

DANIELSON HOLDING CORP

Form 424B5

May 18, 2004

PROSPECTUS SUPPLEMENT TO PROSPECTUS DATED MAY 2, 2001

## Danielson Holding Corporation

### UP TO 27,438,118 SHARES OF COMMON STOCK

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We are conducting a rights offering and issuing at no charge one non-transferable warrant with respect to each share of our common stock outstanding as of the close of business on May 17, 2004. Holders of warrants will be entitled to purchase 0.75 shares of our common stock for every warrant held at an exercise price of \$1.53 per share. If other holders of warrants do not fully exercise their warrants, you may be able to purchase additional shares at the exercise price. This is your oversubscription privilege. If all of the warrants are exercised in the rights offering, the total purchase price of our common stock in the rights offering will be \$41,980,321.

The warrants are exercisable beginning on the date of this prospectus supplement and will expire if they are not exercised by 5:00 p.m., New York City time, on June 9, 2004, unless extended by us from time to time in our sole discretion. Warrants that are not exercised by the expiration date of the rights offering will expire and will have no value. Warrants are not separately transferable. You should note that immediately available funds must be received by the expiration date for an exercise to be valid. Although personal checks will be accepted, if they have not cleared by the expiration date the exercise will not be valid. See *The Rights Offering* for more information on how to exercise your warrants. Holders who exercise their warrants will not be entitled to revoke their exercise. Holders who do not exercise their warrants will relinquish any value inherent in the warrants and their relative ownership level of our outstanding common stock will decrease.

**In order to avoid an ownership change for federal income tax purposes, our certificate of incorporation prohibits any person from becoming a holder of 5% or more of our outstanding common stock, except under limited circumstances. Consequently, there are limitations on the exercise of the warrants as described in this prospectus.**

In order to avoid an ownership change for federal income tax purposes, we have implemented certain escrow protection mechanics as follows: (1) by exercising warrants, each holder will represent to us that such holder will not be, after giving effect to the exercise of warrants and oversubscription privileges, an owner of more than 2,850,000 shares of our common stock; (2) if such exercise would result in such holder owning, directly or indirectly, as described in this prospectus supplement, more than 2,850,000 shares of our common stock, such holder must notify the warrant agent, American Stock Transfer & Trust Company, at the telephone number included in this prospectus supplement; (3) if requested, each holder will be required to provide us with additional information regarding the amount of common stock that the holder owns; and (4) we have the right to instruct the warrant agent to refuse to honor such holder's exercise to the extent such exercise might, in our sole and absolute discretion, result in such holder owning at least 3,201,113 shares, constituting 5% or more of our outstanding common stock. By exercising warrants in the rights offering, you agree that the escrow protection mechanics are valid, binding and enforceable against you. We also have the right, in our sole and absolute discretion, to limit the exercise of warrants, including instructing the warrant agent to refuse to honor any exercise of warrants or oversubscription privileges, by holders of 5% or more of our common stock or persons who would become a 5% holder through the exercise of warrants or oversubscription privileges.

Our obligation to consummate the rights offering is subject to the conditions described in this prospectus supplement. Our common stock is listed on the American Stock Exchange under the symbol *DHC*. The last reported per share sales price of our common stock, on December 1, 2003, the last day on which trading prices were reported prior to the public announcement of the rights offering, was \$1.40. On May 17, 2004, the last reported per share sales price of our common stock was \$8.22. We expect that shares of our common stock issued upon the exercise of the warrants will also be listed on the American Stock Exchange under the same symbol. The warrants are not separately transferable from the underlying common stock. Since the warrants will be transferred only together with a transfer of the underlying shares of stock, and are attached to our outstanding shares of stock, the warrants will not be listed for trading on the American Stock Exchange.

**Exercising the warrants requires an investment in our common stock. An investment in our common stock involves risk. You should consider carefully the risk factors beginning on page S-12 of this prospectus supplement before exercising your warrants.**

We reserve the right to cancel the rights offering at any time. If canceled, the exercise price will be promptly returned by mail to exercising holders, without interest or deduction. If the rights offering is canceled, the warrants will not be exercisable and will have no value.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the prospectus to which it relates is truthful or complete. Any representation to the contrary is a criminal offense.**

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The date of this prospectus supplement is May 18, 2004.

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**ABOUT THIS PROSPECTUS SUPPLEMENT**

This prospectus supplement is a supplement to the accompanying prospectus that is also a part of this document. This prospectus supplement and the accompanying prospectus are part of a shelf registration statement that we filed with the Securities and Exchange Commission. Under the shelf registration process, we may offer from time to time up to 70 million shares of common stock issuable by us upon exercise of non-transferable warrants to be issued to our stockholders, of which this rights offering is a part. In the accompanying prospectus, we provide you with a general description of the securities we may offer from time to time under our shelf registration statement. In this prospectus supplement, we provide you with specific information about this rights offering. This prospectus supplement and the accompanying prospectus and the documents incorporated by reference herein and therein include important information about us, our common stock being offered and other information you should know before investing. This prospectus supplement also adds, updates, and changes information contained in the accompanying prospectus. If any information in this prospectus supplement varies with the information in the accompanying prospectus, you should rely on the information contained in or incorporated by reference into this prospectus supplement.

Unless the context otherwise requires, references in this prospectus supplement to Danielson, and we, our, us and similar terms refer to Danielson Holding Corporation and its subsidiaries; references to NAICC refer to National American Insurance Company of California and its subsidiaries, references to ACL refer to American Commercial Lines LLC and its subsidiaries, and references to Covanta refer to Covanta Energy Corporation and its subsidiaries.

## SUMMARY

### About Danielson Holding Corporation

We are a holding company incorporated in Delaware. Substantially all of our current operations were conducted in the insurance services industry prior to our acquisition of Covanta Energy Corporation in March 2004. We engage in insurance operations through our indirect subsidiaries, National American Insurance Company of California and related entities. We also have investments in companies engaged in the marine transportation and services industry through our investment in ACL. We are the owners of all of the equity interests in ACL. ACL and certain of its related entities are currently subject to Chapter 11 Bankruptcy proceedings.

Our strategy has been to grow by making strategic acquisitions. Such acquisitions have not and may not complement our existing operations. They also have not and may not be related to our current businesses. As part of this corporate strategy, we have sought acquisition opportunities, such as the recent acquisition of Covanta, which management believes will enable us to earn an attractive return on our investment.

As a result of the consummation of the Covanta acquisition on March 10, 2004, our future performance will predominantly reflect the performance of Covanta's operations which are significantly larger than our other operations. As a result, the nature of our business, the risks attendant to such business and the trends that it will face will be significantly altered by the acquisition of Covanta. Accordingly, our prior financial results will not be comparable to our future results.

In May 2002, we acquired a 100% ownership interest in ACL, thereby entering into the marine transportation, construction and related service provider businesses. On January 31, 2003, ACL and many of its subsidiaries and its immediate direct parent entity, American Commercial Lines Holdings, LLC, referred to in this prospectus supplement as ACL Holdings, filed a petition with the U.S. Bankruptcy Court to reorganize under Chapter 11 of the U.S. Bankruptcy Code. Material uncertainty exists as to the impact of the bankruptcy on our equity interest in ACL upon the conclusion of ACL's bankruptcy proceeding. While it cannot presently be determined, we believe that our investment in ACL is likely to have little or no value upon the completion of that bankruptcy proceeding. Accordingly, we attribute no value to our investment in ACL on our financial statements. Danielson, NAICC and the other companies in which we have an equity investment, operating in the marine services industries, are not guarantors of ACL's debt, nor are they contractually liable for any of ACL's liabilities. See Risk Factors ACL Bankruptcy Specific Risks for a more complete discussion of the risk associated with our investment in ACL and the value of ACL.

