PSEG

Energy Holdings L.L.C.

Quarterly Report
September 30, 2008

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

	For The Quarters Ended September 30,		For The Nine Months Ended September 30,	
	2008	2007	2008	2007
	(Millions) (Unaudited)			
OPERATING REVENUES				
Electric Generation Revenues	$ 333	$ 210	$ 651	$ 503
Income (Loss) from Leveraged and Operating Leases	18	31	(409)	96
Other	3	10	9	36
Total Operating Revenues	354	251	251	635
OPERATING EXPENSES				
Energy Costs	214	127	427	354
Operation and Maintenance	28	27	95	90
Write-down of Assets	—	12	—	12
Depreciation and Amortization	7	7	22	23
Total Operating Expenses	249	173	544	479
Income from Equity method Investments	8	30	27	87
OPERATING INCOME (LOSS)	113	108	(266)	243
Other Income	7	—	14	16
Interest Expense	(18)	(37)	(60)	(113)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	102	71	(312)	146
Income Tax Expense	(46)	(15)	(57)	(40)
INCOME (LOSS) FROM CONTINUING OPERATIONS	56	56	(369)	106
Income from Discontinued Operations, including Gain on Disposal, net of tax expense of $160, $4, $174 and $32 for the quarters and nine months ended 2008 and 2007, respectively	180	15	208	12
EARNINGS (LOSS) AVAILABLE TO PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED	$ 236	$ 71	$ (161)	$ 118

See Notes to Condensed Consolidated Financial Statements

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

	September 30, 2008	December 31, 2007
	(Millions) (Unaudited)	
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 45	$ 31
Accounts Receivable:		
Accounts Receivable, net of allowances of $1 in 2008	25	4
Affiliated Companies	1	1
Other	10	—
Notes Receivable – Affiliated Companies	670	841
Inventory	20	19
Restricted Funds	110	57
Assets of Discontinued Operations	122	1,323
Derivative Contracts	39	18
Deferred Income Taxes	28	—
Other	9	5
Total Current Assets	1,079	2,299
PROPERTY, PLANT AND EQUIPMENT	847	851
Less: Accumulated Depreciation and Amortization	(150)	(133)
Net Property, Plant and Equipment	697	718
NONCURRENT ASSETS		
Leveraged Leases, net	2,298	2,826
Corporate Joint Ventures and Partnership Interests	231	223
Intangibles	9	—
Derivative Contracts	40	43
Other	76	54
Total Noncurrent Assets	2,654	3,146
TOTAL ASSETS	$ 4,430	$ 6,163

See Notes to Condensed Consolidated Financial Statements

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

	September 30, 2008	December 31, 2007
	(Millions) (Unaudited)	
LIABILITIES AND MEMBERS' EQUITY		
CURRENT LIABILITIES		
Long-Term Debt Due Within One Year	$ 45	$ 645
Accounts Payable:		
Trade	12	4
Affiliated Companies	69	138
Derivative Contracts	17	3
Accrued Interest	13	19
Deferred Income Taxes	—	150
Liabilities of Discontinued Operations	68	596
Other	39	80
Total Current Liabilities	263	1,635
NONCURRENT LIABILITIES		
Deferred Income Taxes and Investment Tax Credits (ITC)	1,026	1,855
Derivative Contracts	3	4
Long-Term Accrued Taxes	1,109	319
Other	34	33
Total Noncurrent Liabilities	2,172	2,211
COMMITMENTS AND CONTINGENT LIABILITIES (See Note 4)		
MINORITY INTERESTS	11	6
LONG-TERM DEBT		
Senior Notes	525	530
Project Level, Non-Recourse Debt	301	346
Total Long-Term Debt	826	876
MEMBER'S EQUITY		
Ordinary Unit	838	838
Retained Earnings	315	496
Accumulated Other Comprehensive Loss	5	101
Total Member's Equity	1,158	1,435
TOTAL LIABILITIES AND MEMBER'S EQUITY	$ 4,430	$ 6,163

See Notes to Condensed Consolidated Financial Statements

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

	For The Nine Months Ended September 30,	
	2008	2007
	(Millions) (Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (Loss) Income	$ (161)	$ 118
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
(Gain) Loss on Disposal of Discontinued Operations, net of tax	(187)	—
Depreciation and Amortization	23	43
Provision for Deferred Income Taxes (Other than Leases) and ITC	(149)	(27)
Non-Cash Employee Benefit Plan Costs	1	1
Lease Reserves, Net of Taxes	490	—
Leveraged Lease Income, Adjusted for Rents Received and Deferred Taxes	20	46
Undistributed Earnings from Affiliates	(32)	(5)
Change in Fair Value of Derivative Financial Instruments	(32)	(12)
Net Change in Certain Current Assets and Liabilities	(104)	77
Other	(76)	10
Net Cash (Used In) Provided By Operating Activities	(207)	251
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to Property, Plant and Equipment	(6)	(34)
Proceeds from Sale of Discontinued Operations	772	—
Proceeds from Sale of Property, Plant and Equipment	—	12
Proceeds from the Sale of Capital Leases and Investments	37	17
Notes Receivable – Affiliated Company, net	171	(229)
Restricted Funds	(53)	(3)
Other	(2)	(8)
Net Cash Provided By (Used In) Investing Activities	919	(245)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of Non-Recourse Debt	—	163
Repayment of Senior Notes	(612)	—
Repayment of Project-Level, Non-Recourse Debt	(38)	(35)
Premium Paid on Early Extinguishment of Debt	(48)	—
Return of Contributed Capital	—	(145)
Other	—	(4)
Net Cash Used In Financing Activities	(698)	(21)
Effect of Exchange Rate Change	—	2
Net Increase (Decrease) in Cash and Cash Equivalents	14	(13)
Cash and Cash Equivalents at Beginning of Period	31	58
Cash and Cash Equivalents at End of Period	$ 45	$ 45
Supplemental Disclosure of Cash Flow Information:		
Income Taxes Paid (Received)	$ 322	$ (93)
Interest Paid, Net of Amounts Capitalized	$ 41	$ 102

