147               | 328,708              |
| Term Loan Facility due 2014                            | 627,250               | 632,125              |
| Other long-term debt                                   | 621                   | 745                  |
| Total  | 1,428,619             | 1,437,706            |
| Less: current portion                                  | (6,821)               | (7,027)              |
| Total long-term debt                                   | \$ 1,421,798          | \$ 1,430,679         |

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***3.25% Cash Convertible Senior Notes due 2014 ( Notes )***

Under limited circumstances, the Notes are convertible by the holders thereof into cash only, based on an initial conversion rate of 53.9185 shares of our common stock per \$1,000 principal amount of Notes (which represents an initial conversion price of approximately \$18.55 per share) subject to certain customary adjustments as provided in the indenture for the Notes. We will not deliver common stock (or any other securities) upon conversion under any circumstances.

In connection with the special cash dividend declared on June 17, 2010, the conversion rate for the Notes was adjusted to 59.1871 shares of our common stock per \$1,000 principal amount of Notes. The adjusted conversion rate is equivalent to an adjusted conversion price of \$16.90 per share and became effective on July 8, 2010. For additional information related to the special cash dividend, see the Equity discussion below.

For specific criteria related to contingent interest, conversion or redemption features of the Notes and details related to the cash conversion option, cash convertible note hedge and warrants related to the Notes, refer to Note 11 of the Notes to Consolidated Financial Statements in our Form 10-K.

For details related to the fair value for the contingent interest feature, cash conversion option, and cash convertible note hedge related to the Notes, see Note 12. Derivative Instruments.

***1.00% Senior Convertible Debentures due 2027 ( Debentures )***

Under limited circumstances, prior to February 1, 2025, the Debentures are convertible by the holders into cash and shares of our common stock, if any, initially based on a conversion rate of 35.4610 shares of our common stock per \$1,000 principal amount of Debentures, (which represents an initial conversion price of approximately \$28.20 per share) or 13,253,867 issuable shares. As of September 30, 2010, if the Debentures were converted, no shares would have been issued since the trading price of our common stock was below the conversion price of the Debentures.

In connection with the special cash dividend declared on June 17, 2010, the conversion rate for the Debentures was adjusted to 38.9883 shares of our common stock per \$1,000 principal amount of Debentures. The adjusted conversion rate is equivalent to an adjusted conversion price of \$25.65 per share and became effective on July 13, 2010. For additional information related to the special cash dividend, see the Equity discussion below.

For specific criteria related to contingent interest, conversion or redemption features of the Debentures, refer to Note 11 of the Notes to Consolidated Financial Statements in our Form 10-K.

For details related to the fair value for the contingent interest feature related to the Debentures, see Note 12. Derivative Instruments.

**Debt Discount for the Notes and the Debentures**

The debt discount related to the Notes and the Debentures is accreted over their respective terms and recognized as non-cash convertible debt related expense.

The following table details the amount of the accretion of debt discount as of September 30, 2010 included or expected to be included in our condensed consolidated financial statements for each of the periods indicated (in

millions):

|   | <b>Nine Months<br/>Ended<br/>September 30,<br/>2010</b> | <b>Remainder<br/>of<br/>2010</b> | <b>For the Years Ended</b> |             |             |             |
|---|---|----------------------------------|----------------------------|-------------|-------------|-------------|
|   |   |                                  | <b>2011</b>                | <b>2012</b> | <b>2013</b> | <b>2014</b> |
| Non-cash convertible debt discount expense for the Notes          | \$ 15.7   | \$ 5.6                           | \$ 23.5                    | \$ 26.0     | \$ 28.8     | \$ 12.9     |
| Non-cash convertible debt discount expense for the Debentures (1) | \$ 15.4   | \$ 5.4                           | \$ 22.3                    | \$ 1.9      | \$          | \$          |

(1) The Debentures mature on February 1, 2027. At our option, the Debentures are subject to redemption at any time on or after February 1, 2012, in whole or in part. In addition, holders may require us to repurchase their Debentures on February 1, 2012, February 1, 2017, and February 1, 2022, in whole or in part. For purposes of the accretion of the debt discount related to the Debentures, we have assumed that the Debentures will be repurchased pursuant to the holders' option on February 1, 2012. For information detailing the redemption features of the Debentures, see Note 11 of the Notes to Consolidated Financial Statements in our Form 10-K.

## Equity

During the nine months ended September 30, 2010, we granted 816,480 shares of restricted stock awards. For information related to stock-based award plans, see Note 10. Stock-Based Compensation.

On June 17, 2010, the Board of Directors declared a special cash dividend of \$1.50 per share. The special cash dividend of \$233 million was paid on July 20, 2010. We utilized a combination of cash on hand and borrowings under the Revolving Loan Facility (which were subsequently repaid during the quarter) to fund the special cash dividend. In addition, holders of

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

unvested shares of restricted stock received a dividend in the form of additional restricted stock awards totaling 126,267 shares with the same vesting conditions as the underlying shares of restricted stock to which they relate. For information related to the special cash dividend, see Note 10. Stock-Based Compensation.

On June 17, 2010, the Board of Directors increased the authorization to repurchase shares of outstanding common stock to \$150 million. Under the program, stock repurchases may be made in the open market, in privately negotiated transactions from time to time, or by other available methods, at management's discretion in accordance with applicable federal securities laws. The timing and amounts of any repurchases will depend on many factors, including our capital structure, the market price of our common stock and overall market conditions. During the three months ended September 30, 2010, we repurchased 2,499,500 shares of our common stock at a weighted average cost of \$14.69 per share for an aggregate amount of approximately \$36.7 million. As of September 30, 2010, the amount remaining under our currently authorized share repurchase program is \$113.3 million.

During the nine months ended September 30, 2009, we repurchased 139,762 shares of our common stock in connection with tax withholdings for vested stock awards.

**NOTE 7. INCOME TAXES**

We record our interim tax provision based upon our estimated annual effective tax rate and account for the tax effects of discrete events in the period in which they occur. We file a federal consolidated income tax return with our eligible subsidiaries. Our federal consolidated income tax return also includes the taxable results of certain grantor trusts described below.

We currently estimate our annual effective tax rate for the year ended December 31, 2010 to be approximately 49.9%. The increase in the estimated annual effective tax rate for 2010 was primarily a result of the sunset of eligibility for production tax credits at some of our biomass facilities, as well as the non-cash impairment of our investment in Dublin. See discussion in Note 8. Supplementary Information. A minimal tax benefit is being recognized at this time associated with the Dublin non-cash impairment. We review the annual effective tax rate on a quarterly basis as projections are revised and laws are enacted. The effective income tax rate was 51.0% and 34.0% for the three months ended September 30, 2010 and 2009, respectively, and was 46.3% and 35.3% for the nine months ended September 30, 2010 and 2009, respectively. The liability for uncertain tax positions, exclusive of interest and penalties, was \$130.7 million and \$131.2 million as of September 30, 2010 and December 31, 2009, respectively. Liabilities for uncertain tax positions decreased by approximately \$0.5 million during the nine months ended September 30, 2010. Included in the balance of unrecognized tax benefits as of September 30, 2010 are potential benefits of \$117.9 million that, if recognized, would impact the effective tax rate. Acquisition related reserves in the liability for uncertain tax positions may decrease by approximately \$22.9 million in the next twelve months with respect to the expiration of statutes. Approximately \$7.2 million of these reserves may impact the tax provision.

For the three months ended September 30, 2010 and 2009, we recognized expenses of \$0.4 million and \$0.1 million, respectively, and for the nine months ended September 30, 2010 and 2009, we recognized a benefit of \$1.3 million and an expense of \$0.5 million, respectively, of interest and penalties on uncertain tax positions. As of September 30, 2010 and December 31, 2009, we had accrued interest and penalties associated with liabilities for unrecognized tax positions of \$7.1 million and \$8.4 million, respectively. We continue to reflect interest accrued on uncertain tax positions and penalties as part of the tax provision.

As issues are examined by the Internal Revenue Service and state auditors, we may decide to adjust the existing liability for uncertain tax positions for issues that were not deemed an exposure at the time we adopted accounting standards related to the accounting for uncertainty in income taxes. Accordingly, we will continue to monitor the results of audits and adjust the liability as needed. Federal income tax returns for Covanta Energy are closed for the years through 2003. However, to the extent net operating loss carryforwards ( NOLs ) are utilized from earlier years, federal income tax returns for Covanta Holding Corporation, formerly known as Danielson Holding Corporation, are still open. State income tax returns are generally subject to examination for a period of three to five years after the filing of the respective return. The state impact of any federal changes remains subject to examination by various states for a period of up to one year after formal notification to the states. We have various state income tax returns in the process of examination, administrative appeals or litigation.

Our NOLs predominantly arose from our predecessor insurance entities (which were subsidiaries of our predecessor, formerly named Mission Insurance Group, Inc., Mission ). These Mission insurance entities have been in state insolvency proceedings in California and Missouri since the late 1980 s. The amount of NOLs available to us will be reduced by any taxable income or increased by any taxable losses generated by current members of our consolidated tax group, which include grantor trusts associated with the Mission insurance entities.

While we cannot predict with certainty what amounts, if any, may be includable in taxable income as a result of the final administration of these grantor trusts, substantial actions toward such final administration have been taken and we believe that neither arrangements with the California Commissioner nor the final administration by the Missouri Director will result in a material reduction in available NOLs.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

We had consolidated federal NOLs estimated to be approximately \$545 million for federal income tax purposes as of December 31, 2009, based on the tax returns as filed. The federal NOLs will expire in various amounts from December 31, 2011 through December 31, 2028, if not used. Current forecasts indicate we will utilize consolidated federal NOLs in 2010 which will otherwise expire in 2011. In addition to the consolidated federal NOLs, as of December 31, 2009, we had state NOL carryforwards of approximately \$264.7 million, which expire between 2011 and 2027, capital loss carryforwards of \$0.2 million expiring in 2013, and additional federal credit carryforwards, including production tax credits and minimum tax credits, of \$47.5 million. These deferred tax assets are offset by a valuation allowance of approximately \$20.5 million.

In March 2010, U.S. Federal legislation enacted the Patient Protection and Affordable Care Act ( PPACA ) as well as a companion bill, the Health Care and Education Reconciliation Act of 2010 ( the Reconciliation Act ). As a result of enactment of the PPACA and the Reconciliation Act (collectively, the Acts ), employers receiving the Medicare Part D subsidy will recognize a deferred tax charge for the reduction in deductibility of postretirement prescription drug coverage for eligible retirees. The resulting deferred tax charge from enactment of the Acts was recognized in the results for the nine months ended September 30, 2010. This charge was not material to our condensed consolidated financial statements.

For further information, refer to Note 16. Income Taxes of the Notes to the Consolidated Financial Statements in our Form 10-K.

**NOTE 8. SUPPLEMENTARY INFORMATION****Operating Revenues**

The components of waste and service revenues are as follows (in thousands):

|   | <b>For the Three Months<br/>Ended September 30,</b> |             | <b>For the Nine Months<br/>Ended September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2010</b>   | <b>2009</b> | <b>2010</b>  | <b>2009</b> |
| Waste and service revenues unrelated to project debt        | \$ 239,722  | \$ 212,841  | \$ 707,122   | \$ 608,050  |
| Revenue earned explicitly to service project debt-principal | 13,538  | 14,759      | 47,022   | 42,198      |
| Revenue earned explicitly to service project debt-interest  | 4,618   | 5,587       | 14,289   | 17,050      |
| Total waste and service revenues                            | \$ 257,878  | \$ 233,187  | \$ 768,433   | \$ 667,298  |

Under some of our service agreements, we bill municipalities fees to service project debt (principal and interest). The amounts billed are based on the actual principal amortization schedule for the project bonds. Regardless of the amounts billed to client communities relating to project debt principal, we recognize revenue earned explicitly to service project debt principal on a levelized basis over the term of the applicable agreement. In the beginning of the agreement, principal billed is less than the amount of levelized revenue recognized related to principal and we record an unbilled service receivable asset. At some point during the agreement, the amount we bill will exceed the levelized

revenue and the unbilled service receivable begins to reduce, and ultimately becomes nil at the end of the contract.

In the final year(s) of a contract, cash may be utilized from available debt service reserve accounts to pay remaining principal amounts due to project bondholders and such amounts are no longer billed to or paid by municipalities. Generally, therefore, in the last year of the applicable agreement, little or no cash is received from municipalities relating to project debt, while our levelized service revenue continues to be recognized until the expiration date of the term of the agreement.

Our independent power production facilities in India generate electricity and steam explicitly for specific purchasers and as such, these agreements are considered lease arrangements. Electricity and steam sales included lease income from our international business of \$27.2 million and \$46.4 million for the three months ended September 30, 2010 and 2009, respectively, and \$107.2 million and \$110.0 million for the nine months ended September 30, 2010 and 2009, respectively.

### **Operating Costs**

#### *Pass through costs*

Pass through costs are costs for which we receive a direct contractually committed reimbursement from the municipal client which sponsors an energy-from-waste project. These costs generally include utility charges, insurance premiums, ash residue transportation and disposal and certain chemical costs. These costs are recorded net of municipal client reimbursements in our condensed consolidated financial statements. Total pass through costs were \$21.4 million and \$16.6 million for the three months ended September 30, 2010 and 2009, respectively, and \$64.9 million and \$46.4 million for the nine months ended September 30, 2010 and 2009, respectively.



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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Other operating expenses*

The components of other operating expenses are as follows (in thousands):

|   | <b>Other Operating Expenses</b>                              |                  |   |                  |
|---|--|------------------|---|------------------|
|   | <b>For the Three Months<br/>Ended September 30,<br/>2010</b> |                  | <b>For the Nine Months<br/>Ended September 30,<br/>2009</b> |                  |
| Construction expense                        | \$ 22,215  | \$ 7,169         | \$ 63,354   | \$ 18,494        |
| Insurance subsidiary operating expenses (1) | 6,805  | 7,022            | 15,347  | 15,524           |
| Foreign exchange loss (gain)                | 44   | 35               | (765)   | (271)            |
| Other                                       | (357)  | 578              | (368)   | 523              |
| <b>Total other operating expenses</b>       | <b>\$ 28,707</b>   | <b>\$ 14,804</b> | <b>\$ 77,568</b>  | <b>\$ 34,270</b> |

(1) Insurance subsidiary operating expenses are primarily comprised of incurred but not reported loss reserves, loss adjustment expenses and policy acquisition costs.

*Amortization of waste, service and energy contracts*

Our waste, service and energy contracts are intangible assets and liabilities relating to long-term operating contracts at acquired facilities and are recorded upon acquisition at their estimated fair market values based upon discounted cash flows. Intangible assets and liabilities are amortized using the straight line method over their remaining useful lives. The following table details the amount of the actual/estimated amortization expense and contra-expense associated with these intangible assets and liabilities as of September 30, 2010 included or expected to be included in our condensed consolidated statement of income for each of the years indicated (in thousands):

|                                      | <b>Waste, Service and<br/>Energy Contracts<br/>(Amortization Expense)</b> |                | <b>Waste and Service<br/>Contracts<br/>(Contra-Expense)</b> |                 |
|--------------------------------------|---|----------------|---|-----------------|
| Nine Months ended September 30, 2010 | \$  | 30,512         | \$  | (9,527)         |
| Remainder of 2010                    | \$  | 10,017         | \$  | (3,248)         |
| 2011                                 |   | 37,784         |   | (12,408)        |
| 2012                                 |   | 35,690         |   | (12,412)        |
| 2013                                 |   | 32,124         |   | (12,390)        |
| 2014                                 |   | 29,128         |   | (12,500)        |
| 2015                                 |   | 25,835         |   | (8,188)         |
| Thereafter                           |   | 310,153        |   | (30,681)        |
| <b>Total</b>                         | <b>\$</b>   | <b>480,731</b> | <b>\$</b>   | <b>(91,827)</b> |

*Write-down of Assets*

Americas-Harrisburg Energy-from-Waste Facility

In 2008, we entered into a ten year agreement with The Harrisburg Authority to maintain and operate an 800 tpd energy-from-waste facility located in Harrisburg, Pennsylvania. We also agreed to provide construction management services and to advance up to \$25.5 million in funding to The Harrisburg Authority for certain facility improvements required to enhance facility performance, which improvements were substantially completed during 2010. The repayment of this funding is guaranteed by the City of Harrisburg, but is otherwise unsecured, and is junior to project bondholders' rights. We have advanced \$21.7 million, of which \$19.8 million is outstanding as of September 30, 2010 under this funding arrangement. Four repayment installments under this funding arrangement, which were due to us on April 1, 2010, July 1, 2010, August 1, 2010 and October 1, 2010, totaling an aggregate of \$2.0 million, have not been paid. The City of Harrisburg requested a forbearance period in April 2010, but meaningful discussion of forbearance and of the City's related plan for financial recovery did not develop on a timely basis. On October 5, 2010, we filed suit against the City of Harrisburg in the Dauphin County Court of Common Pleas seeking to enforce our rights under the City's guaranty. We believe that the City of Harrisburg is in a precarious financial condition with substantial obligations, and it has reported both its inability to pay its obligations and consideration of various future options (including state oversight and seeking bankruptcy protection). We intend to pursue our lawsuit in parallel with efforts to work with the City of Harrisburg and other stakeholders to protect the full recovery of our advance and to maintain our position in the project. As a result of these recent developments, we recorded a non-cash impairment charge of \$6.6 million, pre-tax, during the three months ended September 30, 2010, to write-down the receivable to \$13.2 million, which was calculated based on a range of potential outcomes utilizing various estimated cash flows for the receivable.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
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**Americas - Corporate Real Estate**

During the three months ended September 30, 2010, we recorded a non-cash impairment charge of \$2.6 million which is comprised primarily of the write-down of real estate for our corporate office to estimated fair value.

