

PSEG ENERGY HOLDINGS LLC  
Form 10-Q/A  
August 01, 2007

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

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FORM 10-Q/A  
Amendment No. 1

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007  
OR  
 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	Registrants, State of Incorporation, Address, and Telephone Number	I.R.S. Employer Identification No.
001-09120	<b>PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED</b> (A New Jersey Corporation) 80 Park Plaza, P.O. Box 1171 Newark, New Jersey 07101-1171 973 430-7000 <a href="http://www.pseg.com">http://www.pseg.com</a>	22-2625848
000-32503	<b>PSEG ENERGY HOLDINGS L.L.C.</b> (A New Jersey Limited Liability Company) 80 Park Plaza T20 Newark, New Jersey 07102-4194 973 430-7000 <a href="http://www.pseg.com">http://www.pseg.com</a>	42-1544079

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Indicate by check mark whether the registrants (1) have 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 registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days. Yes  No

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

Public Service Enterprise Group Incorporated      Large accelerated filer  Accelerated filer  Non-accelerated filer

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PSEG Energy Holdings L.L.C.                      Large accelerated filer    Accelerated filer    Non-accelerated filer  S  
Indicate by check mark whether any of the registrants is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No  S

As of April 30, 2007, Public Service Enterprise Group Incorporated had outstanding 253,516,650 shares of its sole class of Common Stock, without par value.

PSEG Energy Holdings L.L.C. is a wholly owned subsidiary of Public Service Enterprise Group Incorporated and meets the conditions set forth in General Instruction H(1) (a) and (b) of Form 10-Q and is filing its Quarterly Report on Form 10-Q with the reduced disclosure format authorized by General Instruction H.

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**EXPLANATORY NOTE RESTATEMENT**

This Form 10-Q/A is being filed to amend the Form 10-Q for the quarter ended March 31, 2007 to reflect a change to the Condensed Consolidated Balance Sheets as of March 31, 2007 for Public Service Enterprise Group Incorporated (PSEG) and PSEG Energy Holdings L.L.C. (Energy Holdings) to reclass \$207 million from Long-Term Debt to Long-Term Debt Due Within One Year. This change relates to an error in the classification of \$207 million of Energy Holdings Senior Notes due in February 2008 as reported in the PSEG and Energy Holdings March 31, 2007, Form 10-Q. In addition, during the second quarter of 2007, an immaterial error was discovered in the calculation of the cumulative effect of adopting Financial Accounting Standards Board (FASB) Staff Position (FSP) No. FAS 13-2

Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction (FSP 13-2) recorded in the first quarter of 2007. As a result, Energy Holdings recognized an additional \$15 million reduction in Retained Earnings, an increase of \$19 million in Deferred Taxes and an increase of \$4 million in Investment in Leveraged Leases. This restatement is limited to these line items and time period, and had no effect on PSEG's or Energy Holdings' results of operations, cash flows or margins.

For purposes of this Form 10-Q/A, and in accordance with Rule 12b-15 under the Securities Exchange Act of 1934, as amended, each item of the Form 10-Q for the quarter ended March 31, 2007 as originally filed on May 4, 2007 that was affected by the restatement has been amended to the extent affected and restated in its entirety. No attempt has been made in this Form 10-Q/A to modify or update other disclosures as presented in the original Form 10-Q except as required to reflect the effects of the restatement.

This combined Form 10-Q/A for the quarter ended March 31, 2007 is being filed by PSEG and Energy Holdings. Except for Part I, Items 1, 2 and 4 and certain exhibits under Part II, Item 6, no other information included in the Form 10-Q, as originally filed on May 4, 2007, is being revised by or being repeated in this document.

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## FORWARD-LOOKING STATEMENTS

Certain of the matters discussed in this report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are subject to risks and uncertainties, which could cause actual results to differ materially from those anticipated. Such statements are based on management's beliefs as well as assumptions made by and information currently available to management. When used herein, the words anticipate, intend, estimate, believe, expect, plan, hypothetical, potential, forecast, of such words and similar expressions are intended to identify forward-looking statements. Public Service Enterprise Group Incorporated (PSEG), Public Service Electric and Gas Company (PSE&G), PSEG Power LLC (Power) and PSEG Energy Holdings L.L.C. (Energy Holdings) undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The following review should not be construed as a complete list of factors that could affect forward-looking statements. In addition to any assumptions and other factors referred to specifically in connection with such forward-looking statements discussed above, factors that could cause actual results to differ materially from those contemplated in any forward-looking statements include, among others, the following:

regulatory issues  
that significantly  
impact operations;

ability to attain  
satisfactory  
regulatory results;

operating  
performance or  
cash flow from  
investments  
falling below  
projected levels;

credit, commodity,  
interest rate,  
counterparty and  
other financial  
market risks;

liquidity and the  
ability to access  
capital and  
maintain adequate  
credit ratings;

adverse or  
unanticipated  
weather conditions  
that significantly  
impact costs  
and/or operations,  
including

generation;

ability to attract  
and retain  
management and  
other key  
employees;

changes in the  
electric industry,  
including changes  
to regional  
transmission  
organizations and

power pools;

changes in energy  
policies and  
regulation;

changes in  
demand;

changes in the  
number of market  
participants and  
the risk profiles of  
such participants;

availability of  
power  
transmission  
facilities that  
impact the ability  
to deliver output  
to customers;

growth in costs  
and expenses;

environmental  
regulations that  
significantly  
impact operations;

changes in rates of  
return on overall  
debt and equity  
markets that could  
adversely impact

the value of  
pension and other  
postretirement  
benefits assets and  
liabilities and the  
Nuclear  
Decommissioning  
Trust Funds;

changes in  
political  
conditions;

changes in  
technology that  
make generation,  
transmission  
and/or distribution  
assets less  
competitive;

continued  
availability of  
insurance  
coverage at  
commercially  
reasonable rates;

involvement in  
lawsuits, including  
liability claims  
and commercial  
disputes;

acquisitions,  
divestitures,  
mergers,  
restructurings or  
strategic initiatives  
that change  
PSEG's, PSE&G's,  
Power's and  
Energy Holdings  
strategy or  
structure;

business  
combinations  
among  
competitors and  
major customers;

general economic conditions, including inflation or deflation;

changes in tax laws and regulations;

changes to accounting standards or accounting principles generally accepted in the U.S., which may require adjustments to financial statements;

ability to recover investments or service debt as a result of any of the risks or uncertainties mentioned herein;

acts of war or terrorism;



**PSEG, PSE&G and Energy Holdings**

adverse  
changes in  
rate  
regulation  
and/or  
ability to  
obtain  
adequate  
and timely  
rate relief;

**PSEG, Power and Energy Holdings**

inability to  
effectively  
manage  
portfolios of  
electric  
generation  
assets, gas  
supply contracts  
and electric and  
gas supply  
obligations;

inability to meet  
generation  
operating  
performance  
expectations;

energy  
transmission  
constraints or  
lack thereof;

adverse changes  
in the market  
for energy,  
capacity, natural  
gas, coal,  
nuclear fuel,  
emissions  
credits,  
congestion  
credits and  
other  
commodity

prices,  
especially  
during  
significant price  
movements for  
natural gas and  
power;

adverse market  
developments  
or changes in  
market rules,  
including delays  
or impediments  
to  
implementation  
of reasonable  
capacity  
markets;

surplus of  
energy capacity  
and excess  
supply;

substantial  
competition in  
the domestic  
and worldwide  
energy markets;

margin posting  
requirements,  
especially  
during  
significant price  
movements for  
natural gas and  
power;

availability of  
fuel and timely  
transportation at  
reasonable  
prices;

effects on  
competitive  
position of  
actions  
involving

competitors or  
major  
customers;

changes in  
product or  
sourcing mix;

delays, cost  
escalations or  
unsuccessful  
construction  
and  
development;

**PSEG and Power**

changes in  
regulation  
and safety  
and security  
measures at  
nuclear  
facilities;

ability to  
maintain  
nuclear  
operating  
performance  
at projected  
levels;

**PSEG and Energy Holdings**

changes in  
foreign  
currency  
exchange  
rates;

deterioration  
in the credit of  
lessees and  
their ability to  
adequately  
service lease  
rentals;

ability to  
realize tax

benefits and  
favorably  
resolve tax  
audit claims;

changes in  
political  
regimes in  
foreign  
countries; and

international  
developments  
negatively  
impacting  
business.

Consequently, all of the forward-looking statements made in this report are qualified by these cautionary statements and PSEG, PSE&G, Power and Energy Holdings cannot assure you that the results or developments anticipated by management will be realized, or even if realized, will have the expected consequences to, or effects on, PSEG, PSE&G, Power and Energy Holdings or their respective business prospects, financial condition or results of operations. Undue reliance should not be placed on these forward-looking statements in making any investment decision. Each of PSEG, PSE&G, Power and Energy Holdings expressly disclaims any obligation or undertaking to release publicly any updates or revisions to these forward-looking statements to reflect events or circumstances that occur or arise or are anticipated to occur or arise after the date hereof. In making any investment decision regarding PSEG s, PSE&G s, Power s and Energy Holdings securities, PSEG, PSE&G, Power and Energy Holdings are not making, and you should not infer, any representation about the likely existence of any particular future set of facts or circumstances. The forward-looking statements contained in this report are intended to qualify for the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.

**PART I. FINANCIAL INFORMATION**  
**ITEM 1. FINANCIAL STATEMENTS**

**PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>For the Quarters Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Millions) (Unaudited)</b>	
OPERATING REVENUES	\$ 3,614	\$ 3,461
OPERATING EXPENSES		
Energy Costs	2,041	2,146
Operation and Maintenance	610	578
Depreciation and Amortization	196	201
Taxes Other Than Income Taxes	43	41
Total Operating Expenses	2,890	2,966
Income from Equity Method Investments	26	33
OPERATING INCOME	750	528
Other Income	72	50
Other Deductions	(37 )	(27 )
Interest Expense	(187 )	(193 )
Preferred Stock Dividends	(1 )	(1 )
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	597	357
Income Tax Expense	(262 )	(149 )
INCOME FROM CONTINUING OPERATIONS	335	208
Loss from Discontinued Operations, net of tax benefit of \$4 and \$5 in 2007 and 2006, respectively	(6 )	(5 )
NET INCOME	\$ 329	\$ 203
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING (THOUSANDS):		
BASIC	252,892	251,187

DILUTED	253,356	252,065
EARNINGS PER SHARE:		
BASIC		
INCOME FROM CONTINUING OPERATIONS	\$ 1.32	\$ 0.83
NET INCOME	\$ 1.30	\$ 0.81
DILUTED		
INCOME FROM CONTINUING OPERATIONS	\$ 1.32	\$ 0.83
NET INCOME	\$ 1.30	\$ 0.81
DIVIDENDS PAID PER SHARE OF COMMON STOCK	\$ 0.585	\$ 0.57

See Notes to Condensed Consolidated Financial Statements.

**PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
	<b>(As Restated see Note 15)</b>	
	<b>(Millions) (Unaudited)</b>	
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 483	\$ 141
Accounts Receivable, net of allowances of \$60 and \$52 in 2007 and 2006, respectively	1,806	1,368
Unbilled Revenues	260	328
Fuel	355	847
Materials and Supplies	297	290
Prepayments	54	72
Restricted Funds	46	79
Derivative Contracts	53	127
Assets of Discontinued Operations	325	325
Assets Held for Sale	42	40
Other	48	45
<b>Total Current Assets</b>	<b>3,769</b>	<b>3,662</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>	<b>19,107</b>	<b>18,851</b>
Less: Accumulated Depreciation and Amortization	(5,974 )	(5,849 )
<b>Net Property, Plant and Equipment</b>	<b>13,133</b>	<b>13,002</b>
<b>NONCURRENT ASSETS</b>		
Regulatory Assets	5,288	5,694
Long-Term Investments	3,778	3,868
Nuclear Decommissioning Trust (NDT) Funds	1,324	1,256
Other Special Funds	154	147
Goodwill	534	539
Intangibles	49	46
Derivative Contracts	37	55
Other	300	301
<b>Total Noncurrent Assets</b>	<b>11,464</b>	<b>11,906</b>

TOTAL ASSETS	\$ 28,366	\$ 28,570
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See Notes to Condensed Consolidated Financial Statements.



**PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
	<b>(As Restated see Note 15)</b>	<b>(Millions) (Unaudited)</b>
<b>LIABILITIES AND CAPITALIZATION</b>		
<b>CURRENT LIABILITIES</b>		
Long-Term Debt Due Within One Year	\$ 946	\$ 849
Commercial Paper and Loans	277	381
Accounts Payable	1,013	964
Derivative Contracts	414	335
Accrued Interest	185	124
Accrued Taxes	225	152
Clean Energy Program	123	120
Other	508	481
<b>Total Current Liabilities</b>	<b>3,691</b>	<b>3,406</b>
<b>NONCURRENT LIABILITIES</b>		
Deferred Income Taxes and Investment Tax Credits (ITC)	4,098	4,462
Regulatory Liabilities	448	646
Asset Retirement Obligations	517	509
Other Postretirement Benefit (OPEB) Costs	1,091	1,089
Accrued Pension Costs	330	327
Clean Energy Program	105	133
Environmental Costs	416	421
Derivative Contracts	200	204
Long-Term Accrued Taxes	496	
Other	173	176
<b>Total Noncurrent Liabilities</b>	<b>7,874</b>	<b>7,967</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES (See Note 5)</b>		
<b>CAPITALIZATION</b>		
<b>LONG-TERM DEBT</b>		
Long-Term Debt	7,431	7,636
Securitization Debt	1,668	1,708

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Project Level, Non-Recourse Debt	822	840
Debt Supporting Trust Preferred Securities	186	186
<b>Total Long-Term Debt</b>	<b>10,107</b>	<b>10,370</b>
<b>SUBSIDIARIES PREFERRED SECURITIES</b>		
Preferred Stock Without Mandatory Redemption, \$100 par value, 7,500,000 authorized; issued and outstanding, 2007 and 2006 795,234 shares	80	80
<b>COMMON STOCKHOLDERS EQUITY</b>		
Common Stock, no par, authorized 500,000,000 shares; issued; 2007 266,576,508 shares; 2006 266,372,440 shares	4,683	4,661
Treasury Stock, at cost; 2007 13,189,987 shares; 2006 13,727,032 shares	(499 )	(516 )
Retained Earnings	2,702	2,710
Accumulated Other Comprehensive Loss	(272 )	(108 )
<b>Total Common Stockholders Equity</b>	<b>6,614</b>	<b>6,747</b>
<b>Total Capitalization</b>	<b>16,801</b>	<b>17,197</b>
<b>TOTAL LIABILITIES AND CAPITALIZATION</b>	<b>\$ 28,366</b>	<b>\$ 28,570</b>

See Notes to Condensed Consolidated Financial Statements.

**PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>For The Quarters Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Millions)</b>	
	<b>(Unaudited)</b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	\$ 329	\$ 203
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	196	205
Amortization of Nuclear Fuel	25	25
Provision for Deferred Income Taxes (Other than Leases) and ITC	(13 )	3
Non-Cash Employee Benefit Plan Costs	46	59
Leveraged Lease Income, Adjusted for Rents Received and Deferred Taxes	(15 )	(22 )
Gain on Sale of Investments	(16 )	
Undistributed Losses (Earnings) from Affiliates	31	(29 )
Foreign Currency Transaction Loss (Gain)	1	(1 )
Unrealized Losses on Energy Contracts and Other Derivatives	34	21
(Under) Over Recovery of Electric Energy Costs (BGS and NTC) and Gas Costs	(47 )	49
Under Recovery of Societal Benefits Charge (SBC)	(1 )	(19 )
Net Realized Gains and Income from NDT Funds	(19 )	(18 )
Net Change in Certain Current Assets and Liabilities	450	524
Employee Benefit Plan Funding and Related Payments	(21 )	(35 )
Investment Income and Dividend Distributions from Partnerships	11	1
Other	(35 )	(56 )
 Net Cash Provided By Operating Activities	 956	 910
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Additions to Property, Plant and Equipment	(275 )	(240 )
Proceeds from the Sale of Investments and Return of Capital from Partnerships	7	2
Proceeds from NDT Funds Sales	501	300
Investment in NDT Funds	(511 )	(305 )
Restricted Funds	34	(17 )
NDT Funds Interest and Dividends	12	10
Other	(1 )	17
 Net Cash Used In Investing Activities	 (233 )	 (233 )

## CASH FLOWS FROM FINANCING ACTIVITIES

Net Change in Commercial Paper and Loans	(104 )	54
Issuance of Common Stock	33	17
Redemptions of Long-Term Debt	(113 )	(457 )
Repayment of Non-Recourse Debt	(16 )	(12 )
Redemption of Securitization Debt	(38 )	(36 )
Redemption of Debt Underlying Trust Securities		(154 )
Cash Dividends Paid on Common Stock	(148 )	(143 )
Other	5	(15 )
Net Cash Used In Financing Activities	(381 )	(746 )
Effect of Exchange Rate Change		(1 )
Net Increase (Decrease) in Cash and Cash Equivalents	342	(70 )
Cash and Cash Equivalents at Beginning of Period	141	288
Cash and Cash Equivalents at End of Period	\$ 483	\$ 218
Supplemental Disclosure of Cash Flow Information:		
Income Taxes Paid	\$ 85	\$ 25
Interest Paid, Net of Amounts Capitalized	\$ 126	\$ 134

See Notes to Condensed Consolidated Financial Statements.

**PUBLIC SERVICE ELECTRIC AND GAS COMPANY**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>For The Quarters Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Millions) (Unaudited)</b>	
OPERATING REVENUES	\$ 2,486	\$ 2,293
OPERATING EXPENSES		
Energy Costs	1,665	1,574
Operation and Maintenance	325	301
Depreciation and Amortization	145	152
Taxes Other Than Income Taxes	43	41
<b>Total Operating Expenses</b>	<b>2,178</b>	<b>2,068</b>
OPERATING INCOME	308	225
Other Income	5	4
Other Deductions	(1)	(1)
Interest Expense	(81)	(85)
<b>INCOME BEFORE INCOME TAXES</b>	<b>231</b>	<b>143</b>
Income Tax Expense	(99)	(65)
<b>NET INCOME</b>	<b>132</b>	<b>78</b>
Preferred Stock Dividends	(1)	(1)
<b>EARNINGS AVAILABLE TO PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED</b>	<b>\$ 131</b>	<b>\$ 77</b>

See disclosures regarding Public Service Electric and Gas Company  
included in the Notes to Condensed Consolidated Financial Statements.

**PUBLIC SERVICE ELECTRIC AND GAS COMPANY**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
	(Millions)	
	(Unaudited)	
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 45	\$ 28
Accounts Receivable, net of allowances of \$55 in 2007 and \$46 in 2006	1,142	805
Unbilled Revenues	260	328
Materials and Supplies	57	50
Prepayments	16	14
Restricted Funds	13	12
Other	44	38
<b>Total Current Assets</b>	<b>1,577</b>	<b>1,275</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>	<b>11,193</b>	<b>11,061</b>
Less: Accumulated Depreciation and Amortization	(3,853 )	(3,794 )
<b>Net Property, Plant and Equipment</b>	<b>7,340</b>	<b>7,267</b>
<b>NONCURRENT ASSETS</b>		
Regulatory Assets	5,288	5,694
Long-Term Investments	150	149
Other Special Funds	54	53
Other	115	115
<b>Total Noncurrent Assets</b>	<b>5,607</b>	<b>6,011</b>
<b>TOTAL ASSETS</b>	<b>\$ 14,524</b>	<b>\$ 14,553</b>

See disclosures regarding Public Service Electric and Gas Company  
included in the Notes to Condensed Consolidated Financial Statements.

**PUBLIC SERVICE ELECTRIC AND GAS COMPANY  
CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
	<b>(Millions) (Unaudited)</b>	
<b>LIABILITIES AND CAPITALIZATION</b>		
<b>CURRENT LIABILITIES</b>		
Long-Term Debt Due Within One Year	\$ 173	\$ 284
Commercial Paper and Loans	269	31
Accounts Payable	261	254
Accounts Payable - Affiliated Companies, net	503	645
Accrued Interest	43	55
Clean Energy Program	123	120
Derivative Contracts	15	2
Other	398	322
<b>Total Current Liabilities</b>	<b>1,785</b>	<b>1,713</b>
<b>NONCURRENT LIABILITIES</b>		
Deferred Income Taxes and ITC	2,494	2,517
Other Postretirement Benefit (OPEB) Costs	897	898
Accrued Pension Costs	133	133
Regulatory Liabilities	448	646
Clean Energy Program	105	133
Environmental Costs	363	367
Asset Retirement Obligations	223	221
Derivative Contracts	27	18
Long-Term Accrued Taxes Due to Affiliate	51	
Other	6	6
<b>Total Noncurrent Liabilities</b>	<b>4,747</b>	<b>4,939</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES (See Note 5)</b>		
<b>CAPITALIZATION</b>		
<b>LONG-TERM DEBT</b>		
Long-Term Debt	3,003	3,003
Securitization Debt	1,668	1,708
<b>Total Long-Term Debt</b>	<b>4,671</b>	<b>4,711</b>

## PREFERRED SECURITIES

Preferred Stock Without Mandatory Redemption, \$100 par value, 7,500,000 authorized; issued and outstanding, 2007 and 2006 795,234 shares	80	80
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## COMMON STOCKHOLDER S EQUITY

Common Stock; 150,000,000 shares authorized, 132,450,344 shares issued and outstanding	892	892
Contributed Capital	170	170
Basis Adjustment	986	986
Retained Earnings	1,192	1,061
Accumulated Other Comprehensive Income	1	1
 Total Common Stockholder s Equity	 3,241	 3,110
 Total Capitalization	 7,992	 7,901

TOTAL LIABILITIES AND CAPITALIZATION	\$ 14,524	\$ 14,553
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See disclosures regarding Public Service Electric and Gas Company included in the Notes to Condensed Consolidated Financial Statements.



**PUBLIC SERVICE ELECTRIC AND GAS COMPANY**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>For the Quarters Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Millions) (Unaudited)</b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	\$ 132	\$ 78
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	145	152
Provision for Deferred Income Taxes and ITC	(24 )	(25 )
Non-Cash Employee Benefit Plan Costs	35	42
Non-Cash Interest Expense	1	
Employee Benefit Plan Funding and Related Payments	(16 )	(13 )
Over Recovery of Electric Energy Costs (BGS and NTC)	4	19
(Under)/Over Recovery of Gas Costs	(51 )	30
Under Recovery of SBC	(1 )	(19 )
Other Non-Cash Charges	(1 )	(1 )
Net Changes in Certain Current Assets and Liabilities:		
Accounts Receivable and Unbilled Revenues	(269 )	82
Materials and Supplies	(7 )	
Prepayments	(4 )	35
Accrued Taxes	41	22
Accrued Interest	(11 )	(16 )
Accounts Payable	7	(34 )
Accounts Receivable/Payable-Affiliated Companies, net	59	(52 )
Other Current Assets and Liabilities	27	(21 )
Other	(6 )	(12 )
<b>Net Cash Provided By Operating Activities</b>	<b>61</b>	<b>267</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Additions to Property, Plant and Equipment	(130 )	(108 )
<b>Net Cash Used In Investing Activities</b>	<b>(130 )</b>	<b>(108 )</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net Change in Short-Term Debt	238	

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Redemption of Securitization Debt	(38 )	(36 )
Redemption of Long-Term Debt	(113 )	(148 )
Preferred Stock Dividends	(1 )	(1 )
Net Cash Provided by (Used In) Financing Activities	86	(185 )
Net Increase (Decrease) In Cash and Cash Equivalents	17	(26 )
Cash and Cash Equivalents at Beginning of Period	28	159
Cash and Cash Equivalents at End of Period	\$ 45	\$ 133

Supplemental Disclosure of Cash Flow Information:

Income Taxes Paid	\$ 49	\$ (4 )
Interest Paid, Net of Amounts Capitalized	\$ 102	\$ 92

See disclosures regarding Public Service Electric and Gas Company included in the Notes to Condensed Consolidated Financial Statements.

**PSEG POWER LLC**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>For the Quarters Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Millions) (Unaudited)</b>	
OPERATING REVENUES	\$ 2,149	\$ 1,967
OPERATING EXPENSES		
Energy Costs	1,488	1,487
Operation and Maintenance	238	232
Depreciation and Amortization	34	31
Total Operating Expenses	1,760	1,750
OPERATING INCOME	389	217
Other Income	51	41
Other Deductions	(29 )	(19 )
Interest Expense	(37 )	(32 )
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	374	207
Income Tax Expense	(155 )	(86 )
INCOME FROM CONTINUING OPERATIONS	219	121
Loss from Discontinued Operations, net of tax benefit of \$4 and \$6 in 2007 and 2006, respectively	(6 )	(9 )
EARNINGS AVAILABLE TO PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED	\$ 213	\$ 112

See disclosures regarding PSEG Power LLC included in the  
Notes to Condensed Consolidated Financial Statements.

**PSEG POWER LLC**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	March 31, 2007	December 31, 2006
	(Millions) (Unaudited)	
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 7	\$ 13
Accounts Receivable	535	430
Accounts Receivable - Affiliated Companies, net	251	495
Short-Term Loan to Affiliate	525	
Fuel	354	846
Materials and Supplies	204	202
Energy Trading Contracts	50	55
Derivative Contracts	1	56
Assets of Discontinued Operations	325	325
Assets Held for Sale	40	40
Other	23	26
<b>Total Current Assets</b>	<b>2,315</b>	<b>2,488</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>	<b>5,969</b>	<b>5,868</b>
Less: Accumulated Depreciation and Amortization	(1,696 )	(1,638 )
<b>Net Property, Plant and Equipment</b>	<b>4,273</b>	<b>4,230</b>
<b>NONCURRENT ASSETS</b>		
Deferred Income Taxes and Investment Tax Credits (ITC)	39	
Nuclear Decommissioning Trust (NDT) Funds	1,324	1,256
Goodwill	16	16
Other Intangibles	38	35
Other Special Funds	43	42
Energy Trading Contracts	10	10
Derivative Contracts	19	19
Other	51	50
<b>Total Noncurrent Assets</b>	<b>1,540</b>	<b>1,428</b>
<b>TOTAL ASSETS</b>	<b>\$ 8,128</b>	<b>\$ 8,146</b>

<b>LIABILITIES AND MEMBER S EQUITY</b>			
<b>CURRENT LIABILITIES</b>			
Accounts Payable	\$	623	\$ 589
Short-Term Loan from Affiliate			54
Energy Trading Contracts		66	222
Derivative Contracts		311	90
Accrued Interest		80	34
Other		96	95
<b>Total Current Liabilities</b>		<b>1,176</b>	<b>1,084</b>
<b>NONCURRENT LIABILITIES</b>			
Deferred Income Taxes and Investment Tax Credits (ITC)			48
Asset Retirement Obligations		292	287
Other Postretirement Benefit (OPEB) Costs		139	138
Energy Trading Contracts		5	19
Derivative Contracts		157	151
Accrued Pension Costs		107	106
Environmental Costs		53	54
Long-Term Accrued Taxes due to Affiliate		22	
Other		16	18
<b>Total Noncurrent Liabilities</b>		<b>791</b>	<b>821</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES (See Note 5)</b>			
<b>LONG-TERM DEBT</b>			
Total Long-Term Debt		2,818	2,818
<b>MEMBER S EQUITY</b>			
Contributed Capital		2,000	2,000
Basis Adjustment		(986 )	(986 )
Retained Earnings		2,661	2,586
Accumulated Other Comprehensive Loss		(332 )	(177 )
<b>Total Member s Equity</b>		<b>3,343</b>	<b>3,423</b>
<b>TOTAL LIABILITIES AND MEMBER S EQUITY</b>	<b>\$</b>	<b>8,128</b>	<b>\$ 8,146</b>

See disclosures regarding PSEG Power LLC included in the Notes to Condensed Consolidated Financial Statements.



**PSEG POWER LLC**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>For The Quarters Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Millions) (Unaudited)</b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	\$ 213	\$ 112
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	34	35
Amortization of Nuclear Fuel	25	25
Interest Accretion on Asset Retirement Obligations	6	8
Provision for Deferred Income Taxes and ITC	26	24
Unrealized Losses on Energy Contracts and Other Derivatives	4	21
Non-Cash Employee Benefit Plan Costs	7	11
Net Realized Gains and Income from NDT Funds	(19 )	(18 )
Net Change in Certain Current Assets and Liabilities:		
Fuel, Materials and Supplies	490	413
Accounts Receivable	(105 )	187
Accrued Interest	46	55
Accounts Payable	57	(292 )
Accounts Receivable/Payable-Affiliated Companies, net	72	145
Other Current Assets and Liabilities	4	18
Employee Benefit Plan Funding and Related Payments	(1 )	(16 )
Other	(35 )	(46 )
 Net Cash Provided By Operating Activities	 824	 682
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Additions to Property, Plant and Equipment	(126 )	(118 )
Proceeds from NDT Funds Sales	501	300
NDT Funds Interest and Dividends	12	10
Investment in NDT Funds	(511 )	(305 )
Short-Term Loan - Affiliated Company, net	(525 )	(380 )
Other	(2 )	10
 Net Cash Used In Investing Activities	 (651 )	 (483 )

## CASH FLOWS FROM FINANCING ACTIVITIES

Cash Dividend Paid	(125 )	
Short-Term Loan - Affiliated Company, net	(54 )	(202 )
Net Cash Used In Financing Activities	(179 )	(202 )
Net Decrease in Cash and Cash Equivalents	(6 )	(3 )
Cash and Cash Equivalents at Beginning of Period	13	8
Cash and Cash Equivalents at End of Period	\$ 7	\$ 5

## Supplemental Disclosure of Cash Flow Information:

Income Taxes Paid	\$ 24	\$ 18
Interest Paid, Net of Amounts Capitalized	\$ 3	\$ 2

See disclosures regarding PSEG Power LLC included in the  
Notes to Condensed Consolidated Financial Statements.