See Notes to Condensed Consolidated Financial Statements

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Organization and Basis of Presentation

Organization

PSEG Energy Holdings L.L.C. (Energy Holdings) is a wholly owned subsidiary of Public Service Enterprise Group Incorporated (PSEG). Energy Holdings has two principal direct wholly owned subsidiaries: PSEG Global L.L.C. (Global) and PSEG Resources L.L.C. (Resources).

Global

Global has investments in power producers that own and operate electric generation. Global owns 100% of PSEG Texas, LP (PSEG Texas) which owns and operates two gas-fired, combined cycle generation facilities with a total generating capacity of 2,000 MW; one in Guadalupe County in south central Texas (Guadalupe) and one in Odessa in western Texas (Odessa). Guadalupe and Odessa each has generation capacity of 1,000 MW.

Global has other domestic projects in California and Hawaii, with smaller investments in New Hampshire and Pennsylvania. Global has reduced its international risk by monetizing the majority of its international investments. In July 2008, Global closed on the sale of its largest remaining international investment in the SAESA Group. In August 2008, Global entered into an agreement to sell its 85% ownership interest in Bioenergie S.p.A. (Bioenergie), which was completed in November 2008. For additional information, see Note 3. Discontinued Operations, Dispositions and Impairments. Global's remaining international investments in Venezuela and India had a total net book value of $52 million as of September 30, 2008.

Resources

Resources has investments in energy-related financial transactions and manages a diversified portfolio of assets, including leveraged leases, operating leases, a leveraged buyout fund, limited partnerships and marketable securities.

Enterprise Group Development Corporation (EGDC)

Energy Holdings also owns EGDC, a commercial real estate property management business. Energy Holdings' investment in EGDC was $50 million as of September 30, 2008.

Basis of Presentation

The Condensed Consolidated Financial Statements included herein have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). These Condensed Consolidated Financial Statements and Notes to Condensed Consolidated Financial Statements (Notes) should be read in conjunction with and update and supplement matters discussed in Energy Holdings' Annual Report for the year ended December 31, 2007 and Quarterly Reports for the quarters ended March 31, 2008 and June 30, 2008.

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 Sheet was derived from the audited Consolidated Financial Statements included in the Annual Report for the year ended December 31, 2007.

Reclassifications

Certain reclassifications have been made to the prior period financial statements to conform to the 2008 presentation. Operating results for the SAESA Group and Bioenergie were reclassified to Income from Discontinued Operations on the Condensed Consolidated Statements of Operations of Energy Holdings for the quarter and nine months ended September 30, 2007. See Note 3. Discontinued Operations, Dispositions and Impairments.

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 Energy Holdings.

Energy Holdings will adopt the following new standards effective January 1, 2009 and do not anticipate a material impact to its financial statements upon adoption.

- **Statement of Financial Accounting Standards (SFAS) No. 141 (revised 2007), "Business Combinations" (SFAS 141(R))**

In December 2007, the FASB issued SFAS 141(R) which will change financial accounting and reporting of business combination transactions. It is based on the principle that all assets acquired and liabilities assumed in a business combination should be measured at their acquisition date fair values, with limited exceptions. This standard applies to all transactions and events in which an entity obtains control of one or more businesses of an acquiree. The standard also expands the definition of a business. A transaction formerly recorded as an asset acquisition may qualify as a business combination under SFAS 141(R). It also requires that acquisition-related costs and certain restructuring costs be recognized separately from the business combination.

Any business combinations for which the acquisition date is on or after January 1, 2009 will be accounted for under this new guidance.

- **SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin (ARB) No. 51" (SFAS 160)**

In December 2007, the FASB issued SFAS 160 which significantly changes the financial reporting relationship between a parent and non-controlling interests (i.e. minority interests). SFAS 160 requires all entities to report minority interests in subsidiaries as a separate component of equity in the consolidated financial statements. Accordingly, the amount of net income attributable to the noncontrolling interest is required to be included in consolidated net income on the face of the income statement. Further, SFAS 160 requires that transactions between a parent and noncontrolling interests should be treated as equity. However, if a subsidiary is deconsolidated, a parent is required to recognize a gain or loss.

SFAS 160 will be applied prospectively, except for presentation and disclosure requirements which are required to be applied retrospectively.

- **SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133" (SFAS 161)**

In March 2008, the FASB issued SFAS 161 which expands derivative disclosures by requiring an entity to disclose: i) an understanding of how and why an entity uses derivatives, ii) an understanding of how derivatives and related hedged items are accounted for and iii) transparency into the overall impact of derivatives on an entity's financial statements.

- **FASB Staff Position (FSP) FAS 142-3, "Determination of the Useful Life of Intangible Assets" (FSP FAS 142-3)**

In April 2008, the FASB issued FSP FAS 142-3 to amend the factors an entity should consider in determining the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets." The FSP would allow an entity to consider its own experience regarding renewals and extensions, as long as an entity's own experience is consistent with the intended use of similar assets. If an entity lacks such experience, it would look to market participant information that is consistent with the highest and best use of the asset and make adjustments for other entity-specific factors.

