As filed with the Securities and Exchange Commission on February 18, 2005

FILE NOS. 70-10251 and 70-10100

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

COMMENTS AND REQUEST FOR HEARING OF HARBERT DISTRESSED

INVESTMENT

MASTER FUND, LTD.

REGARDING FORM U-1

AND DECLARATION OF ALLEGHENY ENERGY

UNDER

THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Harbert Distressed Investment Master Fund, Ltd.
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The Commission is requested to send copies of all notices, orders and communications in connection with this matter to:

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COMMENTS AND REQUEST FOR HEARING OF HARBERT DISTRESSED INVESTMENT MASTER FUND, LTD.

On September 21, 2004, Allegheny Energy, Inc. ("AYE" or "the holding company") and Allegheny Energy Supply Company LLC ("Supply") (collectively, the "Applicants") filed a Declaration/Application as thereafter amended ("Application") seeking a variety of authorizations from the Commission under the Public Utility Holding Company Act of 1935 (the "Act" or "PUHCA"). The authorizations would allow the Applicants significant discretion to undertake numerous financing transactions for nearly three years, until September 30, 2007, and may involve the operating utility subsidiaries of AYE, namely West Penn Power, Monongahela Power and Potomac Edison (the "Operating Utilities"). In effect, granting the requested authorizations would afford the Applicants significant latitude regarding their finances while they continue to fail to meet minimum equity levels required under PUHCA and in many respects would treat them as though they had achieved a 30% equity capitalization ratio already, although they are far below that level. Moreover, while in the past the Applicants have sought authorization for relative short periods, the original Application in File No. 70-10251 sought authorization that would continue for three years. This request is made notwithstanding Applicants' track record of revisiting the Commission year after year for piecemeal waivers of, and extensions of time to comply with, the Commission's regulations accompanied by further requests for special treatment and representations regarding Applicants' "progress" which to date has severely diminished shareholders' equity.

The Commission by notice of January 24, 2005 set February 18, 2005 as the date for submitting comments or requesting a hearing on the Application in File No. 70-10251. Additionally, on November 23 and December 3, 2004, Applicants in File No. 70-10100 requested that the Commission through April 30, 2005 apply to the Applicants less demanding

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standards than usual. A grant of authority in File No. 70-10251 could moot authorization derived from File No. 70-10100.

I. SUMMARY

A. The Problem

The Commission is presented with a stark choice. On the one hand the Commission can take the pro-active steps requested below to stop any further expansion of liability and harm that captive retail ratepayers of, and investors in, the Operating Utilities already have been exposed to, as Applicants continue their attempt to resuscitate Supply from a series of catastrophic mistakes. If the Commission implements this relief, which still allows Supply to seek financing independently, but without leaning on the Operating Utilities and AYE, then retail ratepayers of and sources of credit to the Operating Utilities can be shielded from the worst consequences of a Supply bankruptcy.

On the other hand, granting the authority requested by Applicants invites even greater compromising of the Operating Utilities' financial viability. This Commission thus faces a very serious decision. A year from now we could conclude that the Commission protected retail ratepayers of and investors in the Operating Utilities. Or, despite clear warning signs and requests by investors for assistance, the Commission could adopt a status quo approach based upon non-public projections and aspirations, not facts, which resulted in the type of severe harm to retail ratepayers and investors the Act was intended to prevent.

The credit quality of AYE and the Operating Utilities has diminished because of problems in the merchant generation and marketing operations of Supply, draining equity from AYE. As a result, even on a pro forma basis excluding the Supply debt, as of September 30, 2004 the Operating Utilities and the holding company together have weak financial ratios compared to their peers and PUHCA yardsticks,[1] with large amounts of maturing debt, and significant exposures to commodity and regulatory risk. Cash flow and equity value of AYE and the Operating Utilities are being diverted to support staggering losses and deteriorating equity levels at the unregulated business. At bottom, as Applicants admit, the continuing liquidity drain has only one cause: Supply. Huge reductions in equity value resulting from unregulated operations occurred in almost every quarter since this Commission originally granted Allegheny waiver of the 30% equity capitalization threshold, up to and including a loss of $376 million in the quarter ended September 2004.

Applicants fail to acknowledge the continued financial, operating and regulatory risks facing Applicants and overstate the impact of possible improvements. While acknowledging the serious circumstances Allegheny faced in 2002, the Application proceeds to assert – erroneously – that Allegheny has "reversed this situation fundamentally" placing operations "on a steady course to return to full financial health and compliance with the Commission's benchmark 30 percent common equity requirement." Application at 2-3. This assertion is wrong on many counts. The equity component of the Applicants' capital structure has gotten much thinner – not thicker – since the full impact of the financial crisis facing the company became apparent. The "steady course" pursued by Applicant continues to be based upon:

(a) sales of assets, including one that is still pending and highly conditional, that would, if consummated, permit debt reduction but at valuations *that have materially impaired AYE's nominal dollar equity and the share of equity as a percentage of its capitalization*;

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[1] Even if Supply were to be deconsolidated from AYE, Harbert estimates that as of September 30, 2004 the holding company and Operating Utilities would have equity of only about 25%. All the Operating Utilities are rated sub-investment grade by Standard & Poors and Moody's. The "Risk Factors" in the November 2004 Prospectus for Potomac Edison First Mortgage Bonds include multiple references to its inability to pass through all purchased power and transmission costs to retail customers, including amounts paid to Supply.

(b) aspirational goals for plant operating improvements, in contrast to the hard reality of recent serious operational failures;

(c) burdening the Operating Utilities' customers, cash flow and equity value to support Supply's liquidity needs, including potential fuel increases, potential penalties for violations of environmental regulations and future environmental capital expenditures;

(d) projected cost reductions in "outside services" at a time when Applicants continue to fail to resolve independent auditors' concerns voiced for two years that financial control weaknesses persist and in the face of the surprising termination of its General Counsel;

(e) dependence on the absence during future periods of volatility in AYE's stock price to presume mandatory conversion of holding company debt; and

(f) reliance on unusually aggressive debt markets and low interest rates to provide continued access to debt on attractive terms, much at floating rates.

None of these strategies address the fundamental cause of the huge burden facing AYE, namely Supply.

As to the assertion that the Applicants are on course to satisfy "the Commission's benchmark 30 percent common equity requirement," Supply's equity cushion *continued to shrink from 19% to 10%* over the nine months ending September 2004 (about two years after the first events which required this agency's waiver of the 30% threshold) and its demands for support from its affiliates have increased rather than abated. The Supply equity ratio would reach only 15% even if AYE closes, as it hopes to, the additional lifeline transactions for Supply, after adjusting for the downstreaming of proceeds of an AYE October equity issue into Supply to prepay Supply's debt (instead of providing liquidity at AYE for maturing short term holding company debt). On a consolidated basis for all of AYE, by incorporating into the September 30, 2004 balance sheet the announced transactions to date and assuming an additional $100 million in proceeds (with no further writedown) for sale of the as yet unsold Enron peaking units, Harbert estimates that equity will not even reach 23% of capitalization *even assuming all cash is used to prepay debt and no cash is used for other purposes.*

The IBES survey of investment community expectations indicates that AYE is not about to earn its way to a 30% equity ratio. In that survey's shows consensus view, AYE will have earnings of $.90/share in 2005 and $1.20/share in 2006, producing a total over the two years of $290 million net income. Reflecting that income as additive to AYE's capital structure as of September 30, 2004 (*i.e.*, presuming at least a portion is not spent on environmental litigation or compliance, as described below) would produce only a 23% equity ratio at the end of 2006 (not 2005).

For AYE to reach 30% equity on a consolidated basis by the end of 2005 as promised by Applicants, they would need to: sell enough additional assets at prices which do not create book losses and which raise proceeds to reduce debt by another $1.3 billion; or increase equity by $400 million to prepay debt either from cash through an issuance of common equity or from 2005 net income and operating cash flow after capital expenditures. The foregoing alternatives for reaching a 30% equity threshold by the end of 2005 are implausible. [2] Supply has sold its material non-core assets and a sale of its core assets is not likely to occur at valuations which will thicken the proportion of capitalization attributable to equity because such assets are committed to POLR supply and require large environmental capital expenditures. Net income and cash flows at the Operating Utilities and Supply are not expected to improve considerably over the next two years absent dramatic operational improvements: power prices for most of Supply's

2 The extent of the problem is inadvertently highlighted by the Applicants' statement that "its common equity ratio has improved somewhat since the recent issuance of approximately $152 million of Common Stock" (Amendment No. 1 to the Application, n.42). In fact, if the $152 million were to be included, the ratio would rise to 19.3%, conveying a sense of the magnitude of the challenge of reaching 30%.

output are fixed and Supply's expenses (*e.g.*, operational costs and emission allowances) and capital expenditures remain highly volatile.

Banking on the Applicants' ability to achieve a 30% equity level is not prudent. Applicants have failed to improve consolidated equity levels to date; relied on consummating speculative near term transactions for equity enhancement; since August 2002 have lacked adequate financial controls required to prepare reliable projections; and face serious near term business risks. The full impact of prior obligations (*e.g.*, the Intercreditor Agreement, discussed at 37-39, *infra*) has not been fairly analyzed and presented in the Applicants' filings - - even when the obligations directly limit the financial flexibility of the Operating Utilities.[3]

The Applicants seek greater flexibility from the Commission and offer little by way of protection for the Operating Utilities' investors, as though Applicants' problems over the past three years have arisen because management lacked sufficient latitude. Just the contrary is true, however: the serious problems at Supply have arisen because the management of Applicants squandered on merchant generation and trading transactions the strengths derived from the Operating Utilities.

The Application itself would continue this practice. "Supply, the Utility Applicants and the Non-Utility Applicants seek the flexibility to issue secured short-term debt as circumstances warrant *to provide maximum flexibility for their financial operations* . . . . Applicants propose . . . taking appropriate long and short term considerations into account, to utilize the most economic

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[3] A fine example is furnished by the amendments to the Application. The Application, filed September 21, 2004 offers no substantive discussion of the Intercreditor Agreement. The Intercreditor Agreement is not a new development from the perspective of Applicants, who entered into the Intercreditor Agreement in 2003. Additionally, the proposal subject to the Application has not changed so significantly by virtue of the amendments that the Intercreditor Agreement was transformed from an irrelevant or marginal document to a very important one. Nonetheless, the Applicants' original amendment was filed without any substantive discussion of the significance of the Intercreditor Agreement, yet the amendment to Applicants' U-1 contained a much longer discussion of the Intercreditor Agreement in Item I.E.(vi)(i). A longer discussion should not be confused with a more illuminating discussion.

means available at any time to meet their short-term financing requirements and will ensure that the Utility Applicants, the Non-Utility Applicants and any Capital Corp will do likewise." (First Amended Application at 12; emphasis added). This statement indicates Applicants will use the Operating Utilities' attractive characteristics to obtain financing that ultimately could flow to Supply.

AYE admits that it "will seek, consistent with regulatory constraints, to manage its business lines as an integrated whole. Implementing this strategy will be a significant challenge, in part, because of the continuing legacy of past transactions that have negatively affected Allegheny's operations and financial condition." Allegheny Energy, Inc., Form 10-Q for the fiscal period ending September 30, 2003, at 36-37 (January 23, 2004) (hereinafter "Third Quarter 2003 10-Q"). Similarly, Applicants' description of the Intercreditor Agreement indicates that Supply's lenders would not have extended credit to Supply in 2003 but for the financial support provided by the Operating Utilities under the Intercreditor Agreement.

Harbert Distressed Investment Master Fund, Ltd. ("Harbert") invests in securities of various companies in the electric power industry, including Applicants and the Operating Utilities. Harbert seeks the protection of AYE's and the Operating Utilities' credit quality and access to capital. The steps outlined below in Part I.B are essential to achieve that protection. Without the affirmative action identified herein, the Commission would allow the Applicants to pursue more of the same, with potentially grave detriment to the Operating Utilities and their stakeholders.