As a result of the bankruptcy filing, while we continue to exercise influence over the operating and financial policies of ACL through our ownership of all of the equity interests in ACL, we no longer maintain control of ACL. Accordingly, beginning for the year ended December 31, 2003, we account for our investments in ACL, Global Materials Services LLC and Vessel Leasing LLC, entities in which we have an equity investment, using the equity method of accounting. Under the equity method of accounting, we report our share of the equity investees' income or loss based on our ownership interest. In determining the proper equity method earnings to be recognized for ACL, we do not recognize losses in excess of our investment, carrying value of zero at December 31, 2003, as we are not liable either directly or as guarantor for such losses.

SZ Investments, L.L.C., a significant stockholder of ours, and a company affiliated with Sam Zell, our Chairman of the Board of Directors, William Pate, a member of our Board of Directors and Philip Tinkler, our Chief Financial Officer, is a holder through its affiliate, HY I Investments, L.L.C., of approximately 42% of ACL's senior notes and payment-in-kind notes. As a result, a special committee of DHC's Board of Directors was formed in November 2002, composed solely of disinterested directors, to oversee our investment in ACL and its related Chapter 11 bankruptcy proceedings.

As of the end of 2003, we reported aggregate consolidated net operating loss tax carryforwards, which we refer to as NOLs in this prospectus supplement, for federal income tax purposes of approximately \$652 million. These losses will expire over the course of the next 19 years unless utilized prior thereto.

Our principal executive offices are located at 2 North Riverside Plaza, Suite 600, Chicago, Illinois 60606, and our telephone number is (312) 466-4030.

### **About Covanta Energy Corporation**

Covanta develops, constructs, owns and operates for itself and others infrastructure for the conversion of waste to energy, independent power production and the treatment of water and wastewater in the United States and abroad. Covanta owns or operates 55 power generation facilities, 40 of which are in the United States and 15 of which are located outside of the United States. Covanta's power generation facilities use a variety of fuels, including municipal solid waste, water (hydroelectric), natural gas, coal, wood waste, landfill gas and heavy fuel oil. Covanta also operates water or wastewater treatment facilities, all of which are located in the United States. Until September 1999, and under prior management, Covanta was also actively involved in the entertainment and aviation services industries. Covanta's principal executive offices are located at 40 Lane Road, Fairfield, New Jersey and its telephone number is (973) 882-9000.

Prior to March 10, 2004 when we acquired Covanta, it and most of its domestic subsidiaries had been operating as debtors in possession under Chapter 11 of the United States Bankruptcy Code.

### **Acquisition of Covanta**

On December 2, 2003, we executed a definitive investment and purchase agreement to acquire Covanta in connection with Covanta's emergence from Chapter 11 proceedings in bankruptcy after the non-core and geothermal assets of Covanta were divested. The primary components of the transaction were: (1) the purchase by us of 100% of the equity of Covanta in consideration for a cash purchase price of approximately \$30 million, and (2) agreement as to new letter of credit and revolving credit facilities for Covanta's domestic and international operations, provided by some of the existing Covanta lenders and three additional lenders arranged by us.

As required by the investment and purchase agreement, Covanta filed a proposed plan of reorganization, a proposed plan of liquidation for specified non-core businesses, and the related draft disclosure statement, each reflecting the transactions contemplated under the investment and purchase agreement, with the Bankruptcy Court. On March 5, 2004, the Bankruptcy Court confirmed the proposed plans.

Under the terms of the investment and purchase agreement, on March 10, 2004, we acquired 100% of Covanta's equity in consideration for approximately \$30 million. As part of the investment and purchase agreement, we arranged for a new \$118 million replacement letter of credit facility for Covanta, secured by a second lien on Covanta's domestic assets. This financing was provided by SZ Investments, L.L.C., a Danielson stockholder referred to in this prospectus supplement as "SZ Investments", Third Avenue Trust, on behalf of Third Avenue Value Fund Series, a Danielson stockholder referred to in this prospectus supplement as "Third Avenue", and D. E. Shaw Laminar Portfolios, L.L.C., a creditor of Covanta and a Danielson stockholder referred to in this prospectus supplement as "Laminar". Subsequent to the signing of the investment and purchase agreement, each of Third Avenue and Laminar assigned approximately 30% of their participation in the letter of credit facility to Goldman Sachs Credit Partners, L.P. and Laminar assigned the remainder of its participation in the letter of credit facility to TRS Elara, LLC. In addition, in connection with a note purchase agreement described below, Laminar arranged for a \$10.0 million revolving loan facility for Covanta's international operations, secured by Covanta's international assets.

The purchase price recognized by us in our financial statements was \$47.5 million which includes the cash purchase price of \$29.8 million, an expense estimate of approximately \$6.4 million for professional fees and other costs incurred in connection with the acquisition, and an estimated fair value of \$11.3 million for our commitment to sell up to 3.0 million shares of our common stock at \$1.53 per share to a class of creditors of Covanta, subject to certain limitations.

We obtained the financing necessary for the Covanta acquisition pursuant to a note purchase agreement dated December 2, 2003, with each of SZ Investments, Third Avenue and Laminar, referred to collectively in this prospectus supplement as the "Bridge Lenders". Pursuant to the note purchase agreement, the Bridge

Lenders severally provided us with an aggregate of \$40.0 million of bridge financing in exchange for notes issued by us. In the event that we are unable to repay all or a portion of the notes with the proceeds from this rights offering of our common stock, then the notes are convertible without action by the Bridge Lenders into shares of our common stock at a price of \$1.53 per share subject to agreed upon limitations. These notes have a scheduled maturity date of January 2, 2005 and an extended maturity date of July 15, 2005, and bear interest at a rate of 12% per annum through July 15, 2004 and 16% per annum thereafter. In the event of a default or the failure to pay a note on its maturity, the interest rate under the note increases by 2% per annum. We used \$30 million of the proceeds from the notes to post an escrow deposit prior to the closing of the transactions contemplated by an investment and purchase agreement with Covanta. At closing, the purchase price deposit was used as our purchase price for Covanta. We have been and will use the remainder of the proceeds to pay transaction expenses and for general corporate purposes.

We issued to the Bridge Lenders an aggregate of 5,120,853 shares of our common stock primarily in consideration for the \$40.0 million of bridge financing. At the time that we entered into the note purchase agreement, agreed to issue the notes convertible into shares of our common stock and issued the equity compensation to the Bridge Lenders, the trading price of our common stock was below the \$1.53 per share conversion price of the notes. On December 1, 2003, the day prior to the announcement of the Covanta acquisition, the closing price of our common stock on the American Stock Exchange was \$1.40 per share.

In addition, under the note purchase agreement Laminar has agreed to convert an amount of notes to acquire up to an additional 8.75 million shares of our common stock at \$1.53 per share based upon the levels of public participation in this rights offering. Further, we have agreed, in connection with the note purchase agreement, to sell up to an additional 3.0 million shares of our common stock at \$1.53 per share to certain creditors of Covanta based upon the levels of public participation in the rights offering and subject to change of ownership and other limitations. See *Acquisition of Covanta Energy Corporation Note Purchase Agreement* for a detailed discussion of the terms for issuing such shares and making such offering.

