

combustion turbine and the Hunlock Power Station at a price that would be greater than their then current market value.

B. Conemaugh Guarantees

On February 25, 2003, AE Supply and its wholly-owned subsidiary, Allegheny Energy Supply Conemaugh, LLC ("Conemaugh"), an EWG under the Act, entered into an agreement ("Conemaugh Agreement") to sell the Conemaugh Interest, which is an 83-megawatt ("MW") share of the 1,711-MW coal-fired Conemaugh Generating Station, to UGI Development Company ("UGI Development"), an indirect, wholly owned subsidiary of UGI Corp. ("UGI"). The agreed upon sale price was approximately \$51.25 million, subject to a \$3 million credit in favor of UGI Development. That sale supplied (and the return on the aggregate \$6 million placed into two escrows will supply) cash needed to reduce debt and is part of Allegheny's overall plan to return to financial health.

Under the Conemaugh Agreement, AE Supply and Conemaugh agreed, jointly and severally, to indemnify UGI Development, its affiliates, and their respective directors, officers, employees, agents and representatives (collectively, "UGI Parties") against certain losses arising in the event of a breach of the Conemaugh Agreement. Any requirement that AE Supply in fact indemnify a UGI Party under its joint and several obligations for a breach by Conemaugh would represent a guarantee of the obligations of its subsidiary, which would be contrary to the Capitalization Order as long as the capitalization standards set forth in that order are not met. In addition, although the sale of the Conemaugh Interest resulted in Conemaugh exiting the generation business, to the extent it retains EWG status, indemnification of its obligations by AE Supply also could have been viewed as an additional investment in an EWG. The additional investments would be contrary to the Capitalization Order as long as the Common Equity Conditions are not met.

For these reasons, the parties amended the Conemaugh Agreement to delete all obligations of AE Supply to indemnify the UGI Parties for losses arising out of breaches of the Conemaugh Agreement by Conemaugh. The sale price for the amended transaction was \$51.25 million, without a \$3-million credit for UGI Development. The parties agreed that \$5 million of the sale price for the Conemaugh Interest would be placed into escrow until the earlier of (i) the time when AE Supply entered into an

agreement to guarantee Conemaugh's indemnification obligations ("Conemaugh Obligations") and an agreement to guarantee the Hunlock Obligation or (ii) April 15, 2006 ("Escrow Termination Date"). Prior to the Escrow Termination Date, UGI will be entitled to distributions in accordance with the Conemaugh Obligations or the Hunlock Obligation. Furthermore, the parties entered into an agreement ("Filing Agreement") to require AE Supply to file with the Commission for authority to guarantee the Conemaugh Obligations and the Hunlock Obligation within 60 days of the closing (June 26, 2003) of the sale of the Conemaugh Interest. AE Supply deposited \$1 million into escrow to guarantee its obligation to file with the Commission as set forth in the Filing Agreement. The parties also agreed that AE Supply would enter into an agreement to guarantee the Conemaugh Obligations and the Hunlock Obligation upon receipt from the Commission of authority under the Act to do so.

Applicants, therefore, are requesting that the Commission authorize AE Supply to guarantee those obligations. Applicants state that this authority is appropriate because the burden of undertaking this guarantee obligation easily is offset by the benefits the Allegheny system currently derives through the sale of the Conemaugh Interest and will derive from the receipt of the portion of the sale price currently held in escrow.

Applicants state that the indemnification obligations that AE Supply would guarantee are customary obligations of sellers of assets of this type. They fall into four broad classes, viz., obligations to indemnify for losses arising out of: (i) Breaches by Conemaugh of its obligations under any of its covenants or agreements contained in the Conemaugh Agreement or the agreement relating to the Hunlock facility; (ii) breaches by Conemaugh of its representations and warranties made in the Conemaugh Agreement, (iii) certain liabilities or obligations of Conemaugh or associated with its ownership of the Conemaugh Interest, and (iv) the failure of Conemaugh to comply with the provisions of any applicable bulk sales or transfer laws. This list of obligations and liabilities that AE Supply would guarantee is typical of the guarantee or indemnification obligations that parent companies normally provide in a commercial context, according to the Applicants.

In addition, Conemaugh only has an obligation to indemnify UGI Parties to the extent the UGI Parties' losses subject

to indemnification exceed \$500,000; however, this limitation on indemnification does not apply to losses related to breaches of Conemaugh's representations and warranties regarding title to the Conemaugh Interest or to breaches of its covenants or agreements. Applicants, therefore, submit that the undertaking by AE Supply of the proposed guarantee obligations is partially mitigated and that the remaining risk is outweighed by the benefits that will accrue to the Allegheny system through the return of the escrowed funds and the use of the escrowed funds to reduce debt.

C. West Book Guarantees and Dividend Authority

As noted above, AE Supply and its subsidiary ATF completed the sale of the West Book to Aron.

i. Guarantee Authority

AE Supply has agreed as part of the West Book sale to seek authority from the Commission to guarantee ATF's payment obligations under the sales agreement. ATF was established for the sole purpose of owning the CDWR Contract and performing obligations under that contract. Accordingly, upon the distribution of the proceeds of the sale of the contract from ATF to AE Supply, ATF would be left without resources to meet indemnification obligations, if any arise. ATF's potential payment obligations under the sales agreement consist of indemnification paid to Aron and its affiliates for losses they incur arising out of breaches of representations, warranties, covenants, agreements and other obligations contained in or connected with the sales agreement.

Other obligations of ATF that AE Supply would guarantee include a duty to operate its business prior to closing in accordance with past practice; to provide Aron with access to books and records relating to the contracts and to cooperate in the exchange of information, to use its best efforts to obtain necessary regulatory approvals, to notify Aron of significant changes in facts and circumstances, to pay all taxes attributable to the transfer of the contracts, and to file tax returns relating to the contracts for all periods prior to the closing date. ATF also has agreed to indemnify Aron against losses incurred as a result of certain specified pending class-action litigations relating to wholesale sales of electricity in California, which would be guaranteed by AE Supply under the authority sought. ATF's indemnification obligations are subject to a \$2 million deductible. Applicants do not believe