B. <u>The Solution</u>

The appropriate remedy is to "ring-fence" the Operating Utilities and the holding company from Supply's risks, an arrangement frequently advocated by credit rating agencies and adopted by regulators for other utilities in similar situations.[4] Ring-fencing has been described in shorthand as "shielding [the beneficiary entity's] assets from creditors in any future bankruptcy proceeding."[5] The Operating Utilities, their subsidiaries and AYE should be made bankruptcy remote from the rest of the enterprise, *i.e.* the corporate structure and/or debt of the holding company and the Operating Utilities should be modified to eliminate the potential for defaults which can be triggered by events at Supply or changes in the financial condition or financial statements of Supply; Supply and AYE and the Operating Utilities should each appoint non-overlapping independent directors; and the corporate organizational documents of AYE and the Operating Utilities should covenant that so long as they are solvent they will not voluntarily file for bankruptcy due to a Supply bankruptcy. In addition, to avoid retail ratepayer subsidization of unregulated losses and capital costs of environmental compliance at unregulated assets, any new commercial contracts or amendments to existing contracts to which Supply and any of its rate-regulated affiliates are parties should be put out to the market in a competitive bid, with Supply only entering into such contracts which produce pricing, terms and conditions at least as favorable to the rate-regulated affiliate as those available in the market. No further funds transfers should be permitted from AYE (or its subsidiaries) to Supply or from the Operating Utilities to Supply directly or indirectly. Proceeds of securities issuances at AYE or the Operating Utilities should reduce holding company or Operating Utility debt or fund rate-regulated capital expenditures, instead of reducing Supply debt or funding unregulated investments.

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4 *See e.g., Cal. v. PG&E Corp.*, 281 B.R. 1 (2002).

5 *Cal. ex rel. Lockyer v. FERC*, 329 F.3d 700, 704-05 (9th Cir. 2004).

Straightforward and logical protections, consistent with ample precedent involving other financially challenged utilities, can avert increased and potentially financially crippling exposure for the Operating Utilities. If Applicants are correct in assuming Supply's ability to improve equity over time, then Supply should do so independently without further harming the Operating Utilities, and ultimately the foregoing protections can be unwound. If Applicants are incorrect and Supply files for bankruptcy, the arrangements described above will dramatically reduce the risk that the Operating Utilities and the holding company would be forced to file as well, and will prevent further commitment of resources conscripted from the Operating Utilities' ratepayers and investors to a doomed rescue effort.

This Commission should not condone a continuation of the circumstances that create or simply extend the period when Supply's insolvency could bring down the Operating Utilities as well. AYE seems intent on taking its Operating Utilities and their ratepayers long-term hostages to the vagaries of Supply's operations. Ring-fencing can bring a finite conclusion to AYE's problems. Without ring-fencing, what should have been a problem lasting a year (*see* Xcel discussion at 41-43, *infra*) instead appears to be of indefinite longevity. One need not subscribe to ring-fencing as a general proposition in all instances in order to recognize its value given Allegheny's circumstances here.

Greater flexibility as requested in the Application would permit Applicants to substantially compromise the Operating Utilities in the face of an escalating financial crisis to the point where it would be too late to prevent the Operating Utilities from being *bankrupted* by Supply. Conditioning of prior authorizations granted to the Applicants based upon periodic reporting obligations has been thwarted and ineffectual, as shown below, while the equity component of capitalization of the Applicants has been bled away. Therefore, the Application should be denied unless the Commission implements effective ring-fencing measures henceforth to prevent Allegheny from subsidizing and sustaining the losses at Supply based upon the financial strength of AYE's Operating Utilities, ultimately backstopped by the Operating Utilities' investors and retail ratepayers. The Act was not designed to protect investors in a holding company's non-utility subsidiaries. Instead, the PUHCA was enacted to protect investors in, and the retail ratepayers of, utilities from predations of affiliated, unregulated enterprises.

II. BACKGROUND

A. Supply's Crisis Was Caused by Multiple Unregulated Business Failures

Prior to 2001, AYE maintained an adequate equity component in its capital structure. However, the equity cushion collapsed following several calamitous transactions in which Supply and affiliates expanded into unregulated merchant activities at the top of the energy market bubble in 2001. Equity was drained rapidly because Supply overpaid for businesses in the merchant generation and trading field, financed these acquisitions with short term debt, botched its commodity hedging and failed to maintain financial accounting controls. These events sapped Supply's financial strength and should not further impair economical access to capital for the Operating Utilities.

In 2001 AYE and Supply purchased Merrill Lynch's energy marketing and trading business in a transaction imposing on AYE the obligation to pay Merrill Lynch up to $604 million. *See* Third Quarter 2003 10-Q. On September 24, 2002, Merrill Lynch sued AYE, alleging that AYE breached the asset purchase agreement, seeking damages in excess of $125 million; a day later, Supply responded by claiming that Merrill Lynch fraudulently induced AYE to purchase the business and had breached various representations and warranties, seeking damages in excess of $605 million, among other relief. *See* Third Quarter 2003 10-Q at 58-59.

The claimed damages indicate the almost complete loss of value related to assets acquired from Merrill Lynch. Merrill Lynch continues to pursue the litigation against Supply, which if successful will further reduce equity in the Applicants.

As an outgrowth of Supply's acquisition of the Merrill Lynch trading operations, Supply's trading desk entered into a series of hedges to offset risks of a large sale of power into volatile West Coast markets. These forward purchases resulted in significant negative cash flows from the summer of 2001 through 2003, *see* Allegheny Energy, Inc., 2003 SEC LEXIS 1704, Holding Co. Act Release No. 35-27701, File No. 70-10100, at 3-4 (July 23, 2003) (hereinafter "July 2003 Order"), which ended only when the portfolio was sold to Goldman, Sachs. While Applicants' previous pleadings to the SEC claim the sale to Goldman, Sachs showed the "steady course" Applicants were pursuing to improve its equity levels, most of the sale proceeds were paid to third parties to terminate related hedges, resulting in less than $100 million in debt reduction, at the price of *more than $500 million in equity writeoffs*. All told, the West Coast contract and related forward purchase hedges have caused cash losses at Supply of more than $400 million since 2001. *Id.*

Also in 2001 Supply purchased 1700 MW of peakers from Enron for about $1 billion, or almost $700/kw. But in 2003 Applicant did not sell its generating assets, such as these peakers because, according to statements to the investment community at the time, valuations from the Applicants' perspective were not attractive. It is not clear to what extent those valuations and the resulting writedowns and reductions to Supply equity were reflected in confidential projections of equity levels prepared in previous applications filed with this Commission, or in Supply's financial statements at the time. Applicants finally succeeded in mid-2004 in selling one of the peakers for about $250/kw, reducing debt by only about $175 million compared to a reduction of equity of over $650 million (pretax), providing further evidence of the "steady course" producing a collapse in shareholder equity manifest in 2003.

By year end 2002, according to Applicants, common stock equity had fallen below 28% of total capitalization. *Id.* at 7. Allegheny admitted that cancellation of its St. Joseph, Indiana merchant generation project, revaluation of its merchant trading book, "together with other unusual items such as . . . net losses recorded with respect to asset sales . . . decreased Allegheny's stockholder's equity by approximately $740 million in 2002." Allegheny Energy Inc., Amendment No. 4 to Form U-1 in File No. 70-10100 (July 17, 2003). The St. Joseph merchant project, the Enron peakers, the Merrill Lynch merchant trading business plus the West Coast power contract and associated hedges all belonged to Supply.

These setbacks prompted AYE to seek greater latitude in its financing, operations and capital structure. In February, 2003, the Commission authorized AYE to engage in financing transactions so long as AYE's equity on a consolidated basis did not fall below 28% and Supply's equity ratio did not fall below 20% ("the 28/20 Condition").[6]

Supply's downward financial spiral continued in 2003. According to an AYE disclosure statement:

> The net value of AE Supply's commodity contracts decreased by $509.2 million for the nine months ended September 30, 2003, as a result of $499.1 million of unrealized losses recorded during the first nine months of 2003 which are comprised of changes in market conditions ($159.9 million), the renegotiation of CDWR contract terms ($152.2 million), the sale of energy trading portfolio and contracts ($167.3 million), the cumulative effect of the adoption of EITF 02-3 ($19.7 million), and option premium expirations of ($10.1 million) during the first nine months of 2003. For the nine months ended September 30, 2003 and 2002, AE

[6] Allegheny Energy, Inc., Holding Co. Act Release No. 27652 (Feb. 21, 2003).

> Supply reported $451.0 million and $210.8 million, respectively, in losses from wholesale operating revenues.

Third Quarter 2003 10-Q.

The annual results for 2003 for Supply's operations were dismal. "AE Supply's 2003 financial performances and cash flows have been substantially weaker than projected." *Id.* "AE Supply requires external funds to meet its immediate liquidity needs." *Id.* at 10. According to Applicants at the time, "AE Supply's common equity ratio is near 20%." *Id.* at 11 n.3.

B. <u>The Operating Utilities Are Called Upon to Rescue Supply and AYE</u>

In response to its missteps in the merchant generation and energy trading business, AYE needed to secure rescue financing in the first quarter of 2003 for Supply and for the regulated holding company itself. According to AYE, it, "Supply, Monongahela, and West Penn entered into agreements (Borrowing Facilities) totaling $2,447.8 million with various credit providers *to refinance and restructure the bulk of AE and . . . Supply's short term debt.*" *Id.* at 58 (emphasis added). Importantly, at this time Operating Utilities and the holding company also were in default under their own debt agreements due to the inability of the Applicants to file timely financial statements, again as a result of the turmoil at Supply, which was finally cured only when financials were completed in January 2004. The rescue financing came with a number of strings attached, including the imposition of the "Intercreditor Agreement," described in Part IV. D. *infra*. Particularly, whenever the Operating Utilities receive incremental capital infusions, the Intercreditor Agreement requires them to pay the proceeds via a convoluted process over to Supply. The significance of this critical obligation and the potential consequences were not adequately described at the outset, and only gradually have AYE's pleadings begun to suggest many of the troubling aspects of the Intercreditor Agreement.

Notwithstanding the Commission's February 2003 authorization of a 28% equity ratio for AYE and a 20% equity ratio for Supply, circumstances worsened. In July 2003, Moody's Investors Service reduced its rating of the Operating Utilities to below investment grade.[7] This occurred despite the fact that on a stand-alone basis, the Operating Utilities have the financial characteristics that would command an investment grade rating. The reason for the Operating Utilities remaining below investment grade lies with the credit rating agencies' concerns about the utilities' potential to be conscripted to prop up Supply, a concern that would be resolved by ring-fencing.

During 2003, the Applicants approached this Commission seeking permission to engage in additional transactions which, it was represented, could restore them to financial health. The Commission's Order in July 2003 summarized AYE's arguments on behalf of its application as follows: "Applicants are taking actions to improve their long-term financial problems . . . . Although AE Supply is in the process of selling various assets, the timing of such sales will not provide sufficient amounts soon enough to meet its immediate needs." July 2003 Order at 12. According to the Commission's July 2003 Order, the "*Applicants* have provided *projections* that *show the holding company's consolidated common equity ratio returning to 30% by the end of 2005*. Allegheny's new management believes that these projections are reasonably achievable through the execution of their strategic and financial plan." *Id.* at 24-25 (emphasis added).

The Applicants represented that the relief they sought would not "adversely affect the Operating Companies [*i.e.*, the Operating Utilities] and their customers." *Id.* at 26. The Commission granted the requested relief. As part of authorization issued in July 2003 by the Commission for AYE to engage in a series of financing transactions, AYE was obligated to file

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[7] Allegheny Energy, Inc., Amendment No. 4 to Form U-1 in File No. 70-10100, at 18 (July 17, 2003).

on a quarterly basis certificates showing, *inter alia*, the percentage components of the capital structure for itself and Supply. However, that step was rendered meaningless when AYE asserted that it could not supply data for the period in question, or filed data under claims of confidentiality as described below.

In the summer of 2003, AYE sold $300 million of subordinated convertible debenture debt securities in a private placement; and proceeds were used to satisfy 2003 maturities of *both* AYE and Supply. The financing was issued at AYE instead of Supply, with the result that the lenders could look to the equity value of the Operating Utilities to support the loan, thereby adversely affecting the Operating Utilities given the loan's relatively high interest rate, short maturity and impact on leverage. Applicants cite this transaction as part of their "steady course" of improved equity capitalization. However, the Operating Utilities' cash flows now must support $300 million of high interest rate debt which is subject to mandatory conversion to equity only if the common stock trades above $15 for a specified period of time after June 2006, a circumstance that Applicants undoubtedly hope will occur but which represents a roll of the financial dice, not a steady course of debt reduction. Since the financial crisis in late 2002, AYE stock has only been above $15, the level at which conversion is mandatory, for less than five months during a period when the cyclical Philadelphia Utility Index is at a fifteen year high.