As part of our negotiations with Laminar and its becoming a 5% stockholder, pursuant to a letter agreement dated December 2, 2003, Laminar has agreed to additional restrictions on the transferability of the shares of our common stock that Laminar holds or will acquire. Further in accordance with the transfer restrictions contained in Article Fifth of our charter restricting the resale of our common stock by 5% stockholders, we have agreed with Laminar to provide it with limited rights to resell the common stock that it holds. See *Acquisition of Covanta Energy Corporation Laminar Letter Agreement* for a more complete discussion of Laminar's ability to transfer our common stock. Finally, we have agreed with the Bridge Lenders to file a registration statement with the SEC to register the shares of common stock issued to or acquired by each of them under the note purchase agreement not later than the earlier of June 30, 2004 and ten days after closing of the rights offering.

Samuel Zell, Danielson's Chairman of the Board of Directors, Philip Tinkler, Danielson's Chief Financial Officer and William Pate, a director of Danielson, are affiliated with SZ Investments. Martin Whitman and David Barse, directors of Danielson, are officers and trustees of Third Avenue and also serve as officers of the management company that manages the investments of Third Avenue. The note purchase agreement and other transactions involving the Bridge Lenders were negotiated, reviewed and approved by a special committee of our Board of Directors composed solely of disinterested directors and advised by independent legal and financial advisors.

### *The Rights Offering*

#### Warrants

We are conducting a rights offering and issuing, at no charge, one non-transferable warrant with respect to each share of our common stock outstanding as of the opening of business on the record date. If all of the warrants are exercised in the rights offering, the total purchase price of our common stock in the rights offering will be \$41,980,321.



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Record Date	May 17, 2004. This is the date the warrants are issued to record holders of our common stock.
Transferability of Warrants	The warrants are not transferable separately from the underlying shares of our common stock. Transfer of ownership of a share of our common stock after the record date will also transfer ownership of the warrant issued with respect to such share.
Basic Subscription Privilege Exercise Price	Holders of warrants will be entitled to purchase 0.75 shares of our common stock for every warrant held at an exercise price of \$1.53 per share, in immediately available funds.
Oversubscription Privilege	Each warrant holder may also subscribe for additional shares at the same exercise price per share pursuant to the oversubscription privilege. If an insufficient number of shares are available to fully satisfy oversubscription privilege requests, the available shares, if any, will be allocated pro rata among warrant holders who exercised their oversubscription privilege based upon the number of shares each warrant holder subscribed for under the basic subscription privilege and the application of our certificate of incorporation's ownership change limitations. The warrant agent will return any excess payments by mail or by book-entry transfer, without interest or deduction, as soon as is reasonably practicable following the expiration of the rights offering.
Conditions to the Rights Offering	The closing of the rights offering is subject to conditions. See <a href="#">The Rights Offering</a> <a href="#">Conditions to the Rights Offering</a> for more details. Your right to exercise your warrants is subject to, among other things, ownership restrictions imposed by our certificate of incorporation and the escrow protection mechanics described herein.
Expiration Date	The warrants will expire if they are not exercised by 5:00 p.m., New York City time, on June 9, 2004, unless extended by us from time to time in our sole discretion.
Certificate of Incorporation Restrictions; Escrow Protection Mechanics	Our ability to utilize our NOLs would be substantially reduced if we were to undergo an ownership change within the meaning of Section 382 of the Internal Revenue Code. In order to reduce the risk of an ownership change, our certificate of incorporation restricts the ability of any holder of 5% or more of our common stock to sell or otherwise transfer any shares owned by such holder or to purchase or otherwise acquire shares of our common stock. Our certificate of incorporation also restricts the ability of any other holder to make an acquisition of our common stock which will result in total ownership by such stockholder of 5% or more of our common stock. These restrictions will apply unless and until we determine that such transaction will not result in an unreasonable risk of an ownership change. We have the right, in our sole and absolute discretion, to limit the exercise of warrants and oversubscription privileges, including instructing the warrant agent to refuse to honor any exercise of warrants and oversubscription privileges, by 5% stockholders or stockholders who would become 5% holders upon exercise of their warrants.

The total number of shares of our common stock to be outstanding upon completion of the rights offering, assuming the offering is fully subscribed, would be 64,022,276. Five percent of 64,022,276 is 3,201,113.

In order to avoid an ownership change for federal income tax purposes, we have implemented the escrow protection mechanics, which are as follows: (1) by exercising warrants, each holder will represent to us that such holder will not be, after giving effect to the exercise of warrants, an owner, directly or indirectly (as described in this prospectus supplement), of more than 2,850,000 shares; (2) if such exercise would result in such holder owning more than 2,850,000 shares of our common stock, such holder must notify the warrant agent at the telephone number set forth under The Rights Offering Delivery of Subscription Materials and Payment ; (3) if requested, each holder will provide us with additional information regarding the amount of common stock that the holder owns; and (4) we shall have the right to instruct the warrant agent to refuse to honor such holder's exercise to the extent such exercise of warrants or oversubscription privileges might, in our sole and absolute discretion, result in such holder owning 5% or more of our common stock. By exercising warrants in the rights offering, you agree that the escrow protection mechanics are valid, binding and enforceable against you. See The Rights Offering Certificate of Incorporation Restrictions; Escrow Protection Mechanics.

#### Procedure for Exercising Warrants

You may exercise all or any portion of your warrants by delivering the following to the warrant agent at the address and in the manner described below at or prior to 5:00 p.m., New York City time, on the expiration date:

your properly completed and executed exercise form with any required signature guarantees or other supplemental documentation; and

your full exercise price payment for each share subscribed for under your basic subscription privilege and your oversubscription privilege; and

if you hold your shares of our common stock in certificated form, the certificates evidencing the shares of our common stock in an amount at least equal to the warrants to be exercised; or

if you hold your shares of our common stock through the Depository Trust Company, referred to as DTC, an exercise form instructing your broker, nominee or other custodian to instruct DTC to transfer the shares of common stock representing the warrants to be exercised to a suspense account with the warrant agent, to be held in escrow for you until after the expiration date.

Once you have exercised the basic subscription privilege or oversubscription privilege, your exercise may not be revoked in whole or in part.

Warrants not exercised prior to the expiration date will lose their value.

United States Federal Income Tax  
Consequences to Holders of Our  
Common Stock

For United States federal income tax purposes, the receipt of warrants in the rights offering by holders of our common stock should not be a taxable event.

Issuance of Our Common Stock

We will issue certificates or make the necessary book-entry transfers representing shares purchased in the rights offering, and return the underlying shares of common stock delivered to us, as soon as reasonably practicable after the closing of the rights offering. All exercises of warrants will be effective on the closing of the rights offering.

No Recommendation to Warrant  
Holders

Our board of directors is not making any recommendation to you as to whether you should exercise your warrants. You should decide whether to exercise your warrants based upon your own assessment of your best interests.