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**PSEG ENERGY HOLDINGS L.L.C.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>For The Quarters Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Millions) (Unaudited)</b>	
<b>OPERATING REVENUES</b>		
Electric Generation and Distribution Revenues	\$ 201	\$ 263
Income from Leveraged and Operating Leases	33	39
Other	20	10
<b>Total Operating Revenues</b>	<b>254</b>	<b>312</b>
<b>OPERATING EXPENSES</b>		
Energy Costs	161	194
Operation and Maintenance	53	49
Depreciation and Amortization	14	12
<b>Total Operating Expenses</b>	<b>228</b>	<b>255</b>
Income from Equity Method Investments	26	33
<b>OPERATING INCOME</b>	<b>52</b>	<b>90</b>
Other Income	16	7
Other Deductions	(2)	(7)
Interest Expense	(43)	(50)
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>	<b>23</b>	<b>40</b>
Income Tax Expense	(20)	(12)
<b>INCOME FROM CONTINUING OPERATIONS</b>	<b>3</b>	<b>28</b>
Income from Discontinued Operations, net of tax expense of \$1 in 2006		4
<b>EARNINGS AVAILABLE TO PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED</b>	<b>\$ 3</b>	<b>\$ 32</b>

See disclosures regarding PSEG Energy Holdings L.L.C. included in the  
Notes to Condensed Consolidated Financial Statements.



**PSEG ENERGY HOLDINGS L.L.C.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
	<b>(As Restated See Note 15)</b>	
	<b>(Millions) (Unaudited)</b>	
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 65	\$ 98
Accounts Receivable:		
Trade-net of allowances of \$5 and \$6 in 2007 and 2006, respectively	111	103
Other Accounts Receivable	18	29
Affiliated Companies	33	
Notes Receivable:		
Affiliated Companies	25	28
Inventory	35	41
Restricted Funds	33	67
Assets Held for Sale	2	
Derivative Contracts	2	14
Other	7	8
<b>Total Current Assets</b>	<b>331</b>	<b>388</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>	<b>1,726</b>	<b>1,706</b>
Less: Accumulated Depreciation and Amortization	(310 )	(307 )
<b>Net Property, Plant and Equipment</b>	<b>1,416</b>	<b>1,399</b>
<b>NONCURRENT ASSETS</b>		
Leveraged Leases, net	2,750	2,810
Corporate Joint Ventures and Partnership Interests	836	868
Goodwill	518	523
Intangibles	11	11
Derivative Contracts	8	26
Other	139	139
<b>Total Noncurrent Assets</b>	<b>4,262</b>	<b>4,377</b>

TOTAL ASSETS	\$ 6,009	\$ 6,164
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See disclosures regarding PSEG Energy Holdings L.L.C. included in the  
Notes to Condensed Consolidated Financial Statements.

**PSEG ENERGY HOLDINGS L.L.C.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
	<b>(As Restated See Note 15)</b>	<b>(Millions) (Unaudited)</b>
<b>LIABILITIES AND MEMBER S EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Long-Term Debt Due Within One Year	\$ 250	\$ 42
Short-Term Borrowings	8	
Accounts Payable:		
Trade	67	54
Affiliated Companies	2	12
Derivative Contracts	17	16
Accrued Interest	44	27
Other	63	72
<b>Total Current Liabilities</b>	<b>451</b>	<b>223</b>
<b>NONCURRENT LIABILITIES</b>		
Deferred Income Taxes and Investment and Energy Tax Credits	1,672	1,925
Derivative Contracts	8	11
Long-Term Accrued Taxes due to Affiliate	424	
Other	103	102
<b>Total Noncurrent Liabilities</b>	<b>2,207</b>	<b>2,038</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES (See Note 5)</b>		
<b>MINORITY INTERESTS</b>	<b>26</b>	<b>26</b>
<b>LONG-TERM DEBT</b>		
Project Level, Non-Recourse Debt	822	840
Senior Notes	942	1,149
<b>Total Long-Term Debt</b>	<b>1,764</b>	<b>1,989</b>
<b>MEMBER S EQUITY</b>		
Ordinary Unit	1,048	1,193

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Retained Earnings	419	592
Accumulated Other Comprehensive Income	94	103
Total Member s Equity	1,561	1,888
<b>TOTAL LIABILITIES AND MEMBER S EQUITY</b>	<b>\$ 6,009</b>	<b>\$ 6,164</b>

See disclosures regarding PSEG Energy Holdings L.L.C. included in the  
Notes to Condensed Consolidated Financial Statements.

**PSEG ENERGY HOLDINGS L.L.C.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>For The Quarters Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Millions)</b>	
	<b>(Unaudited)</b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	\$ 3	\$ 32
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	14	13
Demand Side Management Amortization		1
Deferred Income Taxes (Other than Leases)	(14 )	4
Leveraged Lease Income, Adjusted for Rents Received and Deferred Income Taxes	(15 )	(22 )
Undistributed Losses (Earnings) from Affiliates	31	(29 )
Gain on Sale of Investments	(16 )	(2 )
Unrealized Gain on Investments		(1 )
Foreign Currency Transaction Loss (Gain)	1	(1 )
Change in Fair Value of Derivative Financial Instruments	30	1
Net Changes in Certain Current Assets and Liabilities:		
Accounts Receivable	13	25
Inventory	5	3
Accounts Payable	21	(29 )
Other Current Assets and Liabilities	7	4
Investment Income and Dividend Distributions from Partnerships	11	1
Other		1
 Net Cash Provided By Operating Activities	 91	 1
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Additions to Property, Plant and Equipment	(16 )	(14 )
Proceeds from Sale of Property		1
Proceeds from the Sale of Investments	7	2
Short-Term Loan Receivable - Affiliated Company, net	3	351
Restricted Funds	34	(17 )
Other	1	1
 Net Cash Provided By Investing Activities	 29	 324



## CASH FLOWS FROM FINANCING ACTIVITIES

Net Change in Short-Term Borrowings	8	
Repayment of Non-Recourse Long-Term Debt	(16 )	(12 )
Repayment of Senior Notes		(309 )
Return of Contributed Capital	(145 )	
Other		(1 )

Net Cash Used In Financing Activities	(153 )	(322 )
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Effect of Exchange Rate Change		(1 )
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Net (Decrease) Increase In Cash and Cash Equivalents	(33 )	2
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Cash and Cash Equivalents at Beginning of Period	98	68
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Cash and Cash Equivalents at End of Period	\$ 65	\$ 70
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## Supplemental Disclosure of Cash Flow Information:

Income Taxes Paid	\$ 1	\$ 2
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Interest Paid, Net of Amounts Capitalized	\$ 23	\$ 26
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See disclosures regarding PSEG Energy Holdings L.L.C. included in the  
Notes to Condensed Consolidated Financial Statements.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

This combined Form 10-Q/A is separately filed by Public Service Enterprise Group Incorporated (PSEG), and PSEG Energy Holdings L.L.C. (Energy Holdings). Information contained herein relating to any individual company is filed by such company on its own behalf. Energy Holdings makes representations only as to itself and makes no representations as to any other company.

**Note 1. Organization and Basis of Presentation**

**Organization**

**PSEG**

PSEG has four principal direct wholly owned subsidiaries: PSE&G, Power, Energy Holdings and PSEG Services Corporation (Services).

**PSE&G**

PSE&G is an operating public utility engaged principally in the transmission of electric energy and distribution of electric energy and natural gas in certain areas of New Jersey. PSE&G is subject to regulation by the New Jersey Board of Public Utilities (BPU) and the Federal Energy Regulatory Commission (FERC).

PSE&G also owns PSE&G Transition Funding LLC (Transition Funding) and PSE&G Transition Funding II LLC (Transition Funding II), bankruptcy-remote entities that purchased certain transition property from PSE&G and issued transition bonds secured by such property. The transition property consists principally of the rights to receive electricity consumption-based per kilowatt-hour (kWh) charges from PSE&G electric distribution customers, which represent irrevocable rights to receive amounts sufficient to recover certain of PSE&G's transition costs related to deregulation, as approved by the BPU.

**Power**

Power is a multi-regional, wholesale energy supply company that integrates its generating asset operations and gas supply commitments with its wholesale energy, fuel supply, energy trading and marketing and risk management function through three principal direct wholly owned subsidiaries: PSEG Nuclear LLC (Nuclear), PSEG Fossil LLC (Fossil) and PSEG Energy Resources & Trade LLC (ER&T). Nuclear and Fossil own and operate generation and generation-related facilities. ER&T is responsible for the day-to-day management of Power's portfolio. Fossil, Nuclear and ER&T are subject to regulation by FERC, and certain Fossil subsidiaries are also subject to state regulation, and Nuclear is also subject to regulation by the Nuclear Regulatory Commission (NRC).

**Energy Holdings**

Energy Holdings has two principal direct wholly owned subsidiaries: PSEG Global L.L.C. (Global), which owns and operates international and domestic projects engaged in the generation and distribution of energy and PSEG Resources L.L.C. (Resources), which has invested primarily in energy-related leveraged leases. Energy Holdings also owns Enterprise Group Development Corporation (EGDC), a commercial real estate property management business.

**Services**

Services provides management and administrative and general services to PSEG and its subsidiaries. These include accounting, treasury, risk management, planning, information technology, tax, law, corporate secretarial, human

resources, investor relations, corporate communications and certain other services. Services charges PSEG and its subsidiaries for the cost of work performed and services provided pursuant to the terms and conditions of intercompany service agreements.

### **Basis of Presentation**

#### **PSEG, PSE&G, Power and Energy Holdings**

The respective financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) for Quarterly Reports on Form 10-Q. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted pursuant to such rules and regulations. These Condensed Consolidated Financial Statements and Notes to

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

Condensed Consolidated Financial Statements (Notes) should be read in conjunction with, and update and supplement matters discussed in PSEG's, PSE&G's, Power's and Energy Holdings' respective Annual Reports on Form 10-K for the year ended December 31, 2006.

The unaudited condensed consolidated financial information furnished herein reflects all adjustments which are, in the opinion of management, necessary to fairly state the results for the interim periods presented. All such adjustments are of a normal recurring nature. The year-end Condensed Consolidated Balance Sheets were derived from the audited Consolidated Financial Statements included in the Annual Report on Form 10-K for the year ended December 31, 2006.

**Reclassifications**

**PSEG, PSE&G, Power and Energy Holdings**

Certain reclassifications have been made to the prior quarter financial statements to conform to the current quarter presentation. The reclassifications relate primarily to PSE&G's determination, during the fourth quarter of 2006, that the revenues and expenses related to one of its contracts that had been recorded on a gross basis would more appropriately be recorded on a net basis in Operating Revenues based upon the provisions of EITF 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent. Therefore, prior amounts have been reclassified, resulting in a reduction of \$57 million in both Operating Revenues and Energy Costs for the quarter ended March 31, 2006 for PSEG and PSE&G, with no impact on Operating Income.

**Note 2. Recent Accounting Standards**

**The following accounting standards were issued by the Financial Accounting Standards Board (FASB), but have not yet been adopted by PSEG, PSE&G, Power and Energy Holdings.**

**Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS 157)**

**PSEG, PSE&G, Power and Energy Holdings**

In September 2006, the FASB issued SFAS 157, which provides a single definition of fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Prior to SFAS 157, guidance for applying fair value was incorporated into several accounting pronouncements. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy that distinguishes between assumptions based on market data obtained from independent sources (observable inputs) and those based on an entity's own assumptions (unobservable inputs). Under SFAS 157, fair value measurements are disclosed by level within that hierarchy, with the highest priority being quoted prices in active markets. While this statement does not require any new fair value measurements, the application of this statement will change current practice for some fair value measurements.

This statement also nullifies the guidance in footnote 3 of Emerging Issues Task Force (EITF) Issue No. 02-3, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities (EITF 02-3). The guidance in footnote 3 applies to derivative instruments measured at fair value at initial recognition, and it precludes immediate recognition in earnings of an unrealized gain or loss, measured as the difference between the transaction price and the fair value of the instrument at initial recognition, if the fair value of the instrument is determined using significant unobservable inputs. Under EITF 02-3, an entity cannot recognize an unrealized gain or loss at inception of a derivative instrument unless the fair value of that instrument is

obtained from a quoted market price in an active market or is otherwise evidenced by comparison to other observable current market transactions or based on a valuation technique incorporating observable market data. SFAS 157 requires that the principles of fair value measurement apply for derivatives and other financial instruments at initial recognition and in all subsequent periods.

SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007; however, earlier application is encouraged. PSEG, PSE&G, Power and Energy Holdings are currently assessing the potential impact of SFAS 157 on their respective consolidated financial positions and results of operations.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159)**

**PSEG, PSE&G, Power and Energy Holdings**

In February 2007, the FASB issued SFAS 159, which permits entities to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. An entity will report unrealized gains and losses on items where the fair value option has been elected in earnings at each subsequent reporting date. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The decision about whether to elect the fair value option is applied instrument by instrument, with a few exceptions; the decision is irrevocable; and the decision is required to be applied to entire instruments and not to portions of instruments.

The statement requires disclosures that facilitate comparisons (a) between entities that choose different measurement attributes for similar assets and liabilities and (b) between assets and liabilities in the financial statements of an entity that selects different measurement attributes for similar assets and liabilities.

SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Upon implementation, an entity shall report the effect of the first remeasurement to fair value as a cumulative effect adjustment to the opening balance of Retained Earnings. PSEG, PSE&G, Power and Energy Holdings are currently assessing the potential impact of SFAS 159 on their respective consolidated financial positions and results of operations.

**The following new accounting standards were adopted by PSEG, PSE&G, Power and Energy Holdings during 2007.**

**FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement 109 (FIN 48)**

**PSEG, PSE&G, Power and Energy Holdings**

In July 2006, the FASB issued FIN 48, which prescribes a model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. Under FIN 48, the financial statements reflect expected future tax consequences of such positions presuming the tax authorities' full knowledge of the position and all relevant facts. FIN 48 permits recognition of the benefit of tax positions only when it is more likely-than-not that the position is sustainable based on the merits of the position. It further limits the amount of tax benefit to be recognized to the largest amount of benefit that is greater than 50% likely of being realized. FIN 48 also requires explicit disclosures about uncertainties in income tax positions, including a detailed roll-forward of unrecognized tax benefits taken that do not qualify for financial statement recognition.