The ineffectiveness of the conditions contained in the July 2003 order was illustrated in short order. With respect to the requirement that AYE state its equity ratio, AYE informed the Commission on December 17, 2003 that "Allegheny is unable to supply this information for the current year because financial statements for that period are not yet available." *See* Exhibit 1 hereto. Subsequently, AYE claimed confidential status for its capital structure information.[8]

[8] "Certificate of Notification Pursuant to Rule 24," File No. 70-10100 (May 7, 2004).

Recently, Supply announced it was seeking de-registration of its debt securities, which will further reduce public disclosure regarding Supply's financial circumstances. *See* Exhibit 2 hereto. The Applicants continue to rely upon projections, extrapolations and claims that they will not expose to the light of day. *See, e.g.*, the Application at 25 (relying upon Exhibit H which is AYE management's non-public projection intended to show a 30% equity ratio by December 31, 2005) and at 29 (filing Exhibit H in a manner to conceal it from public disclosure and scrutiny); *see also*, Amendment Nos. 17 and 19 to Form U-1 in File No. 70-10100 (April 29 and July 27 respectively) at 20 (citing to confidential Exhibit H), and at 8 (citing to confidential Exhibits H and I). These attempts to shield AYE from disclosure obligations illustrate the difficulty in policing AYE's activities. Applicants have failed to justify why their projections that they will reach a 30% equity level in short order should remain concealed from the public.[9] Surely investors are entitled to know at least the building blocks for the claim that the Applicants can reach a 30% equity ratio. As Harbert has shown, a 30% equity ratio would seem fanciful, and Harbert has publicly explained its conclusion; Applicants have not made such a public showing, and should not be permitted to engage in essentially *ex parte* presentations to make their case.

Five days after AYE informed the Commission on December 17, 2003 that AYE could not furnish capitalization ratios, AYE sought additional time (*i.e.* through April 30, 2004) to take advantage of the loosened parameters granted by the Commission, including continued non-compliance with the 30% equity threshold. AYE represented that "Applicants have made

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9 Particularly, Applicants have not satisfied the standards required to impose confidentiality under Section 250.104. Their filing does not contain any substantive showing that would trump the requirement that "all information contained in any . . . application . . . or other document filed with the Commission shall be available to the public . . . ." Applicants have not met the requirements of Section 250.104(b)(2) of the Commission's regulations, and all information in their filings should be exposed to public review and comment.

substantial progress in implementing their plan for returning to financial health and compliance with Commission's 30 percent common equity requirement for registered holding companies." *Id.* at 7.[10] Given that financial statements were unavailable, it is difficult to understand how AYE could have confidently represented that it had made "substantial progress." Indeed, this statement directly conflicts with subsequent developments at AYE and Supply.

In the wake of this "substantial progress," AYE subsequently disclosed that the capital structures in effect for AYE and Supply when they received extended authorization in December 2003 (and at the time were "unable to supply" the equity ratios) were far below even the 28% threshold. Particularly, AYE indicated that common equity represented 20% of its capitalization and Supply's common equity was approximately 19%.[11] This occurred notwithstanding the fact that the Applicants were granted relief they had requested from this Commission, and that they issued additional securities and executed multiple refinancings and asset sales.

The diminution in the equity cushion occurred notwithstanding the fact that the Operating Utilities were conscripted into propping up Supply. The Operating Utilities paid AYE approximately $129 million in dividends during 2002 and approximately $117 million in 2003. Allegheny Energy, Inc., Form 10-K for the year ending December 31, 2003, at 64-65, Item 5. In turn, AYE contributed $222 million to Supply in July and December 2003. *Id.* at 64.

On October 4, 2004, AYE sold 10 million common shares at $15.15 per share in a private placement.[12] On November 2, 2004, AYE used the $150 million of stock proceeds and $50 million from "cash on hand" to repay $200 million of *Supply's* term loans. AYE elected to sell equity in the holding company instead of equity in Supply for a deleveraging of Supply. These

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[10] Allegheny Energy, Inc., Amendment No. 10 to Form U-1 in File No. 70-10100, at 7 (Dec. 22, 2003).

[11] "Certificate of Notification Pursuant to Rule 24," File No. 70-10100, at 2 (Mar. 30,2004).

[12] Allegheny Energy, Inc., Form 8-K, at 92, Part III, Item 2 (Nov. 5, 2004) (hereinafter "Form 8-K").

equity investors therefore benefited from the support of the Operating Utilities' equity value to fund an equity investment in Supply. A press release announcing the transaction is attached hereto as Exhibit 3.

Debt reduction based on compromising utility investors and retail ratepayers is also illustrated in the proposed sale of Mountaineer Gas, a subsidiary of Monongahela Power, whose sale is contingent upon approval of a Mountaineer rate increase. AYE had been attempting to sell Mountaineer for at least a year, apparently without an acceptable valuation based upon existing revenues. In September 2004, Monongahela and Mountaineer petitioned the West Virginia Public Service Commission ("PSC") for authorization to transfer the stock of Mountaineer, with the purchaser's obligation to close the transaction conditioned on approval of a 10% rate increase for the benefit of the purchaser,[13] with net sale proceeds to address financial pressures on the Allegheny holding company system created by Supply. Mountaineer was purchased by AYE in 2000 for $323 million, 50% more than the sales price that will be received today, and the resulting loss on the sale reduced equity in the third quarter of 2004.

Any ultimate benefit that the agreement to sell Mountaineer could provide to AYE's financial circumstances ranges between speculative and non-existent. The PSC has set the application of Mountaineer for hearing in May 2005; briefing is scheduled to conclude in June, 2005 (*see* "Procedural Order," *Mountaineer Gas Co., et al.*, Case Nos. 04-1596-G-PC, *et al.* (December 16, 2004) (ordering Paragraph No. 10) attached hereto as Exhibit 4); the administrative law judge must issue a decision by July, and a decision of the full Commission is not required until September, 2005. *See* "Commission Order," *Mountaineer Gas Co, et al.*, Case Nos. 04-1595-G-42T, *et al.* (Nov. 23, 2004), attached hereto as Exhibit 5. However, by its

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[13] *Id.* at 89.

terms, the agreement to sell Mountaineer specifies that closing will not occur before receipt of approval of the PSC (as well as other approvals, *e.g.*, Hart-Scott-Rodino, *etc.*). *See* Allegheny Energy, Inc. Amendment No. 1 to Form U-1 in File No. 70-10270, at 21-24, 41-42 (Dec. 22, 2004), the relevant portion of which is attached hereto as Exhibit 6. Consequently, there is no assurance that the agreement will remain in force, or that approval will be received from the PSC, in time to assist with meeting the AYE debt obligations due this summer.

C. A 30% Equity Cushion Will Not Be Restored In The Foreseeable Future And Liquidity Will Continue As A Problem For The Operating Utilities And The Holding Company

Notwithstanding the "substantial progress" AYE represented to the Commission, the equity component of capitalization in AYE and Supply shrank further by the third quarter of 2004, according to the Applicants' own disclosure materials. According to a filing dated November 29, 2004, AYE's common equity as of September 30, 2004 was 17.4%; Supply's was 10.3%.[14] If the October 2004 equity issuance and cash on hand used to prepay Supply debt is reflected in this calculation, the equity share of AYE's capitalization increases to only 20%.[15] *Even taking into account the two asset sales made in December 2004 and January 2005, and presuming that the highly contingent Mountaineer asset sale is successfully consummated and all of the Company's cash on hand is used to prepay debt, the equity component at best falls within the 22-23% range.*[16]

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[14] "Certification of Notification Pursuant to Rule 24," File No. 70-10100 (Nov. 29, 2004).

[15] *I.e.*, prepayment of Supply's $200 million of debt by $50 million of available cash and $150 million of equity increased equity to $1.286 billion ($1.136 billion plus $150 million) and reduced debt by $200 million, to $5.102 billion, yielding an equity capitalization of 19.99% (*i.e.*, $1.286 billion ÷ ($5.102 billion debt +$74 million preferred+ 1.286 billion equity)).

[16] Ohio Valley Electric Cooperative ("OVEC") yielded $102 million of cash proceeds and $37 million of debt reduction; the Mountaineer sale would yield $141 million in cash and $87 million in debt reduction; and the peaker sale yielded $175 million in cash. AYE informed the Commission on December 15, 2004 and January 10, 2005 that it had consummated the peaker and OVEC transactions, respectively. All of these figures ignore transaction costs and any adjustments that might be required at closing, and thus overstate the benefits to Applicants of such sales.

So something else, quite dramatic, must take place allowing Applicants to reach the 30% threshold. To reach the 30% equity threshold, AYE would either have to reduce debt by another $1.3 billion or, raise another $400 million in equity which would be used exclusively to pay down debt. Thus, AYE must (a) sell more assets (but presently AYE indicates only the last two of the ill-fated 2001 Enron peakers are for sale, yielding at most $200 million in revenue based on management's remaining targets for asset sale proceeds and perhaps further diluting equity if sold at an even worse price); or (b) issue an additional $400 million in equity which is exclusively dedicated to reducing debt; or (c) accumulate earnings of $400 million. Even these aspirations would depend upon an extraordinary run of good luck and no misfortunes, such as the operational problems Allegheny experienced in 2004 (ignoring for the moment significant environmental expenditures detailed in Part II.D, *infra*).

Operational problems at the Supply power plants reduced equity by about $93 million in the first half of 2004, both from the costs of repairing the plants themselves, and the cost of purchasing replacement power.[17] In addition, higher maintenance, fuel costs and emission allowance prices are now being incurred by Supply, further reducing its potential net income available to increase equity through earnings. Higher market prices for power in Supply's region do not improve Supply net income materially because it has contracted at fixed prices with its affiliates for most of its output through 2008. Therefore, while coal-fired power plant owners

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Based on the foregoing, cash proceeds for debt reduction would be $418 million (i.e., $102 million (OVEC) plus $141 million (Mountaineer) plus $175 million (peakers), and long term debt would be $4.560 billion (i.e., $5.102 (from the prior calculation) less $37 million (OVEC assumed debt) less $87 million (Mountaineer assumed debt) less $418MM of cash proceeds).

In that circumstance, equity would represent 21.72% (*i.e.*, $1.286 billion ÷ ($4.560 billion debt +$74 million preferred+ $1.286 billion equity)).

If, in addition, $183 million of remaining available cash ($233 million consolidated at Sept. 30, 2004 less the $50 million assumed to have been already used at Supply) is used to pay off debt, the equity ratio becomes 22.42% (i.e., $1.286 billion ÷ [$4.560 billion debt minus ($0.183 billion cash) plus $74 million preferred plus $1.286 billion equity.]

17 Allegheny Energy Inc., Form 10-Q for the fiscal period ending June 30, 2004, at 57 (Aug. 5, 2004).

selling into the market can capture the recognition of such increased coal and emission allowances in market revenues and improving earnings, Supply cannot expect this contribution in the foreseeable future.

AYE's improvident prepayment of Supply's debt with a holding company equity issuance creates a near term liquidity crisis at the holding company level. Harbert believes the planned uses of asset sale proceeds[18] may not allow for sufficient cash to be generated at the holding company to meet the $300 million August 2005 maturity debt without additional borrowings under the holding company revolver. For the ten month period beginning October 2004 and ending July 2005, when the $300 million holding company debt matures, Harbert estimates only about $100 million in cash will be available at the holding company from the Operating Utilities consisting of the Operating Utilities' earnings before interest, taxes and depreciation (EBITDA) of about $500 million less regulated and holding company interest of about $200 million and Operating Utilities' capital expenditures of $200 million. Thus the cash flow from the Operating Utilities will not be close to providing for the $300 million summer 2005 maturity.