**International - Dublin Joint Venture**

In 2007, we entered into agreements to build, own, and operate a 1,700 metric tpd energy-from-waste project serving the City of Dublin, Ireland and surrounding communities at an estimated cost of 350 million. Dublin Waste to Energy Limited, which we control and co-own with DONG Energy Generation A/S, developed the project and has a 25 year tip fee type contract to provide disposal service for 320,000 metric tons of waste annually, representing approximately 50% of the facility's processing capacity. The project is expected to sell electricity into the local electricity grid, at rates partially supported by a preferential renewable tariff. While the primary approvals and licenses for the project have been obtained, the longstop date for acquiring necessary property rights and achieving certain other conditions precedent under the project agreement expired on September 4, 2010, without the satisfaction of all the conditions precedent. The parties will need to agree to proceed and are currently working toward addressing the current project issues. In light of the current circumstances surrounding the project, we recorded a non-cash impairment charge of \$23.1 million, pre-tax, during the three months ended September 30, 2010. This charge was comprised of the entire capitalized pre-construction and construction costs for the project, net of approximately \$7.5 million in recoverable assets net of liabilities that remain on the condensed consolidated balance sheet primarily related to recoverable premiums under project insurance.

**Non-Cash Convertible Debt Related Expense**

The components of non-cash convertible debt related expense are as follows (in thousands):

|  | <b>Non-Cash Convertible Debt Related Expense</b>    |             |  |             |
|--|---|-------------|--|-------------|
|  | <b>For the Three Months<br/>Ended September 30,</b> |             | <b>For the Nine Months<br/>Ended September 30,</b> |             |
|  | <b>2010</b>   | <b>2009</b> | <b>2010</b>  | <b>2009</b> |
| Debt discount accretion related to the Notes             | \$ 5,382  | \$ 4,742    | \$ 15,745  | \$ 6,967    |
| Debt discount accretion related to the Debentures        | 5,239   | 4,874       | 15,439   | 14,363      |
| Fair value changes related to the Note Hedge             | (10,093)  | 10,515      | 33,848   | 3,378       |
| Fair value changes related to the Cash Conversion Option | 9,251   | (16,666)    | (35,272)   | (10,146)    |
| Total non-cash convertible debt related expense          | \$ 9,779  | \$ 3,465    | \$ 29,760  | \$ 14,562   |

**Comprehensive Income**

The components of comprehensive income are as follows (in thousands):

|   | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|   | <b>2010</b>               | <b>2009</b> | <b>2010</b>              | <b>2009</b> |
| Comprehensive income, net of income taxes:                                    |                           |             |                          |             |
| Net income attributable to Covanta Holding Corporation                        | \$ 20,157                 | \$ 40,852   | \$ 38,713                | \$ 73,368   |
| Foreign currency translation  | 10,424                    | (870)       | 560                      | 3,478       |
| Pension and other postretirement plan unrecognized net loss                   | (74)                      | (42)        | (221)                    | (126)       |
| Net unrealized gain on derivatives  | 512                       |             | 512                      |             |
| Net unrealized gain on securities   | 531                       | 458         | 609                      | 947         |
| Other comprehensive income (loss) attributable to Covanta Holding Corporation | 11,393                    | (454)       | 1,460                    | 4,299       |
| Comprehensive income attributable to Covanta Holding Corporation              | \$ 31,550                 | \$ 40,398   | \$ 40,173                | \$ 77,667   |
| Net income attributable to noncontrolling interests in subsidiaries           | \$ 2,451                  | \$ 2,768    | \$ 6,436                 | \$ 6,312    |
| Foreign currency translation  | 880                       | (766)       | 1,039                    | 741         |
| Comprehensive income attributable to noncontrolling interests in subsidiaries | \$ 3,331                  | \$ 2,002    | \$ 7,475                 | \$ 7,053    |

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Goodwill**

The following table details the changes in the carrying value of goodwill (in thousands):

|                                     | <b>Total</b> |
|-------------------------------------|--------------|
| Balance as of December 31, 2009     | \$ 202,996   |
| Veolia EfW Acquisition (See Note 3) | 27,024       |
| Balance as of September 30, 2010    | \$ 230,020   |

**NOTE 9. BENEFIT OBLIGATIONS****Pension and Other Benefit Obligations**

The components of net periodic (credit) benefit costs are as follows (in thousands):

|  | <b>Pension Benefits</b>  |        |   |         | <b>Other Post-Retirement Benefits</b>                            |       |   |        |
|--|--|--------|---|---------|--|-------|---|--------|
|  | <b>For the Three<br/>Months Ended<br/>September 30,<br/>2010</b> |        | <b>For the Nine<br/>Months Ended<br/>September 30,<br/>2009</b> |         | <b>For the Three<br/>Months Ended<br/>September 30,<br/>2010</b> |       | <b>For the Nine<br/>Months Ended<br/>September 30,<br/>2009</b> |        |
| Service cost                                 | \$   | \$     | \$  | \$      | \$   | \$    | \$  | \$     |
| Interest cost                                | 1,056  | 1,197  | 3,167   | 3,591   | 118  | 122   | 356   | 367    |
| Expected return<br>on plan assets            | (1,237)  | (975)  | (3,711)   | (2,925) |  |       |   |        |
| Amortization of<br>net prior service<br>cost | (83)   | 19     | (247)   | 57      |  |       |   |        |
| Amortization of<br>actuarial gain            | (15)   | (46)   | (45)  | (138)   | (26)   | (37)  | (76)  | (112)  |
| Net periodic<br>(credit) benefit<br>costs    | \$ (279)   | \$ 195 | \$ (836)  | \$ 585  | \$ 92  | \$ 85 | \$ 280  | \$ 255 |

**Defined Contribution Plans**

Substantially all of our employees in the United States are eligible to participate in defined contribution plans we sponsor. Our costs related to defined contribution plans were \$3.6 million and \$3.3 million for the three months ended September 30, 2010 and 2009, respectively, and \$11.9 million and \$10.7 million for the nine months ended

September 30, 2010 and 2009, respectively.

#### **NOTE 10. STOCK-BASED COMPENSATION**

During the nine months ended September 30, 2010, we awarded certain employees 749,805 shares of restricted stock. The restricted stock will be expensed over the requisite service period, subject to an assumed 10% forfeiture rate. The terms of the restricted stock awards include vesting provisions based solely on continued service. If the service criteria are satisfied, the awards vest during March of 2011, 2012 and 2013.

Effective August 16, 2010, we awarded 30,675 shares of restricted stock to the Executive Vice President and Chief Financial Officer in connection with his appointment. The restricted stock will be expensed over the four-year vesting period. If the service criteria are satisfied, the awards vest during March of 2011, 2012, 2013 and 2014.

A special cash dividend was paid on July 20, 2010. Holders of unvested shares of restricted stock received the dividend in the form of additional restricted stock awards totaling 122,471 shares for employees and 3,796 for directors, with the same vesting conditions as the underlying shares of restricted stock to which they relate. See Special Cash Dividend discussion below.

On May 6, 2010, in accordance with our existing program for annual director compensation, we awarded 36,000 shares of restricted stock under the Directors Plan. We determined that the service vesting condition of these awards to be non-substantive and, in accordance with accounting principles for stock compensation, recorded the entire fair value of the award as compensation expense on the grant date.

During the nine months ended September 30, 2010, we adopted a Growth Equity Plan, which is to be used for awards pursuant to our Equity Award Plan for Employees and Officers. The Growth Equity Plan provides for the award of restricted stock units ( RSUs ) to certain employees in connection with specified growth-based acquisitions that have been completed or development projects that have commenced. We awarded certain employees 1,085,040 shares of restricted stock units under the Growth Equity Plan.

The Growth Equity Plan provides that as of the award date of the RSUs, the Compensation Committee shall determine the net present value of cash flows for the applicable acquisitions or development projects ( Projected NPV ). Vesting of RSUs will not occur until at least three years have passed following an acquisition or upon the later of three years from the grant date or one year following the commencement of commercial operations for development projects. Upon the vesting date, the Compensation Committee will re-calculate the net present values of the cash flows ( Bring Down NPV ). If the ratio of the

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Bring Down NPV to the Projected NPV is greater than 95% all of the RSUs related to the particular project will vest. If the ratio is less than 95%, the number of RSUs originally issued will be proportionately reduced.

Compensation expense related to our stock-based awards totaled \$3.9 million and \$13.3 million during the three and nine months ended September 30, 2010, respectively, and \$3.0 million and \$10.7 million during the three and nine months ended September 30, 2009, respectively. Compensation expense for the nine months ended September 30, 2010 includes additional expense of \$1.3 million resulting from the reduction of the exercise price of outstanding options as discussed below under Special Cash Dividend.

As of September 30, 2010, we had approximately \$13.1 million, \$5.2 million and \$1.7 million of unrecognized compensation expense related to our unvested restricted stock, RSUs, and unvested stock options, respectively. We expect this compensation expense to be recognized over a weighted average period of approximately 1.3 years for our unvested restricted stock awards, approximately 2.6 years for our unvested RSUs and approximately 1.3 years for our unvested stock options.

**Special Cash Dividend**

The special cash dividend described in Note 6. Changes in Capitalization was paid on July 20, 2010 and was deemed an equity restructuring in accordance with accounting principles for stock compensation. The impact of the special cash dividend on the various share-based awards is as follows:

We reduced the exercise price of options granted under the 2004 plan by \$1.50 per share. We recorded additional expense of \$1.3 million during the three months ended June 30, 2010 and expect to record \$0.2 million over the remaining vesting period.

As contractually required by the restricted stock agreements, employees and directors who were holders of unvested shares of restricted stock received the dividend in the form of additional restricted stock of 122,471 shares and 3,796 shares, respectively, with the same vesting conditions as the underlying shares of restricted stock to which they relate.

As contractually required by the RSU agreements, dividends of \$1.4 million on the RSUs were paid in cash and put into escrow, and will be subject to the same vesting criteria as the underlying shares of RSUs to which they relate.

**NOTE 11. FINANCIAL INSTRUMENTS**

**Fair Value Measurements**

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

For cash and cash equivalents, restricted funds, and marketable securities, the carrying value of these amounts is a reasonable estimate of their fair value. The fair value of restricted funds held in trust is based on quoted market prices of the investments held by the trustee.

Fair values for long-term debt and project debt are determined using quoted market prices.

The fair value of the Note Hedge and the Cash Conversion Option are determined using an option pricing model based on observable inputs such as implied volatility, risk free rate, and other factors. The fair value of the Note

Hedge is adjusted to reflect counterparty risk of non-performance, and is based on the counterparty's credit spread in the credit derivatives market. The contingent interest features related to the Debentures and the Notes are valued quarterly using the present value of expected cash flow models incorporating the probabilities of the contingent events occurring.

The estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that we would realize in a current market exchange. The fair-value estimates presented herein are based on pertinent information available to us as of September 30, 2010. However, such amounts have not been comprehensively revalued for purposes of these financial statements since September 30, 2010, and current estimates of fair value may differ significantly from the amounts presented herein.



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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table presents information about the fair value measurement of our assets and liabilities as of September 30, 2010:

| Financial Instruments Recorded at Fair Value<br>on a Recurring Basis:     | As of September 30, 2010 |                         | Fair Value Measurements at<br>Reporting Date Using   |   |   |
|---|--------------------------|-------------------------|--|---|---|
|   | Carrying<br>Amount       | Estimated<br>Fair Value | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1)<br>(In<br>thousands) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level<br>3) |
| <b>Assets:</b>  |                          |                         |  |   |   |
| Cash and cash equivalents:  |                          |                         |  |   |   |
| Bank deposits and certificates of deposit                                 | \$ 66,898                | \$ 66,898               | \$ 66,898  | \$  | \$  |
| Money market funds  | 9,609                    | 9,609                   | 9,609  |   |   |
| Total cash and cash equivalents:  | 76,507                   | 76,507                  | 76,507   |   |   |
| Restricted funds held in trust:   |                          |                         |  |   |   |
| Bank deposits and certificates of deposit                                 | 28,826                   | 28,816                  | 28,816   |   |   |
| Money market funds  | 185,406                  | 185,406                 | 185,406  |   |   |
| U.S. Treasury/Agency obligations (a)                                      | 51,520                   | 51,528                  | 51,528   |   |   |
| State and municipal obligations   | 12,783                   | 12,783                  | 12,783   |   |   |
| Commercial paper/Guaranteed investment<br>contracts/Repurchase agreements | 59,186                   | 59,527                  | 59,527   |   |   |
| Total restricted funds held in trust:                                     | 337,721                  | 338,060                 | 338,060  |   |   |
| Restricted funds other:   |                          |                         |  |   |   |
| Bank deposits and certificates of deposit (b)                             | 20,263                   | 20,263                  | 20,263   |   |   |
| Money market funds (c)  | 13,118                   | 13,118                  | 13,118   |   |   |
| Total restricted funds other:   | 33,381                   | 33,381                  | 33,381   |   |   |
| Investments:  |                          |                         |  |   |   |
| Mutual and bond funds (b)   | 2,185                    | 2,185                   | 2,185  |   |   |
| Investments available for sale:   |                          |                         |  |   |   |
| U.S. Treasury/Agency obligations (d)                                      | 8,696                    | 8,696                   | 8,696  |   |   |
| Residential mortgage-backed securities (d)                                | 2,694                    | 2,694                   | 2,694  |   |   |
| Corporate investments (d)   | 13,893                   | 13,893                  | 13,893   |   |   |
| Other government obligations (d)  | 1,376                    | 1,376                   | 1,376  |   |   |
| Equity securities (c)   | 1,099                    | 1,099                   | 1,099  |   |   |

|                        |   |            |    |         |    |         |    |           |
|------------------------|---|------------|----|---------|----|---------|----|-----------|
| Total investments:     |   | 29,943     |    | 29,943  |    | 29,943  |    |           |
| Derivative Asset       | Energy Hedge  | 847        |    | 847     |    |         |    | 847       |
| Derivative Asset       | Note Hedge  | 89,695     |    | 89,695  |    |         |    | 89,695    |
| Total assets:          |   | \$ 568,094 | \$ | 568,433 | \$ | 477,891 | \$ | 90,542 \$ |
| <b>Liabilities:</b>    |   |            |    |         |    |         |    |           |
| Derivative Liability   | Cash Conversion Option                                      | \$ 93,331  | \$ | 93,331  | \$ |         | \$ | 93,331 \$ |
| Derivative Liabilities | Contingent interest features<br>of the Notes and Debentures | 0          |    | 0       |    |         |    | 0         |
| Total liabilities:     |   | \$ 93,331  | \$ | 93,331  | \$ |         | \$ | 93,331 \$ |

**Financial Instruments Recorded at Carrying Amount:****Assets:**

|                          |    |         |    |         |
|--------------------------|----|---------|----|---------|
| Accounts receivables (e) | \$ | 298,092 | \$ | 298,092 |
|--------------------------|----|---------|----|---------|

**Liabilities:**

|   |    |           |    |           |
|---|----|-----------|----|-----------|
| Long-term debt (excluding Cash Conversion Option) | \$ | 1,335,288 | \$ | 1,337,037 |
| Project debt                                      | \$ | 891,033   | \$ | 912,686   |

- The U.S. Treasury/Agency obligations in restricted funds held in trust are primarily comprised of Federal Home Loan Mortgage Corporation securities at fair value.
- Included in other noncurrent assets in the condensed consolidated balance sheets.
- Included in prepaid expenses and other current assets in the condensed consolidated balance sheets.
- Included in investments in fixed maturities at market in the condensed consolidated balance sheets.
- Includes \$24.8 million of noncurrent receivables in other noncurrent assets in the condensed consolidated balance sheets.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table presents information about the fair value measurement of our assets and liabilities as of December 31, 2009:

| Financial Instruments Recorded at Fair Value<br>on a Recurring Basis:     | As of December 31, 2009 |   | Fair Value Measurements at<br>Reporting Date Using                                  |   |   |
|---|-------------------------|---|---|---|---|
|   | Carrying<br>Amount      | Estimated<br>Fair Value<br>(In thousands) | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level<br>3) |
| <b>Assets:</b>  |                         |   |   |   |   |
| Cash and cash equivalents:  |                         |   |   |   |   |
| Bank deposits and certificates of deposit                                 | \$ 81,458               | \$ 81,458                                 | \$ 81,458   |   | \$  |
| Money market funds  | 352,225                 | 352,225                                   | 352,225   |   |   |
| Total cash and cash equivalents:  | 433,683                 | 433,683                                   | 433,683   |   |   |
| Restricted funds held in trust:   |                         |   |   |   |   |
| Bank deposits and certificates of deposit                                 | 32,765                  | 32,765                                    | 32,765  |   |   |
| Money market funds  | 152,571                 | 152,569                                   | 152,569   |   |   |
| U.S. Treasury/Agency obligations (a)                                      | 35,382                  | 35,388                                    | 35,388  |   |   |
| State and municipal obligations   | 8,582                   | 8,582                                     | 8,582   |   |   |
| Commercial paper/Guaranteed investment<br>contracts/Repurchase agreements | 48,452                  | 48,469                                    | 48,469  |   |   |
| Total restricted funds held in trust:                                     | 277,752                 | 277,773                                   | 277,773   |   |   |
| Restricted funds other:   |                         |   |   |   |   |
| Bank deposits and certificates of deposit(b)                              | 20,243                  | 20,243                                    | 20,243  |   |   |
| Money market funds (c)  | 6,106                   | 6,106                                     | 6,106   |   |   |
| Total restricted funds other:   | 26,349                  | 26,349                                    | 26,349  |   |   |
| Investments:  |                         |   |   |   |   |
| Marketable securities available for sale (c)                              | 300                     | 300                                       | 300   |   |   |
| Mutual and bond funds (b)   | 1,802                   | 2,105                                     | 2,105   |   |   |
| Investments available for sale:   |                         |   |   |   |   |
| U.S. Treasury/Agency obligations (d)                                      | 13,726                  | 13,726                                    | 13,726  |   |   |
| Residential mortgage-backed securities (d)                                | 5,203                   | 5,203                                     | 5,203   |   |   |
| Corporate investments (d)   | 9,213                   | 9,213                                     | 9,213   |   |   |
| Equity securities (c)   | 871                     | 871                                       | 871   |   |   |

|                        |  |            |    |         |    |         |    |            |
|------------------------|--|------------|----|---------|----|---------|----|------------|
| Total investments:     |  | 31,115     |    | 31,418  |    | 31,418  |    |            |
| Derivative Asset       | Note Hedge   | 123,543    |    | 123,543 |    |         |    | 123,543    |
| Total assets:          |  | \$ 892,442 | \$ | 892,766 | \$ | 769,223 | \$ | 123,543 \$ |
| <b>Liabilities:</b>    |  |            |    |         |    |         |    |            |
| Derivative Liability   | Cash Conversion Option                                   | \$ 128,603 | \$ | 128,603 | \$ |         | \$ | 128,603 \$ |
| Derivative Liabilities | Contingent interest features of the Notes and Debentures | 0          |    | 0       |    |         |    | 0          |
| Total liabilities:     |  | \$ 128,603 | \$ | 128,603 | \$ |         | \$ | 128,603 \$ |