- **Emerging Issues Task Force (EITF) Issue No. 08-5, "Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Guarantee" (EITF 08-5)**

In September 2008, the FASB ratified the EITF 08-5 consensus on fair valuing of liabilities that are recognized or disclosed at fair value and have third party guarantees or other third party credit enhancements. Under EITF 08-5, an issuer of a liability with third party guarantees or other third party credit enhancements would not include the effect of the third party guarantees (or credit enhancements) in the fair value measurement of the liability.

Energy Holdings will adopt the following new standard when effective. Energy Holdings does not anticipate a material impact to its financial statements upon adoption.

- **FSP FAS 133-1 and FASB Interpretation (FIN) 45-4, "Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161" (FSP FAS 133-1 and FIN 45-4)**

In September 2008, the FASB issued FSP FAS 133-1 and FIN 45-4 to require enhanced disclosures for credit derivatives within the scope of SFAS 133 and all financial guarantees subject to FIN 45.

The FSP amends FAS 133 to require sellers of credit derivatives, including credit derivatives embedded in hybrid instruments, to disclose information that would enable users of the financial information to assess the potential effect of the instruments on the reporting company's financial position. It also amends FIN 45 to require guarantors to disclose the current status of the payment / performance risk.

FSP FAS 133-1 and FIN 45-4 are effective for reporting periods ending after November 15, 2008. Earlier adoption is encouraged. Energy Holdings will include additional disclosures, as suggested by this FSP, in its annual financial statements for 2008 and subsequent interim and annual periods and does not anticipate a material impact to its financial statements upon adoption.

FSP FAS 133-1 and FIN 45-4 also clarify the effective date for SFAS 161, stating that the disclosure requirements of SFAS 161 will be effective for quarterly periods beginning after November 15, 2008 and fiscal years that include those periods.

The following new accounting standards were adopted by Energy Holdings during 2008.

- **SFAS No. 157, "Fair Value Measurements" (SFAS 157)**

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.

Energy Holdings adopted SFAS 157 (except for certain non-financial assets and non-financial liabilities as described in FSP FAS 157-2) effective January 1, 2008. In accordance with the provisions of SFAS 157, Energy Holdings recorded a cumulative effect adjustment of $22 million (after-tax) to January 1, 2008 Retained Earnings associated with the implementation of SFAS 157. In February 2008, the FASB issued FSP FAS 157-2 to partially defer the effective date of SFAS 157 for certain nonfinancial assets and nonfinancial liabilities. In February 2008, the FASB issued FSP FAS 157-1 to exclude leasing transactions from SFAS 157's scope. In October 2008, the FASB also issued FSP FAS 157-3 to address entities' concerns about lack of observable markets or observable inputs in determining the fair value of a financial asset when the market for that asset is not active.

For additional information, see Note 12. Fair Value Measurements.

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

In February 2007, the FASB issued SFAS 159, which permits entities to measure many financial instruments and certain other items at fair value that would not otherwise be required to be measured at fair value. An entity would report unrealized gains and losses in earnings at each subsequent reporting date on items for which the fair value option has been elected. 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 whether to elect the fair value option is applied instrument by instrument, with a few exceptions. The decision is irrevocable and it is required to be applied only 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 was 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.

Energy Holdings adopted SFAS 159 effective January 1, 2008; however, to date, Energy Holdings has not elected to measure any of its assets or liabilities at fair value under this standard.

Note 3. Discontinued Operations, Dispositions and Impairments

Discontinued Operations

Bioenergie

In November 2008, PSEG Global sold its 85% ownership interest in Bioenergie, which owns three biomass generation plants in Italy through its ownership of 100% of San Marco Bioenergie S.p.A. and 50% of Biomasse for $40 million. The sale resulted in after tax losses of $11 million, which were recorded in 2008, including the impairment and related tax benefits discussed below. After realization of tax benefits, the sale will produce after-tax cash to Energy Holdings of approximately $70 million.

Bioenergie's operating results for the quarters and nine months ended September 30, 2008 and 2007, which are included in Discontinued Operations, are summarized below:

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(Millions)			
Operating Revenues	$ 13	$ 10	$ 35	$ 10
Income (Loss) Before Income Taxes	$ (29)	$ 1	$ (28)	$ (10)
Net Income (Loss)	$ (8)	$ 1	$ (9)	$ (13)

Bioenergie's operating results for the quarter and nine months ended September 30, 2008 include a pre-tax impairment charge of $33 million and related tax benefits of $13 million.

The carrying amounts of Bioenergie's assets as of September 30, 2008 and December 31, 2007 are summarized in the following table:

	As of September 30, 2008	As of December 31, 2007
	(Millions)	
Current Assets	$ 25	$ 23
Noncurrent Assets	97	138
Total Assets of Discontinued Operations	$ 122	$ 161
Current Liabilities	$ 21	$ 21
Noncurrent Liabilities	47	55
Total Liabilities of Discontinued Operations	$ 68	$ 76

SAESA Group

In June 2008, Global signed an agreement to sell its investment in the SAESA Group, which consists of four distribution companies, one transmission company and a generation facility located in Chile. The sale was completed in July 2008 for a total purchase price of $1.3 billion, including the assumption of $413 million of the consolidated debt of the group. The sale resulted in an after-tax gain of $187 million, which is reported as Gain on Disposal of Discontinued Operations. Net cash proceeds, after Chilean and U.S. taxes of $269 million, were $612 million. A tax charge of $82 million was recognized in the fourth quarter of 2007 relating to the discontinuation of applying Accounting Principle Board No. 23, "Accounting for Income Taxes—Special Areas."