Consistent with other efforts to reduce information to investors and this Commission as described above, it was recently announced that Supply's bonds would be de-registered. By this step, Allegheny banishes its most serious problem child from public view. But concealing

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18 Applicant on its third quarter earnings call, in its Third Quarter 2004 10-Q and in other materials presently posted on its website has stated that:

(1) Applicants have targeted debt reduction and equity goals on a consolidated basis, not by separate subsidiaries;

(2) the $275 million in asset sale proceeds and $37 million in assumed debt in the Enron units and OVEC sales, as well as any Supply operating cash flows will remain at Supply and will be used to prepay Supply debt, not to reduce holding company or Operating Utility debt; and

(3) the Mountaineer sale proceeds and debt reduction will be used to reduce Monongahela debt but not holding company debt.

information about the primary source of Applicants' financial stress will decrease access to critical information and undermine investor confidence. AYE attempts to justify concealment of financial data by claiming that de-registration will produce cost savings and streamline procedures, in the same month it elects to pay its General Counsel severance of over $5 million while being dismissed for cause. Reduced disclosure is precisely the wrong step to take.

D. Applicants' Plans to Further Burden Regulated Operations

Against this backdrop, in September 2004 West Penn Power filed with the Pennsylvania Public Utility Commission ("PUC") a request for approval of a new rate plan. The rate plan would increase the price of Provider of Last Resort support service ("POLR") for 2007-2008 which was previously established in a 1998 settlement filed with the PUC, as well as fixed rates at far higher escalating levels for an additional two year period 2009-2010, without a competitive bidding process to test whether Supply's extended POLR support supply prices may in fact be above market.

The new plan should be scrutinized because it is not in the interests of the Operating Utilities and their residential ratepayers. Attached hereto is Exhibit 7, which shows that a delay in locking in long term pricing or a solicitation in the PJM region likely would result in lower prices and better terms. If a better deal for POLR supply support is available, why should Supply be able to lean on West Penn and extract supra-market prices? The Supply – West Penn contract is not at retail and thus the PUC does not have jurisdiction to establish the applicable rates. Because the contract is between holding company affiliates, this Commission can prescribe adequate remedies.

In contrast to the above-market POLR support contract proposed among Allegheny affiliates, a market solicitation of the POLR service for this period could be expected to result in a response from a broad universe of suppliers with investment grade credit ratings which would stand behind the prices in the contract, something Supply does not offer. Any contract amendment should be used as an opportunity to negotiate market terms to protect the regulated affiliates from a Supply rejection of the inter-affiliate wholesale contract in bankruptcy. Consistent with current market practice, Supply should be required to post collateral or provide an investment grade guarantor to back up what it claims is a "below market" contract. Otherwise it is difficult to see why an extension of the contract at this time, and increased reliance on Supply, is in the interest of the Operating Utilities' financial health. This Commission must guard against a situation in which the Operating Utilities continue to be milked to support Supply until Supply goes bankrupt, after which Supply holds the option to either bleed the Operating Utilities even further if the POLR contract in its entirety yields above market prices, or reject the POLR contracts if they would yield below market prices benefiting the Operating Utilities (which below market prices presumably were the quid pro quo of the Operating Utilities' agreements to transfer their assets to Supply).

On May 20, 2004, the Attorneys General of the States of New York, New Jersey and Connecticut and the Department of Environmental Protection Agency of the Commonwealth of Pennsylvania notified AYE of their intent to sue over claimed violations of the Clean Air Act ("CAA"). *See* Exhibit 8 hereto. The notice indicated the Attorneys General would be "willing to discuss a settlement of this matter that would achieve our goal" of "clean air." Exhibit 8 at 5. The letter noted that the Pennsylvania Department of Environmental Protection had contacted AYE regarding alleged CAA violations in Pennsylvania as well, and reserved the right to sue based on such grounds if agreement was not reached on those plants.

In its communications with the investment community since receiving this notice, management estimated the cost of compliance expenditures to be about $1.3 billion.[19] Management also acknowledged that even if it is not in violation of any law, and even without rate increases, these investments would be desirable from an environmental perspective and a good economic proposition given the large reduction in emission allowance purchase costs that would result. As illustrated in Exhibit 10 hereto, the fact that Supply and most of its competitors in PJM have already elected to install similar equipment on large coal plants, and the rapidly rising cost to Supply of purchasing allowances in the market (estimated to be $25-150 million annually in 2005-2007) makes these expenditures, and the increase in Supply debt associated with them, a highly likely outcome, regardless of whether the CAA violations occurred.

In these same discussions with investors, management has stated publicly that as a practical matter it cannot afford to make these investments without financial assistance from the Operating Utilities and their regulators and is "[i]n discussions with state . . . authorities," including with the Attorneys General. *See* Exhibit 11. However, additional "financial assistance" should not be provided because (a) the economic terms of the original transfer of these plants from the Operating Utilities to Supply anticipated that Supply, not retail ratepayers, would bear the prospective obligation to be responsible for these environmental exposures; (b) Supply will recover the cost of the investments from increased wholesale margins, particularly by eliminating emission allowance purchases; and (c) when the POLR contracts end, Supply will have the opportunity, like all of Supply's competitors, to recover these costs through market power prices which should adjust to reflect these new environmental costs. As for the Operating

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19 *See* Exhibit 9 hereto, containing excerpts from a recent AYE presentation.

Utilities, they should be given the opportunity to shop for POLR providers which have already installed this equipment and which do not require customers to provide "financial assistance."

In January, 2005, in a sign that Applicants and the Attorneys General had not made significant progress in resolving their differences, Allegheny filed a lawsuit against the Attorneys General. According to AYE's Chairman, "[a]fter eight months of discussions, . . . it's time to seek the clarity that only a court can provide on these issues." *See* Exhibit 12 hereto. Of course, bringing the action in court is the beginning, not the end, of a lengthy process. This action is a radical departure from the positions adopted by most other electric generators targeted by the Attorneys General (even those operating under the protection of the bankruptcy courts) which have announced settlements or plans to meet more stringent emissions standards.[20] The filing of the action suggests that AYE has concluded that the odds for settlement with the Attorneys General are poor, so a more extreme, if riskier and more unpredictable, approach is necessary.

In a dramatic illustration of its priorities, in November 2004, at the same time Supply was in discussions to shift the burden for these costs to retail ratepayers, it elected to use a $200 million capital infusion from AYE to prepay Supply debt instead of funding these capital expenditures. The result is that the *Operating Utilities* will hold *increased downside risk* associated with fixed cost funding of Supply's environmental equipment and *Supply* will have the *upside benefits* of improved asset values on its generating plants, and the greater potential to sell emissions credits. If Supply succeeds in shifting much of the $1.3 billion in capital costs to the Operating Utilities while retaining the long term benefit of the resulting reduction in emission costs, it is conceivable that Supply will eventually have a higher credit rating than the Operating Utilities.

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20 *See, e.g.*, Exhibit 15, hereto, containing an announcement of Mirant's settlement with Maryland, Virginia, and U.S. environmental authorities.

Supply does not provide projections for its financial results, but Harbert estimates that Supply's next twelve months EBITDA is only barely sufficient to meet its budgeted capital expenditures and interest payments, leaving no room for unexpected surprises such as the plant failures that occurred in late 2003 or the environmental expenditures referenced above, or rising costs of emission allowances. *See* Exhibit 13. AYE is relatively unusual among comparable companies in its inability to provide to investors guidance regarding future financial performance and attributes this in part to the ongoing struggle to address material weaknesses in its financial controls, first identified in mid-2002, more than two years ago. In a presentation to investors in February 2004, AYE acknowledged this required "replacing about two-thirds of accounting staff in 2003-2004," which does not inspire confidence in the projections provided to the Commission. *See* Exhibit 14. According to AYE's Form 8-K filed November 5, 2004, its independent auditor "advised Allegheny's Audit Committee that although management has made signification progress in addressing the specific control weaknesses previously identified, not all of these deficiencies have been remedied, and certain internal control material weaknesses remain." Form 8-K at 90. Similar language appears in the prospectus issued by one of the Operating Utilities in a prospectus dated November 15, 2004. This is a long lapse for the resolution of such a fundamental matter. The Commission is being asked to rely on projections provided confidentially by AYE in spite of this reservation on Applicants' part with respect to its financial controls.

On December 3, 2004, the Commission granted in File No. 70-10100 AYE's request for a continuation of loosened standards through April 30, 2005,[21] reserving jurisdiction over transactions authorized by previous financing orders but not covered by its April 29, 2004 order

[21] Allegheny Energy, Inc., Holding Co. Act Release No. 35-27920 in File No. 70-10100.

so long as the 28/20 Condition was not satisfied.[22] That authorization would be superceded by the authorization sought by the Application, and in any event would lapse April 30, 2005.

On December 9, 2004, it was announced that Allegheny Energy's General Counsel was no longer employed by the Company. The report indicated that the General Counsel had not "resigned solely of his own accord," because if he had, he would not have received the $5.6 million that was paid to him as severance; "if he had been terminated without cause," he would have been paid an additional $5.9 million. *See* Exhibit 15 hereto. Thus, the General Counsel did not resign solely of his own accord, and was terminated with cause, from the Company's perspective. The General Counsel was terminated without the identification of a permanent replacement, notwithstanding the fact that Applicants (i) were in the middle of a dispute involving over one billion dollars with the Attorneys General of multiple states turning on the legal interpretation of complex regulations, (ii) were not compliant with Sarbanes-Oxley, (iii) were amidst intricate rate and asset divestiture proceedings before multiple fora, and (iv) had pending before the Commission their Application, along with other issues under the Act. Regardless of whether the General Counsel's departure signals deeper troubles, the resulting void means that this is an enterprise warranting greater, not reduced, supervision.

III. ALLEGHENY'S APPLICATION

The Applicants justify the relief requested in their Application as simply an effort to clean up "an intricate system of requirements whose complexity does not serve the interests of either the Applicants or the Commission." Application at 3. Conspicuously absent from that statement is any acknowledgement of the interests of investors and retail ratepayers, as well as the interests of the Operating Utilities, which are the interests the Act must protect.

[22] *Id.* at 2-3, 7.

Significantly, the Application provides the vague guidance that proceeds from financings contemplated by the authorization, *inter alia*, "will be used for general corporate purposes . . . of the Allegheny System, [and] for the . . . retirement, and redemption of securities previously issued by Allegheny or its subsidiaries . . . ." *Id.* Among the authorizations requested is that:

> AYE be authorized to issue and sell additional securities, and the Applicants be allowed to issue and sell certain preferred securities, through special purpose entities up to $1.55 billion.
>
> Applicants be allowed to issue and sell all types of debt and AYE and the Operating Utilities be allowed to issue short term debt for, *inter alia*, "general corporate purposes."
>
> Applicants and the Operating Utilities be allowed to "enter into guarantees, letters of credit . . . or otherwise provide credit support and guarantees of contractual obligations with respect to the obligations of direct and indirect subsidiaries," up to $3 billion (*id.* at 13), including on behalf of Supply.
>
> "Applicants and the Non-Utility Subsidiaries [be allowed] to engage in intra-system financings . . . in an aggregate amount not to exceed $4.0 billion any time outstanding," which could of course involve Supply (*id.* at 14-15).

Id. at 3-5.

IV. <u>ARGUMENT</u>

Applicants' request for additional discretion to issue debt, and undertake intra-corporate guarantees on behalf of, *inter alia*, Supply should be denied. Without tighter controls and more explicit protections for the ratepayers of and investors in the Operating Utilities, Applicants will have the opportunity to enter into more arrangements comparable to the Intercreditor Agreement. Any authorizations issued to the Applicants should be made contingent on AYE and the Operating Utilities implementing and observing a comprehensive ring-fencing plan to protect the finances of the Operating Utilities and the holding company from additional conscription to bail out Supply. The Applicants' track record since the new management team at AYE has been in place has not materially enhanced liquidity or equity -- in fact, quite the contrary. Poor operational performance and unusually high leverage at Supply's operations has continued to consume liquidity, generate losses and reduce equity at Allegheny. In six of the past seven fiscal quarters (first quarter of 2003 through the third quarter of 2004), Supply and AYE have each recorded net losses. The exception was 25 cents per share of income reported by AYE in the first quarter of 2004, which was subsequently offset by losses of more than $2 per share for the first nine months of 2004, a level of losses *higher* than the first nine months of 2003. It is hard not to conclude that we are watching, and being asked to refrain from preventing, a slow motion train wreck.