**Financial Instruments Recorded at Carrying Amount:****Assets:**

|                          |            |    |         |
|--------------------------|------------|----|---------|
| Accounts receivables (e) | \$ 336,876 | \$ | 336,876 |
|--------------------------|------------|----|---------|

**Liabilities:**

|   |              |    |           |
|---|--------------|----|-----------|
| Long-term debt (excluding Cash Conversion Option) | \$ 1,309,103 | \$ | 1,314,264 |
| Project debt                                      | \$ 959,364   | \$ | 983,474   |

- The U.S. Treasury/Agency obligations in restricted funds held in trust are primarily comprised of Federal Home Loan Mortgage Corporation securities at fair value.
- Included in other noncurrent assets in the condensed consolidated balance sheets.
- Included in prepaid expenses and other current assets in the condensed consolidated balance sheets.
- Included in investments in fixed maturities at market in the condensed consolidated balance sheets.
- Includes \$32.7 million of noncurrent receivables in other noncurrent assets in the condensed consolidated balance sheets.

**Investments**

Our insurance subsidiaries' fixed maturity debt and equity securities portfolio are classified as available-for-sale and are carried at fair value. Equity securities that are traded on a national securities exchange are stated at the last reported sales price on the day of valuation. Debt securities values are determined by third party matrix pricing based on the last days trading activity. Changes in fair values are credited or charged directly to Accumulated Other Comprehensive Income (AOCI) in the condensed consolidated statements of equity as unrealized gains or losses, respectively. Investment gains or losses realized on the sale of securities are determined using the specific identification method. Realized gains and losses are recognized in the condensed consolidated statements of income based on the amortized cost of fixed maturities and the cost basis for equity securities on the date of trade, subject to any previous adjustments for other-than-temporary declines. Other-than-temporary declines in fair value are recorded as realized losses in the condensed consolidated statements of

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

income to the extent they relate to credit losses, and to AOCI to the extent they are related to other factors. The cost basis of the security is also reduced. We consider the following factors in determining whether declines in the fair value of securities are other-than-temporary:

the significance of the decline in fair value compared to the cost basis;  
the time period during which there has been a significant decline in fair value;  
whether the unrealized loss is credit-driven or a result of changes in market interest rates;  
a fundamental analysis of the business prospects and financial condition of the issuer; and  
our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

Other investments, such as investments in companies in which we do not have the ability to exercise significant influence, are carried at the lower of cost or estimated realizable value.

The cost or amortized cost, unrealized gains, unrealized losses and the fair value of our investments categorized by type of security, were as follows (in thousands):

|  | As of September 30, 2010     |                    |                    |                 | As of December 31, 2009      |                    |                    |                 |
|--|------------------------------|--------------------|--------------------|-----------------|------------------------------|--------------------|--------------------|-----------------|
|  | Cost or<br>Amortized<br>Cost | Unrealized<br>Gain | Unrealized<br>Loss | Fair<br>Value   | Cost or<br>Amortized<br>Cost | Unrealized<br>Gain | Unrealized<br>Loss | Fair<br>Value   |
| <b>Current investments:</b>                  |                              |                    |                    |                 |                              |                    |                    |                 |
| Fixed maturities                             | \$                           | \$                 | \$                 | \$              | \$ 300                       | \$                 | \$                 | \$ 300          |
| Equity securities insurance<br>business      | 894                          | 230                | 25                 | 1,099           | 732                          | 150                | 11                 | 871             |
| <b>Total current investments</b>             | <b>\$ 894</b>                | <b>\$ 230</b>      | <b>\$ 25</b>       | <b>\$ 1,099</b> | <b>\$ 1,032</b>              | <b>\$ 150</b>      | <b>\$ 11</b>       | <b>\$ 1,171</b> |
| <b>Noncurrent investments:</b>               |                              |                    |                    |                 |                              |                    |                    |                 |
| Fixed maturities insurance<br>business:      |                              |                    |                    |                 |                              |                    |                    |                 |
| U.S. government<br>obligations               | \$                           | \$                 | \$                 | \$              | \$ 315                       | \$ 6               | \$                 | \$ 321          |
| U.S. government agencies                     | 8,570                        | 127                | 1                  | 8,696           | 13,157                       | 257                | 9                  | 13,405          |
| Residential<br>mortgage-backed securities    | 2,594                        | 102                | 2                  | 2,694           | 5,150                        | 74                 | 21                 | 5,203           |
| Corporate investments                        | 13,201                       | 694                | 2                  | 13,893          | 8,878                        | 337                | 2                  | 9,213           |
| Other government<br>obligations              | 1,348                        | 29                 | 1                  | 1,376           |                              |                    |                    |                 |
| Total fixed maturities<br>insurance business | 25,713                       | 952                | 6                  | 26,659          | 27,500                       | 674                | 32                 | 28,142          |
| Mutual and bond funds                        | 2,185                        | 182                |                    | 2,367           | 1,802                        | 303                |                    | 2,105           |

**Total noncurrent investments**                    \$ 27,898   \$ 1,134   \$ 6   \$ 29,026   \$ 29,302   \$ 977   \$ 32   \$ 30,247

The following table sets forth a summary of temporarily impaired investments held by our insurance subsidiary (in thousands):

| Description of Investments                                 | As of September 30,<br>2010 |                      | As of December 31,<br>2009 |                      |
|--|-----------------------------|----------------------|----------------------------|----------------------|
|  | Fair<br>Value               | Unrealized<br>Losses | Fair<br>Value              | Unrealized<br>Losses |
| U.S. Treasury and other direct U.S. government obligations | \$                          | \$                   | \$ 341                     | \$ 9                 |
| Federal agency mortgage-backed securities                  | 512                         | 3                    | 1,503                      | 21                   |
| Other government obligations                               | 672                         | 1                    |                            |                      |
| Corporate investments                                      | 534                         | 2                    | 100                        | 2                    |
| Total fixed maturities                                     | 1,718                       | 6                    | 1,944                      | 32                   |
| Equity securities  | 166                         | 25                   | 94                         | 11                   |
| Total temporarily impaired investments                     | \$ 1,884                    | \$ 31                | \$ 2,038                   | \$ 43                |

One of each of the U.S. Treasury and federal agency obligations, mortgage-backed securities, other government obligations, and corporate bonds is temporarily impaired. As of September 30, 2010, all of the temporarily impaired fixed maturity investments had maturities greater than 12 months.

Our fixed maturities held by our insurance subsidiary include mortgage-backed securities and collateralized mortgage obligations, collectively ( MBS ) representing 10.1%, and 18.5% of the total fixed maturities as of September 30, 2010 and December 31, 2009, respectively. Our MBS holdings are issued by the Federal National Mortgage Association ( FNMA ), the Federal Home Loan Mortgage Corporation ( FHLMC ), or the Government National Mortgage Association ( GNMA ) all of which are rated AAA by Moody's Investors Services. MBS and callable bonds, in contrast to other bonds, are more sensitive to market value declines in a rising interest rate environment than to market value increases in a declining interest rate environment.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The expected maturities of fixed maturity securities, by amortized cost and fair value are shown below (in thousands):

|                              | <b>As of September 30, 2010</b> |                   |
|------------------------------|---------------------------------|-------------------|
|                              | <b>Amortized<br/>Cost</b>       | <b>Fair Value</b> |
| Available-for-sale:          |                                 |                   |
| One year or less             | \$ 11,904                       | \$ 12,080         |
| Over one year to five years  | 12,485                          | 13,188            |
| Over five years to ten years | 1,324                           | 1,391             |
| More than ten years          |                                 |                   |
| Total fixed maturities       | \$ 25,713                       | \$ 26,659         |

The following reflects the change in net unrealized gain on securities included as a separate component of AOCI in the condensed consolidated statements of equity (in thousands):

|  | <b>For the Three Months<br/>Ended September 30,<br/>2010</b> |             | <b>For the Nine Months<br/>Ended September 30,<br/>2010</b> |             |
|--|--|-------------|---|-------------|
|  | <b>2010</b>  | <b>2009</b> | <b>2010</b>   | <b>2009</b> |
| Fixed maturities, net  | \$ 274   | \$ 265      | \$ 304  | \$ 692      |
| Equity securities, net   | 114  | 79          | 66  | 44          |
| Mutual and bond funds  | 107  | 114         | 182   | 211         |
| Change in net unrealized gain on available-for-sale securities | 495  | 458         | 552   | 947         |
| Money market funds restricted                                  | 36   |             | 57  |             |
| Change in net unrealized gain on securities                    | \$ 531   | \$ 458      | \$ 609  | \$ 947      |

The components of net unrealized gain on securities consist of the following (in thousands):

|  | <b>For the Three<br/>Months<br/>Ended September 30,<br/>2010</b> |             | <b>For the Nine<br/>Months<br/>Ended September 30,<br/>2010</b> |             |
|--|--|-------------|---|-------------|
|  | <b>2010</b>  | <b>2009</b> | <b>2010</b>   | <b>2009</b> |
| Net unrealized holding gain arising during the period                      | \$ 495   | \$ 458      | \$ 544  | \$ 924      |
| Reclassification adjustment for net realized losses included in net income |  |             | 8   | 23          |

|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Net unrealized gain on available-for-sale securities             | 495    | 458    | 552    | 947    |
| Net unrealized holding gain arising during the period restricted | 36     |        | 57     |        |
| Net unrealized gain on securities                                | \$ 531 | \$ 458 | \$ 609 | \$ 947 |

**NOTE 12. DERIVATIVE INSTRUMENTS**

The following disclosures summarize the fair value of derivative instruments not designated as hedging instruments in the condensed consolidated balance sheets and the effect of changes in fair value related to those derivative instruments not designated as hedging instruments on the condensed consolidated statements of income.

**Derivative Instruments Not Designated**

| As Hedging Instruments                                   | Balance Sheet Location       | Fair Value as of   |                   |
|--|------------------------------|--------------------|-------------------|
|  |                              | September 30, 2010 | December 31, 2009 |
|  |                              | (In thousands)     |                   |
| <b>Asset Derivatives:</b>                                |                              |                    |                   |
| Note Hedge   | Other noncurrent assets      | \$ 89,695          | \$ 123,543        |
| <b>Liability Derivatives:</b>                            |                              |                    |                   |
| Cash Conversion Option                                   | Long-term debt               | \$ 93,331          | \$ 128,603        |
| Contingent interest features of the Debentures and Notes | Other noncurrent liabilities | \$ 0               | \$ 0              |



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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

| Effect on Income of Derivative   | Location of Gain or (Loss) Recognized in          | Amount of Gain or (Loss) Recognized in Income on Derivative |   |  |  |
|--|---|---|---|--|--|
|  |   | For the Three Months Ended September 30, 2010               | For the Three Months Ended September 30, 2009 | For the Nine Months Ended September 30, 2010 | For the Nine Months Ended September 30, 2009 |
| <b>Instruments Not Designated As Hedging Instruments</b>                         | <b>(Loss) Recognized in Income on Derivatives</b> |   |   |  |  |
|  |   | <b>(In thousands)</b>                                       |   |  |  |
| Note Hedge   | Non-cash convertible debt related expense         | \$ 10,093   | \$ (10,515)                                   | \$ (33,848)                                  | \$ (3,378)                                   |
| Cash Conversion Option   | Non-cash convertible debt related expense         | (9,251)   | 16,666  | 35,272                                       | 10,146                                       |
| Contingent interest features of the Notes and Debentures                         | Non-cash convertible debt related expense         |   |   |  |  |
| Effect on income of derivative instruments not designated as hedging instruments |   | \$ 842  | \$ 6,151                                      | \$ 1,424                                     | \$ 6,768                                     |

**Cash Conversion Option, Note Hedge and Contingent Interest features related to the 3.25% Cash Convertible Senior Notes**

The Cash Conversion Option is a derivative instrument which is recorded at fair value quarterly with any change in fair value being recognized in our condensed consolidated income statement as non-cash convertible debt related expense. The Note Hedge is accounted for as a derivative instrument and as such, is recorded at fair value quarterly with any change in fair value being recognized in our condensed consolidated statements of income as non-cash convertible debt related expense.

We expect the gain or loss associated with changes to the valuation of the Note Hedge to substantially offset the gain or loss associated with changes to the valuation of the Cash Conversion Option. However, they will not be completely offsetting as a result of changes in the credit valuation adjustment related to the Note Hedge. Our most significant credit exposure arises from the Note Hedge. The fair value of the Note Hedge reflects the maximum loss that would be incurred should the Option Counterparties fail to perform according to the terms of the Note Hedge agreement. For specific details related to the Cash Conversion Option, Note Hedge and contingent interest features of the Notes, refer to Note 11 of the Notes to Consolidated Financial Statements in our Form 10-K.

**Contingent Interest feature of the 1.00% Senior Convertible Debentures**

The contingent interest feature in the Debentures is an embedded derivative instrument. The first contingent cash interest payment period would not commence until February 1, 2012. For specific criteria related to the contingent interest features of the Debentures, refer to Note 11 and Note 14 of the Notes to Consolidated Financial Statements in our Form 10-K.

## **Energy Price Risk**

Following the expiration of certain long-term energy sales contracts, we may have exposure to market risk, and therefore revenue fluctuations, in energy markets. We may enter into contractual arrangements that will mitigate our exposure to this volatility through a variety of hedging techniques. Our efforts in this regard will involve only mitigation of price volatility for the energy we produce, and will not involve speculative energy trading. Consequently, we have entered into swap agreements with various financial institutions to hedge our exposure to market risk. As of September 30, 2010, the fair value of the energy derivatives of \$0.8 million, pre-tax, was recorded as a current asset and as a component of AOCI.

## **NOTE 13. RELATED-PARTY TRANSACTIONS**

We hold a 26% investment in Quezon Power, Inc. ( Quezon ). We are party to an agreement with Quezon in which we assumed responsibility for the operation and maintenance of Quezon s coal-fired electricity generation facility. Accordingly, 26% of the net income of Quezon is reflected in our condensed consolidated statements of income and as such, 26% of the revenue earned under the terms of the operation and maintenance agreement is eliminated against Equity in Net Income from Unconsolidated Investments. For the three months ended September 30, 2010 and 2009, we collected \$8.3 million and \$8.5 million, respectively, and for the nine months ended September 30, 2010 and 2009, we collected \$23.0 million and \$26.8 million, respectively, for the operation and maintenance of the facility. As of September 30, 2010 and December 31, 2009, the net amount due to Quezon was \$4.6 million and \$5.0 million, respectively, which represents advance payments received from Quezon for operation and maintenance costs.

## **NOTE 14. COMMITMENTS AND CONTINGENCIES**

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

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Environmental Matters**

Our operations are subject to environmental regulatory laws and environmental remediation laws. Although our operations are occasionally subject to proceedings and orders pertaining to emissions into the environment and other environmental violations, which may result in fines, penalties, damages or other sanctions, we believe that we are in substantial compliance with existing environmental laws and regulations.

We may be identified, along with other entities, as being among parties potentially responsible for contribution to costs associated with the correction and remediation of environmental conditions at disposal sites subject to federal and/or analogous state laws. In certain instances, we may be exposed to joint and several liabilities for remedial action or damages. Our ultimate liability in connection with such environmental claims will depend on many factors, including our volumetric share of waste, the total cost of remediation, and the financial viability of other companies that also sent waste to a given site and, in the case of divested operations, its contractual arrangement with the purchaser of such operations.