SAESA Group's operating results for the quarters and nine months ended September 30, 2008 and 2007, which are included in Discontinued Operations, are summarized below:

	Quarters Ended September 30, 2008	Quarters Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
	(Millions)			
Operating Revenues	$ 38	$ 119	$ 379	$ 317
Income (Loss) Before Income Taxes	$ (5)	$ 11	$ 36	$ 40
Net Income	$ 1	$ 10	$ 30	$ 35

The carrying amounts of SAESA Group's assets as of December 31, 2007 are summarized in the following table:

	As of December 31, 2007
	(Millions)
Current Assets	$ 191
Noncurrent Assets	971
Total Assets of Discontinued Operations	$ 1,162
Current Liabilities	$ 130
Noncurrent Liabilities	390
Total Liabilities of Discontinued Operations	$ 520

Electroandes S.A. (Electroandes)

On October 17, 2007, Global sold its investment in Electroandes, a hydro-electric generation and transmission company in Peru that owns and operates four hydro-generation plants with total capacity of 180 MW and 437 miles of electric transmission lines, for a total purchase price of $390 million, including the assumption of approximately $108 million of debt.

Electroandes' operating results for the quarter and nine months ended September 30, 2007, which are included in Discontinued Operations, are summarized below:

	Quarter Ended September 30, 2007	Nine Months Ended September 30, 2007
	(Millions)	
Operating Revenues	$ 14	$ 38
Income Before Income Taxes	$ 7	$ 14
Net Income (Loss)	$ 4	$ (10)

Dispositions

Chilquinta Energia S.A. (Chilquinta) and Luz del Sur S.A.A. (LDS)

In December 2007, Global closed on the sales of its ownership interest in the Chilean electric distributor, Chilquinta and its affiliates, and in the Peruvian electric distributor, LDS and its affiliates, for $685 million. Net cash proceeds after taxes were approximately $480 million, which resulted in an after-tax loss of $23 million.

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

In January 2007, Global sold its interest in Tracy Biomass for approximately $7 million, resulting in a 2007 pre-tax gain of approximately $7 million ($6 million after-tax).

Impairments

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 Company Inc. (Turboven), an entity which is jointly-owned by Global (50%) and Corporacion Industrial de Energia (CIE). Global also has a 9% indirect interest in Turbogeneradores de Maracay through a partnership with CIE.

During 2007, the Venezuelan government announced its intention to nationalize certain sectors of Venezuelan industry and commerce, including Turboven. Global entered into valuation discussions with the government of Venezuela as part of the nationalization efforts and, based upon a review of the circumstances in September 2007, recorded an impairment charge of $11 million ($7 million, after-tax), reflecting Global's estimated market valuation of the project.

Note 4. Commitments and Contingent Liabilities

Leveraged Lease Investments

In November 2006, the IRS issued its Revenue Agent's Report with respect to its audit of PSEG's federal corporate income tax returns for tax years 1997 through 2000, which disallowed all deductions associated with certain lease transactions that are similar to a type that the IRS publicly announced its intention to challenge. In addition, the IRS Report proposed a 20% penalty for substantial understatement of tax liability. In February 2007, Energy Holdings filed a protest of these findings with the Office of Appeals of the IRS.

In April 2008, the IRS issued its Revenue Agent's Report for tax years 2001 through 2003, which disallowed all deductions associated with lease transactions similar to those disallowed in its 1997 through 2000 Report. As in its prior report, the IRS proposed a 20% penalty. Energy Holdings also filed a protest to this report with the Office of Appeals of the IRS.

As of September 30, 2008 and December 31, 2007, Resources' total gross investment in such transactions was $1 billion and $1.5 billion, respectively.

Energy Holdings has been in discussions with the Office of Appeals of the IRS concerning the deductions that have been disallowed. Energy Holdings believes that its tax position related to these transactions was proper based on applicable statutes, regulations and case law in effect at the time that the deductions were taken.

There are several tax cases involving other taxpayers with similar leveraged lease investments that are pending. To date, three cases have been decided at the trial court level, two of which were decided in favor of the government. An appeal of one of these decisions was recently affirmed. The third case involves a jury verdict that is currently being challenged by both parties on inconsistency grounds.

In August 2008, the IRS publicly announced that it was issuing letters to a number of taxpayers with these types of lease transactions containing a generic settlement offer. Energy Holdings did not accept the IRS' settlement offer and will likely proceed to litigation.

Earnings Impact

As a result of the recent court decisions regarding these types of leveraged lease transactions, Energy Holdings evaluated its unrecognized tax benefits under FIN 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement 109" (FIN 48), and recorded an after-tax increase to the interest reserve of $135 million in the second quarter of 2008. This charge is recorded in Income Tax Expense in Energy Holdings' Condensed Consolidated Statements of Operations. The after-tax increase to the interest reserve charged to income in the third quarter was $10 million.

Assuming all rental payments are made pursuant to the original lease agreement, and there are no changes in tax legislation and rates, the total cash and income included in a leveraged lease transaction will not change over the lease term. However, the timing of the cash flow can change due to changes in the timing of tax deductions. Changes in the timing of cash flows affect the overall return, or yield, that is recorded as income at a constant rate throughout the lease term. If there is a change in cash flow timing, pursuant to FSP 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," the lease must be recalculated from inception assuming the new lease yield. Differences between the current gross lease investment and the gross lease investment per the recalculated lease must be recognized immediately in income.