A. <u>Statutory Provisions of the Act</u>

The results of the last three years of Allegheny operations, and the relief requested in the Application, conflict with the goals of the Act. Section 12 of the Act makes it unlawful for a registered holding company to "directly or indirectly" borrow or receive an extension of credit from a public utility company subsidiary, and makes it unlawful for a registered holding company to extend credit or lend to any company in the same holding system, in contravention of orders of this Commission issued to protect the public interest, investors or consumers. 15 U.S.C. § 79k(a),(b) (2004).[23] Congress intended Section 12(c) of the Act to prevent the "milking of operating companies in the interest of the controlling holding company groups" and to safeguard the working capital of the public-utility companies.[24] The Act is administered to ensure "that captive ratepayers of the holding company's public-utility subsidiaries will not be 'milked' in order to satisfy the parent company's debt obligations." *The Southern Co.*, 2000

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23 Rule 45 provides that no registered holding company or subsidiary company shall, directly or indirectly, lend or any manner extend its credit to or indemnify, or make any donation or capital contribution to, any company in the same holding company system, except pursuant to a declaration.

24 Eastern Utilities Associates, Holding Co. Act Release No. 25330 (June 13, 1991), *citing* S. Rep. No. 621, 74th Cong., 1st Sess. 3434 (1935) and Summary Report of the FTC to the U.S. Senate Pursuant to S.R. No. 83, 70th Cong., 1st Sess. Doc. 92, Vol. 73-A, at 61-62.

SEC LEXIS 200, *26 (2000). The Commission has stated that the provisions of Section 12 "require the protection of a company's financial integrity and the prevention of the circumvention of the provisions of the Act . . . ." [25] As the Commission told Congress less than a year ago in the wake of the Enron debacle:

> the Act is primarily focused on ensuring that the holding company structure is not used to abuse investors . . . . Among the abuses sought to be corrected, for example, were, . . . the overburdening of the operating companies with excessive debt and otherwise unsound financial structures, and draining excessive funds from them and imposing financial policies and unwarranted charges, all of which benefited the controlling groups in the top companies at the expense and to the serious detriment of investors and the securities markets generally and the utility consumers affected." *Vernon Yankee Nuclear Power Corp.*, 43 S.E.C. 693, 700 (1968), citing Senate Report at 2-4, 55-60, *remanded on other grounds, Municipal Electric Association of Massachusetts v. SEC*, 413 F.2d 1052 (D.C. Cir. 1969) and *American Light & Power v. SEC*, 329 U.S. 90, 101-06 (1946).[26]

The Application's requested relief does not protect investors, consumers or the public interest, and further extensions of credit to Supply from AYE and, indirectly, from the Operating Utilities, and extensions of commercial contracts between Supply and the Operating Utilities, should not be permitted.

Section 7(d), 15 U.S.C. § 79g (2004), is the primary section in the Act governing the issuance of securities by registered system companies. Notably, under section 7(d), the Commission cannot approve a proposed financing if it finds, (1) that the security is not "reasonably adapted to the security structure of the declarant and other companies in the same holding-company system"; (2) that the "issue and sale of the particular security is [not] . . .

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[25] *Standard Power and Light Corp.*, 35 S.E.C. 440, 443 (Nov. 9, 1953).

[26] *See* memo from Paul Roye, Director, Division of Investment Management, to William H. Donaldson, Chairman of the SEC (June 28, 2004) at 7 attached to a letter from William H. Donaldson to United States Representatives Dingell and Markey (June 29, 2004).

necessary or appropriate to the economical and efficient operation of [the applicant's] business;" (3) the security is not reasonably adapted to the earning power of the declarant; or (4) the terms and conditions of the issue or sale of the security are detrimental "to the public interest or the interest of investors or consumers."[27] Applicants' request fails on all counts, as discussed below. The issuance of more securities without sufficient controls and protections for investors in and consumers served by the Operating Utilities, will profoundly harm these parties.

The authorizations requested by the Applicants neither are reasonably adopted to the circumstances facing the Allegheny system nor are likely to promote efficient and economical operation of the Operating Utilities' business. Clearly the financial integrity of entities in the Allegheny family is placed at issue by Supply's problems. Nor can it be fairly said that the additional new debt incurred and the intra-Allegheny transfer payments since 2002 have not "adversely affect[ed] the Operating Companies and their customers."[28] The Operating Utilities' dividends have not gone to increasing equity value at the holding company or Operating Utility level; nor have they been paid out to public shareholders. Indeed, AYE dividends have been terminated because of Supply's problems, with serious consequences for AYE stock values. The Operating Utilities' credit ratings have been lowered because of the fallout from Supply, while revenue is being diverted to Supply.

It is clear that the increased debt levels the Applicants have incurred disadvantage the Operating Utilities, their investors and their customers. Higher levels of AYE leverage produce lower credit ratings and higher debt and equity costs to the holding company, which must consume the dividend dollars to cover the debt. As noted above, since July 2003 (after

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27 15 U.S.C. § 79g (d)(1), (2), (3) and (6) (2004.

28 Third Quarter 2003 10-Q, at 26.

implementation of rescue financing) Moody's rated, and continues to rate, the Operating Utilities below investment grade. The holding company fairs no better, which is important because it is the means by which the Operating Utilities access equity markets. Incredibly, AYE cites as a prime argument for the Commission's continued indulgence the fact that rating agencies deem the holding company "stable", which means the agencies do not see circumstances in the foreseeable future that would materially improve AYE's situation.

B. <u>The Applicants' Equity Levels Signal Distress, Not "Progress"</u>

A 30% equity capitalization ratio is generally recommended by the SEC. *See, e.g., Pepco Holdings Inc., et al.*, 2002 SEC LEXIS 2004 (2002). As a result, the Commission limits common stock redemptions to ensure that the 30% equity cushion is maintained. *See, e.g., Maine Yankee Atomic Power Co.*, 2001 SEC LEXIS 1832 at *2 (2001). The Commission regularly directs that a holding company seeking authority to issue debt "must maintain a capitalization ratio of at least thirty percent." *See, e.g., The Southern Co.*, 2000 SEC LEXIS 200 (2000). The Commission has repeatedly used the 30% equity ratio as an important milestone; the equity ratio can be observed on an objective basis and can be controlled by the Company's issuance of securities. In contrast, other measures (such as interest coverage projections) are susceptible of manipulation and great uncertainty given the nature of projections. Moreover, sales into spot markets by power merchants industry leave revenue levels largely beyond the control of the power merchant, and can be quite volatile, making projection of coverage ratios a speculative enterprise. It is no surprise, therefore, that the Commission historically has relied on the equity ratio.

In granting requests for a capital structure with an equity ratio below 30%, the Commission stated that it "under appropriate circumstances has applied capitalization ratio standards flexibly where, for example, there was assurance that capitalization ratios would improve over the foreseeable future, and where it was in the public interest and the interest of investors and consumers that a proposed financing should be permitted to go forward."[29] Here there is no assurance that continuing down the current route will improve capitalization ratios in the foreseeable future. In fact, quite the contrary.

The Commission's notice of the instant Application states that the Applicants contend that they had "carefully analyzed their current situation and have made significant efforts to develop a systematic plan for returning to a financial condition that is consistent with the Commission's traditional standards. They maintain that the authorizations sought in this Application are essential *to continuing their progress toward financial health*."[30] These statements are absurd given the fact that in 2002, 2003 and through 2004, equity's share of capitalization fell, both for AYE and Supply. When Applicants speak of "continuing their progress" they cannot seriously be referencing an improved equity ratio, which dropped through much of the period, or earnings, which have been negative six out of the seven quarters ending September 30, 2004, or resolution of environmental compliance cost issues, when recent developments signal greater polarization and uncertainty rather than resolution. As discussed above, Supply's margins are unlikely to improve materially in 2005 even assuming no new demands are placed on the Allegheny system (ignoring for the moment the notice the Allegheny system has received that several States' Attorneys General will sue AYE and affiliates if very substantial additional capital improvements are not undertaken). AYE's turn-around story, which depends on effective cost control, is undermined by AYE's acknowledgement of

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[29] *Eastern Utilities Associates*, Holding Co. Act Release No. 24879, at n.49 (May 5, 1989) (citing *Central Power & Light Co.*, 27 S.E.C. 185 (1947); *Indiana Service Corp.*, 24 S.E.C. 463 (1946); *Republic Service Corp.*, 23 S.E.C. 436 (1946); *Alabama Power Co.*, 22 S.E.C. 267 (1946); *Consumer's Power Company*, 20 S.E.C. 413 (1945); and *Ohio Edison Co.*, 18 S.E.C. 529 (1945)).

[30] 70 Fed. Reg. at 4894 (January 31, 2005) (emphasis added).

inadequate controls. "Continuing their progress" has not changed AYE's well-below investment grade status which rating agencies have indicated is not likely to change in the foreseeable future. Sloganeering is no substitute for facts and substantive analyses, which indicate that it is highly improbable that Applicants will reach a 30% equity ratio by December 31, 2005.

Of course, AYE has claimed that there would be serious consequences to having Supply stand on its own financial feet. For instance, Supply may argue that a default by Supply on its contracts to furnish generation to the Operating Utilities will force the latter to acquire replacement power on less favorable terms. Further, AYE has argued in the past that Supply's default would impose upon the Operating Utilities debt service obligations or exposure for violations of guarantees regarding Supply's pollution control bonds. July 2003 Order, slip op. at 27-28. This argument simply highlights the Applicants' failure, in the series of refinancings that occurred over the past two years, to extricate the Operating Utilities from such exposure, a prime example of which is the Intercreditor Agreement described in the next section. The Applicants' conduct presents the question of whether Applicants have unnecessarily permitted the Operating Utilities to be taken hostage in Supply's refinancings. A domino bankruptcy of Supply and the Operating Utilities would eliminate the ability of the Operating Utilities to raise equity, and eliminate the value they previously conferred on the holding company; indeed just a Supply bankruptcy could precipitate a change in control of the Operating Utilities even if the Operating Utilities themselves do not declare bankruptcy.

In addition to brandishing the default threat, AYE also has referenced the impact upon services provided to the utility subsidiaries by Allegheny Energy Service Corp. *Id.* Neither argument has merit. First, there is no assurance that granting AYE further latitude will avoid Supply's bankruptcy. Over the last 24 months book equity of Applicants has only deteriorated, as noted above. The Applicants' projected equity improvements rely excessively and recklessly on the conditional Mountaineer asset sale, obtaining rate relief, avoiding environmental compliance costs, and a gamble regarding future common stock prices to force a conversion of AYE debt. Even assuming that forcing Supply to stand on its own without further financial support from the Operating Utilities or AYE would increase the likelihood of Supply's bankruptcy, a bankruptcy will not disrupt the physical supply of electricity as has been repeatedly demonstrated by other bankruptcies of power producers and utilities.

Bankruptcy is not idle speculation. Supply and AYE confront difficult circumstances going forward. AYE has $300 million in debt maturing in August 2005. To address that obligation, AYE could have retained the $150 million in proceeds from its October, 2004 equity private placement, the $50 million in cash on hand, and accumulated dividends from its operating utilities (historically averaging $123 million annually), providing AYE with sufficient cash on hand to satisfy the $300 million debt obligation in August 2005. Instead, however, AYE used those funds to pay down Supply debt that was not due before August 2005. It is not clear now where AYE will obtain all of the $300 million to retire the debt due in August 2005, other than from some still conditional asset sale transactions or new borrowings.

As described, *supra*, Supply's free cash flow will not reliably satisfy the obligations necessary to meet debt service and presently budgeted capital expenditures. Any potential shortfall must be made up from some other source, which is not dependent upon the merchant generation business. In other words, the remaining operations of Supply are running hard just to stay in place. Supply cannot sustain additional financial stress.

But that is exactly what Supply faces. As noted above, Supply must install $1.3 billion in environmental controls or face annual emissions costs of $100 million or more. Most of its coal supply is not locked in for 2006 and beyond, and coal prices are highly volatile. Its financial controls are inadequate and it has replaced most of its accounting staff, making further operating cost reductions and financial projections more dubious propositions.