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

*Wallingford Matter.* Recent compliance stack testing indicated that one of the three combustion units at the Wallingford energy-from-waste facility had exceeded the permit limit for dioxin/furan emissions. We promptly shut down the affected combustion unit and self-reported the test results to the Connecticut Department of Environmental Protection ( CTDEP ). On August 18, 2010, the Connecticut Office of the Attorney General ( AG ), on behalf of the CTDEP, commenced an enforcement action in Connecticut Superior Court (Hartford) with respect to the results of the recent compliance stack testing. We are working cooperatively with the CTDEP and AG to reach agreement on a restart and test program to demonstrate that the affected combustion unit has been returned to compliance. The case is in the initial stages and it is not possible at this time to predict the outcome or to estimate our ultimate liability in the matter; however, we believe this proceeding and related suspension in operation will not have a material adverse effect on our consolidated financial position or results of operations.

*Lower Passaic River Matter.* In August 2004, the United States Environmental Protection Agency ( EPA ) notified Covanta Essex Company ( Essex ) that it was a potentially responsible party ( PRP ) for Superfund response actions in the Lower Passaic River Study Area, referred to as LPRSA, a 17 mile stretch of river in northern New Jersey. Essex is one of 71 PRPs named thus far that have joined the LPRSA PRP group, which is undertaking a Remedial Investigation/Feasibility Study ( Study ) of the LPRSA under EPA oversight. Essex's share of the Study costs to date are not material to its financial position and results of operations; however, the Study costs are exclusive of any LPRSA remedial costs or natural resource damages that may ultimately be assessed against PRPs. In February 2009, Essex and over 300 other PRPs were named as third-party defendants in a suit brought by the State of New Jersey Department of Environmental Protection ( NJDEP ) in New Jersey Superior Court of Essex County against Occidental Chemical Corporation and certain related entities ( Occidental ) with respect to alleged contamination of the LPRSA by Occidental. The Occidental third-party complaint seeks contribution with respect to any award to NJDEP of damages against Occidental in the matter. Considering the history of industrial and other discharges into the LPRSA from other sources, including named PRPs, Essex believes any releases to the LPRSA from its facility to be de minimis;

however, it is not possible at this time to predict that outcome or to estimate Essex's ultimate liability in the matter, including for LPRSA remedial costs and/or natural resource damages and/or contribution claims made by Occidental and/or other PRPs.

### Other Matters

Other commitments as of September 30, 2010 were as follows (in thousands):

|                             | Commitments Expiring by Period |                       |                       |
|-----------------------------|--------------------------------|-----------------------|-----------------------|
|                             | Total                          | Less Than<br>One Year | More Than<br>One Year |
| Letters of credit           | \$ 300,434                     | \$ 10,576             | \$ 289,858            |
| Surety bonds                | 111,893                        |                       | 111,893               |
| Total other commitments net | \$ 412,327                     | \$ 10,576             | \$ 401,751            |

The letters of credit were issued under various credit facilities (primarily the Funded L/C Facility) to secure our performance under various contractual undertakings related to our domestic and international projects or to secure obligations under our insurance program. Each letter of credit relating to a project is required to be maintained in effect for the period specified in related project contracts, and generally may be drawn if it is not renewed prior to expiration of that period.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Concluded)**

We believe that we will be able to fully perform under our contracts to which these existing letters of credit relate, and that it is unlikely that letters of credit would be drawn because of a default of our performance obligations. If any of these letters of credit were to be drawn by the beneficiary, the amount drawn would be immediately repayable by us to the issuing bank. If we do not immediately repay such amounts drawn under these letters of credit, unreimbursed amounts would be treated under the Credit Facilities as additional term loans in the case of letters of credit issued under the Funded L/C Facility, or as revolving loans in the case of letters of credit issued under the Revolving Loan Facility.

The surety bonds listed on the table above relate primarily to performance obligations (\$100.9 million) and support for closure obligations of various energy projects when such projects cease operating (\$11.0 million). Were these bonds to be drawn upon, we would have a contractual obligation to indemnify the surety company.

We have certain contingent obligations related to the Notes. These are:

- holders may require us to repurchase their Notes, if a fundamental change occurs; and
- holders may exercise their conversion rights upon the occurrence of certain events, which would require us to pay the conversion settlement amount in cash.

For specific criteria related to contingent interest, conversion or redemption features of the Notes, see Note 6. Changes in Capitalization.

We have certain contingent obligations related to the Debentures. These are:

- holders may require us to repurchase their Debentures on February 1, 2012, February 1, 2017 and February 1, 2022;
- holders may require us to repurchase their Debentures, if a fundamental change occurs; and
- holders may exercise their conversion rights upon the occurrence of certain events, which would require us to pay the conversion settlement amount in cash and/or our common stock.

For specific criteria related to contingent interest, conversion or redemption features of the Debentures, refer to Note 11 of the Notes to Consolidated Financial Statements in our Form 10-K.

We have issued or are party to guarantees and related contractual support obligations undertaken pursuant to agreements to construct and operate waste and energy facilities. For some projects, such performance guarantees include obligations to repay certain financial obligations if the project revenues are insufficient to do so, or to obtain or guarantee financing for a project. With respect to our businesses, we have issued guarantees to municipal clients and other parties that our subsidiaries will perform in accordance with contractual terms, including, where required, the payment of damages or other obligations. Additionally, damages payable under such guarantees for our energy-from-waste facilities could expose us to recourse liability on project debt. If we must perform under one or more of such guarantees, our liability for damages upon contract termination would be reduced by funds held in trust and proceeds from sales of the facilities securing the project debt and is presently not estimable. Depending upon the circumstances giving rise to such damages, the contractual terms of the applicable contracts, and the contract counterparty's choice of remedy at the time a claim against a guarantee is made, the amounts owed pursuant to one or more of such guarantees could be greater than our then-available sources of funds. To date, we have not incurred material liabilities under such guarantees.



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

The terms we, our, ours, us, Covanta and Company refer to Covanta Holding Corporation and its subsidiaries. The term Covanta Energy refers to our subsidiary Covanta Energy Corporation and its subsidiaries. The following discussion addresses our financial condition as of September 30, 2010 and our results of operations for the three and nine months ended September 30, 2010, compared with the same periods last year. It should be read in conjunction with our Audited Consolidated Financial Statements and Notes thereto for the year ended December 31, 2009 and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Form 10-K for the year ended December 31, 2009 ( Form 10-K ), and in the interim unaudited financial statements and notes included in our Quarterly Reports on Form 10-Q for the period ended March 31, 2010 and June 30, 2010, to which the reader is directed for additional information.

The preparation of interim financial statements necessarily relies heavily on estimates. Due to the use of estimates and certain other factors, such as the seasonal nature of our waste and energy services business, as well as competitive and other market conditions, we do not believe that interim results of operations are indicative of full year results of operations. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts and classification of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

**OVERVIEW**

We are a leading developer, owner and operator of infrastructure for the conversion of waste to energy (known as energy-from-waste or EfW ), as well as other waste disposal and renewable energy production businesses in the Americas, Europe and Asia. Our reportable segments are Americas and International. We are organized as a holding company and conduct all of our operations through subsidiaries which are engaged predominantly in the businesses of waste and energy services. We also engage in the independent power production business outside the Americas.

We own, have equity investments in, and/or operate 65 energy generation facilities, 57 of which were in the Americas and eight of which were located outside the Americas. Our energy generation facilities use a variety of fuels, including municipal solid waste, wood waste (biomass), landfill gas, water (hydroelectric), natural gas, coal, and heavy fuel-oil. We also own or operate several businesses that are associated with our energy-from-waste business, including a waste procurement business, two ash fills and two landfills, which we use primarily for ash disposal, and 13 waste transfer stations.

We have extensive experience in developing, constructing, operating, acquiring and integrating waste and energy services businesses. We are focusing our efforts on operating our existing business and pursuing strategic growth opportunities through development and acquisition with the goal of maximizing long-term shareholder return. We anticipate that a part of our future growth will come from investing in or acquiring additional energy-from-waste, waste disposal and renewable energy production businesses, primarily in the Americas and Europe. We are also exploring the sale of our fossil fuel independent power production facilities in the Philippines, India and Bangladesh. Our business is capital intensive because it is based upon building and operating municipal solid waste processing and energy generating projects. In order to provide meaningful growth, we must be able to invest our funds, obtain equity and/or debt financing, and provide support to our operating subsidiaries. The timing and scale of our investment activity in growth opportunities is often unpredictable and uneven.

We are committed to operate with an efficient capital structure by returning surplus capital to shareholders and funding high value development projects when they come to fruition. Given our strong cash generation and the status

of our various development efforts, we plan on making additional opportunistic share repurchases in future quarters generally consistent with our actions in the third quarter of 2010.

**The Energy-From-Waste Solution**

We believe that our business offers solutions to public sector leaders around the world in two related elements of critical infrastructure: waste disposal and renewable energy generation. We believe that the environmental benefits of energy-from-waste, as an alternative to landfilling, are clear and compelling: by processing municipal solid waste in energy-from-waste facilities we reduce greenhouse gas ( GHG ) emissions, lower the risk of groundwater contamination, and conserve land. At the same time, energy-from-waste generates clean, reliable energy from a renewable fuel source, thus reducing dependence on fossil fuels, the combustion of which is itself a major contributor to GHG emissions. As public planners in the Americas, Europe and Asia address their needs for more environmentally sustainable waste disposal and energy generation in the years ahead, we believe that energy-from-waste will be an increasingly attractive alternative. We will also consider, for application in the Americas and International segments, acquiring or developing new technologies that complement our existing renewable energy and waste services businesses.



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Our business offers sustainable solutions to energy and environmental problems, and our corporate culture is focused on themes of sustainability in all of its forms. We aspire to continuous improvement in environmental performance, beyond mere compliance with legally required standards. This ethos is embodied in our Clean World Initiative, an umbrella program under which we are:

- investing in research and development of new technologies to enhance existing operations and create new business opportunities in renewable energy and waste management;
- exploring and implementing processes and technologies at our facilities to improve energy efficiency and lessen environmental impacts; and
- partnering with governments and non-governmental organizations to pursue sustainable programs, reduce the use of environmentally harmful materials in commerce and communicate the benefits of energy-from-waste.

Our Clean World Initiative is designed to be consistent with our mission to be the world's leading energy-from-waste company by providing environmentally superior solutions, advancing our technical expertise and creating new business opportunities. It represents an investment in our future that we believe will enhance stockholder value.

In order to create new business opportunities and benefits and enhance stockholder value, we are actively engaged in the current discussion among policy makers in the United States regarding the benefits of energy-from-waste and the reduction of our dependence on landfilling for waste disposal and fossil fuels for energy. Given the ongoing global economic slowdown and related unemployment, policy makers are also expected to focus on economic stimulus, job creation, and energy security. We believe that the construction and permanent jobs created by additional energy-from-waste development represent the type of green jobs that are consistent with this focus. The extent to which we are successful in growing our business will depend in part on our ability to effectively communicate the benefits of energy-from-waste to public planners seeking waste disposal solutions and to policy makers seeking to encourage renewable energy technologies (and the associated jobs) as viable alternatives to reliance on fossil fuels as a source of energy.

The United States Congress is currently debating proposals designed to encourage two broad policy objectives: increased renewable energy generation, and reduction of fossil fuel usage and related GHG emissions. The United States House of Representatives passed a bill known as the America Clean Energy and Security Act of 2009 ( ACES ) which addresses both policy objectives, by means of a phased-in national renewable energy standard and a cap-and-trade system to reduce GHG emissions. Energy-from-waste and biomass have generally been included in the ACES bill to be among the technologies that help to achieve both policy objectives. Similar legislation has been introduced in the United States Senate. While legislation is far from final, the direction of Congressional efforts to date lead us to believe legislation might be passed that could create additional growth opportunities for our business and increase energy revenue from existing facilities.

### **Factors Affecting Business Conditions and Financial Results**

***Market Pricing for Waste, Energy and Metal*** Global and regional economy activity, as well as technological advances, regulations and a variety of other factors, will affect market supply and demand and therefore prices for waste disposal services, energy (including electricity and steam) and other commodities such as scrap metal. As market prices for waste disposal, electricity, steam and recycled metal rise it benefits our existing business as well as our prospects for growth through expansions or new development. Conversely, market price declines for these services and commodities will adversely affect both our existing business and growth prospects.

***Seasonal*** Our quarterly operating income for the Americas and International segments, within the same fiscal year, typically differ substantially due to seasonal factors, primarily as a result of the timing of scheduled plant maintenance. We typically conduct scheduled maintenance periodically each year, which requires that individual

boiler units temporarily cease operations. During these scheduled maintenance periods, we incur material repair and maintenance expenses and receive less revenue until the boiler units resume operations. This scheduled maintenance typically occurs during periods of off-peak electric demand in the spring and fall. The spring scheduled maintenance period is typically more extensive than scheduled maintenance conducted during the fall. As a result, we typically incur the highest maintenance expense in the first half of the year. Given these factors, we typically experience lower operating income from our projects during the first six months of each year and higher operating income during the second six months of each year.

In addition, at certain of our project subsidiaries, distributions of excess earnings (above and beyond monthly operation and maintenance service payments) are subject to periodic tests of project debt service coverage or requirements to maintain minimum working capital balances. While these distributions occur throughout the year based upon the specific terms of the relevant project debt arrangements, they are typically highest in the fourth quarter. Our net cash provided by operating activities exhibits seasonal fluctuations as a result of the timing of these distributions, including a benefit in the fourth quarter compared to the first nine months of the year.

***Other Factors Affecting Performance*** We have historically performed our operating obligations without experiencing material unexpected service interruptions or incurring material increases in costs. In addition, with respect to many of our contracts, we generally have limited our exposure for risks not within our control. For additional information about such risks and damages that we may owe for unexcused operating performance failures, see *Item 1A. Risk Factors*. In monitoring and assessing the ongoing operating and financial performance of our businesses, we focus on certain key factors: tons of waste processed, electricity and steam sold, and boiler availability.

**Table of Contents****Business Segments**

Our reportable segments are Americas and International. The Americas segment is comprised of waste and energy services operations primarily in the United States and Canada. The International segment is comprised of waste and energy services operations in other countries, currently those of the United Kingdom, Italy, China, the Philippines, India and Bangladesh.

**Segment****Business Description**

Americas

Our business in the Americas is comprised primarily of energy-from-waste projects. For all of these projects, we earn revenue from two primary sources: fees charged for operating projects or processing waste received and payments for electricity and steam sales. We also operate, and in some cases have ownership interests in, transfer stations and landfills which generate revenue from waste and ash disposal fees or operating fees. In addition, we own and in some cases operate, other renewable energy projects primarily in the United States which generate electricity from wood waste (biomass), landfill gas, and hydroelectric resources. The electricity from these other renewable energy projects is sold to utilities. We may receive additional revenue from construction activity during periods when we are constructing new facilities or expanding existing facilities.

International

We have ownership interests in and/or operate facilities internationally, including independent power production facilities in the Philippines, Bangladesh, China and India where we generate electricity by combusting coal, natural gas and heavy fuel-oil, and energy-from-waste facilities in China and Italy. We are constructing energy-from-waste facilities in China. We earn revenue from operating fees, waste processing fees, electricity and steam sales, construction activities, and in some cases, we receive cash from equity distributions.

**Contract Structures**

Most of our energy-from-waste projects were developed and structured contractually as part of competitive procurement processes conducted by municipal entities. As a result, many of these projects have common features. However, each service agreement is different reflecting the specific needs and concerns of a client community, applicable regulatory requirements and other factors. Often, we design the facility, help to arrange for financing and then we either construct and equip the facility on a fixed price and schedule basis, or we undertake an alternative role, such as construction management, if that better meets the goals of our municipal client. Following construction and during operations, we earn revenue from two primary sources: fees we receive for operating projects or for processing waste received, and payments we earn for electricity and/or steam we sell. Typical features of these agreements are as follows:

| <b>Contract types</b> | <b>Current number of projects</b> | <b>Fees for operating projects or for processing waste received</b>  | <b>Payments for electricity and/or steam we sell</b>  |
|-----------------------|-----------------------------------|--|---|
| Service Fee           | 29                                | We charge a fixed fee (which adjusts over time pursuant to contractual indices that we believe are appropriate to reflect price inflation) for operation and maintenance services provided to these energy-from-waste projects. At | At most of our Service Fee projects, the operating subsidiary retains only a fraction of the energy revenues generated, with the balance (generally 90%) used to provide a credit to the municipal client against |

projects that we own and where project debt is in place, a portion of our fee is dedicated to project debt service. Our contracts at Service Fee projects provide revenue that does not materially vary based on the amount of waste processed or energy generated and as such is relatively stable for the contract term. (29 Americas segment Service Fee projects).

its disposal costs. Therefore, in these projects, the municipal client derives most of the benefit and risk of energy production and changing energy prices.

Tip Fee

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We receive a per-ton fee under contracts for processing waste at Tip Fee projects. We generally enter into long-term waste disposal contracts for a substantial portion of the project's disposal capacity. The waste disposal and energy revenue from these projects is more dependent upon operating performance and, as such, is subject to greater revenue fluctuation to the extent performance levels fluctuate. (13 Americas segment Tip Fee projects and 3 International segment Tip Fee projects).

Where Tip Fee structures exist, we generally retain 100% of the energy revenues as well as risk associated with energy production and changing energy pricing. The majority of Tip Fee structures are under long-term fixed-price energy contracts.

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Under both structures, our returns are expected to be stable if we do not incur material unexpected operation and maintenance costs or other expenses. In addition, most of our energy-from-waste project contracts are structured so that contract counterparties generally bear, or share in, the costs associated with events or circumstances not within our control, such as uninsured force majeure events and changes in legal requirements. The stability of our revenues and returns could be affected by our ability to continue to enforce these obligations. Also, at some of our energy-from-waste facilities, commodity price risk is mitigated by passing through commodity costs to contract counterparties. With respect to our other renewable energy projects and international independent power projects, such structural features generally do not exist because either we operate and maintain such facilities for our own account or we do so on a cost-plus basis rather than a fixed-fee basis.