American Stock Exchange Listing of  
our Common Stock

Our common stock is traded on the American Stock Exchange, which we sometimes refer to as the AMEX, under the symbol DHC. On December 1, 2003, the last trading day prior to our public announcement of our decision to commence the rights offering, the closing price of our common stock on the AMEX was \$1.40 per share. On May 17, 2004, the closing price of our common stock on the AMEX was \$8.22 per share. We expect that shares of our common stock issued upon the exercise of the warrants will also be listed on the AMEX under the same symbol.

Listing of the Warrants

The warrants will not be listed on AMEX or any stock exchange or market.

**QUESTIONS AND ANSWERS ABOUT THIS RIGHTS OFFERING**

*This section highlights information contained elsewhere or incorporated by reference in this prospectus supplement. This section does not contain all of the important information that you should consider before exercising your warrants and investing in our common stock. You should read this entire prospectus supplement carefully.*

**Q: WHAT ARE WE OFFERING IN THIS PROSPECTUS SUPPLEMENT?**

**A:** We are conducting a rights offering and issuing at no charge one non-transferable warrant with respect to each share of our common stock outstanding as of the close of business on May 17, 2004. Through this prospectus supplement, we are offering the shares of common stock that holders of warrants may purchase upon exercise of their warrants.

**Q: WHO MAY PARTICIPATE IN THIS RIGHTS OFFERING AND ON WHAT DATE WILL THE COMPANY DETERMINE WHO ARE ITS STOCKHOLDERS?**

**A:** Holders of record of our common stock as of the close of business on May 17, 2004, or the record date, will receive one warrant for each outstanding share of our common stock that they hold. Since the warrants do not trade separately from our common stock, any purchaser of those shares of common stock after the record date and prior to the expiration or termination of this rights offering will be permitted to exercise the warrants stapled to such shares of our common stock.

**Q: WHAT IS THE SUBSCRIPTION PRIVILEGE I AM ENTITLED TO FOR EACH WARRANT?**

**A:** Each warrant carries with it a basic subscription privilege to purchase 0.75 shares of our common stock and an oversubscription privilege.

**Q: WHAT IS THE BASIC SUBSCRIPTION PRIVILEGE EACH WARRANT GIVES ME THE RIGHT TO PURCHASE?**

**A:** Each warrant issued under this rights offering entitles you to purchase 0.75 shares of our common stock at an exercise price of \$1.53 per share. You may exercise any number of your warrants, or you may choose not to exercise any of the warrants issued to you. We will not distribute any fractional shares, but instead will pay you cash in lieu of fractional shares as a result of your exercise of your warrants pursuant to this rights offering.

**Q: WHAT IS THE OVERSUBSCRIPTION PRIVILEGE ASSOCIATED WITH EACH WARRANT?**

**A:** If all of our stockholders do not exercise all of the warrants issued to them pursuant to this rights offering, then you may have the opportunity to purchase additional shares of our common stock at \$1.53 per share under the oversubscription privilege. By extending oversubscription privileges to our stockholders, we are providing stockholders that exercise all of their warrants with the opportunity to purchase those shares that are not purchased by other stockholders in this rights offering, at \$1.53 per share. If there are not enough shares available to fully satisfy all oversubscription privilege requests, the available shares will be distributed proportionately among rights holders who exercised their oversubscription privilege based on the number of shares each rights holder subscribed for under the basic subscription privilege. The warrant agent, American Stock Transfer & Trust Company, will return any excess payments by mail without interest or deduction as soon as reasonably practical after the expiration of the subscription period.

**Q: HOW LONG WILL THE SUBSCRIPTION PERIOD LAST?**

**A:** You will be able to exercise your warrants only during a limited period. If you do not exercise your warrants before 5:00 p.m., New York City time, on June 9, 2004, your warrants will expire and be of no further value. We may, in our sole discretion, decide to extend this offering until some later time. If we extend the expiration date, we will give oral or written notice to the warrant agent on or before such expiration date, followed by a press release no later than 9:00 a.m., New York City time, on the next business day after the previously scheduled expiration date.

Q: IS THERE ANY LIMIT ON HOW LONG WILL THE SUBSCRIPTION PERIOD WILL LAST?

A: Although the rights offering is scheduled to remain open until June 9, 2004, we have kept the ability to extend the rights offering for as long or as many times as our Board of Directors determines is necessary to consummate the rights offering or otherwise in our best interests.

Q: AM I REQUIRED TO PARTICIPATE IN THIS RIGHTS OFFERING?

A: No.

Q: WHAT HAPPENS IF I CHOOSE NOT TO EXERCISE MY WARRANTS?

A: You will retain your current number of shares of common stock even if you do not exercise your warrants. If you choose not to exercise your warrants, then the percentage of our common stock that you own will decrease. The magnitude of the reduction of your percentage ownership will depend upon the extent to which you and the other stockholders exercise their rights. See Risk Factors Risks Related to The Rights Offering Stockholders Who Do Not Fully Exercise Their Warrants Will Have Their Interests Diluted by Those Other Stockholders Who Do Exercise Their Warrants for more information regarding the amount of potential dilution.

Q: HOW DO I EXERCISE MY WARRANTS?

A: You may exercise your warrants by delivering the following to the warrant agent at or prior to 5:00 p.m., New York City time, on the expiration date:

your properly completed and executed exercise form with any required signature guarantees or other supplemental documentation; and

your full exercise price payment (by check, bank draft, money order or wire transfer) for each share subscribed for under your subscription privileges and any oversubscription privilege; and

if you hold your shares of our common stock in certificated form, certificates representing at least the number of shares of our common stock representing the warrants to be exercised; or

if you hold your shares of our common stock through Depository Trust Company, or DTC, an exercise form instructing your broker, nominee or other custodian to instruct DTC to transfer the shares of common stock representing the warrants to be exercised to a suspense account established by the warrant agent, to be held in escrow for you until after the expiration date.

If you use the mail, we recommend that you use insured, registered mail, return receipt requested. If you pay by an uncertified personal check, your warrants will not be deemed exercised until such uncertified check clears. See The Rights Offering Delivery of Subscription Materials and Payment.

Q: WHAT SHOULD I DO IF I WANT TO EXERCISE MY WARRANTS BUT MY SHARES ARE HELD IN THE NAME OF MY BROKER, CUSTODIAN BANK OR OTHER NOMINEE?

A: If you hold shares of our common stock through a broker, custodian bank or other nominee, we will ask your broker, custodian bank or other nominee to notify you of this rights offering. If you wish to exercise your warrants, you will need to have your broker, custodian bank or other nominee act for you. To indicate your decision, you should complete and return to your broker, custodian bank or other nominee the form entitled Nominee Holder Certification. You should receive this form from your broker, custodian bank or other nominee with the other offering materials. You should contact your broker, custodian bank or other nominee if you believe you are entitled to participate in this rights offering but you have not received this form.

Q: WHAT RESTRICTIONS MAY THERE BE ON MY RIGHT TO EXERCISE MY WARRANTS?

A: Our ability to utilize our net operating loss tax carryforwards, which we refer to as NOLs in this prospectus supplement, would be substantially reduced if we were to undergo an ownership change as that term is defined under federal income tax regulations. In order to reduce the risk of an ownership change, our certificate of incorporation restricts the ability of any holder of 5% or more of our common

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stock to purchase or otherwise acquire additional shares of our common stock. Our certificate of incorporation also restricts the ability of any other holder to purchase or otherwise acquire shares of our

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common stock which will result in total ownership by such stockholder of 5% or more of our common stock. We have the right, in our sole and absolute discretion, to limit the exercise of warrants, including instructing the warrant agent to refuse to honor any exercise of warrants, by 5% stockholders or by any stockholders who would become 5% stockholders through the exercise of their warrants or oversubscription rights. In order to avoid an ownership change. We are requiring any holder who holds at least 2,850,000 shares or holders who would acquire this number of shares through the exercise of warrants or oversubscription privileges to notify the warrant agent and to provide us with additional information we may request. See The Rights Offering Certificate of Incorporation Restrictions; Escrow Protection Mechanics for a discussion on how our escrow mechanics operate.