In the second quarter of 2008, Energy Holdings recalculated its lease transactions, incorporating potential cash payments (discussed below) consistent with the FIN 48 reserve position, and recorded an after-tax charge of $355 million. This charge is reflected as a reduction in Operating Revenues of $485 million with a partially offsetting reduction in Income Tax Expense of $130 million in Energy Holdings' Condensed Consolidated Statement of Operations. The $355 million will be recognized as income over the remaining term of the affected leases. In the third quarter, the additional reduction of operating revenues was $10 million with a partially offsetting reduction in income tax expense of $2 million, resulting in a net after-tax income reduction of $8 million.

This represents Energy Holdings' view of most of the financial statement exposure related to these lease transactions, although a total loss, consistent with the broad settlement offer recently proposed by the IRS, would result in an additional earnings charge of $110 million to $130 million.

Cash Impact

As of September 30, 2008, an aggregate $1.2 billion would become currently payable if Energy Holdings conceded 100% of deductions taken through that date. In December 2007, Energy Holdings deposited $100 million with the IRS to defray potential interest costs associated with this disputed tax liability. In September 2008, Energy Holdings deposited an additional $80 million bringing to $180 million the total cash deposited with the IRS. In the event Energy Holdings is successful in defense of its position, the deposit is fully refundable with interest. These deposits reduce the $1.2 billion cash exposure noted above to approximately $1 billion. As of September 30, 2008, penalties of $151 million would also become payable if the IRS was successful in its deficiency claims against Energy Holdings, and asserted and successfully litigated a case against Energy Holdings regarding penalties. Energy Holdings has not established a reserve for penalties because it believes it has strong defenses to the assertion of penalties under applicable law. Interest and penalty exposure grow at the rate of $15 million per quarter. Should Energy Holdings lose its case in litigation, and the IRS is successful in a litigated case consistent with the positions it has taken in the generic settlement offer recently proposed, an additional $130 million to $150 million of tax would be due for tax positions through September 30, 2008.

Based on the status of discussions with the IRS, and considering developments in other cases, Energy Holdings currently anticipates that it will pay between $230 million and $360 million in tax, interest and penalties for the tax years 1997-2000 during the first half of 2009 and subsequently commence litigation to recover these amounts. Further it is possible that an additional payment of between $270 million and $550 million could be required in late 2009 for tax years 2001-2003 followed by further litigation to recover those taxes. Theses amounts are in addition to tax deposits made to date for the years referenced above.

The actions described above concerning the leveraged lease investments are not expected to violate any covenant or result in a default under either Energy Holdings' credit facility or Senior Notes indenture.

Sales and Fuel Supply Contracts

Approximately 40% to 50% of the expected output of PSEG Texas for 2008 has been sold via bilateral agreements and additional bilateral sales for peak and off-peak services are expected to be signed as the year progresses. Any remaining uncommitted output will be sold in the Texas spot market. Included in Odessa's 1,000 MW of generation capacity is a 350 MW daily capacity call option at Odessa that expires on December 31, 2010.

The Guadalupe and Odessa plants of PSEG Texas have entered into gas supply agreements for their anticipated fuel requirements to satisfy obligations under their forward energy sales contracts. As of September 30, 2008, the plants had fuel purchase commitments totaling $45 million to support all of their contracted energy sales.

Global's projects in California, Hawaii and New Hampshire are fully contracted under long-term Power Purchase Agreements (PPAs) with the public utilities or power procurers in those areas, therefore, Global does not have price risk with respect to the output of such assets. Fuel for Global's California projects is procured under shorter-term agreements with several suppliers and is subject to market price trends. Global's other risks related to these projects are primarily operational in nature and have historically been minimal.

Note 5. Financial Risk Management Activities

Energy Holdings' operations are exposed to market risks from changes in commodity prices, foreign currency exchange rates, interest rates and equity prices that could affect results of operations and financial conditions. Energy Holdings manages exposure to these market risks through its regular operating and financing activities and, when deemed appropriate, hedges these risks through the use of derivative financial instruments. Energy Holdings uses the term 'hedge' to mean a strategy designed to manage risks of volatility in prices or rate movements on certain assets, liabilities or anticipated transactions and by creating a relationship in which gains or losses on derivative instruments are expected to counterbalance the gains or losses on the assets, liabilities or anticipated transactions exposed to such market risks. Energy Holdings uses derivative instruments as risk management tools consistent with its business plan and prudent business practices.

Derivative Instruments and Hedging Activities

Energy Contracts

Cash Flow Hedges

Energy Holdings uses forward sale and purchase contracts and swaps to hedge forecasted energy sales from one of its generation stations. Energy Holdings also enters into swap transactions to hedge the price of fuel. These derivative transactions are designated and effective as cash flow hedges under SFAS 133. As of September 30, 2008, the fair value of these hedges was $4 million. During the 12 months ending September 30, 2009, substantially all of the after-tax unrealized gains on these commodity derivatives are expected to be reclassified to earnings. There was no ineffectiveness associated with these hedges, as defined in SFAS 133. These hedges resulted in an after-tax impact of $2 million on Accumulated Other Comprehensive Loss. The expiration date of the longest-dated cash flow hedge is in 2009.