We receive the majority of our revenue under short- and long-term contracts with little or no exposure to price volatility but with adjustments intended to reflect changes in our costs. Where our revenue is received under other arrangements and depending upon the revenue source, we have varying amounts of exposure to price volatility. The largest component of our revenue is waste revenue, which has generally been subject to less price volatility than our revenue derived from sales of energy and metals. During the second and third quarters of 2008, pricing for energy reached historically high levels and has subsequently declined materially.

At some of our renewable energy and international independent power projects, our operating subsidiaries purchase fuel in the open markets which exposes us to fuel price risk. At other projects, fuel costs are contractually included in our electricity revenues, or fuel is provided by our customers. In some of our international projects, the project entity (which in some cases is not our subsidiary) has entered into long-term fuel purchase contracts that protect the project from fuel shortages, provided counterparties to such contracts perform their commitments.

We generally sell the energy output from our projects to local utilities pursuant to long-term contracts. At several of our energy-from-waste projects, we sell energy output under short-term contracts or on a spot-basis to our customers.

## **Contracted and Merchant Capacity**

We generally have long-term contracts to operate, or obtain waste supplies for, our energy-from-waste projects. For those projects we own, our contract to sell the project's energy output (either electricity or steam) generally expires on or after the date when the initial term of our contract to operate or receive waste also expires. Expiration of both our operating agreements and our agreements to sell energy output will subject us to greater market risk in maintaining and enhancing revenues. As contracts expire at projects we own, we intend to enter into replacement or additional contracts for waste supplies and will sell our energy output either into the regional electricity grid or pursuant to new contracts. Because project debt on these facilities will be paid off at such time, we believe that we will be able to offer disposal services at rates that will attract sufficient quantities of waste and provide acceptable revenues. For those projects we operate but do not own, prior to the expiration of the initial term of our operating contract, we will seek to enter into renewal or replacement contracts to continue operating such projects.

## **Growth and Development**

We are focusing our efforts on operating our existing business and pursuing strategic growth opportunities through development and acquisition with the goal of maximizing long-term shareholder return. We anticipate that a part of our future growth will come from investing in or acquiring additional energy-from-waste, waste disposal and renewable energy production businesses. We are pursuing additional growth opportunities particularly in locations where the market demand, regulatory environment or other factors encourage technologies such as energy-from-waste to reduce dependence on landfilling for waste disposal and fossil fuels for energy production in order to reduce GHG emissions. We are focusing on the United Kingdom, Ireland, Canada and the United States. Our growth opportunities include: new energy-from-waste and other renewable energy projects, existing project expansions, contract

extensions, acquisitions, and businesses ancillary to our existing business, such as additional waste transfer, transportation, processing and disposal businesses. We also intend to maintain a focus on research and development of technologies that we believe will enhance our competitive position, and offer new technical solutions to waste and energy problems that augment and complement our business.

We have a robust growth pipeline and continue to pursue several billion dollars worth of energy-from-waste development opportunities. However, much remains to be done and there is substantial uncertainty relating to the bidding and permitting process for each project opportunity. If, and when, these development efforts are successful, we plan to invest in these projects to achieve an attractive return on capital particularly when leveraged with project debt which we intend to utilize for all of our development projects.

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The following is a discussion of acquisitions and business development for 2010 and 2009. See *Item 1. Financial Statements Note 3. Acquisitions, Business Development and Dispositions* for additional information.

**ACQUISITIONS, BUSINESS DEVELOPMENT AND CONTRACT TRANSITIONS**

| <b>Facility/Operating Contract</b> | <b>Location</b> | <b>Year</b> | <b>Transaction</b> | <b>Type</b> | <b>Summary</b>   |
|------------------------------------|-----------------|-------------|--------------------|-------------|--|
| Wallingford                        | CT              | 2010        | Contract           | EfW         | We entered into new tip fee contracts which commenced upon expiration of the existing service fee contract in June 2010. These contracts in total are expected to supply waste utilizing most or all of the facility's capacity through 2020.  |
| Huntington                         | NY              | 2010        | Acquisition        | EfW         | We acquired a nominal limited partnership interest held by a third party in Covanta Huntington Limited Partnership, our subsidiary which owns and operates an energy-from-waste facility in Huntington, New York.  |
| Dade                               | FL              | 2010        | Acquisition        | EfW         | We acquired seven energy-from-waste businesses and one transfer station business from Veolia Environmental Services North America Corp. (the Veolia EfW Acquisition). The acquired businesses have a combined capacity of 9,600 tons per day ( tpd ). Each of the operations acquired includes a long-term operating contract with the respective municipal client. Six of the energy-from-waste facilities and the transfer station are publicly-owned facilities. We acquired a majority ownership stake in one of the energy-from-waste facilities and subsequently purchased the remaining ownership stake in this facility. |
| Long Beach                         | CA              | 2009        |                    | EfW         |  |
| Hudson Valley                      | NY              | 2009        |                    | EfW         |  |
| MacArthur                          | NY              | 2009        |                    | EfW         |  |
| Plymouth                           | PA              | 2009        |                    | EfW         |  |
| York                               | PA              | 2009        |                    | EfW         |  |
| Burnaby                            | Canada          | 2009        |                    | EfW         |  |
| Abington                           | PA              | 2009        |                    | Trans.St.   |  |
| Stanislaus County                  | CA              | 2009        | Contract           | EfW         | The service fee contract with Stanislaus County was extended from 2010 to 2016.  |
| Philadelphia Transfer Stations     | PA              | 2009        | Acquisition        | Trans.St.   | We acquired two waste transfer stations with combined capacity of 4,500 tpd in Philadelphia, Pennsylvania.   |

***ENERGY-FROM-WASTE  
PROJECTS UNDER ADVANCED DEVELOPMENT OR CONSTRUCTION***

| <b>Project/Facility</b>    | <b>Location</b> | <b>Summary</b>   |
|----------------------------|-----------------|--|
| Technology Development     |                 | We entered into various agreements with multiple partners to invest in the development, testing or licensing of new technologies related to the transformation of waste materials into renewable fuels or the generation of energy. Licensing fees and demonstration unit purchases aggregated \$4.4 million during the nine months ended September 30, 2010 and, \$4.7 million and \$6.5 million during the years ended December 31, 2009 and 2008, respectively.   |
| <br><b><i>AMERICAS</i></b> |                 |  |
| Honolulu                   | HI              | We operate and maintain the energy-from-waste facility located in and owned by the City and County of Honolulu, Hawaii. In December 2009, we entered into agreements with the City and County of Honolulu to expand the facility's waste processing capacity from 2,160 tpd to 3,060 tpd and to increase the gross electricity capacity from 57 megawatts ( MW ) to 90 MW. The agreements also extend the service contract term by 20 years. The \$302 million expansion project is a fixed-price construction project which will be funded and owned by the City and County of Honolulu. Construction commenced at the end of 2009. |
| Hillsborough               | FL              | During the third quarter of 2009, we completed the expansion and commenced the operations of the expanded energy-from-waste facility located in Hillsborough County, Florida. We expanded waste processing capacity from 1,200 tpd to 1,800 tpd and increased gross electricity capacity from 29.0 MW to 46.5 MW. As part of the agreement to implement this expansion, we received a long-term operating contract extension to 2027.  |



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| <i>INTERNATIONAL</i> | <b>Location</b> | <b>Summary</b>  |
|----------------------|-----------------|---|
| Dublin               | Ireland         | In 2007, we entered into agreements to build, own, and operate a 1,700 metric tpd energy-from-waste project serving the City of Dublin, Ireland and surrounding communities at an estimated cost of 350 million. Dublin Waste to Energy Limited, which we control and co-own with DONG Energy Generation A/S, developed the project and has a 25 year tip fee type contract to provide disposal service for 320,000 metric tons of waste annually, representing approximately 50% of the facility's processing capacity. The project is expected to sell electricity into the local electricity grid, at rates partially supported by a preferential renewable tariff. While the primary approvals and licenses for the project have been obtained, the longstop date for acquiring necessary property rights and achieving certain other conditions precedent under the project agreement expired on September 4, 2010. As a result, the parties will need to agree to proceed and are currently working toward that objective. See discussion in Note 8. Supplementary Information for accounting information for the Dublin project. |
| Taixing              | China           | Taixing Covanta Yanjiang Cogeneration Co., Ltd., of which we own 85%, entered into a 25 year concession agreement and waste supply agreements to build, own and operate a 350 metric tpd energy-from-waste facility for Taixing Municipality, in Jiangsu Province, People's Republic of China. The project, which will be built on the site of our existing coal-fired facility in Taixing, will supply steam to an adjacent industrial park under short-term arrangements. We will continue to operate our existing coal-fired facility. The project company has obtained Rmb 165 million in project financing which, together with available cash from existing operations will fund construction costs. The Taixing project commenced construction in late 2009.   |
| Chengdu              | China           | We and Chongqing Iron & Steel Company (Group) Limited have entered into an agreement to build, own, and operate an 1,800 metric tpd energy-from-waste facility for Chengdu Municipality in Sichuan Province, People's Republic of China. We also executed a 25 year waste concession agreement for this project. In connection with this project, we acquired a 49% equity interest in the project company. Construction of the facility has commenced and the project company has obtained Rmb 480 million in project financing, of which 49% is guaranteed by us and 51% is guaranteed by Chongqing Iron & Steel Company (Group) Limited until the project has been constructed and for one year after operations commence.   |

**DISPOSITIONS**

| <b>Facility/Operating Contract</b> | <b>Location</b> | <b>Year</b> | <b>Transaction</b> | <b>Type</b> | <b>Summary</b> |
|------------------------------------|-----------------|-------------|--------------------|-------------|----------------|
|------------------------------------|-----------------|-------------|--------------------|-------------|----------------|

|         |    |           |          |     |  |
|---------|----|-----------|----------|-----|--|
| Detroit | MI | 2009/2010 | Contract | EfW | <p>On June 30, 2009, our long-term operating contract with the Greater Detroit Resource Recovery Authority ( GDRRA ) to operate the 2,832 tpd energy-from-waste facility located in Detroit, Michigan (the Detroit Facility ) expired. Effective June 30, 2009, we purchased an undivided 30% owner-participant interest in the Detroit Facility and entered into certain agreements for continued operation of the Detroit Facility for a term expiring June 30, 2010. During this one-year period, we were unable to secure an acceptable steam off-take arrangement. Effective June 30, 2010, we agreed to sell our entire interest in the Detroit Facility, subject to the buyer s due diligence and any required regulatory approvals, and to continue operating the Detroit Facility under commercial arrangements until the earlier of the closing of the sale transaction or September 30, 2010. The sale agreement did not close or extend on September 30, 2010, and the commercial arrangements expired on that date at which time we decided that it was in our best interest to shut down the Detroit Facility. Regardless the Detroit Facility is permanently shut down, re-started or sold, we do not expect it to have a material effect on our condensed consolidated financial statements.</p> |
|---------|----|-----------|----------|-----|--|

**Table of Contents****RESULTS OF OPERATIONS**

The comparability of the information provided below with respect to our revenues, expenses and certain other items for the periods presented was affected by several factors. As outlined above under *Overview Growth and Development*, our acquisition and business development initiatives resulted in various additional projects which increased comparative revenues and expenses. These factors must be taken into account in developing meaningful comparisons between the periods compared below.

**RESULTS OF OPERATIONS Three and Nine Months Ended September 30, 2010 vs. Three and Nine Months Ended September 30, 2009**

|   | For the                                     |            | For the                                    |              | Variance                              |               |
|---|---|------------|--|--------------|---------------------------------------|---------------|
|   | Three Months Ended<br>September 30,<br>2010 | 2009       | Nine Months Ended<br>September 30,<br>2010 | 2009         | Increase/(Decrease)<br>Three<br>Month | Nine<br>Month |
| (Unaudited, in thousands)   |   |            |  |              |                                       |               |
| <b>CONSOLIDATED</b>   |   |            |  |              |                                       |               |
| <b>RESULTS OF OPERATIONS:</b>   |   |            |  |              |                                       |               |
| Total operating revenues  | \$ 436,977                                  | \$ 408,709 | \$ 1,288,983                               | \$ 1,143,255 | \$ 28,268                             | \$ 145,728    |
| Total operating expenses  | 384,613                                     | 337,730    | 1,178,169                                  | 1,007,752    | 46,883                                | 170,417       |
| Operating income  | 52,364                                      | 70,979     | 110,814                                    | 135,503      | (18,615)                              | (24,689)      |
| Other income (expense):   |   |            |  |              |                                       |               |
| Investment income   | 574   | 952        | 1,669                                      | 3,136        | (378)                                 | (1,467)       |
| Interest expense  | (10,970)                                    | (10,843)   | (32,250)                                   | (27,291)     | 127                                   | 4,959         |
| Non-cash convertible debt related expense   | (9,779)                                     | (3,465)    | (29,760)                                   | (14,562)     | 6,314                                 | 15,198        |
| Total other expenses  | (20,175)                                    | (13,356)   | (60,341)                                   | (38,717)     | 6,819                                 | 21,624        |
| Income before income tax expense and equity in net income from unconsolidated investments | 32,189                                      | 57,623     | 50,473                                     | 96,786       | (25,434)                              | (46,313)      |
| Income tax expense  | (16,414)                                    | (19,614)   | (23,348)                                   | (34,197)     | (3,200)                               | (10,849)      |
| Equity in net income from unconsolidated investments                                      | 6,833                                       | 5,611      | 18,024                                     | 17,091       | 1,222                                 | 933           |
| NET INCOME  | 22,608                                      | 43,620     | 45,149                                     | 79,680       | (21,012)                              | (34,531)      |
|   | (2,451)                                     | (2,768)    | (6,436)                                    | (6,312)      | (317)                                 | 124           |

Less: Net income  
attributable to  
noncontrolling interests  
in subsidiaries

NET INCOME  
ATTRIBUTABLE TO  
COVANTA HOLDING  
CORPORATION

|  |    |        |    |        |    |        |    |        |          |          |
|--|----|--------|----|--------|----|--------|----|--------|----------|----------|
|  | \$ | 20,157 | \$ | 40,852 | \$ | 38,713 | \$ | 73,368 | (20,695) | (34,655) |
|--|----|--------|----|--------|----|--------|----|--------|----------|----------|

Weighted Average  
Common  
Shares Outstanding:

|       |  |         |  |         |  |         |  |         |       |     |
|-------|--|---------|--|---------|--|---------|--|---------|-------|-----|
| Basic |  | 153,443 |  | 153,779 |  | 153,907 |  | 153,660 | (336) | 247 |
|-------|--|---------|--|---------|--|---------|--|---------|-------|-----|

|         |  |         |  |         |  |         |  |         |       |       |
|---------|--|---------|--|---------|--|---------|--|---------|-------|-------|
| Diluted |  | 154,312 |  | 155,110 |  | 154,639 |  | 154,935 | (798) | (296) |
|---------|--|---------|--|---------|--|---------|--|---------|-------|-------|

Earnings Per Share:

|       |    |      |    |      |    |      |    |      |    |        |    |        |
|-------|----|------|----|------|----|------|----|------|----|--------|----|--------|
| Basic | \$ | 0.13 | \$ | 0.27 | \$ | 0.25 | \$ | 0.48 | \$ | (0.14) | \$ | (0.23) |
|-------|----|------|----|------|----|------|----|------|----|--------|----|--------|

|         |    |      |    |      |    |      |    |      |    |        |    |        |
|---------|----|------|----|------|----|------|----|------|----|--------|----|--------|
| Diluted | \$ | 0.13 | \$ | 0.26 | \$ | 0.25 | \$ | 0.47 | \$ | (0.13) | \$ | (0.22) |
|---------|----|------|----|------|----|------|----|------|----|--------|----|--------|

Cash Dividend Declared  
Per Share:

|  |    |  |    |  |    |      |    |  |    |  |    |      |
|--|----|--|----|--|----|------|----|--|----|--|----|------|
|  | \$ |  | \$ |  | \$ | 1.50 | \$ |  | \$ |  | \$ | 1.50 |
|--|----|--|----|--|----|------|----|--|----|--|----|------|

Diluted Earnings Per  
Share, Excluding Special  
Items:

|  |    |      |    |      |    |      |    |      |    |      |    |        |
|--|----|------|----|------|----|------|----|------|----|------|----|--------|
|  | \$ | 0.28 | \$ | 0.26 | \$ | 0.40 | \$ | 0.47 | \$ | 0.02 | \$ | (0.07) |
|--|----|------|----|------|----|------|----|------|----|------|----|--------|

The following general discussions should be read in conjunction with the above table, the condensed consolidated financial statements and the Notes thereto and other financial information appearing and referred to elsewhere in this report. Additional detail relating to changes in operating revenues and operating expenses, and the quantification of specific factors affecting or causing such changes, is provided in the Americas and International segment discussions below.

**Quarterly Supplementary Financial Information – Diluted Earnings Per Share, Excluding Special Items (Non-GAAP Discussion)**

We use a number of different financial measures, both United States generally accepted accounting principles ( GAAP ) and non-GAAP, in assessing the overall performance of our business. To supplement our results prepared in accordance with GAAP, we use the measure of Diluted Earnings Per Share, Excluding Special Items, which is a non-GAAP measure as defined by the Securities and Exchange Commission. The non-GAAP financial measures of Diluted Earnings Per Share, Excluding Special Items is not intended as a substitute or as an alternative to diluted earnings per share as an indicator of our performance or any other measure of performance derived in accordance with GAAP. In addition, our non-GAAP financial measures may be different from non-GAAP measures used by other companies, limiting their usefulness for comparison purposes.