Q: WHAT SHOULD I DO IF I WANT TO EXERCISE MY WARRANTS AND I AM A STOCKHOLDER IN A FOREIGN COUNTRY OR IN THE ARMED SERVICES?

A: The warrant agent will mail rights offering materials to you if you are a rights holder whose address is outside the United States or if you have an Army Post Office or a Fleet Post Office address. To exercise your rights, you must notify the warrant agent on or prior to 5:00 p.m., New York City time, on June 9, 2004, and take all other steps which are necessary to exercise your rights, on or prior to that time. If you do not follow these procedures prior to the expiration date, your rights will expire.

Q: WILL I BE CHARGED A SALES COMMISSION OR A FEE IF I EXERCISE MY WARRANTS?

A: No. We will not charge a brokerage commission or a fee to rights holders for exercising their warrants. However, if you exercise your warrants through a broker or nominee, you will be responsible for any fees charged by your broker or nominee.

Q: WHAT ARE THE UNITED STATES FEDERAL INCOME TAX CONSEQUENCES OF EXERCISING MY WARRANTS AS A HOLDER OF COMMON STOCK?

A: A holder of common stock generally will not recognize income or loss for federal income tax purposes in connection with the receipt or exercise of warrants. We urge you to consult your own tax advisor with respect to the particular tax consequences of this rights offering to you. See also United States Federal Income Tax Consequences for more information on the tax consequences of this rights offering.

Q: WHEN WILL I RECEIVE CERTIFICATES FOR THE SHARES PURCHASED IN THIS RIGHTS OFFERING?

A: We will issue certificates representing shares purchased in this rights offering to you or to the Depository Trust Company on your behalf, as the case may be, as soon as practicable after the expiration of the subscription period and after all allocations and adjustments have been completed.

Q: IF THIS RIGHTS OFFERING IS NOT COMPLETED, WILL MY SUBSCRIPTION PAYMENT BE REFUNDED TO ME?

A: Yes. The warrant agent will hold all funds it receives in escrow until completion of this offering. If this rights offering is not completed, the warrant agent will return promptly, without interest, all subscription payments and any oversubscription payments that are not exercised.

Q: ARE THERE RISKS IN EXERCISING MY WARRANTS?

A: Yes. The exercise of your rights involves risks. Exercising your rights means buying additional shares of our common stock and should be considered as carefully as you would consider any other equity investment in our company. Among other things, you should carefully consider the risks described under the heading Risk Factors, beginning on page S-12 of this prospectus supplement.

Q: AFTER I EXERCISE MY WARRANTS, CAN I CHANGE MY MIND AND CANCEL MY PURCHASE?

A: No. Once you send in your subscription certificate and payment you will not be able to revoke the exercise of your warrants even if you later learn information about us that you consider to be unfavorable

and even if the market price of our common stock is below the warrant exercise price. You should not exercise your warrants unless you are certain that you wish to purchase additional shares of our common stock at the warrant exercise price.

Q: MAY I TRANSFER MY WARRANTS IF I DO NOT WANT TO PURCHASE ANY SHARES?

A: No. The warrants are not separately transferable. Transfer of ownership of a share of our common stock, however, after the record date and before any warrant associated with such share is exercised will also transfer ownership of the warrant issued with respect to such share.

Q: CAN I SELL MY SHARES AFTER I HAVE EXERCISED MY WARRANTS?

A: No. The exercise of your warrants in the rights offering requires you to deliver to the warrant agent the certificates of shares of our common stock representing at least the shares of stock exercised in the rights offering. Therefore, if you exercise your warrants, you will be unable to sell or otherwise transfer your shares of our common stock until your stock certificates are returned after completion or termination of the rights offering. This also means that if you only exercise a portion of your warrants and deliver stock certificates representing more shares than the warrants you are exercising, you will not be able to sell those shares represented by certificates held by the warrant agent until they are returned after completion or termination of the rights offering.

Q: IF I PURCHASE SHARES AFTER THE RIGHTS OFFERING HAS COMMENCED, WILL I BE ABLE TO PARTICIPATE IN THE RIGHTS OFFERING?

A: You will be able to participate in the rights offering only if you can deliver your shares of common stock to the warrant agent in accordance with the instructions in this prospectus supplement. Since stock trades may take three business days to settle, you may not receive your shares in time to be able to satisfy our delivery and escrow requirements. In particular, purchases of our common stock after June 3, 2004 may not settle in sufficient time to be able to satisfy the delivery procedures in this prospectus supplement unless you direct that such trades are made on a next day or cash for settlement basis. We are under no obligation, and have no intention, to adjust our procedures to accommodate holders who acquire shares after the rights offering has commenced.

Q: WHY IS DANIELSON HOLDING CORPORATION ENGAGING IN THIS RIGHTS OFFERING?

A: We are making this offering in order to raise approximately \$42.0 million before expenses in new capital to be used as follows:

to repay the portion of the \$40.0 million of principal amount of bridge notes not converted into common stock. These bridge notes were issued by us in connection with financing our acquisition of Covanta Energy Corporation, and

any remaining proceeds, if any, will be available for general corporate purposes, including expenses of this rights offering and additional working capital.

Q: HOW WERE THE TERMS OF THE RIGHTS OFFERING AND THE WARRANT EXERCISE PRICE ESTABLISHED?

A: The warrant exercise price and other terms of the rights offering were approved by a special committee of independent members of our board of directors who were advised by independent financial and legal advisors.

Q: WHAT IS THE BOARD OF DIRECTORS' RECOMMENDATION REGARDING THIS RIGHTS OFFERING?

A: Our board of directors is not making any recommendation as to whether you should exercise your warrants. You should make your decision based on your own assessment of this rights offering and our company.



Q: HOW MANY SHARES OF OUR COMMON STOCK WILL BE OUTSTANDING AFTER THIS RIGHTS OFFERING?

A: As of May 17, 2004, we had 36,584,158 shares of common stock issued and outstanding. After this rights offering, we anticipate that we will have 64,022,276 shares of common stock outstanding upon the completion of the rights offering assuming all the warrants that are issued pursuant to the rights offering are exercised.

Q: WILL THE NEW SHARES BE INITIALLY LISTED ON THE AMERICAN STOCK EXCHANGE AND TREATED LIKE OTHER SHARES?

A: Yes. Our common stock is traded on the American Stock Exchange under the symbol DHC. The shares of common stock issued upon the exercise of warrants will also be listed on AMEX under the same symbol. The warrants, however, do not trade separately and will not be listed on AMEX or any other stock exchange or market.

Q: CAN THE BOARD OF DIRECTORS AMEND OR WITHDRAW THIS RIGHTS OFFERING?