Other Derivatives

PSEG Texas enters into electricity forward and capacity sales contracts to sell a portion of its 2,000 MW capacity with the balance sold into the daily spot market. PSEG Texas also enters into gas purchase contracts to specifically match the generation requirements to support the electricity forward sales contracts. Although these contracts fix the amount of revenue, fuel costs and cash flows, and thereby provide financial stability to PSEG Texas, these contracts are, based on their terms, derivatives that do not meet the specific accounting criteria in SFAS 133 to qualify for the normal purchases and normal sales exception, or to be designated as a hedge for accounting purposes. As a result, these contracts must be recorded at fair value through the Consolidated Statements of Operations. The net fair value of the open positions was $60 million and $63 million as of September 30, 2008 and December 31, 2007, respectively.

Interest Rates

Energy Holdings is subject to the risk of fluctuating interest rates in the normal course of business. Energy Holdings' policy is to manage interest rate risk through the use of fixed and floating rate debt and interest rate derivatives.

Other Derivatives

Energy Holdings uses interest rate swaps at PSEG Texas to manage its exposure to variability of cash flows, primarily related to variable-rate debt instruments. The interest rate derivatives were previously effective as cash flow hedges; however as of September 30, 2008 they were de-designated due to a change in their underlying interest basis. The fair value of these swaps recorded in Accumulated Other Comprehensive Loss as of September 30, 2008 was ($6) million and will be amortized to earnings over the remaining life of the underlying debt. The fair value changes of the swap beginning October 2008 will be marked to market through earnings.

Note 6. Comprehensive Income, Net of Tax

	For the Quarter Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
	(Millions)			
Net Income (Loss)	$ 236	$ 71	$ (161)	$ 118
Other Comprehensive (Loss) Income	(76)	32	(96)	51
Comprehensive Income (Loss)	$ 160	$ 103	$ (257)	$ 169

Accumulated Other Comprehensive Income (Loss)

	Balance as of December 31, 2007	2008 Activity	Balance as of September 30, 2008
		(Millions)	
For the Nine Months Ended September 30, 2008:			
Derivative Contracts	$ (6)	$ 4	$ (2)
Pension and OPEB Plans	—	(1)	(1)
Currency Translation Adjustment	107	(99)	8
	$ 101	$ (96)	$ 5

	Balance as of December 31, 2006	2007 Activity	Balance as of September 30, 2007
		(Millions)	
For the Nine Months Ended September 30, 2007:			
Derivative Contracts	$ (2)	$ (1)	$ (3)
Pension and OPEB Plans	(5)	—	(5)
Currency Translation Adjustment	110	52	162
	$ 103	$ 51	$ 154

Note 7. Changes in Capitalization

In March 2008, Energy Holdings repurchased $5 million of its $530 million then outstanding 8.50% Senior Notes due 2011.

In February 2008, Energy Holdings repaid at maturity $207 million of its 8.625% Senior Notes.

In January 2008, Energy Holdings redeemed its outstanding $400 million of 10% Senior Notes due 2009.

During the first nine months of 2008, Energy Holdings paid $48 million in premiums related to the early redemption of its outstanding debt.

During the first nine months of 2008, Energy Holdings' subsidiaries repaid $38 million of non-recourse debt, primarily related to the PSEG Texas generation facilities.

Note 8. Other Income

	For the Quarter Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
		(Millions)		
Interest and Dividend Income	$ 7	$ 2	$ 14	$ 8
Arbitration Award (Konya-Ilgin)	—	—	—	9
Other	—	(2)	—	(1)
Total Other Income	$ 7	$ —	$ 14	$ 16

Note 9. Pension and Other Postretirement Benefits (OPEB)

PSEG sponsors several qualified and nonqualified pension plans and OPEB plans covering Energy Holdings' and its participating affiliates' current and former employees who meet certain eligibility criteria. Energy Holdings' share of the net periodic benefit costs relating to all qualified and nonqualified pension and OPEB plans on an aggregate basis for the nine months ended September 30, 2008 and 2007 were $1 million.

Note 10. Income Taxes

An analysis of the tax provision expense is as follows:

	For the Quarter Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
	(Millions)			
Income (Loss) Before Income Taxes	$ 102	$ 71	$ (312)	$ 146
Tax Computed at the Statutory Rate	36	25	(109)	51
Increase (Decrease) Attributable to Flow Through of Certain Tax Adjustments:				
State Income Taxes after Federal Benefit	1	(1)	36	(2)
Foreign Operations	—	(13)	—	(19)
Uncertain Tax Positions	9	5	131	11
Other	—	(1)	(1)	(1)
Total Income Tax Expense	$ 46	$ 15	$ 57	$ 40
Effective Income Tax Rate	45.1%	21.1%	N/A	27.4%

Energy Holdings provides deferred taxes at the enacted statutory tax rate for all temporary differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities.

Energy Holdings and its subsidiaries adopted FIN 48 effective January 1, 2007, which prescribes a model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return.

On December 17, 2007 and September 15, 2008, Energy Holdings made tax deposits with the IRS in the amount of $100 million and $80 million, respectively, to defray interest costs associated with disputed tax assessments associated with certain lease investments (see Note 4. Commitments and Contingent Liabilities). The $180 million of deposits are fully refundable and is recorded as a reduction to the Unrecognized Tax Benefit liability on Energy Holdings' Condensed Consolidated Balance Sheet.

It is reasonably possible that total unrecognized tax benefits at Energy Holdings will decrease by approximately $23 million within the next 12 months due to either agreement with various taxing authorities upon audit or the expiration of the Statute of Limitations.