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Diluted Earnings Per Share, Excluding Special Items excludes certain income and expense items that are not representative of our ongoing business and operations, which are included in the calculation of Diluted Earnings Per Share in accordance with GAAP. During the current quarter we included the write-down of assets as Special Items. The following items are not all-inclusive, but examples of other items that would be included as Special Items in prior comparative and future periods. They would include significant gains or losses from the disposition of businesses, gains or losses on the extinguishment of debt and other significant items that would not be representative of our ongoing business.

We use the non-GAAP measure of Diluted Earnings Per Share, Excluding Special Items to enhance the usefulness of our financial information by providing a measure which management internally uses to assess and evaluate the overall performance and highlight trends in the ongoing business.

In order to provide a meaningful basis for comparison, we are providing information with respect to our Diluted Earnings Per Share, Excluding Special Items for the three and nine months ended September 30, 2010 and 2009, reconciled for each such period to diluted earnings per share, which is believed to be the most directly comparable measures under GAAP.

The following is a reconciliation of diluted earnings per share to Diluted Earnings Per Share, Excluding Special Items (in thousands):

|  | <b>For the<br/>Three Months Ended<br/>September 30,<br/>2010</b> |         | <b>For the<br/>Nine Months Ended<br/>September 30,<br/>2009</b> |         |
|--|--|---------|---|---------|
| Diluted Earnings Per Share:                          | \$ 0.13  | \$ 0.26 | \$ 0.25   | \$ 0.47 |
| Special Items <sup>(A)</sup>                         | 0.15   |         | 0.15  |         |
| Diluted Earnings Per Share, Excluding Special Items: | \$ 0.28  | \$ 0.26 | \$ 0.40   | \$ 0.47 |

(A) Additional information is provided in the Special Items table below.

| <b>Special Items</b>  | <b>For the<br/>Three Months Ended<br/>September 30,<br/>2010</b> |    | <b>For the<br/>Nine Months Ended<br/>September 30,<br/>2009</b> |    |
|---|--|----|---|----|
|   | <b>(Unaudited, in thousands)</b>                                 |    |   |    |
| Non-cash write-down of loan issued for the Harrisburg EfW facility to fund certain facility improvements <sup>(A)</sup> | \$ 6,580   | \$ | \$ 6,580  | \$ |
| Non-cash write-down of capitalized costs related to the Dublin development project <sup>(A)</sup>                       | 23,130   |    | 23,130  |    |
| Non-cash write-down of corporate real estate  | 2,611  |    | 2,611   |    |
| Total Special Items, pre-tax:   | 32,321   |    | 32,321  |    |

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|   |           |         |           |         |
|---|-----------|---------|-----------|---------|
| Proforma income tax impact <sup>(B)</sup>   | (9,475)   |         | (9,475)   |         |
| Total Special Items, net of tax:            | \$ 22,846 | \$      | \$ 22,846 | \$      |
| Diluted Earnings Per Share Impact           | \$ 0.15   | \$      | \$ 0.15   | \$      |
| Weighted Average Diluted Shares Outstanding | 154,312   | 155,110 | 154,639   | 154,935 |

(A) Additional information is provided in the Americas and International segment discussions below.

(B) There is minimal tax benefit from the non-cash write-down related to the Dublin assets. As a result, this non-cash write-down is significant to the effective tax rate. Accordingly, we are presenting this proforma calculation of the income tax effect from the total non-cash write-downs in the third quarter of 2010 to illustrate the proforma impact upon income tax expense and net income. The proforma income tax impact represents the tax provision amount related to the overall tax provision calculated without the non-cash write-downs when compared to the tax provision reported under GAAP in the condensed consolidated statement of income.

| Effective Tax Rate                | Three Months Ended<br>September 30, |       | Nine Months Ended<br>September 30, |       |
|-----------------------------------|-------------------------------------|-------|------------------------------------|-------|
|                                   | 2010                                | 2009  | 2010                               | 2009  |
|                                   |                                     |       |                                    |       |
| Effective Tax Rate <sup>(A)</sup> | 51.0%                               | 34.0% | 46.3%                              | 35.3% |

(A) Our full year estimated effective tax rate ( ETR ) increased during the third quarter of 2010 compared to our prior estimate due to the non-cash write-down related to the Dublin project. Since we have no income in Ireland to offset the non-cash write-down, we are unable to recognize a tax benefit at this time. GAAP requirements for tax accounting require the ETR to be calculated on a full year basis, which has the result of increasing the ETR for both the third and the fourth quarters of 2010. The ETR for the third quarter of 2010 was 51% and we expect the ETR for the fourth quarter of 2010 to be approximately 53%, absent discrete items.

**Table of Contents*****Consolidated Results of Operations Comparison of Results for the Three and Nine Months Ended September 30, 2010 vs. Results for the Three and Nine Months Ended September 30, 2009***

Operating revenues increased by \$28.3 million and \$145.7 million for the three and nine month comparative periods, respectively, primarily due to increased waste and services revenues in our Americas segment due to the acquisition of Veolia EfW businesses; increased recycled metal revenues due primarily to higher market prices; and increased construction revenue due to the Honolulu expansion projects. These increases were offset by the impact of contract transitions at our Hempstead, Union and Detroit facilities.

Operating expenses increased by \$46.9 million and \$170.4 million for the three and nine month comparative periods, respectively, primarily due to increased operating costs related to the acquisition of Veolia EfW businesses; increased construction expenses due to the Honolulu expansion projects; and the non-cash write-down of assets related to a notes receivable from our Harrisburg EfW facility and the write-down of assets related to the Dublin project.

Operating income decreased by \$18.6 million and \$24.7 million for the three and nine month comparative periods, respectively, primarily due to the non-cash write-down of assets noted above and the impact of contract transitions at our Hempstead, Union and Detroit facilities, offset by the benefits of the acquisition of Veolia EfW businesses. See *Note 8. Supplementary Information of the Notes* for additional information.

Excluding the special items noted above, operating income in our Americas segment was increased slightly for both the three and nine month comparative periods primarily due to the benefit of the acquisition of Veolia businesses and higher market prices for recycled metals, which was offset by contract transitions at our Hempstead, Union and Detroit facilities. Excluding the special items noted above, in our International segment operating income declined for both the three and nine month comparative periods primarily due to primarily to lower profitability at our Indian facilities related to lower electricity sales and higher fuel prices.

Interest expense increased \$5.0 million for the nine month comparative period primarily due to the issuance of the 3.25% Cash Convertible Senior Notes ( Notes ) which were issued in 2009, offset by lower floating interest rates on the Term Loan Facility (as defined in the *Liquidity* section below). Non-cash convertible debt related expense increased by \$6.3 million and \$15.2 million for the three and nine month comparative periods, respectively, primarily due to the amortization of the debt discount for the Notes which were issued in 2009, offset by the net changes to the valuation of the derivatives associated with the Notes.

Income tax expense decreased by \$3.2 million and \$10.8 million for the three and nine month comparative periods, respectively, primarily due to lower pre-tax operating income, offset by lower production tax credits. No tax benefit is being recognized at this time associated with the non-cash impairment of the investment in Dublin. See Item 1. *Financial Statements Note 7. Income Taxes* for additional information.

On June 17, 2010, the Board of Directors declared a special cash dividend of \$1.50 per share (approximately \$233 million) which was paid on July 20, 2010. During the three months ended September 30, 2010, we repurchased 2,499,500 shares of our common stock at a weighted average cost of \$14.69 per share for an aggregate amount of approximately \$36.7 million. For additional information, see *Liquidity* below.

***Americas Segment Results of Operations Comparison of Results for the Three and Nine Months Ended September 30, 2010 vs. Results for the Three and Nine Months Ended September 30, 2009*****For the****For the**

|                                       | Three Months Ended<br>September 30, |                  | Nine Months Ended<br>September 30, |                   | Variance<br>Increase/(Decrease) |                |
|---------------------------------------|-------------------------------------|------------------|------------------------------------|-------------------|---------------------------------|----------------|
|                                       | 2010                                | 2009             | 2010                               | 2009              | Three<br>Month                  | Nine<br>Month  |
|                                       |                                     |                  | (Unaudited, in thousands)          |                   |                                 |                |
| Waste and service revenues            | \$ 256,846                          | \$ 232,197       | \$ 765,431                         | \$ 664,430        | \$ 24,649                       | \$ 101,001     |
| Electricity and steam sales           | 110,787                             | 104,587          | 300,200                            | 301,831           | 6,200                           | (1,631)        |
| Other operating revenues              | 26,146                              | 8,859            | 68,072                             | 22,010            | 17,287                          | 46,062         |
| <b>Total operating revenues</b>       | <b>393,779</b>                      | <b>345,643</b>   | <b>1,133,703</b>                   | <b>988,271</b>    | <b>48,136</b>                   | <b>145,432</b> |
| Plant operating expenses              | 212,320                             | 190,320          | 695,620                            | 595,812           | 22,000                          | 99,808         |
| Other operating expense               | 21,111                              | 7,225            | 62,603                             | 18,800            | 13,886                          | 43,803         |
| General and administrative expenses   | 15,474                              | 22,083           | 55,381                             | 61,464            | (6,609)                         | (6,083)        |
| Depreciation and amortization expense | 46,652                              | 45,710           | 140,652                            | 144,816           | 942                             | (4,164)        |
| Net interest expense on project debt  | 9,379                               | 11,574           | 29,473                             | 34,409            | (2,195)                         | (4,936)        |
| Write-down of assets                  | 9,191                               |                  | 9,191                              |                   | 9,191                           | 9,191          |
| <b>Total operating expenses</b>       | <b>314,127</b>                      | <b>276,912</b>   | <b>992,920</b>                     | <b>855,301</b>    | <b>37,215</b>                   | <b>137,619</b> |
| <b>Operating income</b>               | <b>\$ 79,652</b>                    | <b>\$ 68,731</b> | <b>\$ 140,783</b>                  | <b>\$ 132,970</b> | <b>10,921</b>                   | <b>7,813</b>   |

### *Operating Revenues*

Operating revenues for the Americas segment increased by \$48.1 million and \$145.4 million for the three and nine month comparative periods, respectively.



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Revenues from Service Fee arrangements increased by \$22.1 million for the three month comparative period primarily due to the acquisition of Veolia EfW businesses and by service fee contract escalations, partially offset by lower revenues earned explicitly to service project debt of \$5.2 million. Revenues from Service Fee arrangements increased by \$81.1 million for the nine month comparative period primarily due to the acquisition of Veolia EfW businesses and by the Hillsborough expansion coming on line plus service fee contract escalations, partially offset by the Detroit facility's contract transition and lower revenues earned explicitly to service project debt of \$9.1 million.

Revenues from Tip Fee arrangements decreased by \$1.7 million for the three month comparative period primarily due to lower tip fee pricing offset by higher waste volumes. Revenues from Tip Fee arrangements decreased by \$0.6 million for the nine month comparative period primarily due to lower waste volumes and tip fee pricing, offset by the acquisition of Veolia EfW businesses and the Philadelphia Transfer Stations.

Recycled metal revenues increased by \$4.2 million and \$20.5 million for the three and nine month comparative periods, respectively, primarily due to higher pricing. Historically, we have experienced volatile prices for recycled metal which has affected our recycled metal revenue as reflected in the table below (in millions):

| <b>Total Recycled Metal Revenues</b>  | <b>For the<br/>Quarters Ended</b> |             |             |
|---------------------------------------|-----------------------------------|-------------|-------------|
|                                       | <b>2010</b>                       | <b>2009</b> | <b>2008</b> |
| March 31,                             | \$ 12.6                           | \$ 5.2      | \$ 11.4     |
| June 30,                              | 14.8                              | 5.8         | 19.0        |
| September 30,                         | 13.3                              | 9.1         | 17.3        |
| December 31,                          |                                   | 9.1         | 5.9         |
| Total for the Year Ended December 31, | \$ N/A                            | \$ 29.2     | \$ 53.6     |

Electricity and steam sales increased by \$6.2 million for the three month comparative period due to the acquisition of Veolia EfW businesses, higher pricing, and higher production, offset by contract transitions at our Hempstead and Union facilities. Electricity and steam sales decreased by \$1.6 million for the nine month comparative period due to contract transitions at our Hempstead, Union and Detroit facilities and lower production primarily due to economically dispatching one of our biomass facilities offset by the acquisition of Veolia EfW businesses and higher pricing at other facilities primarily at our biomass facilities.

Other operating revenues for existing business increased primarily due to increased construction revenue related to the Honolulu expansion project.

*Operating Expenses*

Plant operating expenses increased by \$22.0 million for the three month comparative period. This increase was primarily due to a full quarter of expense related to the acquisition of Veolia EfW businesses, plus, to a smaller degree, higher costs caused by a contract transition at the Hempstead facility and lower alternative fuel credits. Excluding the effect of the acquisition, contract transition and lower credits, the remaining plant operating expenses were flat compared to the prior year.

Plant operating expenses increased by \$99.8 million for the nine month comparative period. This increase was primarily due to expense related to the Veolia EfW and Philadelphia transfer stations acquisitions. Other factors that cause the increase included the contract transition at the Hempstead facility as well as lower alternative fuel and Renewable Energy Credits which was partially offset by a contract transition at the Detroit facility and lower costs

related to a biomass facility being economically dispatched off-line. Excluding the effect of the acquisitions, contract transitions, lower credits and the biomass dispatch, the remaining plant operating expenses increased 2.7% compared to the prior year.

Other operating expenses increased for the three and nine month comparative periods primarily due to increased construction expense related to the Honolulu expansion project.

General and administrative expenses decreased for the three and nine month comparative periods primarily due to transaction costs related to the Veolia EfW acquisition in 2009.

During the three months ended September 30, 2010, we recorded a non-cash impairment of \$6.6 million related to funds advanced for certain facility improvements required to enhance facility performance at the Harrisburg EfW facility and a non-cash impairment of \$2.6 million related to the write-down to fair value for corporate real estate and other assets. See *Note 8. Supplementary Information of the Notes* for additional information.

### *Operating Income*

Operating income increased by \$10.9 million and \$7.8 million for the three and nine month comparative periods, respectively, primarily due to the benefit of the acquisition of Veolia EfW businesses, higher recycled metal revenues and improved performance at recently acquired facilities. These amounts were partially offset by the impact of contract transitions at our Hempstead, Union and Detroit facilities, and the write-down of assets.

**Table of Contents*****International Segment Results of Operations Comparison of Results for the Three and Nine Months Ended September 30, 2010 vs. Results for the Three and Nine Months Ended September 30, 2009***

|  | For the<br>Three Months Ended<br>September 30, |                 | For the<br>Nine Months Ended<br>September 30, |                 | Variance<br>Increase/(Decrease) |                 |
|--|--|-----------------|---|-----------------|---------------------------------|-----------------|
|  | 2010   | 2009            | 2010  | 2009            | Three<br>Month                  | Nine<br>Month   |
|  |  |                 | (Unaudited, in<br>thousands)                  |                 |                                 |                 |
| Waste and service revenues               | \$ 1,032                                       | \$ 990          | \$ 3,002                                      | \$ 2,868        | \$ 42                           | \$ 134          |
| Electricity and steam sales              | 37,264   | 56,755          | 137,805                                       | 137,920         | (19,491)                        | (115)           |
| <b>Total operating revenues</b>          | <b>38,296</b>                                  | <b>57,745</b>   | <b>140,807</b>                                | <b>140,788</b>  | <b>(19,449)</b>                 | <b>19</b>       |
| Plant operating expenses                 | 29,749   | 42,970          | 117,466                                       | 108,076         | (13,221)                        | 9,390           |
| Other operating expenses<br>(income)     | 792  | 557             | (382)   | (54)            | 235                             | (328)           |
| General and administrative<br>expenses   | 6,939  | 6,247           | 20,458  | 18,064          | 692                             | 2,394           |
| Depreciation and<br>amortization expense | 1,945  | 2,310           | 5,798   | 5,819           | (365)                           | (21)            |
| Net interest expense on<br>project debt  | 501  | 1,060           | 1,793   | 3,102           | (559)                           | (1,309)         |
| Write-down of assets                     | 23,130   |                 | 23,130  |                 | 23,130                          | 23,130          |
| <b>Total operating expenses</b>          | <b>63,056</b>                                  | <b>53,144</b>   | <b>168,263</b>                                | <b>135,007</b>  | <b>9,912</b>                    | <b>33,256</b>   |
| <b>Operating (loss) income</b>           | <b>\$ (24,760)</b>                             | <b>\$ 4,601</b> | <b>\$ (27,456)</b>                            | <b>\$ 5,781</b> | <b>(29,361)</b>                 | <b>(33,237)</b> |

Operating revenues for the International segment decreased by \$19.4 million for the three month comparative period and were flat for the nine month comparative period. The revenue decline for the three month comparative period was primarily due to by lower demand from the electricity offtaker, resulting in lower electricity generation at our Indian facilities. The decrease was partially offset by the higher fuel costs, which are a pass through at both facilities, positive impacts of foreign currency translations and higher steam sales in China.