FIN 48 was effective January 1, 2007. In general, companies record the change in net assets that resulted from the application of FIN 48 as an adjustment to Retained Earnings. However, for PSE&G, because any charges to income arising from the adoption of FIN 48 would be recoverable in future rates, the offset to any incremental PSE&G liability is recorded as a Regulatory Asset rather than Retained Earnings. The following table presents the impact at January 1, 2007 on the Condensed Consolidated Balance Sheets for PSEG and its subsidiaries as a result of implementing FIN 48:

	<b>PSE&amp;G</b>	<b>Power</b>	<b>Energy Holdings</b>	<b>PSEG Consolidated</b>
<b>Balance Sheet</b>			(Millions)	
Increase to Long Term Accrued Taxes	\$ 20	\$ 21	\$ 355	\$ 396
Decrease to Accumulated Deferred Income Tax Liability	\$ 9	\$ 7	\$ 246	\$ 262
Increase to Regulatory Assets	\$ 11	\$	\$	\$ 11
Decrease to Retained Earnings	\$	\$ 14	\$ 109	\$ 123

The impact to earnings resulting from the adoption of FIN 48 for the quarter ended March 31, 2007 was an after-tax decrease of \$6 million for PSEG, including \$1 million for Power and \$5 million for Energy Holdings. There was no impact on earnings for PSE&G. For additional information relating to the impacts of FIN 48, see Note 11. Income Taxes.

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**FASB Staff Position (FSP) No. FAS 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction (FSP 13-2)**

**PSEG and Energy Holdings**

In July 2006, the FASB issued FSP 13-2, which addressed how a change or projected change in the timing of cash flows relating to income taxes generated by a leveraged lease transaction affects the accounting by a lessor for that lease. The FSP amends SFAS 13, Accounting for Leases, stating that a change in the timing of the above referenced cash flows must be reviewed at least annually or more frequently, if events or circumstances indicate a change in timing is probable. If a change in timing has occurred, or is projected to occur, the rate of return and the allocation of income to positive investment years must be recalculated from the inception of the lease.

The guidance in this FSP was adopted January 1, 2007. The cumulative effect of applying the provisions of this FSP is reported as an adjustment to the beginning balance of Retained Earnings as of the date of adoption. As a result of implementing FSP 13-2, upon adoption PSEG and Energy Holdings each recognized a reduction in Investment in Leveraged Leases of \$69 million, a reduction in Deferred Income Taxes of \$2 million and a reduction in Retained Earnings of \$67 million.

The impact to earnings resulting from the adoption of FSP 13-2 for the quarter ended March 31, 2007 was an after-tax decrease of \$3 million for PSEG and Energy Holdings.

**Note 3. Discontinued Operations, Dispositions and Impairments**

**Discontinued Operations**

**Power**

***Lawrenceburg Energy Center (Lawrenceburg)***

On December 29, 2006, Power entered into an agreement to sell its natural gas-fired Lawrenceburg facility located in Lawrenceburg, Indiana to AEP Generating Company, a subsidiary of American Electric Power Company, Inc. (AEP).

The sale price for the facility and inventory is \$325 million. The proceeds, together with anticipated reduction in tax liability, are expected to be approximately \$425 million and will be used to retire debt. The transaction will result in an after-tax charge to PSEG's and Power's earnings of approximately \$208 million, or about \$0.82 cents per share of PSEG common stock, which was reflected as a charge in Discontinued Operations in the fourth quarter of 2006.

Power has received the required regulatory approvals for the sale and anticipates that the transaction will close in the second quarter of 2007.

Lawrenceburg's operating results for the quarters ended March 31, 2007 and 2006, which were reclassified to Discontinued Operations, are summarized below:

<b>Quarters Ended</b>	
<b>March 31,</b>	
<b>2007</b>	<b>2006</b>



**(Millions)**

Operating Revenues	\$	\$
Loss Before Income Taxes	\$ (10 )	\$ (15 )
Net Loss	\$ (6 )	\$ (9 )

The carrying amounts of the assets of Lawrenceburg as of March 31, 2007 and December 31, 2006 are summarized in the following table:

	<b>As of March 31, 2007</b>	<b>As of December 31, 2006</b>
	<b>(Millions)</b>	
Current Assets	\$ 10	\$ 10
Noncurrent Assets	315	315
<b>Total Assets of Discontinued Operations</b>	<b>\$ 325</b>	<b>\$ 325</b>

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**Energy Holdings***Elektrociepownia Chorzow Elcho Sp. Z o.o. (Elcho) and Elektrownia Skawina SA (Skawina)*

On May 29, 2006, Global completed the sale of its interest in two coal-fired plants in Poland, Elcho and Skawina. Proceeds, net of transaction costs, were \$476 million, resulting in a gain of \$227 million net of tax expense of \$142 million. The 2006 operating results for Global's assets in Poland have been reclassified to Discontinued Operations.

Elcho's and Skawina's operating results for the quarter ended March 31, 2006 are summarized below:

	<b>Quarter Ended March 31, 2006</b>	
	<b>Elcho</b>	<b>Skawina</b>
	<b>(Millions)</b>	
Operating Revenues	\$ 30	\$ 33
Income Before Income Taxes	\$ 3	\$ 2
Net Income	\$ 3	\$ 1

**Dispositions****Power**

In December 2006, Power recorded a pre-tax impairment loss of \$44 million to write down four turbines to their estimated realizable value and reclassified them to Assets Held for Sale on Power's Condensed Consolidated Balance Sheet. In April 2007, Power sold the four turbines to a third party and received proceeds of approximately \$40 million, which approximates the recorded book value.

**Energy Holdings***Thermal Energy Development Partnership, L.P. (Tracy Biomass)*

On December 22, 2006, Global entered into an agreement to sell its 34.5% interest in Tracy Biomass for approximately \$7 million. The sale closed on January 26, 2007 and resulted in a 2007 pre-tax gain of approximately \$7 million (\$6 million after-tax).

**Impairment****Energy Holdings***Venezuela*

PSEG has indirect ownership interests in two generating facilities in Maracay and Cagua, Venezuela that have a total capacity of 120 MW. The projects are owned and operated by Turboven, an entity which is jointly-owned by Global (50%) and Corporacion Industrial de Energia (CIE). Global also has a 9% indirect interest in TGM through a partnership with CIE. As of March 31, 2007, the book value of these investments was approximately \$35 million.

During Global's year-end review of its equity method investments, management concluded that due to the current political situation in Venezuela, it is probable that Global would not be able to recover its capitalized costs associated with its investments in Venezuela. Therefore, Global recorded a pre-tax impairment loss of approximately \$7 million to write down these investments in the fourth quarter of 2006.

In January 2007, the Venezuelan government announced its intention to nationalize certain sectors of Venezuelan industry and commerce, including certain foreign-owned energy and communications companies. In a subsequent press release, Turboven was named as one of the companies that Venezuela intended to nationalize. Since these announcements, Venezuela has proceeded to nationalize certain companies; however, Global has not received any further official communication from the government of Venezuela regarding Turboven.

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**Note 4. Earnings Per Share (EPS)****PSEG**

Diluted EPS is calculated by dividing Net Income by the weighted average number of shares of common stock outstanding, including shares issuable upon exercise of stock options outstanding under PSEG's stock option plans and upon payment of performance units. The following table shows the effect of these stock options and performance units on the weighted average number of shares outstanding used in calculating diluted EPS:

	<b>Quarters Ended March 31,</b>			
	<b>2007</b>		<b>2006</b>	
	<b>Basic</b>	<b>Diluted</b>	<b>Basic</b>	<b>Diluted</b>
<b>EPS Numerator:</b>				
<b>Earnings (Millions)</b>				
Continuing Operations	\$ 335	\$ 335	\$ 208	\$ 208
Discontinued Operations	(6)	(6)	(5)	(5)
<b>Net Income</b>	<b>\$ 329</b>	<b>\$ 329</b>	<b>\$ 203</b>	<b>\$ 203</b>
<b>EPS Denominator (Thousands):</b>				
Weighted Average Common Shares Outstanding	252,892	252,892	251,187	251,187
Effect of Stock Options		390		787
Effect of Stock Performance Units		74		91
<b>Total Shares</b>	<b>252,892</b>	<b>253,356</b>	<b>251,187</b>	<b>252,065</b>
<b>EPS:</b>				
Continuing Operations	\$ 1.32	\$ 1.32	\$ 0.83	\$ 0.83
Discontinued Operations	(0.02)	(0.02)	(0.02)	(0.02)
<b>Net Income</b>	<b>\$ 1.30</b>	<b>\$ 1.30</b>	<b>\$ 0.81</b>	<b>\$ 0.81</b>

Dividend payments on common stock for the quarter ended March 31, 2007 were \$0.585 per share and totaled approximately \$148 million. Dividend payments on common stock for the quarter ended March 31, 2006 were \$0.57 per share and totaled approximately \$143 million.

**Note 5. Commitments and Contingent Liabilities**

## Guaranteed Obligations

### Power

Power contracts for electricity, natural gas, oil, coal, pipeline capacity, transportation and emission allowances and engages in risk management activities through ER&T. These activities primarily involve the purchase and sale of energy and related products under transportation, physical, financial and forward contracts at fixed and variable prices. These transactions are executed with both numerous counterparties and brokers. Counterparties and brokers may require guarantees, cash or cash related instruments to be deposited on these transactions as described below.

Power has unconditionally guaranteed payments by its subsidiaries, ER&T and PSEG Power New York Inc. (Power New York) in commodity-related transactions to support current exposure, interest and other costs on sums due and payable in the ordinary course of business. These payment guarantees are provided to counterparties in order to obtain credit. Under these agreements, guarantees cover lines of credit between entities and are often reciprocal in nature. The exposure between counterparties can move in either direction. The face value of the guarantees outstanding as of March 31, 2007 and December 31, 2006 was approximately \$1.6 billion.

In order for Power to incur a liability for the face value of the outstanding guarantees, ER&T and Power New York would have to fully utilize the credit granted to them by every counterparty to whom Power has provided a guarantee and all of ER&T's and Power New York's contracts would have to be out-of-the-

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money (if the contracts are terminated, Power would owe money to the counterparties). The probability of all contracts at ER&T and Power New York being simultaneously out-of-the-money is highly unlikely due to offsetting positions within the portfolio. For this reason, the current exposure at any point in time is a more meaningful representation of the potential liability to Power under these guarantees. The current exposure consists of the net of accounts receivable and accounts payable and the forward value on open positions, less any margins posted. The current exposure from such liabilities was \$532 million and \$518 million as of March 31, 2007 and December 31, 2006, respectively.

Power is subject to counterparty collateral calls related to commodity contracts that are bilateral and are subject to certain creditworthiness standards as guarantor under performance guarantees for ER&T's agreements. Changes in commodity prices, including fuel, emissions allowances and electricity, can have a material impact on margin requirements under such contracts. As of March 31, 2007, Power had posted margin of approximately \$66 million, primarily in the form of letters of credit, and received margin of approximately \$57 million to satisfy collateral obligations and support various contractual and environmental obligations. As of December 31, 2006, Power had posted margin of approximately \$40 million, primarily in the form of letters of credit, and received margin of approximately \$86 million, including approximately \$82 million in the form of letters of credit.

Power also routinely enters into exchange-traded futures and options transactions for electricity and natural gas as part of its operations. Generally, such future contracts require a deposit of cash margin, the amount of which is subject to change based on market movement and in accordance with exchange rules. As of March 31, 2007 and December 31, 2006, Power had deposited margin of approximately \$164 million and \$89 million, respectively. Exchange-traded transactions that are margined and monitored separately from physical trading activity may not be subject to change in the event of a downgrade to Power's rating.

In the event of a deterioration of Power's credit rating to below investment grade, which would represent a two level downgrade from its current ratings, many of these agreements allow the counterparty to demand that ER&T provide further performance assurance. As of March 31, 2007, if Power were to lose its investment grade rating and, assuming all counterparties to which ER&T is out-of-the-money were contractually entitled to demand, and demanded, performance assurance, ER&T could be required to post additional collateral in an amount equal to approximately \$664 million. Power believes that it has sufficient liquidity to post such collateral, if necessary.

### **Energy Holdings**

Energy Holdings and/or Global have guaranteed certain obligations of their subsidiaries or affiliates, including the successful completion, performance or other obligations related to certain projects.

In 2006, Global sold its investments in Poland. As of March 31, 2007 and December 31, 2006, Global was still obligated for the \$6 million equity commitment guarantee at Skawina. The guarantee expires in August 2007. If payments are required, such payments are indemnified by the purchaser in accordance with the purchase agreement.

Global also has a contingent guarantee expiring in April 2011 related to debt service obligations associated with Chilquinta Energia S.A., an energy distribution company in Chile in which Global owns 50%. As of March 31, 2007 and December 31, 2006, the contingent guarantee was approximately \$25 million.

In September 2003, Energy Holdings completed the sale of PSEG Energy Technologies Inc. (Energy Technologies) and nearly all of its assets. However, Energy Holdings retained certain outstanding construction and warranty obligations related to ongoing construction projects previously performed by Energy Technologies. These construction obligations have performance bonds issued by insurance companies for which exposure is adequately

supported by the outstanding letters of credit shown in the table above for PSEG Energy Technologies Asset Management Company LLC. As of March 31, 2007 and December 31, 2006, there were \$14 million of such bonds outstanding, which are related to uncompleted construction projects. As of March 31, 2007 and December 31, 2006, there was an additional \$2 million of performance guarantees related to Energy Technologies.

As of March 31, 2007 and December 31, 2006, Energy Holdings and/or Global have various other guarantees amounting to \$28 million and \$30 million, respectively.

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**Environmental Matters**

**PSEG, PSE&G and Power**

*Hazardous Substances*

The New Jersey Department of Environmental Protection (NJDEP) has regulations in effect concerning site investigation and remediation that require an ecological evaluation of potential damages to natural resources in connection with an environmental investigation of contaminated sites. These regulations may substantially increase the costs of environmental investigations and necessary remediation, particularly at sites situated on surface water bodies. PSE&G, Power and their respective predecessor companies own or owned and/or operate or operated certain facilities situated on surface water bodies, certain of which are currently the subject of remedial activities.