A: Yes. We reserve the right to cancel the rights offering at any time. If canceled, the exercise price and certificates for the underlying shares will be promptly returned by mail to exercising warrant holders, without interest or deduction. If the rights offering is canceled, the warrants will not be exercisable and will have no value. We also reserve the right to extend the expiration date and to amend the terms or conditions of the rights offering. If the rights offering is extended the warrant agent will hold your shares and exercise funds, and you will not be able to sell or transfer your shares so held during the extension period. If we amend the terms or conditions of the rights offering, a new prospectus supplement will be distributed to all warrant holders who have previously exercised warrants and to holders of record of unexercised warrants on the date we amend the terms, and such warrant holders will once again be given the opportunity to participate or withdraw from the rights offering.

Q: WHAT SHOULD I DO IF I HAVE OTHER QUESTIONS OR NEED ASSISTANCE?

A: We have appointed Innisfree M&A Incorporated as information agent for the rights offering. Any questions or requests for additional copies of this prospectus supplement or any ancillary documents may be directed to the information agent at the following address and telephone number:

501 Madison Avenue  
20th Floor  
New York, New York 10022  
Telephone: (888) 750-5834 (toll-free)

**For a more complete description of this offering, see The Rights Offering beginning on page S-49.**

### **Risk Factors**

Exercising the warrants requires an investment in our common stock. An investment in our common stock is very risky. You should consider carefully the risk factors beginning on page S-12 of this prospectus supplement before exercising your warrants.

### **Use of Proceeds**

The proceeds from the rights offering, will be used to repay the convertible notes issued by us in connection with financing our acquisition of Covanta, to the extent not converted into common stock, and the remainder, if any, will be available for general corporate purposes.

## RISK FACTORS

An investment in our common stock is very risky. You should carefully consider the following factors and all the information in this prospectus supplement, the accompanying prospectus and the information incorporated by reference herein before deciding to exercise your warrants.

### Risks Related to The Rights Offering

#### ***Stockholders Who Do Not Fully Exercise Their Warrants Will Have Their Interests Diluted by Those Other Stockholders Who Do Exercise Their Warrants.***

Prior to this rights offering, we had 36,584,158 shares of stock outstanding. Because of the conversion features in the bridge financing, whether the rights offering is fully subscribed or not, we will issue an additional 27,438,118 shares of our common stock through the exercise of warrants and issuance of up to another 11.75 million shares pursuant to the sale of 8.75 million shares to Laminar and up to 3.0 million shares to certain creditors of Covanta. If you choose not to fully exercise your warrants, your relative ownership interest in our common stock will be diluted. Warrantheolders who do not exercise their warrants will lose any value in their warrants.

#### ***We Have The Right to Limit The Exercise of The Warrants.***

Our certificate of incorporation generally restricts the ability of any 5% holder of our common stock from disposing of or acquiring shares of our common stock without our consent. Our certificate of incorporation also restricts the ability of other holders from becoming 5% stockholders without our consent. In order to comply with these restrictions, the terms of the warrants may limit the number of shares exercisable by a holder. If the exercise of your warrants might result in a risk of your becoming a 5% stockholder, your exercise may be reduced in order to eliminate that risk. We may also limit the exercise of warrants by holders who possess 5% of our outstanding common stock. In addition, you may be required to provide certain information concerning your share ownership in order to help us enforce these restrictions.

#### ***Warrantheolders Who Exercise Their Warrants Will Be Unable to Sell or Otherwise Transfer Their Shares During The Rights Offering.***

Warrantheolders who exercise their warrants in the rights offering are required to deliver to the warrant agent the certificates of shares of our common stock representing at least the shares of stock exercised in the rights offering. Therefore, if you exercise your warrants, you will be unable to sell or otherwise transfer the shares of our common stock represented by the certificates held by the warrant agent during the rights offering, even if you are only exercising a portion of the warrants attached to such shares.

#### ***The Market Price of Our Common Stock May Decline Prior to The Expiration Date of The Rights Offering.***

The exercise of warrants pursuant to the rights offering is irrevocable. During the past twelve months, the market price per share of our common stock has ranged from \$0.71 to \$10.40. Although the exercise price is at a significant discount to the market price per share of our common stock as of the commencement of the rights offering, the market price of our common stock may decline prior to the expiration date due to many factors, including business exigencies, acts of terrorism, general market declines, interruptions to our business, accidents or other catastrophic events, changes in investor perception, unanticipated financial results, defaults on indebtedness or other factors that could affect our stock price. In such event, you may be forced to purchase the common stock at a price higher than the market price.

***Because of The Stock Delivery Requirements and Our Escrow Protection Mechanics You May Not Be Able to Trade Our Stock During this Rights Offering.***

In order to prevent an ownership change for Internal Revenue Code purposes, we have instituted stock delivery requirements and escrow protection mechanics. As a result, particularly toward the end of the rights offering as more shares are submitted for exercise of warrants, there may not be sufficient liquidity in our shares to permit active trading and order imbalances between buyers and sellers of our stock may result in a halt in the trading of our common stock. If such lack of liquidity or order imbalances occur, you may not be able to buy additional shares or sell the shares of our common stock that you own.

***We May Cancel the Rights Offering At Any Time.***

We may cancel the rights offering at any time. If we cancel the rights offering, the warrants cannot be exercised unless and until another rights offering is commenced by us.

**General Corporate Risks**

**Danielson Specific Risks**

***We Cannot Be Certain That The Net Operating Loss Tax Carryforwards Will Continue to Be Available to Offset Our Tax Liability.***

As of December 31, 2003, we had approximately \$652 million of net operating loss tax carryforwards for Federal income tax purposes, which we refer to as NOLs. In order to utilize the NOLs, we must generate taxable income which can offset such carryforwards. The NOLs are also utilized by income from certain grantor trusts that were established as part of the Mission Insurance organization. The NOLs will expire if not used. The availability of NOLs to offset taxable income would be substantially reduced if we were to undergo an ownership change within the meaning of Section 382(g)(1) of the Internal Revenue Code. We will be treated as having had an ownership change if there is more than a 50% change in stock ownership during a three year testing period by 5% stockholders.

In order to help us preserve the NOLs, our certificate of incorporation contains stock transfer restrictions designed to reduce the risk of an ownership change for purposes of Section 382 of the Internal Revenue Code. The transfer restrictions were implemented in 1990, and we expect that the restrictions will remain in force as long as the NOLs are available. We cannot be certain, however, that these restrictions will prevent an ownership change.

The NOLs will expire in various amounts, if not used, between 2004 and 2023. The Internal Revenue Service has not audited any of our tax returns for any of the years during the carryforward period including those returns for the years in which the losses giving rise to the NOLs were reported. We cannot assure you that we would prevail if the IRS were to challenge the availability of the NOLs. If the IRS was successful in challenging our NOLs, all or some portion of the NOLs would not be available to offset our future consolidated income and we may not be able to satisfy our obligations to Covanta under the Tax Sharing Agreement described below, or to pay taxes that may be due from our consolidated tax group.

In addition to the foregoing, other possible reductions in our NOLs could occur in connection with ACL's emergence from bankruptcy. Management anticipates that should ACL emerge from bankruptcy, while we will attempt to manage the tax consequences of that transaction, taxable income could result from ACL debt forgiveness and asset sales, which could materially reduce our NOLs.

***The Market for Our Common Stock Has Been Historically Illiquid Which May Affect Your Ability To Sell Your Shares.***

The volume of trading in our stock has historically been low. Having a market for shares without substantial liquidity can adversely affect the price of the stock at a time an investor might want to sell his, her or its shares.

