

energy supply contract with the California Department of Water Resources ("CDWR Contract") and associated hedge transactions (collectively, "West Book") to J. Aron & Company ("Aron"), a division of The Goldman Sachs Group, for \$405 million, subject to adjustments for market price changes and hedge transactions not transferred. On September 15, 2003, AE Supply and ATF announced that they completed the sale of the West Book to Aron for \$354 million. Much of the adjustment from the estimated sale price, previously announced on July 28, 2003, is attributable to contracts with one counterparty, valued at \$38.6 million, which were removed from the sale by mutual agreement of the parties. Changes in the mark-to-market value of the remaining contracts at closing and reduction in the number of remaining trades assumed by Aron, account for the rest of the adjustment. The proceeds from the sale will be applied, in large part, to finance the termination of tolling agreements with Williams Companies, Inc. and Las Vegas Cogeneration II and certain related hedging arrangements. In addition, Allegheny will have deposited, after certain escrow funds are released and under authorization by certain of its creditors, the remainder of the proceeds (estimated to be approximately \$75 million) in a cash collateral account for the benefit of certain of its lenders.³ These funds will be available to reduce the amount of AE Supply's debt that must be refinanced should Allegheny receive Commission authorization and then decide to refinance its bank borrowings.

Sale of the West Book and the sale of the securities authorized by the July 23 Order are the major components of Allegheny's plan to return to financial health. In addition, AE Supply and its subsidiaries—Allegheny Energy Supply Conemaugh LLC, Allegheny Energy Supply Hunlock Creek LLC, Allegheny Trading Finance Company, and Allegheny Energy Supply Development Services LLC—have entered into asset sales agreements described below, which also are an important part of this plan. Applicants state that the authority they seek in this Application is important to obtaining full value from these transactions. The resulting proceeds will make available significant additional cash, which can be used to reduce debt and improve the common

equity of the Applicants. In short, authority sought in this Amendment will assist directly in permitting the Applicants to achieve the capitalization standards required by the Commission.

II. Summary of Financing Request

Applicants are seeking a release of jurisdiction by the Commission over authority of AE Supply to engage in certain guarantee and other transactions. In the Capitalization Order, the Commission reserved jurisdiction over the financing authorizations granted in the Financing Order if the Applicants' capitalization did not meet the Common Equity Conditions. Applicants request that the Commission release jurisdiction over \$600 million of the Aggregate Guarantee Limitation, which AE Supply will utilize to undertake the guarantee obligations summarized below. To date, Allegheny and its subsidiaries have used \$42.6 million of \$3 billion Aggregate Guarantee Limitation.

A. Hunlock Guarantees

By agreement, AE Supply agreed to seek authority from the Commission to guarantee certain obligations of Allegheny Energy Supply Hunlock Creek, LLC ("Hunlock"), an exempt wholesale generator ("EWG") and wholly-owned subsidiary of Allegheny. Hunlock owns a 50 percent general partner interest in Hunlock Creek Energy Ventures (the "Hunlock Partnership"), which also is an EWG. UGI Hunlock Development Company ("UGI Hunlock") owns the remaining partnership interests in the Hunlock Partnership. The Hunlock Partnership owns a 44 MW combustion turbine generator and a 48 MW coal-fired generation facility known as the Hunlock Creek Electric Generating Station located in Hunlock Creek, Pennsylvania ("Hunlock Power Station").

In entering into the Hunlock partnership agreement ("Hunlock Partnership Agreement"), Hunlock and UGI Hunlock granted to each other certain put and call options, which, among other things, gave UGI Hunlock the right, for five years from the date of the agreement (December 8, 2000) to cause AE Supply to purchase the combustion turbine and/or the Hunlock Power Station from the Hunlock Partnership for a purchase price of \$15 million plus the value of all the Hunlock Power Station's inventory, and a price for the combustion turbine equal to its then current book value. The current combined price for the combustion turbine and the Hunlock Power Station is estimated at approximately \$42 million, which

exceeds the current estimate of the fair market value of this property. The Hunlock Partnership Agreement also gave Hunlock the right to require the Hunlock Partnership to sell the Hunlock Power Station (but not the combustion turbine) to AE Supply at any time following the failure of UGI Hunlock to participate in certain expansion projects. Because Hunlock, not AE Supply, was the signatory to the Hunlock Partnership Agreement, a *bona fide* dispute arose concerning which company—Hunlock or AE Supply—had the rights and obligations under the Hunlock Partnership Agreement.

AE Supply and Hunlock sought to extend the terms of the put and call options under the Hunlock Partnership Agreement, which currently are exercisable, and to clarify that Hunlock, not AE Supply, would be the obligor on the put option ("Hunlock Obligation"). They also agreed that AE Supply would guarantee the Hunlock Obligation upon receipt from the Commission of authority under the Act to do so. The put and call options were, therefore, amended to provide that they could be exercised only for ninety days following January 1, 2006, with Hunlock confirmed to be the obligor under the put option. AE Supply paid \$3 million to UGI Development (UGI Hunlock's parent) in exchange for UGI Development and UGI Hunlock releasing AE Supply from any current obligation it had under the put option of the Hunlock Partnership Agreement. In addition, UGI Hunlock and Hunlock agreed to extend the terms of the put and call options under the Hunlock Partnership Agreement and clarify that Hunlock would be the obligor under the Hunlock Partnership Agreement.

Applicants therefore request authority for AE Supply to guarantee Hunlock's obligations under the Hunlock Obligation. Entering into this guarantee will allow AE Supply to maximize the proceeds from the sale, which is described below, of interests in the Conemaugh Generating Station near Johnstown, Pennsylvania ("Conemaugh Interest").⁴ Depending upon market prices for generating plants in 2006, AE Supply could be called upon to perform Hunlock's obligations to purchase the

⁴ The \$5 million of the sale price for the Conemaugh Interest placed into escrow will be released at the earlier of (a) the time that AE Supply enters into an agreement to guarantee Allegheny Energy Supply Conemaugh LLC's indemnification obligations and an agreement to guarantee the Hunlock Obligation, or (b) April 15, 2006. Therefore, the guarantee of Hunlock's obligations under the Hunlock Obligation is a precondition to an expeditious release from escrow of the \$5 million of the proceeds of the sale of the Conemaugh Interest.

³ As a condition to closing, Aron escrowed \$71 million of the proceeds pending an order from the Commission authorizing AE Supply to undertake the guarantees connected with the sale of the West Book.