The U.S. Environmental Protection Agency (EPA) has determined that a six-mile stretch of the Passaic River in the area of Newark, New Jersey is a facility within the meaning of that term under the Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA). PSE&G and certain of its predecessors conducted industrial operations at properties adjacent to the Passaic River facility. The operations included one operating electric generating station (Essex Site), one former generating station and four former manufactured gas plants (MGPs). PSE&G's costs to clean up former MGPs are recoverable from utility customers through the Societal Benefits Clause (SBC). PSE&G has sold the site of the former generating station and obtained releases and indemnities for liabilities arising out of the site in connection with the sale. The Essex Site was transferred to Power in August 2000. Power assumed any environmental liabilities of PSE&G associated with the electric generating stations that PSE&G transferred to it, including the Essex Site.

In 2003, the EPA notified 41 potentially responsible parties (PRPs), including PSE&G and Power, that it was expanding its assessment of the Passaic River Study Area to the entire 17-mile tidal reach of the lower Passaic River. The EPA further indicated, with respect to PSE&G, that it believed that hazardous substances had been released from the Essex Site and a former MGP located in Harrison, New Jersey (Harrison Site), which also includes facilities for PSE&G's ongoing gas operations. The EPA estimated that its study would require five to eight years to complete and would cost approximately \$20 million, of which it would seek to recover \$10 million from the PRPs, including PSE&G and Power. Power has provided notice to insurers concerning this potential claim.

Also, in 2003, PSEG, PSE&G and 56 other PRPs received a Directive and Notice to Insurers from the NJDEP that directed the PRPs to arrange for a natural resource damage assessment and interim compensatory restoration of natural resource injuries along the lower Passaic River and its tributaries pursuant to the New Jersey Spill Compensation and Control Act. The NJDEP alleged in the Directive that it had determined that hazardous substances had been discharged from the Essex Site and the Harrison Site. The NJDEP announced that it had estimated the cost of interim natural resource injury restoration activities along the lower Passaic River to approximate \$950 million.

PSE&G and Power have indicated to both the EPA and NJDEP that they are willing to work with the agencies in an effort to resolve their respective claims and, along with approximately 65 other PRPs, have entered into an agreement with the EPA or have indicated their intention to enter an agreement that provides for sharing the costs of the \$20 million study between the government organizations and the PRPs. In 2006, the EPA notified the PRPs that the cost of the study will greatly exceed the \$20 million initially estimated and offered to the PRPs the opportunity to conduct the study themselves rather than reimburse the government for the additional costs it incurs. The PRP group has engaged in discussions with the EPA regarding the offer and approximately 70 PRPs, including PSE&G and Power, have agreed to assume responsibility for the study pursuant to an Administrative Order on Consent and to divide the associated costs among themselves according to a mutually agreed-upon formula. PSEG, PSE&G and Power cannot



predict what further actions, if any, or the costs or the timing thereof, that may be required with respect to the Passaic River or natural resource damages. However, such costs could be material.

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**PSE&G**

***MGP Remediation Program***

PSE&G is currently working with the NJDEP under a program to assess, investigate and remediate environmental conditions at PSE&G's former MGP sites (Remediation Program). To date, 38 sites have been identified as sites requiring some level of remedial action. In addition, the NJDEP has announced initiatives to accelerate the investigation and subsequent remediation of the riverbeds underlying surface water bodies that have been impacted by hazardous substances from adjoining sites. Specifically, in 2005 the NJDEP initiated a program on the Delaware River aimed at identifying the 10 most significant sites for cleanup. One of the sites identified is a former MGP facility located in Camden. The Remediation Program is periodically reviewed, and the estimated costs are revised by PSE&G based on regulatory requirements, experience with the program and available remediation technologies. Since the inception of the Remediation Program in 1988 through March 31, 2007, PSE&G had expenditures of approximately \$390 million.

During the fourth quarter of 2006, PSE&G refined the detailed site estimates. The cost of remediating all sites to completion, as well as the anticipated costs to address MGP-related material discovered in two rivers adjacent to former MGP sites, could range between \$798 million and \$838 million, including amounts spent to date. No amount within the range was considered to be most likely. Therefore, \$408 million was accrued at March 31, 2007, which represents the difference between the low end of the total program cost estimate of \$798 million and the total incurred costs through March 31, 2007 of \$390 million. Of this amount, approximately \$45 million was recorded in Other Current Liabilities and \$363 million was reflected in Other Noncurrent Liabilities. The costs associated with the MGP Remediation Program have historically been recovered through the SBC charges to PSE&G ratepayers. As such, a \$408 million Regulatory Asset was recorded.

Costs for the MGP Remediation Program were approximately \$42 million for 2006. PSE&G anticipates spending \$47 million in 2007, \$50 million in 2008, and an average of approximately \$40 million per year each year thereafter through 2016.

**Power**

***Prevention of Significant Deterioration (PSD)/New Source Review (NSR)***

The PSD/NSR regulations, promulgated under the Clean Air Act (CAA), require major sources of certain air pollutants to obtain permits, install pollution control technology and obtain offsets, in some circumstances, when those sources undergo a major modification, as defined in the regulations. The Federal government may order companies not in compliance with the PSD/NSR regulations to install the best available control technology at the affected plants and to pay monetary penalties of up to approximately \$27,500 for each day of continued violation.

The EPA and the NJDEP issued a demand in March 2000 under the CAA requiring information to assess whether projects completed since 1978 at the Hudson and Mercer coal-burning units were implemented in accordance with applicable PSD/NSR regulations. Power completed its response to requests for information and, in January 2002, reached an agreement with the NJDEP and the EPA to resolve allegations of noncompliance with PSD/NSR regulations. Under that agreement, over the course of 10 years, Power agreed to install advanced air pollution controls to reduce emissions of Sulfur Dioxide (SO<sub>2</sub>), Nitrogen Oxide (NO<sub>x</sub>), particulate matter and mercury from the coal-burning units at the Mercer and Hudson generating stations to ensure compliance with PSD/NSR. Power also agreed to spend at least \$6 million on supplemental environmental projects and pay a \$1 million civil penalty. The agreement resolving the NSR allegations concerning the Hudson and Mercer coal-fired units also resolved a dispute

over Bergen 2 regarding the applicability of PSD requirements and allowed construction of the unit to be completed and operations to commence.

Power subsequently notified the EPA and the NJDEP that it was evaluating the continued operation of the Hudson coal unit in light of changes in the energy and capacity markets, increases in the cost of pollution control equipment and other necessary modifications to the unit. On November 30, 2006, Power reached an agreement with the EPA and NJDEP on an amendment to its 2002 agreement intended to achieve the

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emissions reductions targets of this agreement while providing more time to assess the feasibility of installing additional advanced emissions controls at Hudson.

The amended agreement with the EPA and the NJDEP, which is pending final approval, would allow Power to continue operating Hudson and extend for four years the deadline for installing environmental controls beyond the previous December 31, 2006 deadline. Power will be required to undertake a number of technology projects (SCRs, scrubbers, baghouses, carbon injection), plant modifications and operating procedure changes at Hudson and Mercer designed to meet targeted reductions in emissions of NO<sub>x</sub>, SO<sub>2</sub>, particulate matter and mercury. In addition, Power has agreed to notify the EPA and NJDEP by the end of 2007 whether it will install the additional emissions controls at Hudson by the end of 2010, or plan for the orderly shut down of the unit.

Under the program to date, Power has installed SCRs at Mercer at a cost of approximately \$114 million. The cost of implementing the balance of the amended agreement at Mercer and Hudson is estimated at approximately \$500 million for Mercer and at \$600 million to \$750 million for Hudson and will be incurred in the 2007-2010 timeframe. As part of the agreement, Fossil has agreed to purchase and retire emissions allowances, contribute approximately \$3 million for programs to reduce particulate emissions from diesel engines in New Jersey and pay a \$6 million civil penalty. In addition, in March 2007, Fossil entered into an engineering, procurement and construction contract with a third party contractor to complete all back-end technology requirements for the Mercer station, as referenced above.

As a result of the agreement, Power increased its environmental reserves by approximately \$15 million to account for civil penalties associated with the amendment to the agreement and other costs. PSEG and Power recorded the charge in Other Deductions on their respective Condensed Consolidated Statements of Operations in the fourth quarter of 2006.

***Mercury Regulation***

New Jersey and Connecticut have adopted standards for the reduction of emissions of mercury from coal-fired electric generating units. In February 2007, Pennsylvania also issued new requirements for the reduction of mercury emissions from coal-fired power plants. Connecticut requires coal-fired power plants in Connecticut to achieve either an emissions limit or a 90% mercury removal efficiency through technology installed to control mercury emissions effective in July 2008. The regulations in New Jersey require coal-fired electric generating units in New Jersey to meet certain emissions limits or reduce emissions by 90% by December 15, 2007.

Under the New Jersey regulations, companies that are parties to multi-pollutant reduction agreements are permitted to postpone such reductions on half of their coal-fired electric generating capacity until December 15, 2012. With respect to Power's New Jersey facilities, the other half of the reductions that are required to be achieved by December 15, 2007 will be achieved through the installation of carbon injection technology and baghouses as part of Power's multi-pollutant reduction agreement with the NJDEP, which resulted from the amended 2002 agreement that resolved issues arising out of the PSD and the NSR air pollution control programs at the Hudson, Mercer and Bergen facilities, discussed above. The estimated costs of technology believed to be capable of meeting these emissions limits at Power's coal-fired unit in Connecticut and at its Mercer Station are included in Power's capital expenditures forecast. Total estimated costs for each project are between \$150 million and \$200 million. The Mercer expenditures are included in the PSD/NSR discussion above.

Connecticut has released proposed revisions to mercury regulations that encompass Permit Requirements for Mercury Emissions from Coal-Fired Electric Generating Units. On March 13, 2007, the Connecticut Department of Environmental Protection (CTDEP) released its hearing report on the Permit Requirements from Mercury Emissions from Coal-Fired Electric Generating Units. On February 17, 2007, Pennsylvania finalized its State-specific

requirements to reduce mercury emissions from coal-fired electric generating units. As written, the regulations would not materially affect the costs already identified in Power's capital expenditures forecast.

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***New Jersey Industrial Site Recovery Act (ISRA)***

bsp;13(d)(3) and 14(d)(2) of the Exchange Act) is or becomes a beneficial owner (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 50% or more of the combined voting power of the Company's then outstanding securities eligible to vote for the election of the Board (the Company Voting Securities); provided, however, that the event described in this paragraph (ii) shall not be deemed to be a Change in Control by virtue of any of the following acquisitions: (A) by the Company or any Affiliate, (B) by any employee benefit plan (or related trust) sponsored or maintained by the Company or any Affiliate, (C) by any underwriter temporarily holding securities pursuant to an offering of such securities, (D) pursuant to a Non-Qualifying Transaction, as defined in paragraph (iii), or (E) by any person of Voting Securities from the Company, if a majority of the Incumbent Board approves in advance the acquisition of beneficial ownership of 50% or more of Company Voting Securities by such person;

(iii) The consummation of a merger, consolidation, statutory share exchange or similar form of corporate transaction involving the Company or any of its Affiliates that requires the approval of the Company's stockholders, whether for such transaction or the issuance of securities in the transaction (a Business Combination), unless immediately following such Business Combination: (A) more than 60% of the total voting power of (x) the corporation resulting from such Business Combination (the Surviving Corporation), or (y) if applicable, the ultimate parent corporation that directly or indirectly has beneficial ownership of 100% of the voting securities eligible to elect directors of the Surviving Corporation (the Parent Corporation), is represented by Company Voting Securities that were outstanding immediately prior to such Business Combination (or, if applicable, is represented by shares into which such Company Voting Securities were converted pursuant to such Business Combination), and such voting power among the holders thereof is in substantially the same proportion as the voting power of such Company Voting Securities among the holders thereof immediately prior to the Business Combination, (B) no person (other than any employee benefit plan (or related trust) sponsored or maintained by the Surviving Corporation or the Parent Corporation), is or becomes the beneficial owner, directly or indirectly, of 50% or more of the total voting power of the outstanding voting securities eligible to elect directors of the Parent Corporation (or, if there is no Parent Corporation, the Surviving Corporation) and (C) at least a majority of the members of the board of directors of the Parent Corporation (or, if there is no Parent Corporation, the Surviving Corporation) following the consummation of the Business Combination were Incumbent Directors at the time of the Board's approval of the execution of the initial agreement providing for such Business Combination (any Business Combination which satisfies all of the criteria specified in (A), (B) and (C) above shall be deemed to be a Non-Qualifying Transaction);

(iv) The stockholders of the Company approve a plan of complete liquidation or dissolution of the Company or the consummation of a sale of all or substantially all of the Company's assets; or

(v) The occurrence of any other event that the Board determines by a duly approved resolution constitutes a Change in Control.

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Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any person acquires beneficial ownership of more than 50% of the Company Voting Securities as a result of the acquisition of Company Voting Securities by the Company which reduces the number of Company Voting Securities outstanding; provided, that if after such acquisition by the Company such person becomes the beneficial owner of additional Company Voting Securities that increases the percentage of outstanding Company Voting Securities beneficially owned by such person, a Change in Control of the Company shall then occur.

**12. GENERALLY APPLICABLE PROVISIONS**

**12.1. *Amendment and Termination of the Plan.*** The Board may, from time to time, alter, amend, suspend or terminate the Plan as it shall deem advisable, subject to any requirement for stockholder approval imposed by applicable law, including the rules and regulations of the NASDAQ Stock Market (or such other principal U.S. national securities exchange on which the Shares are traded); provided that the Board may not amend the Plan in any manner that would result in noncompliance with Rule 16b-3 of the Exchange Act; and further provided that the Board may not, without the approval of the Company's stockholders to the extent required by such applicable law, amend the Plan to (a) increase the number of Shares that may be the subject of Awards under the Plan (except for adjustments pursuant to Section 12.2); (b) expand the types of awards available under the Plan; (c) materially expand the class of persons eligible to participate in the Plan; (d) amend any provision of Section 5.3 or the last sentence of Section 6.2(d); or (e) increase the maximum permissible term of any Option specified by Section 5.4 or the maximum permissible term of a Stock Appreciation Right specified by Section 6.2(d). The Board may not without the approval of the Company's stockholders cancel an Option or Stock Appreciation Right in exchange for cash or take any action with respect to an Option or Stock Appreciation Right that may be treated as a repricing under the rules and regulations of the NASDAQ Stock Market (or such other principal U.S. national securities exchange on which the Shares are traded), including a reduction of the exercise price of an Option or the grant price of a Stock Appreciation Right or the exchange of an Option or Stock Appreciation Right for cash or another Award. In addition, no amendments to, or termination of, the Plan shall in any way impair the rights of a Participant under any Award previously granted without such Participant's consent.