***Future Sales of Our Common Stock May Depress Our Stock Price.***

No prediction can be made as to the effect, if any, that future sales of our common stock, or the availability of our common stock for future sales, will have on the market price of our common stock. Sales in the public market of substantial amounts of our common stock, or the perception that such sales could occur, could adversely affect prevailing market prices for our common stock. In addition, in connection with the Covanta acquisition financing, we have entered into a registration rights agreement under which we have agreed to file a registration statement on Form S-3 to register the resale of approximately 17,711,491 shares of our common stock assumed to be held by Laminar, Third Avenue and SZ Investments assuming full participation in the rights offering by the public and these investors. The potential effect of these shares being sold may be to depress the price at which our common stock trades.

***Reduced Liquidity and Price Volatility Could Result in a Loss to Investors.***

Although our common stock is listed on the AMEX, there can be no assurance as to the liquidity of an investment in our common stock or as to the price an investor may realize upon the sale of our common stock. These prices are determined in the marketplace and may be influenced by many factors, including the liquidity of the market for our common stock, the market price of our common stock, investor perception and general economic and market conditions.

***SZ Investments Beneficially Owns Approximately 18.4% of Our Outstanding Common Stock.***

As of May 1, 2004, SZ Investments beneficially owned 6,740,824 shares of our common stock for an aggregate beneficial ownership of approximately 18.4% of our common stock. In addition, our nine member board of directors includes two affiliates of SZ Investments, Samuel Zell, Chairman of the Board, and William Pate, and our Chief Financial Officer is also an affiliate of SZ Investments. Because of its large percentage of ownership, and board and officer representation, SZ Investments may have significant control over our management and policies.

***Concentrated Stock Ownership and Charter Provision May Discourage Unsolicited Acquisition Proposals.***

Assuming full participation in our rights offering by the public and these investors, and the offering of 3.0 million shares of our Common Stock to a class of Covanta creditors, SZ Investments, Third Avenue and Laminar separately own or will have the right to acquire approximately 15.6%, 6.0% and 18.0%, respectively, or when aggregated, 39.6% of our outstanding common stock. Although there are no agreements among them regarding their voting or disposition of shares of our common stock, the level of their combined ownership of shares of common stock could have the effect of discouraging or impeding an unsolicited acquisition proposal. In addition, the change in ownership limitations contained in Article Fifth of our charter could have the effect of discouraging or impeding an unsolicited takeover proposal.

**Risks Related to Covanta's Business**

***Covanta Emerged From Bankruptcy With A Large Amount Of Domestic Debt, And We Cannot Assure You That Its Cash Flow From Domestic Operations Will Be Sufficient To Pay This Debt***

Covanta's plan of reorganization, and the amount of debt issued pursuant to its terms, assumes among other things that the NOLs described above will enhance amounts available for its creditors by reducing its consolidated Federal tax liability. If a sufficient portion of the NOLs are not available and Danielson cannot meet its obligations under the tax sharing agreement to Covanta, it is likely that Covanta will not have sufficient cash flow from operations or other sources of liquidity to pay the principal and interest due with respect to its domestic debt.

Covanta's ability to service its domestic debt will also depend upon:

its ability to continue to operate and maintain its facilities consistent with historical performance levels;

its ability to maintain compliance with its debt covenants;

its ability to avoid increases in overhead and operating expenses in view of the largely fixed nature of its revenues;

its ability to maintain or enhance revenue from renewals or replacement of existing contracts, which begin to expire in October, 2007, and from new contracts to expand existing facilities or operate additional facilities; and

market conditions affecting waste disposal and energy pricing, as well as competition from other companies for contract renewals, expansions, and additional contracts, particularly after its existing contracts expire.

***The Amount of Unsecured Claims for Which Covanta Is Liable Has Not Been Determined and Could Exceed Our Estimates***

In connection with Covanta's emergence from bankruptcy, Covanta authorized the issuance of \$50 million of unsecured notes under an indenture. Although Covanta estimates that it will issue such notes in an amount less than \$40 million, the ultimate amount of unsecured notes will not be determined until remaining claims are resolved through settlement or litigation in Bankruptcy Court. We cannot assure you that the final amount of such notes issued will be less than Covanta's estimate, or that the ultimate resolution of such claims will result in liabilities of less than \$50 million.

***Covanta May Not Be Able to Refinance Its Domestic Debt Agreements Prior to Maturity***

Covanta issued the High Yield Notes described below, which mature in 2011. Prior to maturity, Covanta is obligated to pay only interest, and no principal, with respect to these notes. Covanta's cash flow may be insufficient to pay the principal at maturity, which will be \$230 million at such time. Consequently, Covanta may be obligated to refinance these notes prior to maturity. Covanta may refinance the notes during the first two years after issuance without paying a premium, and thereafter may refinance these notes but must pay a premium to do so.

Several of Covanta's contracts require it to provide certain letters of credit to contract counterparties. The aggregate stated amount of these letters of credit declines materially each year, particularly prior to 2010. Covanta's financing arrangements under which these letters of credit are issued expire in 2009, and so it must refinance these arrangements in order to allow Covanta to continue to provide the letters of credit beyond the current expiration date.

We cannot assure you that Covanta will be able to obtain refinancing on acceptable terms, or at all.

***Covanta's Ability To Grow Its Business Is Limited***

Covanta's ability to grow its domestic business by investing in new projects will be limited by debt covenants in its principal financing agreements, and from potentially fewer market opportunities for new waste-to-energy facilities.

We cannot assure you that, when it seeks to refinance its domestic debt agreements, Covanta will be able to negotiate covenants that will provide it with more flexibility to grow its business.

***Covanta's Liquidity Is Limited by The Amount of Domestic Debt Issued When It Emerged from Bankruptcy.***

Covanta believes that its cash flow from domestic operations will be sufficient to pay for its domestic cash needs, including debt service on its domestic corporate debt, and that its revolving credit facility, described below, will provide a secondary source of liquidity. We cannot assure you that Covanta's cash flow from domestic operations will not be adversely affected by adverse economic conditions or circumstances specific to one or more projects or that if such conditions or circumstances do occur, its revolving credit facility will provide Covanta with access to sufficient cash for such purposes.

***Operation of Covanta's Facilities and the Construction of New or Expanded Facilities Involve Significant Risks That Cannot Always be Covered by Insurance or Contractual Protections.***

The operation of Covanta's facilities and the construction of new or expanded facilities involve many risks, including:

the inaccuracy of Covanta's assumptions with respect to the timing and amount of anticipated revenues;

supply interruptions;

work stoppages;

permitting and other regulatory issues;

labor disputes;

social unrest;

weather interferences;

unforeseen engineering and environmental problems;

unanticipated cost overruns;

catastrophic events including fires, explosions, earthquakes and droughts;

changes in legal requirements;

acts of terrorism;

breakdown or failure of equipment or processes;

performance below expected levels of output or efficiency;

license revocation; and

the exercise of the power of eminent domain.

Expansions of existing plants and construction of new plants may require that Covanta incorporate recently developed and technologically complex equipment, especially in the case of newer environmental emission control technology.

Although Covanta maintains insurance, obtains warranties from vendors, obligates contractors to meet certain performance levels, and attempts, where feasible, to pass risks Covanta cannot control to the service recipient or output purchaser, the proceeds of such insurance, warranties, performance guarantees or risk sharing arrangements may not be adequate to cover lost revenues, increased expenses or liquidated damages payments.