As a result of a change in accounting method for the capitalization of indirect costs, during the first nine months of 2008, Energy Holdings reduced the net amount of its unrecognized tax benefits by $41 million. Because the IRS agreed with Energy Holdings' change in accounting method, it is reasonably possible that our claim related to this matter will be settled with the IRS in the next 12 months, resulting in an increase in the unrecognized tax benefits.

Note 11. Financial Information by Business Segments

Information related to the segments of Energy Holdings and its subsidiaries is detailed below:

	Resources	Global	Other (A)	Consolidated
For the Quarter Ended September 30, 2008:		(Millions)		
Total Operating Revenues	$ 18	$ 332	$ 4	$ 354
(Loss) Income From Continuing Operations	(11)	67	—	56
Loss from Discontinued Operations, net of tax	—	(7)	—	(7)
Gain on Disposal of Discontinued Operations, net of tax	—	187	—	187
Net (Loss) Income	(11)	247	—	236
Segment (Loss) Earnings	(11)	247	—	236
Gross Additions to Long-Lived Assets	1	1	—	2
For the Quarter Ended September 30, 2007:				
Total Operating Revenues	$ 40	$ 209	$ 2	$ 251
Income From Continuing Operations	15	41	—	56
Income from Discontinued Operations, net of tax	—	15	—	15
Net Income	15	56	—	71
Segment Earnings	15	56	—	71
Gross Additions to Long-Lived Assets	—	5	—	5
For the Nine Months Ended September 30, 2008:				
Total Operating (Loss) Revenues	$ (408)	$ 651	$ 8	$ 251
(Loss) Income From Continuing Operations	(466)	99	(2)	(369)
Income from Discontinued Operations, net of tax	—	21	—	21
Gain on Disposal of Discontinued Operations, net of tax	—	187	—	187
Net (Loss) Income	(466)	307	(2)	(161)
Segment (Loss) Earnings	(466)	307	(2)	(161)
Gross Additions to Long-Lived Assets	2	4	—	6
For the Nine Months Ended September 30, 2007:				
Total Operating Revenues	$ 119	$ 510	$ 6	$ 635
Income (Loss) From Continuing Operations	46	62	(2)	106
Income from Discontinued Operations, net of tax	—	12	—	12
Net Income (Loss)	46	74	(2)	118
Segment Earnings (Loss)	46	74	(2)	118
Gross Additions to Long-Lived Assets	1	33	—	34
As of September 30, 2008:				
Total Assets	$ 2,475	$ 1,652	$ 303	$ 4,430
Investments in Equity Method Subsidiaries	$ —	$ 195	$ —	$ 195
As of September 30, 2008:				
Total Assets	$ 2,992	$ 2,334	$ 837	$ 6,163
Investments in Equity Method Subsidiaries	$ —	$ 208	$ —	$ 208

(A) Energy Holdings' other activities include amounts applicable to Energy Holdings (as parent company) and EGDC. No gains or losses are recorded on any intercompany transactions; rather, all intercompany transactions are at cost. For a further discussion of the intercompany transactions, see Note 13. Related-Party Transactions.

Note 12. Fair Value Measurements

Effective January 1, 2008, Energy Holdings adopted SFAS 157 except for non-financial assets and liabilities as described in FSP FAS 157-2 and discussed in Note 2. Recent Accounting Standards. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and establishes a fair value hierarchy that distinguishes between assumptions based on market data obtained from independent sources and those based on an entity's own assumptions. The hierarchy prioritizes the inputs to fair value measurement into three levels:

Level 1—measurements utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that Energy Holdings has the ability to access. These consist primarily of listed equity securities, exchange traded derivatives and certain U.S. government treasury securities.

Level 2—measurements include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and other observable inputs such as interest rates and yield curves that are observable at commonly quoted intervals. These consist primarily of non-exchange traded derivatives such as forward contracts or options and most fixed income securities.

Level 3—measurements use unobservable inputs for assets or liabilities, are based on the best information available and might include an entity's own data. In some valuations, the inputs used may fall into different levels of the hierarchy. In these cases, the financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. These consist mainly of various firm transmission rights (FTRs), other longer term capacity and transportation contracts and certain commingled securities.

In addition to establishing a measurement framework, SFAS 157 nullifies the guidance of EITF 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) which did not allow an entity to recognize an unrealized gain or loss at the inception of a derivative instrument unless the fair value of that instrument was obtained from a quoted market price in an active market or was otherwise evidenced by comparison to other observable current market transactions or based on a valuation technique incorporating observable market data. Under EITF 02-3, Energy Holdings had a deferred inception loss of $34 million, (pre-tax), as of December 31, 2007 related to a five-year capacity contract at its Texas generation facilities, which was being amortized at $11 million per year through 2010. In accordance with the provisions of SFAS 157, Energy Holdings recorded a cumulative effect adjustment of $22 million (after-tax) to January 1, 2008 Retained Earnings in its Condensed Consolidated Balance Sheet associated with the implementation of SFAS 157.

The following table presents information about Energy Holdings' assets and liabilities measured at fair value on a recurring basis at September 30, 2008, including the fair value measurements and the levels of inputs used in determining those fair values.

Recurring Fair Value Measurements as of September 30, 2008

Description	Total as of September 30, 2008	Quoted Market Prices for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(Millions)			
Assets:				
Derivative Contracts:				
Commodity Contracts (A)	$ 79	$ —	$ 18	$ 61
Rabbi Trusts (B)	$ 15	$ 1	$ 12	$ 2
Other Long-Term Investments (C)	$ 1	$ 1	$	$ —
Liabilities:				
Derivative Contracts:				
Commodity Contracts (A)	$ (15)	$ —	$ (15)	$ —
Interest Rate Swaps (D)	$ (6)	$ —	$ (6)	$ —

(A) Commodity contracts primarily include more complex agreements for which limited pricing information is available. These contracts are valued using modeling techniques and assumptions reflective of contractual terms, current market rates, forward price curves, discount rates and risk factors, as applicable.