Plant operating expenses decreased by \$13.2 million for the three month comparative period due primarily to lower generation at our Indian facilities, partially offset by higher fuel costs, lower foreign currency exchange gains and increased steam sales in China. Plant operating expenses increased by \$9.4 million for nine month comparative period due primarily to higher fuel costs at both India facilities and at our coal-fired facility in China, partially offset by lower generation and lower foreign currency exchange gains.

General and administrative expenses increased by \$0.7 million for the three month comparative period due to higher development spending in United Kingdom, partially offset by decreased costs associated with our Shanghai office. General and administrative expenses increased by \$2.4 million for the nine month comparative period primarily due to costs associated with staff reductions in our Shanghai office, additional business development spending in the United

Kingdom, and normal wage and benefit escalations.

During the three months ended September 30, 2010, we recorded a non-cash impairment charge of \$23.1 million which was comprised of capitalized pre-construction and construction costs for the for the Dublin joint venture project. See *Note 8. Supplementary Information of the Notes* for additional information.

#### *Operating Income*

Operating income declined by \$29.4 million and \$33.2 million for the three and nine months comparative periods, respectively, primarily due to the non-cash impairment charge discussed above. Operating income for the three and nine months ended September 30, 2010 also declined due primarily to lower profitability at our Indian facilities related to lower electricity sales and higher fuel prices.

#### **Quarterly Supplementary Financial Information – Adjusted EBITDA (Non-GAAP Discussion)**

To supplement our results prepared in accordance with United States generally accepted accounting principles ( GAAP ), we use the measure of Adjusted EBITDA, which is a non-GAAP measure as defined by the Securities and Exchange Commission. This non-GAAP financial measure is described below, and used in the tables below, is not intended as a substitute and should not be considered in isolation from measures of financial performance prepared in accordance with GAAP. In addition, our use of non-GAAP financial measures may be different from non-GAAP measures used by other companies, limiting their usefulness for comparison purposes. The presentation of Adjusted EBITDA is intended to enhance the usefulness of our financial information by providing a measure which management internally uses to assess and evaluate the overall performance of its business and those of possible acquisition candidates, and highlight trends in the overall business.

We use Adjusted EBITDA to provide further information that is useful to an understanding of the financial covenants contained in the credit facilities of our most significant subsidiary, Covanta Energy, and as an additional way of viewing aspects of its operations that, when viewed with the GAAP results and the accompanying reconciliations to corresponding GAAP financial measures, provide a more complete understanding of our business. The calculation of Adjusted EBITDA is based on the definition in Covanta Energy's credit facilities as described below under *Liquidity and Capital Resources*, which we have guaranteed. Adjusted EBITDA is defined as earnings before interest, taxes, depreciation and amortization, as adjusted for additional items subtracted from or added to net income. Because our business is substantially comprised of that

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of Covanta Energy, our financial performance is substantially similar to that of Covanta Energy. For this reason, and in order to avoid use of multiple financial measures which are not all from the same entity, the calculation of Adjusted EBITDA and other financial measures presented herein are measured on a consolidated basis. Under these credit facilities, Covanta Energy is required to satisfy certain financial covenants, including certain ratios of which Adjusted EBITDA is an important component. Compliance with such financial covenants is expected to be the principal limiting factor which will affect our ability to engage in a broad range of activities in furtherance of our business, including making certain investments, acquiring businesses and incurring additional debt. Covanta Energy was in compliance with these covenants as of September 30, 2010. Failure to comply with such financial covenants could result in a default under these credit facilities, which default would have a material adverse affect on our financial condition and liquidity.

Adjusted EBITDA should not be considered as an alternative to net income or cash flow provided by operating activities as indicators of our performance or liquidity or any other measures of performance or liquidity derived in accordance with GAAP.

In order to provide a meaningful basis for comparison, we are providing information with respect to our Adjusted EBITDA for the three and nine months ended September 30, 2010 and 2009, reconciled for each such period to net income and cash flow provided by operating activities, which are believed to be the most directly comparable measures under GAAP.

The following is a reconciliation of net income to Adjusted EBITDA (in thousands):

|   | <b>For the<br/>Three Months Ended<br/>September 30,<br/>2010</b> |           | <b>For the<br/>Nine Months Ended<br/>September 30,<br/>2009</b> |           |
|---|--|-----------|---|-----------|
| Net Income Attributable to Covanta Holding Corporation                                      | \$ 20,157  | \$ 40,852 | \$ 38,713   | \$ 73,368 |
| Special Items, net of tax <sup>(A)</sup>  | 22,846   |           | 22,846  |           |
| Net Income Attributable to Covanta Holding Corporation, excluding Special Items, net of tax | \$ 43,003  | \$ 40,852 | \$ 61,559   | \$ 73,368 |
| Depreciation and amortization expense   | 48,622   | 48,057    | 146,527   | 150,717   |
| Debt service:   |  |           |   |           |
| Net interest expense on project debt  | 9,880  | 12,634    | 31,266  | 37,511    |
| Interest expense  | 10,970   | 10,843    | 32,250  | 27,291    |
| Non-cash convertible debt related expense   | 9,779  | 3,465     | 29,760  | 14,562    |
| Investment income   | (574)  | (952)     | (1,669)   | (3,136)   |
| Subtotal debt service   | 30,055   | 25,990    | 91,607  | 76,228    |
| Income tax expense, excluding tax effect of Special Items <sup>(A)</sup>                    | 25,889   | 19,614    | 32,823  | 34,197    |
| Other adjustments:  |  |           |   |           |
| Decrease in unbilled service receivables  | 7,170  | 4,129     | 23,574  | 13,656    |
| Non-cash compensation expense   | 3,858  | 3,055     | 13,279  | 10,724    |
| Transaction-related costs <sup>(B)</sup>  | 1,096  | 5,952     | 1,349   | 5,952     |
| Other non-cash expenses <sup>(C)</sup>  | 2,313  | 2,304     | 5,051   | 3,955     |

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|   |                   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|-------------------|
| Other   | 50                |                   | 1,589             |                   |
| Subtotal other adjustments  | 14,487            | 15,440            | 44,842            | 34,287            |
| Net income attributable to noncontrolling interests in subsidiaries | 2,451             | 2,768             | 6,436             | 6,312             |
| Total adjustments   | 121,504           | 111,869           | 322,235           | 301,741           |
| <b>Adjusted EBITDA</b>  | <b>\$ 164,507</b> | <b>\$ 152,721</b> | <b>\$ 383,794</b> | <b>\$ 375,109</b> |

- (A) See discussion in *Management Discussion and Analysis - Results of Operations* above.
- (B) This amount relates primarily to transaction costs related to exploring the sale of our fossil fuel independent power production facilities in the Philippines, India and Bangladesh in 2010 and transaction costs associated with the acquisition of Veolia energy-from-waste businesses in 2009.
- (C) Includes certain non-cash items that are added back under the definition of Adjusted EBITDA in Covanta Energy's credit agreement.

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The following is a reconciliation of cash flow provided by operating activities to Adjusted EBITDA (in thousands):

|   | <b>For the<br/>Three Months Ended<br/>September 30,<br/>2010</b> |            | <b>For the<br/>Nine Months Ended<br/>September 30,<br/>2009</b> |            |
|---|--|------------|---|------------|
| Cash flow provided by operating activities                | \$ 119,176   | \$ 110,411 | \$ 328,107  | \$ 247,733 |
| Debt service  | 30,055   | 25,990     | 91,607  | 76,228     |
| Change in working capital                                 | 2,070  | (5,459)    | (28,383)  | 27,511     |
| Change in restricted funds held in trust                  | 20,625   | 9,478      | 12,881  | 2,824      |
| Non-cash convertible debt related expense                 | (9,779)  | (3,465)    | (29,760)  | (14,562)   |
| Amortization of debt premium and deferred financing costs | 216  | 483        | 576   | 2,791      |
| Equity in net income from unconsolidated investments      | 6,833  | 5,611      | 18,024  | 17,091     |
| Dividends from unconsolidated investments                 | (2,664)  | (375)      | (10,910)  | (2,941)    |
| Current tax provision                                     | 873  | 9,999      | 2,585   | 19,585     |
| Other   | (2,898)  | 48         | (933)   | (1,151)    |
| Adjusted EBITDA   | \$ 164,507   | \$ 152,721 | \$ 383,794  | \$ 375,109 |

For additional discussion related to management's use of non-GAAP measures, see *Liquidity and Capital Resources Quarterly Supplementary Financial Information - Free Cash Flow (Non-GAAP Discussion)* below.

**LIQUIDITY AND CAPITAL RESOURCES**

We generate substantial cash flow from our ongoing business, which we believe will allow us to meet our liquidity needs. As of September 30, 2010, in addition to our ongoing cash flow, we had access to several sources of liquidity, as discussed in *Available Sources of Liquidity* below, including our existing cash on hand of \$76.5 million and the undrawn and available capacity of \$300 million of our Revolving Credit Facility. In addition, we had restricted cash of \$337.7 million, of which \$195.9 million was designated for future payment of project debt principal.

We derive our cash flows principally from our operations from the projects in our Americas and International segments, which allow us to satisfy project debt covenants and payments and distribute cash. We typically receive cash distributions from our Americas segment projects on either a monthly or quarterly basis, whereas a material portion of cash from our international projects is received semi-annually, during the second and fourth quarters. The frequency and predictability of our receipt of cash from projects differs, depending upon various factors, including whether restrictions on distributions exist in applicable project debt arrangements, whether a project is domestic or international, and whether a project has been able to operate at historical levels of production.

Our primary future cash requirements will be to fund capital expenditures to maintain our existing businesses, make debt service payments and grow our business through acquisitions and business development. We will also seek to enhance our cash flow from renewals or replacement of existing contracts, from new contracts to expand existing facilities or operate additional facilities and by investing in new projects. Our business is capital intensive because it is based upon building and operating municipal solid waste processing and energy generating projects. In order to provide meaningful growth through development, we must be able to invest our funds, obtain equity and/or debt

financing, and provide support to our operating subsidiaries. The timing and scale of our investment activity in growth opportunities is often unpredictable and uneven. We are committed to operate with an efficient capital structure by returning surplus capital to shareholders and funding high value development projects when they come to fruition. Given our strong cash generation and the status of our various development efforts, we plan on making additional opportunistic share repurchases in future quarters generally consistent with our actions in the third quarter of 2010. See *Management's Discussion and Analysis of Financial Condition Overview Growth and Development* above.

On June 17, 2010, the Board of Directors declared a special cash dividend of \$1.50 per share (approximately \$233 million) which was paid on July 20, 2010.

On June 17, 2010, the Board of Directors increased the authorization to repurchase shares of outstanding common stock to \$150 million. Under the program, stock repurchases may be made in the open market, in privately negotiated transactions, or by other available methods, from time to time at management's discretion in accordance with applicable federal securities laws. The timing and amounts of any repurchases will depend on many factors, including our capital structure, the market price of our common stock and overall market conditions. During the three months ended September 30, 2010, we repurchased 2,499,500 shares of our common stock at a weighted average cost of \$14.69 per share for an aggregate amount of approximately \$36.7 million. As of September 30, 2010, the amount remaining under our currently authorized share repurchase program is \$113.3 million.



**Table of Contents****Sources and Uses of Cash Flow for the Nine Months Ended September 30, 2010 and 2009:**

|  | <b>For the Nine Months<br/>Ended September 30,</b> |             | <b>Increase<br/>(Decrease)</b> |
|--|--|-------------|--------------------------------|
|  | <b>2010</b>  | <b>2009</b> | <b>2010 vs 2009</b>            |
|  | <b>(Unaudited, in thousands)</b>                   |             |                                |
| Net cash provided by operating activities                    | \$ 328,107   | \$ 247,733  | \$ 80,374                      |
| Net cash used in investing activities                        | (247,573)  | (329,624)   | (82,051)                       |
| Net cash (used in) provided by financing activities          | (437,395)  | 261,902     | (699,297)                      |
| Effect of exchange rate changes on cash and cash equivalents | (315)  | 196         | (511)                          |
| Net (decrease) increase in cash and cash equivalents         | \$ (357,176)                                       | \$ 180,207  | (537,383)                      |

Net cash provided by operating activities for the nine months ended September 30, 2010 was \$328.1 million, an increase of \$80.4 million from the prior year period. The increase was primarily due to the acquisition of Veolia's EfW businesses in the Americas segment and the timing of working capital.

Net cash used in investing activities for the nine months ended September 30, 2010 was \$247.6 million, a decrease of \$82.1 million from the prior year period. The decrease was primarily comprised of lower cash outflows of \$123.5 million related to the acquisition of businesses, primarily the Veolia EfW businesses, offset by \$24.0 million of higher cash outflows for increased capital expenditures largely related to the acquisition of Veolia EfW businesses and \$18.5 million related to the acquisition of land use rights in the United Kingdom.

Net cash used in financing activities for the nine months ended September 30, 2010 was \$437.4 million, a decrease of \$699.3 million. The net change was primarily driven by the cash dividend paid of \$232.7 million and repurchases of common stock of \$36.7 million for the nine months ended September 30, 2010 as compared to proceeds received of \$388.9 million related to the issuance of the 3.25% Cash Convertible Senior Notes and related transactions during the nine months ended September 30, 2009.

**Available Sources of Liquidity*****Cash and Cash Equivalents***

Cash and cash equivalents include all cash balances and highly liquid investments having maturities of three months or less from the date of purchase. These short-term investments are stated at cost, which approximates market value. As of September 30, 2010, we had unrestricted cash and cash equivalents of \$76.5 million (of which approximately \$73.0 million was held by our insurance and international subsidiaries, which is not generally available for near-term liquidity in our domestic operations).

***Short-Term Liquidity***

We have credit facilities which are comprised of a \$300 million revolving credit facility (the Revolving Loan Facility), a \$320 million funded letter of credit facility (the Funded L/C Facility), and a \$650 million term loan (the Term Loan Facility) (collectively referred to as the Credit Facilities). As of September 30, 2010, we had available credit for liquidity as follows (in thousands):

|                            | <b>Total Available</b> |                 | <b>Outstanding Letters of Credit as of September 30, 2010</b> | <b>Available as of September 30, 2010</b> |
|----------------------------|------------------------|-----------------|---|---|
|                            | <b>Under Facility</b>  | <b>Maturing</b> |   |   |
| Revolving Loan Facility(1) | \$ 300,000             | 2013            | \$  | \$ 300,000                                |
| Funded L/C Facility        | \$ 320,000             | 2014            | \$ 294,471  | \$ 25,529                                 |

(1) Up to \$200 million of which may be utilized for letters of credit.

On July 19, 2010, we utilized \$50 million of the Revolving Loan Facility to help fund the special cash dividend, which we subsequently repaid during the three months ended September 30, 2010.

### **Quarterly Supplementary Financial Information – Free Cash Flow (Non-GAAP Discussion)**

To supplement our results prepared in accordance with GAAP, we use the measure of Free Cash Flow, which is a non-GAAP measure as defined by the Securities and Exchange Commission. This non-GAAP financial measure is not intended as a substitute and should not be considered in isolation from measures of liquidity prepared in accordance with GAAP. In addition, our use of Free Cash Flow may be different from similarly identified non-GAAP measures used by other companies, limiting their usefulness for comparison purposes. The presentation of Free Cash Flow is intended to enhance the usefulness of our financial information by providing measures which management internally uses to assess and evaluate the overall performance of our business and those of possible acquisition candidates, and highlight trends in the overall business.

We use the non-GAAP measure of Free Cash Flow as a criterion of liquidity and performance-based components of employee compensation. Free Cash Flow is defined as cash flow provided by operating activities less maintenance capital expenditures, which are capital expenditures primarily to maintain our existing facilities. We use Free Cash Flow as a measure of liquidity to determine amounts we can reinvest in our businesses, such as amounts available to make acquisitions, invest in construction of new projects or make principal payments on debt. For additional discussion related to management s

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use of non-GAAP measures, see *Results of Operations Quarterly Supplementary Financial Information Adjusted EBITDA (Non-GAAP Discussion)* above.

In order to provide a meaningful basis for comparison, we are providing information with respect to our Free Cash Flow for the for the three and nine months ended September 30, 2010 and 2009, reconciled for each such period to cash flow provided by operating activities.

The following is a summary of Free Cash Flow and its primary uses (in thousands):

|   | <b>For the<br/>Three Months Ended<br/>September 30,</b> |              | <b>For the<br/>Nine Months Ended<br/>September 30,</b> |              |
|---|---|--------------|--|--------------|
|   | <b>2010</b>   | <b>2009</b>  | <b>2010</b>  | <b>2009</b>  |
| Cash flow provided by operating activities                            | \$ 119,176  | \$ 110,411   | \$ 328,107   | \$ 247,733   |
| Less: Maintenance capital expenditures (A)                            | (8,203)   | (7,873)      | (56,840)   | (44,145)     |
| Free cash flow  | \$ 110,973  | \$ 102,538   | \$ 271,267   | \$ 203,588   |
| <b>Selected Uses of Free Cash Flow:</b>                               |   |              |  |              |
| Principal payments on long-term debt                                  | \$ (1,731)  | \$ (1,664)   | \$ (4,999)   | \$ (5,009)   |
| Principal payments on project debt, net of restricted funds used(B)   | \$ (34,710)   | \$ (21,455)  | \$ (149,054)   | \$ (89,113)  |
| Distributions to partners of noncontrolling interests in subsidiaries | \$ (1,425)  | \$ (3,511)   | \$ (7,098)   | \$ (9,596)   |
| Acquisition of businesses, net of cash acquired                       | \$  | \$ (234,217) | \$ (128,254)   | \$ (251,734) |
| Acquisition of land use rights  | \$ (3,447)  | \$           | \$ (18,545)  | \$           |
| Acquisition of noncontrolling interests in subsidiary                 | \$  | \$           | \$ (2,000)   | \$           |
| Purchase of equity interests  | \$  | \$           | \$   | \$ (8,938)   |
| Other investment activities, net (C)                                  | \$ 828  | \$ (1,671)   | \$ (15,673)  | \$ (9,843)   |
| Cash dividends paid to shareholders                                   | \$ (232,671)  | \$           | \$ (232,671)   | \$           |
| Common stock repurchased  | \$ (36,708)   | \$           | \$ (36,708)  | \$           |
| <b>Purchases of Property, Plant and Equipment:</b>                    |   |              |  |              |
| Maintenance capital expenditures (A)                                  | \$ (8,203)  | \$ (7,873)   | \$ (56,840)  | \$ (44,145)  |
| Capital expenditures associated with development projects             | (3,979)   | (5,683)      | (13,943)   | (9,794)      |
| Capital expenditures associated with technology development           | (1,335)   | (2,326)      | (4,642)  | (3,269)      |
| Capital expenditures other  | (5,045)   | (1,129)      | (7,676)  | (1,901)      |
| Total purchases of property, plant and equipment                      | \$ (18,562)   | \$ (17,011)  | \$ (83,101)  | \$ (59,109)  |

(A) Capital Expenditures primarily to maintain existing facilities. Purchases of property, plant and equipment is also referred to as Capital Expenditures.