**12.2. *Adjustments.*** In the event of any merger, reorganization, consolidation, recapitalization, dividend or distribution (whether in cash, shares or other property, other than a regular cash dividend), stock split, reverse stock split, spin-off or similar transaction or other change in corporate structure affecting the Shares or the value thereof, such adjustments and other substitutions shall be made to the Plan and to Awards as the Committee deems equitable or appropriate taking into consideration the accounting and tax consequences, including such adjustments in the aggregate number, class and kind of securities that may be delivered under the Plan, the Limitations, the maximum number of Shares that may be issued pursuant to Incentive Stock Options and, in the aggregate or to any one Participant, in the number, class, kind and option or exercise price of securities subject to outstanding Awards granted under the Plan (including, if the Committee deems appropriate, the substitution of similar options to purchase the shares of, or other awards denominated in the shares of, another company) as the Committee may determine to be appropriate in its sole discretion; provided, however, that the number of Shares subject to any Award shall always be a whole number.

**12.3. *Transferability of Awards.*** Except as provided below, no Award and no Shares subject to Awards described in Article 8 that have not been issued or as to which any applicable restriction, performance or deferral period has not lapsed, may be sold, assigned, transferred, pledged or otherwise encumbered, other than by will or the laws of descent and distribution, and such Award may be exercised during the life of the Participant only by the Participant or the Participant's guardian or legal representative. To the extent and under such terms and conditions as determined by the Committee, a Participant may assign or transfer an Award (each transferee thereof, a Permitted Assignee) to a family member as such term is defined in the General Instructions to Form S-8 (whether by gift or a domestic relations order); provided that such Permitted Assignee shall be bound by and subject to all of the terms and conditions of the Plan and the Award Agreement relating to the transferred Award and shall execute an agreement satisfactory to the Company evidencing such obligations; and provided

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further that such Participant shall remain bound by the terms and conditions of the Plan. The Company shall cooperate with any Permitted Assignee and the Company's transfer agent in effectuating any transfer permitted under this Section.

**12.4. Termination of Employment.** The Committee shall determine and set forth in each Award Agreement whether any Awards granted in such Award Agreement will continue to be exercisable, continue to vest or be earned and the terms of such exercise, vesting or earning, on and after the date that a Participant ceases to be employed by or to provide services to the Company or any Affiliate (including as a Director), whether by reason of death, disability, voluntary or involuntary termination of employment or services, or otherwise. The date of termination of a Participant's employment or services will be determined by the Committee, which determination will be final.

**12.5. Deferral; Dividend Equivalents.** The Committee shall be authorized to establish procedures pursuant to which the payment of any Award may be deferred. Subject to the provisions of the Plan and any Award Agreement, the recipient of an Award (including any deferred Award) other than an Option or Stock Appreciation Right may, if so determined by the Committee, be entitled to receive, currently or on a deferred basis, cash, stock or other property dividends, or cash payments in amounts equivalent to cash, stock or other property dividends on Shares ( Dividend Equivalents ) with respect to the number of Shares covered by the Award, as determined by the Committee, in its sole discretion. The Committee may provide that such amounts and Dividend Equivalents (if any) shall be deemed to have been reinvested in additional Shares or otherwise reinvested and may provide that such amounts and Dividend Equivalents are subject to the same vesting or performance conditions as the underlying Award.

## **13. MISCELLANEOUS**

**13.1. Tax Withholding.** The Company shall have the right to make all payments or distributions pursuant to the Plan to a Participant (or a Permitted Assignee thereof) (any such person, a Payee ) net of any applicable federal, state and local taxes required to be paid or withheld as a result of (a) the grant of any Award, (b) the exercise of an Option or Stock Appreciation Right, (c) the delivery of Shares or cash, (d) the lapse of any restrictions in connection with any Award or (e) any other event occurring pursuant to the Plan. The Company or any Affiliate shall have the right to withhold from wages or other amounts otherwise payable to such Payee such withholding taxes as may be required by law, or to otherwise require the Payee to pay such withholding taxes. If the Payee shall fail to make such tax payments as are required, the Company or its Affiliates shall, to the extent permitted by law, have the right to deduct any such taxes from any payment of any kind otherwise due to such Payee or to take such other action as may be necessary to satisfy such withholding obligations. The Committee shall be authorized to establish procedures for election by Participants to satisfy such obligation for the payment of such taxes by tendering previously acquired Shares (either actually or by attestation, valued at their then Fair Market Value), or by directing the Company to retain Shares (up to the Participant's minimum required tax withholding rate or such other rate that will not cause an adverse accounting consequence or cost) otherwise deliverable in connection with the Award.

**13.2. Right of Discharge Reserved; Claims to Awards.** Nothing in the Plan nor the grant of an Award hereunder shall confer upon any Employee, Director or Consultant the right to continue in the employment or service of the Company or any Affiliate or affect any right that the Company or any Affiliate may have to terminate the employment or service of (or to demote or to exclude from future Awards under the Plan) any such Employee, Director or Consultant at any time for any reason. Except as specifically provided by the Committee, the Company shall not be liable for the loss of existing or potential profit from an Award granted in the event of termination of an employment or other relationship. No Employee, Director or Consultant shall have any claim to be granted any Award under the Plan, and there is no obligation for uniformity of treatment of Employees, Directors or Consultants under the Plan.

**13.3. Prospective Recipient.** The prospective recipient of any Award under the Plan shall not, with respect to such Award, be deemed to have become a Participant, or to have any rights with respect to such Award, until and



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unless such recipient shall have executed an agreement or other instrument evidencing the Award and delivered a copy thereof to the Company, and otherwise complied with the then applicable terms and conditions.

**13.4. *Substitute Awards.*** Notwithstanding any other provision of the Plan, the terms of Substitute Awards may vary from the terms set forth in the Plan to the extent the Committee deems appropriate to conform, in whole or in part, to the provisions of the awards in substitution for which they are granted.

**13.5. *Cancellation of Award.***

(a) Notwithstanding anything to the contrary contained herein, an Award Agreement may provide that the Award shall be canceled if the Participant, without the consent of the Company, while employed by, or providing services to, the Company or any Affiliate or after termination of such employment or services, establishes a relationship with a competitor of the Company or any Affiliate or engages in activity that is in conflict with or adverse to the interest of the Company or any Affiliate (including conduct contributing to any financial restatements or financial irregularities), as determined by the Committee in its sole discretion. The Committee may provide in an Award Agreement that if within the time period specified in the Agreement the Participant establishes a relationship with a competitor or engages in an activity referred to in the preceding sentence, the Participant will forfeit any gain realized on the vesting or exercise of the Award and must repay such gain to the Company.

(b) In the event the Participant ceases to be employed by, or provide services to, the Company on account of a termination for cause (as defined below) by the Company, any Award held by the Participant shall terminate as of the date the Participant ceases to be employed by, or provide services to, the Company. In addition, notwithstanding any other provisions of this Section, if the Committee determines that the Participant has engaged in conduct that constitutes cause at any time while the Participant is employed by, or providing services to, the Company or after the Participant's termination of employment or services, any Awards held by the Participant shall immediately terminate. In the event a Participant's employment or services is terminated for cause, in addition to the immediate termination of all Awards, the Participant shall automatically forfeit all shares underlying any exercised portion of an Option for which the Company has not yet delivered the share certificates, upon refund by the Company of the option price paid by the Participant for such shares.

(c) For purposes of this Section, cause shall mean, unless otherwise provided in an Award Agreement or another agreement between the Participant and the Company or an Affiliate or a plan maintained by the Company or an Affiliate in which the Participant participates, a determination by the Committee that the Participant has breached his or her employment or service contract with the Company, or has been engaged in disloyalty to the Company, including, without limitation, fraud, embezzlement, theft, commission of a felony or proven dishonesty in the course of his or her employment or service, or has disclosed trade secrets or confidential information of the Company to persons not entitled to receive such information, or has breached any written noncompetition or nonsolicitation agreement between the Participant and the Company or has engaged in such other behavior detrimental to the interests of the Company as the Committee determines

**13.6. *Stop Transfer Orders.*** All certificates for Shares delivered under the Plan pursuant to any Award shall be subject to such stop-transfer orders and other restrictions as the Committee may deem advisable under the rules, regulations and other requirements of the Securities and Exchange Commission, any stock exchange upon which the Shares are then listed, and any applicable federal or state securities law, and the Committee may cause a legend or legends to be put on any such certificates to make appropriate reference to such restrictions.

**13.7. *Nature of Payments.*** All Awards made pursuant to the Plan are in consideration of services performed or to be performed for the Company or any Affiliate, division or business unit of the Company. Any income or gain realized pursuant to Awards under the Plan constitutes a special incentive payment to the Participant and shall not be taken into account, to the extent permissible under applicable law, as compensation for purposes of

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any of the employee benefit plans of the Company or any Affiliate except as may be determined by the Committee or by the Board or board of directors of the applicable Affiliate.

**13.8. *Other Plans.*** Nothing contained in the Plan shall prevent the Board from adopting other or additional compensation arrangements, subject to stockholder approval if such approval is required; and such arrangements may be either generally applicable or applicable only in specific cases.

**13.9. *Severability.*** The provisions of the Plan shall be deemed severable. If any provision of the Plan shall be held unlawful or otherwise invalid or unenforceable in whole or in part by a court of competent jurisdiction or by reason of a change in a law or regulation, such provision shall (a) be deemed limited to the extent that such court of competent jurisdiction deems it lawful, valid and/or enforceable and as so limited shall remain in full force and effect, and (b) not affect any other provision of the Plan or part thereof, each of which shall remain in full force and effect. If the making of any payment or the provision of any other benefit required under the Plan shall be held unlawful or otherwise invalid or unenforceable by a court of competent jurisdiction, such unlawfulness, invalidity or unenforceability shall not prevent any other payment or benefit from being made or provided under the Plan, and if the making of any payment in full or the provision of any other benefit required under the Plan in full would be unlawful or otherwise invalid or unenforceable, then such unlawfulness, invalidity or unenforceability shall not prevent such payment or benefit from being made or provided in part, to the extent that it would not be unlawful, invalid or unenforceable, and the maximum payment or benefit that would not be unlawful, invalid or unenforceable shall be made or provided under the Plan.

**13.10. *Construction.*** As used in the Plan, the words *include* and *including*, and variations thereof, shall not be deemed to be terms of limitation, but rather shall be deemed to be followed by the words *without limitation*.

**13.11. *Unfunded Status of the Plan.*** The Plan is intended to constitute an unfunded plan for incentive and deferred compensation. With respect to any payments not yet made to a Participant by the Company, nothing contained herein shall give any such Participant any rights that are greater than those of a general creditor of the Company. In its sole discretion, the Committee may authorize the creation of trusts or other arrangements to meet the obligations created under the Plan to deliver the Shares or payments in lieu of or with respect to Awards hereunder; provided, however, that the existence of such trusts or other arrangements is consistent with the unfunded status of the Plan.

**13.12. *Governing Law.*** The Plan and all determinations made and actions taken thereunder, to the extent not otherwise governed by the Code or the laws of the United States, shall be governed by the laws of the State of Delaware, without reference to principles of conflict of laws, and construed accordingly.

**13.13. *Effective Date of Plan; Termination of Plan.*** The Plan shall be effective on the date of the approval of the Plan by the holders of the shares entitled to vote at a duly constituted meeting of the stockholders of the Company. The Plan shall be null and void and of no effect if the foregoing condition is not fulfilled and in such event each Award shall, notwithstanding any of the preceding provisions of the Plan, be null and void and of no effect. Awards may be granted under the Plan at any time and from time to time on or prior to the tenth anniversary of the effective date of the Plan, on which date the Plan will expire except as to Awards then outstanding under the Plan. Such outstanding Awards shall remain in effect until they have been exercised or terminated, or have expired.

**13.14. *Foreign Employees and Consultants.*** Awards may be granted to Participants who are foreign nationals or employed or providing services outside the United States, or both, on such terms and conditions different from those applicable to Awards to Employees employed or providing services in the United States as may, in the judgment of the Committee, be necessary or desirable in order to recognize differences in local law or tax policy. The Committee also may impose conditions on the exercise or vesting of Awards in order to minimize the Company's obligation with respect to tax equalization for Employees or Consultants on assignments outside their home country.

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**13.15. *Compliance with Section 409A of the Code.*** This Plan is intended to comply and shall be administered in a manner that is intended to comply with Section 409A of the Code and shall be construed and interpreted in accordance with such intent. To the extent that an Award or the payment, settlement or deferral thereof is subject to Section 409A of the Code, the Award shall be granted, paid, settled or deferred in a manner that will comply with Section 409A of the Code, including regulations or other guidance issued with respect thereto, except as otherwise determined by the Committee. Any provision of this Plan that would cause the grant of an Award or the payment, settlement or deferral thereof to fail to satisfy Section 409A of the Code shall be amended to comply with Section 409A of the Code on a timely basis, which may be made on a retroactive basis, in accordance with regulations and other guidance issued under Section 409A of the Code.

**13.16. *Captions.*** The captions in the Plan are for convenience of reference only, and are not intended to narrow, limit or affect the substance or interpretation of the provisions contained herein.

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**APPENDIX B**

**ARENA PHARMACEUTICALS, INC.**

**2009 EMPLOYEE STOCK PURCHASE PLAN**

**1. Purpose.** The purpose of the Plan is to provide employees of Arena Pharmaceuticals, Inc. (the Company) and its Designated Subsidiaries with an opportunity to purchase Common Stock of the Company through accumulated payroll deductions. It is the intention of the Company to have the Plan qualify as an Employee Stock Purchase Plan under Section 423 of the Internal Revenue Code of 1986, as amended. The provisions of the Plan, accordingly, shall be construed so as to extend and limit participation in a manner consistent with the requirements of that section of the Code.

After the effective date of the Plan, (i) no new Offering Periods shall commence under the Prior Plan and (ii) all Offering Periods existing under the Prior Plan on the effective date of the Plan are intended to continue in effect under the Plan in accordance with the terms of the Prior Plan.

**2. Definitions.**

- (a) Authorization Form shall mean a form established by the Plan Administrator authorizing payroll deductions, as set forth in Section 4, and containing such other terms and conditions as the Company from time to time may determine.
- (b) Board shall mean the Board of Directors of the Company.
- (c) Code shall mean the Internal Revenue Code of 1986, as amended. References to specific sections of the Code shall be taken to be references to corresponding sections of any successor statute.
- (d) Committee shall mean the committee of members of the Board designated as the Committee in Section 14.
- (e) Common Stock shall mean the common stock of the Company.
- (f) Company shall mean Arena Pharmaceuticals, Inc., or any successor by merger or otherwise, and any Designated Subsidiary of the Company.
- (g) Compensation shall mean all base gross earnings, commissions, overtime, and shift premium before giving effect to any compensation reductions made in connection with plans described in section 401(k) or 125 of the Code, but exclusive of payments for any other compensation.
- (h) Designated Subsidiary shall mean any Subsidiary that has been designated by the Board from time to time in its sole discretion as eligible to participate in the Plan. For purposes of the Plan, BRL Screening, Inc. shall be deemed to have been designated by the Board as a Designated Subsidiary.
- (i) Employee shall mean any individual who is an Employee of the Company for tax purposes whose customary employment with the Company is at least twenty (20) hours per week. For purposes of the Plan, the employment relationship shall be treated as continuing intact while the individual is on sick leave or other leave of absence approved by the Company. Where the period of leave exceeds 90 days and the individual's right to reemployment is not guaranteed either by statute or by contract, the employment relationship shall be deemed to have terminated on the 91st day of such leave.
- (j) Enrollment Date shall mean the first Trading Day of each Offering Period.
- (k) Exercise Date shall mean the last Trading Day of each Purchase Period.

