

SECURITIES AND EXCHANGE COMMISSION

(Release No. 35-28035; 70-10270)

Allegheny Energy, Inc., et al.

Order Authorizing Sale of Gas Utility Company

September 21, 2005

Allegheny Energy, Inc. ("Allegheny"), a registered holding company under the Public Utility Holding Company Act of 1935, as amended ("Act"), its wholly-owned public-utility company subsidiary, Monongahela Power Company ("Monongahela"), and its system service company, Allegheny Energy Service Corporation ("AESC" and, together with Allegheny and Monongahela, "Applicants"), Greensburg, Pennsylvania, have filed with the Securities and Exchange Commission ("Commission") a declaration under sections 12(c), 12(d), and 13 of the Act and rules 44, 46, and 54 under the Act. The Commission issued a notice of the declaration on June 15, 2005 (Holding Co. Act Release No. 35-27983).

The Applicants seek authority for Monongahela to sell to Mountaineer Gas Holdings Limited Partnership ("Buyer"), a West Virginia limited partnership, all of the common stock of Mountaineer Gas Company ("Mountaineer"), a gas utility company under the Act. In addition, Applicants seek authority for Monongahela to sell to the Buyer certain utility assets ("Related Assets")¹ it currently owns directly and that are used to serve natural gas customers. The sale by Monongahela of the common stock of Mountaineer and the Related Assets are referred to as the "Transaction." Monongahela also requests authority to dividend the proceeds from the

¹ These assets include gas distribution pipelines and appurtenant facilities and are listed in Exhibit B of the declaration.

Transaction to Allegheny out of unearned surplus. Finally, Allegheny requests authority for AESC² to perform certain services for Mountaineer following completion of the Transaction.

Mountaineer is a natural gas distribution company that serves approximately 205,000 retail natural gas customers in West Virginia. It owns approximately 4,000 miles of natural gas distribution pipelines. Mountaineer's wholly-owned subsidiary Mountaineer Gas Services, Inc. ("MGS") operates natural gas producing properties, gas gathering facilities, and intra-state transmission pipelines. It also engages in the sale and marketing of natural gas in the Appalachian basin. MGS owns more than 300 natural gas wells and has a net revenue interest in, but does not operate, an additional approximately 100 wells. Mountaineer is regulated by the West Virginia Public Service Commission. Allegheny contributed \$162.5 million of equity into Monongahela when Monongahela purchased Mountaineer in 2000.

The Buyer is a West Virginia limited partnership, all of whose voting securities will be owned by a West Virginia limited liability company that will be formed and named prior to closing (for purposes of this declaration this company is referred to as "Mountaineer Holdings LLC"). IGS Utilities LLC, a West Virginia limited liability company, will own 90.1% of the voting securities of Mountaineer Holdings LLC.³ Wholly-owned subsidiary companies of

² AESC is a wholly owned subsidiary of Allegheny and serves as a service company for the holding company. AESC is reimbursed by Allegheny and its subsidiaries at cost for services it provides.

³ Applicants state that, based upon their conversations with the Buyer, they understand that the Buyer, Mountaineer Holdings LLC, and IGS Utilities LLC each will request exemption under section 3(a)(1) and rule 2 under the Act.

ArcLight Capital Partners, LLC ("ArcLight") will own the remaining 9.9% of those voting securities.⁴ The Buyer has been formed for the sole purpose of acquiring 100% of Mountaineer's common stock and the Related Assets. The principals of IGS Utilities LLC have been involved in the natural gas industry since the mid-1980s. ArcLight is a privately held energy infrastructure investment firm with more than \$2.5 billion under management.

On August 4, 2004, Monongahela and the Buyer executed an acquisition agreement ("Acquisition Agreement") under which Monongahela agreed to sell to the Buyer all of Mountaineer's common stock, the Related Assets, and other assets that do not constitute utility assets under the Act but that are integral to the operation of Mountaineer and the Related Assets. The purchase price for Mountaineer's common stock and the Related Assets was the result of arm's-length bargaining and will be determined according to a formula set forth in the Acquisition Agreement. At the time the Acquisition Agreement was executed, the price was estimated to be \$141 million in cash and \$87 million in assumed debt, subject to certain closing adjustments. In addition, the Buyer will settle certain inter-company accounts over a three-year period. The current estimate of these amounts is approximately \$5 million. Upon closing of the Transaction, Mountaineer and MGS will be wholly owned subsidiaries of the Buyer, which will

⁴ Applicants state that they understand that ArcLight has concluded that because it will indirectly own only 9.9% of Mountaineer's voting securities, neither it nor any of its subsidiary companies or affiliates will become a holding company under section 2(a)(7)(a) of the Act through participation in the transaction.

operate Mountaineer as a stand-alone gas utility based in Charleston, West Virginia.