(B) Principal payments on project debt are net of changes in restricted funds held in trust used to pay debt principal of \$(25.7) million and \$(8.9) million for the three months ended September 30, 2010 and 2009, respectively, and

\$(37.5) million and \$31.0 million for the nine months ended September 30, 2010 and 2009, respectively. Principal payments on project debt excludes principal repayments on working capital borrowings relating to the operations of our Indian facilities of \$4.6 million and \$1.8 million for the three months ended September 30, 2010 and 2009, respectively, and \$11.8 million and \$9.8 million for the nine months ended September 30, 2010 and 2009, respectively. Principal payments on project debt excludes a project debt refinancing transaction of \$63.7 million related to a domestic energy-from-waste facility during the third quarter 2009.

- (C) For the nine months ended September 30, 2010, other investing activities is primarily comprised of net payments from the purchase/sale of investment securities and business development expenses. For the nine months ended September 31, 2009, other investing activities is primarily comprised of a loan issued for the Harrisburg energy-from-waste facility to fund certain facility improvements, net of repayments.

### **Credit Agreement Financial Covenants**

The loan documentation under the Credit Facilities contains customary affirmative and negative covenants and financial covenants as discussed in Note 11. Long-Term Debt of the Notes to the Consolidated Financial Statements included in our Form 10-K. As of September 30, 2010, we were in compliance with the covenants under the Credit Facilities. The maximum Covanta Energy capital expenditures that can be incurred in 2010 to maintain existing operating businesses is approximately \$220 million as of September 30, 2010.

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Long-term debt is as follows (in thousands):

|  | As of                 |                      |
|--|-----------------------|----------------------|
|  | September 30,<br>2010 | December 31,<br>2009 |
| 3.25% Cash Convertible Senior Notes due 2014           | \$ 460,000            | \$ 460,000           |
| Debt discount related to Cash Convertible Senior Notes | (96,730)              | (112,475)            |
| Cash conversion option derivative at fair value        | 93,331                | 128,603              |
| 3.25% Cash Convertible Senior Notes, net               | 456,601               | 476,128              |
| 1.00% Senior Convertible Debentures due 2027           | 373,750               | 373,750              |
| Debt discount related to Convertible Debentures        | (29,603)              | (45,042)             |
| 1.00% Senior Convertible Debentures, net               | 344,147               | 328,708              |
| Term Loan Facility due 2014                            | 627,250               | 632,125              |
| Other long-term debt                                   | 621                   | 745                  |
| Total  | 1,428,619             | 1,437,706            |
| Less: current portion                                  | (6,821)               | (7,027)              |
| Total long-term debt                                   | \$ 1,421,798          | \$ 1,430,679         |

***3.25% Cash Convertible Senior Notes due 2014 ( Notes )***

Under limited circumstances, the Notes are convertible by the holders thereof into cash only, based on an initial conversion rate of 53.9185 shares of our common stock per \$1,000 principal amount of Notes (which represents an initial conversion price of approximately \$18.55 per share) subject to certain customary adjustments as provided in the indenture for the Notes. We will not deliver common stock (or any other securities) upon conversion under any circumstances.

In connection with the special cash dividend declared on June 17, 2010, the conversion rate for the Notes was adjusted to 59.1871 shares of our common stock per \$1,000 principal amount of Notes. The adjusted conversion rate is equivalent to an adjusted conversion price of \$16.90 per share and became effective on July 8, 2010.

For specific criteria related to contingent interest, conversion or redemption features of the Notes and details related to the cash conversion option, cash convertible note hedge and warrants related to the Notes, refer to Note 11 of the Notes to Consolidated Financial Statements in our Form 10-K.

For details related to the fair value for the contingent interest feature, cash conversion option, and cash convertible note hedge related to the Notes, see Note 12. Derivative Instruments.

***1.00% Senior Convertible Debentures due 2027 ( Debentures )***

Under limited circumstances, prior to February 1, 2025, the Debentures are convertible by the holders into cash and shares of our common stock, if any, initially based on a conversion rate of 35.4610 shares of our common stock per \$1,000 principal amount of Debentures, (which represents an initial conversion price of approximately \$28.20 per share) or 13,253,867 issuable shares. As of June 30, 2010, if the Debentures were converted, no shares would have been issued since the trading price of our common stock was below the conversion price of the Debentures.

In connection with the special cash dividend declared on June 17, 2010, the conversion rate for the Debentures was adjusted to 38.9883 shares of our common stock per \$1,000 principal amount of Debentures. The adjusted conversion rate is equivalent to an adjusted conversion price of \$25.65 per share and became effective on July 13, 2010.

For specific criteria related to contingent interest, conversion or redemption features of the Debentures, refer to Note 11 of the Notes to Consolidated Financial Statements in our Form 10-K.

For details related to the fair value for the contingent interest feature related to the Debentures, see Note 12. Derivative Instruments.

**Project Debt**

***Americas Project Debt***

Financing for the energy-from-waste projects is generally accomplished through tax-exempt and taxable municipal revenue bonds issued by or on behalf of the municipal client. For such facilities that are owned by a subsidiary of ours, the municipal issuers of the bond loans the bond proceeds to our subsidiary to pay for facility construction. For such facilities, project-related debt is included as Project debt (short- and long-term) in our condensed consolidated financial statements. Generally, such project debt is secured by the revenues generated by the project and other project assets including the related facility. The only potential recourse to us with respect to project debt arises under the operating performance guarantees described below under *Other Commitments*. Certain subsidiaries had recourse liability for project debt which is recourse to our subsidiary Covanta ARC LLC, but is non-recourse to us, which as of September 30, 2010 aggregated to \$208.5 million.

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On June 1, 2010, we elected to repurchase \$42.7 million of project bonds (issued in connection with our Hempstead facility) under a mandatory tender. The bonds were simultaneously amended to extend their final maturity from December 1, 2010 to June 1, 2015. As a result of this transaction, the bonds have been reflected as repaid in the condensed consolidated financial statements, but may be remarketed to third party investors at any time. In the event we effect such a remarketing, the aggregate amount of our project debt would be increased accordingly.

***International Project Debt***

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

***Restricted Funds Held in Trust***

Restricted funds held in trust are primarily amounts received by third-party trustees relating to certain projects we own which may be used only for specified purposes. We generally do not control these accounts. They primarily include debt service reserves for payment of principal and interest on project debt, and deposits of revenues received with respect to projects prior to their disbursement, as provided in the relevant indenture or other agreements. Such funds are invested principally in money market funds, bank deposits and certificates of deposit, United States treasury bills and notes, and United States government agency securities.

Restricted fund balances are as follows (in thousands):

|                    | <b>As of September 30, 2010</b> |                   | <b>As of December 31, 2009</b> |                   |
|--------------------|---------------------------------|-------------------|--------------------------------|-------------------|
|                    | <b>Current</b>                  | <b>Noncurrent</b> | <b>Current</b>                 | <b>Noncurrent</b> |
| Debt service funds | \$ 142,730                      | \$ 73,157         | \$ 73,406                      | \$ 101,376        |
| Revenue funds      | 31,967                          |                   | 13,061                         |                   |
| Other funds        | 53,373                          | 36,494            | 44,756                         | 45,153            |
| <b>Total</b>       | <b>\$ 228,070</b>               | <b>\$ 109,651</b> | <b>\$ 131,223</b>              | <b>\$ 146,529</b> |

Of the \$337.7 million in total restricted funds as of September 30, 2010, approximately \$195.9 million was designated for future payment of project debt principal.

**Capital Requirements**

Our projected contractual obligations are consistent with amounts disclosed in our Annual Report on Form 10-K for the year ended December 31, 2009. We believe that when combined with our other sources of liquidity, including our existing cash on hand and the Revolving Loan Facility, we will generate sufficient cash over at least the next twelve months to meet operational needs, make capital expenditures, invest in the business and service debt due.

**Other Commitments**

Other commitments as of September 30, 2010 were as follows (in thousands):

|                             | <b>Commitments Expiring by Period</b> |                               |                               |
|-----------------------------|---------------------------------------|-------------------------------|-------------------------------|
|                             | <b>Total</b>                          | <b>Less Than<br/>One Year</b> | <b>More Than<br/>One Year</b> |
| Letters of credit           | \$ 300,434                            | \$ 10,576                     | \$ 289,858                    |
| Surety bonds                | 111,893                               |                               | 111,893                       |
| Total other commitments net | \$ 412,327                            | \$ 10,576                     | \$ 401,751                    |

The letters of credit were issued under various credit facilities (primarily the Funded L/C Facility) to secure our performance under various contractual undertakings related to our domestic and international projects or to secure obligations under our insurance program. Each letter of credit relating to a project is required to be maintained in effect for the period specified in related project contracts, and generally may be drawn if it is not renewed prior to expiration of that period.

We believe that we will be able to fully perform under our contracts to which these existing letters of credit relate, and that it is unlikely that letters of credit would be drawn because of a default of our performance obligations. If any of these letters of credit were to be drawn by the beneficiary, the amount drawn would be immediately repayable by us to the issuing bank. If we do not immediately repay such amounts drawn under these letters of credit, unreimbursed amounts would be treated under the Credit Facilities as additional term loans in the case of letters of credit issued under the Funded L/C Facility, or as revolving loans in the case of letters of credit issued under the Revolving Loan Facility.



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The surety bonds listed on the table above relate primarily to performance obligations (\$100.9 million) and support for closure obligations of various energy projects when such projects cease operating (\$11.0 million). Were these bonds to be drawn upon, we would have a contractual obligation to indemnify the surety company.

We have certain contingent obligations related to the Notes. These are:

- holders may require us to repurchase their Notes, if a fundamental change occurs; and
- holders may exercise their conversion rights upon the occurrence of certain events, which would require us to pay the conversion settlement amount in cash.

For specific criteria related to contingent interest, conversion or redemption features of the Notes, see Note 11 of the Notes to Consolidated Financial Statements in our Form 10-K for the year ended December 31, 2009.

We have certain contingent obligations related to the Debentures. These are:

- holders may require us to repurchase their Debentures on February 1, 2012, February 1, 2017 and February 1, 2022;
- holders may require us to repurchase their Debentures, if a fundamental change occurs; and
- holders may exercise their conversion rights upon the occurrence of certain events, which would require us to pay the conversion settlement amount in cash and/or our common stock.

For specific criteria related to contingent interest, conversion or redemption features of the Debentures, refer to Note 11 of the Notes to Consolidated Financial Statements in our Form 10-K for the year ended December 31, 2009.

We have issued or are party to guarantees and related contractual support obligations undertaken pursuant to agreements to construct and operate waste and energy facilities. For some projects, such performance guarantees include obligations to repay certain financial obligations if the project revenues are insufficient to do so, or to obtain or guarantee financing for a project. With respect to our businesses, we have issued guarantees to municipal clients and other parties that our subsidiaries will perform in accordance with contractual terms, including, where required, the payment of damages or other obligations. Additionally, damages payable under such guarantees for our energy-from-waste facilities could expose us to recourse liability on project debt. If we must perform under one or more of such guarantees, our liability for damages upon contract termination would be reduced by funds held in trust and proceeds from sales of the facilities securing the project debt and is presently not estimable. Depending upon the circumstances giving rise to such damages, the contractual terms of the applicable contracts, and the contract counterparty's choice of remedy at the time a claim against a guarantee is made, the amounts owed pursuant to one or more of such guarantees could be greater than our then-available sources of funds. To date, we have not incurred material liabilities under such guarantees.

## **Recent Accounting Pronouncements**

See Note 2. Recent Accounting Pronouncements of the Notes to the Condensed Consolidated Financial Statements for information related to new accounting pronouncements.

## **Discussion of Critical Accounting Policies and Estimates**

In preparing our condensed consolidated financial statements in accordance with United States generally accepted accounting principles, we are required to use judgment in making estimates and assumptions that affect the amounts reported in our financial statements and related Notes. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. These estimates form the basis for

making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Many of our critical accounting policies are subject to significant judgments and uncertainties which could potentially result in materially different results under different conditions and assumptions. Future events rarely develop exactly as forecast, and the best estimates routinely require adjustment. Management believes there have been no material changes during the nine months ended September 30, 2010 to the items discussed in Discussion of Critical Accounting Policies in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the year ended December 31, 2009.

**Item 3. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***

In the normal course of business, our subsidiaries are party to financial instruments that are subject to market risks arising from changes in commodity prices, interest rates, foreign currency exchange rates, and derivative instruments. Our use of derivative instruments is very limited and we do not enter into derivative instruments for trading purposes.

There have been no material changes during the nine months ended September 30, 2010 to the items discussed in Item 7A. Quantitative and Qualitative Disclosures About Market Risk in our Annual Report on Form 10-K for the year ended December 31, 2009. For details related to fair value estimates for the Cash Conversion Option, Note Hedge and contingent interest as of September 30, 2010, refer to *Item 1. Financial Statements* Note 11. *Financial Instruments* and Note 12. *Derivative Instruments*.

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**Item 4. CONTROLS AND PROCEDURES**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of Covanta's disclosure controls and procedures, as required by Rule 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934 (the Exchange Act) as of September 30, 2010. Our disclosure controls and procedures are designed to reasonably assure that information required to be disclosed by us in reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure and is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

Our Chief Executive Officer and Chief Financial Officer have concluded that, based on their reviews, our disclosure controls and procedures are effective to provide such reasonable assurance.

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must consider the benefits of controls relative to their costs. Inherent limitations within a control system include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the control. While the design of any system of controls is to provide reasonable assurance of the effectiveness of disclosure controls, such design is also based in part upon certain assumptions about the likelihood of future events, and such assumptions, while reasonable, may not take into account all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and may not be prevented or detected.

**Changes in Internal Control over Financial Reporting**

In August 2009, we completed the acquisition of six energy-from-waste businesses and one transfer station business located in New York, Pennsylvania, California and Canada and in February 2010, we completed this acquisition transaction with the purchase of an energy-from-waste business in Florida. We have excluded these businesses from Management's Report on Internal Control over Financial Reporting as of December 31, 2009, and we will include these businesses in Management's Report on Internal Control over Financial Reporting as of December 31, 2010.

There has not been any change in our system of internal control over financial reporting during the fiscal quarter ended September 30, 2010 that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****Item 1. LEGAL PROCEEDINGS**

See Note 14. Commitments and Contingencies of the Notes to the Condensed Consolidated Financial Statements.

**Item 1A. RISK FACTORS**

There have been no material changes during the nine months ended September 30, 2010 to the risk factors discussed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2009.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**Item 4. REMOVED AND RESERVED**

None

**Item 5. OTHER INFORMATION**

(a) None.

(b) Not applicable.

**Item 6. EXHIBITS**

| <b>Exhibit<br/>Number</b> | <b>Description</b>   |
|---------------------------|--|
| 31.1                      | Certification pursuant to Section 302 of Sarbanes-Oxley Act of 2002 by the Chief Executive Officer.  |
| 31.2                      | Certification pursuant to Section 302 of Sarbanes-Oxley Act of 2002 by the Chief Financial Officer.  |
| 32                        | Certification of periodic financial report pursuant to Section 906 of Sarbanes-Oxley Act of 2002 by the Chief Executive Officer and Chief Financial Officer. |
| Exhibit 101.INS:          | XBRL Instance Document*  |
| Exhibit 101.SCH:          | XBRL Taxonomy Extension Schema*  |
| Exhibit 101.CAL:          | XBRL Taxonomy Extension Calculation Linkbase*  |
| Exhibit 101.DEF:          | XBRL Taxonomy Extension Definition Document*   |
| Exhibit 101.LAB:          | XBRL Taxonomy Extension Labels Linkbase*   |
| Exhibit 101.PRE:          | XBRL Taxonomy Extension Presentation Linkbase*   |

\* XBRL information is furnished, not filed.

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**SIGNATURES**

Pursuant to the requirements 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.

COVANTA HOLDING CORPORATION  
(Registrant)

By: /s/ Sanjiv Khattri  
Sanjiv Khattri  
*Executive Vice President and Chief Financial Officer*

By: /s/ Thomas E. Bucks  
Thomas E. Bucks  
*Vice President and Chief Accounting Officer*

Date: October 20, 2010