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(l) Fair Market Value shall mean, as of any date, the value of Common Stock determined as follows:

(1) The per share closing price of the Common Stock as reported on the NASDAQ Stock Market on that date (or if there was no reported closing price on such date, on the last preceding date on which the closing price was reported);

(2) If the Common Stock is not then listed on the NASDAQ Stock Market, the per share closing price of the Common Stock on such other principal U.S. national securities exchange on which the Common Stock is listed (or if there was no reported closing price on such date, on the last preceding date on which the closing price was reported);

(3) If the Common Stock is not listed on any U.S. national securities exchange but is quoted in an inter-dealer quotation system on a last sale basis, the final ask price of the Common Stock reported on such date (or, if there is no such sale on such date, then on the last preceding date on which a sale was reported); or

(4) If the Common Stock is neither listed on a U.S. national securities exchange nor quoted on an inter-dealer quotation system on a last sale basis, the Fair Market Value shall be determined by the Committee in its sole discretion using appropriate criteria.

(m) Offering Periods shall mean the periods established pursuant to Section 4.

(n) Plan shall mean this 2009 Employee Stock Purchase Plan, as amended from time to time.

(o) Plan Administrator shall mean the Company acting through its authorized officers.

(p) Prior Plan shall mean the Company's 2001 Arena Employee Stock Purchase Plan, as amended.

(q) Purchase Period shall mean, except as otherwise determined by the Committee, the three (3) month period commencing on the next Trading Day following the preceding Exercise Date and ending with the next Exercise Date, except that the first Purchase Period of any Offering Period shall commence on the Enrollment Date and end with the next Exercise Date.

(r) Purchase Price shall mean 85% of the Fair Market Value of a share of Common Stock on the Enrollment Date or on the Exercise Date, whichever is lower; provided however, that the Purchase Price may be adjusted by the Board pursuant to Section 20.

(s) Reserves shall mean the number of shares of Common Stock covered by each option under the Plan that have not yet been exercised and the number of shares of Common Stock which have been authorized for issuance under the Plan but not yet placed under option.

(t) Subsidiary shall mean a corporation, domestic or foreign, of which not less than 50% of the voting shares are held by the Company or a Subsidiary, whether or not such corporation now exists or is hereafter organized or acquired by the Company or a Subsidiary.

(u) Trading Day shall mean a day on which the NASDAQ Stock Market (or such other principal U.S. national securities exchange Common Stock is listed) is open for trading.

**3. Eligibility.**

(a) All Employees who are employed by the Company at least one (1) day before a given Enrollment Date shall be eligible to participate in the Plan.

(b) Any provisions of the Plan to the contrary notwithstanding, no Employee shall be granted an option under the Plan (i) to the extent that, immediately after the grant, such Employee (or any other person whose stock

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would be attributed to such Employee pursuant to Section 424(d) of the Code) would own capital stock of the Company and/or hold outstanding options to purchase such stock possessing five percent (5%) or more of the total combined voting power or value of all classes of the capital stock of the Company or of any parent or subsidiary corporation, or (ii) to the extent that his or her rights to purchase stock under all employee stock purchase plans of the Company and any parent or subsidiary corporation accrues at a rate which exceeds Twenty-Five Thousand Dollars (\$25,000) worth of stock (determined at the fair market value of the shares at the time such option is granted) for each calendar year in which such option is outstanding at any time.

### **4. Offering Periods.**

(a) *Plan Implementation.* The Plan shall be implemented by consecutive, overlapping Offering Periods with a new Offering Period commencing on the first Trading Day on or after January 1, April 1, July 1, and October 1 of each year, or on such other date as the Board or the Committee shall determine, and continuing thereafter until terminated in accordance with Section 20 hereof. All Offering Periods existing under the Prior Plan on the effective date of the Plan shall continue in effect under the Plan, but in accordance with the terms of the Prior Plan, including with respect to their Purchase Price and duration. The shares reserved for issuance under the Plan are available for purchase with respect to Offering Periods existing under the Prior Plan on the effective date of the Plan and those commencing at any time under the Plan. The first new Offering Period under the Plan shall begin on July 1, 2009 and, except as may be otherwise provided for in Section 4(c), shall end on the last Trading Day on or before June 30, 2011.

(b) *Offering Period Duration.* Each Offering Period shall be for a period of twenty-four (24) months during which an option granted pursuant to the Plan may be exercised.

(c) *Automatic Transfer to Lower Price Offering Period.* To the extent permitted by any applicable laws, regulations, rules of the NASDAQ Stock Market (or such other principal U.S. national securities exchange on which the Common Stock is listed), if the Fair Market Value of the Common Stock on any Exercise Date in an Offering Period is lower than the Fair Market Value of the Common Stock on the Enrollment Date of such Offering Period, then all participants in such Offering Period shall be automatically withdrawn from such Offering Period immediately after the exercise of their option on such Exercise Date and automatically re-enrolled in the immediately following Offering Period as of the first day thereof.

(d) *Changes in Offering Period.* The Board or the Committee shall have the power to change the duration of Offering Periods (including the commencement dates thereof) with respect to future offerings without stockholder approval if notice of such change is announced to Employees prior to the scheduled beginning of the first Offering Period to be affected thereafter.

### **5. Participation.**

(a) An Employee may become a participant in the Plan by completing an Authorization Form and filing it with the Plan Administrator prior to the applicable Enrollment Date.

(b) Payroll deductions for a participant shall commence on the first payroll following the Enrollment Date and shall end on the last payroll in the Offering Period to which such authorization is applicable, unless sooner terminated by the participant as provided in Section 10 hereof.

### **6. Payroll Deductions.**

(a) At the time a participant files his or her Authorization Form, he or she shall elect to have payroll deductions made on each payday during the Offering Period in an amount not exceeding fifteen percent (15%) of the Compensation which he or she receives on each pay day during the Offering Period (or such other percentage as may be established by the Board or the Committee from time to time in its sole discretion).

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(b) All payroll deductions made for a participant shall be credited to his or her account under the Plan and shall be withheld in whole percentages only. A participant may not make any additional payments into such account.

(c) A participant may discontinue his or her participation in the Plan as provided in Section 10 hereof, or may increase or decrease the rate of his or her payroll deductions during the Offering Period by filing with the Plan Administrator a new Authorization Form authorizing a change in payroll deduction rate. The Board or the Committee may, in its discretion, limit the number of participation rate changes during any Offering Period. Any such reduction or increase would be effective beginning with the first Purchase Period that begins no earlier than 5 business days after the Plan Administrator's receipt of a new Authorization Form from the participant, unless otherwise determined by the Plan Administrator. A participant's Authorization Form shall remain in effect for successive Offering Periods unless terminated as provided in Section 10 hereof.

(d) Notwithstanding the foregoing, to the extent necessary to comply with Section 423(b)(8) of the Code and Section 3(b) hereof, a participant's payroll deductions may be decreased to zero percent (0%) at any time during a Purchase Period. Payroll deductions shall recommence at the rate provided in such participant's Authorization Form at the beginning of the first Purchase Period that is scheduled to end in the following calendar year, unless terminated by the participant as provided in Section 10 hereof.

(e) At the time the option is exercised, in whole or in part, or at the time some or all of the Company's Common Stock issued under the Plan is disposed of, the participant must make adequate provision for the Company's federal, state, or other tax withholding obligations, if any, which arise upon the exercise of the option. If the participant makes a disposition, within the meaning of Section 424(c) of the Code and regulations promulgated thereunder, of any shares of Common Stock issued to such participant pursuant to the exercise of an option, and such disposition occurs within the two-year period commencing on the day after the Offering Date or within the one-year period commencing on the day after the exercise date, such participant shall, within five (5) days of such disposition, notify the Company thereof. In addition, in order to satisfy the requirement to withhold the amount (if any) of federal, state or local taxes that the Company or Subsidiary determines is applicable, the Company and any Subsidiary may deduct such amount from any other compensation payable to the Participant.

**7. Grant of Option.** On the Enrollment Date of each Offering Period, each Employee participating in such Offering Period shall be granted an option to purchase on each Exercise Date during such Offering Period (at the applicable Purchase Price) up to a number of shares of the Company's Common Stock determined by dividing such Employee's payroll deductions accumulated prior to such Exercise Date and retained in the participant's account as of the Exercise Date by the applicable Purchase Price; provided that in no event shall an Employee be permitted to purchase during each Purchase Period more than Six Hundred Twenty Five (625) shares of the Company's Common Stock (subject to any adjustment pursuant to Section 19), and provided further that such purchase shall be subject to the limitations set forth in Sections 3(b) and 12 hereof. The Board or the Committee may, for future Offering Periods, increase or decrease, in its absolute discretion, the maximum number of shares of the Company's Common Stock an Employee may purchase during each Purchase Period of such Offering Period. Exercise of the option shall occur as provided in Section 8 hereof, unless the participant has withdrawn pursuant to Section 10 hereof. The option shall expire on the last day of the Offering Period.

**8. Exercise of Option.**

(a) Unless a participant withdraws from the Plan as provided in Section 10 hereof, his or her option for the purchase of shares shall be exercised automatically on the Exercise Date, and the maximum number of full shares subject to the option shall be purchased for such participant at the applicable Purchase Price with the accumulated payroll deductions in his or her account. No fractional shares shall be purchased; any payroll deductions accumulated in a participant's account which are not sufficient to purchase a full share shall be retained in the participant's account for the subsequent Purchase Period or Offering Period, subject to earlier

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withdrawal by the participant as provided in Section 10 hereof. Any other monies left over in a participant's account after the Exercise Date shall be returned to the participant. During a participant's lifetime, a participant's option to purchase shares hereunder is exercisable only by him or her.

(b) If the Board or the Committee determines that, on a given Exercise Date, the number of shares with respect to which options are to be exercised may exceed (i) the number of shares of Common Stock that were available for sale under the Plan on the Enrollment Date of the applicable Offering Period, or (ii) the number of shares available for sale under the Plan on such Exercise Date, the Board may in its sole discretion (x) provide that the Company shall make a pro rata allocation of the shares of Common Stock available for purchase on such Enrollment Date or Exercise Date, as applicable, in as uniform a manner as shall be practicable and as it shall determine in its sole discretion to be equitable among all participants exercising options to purchase Common Stock on such Exercise Date, and continue all Offering Periods then in effect, or (y) provide that the Company shall make a pro rata allocation of the shares available for purchase on such Enrollment Date or Exercise Date, as applicable, in as uniform a manner as shall be practicable and as it shall determine in its sole discretion to be equitable among all participants exercising options to purchase Common Stock on such Exercise Date, and terminate any or all Offering Periods then in effect pursuant to Section 20 hereof. The Company may make pro rata allocations of the shares available on the Enrollment Date of any applicable Offering Period pursuant to the preceding sentence, notwithstanding any authorization of additional shares for issuance under the Plan by the Company's stockholders subsequent to such Enrollment Date.

**9. Delivery.** As promptly as practicable after each Exercise Date on which a purchase of shares occurs, the Company shall arrange the delivery to each participant, as appropriate, the shares purchased upon exercise of his or her option in a certificate or uncertificated form.

### **10. Withdrawal.**

(a) A participant may withdraw all but not less than all the payroll deductions credited to his or her account and not yet used to exercise his or her option under the Plan at any time by giving written notice to Plan Administrator which is received at least ten (10) days prior to the Exercise Date (or such other notice period as may be established by the Plan Administrator from time to time in its sole discretion). All of the participant's payroll deductions credited to his or her account shall be paid to such participant promptly after receipt of notice of withdrawal and such participant's option for the Offering Period shall be automatically terminated, and no further payroll deductions for the purchase of shares shall be made for such Offering Period. If a participant withdraws from an Offering Period, payroll deductions shall not resume at the beginning of the succeeding Offering Period unless the participant delivers to the Plan Administrator a new Authorization Form.

(b) A participant's withdrawal from an Offering Period shall not have any effect upon his or her eligibility to participate in any similar plan that may hereafter be adopted by the Company or in succeeding Offering Periods that commence after the termination of the Offering Period from which the participant withdraws.

**11. Termination of Employment.** Upon a participant's ceasing to be an Employee, for any reason, he or she shall be deemed to have elected to withdraw from the Plan and the payroll deductions credited to such participant's account during the Offering Period but not yet used to exercise the option shall be returned to such participant or, in the case of his or her death, to the person or persons entitled thereto under Section 15 hereof, and such participant's option shall be automatically terminated.

**12. Interest.** No interest shall accrue on the payroll deductions of a participant in the Plan.

### **13. Stock.**

(a) Subject to adjustment upon changes in capitalization of the Company as provided in Section 19 hereof, the maximum number of shares of the Company's Common Stock which shall be made available for sale under



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the Plan with respect to Exercise Dates (including Exercise Dates with respect to outstanding Offering Periods under the Prior Plan and ones with respect to Offering Periods commencing under the Plan) shall be One Million Five Hundred Thousand (1,500,000) shares, effective as of the date of the effective date of the Plan.

(b) The participant shall have no interest or voting rights in shares covered by his or her option until such option has been exercised.

(c) Shares to be delivered to a participant under the Plan shall be registered in the name of the participant or in the name of the participant and his or her spouse.

**14. Administration.** The Committee shall mean the Compensation Committee of the Board, a subcommittee thereof formed by the Compensation Committee to act as the Committee hereunder or such other committee of members of the Board as delegated by the Board. The Board or the Committee shall administer the Plan. The Board or the Committee shall have full and exclusive discretionary authority to construe, interpret and apply the terms of the Plan, to determine eligibility and to adjudicate all disputed claims filed under the Plan. Every finding, decision and determination made by the Board or the Committee shall, to the full extent permitted by law, be final and binding upon all parties. The Company will pay all expenses incurred in the administration of the Plan. No member of the Committee or individual acting on behalf of the Plan Administrator shall be personally liable for any action, determination, or interpretation made in good faith with respect to the Plan, and all members of the Committee and individuals acting on behalf of the Plan Administrator shall be fully indemnified by the Company with respect to any such good faith action, determination or interpretation.