(B) The Rabbi Trusts maintain investments in various equity and fixed income securities classified as "available for sale" under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." These securities are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. All fair value measurements for the fund securities are provided by the trustees of these funds. Most equity securities are priced utilizing the principal market close price or in some cases midpoint, bid or ask price (primarily Level 1). Fixed income securities are priced using an evaluated pricing approach or the most recent exchange or quoted bid (primarily Level 2). Short-term investments are valued based upon internal matrices using observable market prices or market parameters such as time-to-maturity, coupon rate, quality rating and current yield (primarily Level 2). Certain commingled cash equivalents included in temporary investment funds are measured with significant unobservable inputs and internal assumptions (primarily Level 3).

(C) Other long-term investments consist of equity securities and are valued using a market based approach based on quoted market prices.

(D) Interest rate swaps are valued using quoted prices on commonly quoted intervals, which are interpolated for periods different than the quoted intervals, as inputs to a market valuation model. Market inputs can generally be verified and model selection does not involve significant management judgment.

A reconciliation of the beginning and ending balances of Level 3 derivative contracts and securities follows:

Changes in Level 3 Assets Measured at Fair Value on a Recurring Basis for the Quarter Ending September 30, 2008

	Balance as of July 1, 2008	Total Gains Realized/Unrealized Included in Income (A)	Purchases and (Sales)	Balance as of September 30, 2008
	(Millions)			
Derivative Assets	$ 47	$ 14	$ —	$ 61
Rabbi Trusts	$ 2	$ —	$ —	$ 2

Changes in Level 3 Assets Measured at Fair Value on a Recurring Basis for the Nine Months Ending September 30, 2008

	Balance as of January 1, 2008	Total Gains Realized/Unrealized Included in Income (B)	Purchases and (Sales)	Balance as of September 30, 2008
	(Millions)			
Derivative Assets	$ 28	$ 33	$ —	$ 61
Rabbi Trusts	$ 1	$ —	$ 1	$ 2

(A) Energy Holdings' gains and losses are mainly attributable to changes in derivative assets at PSEG Texas, which are included in Operating Revenues.

(B) Energy Holdings' gains and losses are mainly attributable to changes in derivative assets at PSEG Texas, which are included in Operating Revenues.

As of September 30, 2008, Energy Holdings carried approximately $75 million of net assets that are measured at fair value on a recurring basis, of which approximately $63 million are measured using unobservable inputs and classified as level 3 within the fair value hierarchy. These Level 3 net assets represent approximately 1% of Energy Holdings' total assets and there were no significant transfers in or out of Level 3 during the quarter ended September 30, 2008. The overall impact of gains and losses associated with Level 3 assets was immaterial to Energy Holdings' Condensed Consolidated Financial Statements for the quarter.

Note 13. Related-Party Transactions

Tax Sharing Agreements

Energy Holdings is included in a consolidated federal income tax filed by PSEG. A tax allocation agreement exists between PSEG and Energy Holdings. The general operation of these agreements is that the subsidiary company will compute its taxable income on a stand-alone basis. If the result is a net tax liability, such amount shall be paid to PSEG. If there are net operating losses and/or tax credits, the subsidiary shall receive for the tax savings from PSEG to the extent that PSEG is able to utilize those benefits.

As of September 30, 2008 and December 31, 2007, Energy Holdings had a payable to PSEG of $49 million and $103 million, respectively related to its taxes.

In addition to these tax payable amounts, as of September 30, 2008, Energy Holdings had a $20 million current payable and $1,109 million long-term payable to PSEG related to unrecognized tax positions. As of December 31, 2007, Energy Holdings had a $38 million current payable and $319 million long-term payable to PSEG related to unrecognized tax positions. Energy Holdings and its subsidiaries adopted FIN 48 effective January 1, 2007, which prescribes a model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return. See Note 10. Income Taxes for additional information.

PSEG Services Corporation (Services)

Services is a wholly owned subsidiary of PSEG and provides management and administrative and general services to PSEG and its subsidiaries. These include accounting, treasury, financial risk management, law, tax communications, planning, development, human resources, corporate secretarial, information technology, investor relations, stockholder services, real estate, insurance, library, records and information services, security and certain other services. Services charges Energy Holdings and its subsidiaries for the cost of work performed and services provided pursuant to the terms and conditions of intercompany service agreements. Energy Holdings believes that the costs of services provided by Services approximate market value for such services.

In addition, Energy Holdings has other payables to Services, including amounts related to certain common costs, such as pension and other postretirement benefits (OPEB) costs, which Services pays on behalf of each of the operating companies. Services' billings to Energy Holdings for the each of the quarters ended September 30, 2008 and 2007 were $6 million and $4 million, respectively. Services' billings to Energy Holdings for each of the nine month periods ended September 30, 2008 and 2007 were $17 million and $14 million, respectively. Energy Holdings' payable to Services as of September 30, 2008 and December 31, 2007 was $3 million and $2 million, respectively.

Affiliate Loans and Advances

As of September 30, 2008 and December 31, 2007, Energy Holdings had a demand note receivable from PSEG of $670 million and $841 million, respectively, for short-term funding needs.