C. <u>The Effects of the Intercreditor Agreement</u>

Another example of making the Operating Utilities hostage to Supply's misfortunes, and AYE's failure to protect them when refinancing, is provided by the Intercreditor Agreement ("ICA").[31] During the February 2003 refinancing, "the bank lenders required that Allegheny and AE Supply" agree, *inter alia*, that *if the Operating Utilities obtained incremental capital, the proceeds ultimately must be paid over to Supply.*[32] Thus, proceeds from incremental debt issued by (for instance) West Penn must be invested in Supply and then paid out to West Penn, at a time when Supply is operating with only a 10% equity component and negative $1.2 billion in retained earnings (April 29, 2004 filing at 16). The requirement that the amount be passed through Supply is convoluted, subject to a series of complex contractual arrangements, must be dealt with by extraordinarily strained arguments, and its significance has not been fully analyzed and vetted in a public environment.

The Applicants breezily reassure the Commission that the ICA does not rise to even the level of a nuisance; apparently as part of its "substantial progress" towards recovery, the Applicants have confected a process that (they maintain) allows them to eviscerate features Supply's creditors bargained for and may have imagined were important safeguards. Implicit in the Applicants' theory is that the ICA is so evanescent that the Applicants can (in their own

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[31] One major change that has occurred between the original application (filed on or about September 21, 2004) and Amendment No. 1 thereto (filed on or about November 18, 2004) involves the latter's description of the ICA. The fact that the September 21, 2004 Application barely mentioned the ICA is informative.

[32] *See* Allegheny Energy, Inc., Amendment No. 1 to Form U-1 in File No. 70-10100, at 14 (April 29, 2004) (hereinafter, "April 29, 2004 Filing").

words) round-trip revenues through the Allegheny corporate family. It is unlikely that Supply's secured creditors would agree with Allegheny that the answer is just to keep money churning inside of the Allegheny corporate family, and that the ICA is satisfied if Supply serves simply as a conduit.

The Applicants' November 18, 2004 amendment attempts to talk past this problem by insisting that the ICA effectively is a meaningless exercise, because the Operating Utilities somehow would receive back the amounts in the first instance conveyed to AYE, and thence to Supply, under the ICA. Applicants recognize that such payments by Supply to other affiliates "technically" constitute dividends to be made from capital or unearned surplus accounts, but (they contend), these circumstances should be ignored.

The Applicants' pursuit of the Commission's imprimatur on a scheme to sidestep the effects of the ICA raises troubling questions. Is the ICA so toothless that it can be eviscerated without consequence as advocated by the Applicants? If the ICA is so ineffectual, why was it not eliminated as part of the refinancing undertaken in 2004, given AYE's acknowledgement that the banks that originally had insisted upon the ICA were no longer involved following the 2004 refinancing?[33] If the Commission approves the Application, will Applicants argue that such approval trumps any inconsistency claimed by holders of rights under the ICA? Exactly how is it that the revenues would be re-conveyed by Supply to the Operating Utilities?

What are the consequences of the proposed transaction from a bankruptcy code perspective? What analysis has the Commission made of the impact of the ICA upon various creditors' rights? What happens if the revenue from a West Penn capital injection flows through Supply and Supply files for bankruptcy 30 days later? In the event of bankruptcy, will Supply's

[33] *See* April 29, 2004 Filing at 15 ("This agreement remains in place until November 2007, when debt held by certain *non-bank* parties to the [ICA] matures" (emphasis added)).

creditors agree that it was appropriate for an enterprise with *negative* $1.2 billion in retained earnings (April 29, 2004 Filing at 16) to be paying dividends out of capital accounts, whether "technically" or otherwise? How does such action accord with rules applicable to fraudulent conveyances under the Bankruptcy Code given that dividends are a discretionary act?

Is this treatment consistent with the underlying covenants and contractual obligations? Have the Applicants secured the agreement of the beneficiaries of the ICA to the proposal here at issue, or will Applicants' proposal lead the Commission into the middle of a bigger dispute involving some of Applicants' creditors? How has the Company memorialized its agreement that Applicants' interpretation is shared by the creditors protected under the ICA? Or are the Applicants hoping that such creditors do not monitor the multiple filings and amendments in this matter and will not be aware of the Applicants' interpretation? When was this situation initially analyzed by the Commission?

If West Penn issues debt (as it proposes), and the proceeds are received - - even temporarily - - by Supply, are there any additional creditor repayment or recapitalization obligations that are triggered? If these revenues are dividended out of Supply, does the act of dividending trigger additional rights or entitlements to revenue on the part of Supply's creditors?

These are important issues that require answers before Applicants' proposed sleight-of-hand can be reviewed in a meaningful fashion. The Commission would take on a serious share of responsibility for facilitating subsequent negative consequences if it does not thoroughly analyze the proposed actions.

D. The Applicants Cite Case Law That Does Not Support Their Requested Relief

Applicants repeatedly have cited an inapposite line of cases to the Commission as they have spiraled from 30% capitalization to levels of 17% and 10% for AYE and Supply, respectively. To start with, the cases typically arose because of financial setbacks experienced by regulated utility operations. *See, e.g.*, *Alabama Power Co.*, 1980 LEXIS 731, n.4 and the cases cited in n.16 of the Application. But in the Applicants' circumstance, losses of hundreds of millions of dollars associated with merchant generation and trading business activities, such as West Coast trading and the Enron plants, were wholly unrelated to assets over which a state has direct rate jurisdiction. As Applicants admit, "AE Supply is not a utility for purposes of state regulation nor is it subject to regulation as an electric public utility in any of the states in which it operates."[34] While it is reasonable for this Commission to take steps at the margin to allow state rate regulated assets to recover their balance, Supply's assets are not subject to direct state rate jurisdiction and the stability, as well as the long-run balance of risk and reward, that accompanies state rate jurisdiction is missing here. Indeed, because the source of Applicants' setbacks are not traditional utility operations, recovery will be that much more volatile and uncertain, representing a greater risk. Any analysis that fails to address that distinction cannot constitute reasoned decision-making.

Applicants seek to downplay the 30% threshold as "quite flexible." Application at 11. Yet the cases they cite speak of "the 30% requirement," which would be waived "where . . . it was likely that the standard could be met in the near future." *Connectiv, et al.*, Holding Co. Act Release No. 35-27111 (1999). That test is not met here. *See Public Service Co. of New Hampshire*, Holding Co. Act Release No. 26016 (1994). There is no credible showing in the materials available for review that would indicate "the 30% requirement" is "likely [to] be met in the near future." The evidence Harbert submits in this filing indicates quite the contrary, as do the facts of the past three years. Applicants over the past year have claimed to have been making

34 Allegheny Energy, Inc., Amendment No. 10 to Form U-1 in File No. 70-10100, at 7 (Dec. 22, 2003).

"progress," but that progress has taken the form of a steadily shrinking slice of the capitalization pie for equity, rather than an increasing share.

The cases cited by Applicants typically involve requests that the Commission permit equity ratios to decline to levels which were below 30%, but still as high as 28%.[35] Here Applicants have equity ratios of only 17% and 10%. Clearly, this is not a matter of having missed a target by one or two percentage points, or for simply a year.[36]

Additionally, the Applicants cite the NRG case. But NRG's circumstances are radically different from those of the present case. NRG, another generation and trading entity, was created by Xcel Energy, Inc., a holding company that also owned traditional operating utilities. In 2002, referencing "credit and liquidity issues at NRG,"[37] Xcel acknowledged that its common equity could fall below 30 percent of capitalization for a "temporary" period, but sought to engage in financing transactions even when the equity component fell to as low as 24 percent of total capitalization.[38] Xcel further committed to satisfy the 30 percent test by July 1, 2003.[39]

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35 *Public Service Co. of New Hampshire*, Holding Co. Act Release 35-26046 (May 5, 1994). *Columbia Gas System, Inc.*, 1991 SEC LEXIS 1657 at * 5. Applicants cite *Eastern Utilities Assocs., et al.*, Holding Co. Act Release No. 35-247879; File No. 70-7486 (May 5, 1998) for the proposition that the Commission permits equity ratios as low as approximately 29% and 24%. They ignore the fact that the Commission in that case found that "[f]actoring in the expected sales of common stock [and other factors], . . . the *pro forma consolidated equity of* EUA [as of five months prior to the order] *is 30.1%*" 1989 SEC LEXIS 864 at *15 (emphasis added). The same holds true for the Applicants' citation to *Eastern Utilities Associates, et al.*, 1988 SEC LEXIS 978 at * 14 ("EUA's pro forma consolidated common stock equity ratio . . . will be approximately 31% . . . .") Similarly, while Applicants cite to an *Alabama Power* case to support a lower equity ratio, they fail to acknowledge that in the same time period, Alabama Power's corporate parent enjoyed a capitalization equity ratio above 30%, in contrast to AYE's circumstance. *See Commonwealth and Southern Corp., et al.*, 1947 SEC LEXIS 667 at * 8. *Alabama Power Co.*, 1980 LEXIS 731, showed Alabama Power's common equity coverage, as of five months prior to the Commission's order, as slightly over 28%. Applicants also cite to utilities working through the effects of reorganization directed by the Commission as a part of its original review of holding company structures (*e.g.*, *Republic Service Corp.*, 23 S.E.C. 436 (1946)). Obviously, cases arising in those circumstances, or in the aftermath of the Great Depression and World War II (*see Consumer Power Co.*, 20 S.E.C. 413 (1945)), are hardly analogous to the instant circumstances.

36 *Cf. Public Service Co. of New Hampshire*, Holding Co. Act Release No. 35-26046 (May 5, 1994).

37 Holding Co. Act Release No. 27558, at 9 (Aug. 2, 2002).

38 As of March 31, 2002, Xcel's common equity was 30.8 percent of capitalization. *See id.* at 7.

39 *Id.*

In a November 7, 2002 order, the SEC noted NRG's "severe financial problems" leading to default on a significant portion of debt and below investment grade credit rating status.[40] The November 7, 2002 Order observed that NRG had planned its turn around based upon, *inter alia*, possible asset sales, canceling planned projects and increased efficiency in operations,[41] which were not successful. Xcel's attempts to resolve NRG's financial problems had caused Xcel's equity capitalization to fall to a level below the 30 percent level. Thus, Xcel sought authority from this Commission to issue new debt and guarantees to support the trading obligations of NRG Power Marketing, Inc.[42] The SEC granted Xcel's request based upon the representation that the equity component would return to 30% within 6 months.[43] However, the SEC reserved jurisdiction on other transactions so long as Xcel's equity capitalization was less than 30 percent of its total capitalization.[44]

On December 19, 2002, the SEC gave notice that Xcel sought to increase the aggregate amount of authorized securities issuances.[45] *In exchange for authorization to proceed with its request, Xcel agreed, inter alia, that neither it nor any of its subsidiaries (other than NRG and its subsidiaries) would invest or commit to invest any funds in NRG* and/or any EWG or FUCO, except for any amount required to honor the obligations of Xcel under a prior agreement with NRG, or any valid and binding obligation of Xcel before the time Xcel ceased to comply with

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40 Holding Co. Act Release No. 27597, at 2 (Nov. 7, 2002).

41 *Id.* at 11 and n.8.

42 *Id.* at 20, 21.

43 *Id.* at 39.

44 *Id.* at 4.

45 Holding Co. Act Release No. 27624, at 2-8 (Dec. 19, 2002).

the 30 percent test.[46] In other words, Xcel promised that NRG was "cut off" from any new support, subject to certain conditions.[47]

While NRG and Supply both encountered difficulties in the downdraft that hit the electric generation industry in 2001, Xcel dealt with the NRG problem promptly; Supply's problems will continue to plague AYE for the foreseeable future unless this Commission acts. Xcel's period of noncompliance with the 30% equity threshold was relatively brief. In contrast, AYE will, if things go precisely as it now predicts, spend approximately 3 years below the 30% threshold, and that period could be longer given that events have not transpired as Allegheny has expected. It is notable that today, Xcel and its regulated utility subsidiaries are investment grade and have continued to pay common stock investors a regular dividend, in contrast to AYE for which a common dividend is not permitted under its new debt financing arrangements.