***Performance Reductions Could Materially And Adversely Affect Covanta.***

Any of the risks described in this prospectus supplement or unforeseen problems could cause Covanta's projects to operate below expected levels, which in turn could result in lost revenues, increased expenses, higher maintenance costs and penalties for defaults under Covanta's service agreements and operating contracts. As a result, a project may operate at less than expected levels of profit or at a loss.

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Most of Covanta's service agreements for waste-to-energy facilities provide for limitations on damages and cross-indemnities among the parties for damages that such parties may incur in connection with their performance under the contract. Such contractual provisions excuse Covanta from performance obligations to the extent affected by uncontrollable circumstances and provide for service fee adjustments if uncontrollable circumstances increase its costs.

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Covanta cannot assure you that these provisions will prevent Covanta from incurring losses upon the occurrence of uncontrollable circumstances or that if Covanta were to incur such losses it would continue to be able to service its debt.

Covanta and certain of its subsidiaries have issued performance guarantees, primarily pursuant to agreements to operate energy and waste-to-energy facilities. With respect to its domestic business, Covanta has issued guarantees to its municipal clients and other parties that Covanta's operating subsidiaries will perform in accordance with contractual terms, including, where required, the payment of damages. Such damages may be material, and in circumstances where one or more subsidiary has incurred such damages, Covanta may not have sufficient sources of cash to pay such damages. Although it has not incurred material liability under energy and waste-to-energy guarantees previously, we cannot assure you that Covanta will be able to continue to avoid incurring material payment obligations under such guarantees or that if it did incur such obligations that it would have the cash resources to pay them.

With respect to the international projects, Covanta Power International Holdings, Inc., referred to as CPIH in this prospectus supplement, Covanta and certain of Covanta's domestic subsidiaries have issued guarantees of CPIH's operating obligations. The potential damages that may be owed under these guarantees may be material. As discussed below, Covanta is generally entitled to be reimbursed by CPIH for any payments it may make under guarantees related to international projects.

***Covanta Generates Its Revenue Primarily Under Long Term Contracts, and Must Avoid Defaults Under Its Contracts in Order To Service Its Debt And Avoid Material Liability To Contract Counterparties.***

Covanta must satisfy its performance and other obligations under its contracts to operate waste-to-energy facilities. These contracts typically require Covanta to meet certain performance criteria relating to amounts of waste processed, energy generation rates per ton of waste processed, residue quantity, and environmental standards. Covanta's failure to satisfy these criteria may subject it to material damage liability, and termination of its operating contract, or both. If such a termination were to occur, Covanta would lose the cash flow related to the project, and incur material termination damage liability. In circumstances where the contract of one or more subsidiaries has been terminated for Covanta's default, Covanta may not have sufficient sources of cash to pay such damages.

None of Covanta's operating contracts for its waste-to-energy facilities previously have been terminated for Covanta's default, and it has not incurred material damages for performance failures under such contracts. We cannot assure you, however, that Covanta will be able to continue to be able to perform its obligations under such contracts in order to avoid such contract terminations, or damages for performance failures in the absence of contract termination, or that if it could not avoid such terminations or performance failures that it would have the cash resources to pay amounts that would then become due.

***Covanta May Face Increased Risk of Market Influences on Its Domestic Revenues After Its Contracts Expire.***

Covanta's contracts to operate waste-to-energy projects begin to expire in 2007, and its contracts to sell energy output generally expire when the project's operating contract expires. Expiration of these contracts will subject Covanta to greater market risk in maintaining and enhancing its revenues. As its operating contracts at municipally-owned projects approach expiration, Covanta will seek to enter into renewal or replacement contracts to continue operating such projects. Covanta will seek to bid competitively in the market for additional contracts to operate other facilities as similar contracts of other vendors expire. The expiration of Covanta's existing energy sales contracts, if not renewed, will require Covanta to sell project energy output either into the electricity grid or pursuant to new contracts.

At some of Covanta's facilities, market conditions may allow Covanta to effect extensions of existing operating contracts along with facility expansions which would increase the waste processing capacity of these projects. Such extensions and expansions are currently being considered at a limited number of Covanta's facilities in conjunction with its municipal clients. If Covanta were unable to reach agreement with its municipal clients on the terms under which it would implement such extensions and expansions, or if the



implementation of these extensions and expansions is materially delayed, this may adversely affect Covanta's cash flow and profitability.

Covanta's cash flow and profitability may be adversely affected if it is unable to obtain contracts acceptable to it for such renewals, replacements or additional contracts, or extension and expansion contracts. We cannot assure you that Covanta will be able to enter into such contracts, or that the terms available in the market at the time will be favorable to Covanta.

***Concentration of Suppliers And Customers May Expose Covanta to Heightened Financial Exposure.***

Covanta often relies on single suppliers and single customers at Covanta's facilities, exposing such facilities to financial risks if any supplier or customer should fail to perform its obligations.

Covanta often relies on a single supplier to provide waste, fuel, water and other services required to operate a facility and on a single customer or a few customers to supply waste or purchase all or a significant portion of a facility's output or capacity. In most cases, Covanta has long-term agreements with such suppliers and customers in order to mitigate the risk of supply interruption. The financial performance of these facilities depends on such customers and suppliers continuing to perform their obligations under their long-term agreements. A facility's financial results could be materially and adversely affected if any one customer or supplier fails to fulfill its contractual obligations and Covanta is unable to find other customers or suppliers to produce the same level of profitability. We cannot assure you that such performance failures by third parties will not occur, or that if they do occur, such failures will not adversely affect Covanta's cash flow or profitability.

In addition, for its waste-to-energy facilities, Covanta relies on its municipal clients as a source not only of waste for fuel but also of revenue from fees for disposal services Covanta provides. Because Covanta's contracts with its municipal clients are generally long term (none expires prior to 2007), Covanta may be adversely affected if the credit quality of one or more of its municipal clients were to decline materially. We cannot assure you that such credit quality will not decline, or that if one or more of Covanta's municipal clients' credit quality does decline, that it would not adversely affect Covanta's domestic cash flow or profitability.

***Covanta's International Businesses Emerged from Bankruptcy With A Large Amount Of Debt, And We Cannot Assure You That Its Cash Flow From International Operations Will Be Sufficient To Pay This Debt.***

Covanta's subsidiary holding the equity interests in its international businesses, CPIH, is also highly leveraged, and its debt will be serviced solely from the cash generated from the international operations. Cash distributions from international projects are typically less dependable as to timing and amount than distributions from domestic projects, and we cannot assure you that CPIH will have sufficient cash flow from operations or other sources to pay the principal or interest due on its debt. CPIH's debt is secured by its equity interests in certain of its subsidiaries, and by a pledge of its stock. Although CPIH's debt is non-recourse to Covanta and its domestic businesses, Covanta has pledged its stock in CPIH and CPIH has pledged its equity interests in certain of its subsidiaries to secure the CPIH debt.

CPIH's ability to service its debt will depend upon:

its ability to continue to operate and maintain its facilities consistent with historical performance levels;

stable foreign political environments that do not resort to expropriation, contract renegotiations or currency or exchange changes;

the financial ability of the electric and steam purchasers to pay the full contractual tariffs on a timely basis;