Mountaineer will own the Related Assets.

Monongahela proposes to dividend the proceeds from the Transaction to Allegheny out of unearned surplus. The proceeds will be used to reduce debt.

In connection with the Transaction, AESC and the Buyer propose to enter into a transition services agreement ("TSA"). Under the TSA, AESC would perform various services for the Buyer. These services fall into three broad categories: (i) financial accounting, (ii) technology services, and (iii) call center and billing services. AESC will provide financial accounting and technology services for a period up to 12 months from the date the Transaction closes. AESC will provide call center and billing services for succeeding one year terms beginning on the date the Transaction closes and continuing until terminated by either party under the terms of the TSA. Allegheny seeks Commission authorization for AESC to provide these services.

The transaction is subject to rules 53 and 54 under the Act. Rule 54 states that in determining whether to approve the issue or sale of a security by a registered holding company for purposes other than the acquisition of an exempt wholesale generator ("EWG") or a foreign utility company ("FUCO"), or transactions by a registered holding company or its subsidiaries other than with respect to EWGs or FUCOs, the Commission shall not consider the effect of the capitalization or earnings of any subsidiary which is an EWG or a FUCO upon the registered holding company system if rules 53(a), (b) or (c) are satisfied.

Although Allegheny states that it does not satisfy the requirements of rule 53(a)(1),⁵ Allegheny is in compliance with, and will comply with rule 53(a)(2), rule 53(a)(3) and rule 53(a)(4). None of the circumstances described in rule 53(b)(1) have occurred. The circumstances described in rule 53(b)(2) and rule 53(b)(3) have occurred. The requirements of rule 53(c) are met. Specifically, the requested authorization will not have a substantial adverse impact upon the financial integrity or operations of Allegheny, its operating companies⁶ or their customers. The ratio of common equity to total capitalization of each of the Operating Companies will continue to be maintained at not less than 30%,⁷ and the proposed dividend will not be made if the dividend payment would impair the ability of Monongahela to meet its obligations. In addition, each of the Operating Companies is subject to regulation by state commissions that are able to protect utility customers within their respective states.

⁵ Allegheny states that it does not satisfy the requirements of rule 53(a)(1). By prior order (Holding Co. Act Release No. 27486 (Dec. 31, 2001) (“Financing Order”)), the Commission authorized Allegheny to invest up to \$2 billion in EWGs and FUCOs and found that this investment would not have either of the adverse effects set forth in rule 53(c). As of December 31, 2004, Allegheny's "aggregate investment," as defined in rule 53(a)(1), was approximately \$130 million. However, at present Allegheny cannot make any investments in EWGs and FUCOs without further authorization from the Commission because it is no longer in compliance with the financing conditions set forth in the Financing Order. In the Capitalization Order, Allegheny was authorized to make additional investments in EWGs to the extent necessary to complete any project or desirable to preserve or enhance the value of Allegheny's investment in a project or in connection with the qualification of an existing project as an EWG, as long as the revised financing conditions, as defined in the Capitalization Order, were met.

⁶ Allegheny's utility subsidiaries are Monongahela, West Penn Power Company (“West Penn”), and The Potomac Edison Company (“Potomac Edison”). They are collectively referred to as the operating companies (“Operating Companies”).

⁷ The common equity ratios of the Operating Companies as of December 31, 2004, were:

The fees, commission and expenses incurred or to be incurred in connection with this declaration will not exceed \$10,000.

The West Virginia Public Service Commission (“PSC”) has jurisdiction over the Transaction and approved it on August 24, 2005. The Transaction has also met the requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976. No other state or federal commission, other than this Commission, has jurisdiction over the proposed Transaction.

Due notice of the filing of this declaration has been given in the manner prescribed in rule 23 under the Act, and no hearing has been requested of or ordered by the Commission. Based on the facts in the record, the Commission finds that the applicable standards of the Act and rules are satisfied and that no adverse findings are necessary.

West Penn: 62.3%; Potomac Edison: 49%; and Monongahela Power: 36.2%.

IT IS ORDERED, under the applicable provisions of the Act and the rules under the Act, that the declaration, as amended, be permitted to become effective immediately, subject to the terms and conditions prescribed in rule 24 under the Act.

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

Jonathan G. Katz
Secretary