Moreover, the NRG-Xcel experience demonstrates that as part of the meltdown in the electric industry that destabilized Pacific Gas & Electric Company, Enron, Mirant Corporation and NRG (among others), it is (1) difficult to predict volatile power prices; (2) entirely rationale to take steps to stop the subsidization of merchant generation activities; and (3) important to include in projected financial performance the possibility that unexpected adverse events will occur.

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46 *Id.* at 12.

47 A tentative settlement (Tentative Settlement) was announced on March 26, 2003 among NRG, Xcel and members of NRG's major creditor constituencies, establishing a level of payments by Xcel to NRG and its creditors to settle claims of NRG and its creditors against Xcel. Subsequently as part of a plan or reorganization, Xcel entered into a settlement agreement with NRG that sheltered Xcel from prior, expansive claims exposures. On May 14, 2003, NRG petitioned for protection under Chapter 11 of the U.S. Bankruptcy Code. In a May 29, 2003 order granting Xcel's request for authorization to pay dividends out of capital and unearned surplus, the SEC found that Xcel's exposure to additional losses and charges at NRG had been effectively capped.

E. <u>Ring-Fencing Will Limit Further Exposure</u>

One rational response to these problems is ring-fencing. Ring-fencing is a common technique used to protect utility operations from the consequences of affiliates' bankruptcies. It has been used recently in the instances of Pacific Gas & Electric Company, and Portland General Electric Co. ("PGE") and, as noted below, could have been used to protect the regulated utility operations of the bankrupt NorthWestern Corp. Indeed,

> Regulators are increasingly focused on 'ring fencing' utilities from credit risks of holding companies and their non-utility units, Fitch Ratings said Thursday in a new report . . . .
>
> The Oregon Public Utility Commission's approval of Enron's 1997 acquisition of Portland General Electric is often cited as the "poster child for effective regulatory ring fencing," Fitch said. The PUC used its broad statutory authority over acquisitions to require that PGE have a minimum 48% equity ratio, limited Enron's access to PGE assets and limited the utility's ability to pay upstream dividends. "Because PGE's assets were not pledged to Enron lenders, and the utility's financial integrity remained intact, Fitch added . . . PGE was cut to BB- due to 'group contagion' but that was far above Enron's D rating and the utility has (since) been upgraded to BB with a positive outlook.
>
> On the other hand, "Northwestern (in Montana) exemplifies a company that lacks ring-fencing of the utility" Fitch said. "Its corporate structure has often been cited by Fitch as entailing higher risk for the utility because the utility takes on the equity risk of subsidiaries and the utility's finances are intertwined with non-utility businesses..."

Electric Power Daily (February 27, 2004) (reproduced with permission from Platts).

As the Commission is aware, in the waning days of Enron's liquidity crisis, Enron obligated its wholly-owned indirect pipeline subsidiary Transwestern to enter into a $400 million loan, the proceeds of which were promptly conveyed to Enron just before Enron filed for protection of the bankruptcy courts. *In re Investigation of Certain Financial Data*, 100 FERC ¶ 61,143 (2002). The result was that indirect investors in Transwestern, not protected by ring-fencing, were burdened with an additional $400 million in debt, and in exchange received only a claim on its share of a bankrupt's assets. The contrast between the impact upon the two Enron subsidiaries, PGE and Transwestern, could not be more clear.

The proper course of action is to direct that ring fencing be instituted to protect investors in the Operating Utilities and the holding company from further demands placed upon them to help rescue Supply.

V. CONCLUSION

Before AYE makes its liquidity situation even worse; before the impacts on the Operating Utilities grow even more adverse; before failure of Supply will ensure failure of AYE and the Operating Utilities, this Commission must direct that Supply stand on its own financial feet. The Commission should direct the ring fencing of the Operating Utilities, their subsidiaries, and AYE, and not grant the Applicant's requested relief absent comprehensive protections for investors in and consumers served by the Operating Utilities. Absent such conditions expressly contained in any Commission response to the Applicants' filings, Harbert respectfully requests a hearing so that the current facts of Applicants' circumstances can be known and tested. Without ring-fencing or a meaningful hearing, the Commission will have taken upon itself a heavy responsibility in the event of future misfortune at Allegheny. Supply may represent a slow motion financial train wreck. The Commission has the ability to protect investors, promote transparency in the investment and regulatory spheres, and allow the Applicants' carefully couched and shielded assertions to be tested in the light of day. Failure to do so may lead to very serious consequences.

Respectfully submitted,

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Attorneys for Harbert Distressed Investment Master Fund, Ltd.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing materials has been served upon the Applicants' addresses shown on the Application by First Class, U.S. Mail, Postage Prepaid.

Mark Sundback

Mark F. Sundback

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February 18, 2005

BY MESSENGER

The Filing Clerk
Securities & Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549

Re: *Allegheny Energy Inc., File Nos. 70-10251, et al.*

Dear Sir/Madam:

Enclosed please find Harbert Distressed Investment Master Fund Ltd.'s Comments and Request For Hearing Regarding the Form U-1 filing and Declaration of Allegheny Energy in the referenced proceedings.

Please stamp and return the extra copies to our messenger.

Should you have any questions, please call the undersigned at (202) 662-2755.

Very truly yours,

Mark Sundback

Mark Sundback
An Attorney For Harbert Distressed
Investment Master Fund Ltd.

Enclosures

FILE NO. 70-10100

IN THE MATTER OF

FILE NO. 70-10100

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

CERTIFICATE OF NOTIFICATION PURSUANT TO RULE 24

UNDER

THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Allegheny Energy, Inc.

10435 Downsville Pike
Hagerstown, MD 21740

Allegheny Energy Supply Company, L.L.C.
4350 Northern Pike
Monroeville, PA 15146-2841

Allegheny Energy, Inc.
10435 Downsville Pike
Hagerstown, MD 21740

The Commission is requested to send copies of all notices, orders and communications in connection with this Certificate of Notification to:

David B. Hertzog
Vice President and General Counsel
Allegheny Energy, Inc.
10435 Downsville Pike
Hagerstown, MD 21740

Clifford M. Naeve
William C. Weeden
Paul Silverman
Skadden, Arps, Slate,
Meagher & Flom LLP
1440 New York Avenue, NW
Washington, D.C. 20005

On July 23, 2003, the Securities and Exchange Commission ("Commission") issued an order in File No. 70-10100, Holding Co. Act Release No. 35-27701 (the "Order"), authorizing, among other things, certain financing transactions. The Order directed Allegheny Energy, Inc. ("Allegheny") to file on a quarterly basis with the Commission certificates pursuant to Rule 24 of the Public Utility Holding Company Act of 1935. Those certificates are to contain certain financial information pertaining to Allegheny and Allegheny Energy Supply Company, LLC ("AE Supply"), which Allegheny provides below for the period from July 1, 2003 through September 30, 2003 ("the current period").

1. A table showing, as of the end of each calendar month in the reporting period, the dollar and percentage components of the capital structures of Allegheny and AE Supply:

Allegheny is unable to supply this information for the current period because financial statements for that period are not yet available.

2. The amount and timing of any and all dividends declared and/or paid by AE Supply to Allegheny and calculations showing the effect of such dividends on the retained earnings, the common equity, and the members' interest of AE Supply:

No such dividends were declared and/or paid during the current period.

3. A description of the use by Allegheny of any funds received as a dividend from AE Supply:

No such funds were received during the current period.

4. Updated financial projections for Allegheny and AE Supply, substantially in the form of Exhibit H hereto, including statement of assumptions underlying the financial projections:

Filed in paper copy; confidential treatment requested pursuant to Rule 104(b), 17 CFR ss. 250.104(b).

SIGNATURE

Pursuant to the requirements of the Public Utility Holding Company Act of 1935, Allegheny Energy, Inc. has duly caused this Amendment to be signed on its behalf by the undersigned thereunto duly authorized.

Date: December 17, 2003

Allegheny Energy, Inc.

By: */s/ Regis F. Binder*

Title: *Vice President and Treasurer of Allegheny Energy, Inc.*

End of Filing

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OMB APPROVAL
OMB Number: 3235-0167
Expires: October 31, 2007
Estimated average burden hours per response.....1.50

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 15

CERTIFICATION AND NOTICE OF TERMINATION OF REGISTRATION UNDER SECTION 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934 OR SUSPENSION OF DUTY TO FILE REPORTS UNDER SECTIONS 13 AND 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

Commission File Number 333-72498

Allegheny Energy Supply Company, LLC
(Exact name of registrant as specified in its charter)

4350 Northern Pike, Monroeville, Pennsylvania 15146-2841 (412)858-1600
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

7.8% Notes due 2011
(Title of each class of securities covered by this Form)

None
(Titles of all other classes of securities for which a duty to file reports under section 13(a) or 15(d) remains)

Please place an X in the box(es) to designate the appropriate rule provision(s) relied upon to terminate or suspend the duty to file reports:

Rule 12g-4(a)(1)(i)	|_|	Rule 12h-3(b)(1)(i)	|x|
Rule 12g-4(a)(1)(ii)	|_|	Rule 12h-3(b)(1)(ii)	|_|
Rule 12g-4(a)(2)(i)	|_|	Rule 12h-3(b)(2)(i)	|_|
Rule 12g-4(a)(2)(ii)	|_|	Rule 12h-3(b)(2)(ii)	|_|
		Rule 15d-6	|_|

Approximate number of holders of record as of the certification or notice date: **60**

Pursuant to the requirements of the Securities Exchange Act of 1934, Allegheny Energy Supply Company, LLC has caused this certification/notice to be signed on its behalf by the undersigned duly authorized person.

Date:	January 27, 2005	By:	/s/ Jeffrey D. Serkes
		Name:	Jeffrey D. Serkes
		Title:	Vice President

Instruction: This form is required by Rules 12g-4, 12h-3 and 15d-6 of the General Rules and Regulations under the Securities Exchange Act of 1934. The registrant shall file with the Commission three copies of Form 15, one of which shall be manually signed. It may be signed by an officer of the registrant, by counsel or by any other duly authorized person. The name and title of the person signing the form shall be typed or printed under the signature.

SEC 2069 (12-04) **Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.**

Allegheny Energy, Inc. (ticker: AYE, exchange: New York Stock Exchange) News Release - 2-Nov-2004

Allegheny Refinances and Pays Down Allegheny Energy Supply Term Loans

GREENSBURG, Pa.--(BUSINESS WIRE)--Nov. 2, 2004--Allegheny Energy, Inc. (NYSE:AYE) today announced that its subsidiary, Allegheny Energy Supply Company, LLC, has repaid $200 million of its term loans and has refinanced the remaining $1.04 billion of its term loans. Allegheny Energy expects to save approximately $15 million per year in interest expense through the combination of the repayment of principal and a lower interest rate. The remaining loan will bear interest at a rate of LIBOR plus 2.75% per annum, and will mature on March 8, 2011. The Company used approximately $150 million of proceeds from the recent private placement of its common stock and $50 million of cash on hand at Allegheny Energy Supply to complete the $200 million repayment.

"This refinancing is another step in improving the financial condition of Allegheny Energy and is itself a testimony to the progress we've already made," said Paul Evanson, Chairman and Chief Executive Officer. "We remain on track toward achieving our goal of $1.5 billion of debt reduction by the end of 2005."

Since December 1, 2003, Allegheny Energy has reduced debt by approximately $900 million. Further debt reductions will come from free cash flow and proceeds from asset sales. As previously announced, Allegheny Energy has entered into contracts to sell its West Virginia gas operations, its Lincoln generation facility and a portion of its interest in the Ohio Valley Electric Corporation.

Citigroup Global Markets Inc. is the lead arranger for the refinancing.

Allegheny Energy

Headquartered in Greensburg, Pa., Allegheny Energy is an energy company consisting of two major businesses, Allegheny Energy Supply, which owns and operates electric generating facilities, and Allegheny Power, which delivers low-cost, reliable electric service to customers in Pennsylvania, West Virginia, Maryland, Virginia and Ohio. More information about Allegheny Energy is available at www.alleghenyenergy.com.