## **15. Designation of Beneficiary.**

(a) A participant may file with the Plan Administrator a written designation of a beneficiary who is to receive any shares and cash from the participant's account under the Plan in the event of such participant's death subsequent to an Exercise Date on which the option is exercised but prior to delivery to such participant of such shares and cash. In addition, a participant may file with the Plan Administrator a written designation of a beneficiary who is to receive any cash from the participant's account under the Plan in the event of such participant's death prior to the exercise of the option. If a participant is married and the designated beneficiary is not the spouse, spousal consent shall be required for such designation to be effective.

(b) Such designation of beneficiary may be changed by the participant at any time by written notice to the Plan Administrator. In the event of the death of a participant and in the absence of a beneficiary validly designated under the Plan who is living at the time of such participant's death, the Company shall deliver such shares and/or cash to the executor or administrator of the estate of the participant, or if no such executor or administrator has been appointed (to the knowledge of the Company), the Company, in its discretion, may deliver such shares and/or cash to the spouse or to any one or more dependents or relatives of the participant, or if no spouse, dependent or relative is known to the Company, then to such other person as the Company may designate.

**16. Transferability.** Neither payroll deductions credited to a participant's account nor any rights with regard to the exercise of an option or to receive shares under the Plan may be assigned, transferred, pledged or otherwise disposed of in any way (other than by will, the laws of descent and distribution or as provided in Section 15 hereof) by the participant. Any such attempt at assignment, transfer, pledge or other disposition shall be without effect, except that the Company may treat such act as an election to withdraw funds from an Offering Period in accordance with Section 10 hereof.

**17. Use of Funds.** All payroll deductions received or held by the Company under the Plan may be used by the Company for any corporate purpose, and the Company shall not be obligated to segregate such payroll deductions.

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**18. Reports.** Individual accounts shall be maintained for each participant in the Plan. Statements of account shall be given to participating Employees at least annually, which statements shall set forth the amounts of payroll deductions, the Purchase Price, the number of shares purchased and the remaining cash balance, if any.

### **19. Adjustments Upon Changes in Capitalization, Dissolution, Liquidation, Merger or Asset Sale.**

(a) *Changes in Capitalization.* Subject to any required action by the stockholders of the Company, the Reserves, the maximum number of shares each participant may purchase each Purchase Period (pursuant to Section 7), as well as the price per share and the number of shares of Common Stock covered by each option under the Plan which have not yet been exercised shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, extraordinary cash dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been effected without receipt of consideration. Such adjustment shall be made by the Board or the Committee, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an option.

(b) *Dissolution or Liquidation.* In the event of a proposed dissolution or liquidation of the Company, the Offering Period then in progress shall be shortened by setting a new Exercise Date (the New Exercise Date), and shall terminate immediately prior to the consummation of such proposed dissolution or liquidation, unless provided otherwise by the Board. The New Exercise Date shall be before the date of the Company's proposed dissolution or liquidation. The Board shall notify each participant in writing, at least ten (10) business days prior to the New Exercise Date, that the Exercise Date for the participant's option has been changed to the New Exercise Date and that the participant's option shall be exercised automatically on the New Exercise Date, unless prior to such date the participant has withdrawn from the Offering Period as provided in Section 10 hereof.

(c) *Merger or Asset Sale.* In the event of a proposed sale of all or substantially all of the assets of the Company, or the merger of the Company with or into another corporation, each outstanding option shall be assumed or an equivalent option substituted by the successor corporation or a parent or subsidiary of the successor corporation. In the event that the successor corporation refuses to assume or substitute for the option, any Purchase Periods then in progress shall be shortened by setting a new Exercise Date (the New Exercise Date) and any Offering Periods then in progress shall end on the New Exercise Date. The New Exercise Date shall be before the date of the Company's proposed sale or merger. The Board shall notify each participant in writing, at least ten (10) business days prior to the New Exercise Date, that the Exercise Date for the participant's option has been changed to the New Exercise Date and that the participant's option shall be exercised automatically on the New Exercise Date, unless prior to such date the participant has withdrawn from the Offering Period as provided in Section 10 hereof.

### **20. Amendment or Termination.**

(a) The Board may at any time and for any reason terminate or amend the Plan. Except as provided in Section 19 hereof, no such termination can affect options previously granted, provided that an Offering Period may be terminated by the Board on any Exercise Date if the Board determines that the termination of the Offering Period or the Plan is in the best interests of the Company and its stockholders. Except as provided in Section 19 and this Section 20 hereof, no amendment may make any change in any option theretofore granted which adversely affects the rights of any participant. To the extent necessary to comply with Section 423 of the Code (or any successor rule or provision or any other applicable law, regulation or rule of the NASDAQ Stock Market or such other principal U.S. national securities exchange Common Stock is listed), the Company shall obtain stockholder approval in such a manner and to such a degree as required.

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(b) Without stockholder approval and without regard to whether any participant rights may be considered to have been adversely affected, the Board or the Committee shall be entitled to change the Offering Periods, limit the frequency and/or number of changes in the amount withheld during an Offering Period, establish the exchange ratio applicable to amounts withheld in a currency other than U.S. dollars, permit payroll withholding in excess of the amount designated by a participant in order to adjust for delays or mistakes in the Company's processing of properly completed withholding elections, establish reasonable waiting and adjustment periods and/or accounting and crediting procedures to ensure that amounts applied toward the purchase of Common Stock for each participant properly correspond with amounts withheld from the participant's Compensation, and establish such other limitations or procedures as the Board or the Committee determines in its sole discretion advisable which are consistent with the Plan.

(c) In the event the Board determines that the ongoing operation of the Plan may result in unfavorable financial accounting consequences, the Board may, in its discretion and, to the extent necessary or desirable, modify or amend the Plan to reduce or eliminate such accounting consequences including, but not limited to:

- (1) altering the Purchase Price for any Offering Period including an Offering Period underway at the time of the change in Purchase Price;
- (2) shortening any Offering Period so that the Offering Period ends on a new Exercise Date, including an Offering Period underway at the time of the Board action; and
- (3) allocating shares.

Such modifications or amendments shall not require stockholder approval or the consent of any Plan participants.

**21. Notices.** All notices or other communications by a participant to the Company under or in connection with the Plan shall be deemed to have been duly given when received in the form specified by the Company at the location, or by the person, designated by the Company for the receipt thereof.

**22. Conditions Upon Issuance of Shares.** Shares shall not be issued with respect to an option unless the exercise of such option and the issuance and delivery of such shares pursuant thereto shall comply with all applicable provisions of law, domestic or foreign, including, without limitation, the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the rules and regulations promulgated thereunder, and the requirements of the NASDAQ Stock Market (or any other principal U.S. national securities exchange on which the Common Stock may then be listed), and shall be further subject to the approval of counsel for the Company with respect to such compliance. As a condition to the exercise of an option, the Company may require the person exercising such option to represent and warrant at the time of any such exercise that the shares are being purchased only for investment and without any present intention to sell or distribute such shares if, in the opinion of counsel for the Company, such a representation is required by any of the aforementioned applicable provisions of law.

**23. Term of Plan.** The Plan shall become effective upon its approval by the stockholders of the Company and shall continue in effect until June 25, 2019, unless sooner terminated under Section 20 hereof.

**24. Miscellaneous.**

(a) *Administrative Costs.* The Company shall pay the administrative expenses associated with the operation of the Plan (other than brokerage commissions resulting from sales of Common Stock directed by Employees).

(b) *No Employment Rights.* Participation in the Plan shall not give an Employee any right to continue in the employment of the Company, and shall not affect the right of the Company to terminate the Employee's employment at any time, with or without cause.

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(c) *Repurchase of Stock.* The Company shall not be required to purchase or repurchase from any Employee any of the shares of Common Stock that the Employee acquires under the Plan.

(d) *Internal Revenue Code and ERISA Considerations.* The Plan is intended to constitute an employee stock purchase plan within the meaning of section 423 of the Internal Revenue Code of 1986, as amended, and the regulations thereunder. The provisions of the Plan, accordingly, shall be construed so as to comply with the requirements of that section of the Code or any successor provision, and the regulations thereunder. The Plan is not intended and shall not be construed as constituting an employee benefit plan, within the meaning of section 3(3) of the Employee Retirement Income Security Act of 1974, as amended.

(e) *Headings, Captions, Gender.* The headings and captions herein are for convenience of reference only and shall not be considered as part of the text. The masculine shall include the feminine, and vice versa.

(f) *Severability of Provisions, Prevailing Law.* The provisions of the Plan shall be deemed severable. If any provision of the Plan shall be held unlawful or otherwise invalid or unenforceable in whole or in part by a court of competent jurisdiction or by reason of a change in a law or regulation, such provision shall (a) be deemed limited to the extent that such court of competent jurisdiction deems it lawful, valid and/or enforceable and as so limited shall remain in full force and effect, and (b) not affect any other provision of the Plan or part thereof, each of which shall remain in full force and effect. The Plan shall be governed by the laws of the State of California to the extent such laws are not in conflict with, or superseded by, federal law.

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Arena Pharmaceuticals, Inc.

C123456789

	000004	00000000.000000 ext	00000000.000000 ext
MR A SAMPLE		00000000.000000 ext	00000000.000000 ext
		00000000.000000 ext	00000000.000000 ext

DESIGNATION (IF ANY)

**Electronic Voting Instructions**

**You can vote by Internet or telephone!**

**Available 24 hours a day, 7 days a week!**

ADD 1

ADD 2

ADD 3

ADD 4

ADD 5

ADD 6

Instead of mailing your proxy, you may choose one of the two voting methods outlined below to vote your proxy.

VALIDATION DETAILS ARE LOCATED BELOW IN THE TITLE BAR.

**Proxies submitted by the Internet or telephone must be received by 11:00 p.m. Pacific Time on June 24, 2009.**

**Vote by Internet**

Log on to the Internet and go to **www.investorvote.com/ARNA**. Follow the steps outlined on the secured website.

**Vote by telephone**

Call toll free 1-800-652-VOTE (8683) within the United States, Canada & Puerto Rico any time on a touch tone telephone. There is **NO CHARGE** to you for the call.

Using a **black ink** pen, mark your votes with an **X** as shown in this example. Please do not write outside the designated areas.

**X**

Follow the instructions provided by the recorded message.

q IF YOU HAVE NOT VOTED VIA THE INTERNET OR TELEPHONE, FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE. q



**A** Proposals The Board of Directors recommends a vote **FOR** all the nominees listed in Proposal 1 and **FOR** Proposals 2 through 5.

1. Election of Directors: For Withhold For Withhold For Withhold

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01 - Jack Lief	..	..	02 - Dominic P. Behan, Ph.D.	..	..	03 - Donald D. Belcher	..	..	+
04 - Scott H. Bice	..	..	05 - Harry F. Hixson, Jr., Ph.D.	..	..	06 - J. Clayburn La Force, Jr., Ph.D.	..	..	
07 - Tina S. Nova, Ph.D.	..	..	08 - Phillip M. Schneider	..	..	09 - Christine A. White, M.D.	..	..	
10 - Randall E. Woods	..	..							

	For	Against	Abstain		For	Against	Abstain
2. Approval of the Arena Pharmaceuticals, Inc., 2009 Long-Term Incentive Plan.	..	..	..	3. Approval of the Arena Pharmaceuticals, Inc., 2009 Employee Stock Purchase Plan.	..	..	..
4. Approval of an amendment to Arena's Fifth Amended and Restated Certificate of Incorporation to increase the total number of authorized shares from 150.0 million to 250.0 million and the number of authorized shares of common stock from 142.5 million to 242.5 million.	..	..	..	5. Ratification of the appointment of Ernst & Young LLP, an independent registered public accounting firm, as Arena's independent auditors for the fiscal year ending December 31, 2009.	..	..	..

**B**  
**Non-Voting Items**

**Change of Address** Please print new address below.

**Meeting Attendance**  
Mark box to the right if you plan to attend the Annual Meeting. ..

**IF VOTING BY MAIL, YOU MUST COMPLETE SECTIONS A - C ON BOTH SIDES OF THIS CARD.**

<STOCK#> 01238B

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¶ IF YOU HAVE NOT VOTED VIA THE INTERNET OR TELEPHONE, FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE. ¶

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Proxy **Arena Pharmaceuticals, Inc.**

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**THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS FOR**

**THE 2009 ANNUAL MEETING OF STOCKHOLDERS**

**6154 Nancy Ridge Drive, San Diego, California 92121**

The undersigned stockholder of ARENA PHARMACEUTICALS, INC., a Delaware corporation (the Company), hereby acknowledges receipt of the Notice of Annual Meeting of Stockholders and Proxy Statement, each dated May 15, 2009, and the Annual Report to Stockholders, and hereby appoints Jack Lief and Steven W. Spector, the President and the Secretary, respectively, of the Company, or each of them, as proxies and attorneys-in-fact, with all powers of substitution, to represent and vote, as set forth on the reverse side, the shares of Common Stock of the Company held of record by the undersigned at the close of business on April 27, 2009, at the 2009 Annual Meeting of Stockholders of the Company, which is being held at the offices of the Company at 6154 Nancy Ridge Drive, San Diego, California 92121, on Thursday, June 25, 2009, at 9:00 a.m. Pacific Time, and at any adjournments or postponements of such meeting, with all powers which the undersigned would possess if personally present at such meeting or at any such postponement or adjournment, and, in their discretion, to vote such shares upon any other business that may properly come before the meeting or any adjournments or postponements thereof.

**UNLESS OTHERWISE SPECIFIED BY THE UNDERSIGNED, THE PROXY WILL BE VOTED FOR ALL OF THE NOMINEES LISTED IN PROPOSAL 1 AND FOR PROPOSALS 2 THROUGH 5 AND WILL BE VOTED BY THE PROXYHOLDERS AT THEIR DISCRETION UPON ANY OTHER BUSINESS THAT MAY PROPERLY COME BEFORE THE ANNUAL MEETING OR ANY ADJOURNMENT OR POSTPONEMENTS THEREOF.**

(Items to be voted appear on reverse side.)



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**C** Authorized Signatures This section must be completed for your vote to be counted. Date and Sign Below

NOTE: Please sign your name(s) EXACTLY as your name(s) appear(s) on this proxy. All joint holders must sign. When signing as attorney, trustee, executor, administrator, guardian or corporate officer, please provide your FULL title.

Date (mm/dd/yyyy) Please print date below.

Signature 1 Please keep signature within the box.

Signature 2 Please keep signature within the box.

/ /

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**IF VOTING BY MAIL, YOU MUST COMPLETE SECTIONS A - C ON BOTH SIDES OF THIS CARD.**

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