Forward-Looking Statements

In addition to historical information, this release contains a number of "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Words such as anticipate, expect, project, intend, plan, believe, and words and terms of similar substance used in connection with any discussion of future plans, actions, or events identify forward-looking statements. These include statements with respect to: regulation and the status of retail generation service supply competition in states served by Allegheny Energy's delivery business, Allegheny Power; the closing of various agreements; execution of restructuring activity and liquidity enhancement plans; results of litigation; financing and plans; demand for energy and the cost and availability of inputs; demand for products and services; capacity purchase commitments; results of operations; capital expenditures; regulatory matters; internal controls and procedures and accounting issues; and stockholder rights plans. Forward-looking statements involve estimates, expectations, and projections and, as a result, are subject to risks and uncertainties. There can be no assurance that actual results will not materially differ from expectations. Actual results have varied materially and unpredictably from past expectations. Factors that could cause actual results to differ materially include, among others, the following: execution of restructuring activity and liquidity enhancement plans; complications or other factors that render it difficult or impossible to obtain necessary lender consents or regulatory authorizations on a timely basis; general economic and business conditions; changes in access to capital markets; the continuing effects of global instability, terrorism, and war; changes in industry capacity, development, and other activities by Allegheny's competitors; changes in the weather and other natural phenomena; changes in technology; changes in the price of power and fuel for electric generation; the results of regulatory proceedings, including those related to rates; changes in the underlying inputs, including market conditions, and assumptions used to estimate the fair values of commodity contracts; changes in laws and regulations applicable to Allegheny, its markets, or its activities; environmental regulations; the loss of any significant customers and suppliers; the effect of accounting policies issued periodically by accounting standard-setting bodies; additional collateral calls; and changes in business strategy, operations, or development plans. Additional risks and uncertainties are identified and discussed in Allegheny Energy's reports filed with the Securities and Exchange Commission.

CONTACT: Allegheny Energy, Inc.
Media: Steve Gale, 724-838-6020
Media Hotline: 1-888-233-3583
E-Mail: sgale@alleghenyenergy.com
or
Investor Relations: Max Kuniansky, 724-838-6895
E-Mail: mkunian@alleghenyenergy.com

SOURCE: Allegheny Energy, Inc.

PUBLIC SERVICE COMMISSION

OF STATE VIRGINIA

AT CHARLESTON

Issued: December 16, 2004

CASE NO. 04-1595-G-42T

MOUNTAINEER GAS COMPANY, doing business as
ALLEGHENY POWER
Rule 42T application to increase rates and charges.

CASE NO. 04-1596-G-PC

MONONGAHELA POWER COMPANY and
MOUNTAINEER GAS COMPANY, both doing business
as ALLEGHENY POWER; and MOUNTAINEER GAS
HOLDINGS LIMITED PARTNERSHIP.
Joint petition for consent and approval of purchase
and sale of common stock of Mountaineer Gas Company
and Gas Utility Assets.

PROCEDURAL ORDER

Case No. 04-1595-G-42T

On September 27, 2004, Mountaineer Gas Company (Mountaineer or MGC), doing business as Allegheny Power (AP), tendered for filing revised tariff sheets reflecting increased rates and charges of approximately 9.6% annually, or approximately $23,400,000, for furnishing natural gas service to approximately 205,000 customers in the Counties of Barbour, Berkeley, Boone, Braxton, Brooke, Cabell, Calhoun, Clay, Doddridge, Fayette, Gilmer, Grant, Greenbrier, Hancock, Hardy, Harrison, Jackson, Jefferson, Kanawha, Lewis, Lincoln, Logan, Marion, Marshall, Mason, McDowell, Mercer, Mineral, Mingo, Monongalia, Monroe, Ohio, Preston, Putnam, Raleigh, Randolph, Ritchie, Roane, Summers, Tucker, Tyler, Upshur, Wayne, Wetzel, Wirt, Wood and Wyoming, to become effective on October 27, 2004. As required by *West Virginia Code* §24-2-3a, at least thirty (30) days prior to filing its application to increase rates, Mountaineer filed with the Commission a notice of its intent to file a general rate case. (See, Notice of Intent, filed August 23, 2004).

Mountaineer's resale customers to be affected by any rate change include Ashford Gas Company, Canaan Valley Gas Company, Consumers Gas, Holden Gas, Logan Gas, Southern Public Service, Valley Gas Company and West Virginia Power Gas Service.

Mountaineer has filed Tariff Form No. 6 indicating, among other things, that on September 27, 2004, Tariff Form No. 8 ("Public Notice of Change in Rates with Proposed Effective Date") was delivered to newspapers published and generally circulated in each of the Counties in which MGC provides service, for publication therein once a week for two successive weeks. MGC indicated that a certificate of publication will be furnished to the Commission upon completion of the same. Additionally, the MGC indicated that, on September 27, 2004, it separately mailed Tariff Form No. 8 to each of its resale customers (via United States Certified Mail, return receipt requested) and included Tariff Form No. 8 as a bill insert to its non-resale customers. Voluminous public protests have been filed in this case.

On September 28, 2004, the Consumer Advocate Division filed a Petition to Intervene, stating that Mountaineer's application constitutes a proceeding with potential adverse effects on Mountaineer's customers. Rule 12.6 of the Commission's *Rules of Practice and Procedure* permits intervention by any person having a legal interest in the subject matter of any hearing or investigation pending before the Commission; leave will not be granted except on allegations reasonably pertinent to the issues already presented.

On October 7, 2004, Mountaineer requested a limited waiver, to the extent necessary, of the rules pertaining to notification to customers of the proposed base rate increase. Mountaineer proposed to comply with Section 10.1.b. of Rule 23 by using bill inserts, since monthly bills are sent to its customers. Mountaineer stated the bill inserts will save the cost of mailing separate notices to the 205,000 separate customers. However, since customer billings are on a 30-day cycle, not all of the customers would have been notified within 15 days prior to the proposed effective date. Mountaineer averred that, since the effective date of the proposed base rate change is likely to be suspended by the Commission for up to 270 days, this limited waiver should present no problem or delay to customers in being properly and adequately informed of the proposed increase. MGC also averred that it would accomplish the mailing of separate notices within 40 days. Staff supported the Company's request.

By the October 19, 2004 Commission Order, the Commission made Mountaineer a respondent to this proceeding, and, pending investigation and decision, suspended the revised tariff sheets and the use of the proposed rates until 12:01 a.m. July 25, 2005, to enable the Commission to examine and investigate the supporting data filed with said revised tariff sheets and to provide time for Commission Staff to make reports concerning the matters involved in this case. The Commission granted MGC's Petition for Limited Waiver. The Commission also referred the rate case to the Division of Administrative Law Judges for a decision to be rendered by May 25, 2005, and set March 7, 2005, as the deadline for Staff's audit report, and granted CAD's petition to intervene.

On October 26, 2004, West Virginia Community Action Partnership (WVCAP), the base office for eighteen community action agencies and programs throughout West Virginia which provides support service and assistance to low income families, including assistance on energy consumption, filed a petition to intervene in this matter. WVCAP, stating that federal and state low income assistance funds have been reduced, opined that the decision in this case could have a significant adverse impact on WVCAP's programs.

Also on October 26, 2004, West Virginia State Building and Construction Trades Council, AFL-CIO (Council), a labor organization representing approximately 20,000 construction workers throughout West Virginia whose membership includes ratepayers and employees who work for companies that attempt to compete with non-traditional services offered by Mountaineer and/or entities related to AP, filed its petition to intervene. The Council seeks to intervene to ensure that provision by Mountaineer of such non-traditional services comply with laws relating to unfair competition and cross-subsidization.

On October 28, 2004, Mountaineer submitted publication affidavits indicating compliance with the publication requirements for the Public Notice of Change in Rates with Proposed Effective Date. The Notice provided that parties could petition the Commission to intervene until October 27, 2004.

Also on October 28, 2004, Staff Attorney Chris Howard submitted the Initial Joint Staff Memorandum, attaching the October 22, 2004 Utilities Division Initial Memorandum from Utilities Analyst David Pauley. Staff noted that, while the proposed increase in revenues is approximately 9.6%, the proposed increase in the base rate charge to most residential customers is 41%; commercial and wholesale customers would experience a 40% and 36.4% increase, respectively; and the customer charge for all customer classes would increase by 25%. Staff noted several filing deficiencies and moved that the Commission dismiss the filing, thereby requiring Mountaineer to resubmit the filing once it had corrected all of the deficiencies. Of particular concern to Staff was the incomplete bill analysis for the test year, i.e., it essentially skips per books and jumps straight to the going-level analysis. The filing also was deficient in providing detailed calculations for adjustments. Information was submitted for the filing company only, not for the parent company, as required by *Tariff Rule* 42, i.e., no information was submitted pertaining to Allegheny Energy or the new parent companies, IGS Utilities, LLC, and ArcLight Capital Partners LLC. The rate case is being made in conjunction with the case dealing with the sale of Mountaineer's stock to IGS Utilities, LLC, and IGS Holdings, LLC, which is Case No. 04-1596-G-PC. Many adjustments will have to be made to reflect the effects of this change in ownership. Staff also filed a separate Motion to Dismiss on October 28, 2004. The parties filed several responses to the dismissal motion.

On November 4, 2004, Mountaineer and Mountaineer Gas Holdings submitted a motion to consolidate Case Nos.)4-1595-G-42T and 04-1596-G-PC. The parties filed several responses to the consolidation motion.

<u>Case No. 04-1596-G-PC</u>

Also on September 27, 2004, Monongahela Power Company (Mon Power) and Mountaineer Gas Company, both doing business as Allegheny Power, and Mountaineer Gas Holdings Limited Partnership (Mountaineer Holdings) (collectively the Applicants), jointly filed a petition seeking the Commission's consent and approval of Mon Power's sale of Mountaineer's common stock, as well as the utility assets of West Virginia Power Gas Service (WVPGS) owned directly by Mon Power.

<u>Consolidation</u>

By the November 16, 2004 Commission Referral Order, the Commission referred Case No. 04-1596-G-PC, the stock/asset acquisition case, to the ALJ Division, thereby consolidating Case No. 04-1596-G-PC with Case No. 04-1595-G-42T, with the same decision due date as had been established in the rate case.

As reported in the November 23, 2004 Commission Order, since disputes had arisen between Staff and the CAD regarding the sufficiency of the information filed in support of the rate case, the CAD also filed a separate motion to dismiss the rate case. Despite the pending motions to dismiss, the Applicants worked to resolve their differences with Staff and the CAD and to provide additional information. As a result of these efforts, the Applicants, Staff and CAD agreed to the following:

1. The Applicants would ask the Commission to extend deadlines for 45 days, more particularly as follows:

Deadline Affected	*Existing*	*Proposed*
Staff's audit report	March 7, 2005	April 21, 2005
ALJ decision due date	May 25, 2005	July 11, 2005
Statutory period to process case	July 24, 2005	September 7, 2005
Suspension ends 12:01 a.m.	July 25, 2005	September 8, 2005

2. The Applicants would provide a Cost of Service Study to the parties by January 14, 2005.
3. The Applicants would ask the Commission to deem both motions to dismiss as withdrawn.

Responding to all of the above, by the November 23, 2004 Commission Order, the Commission granted the Applicants' Motion to Toll and Extend Dates, thereby tolling for 45 days the statutory deadline to process Case No. 04-1595-G-42T, i.e., the new deadline is September 7, 2005. The Order also further suspended Mountaineer's use of the proposed natural gas rates and

charges until 12:01 a.m., September 8, 2005, unless otherwise ordered by the Commission; established April 21, 2005 as the new deadline for Staff to submit its audit report; extended the ALJ Division's recommended decision due date in both cases until July 11, 2005; required that the Applicants provide a cost of service study to the parties by January 14, 2005; held that the Staff and CAD motions to dismiss were both deemed withdrawn; and held that, except as modified by this order, all other Commission orders in these cases shall remain in full force and effect.

DISCUSSION

Having considered all of the above, the ALJ holds that he will establish the following procedural schedule in this matter to accommodate filing testimony, scheduling hearings, filing briefs and entering a recommended decision, in accordance with the October 19, November 16 and 23, 2004 Orders:

1. As previously ordered, Mountaineer shall file its cost of service study with the Commission by Friday,

January 14, 2004, and shall provide a copy of the same to all of the parties;

2. Mountaineer shall file its prepared direct testimony no later than Thursday, February 10, 2005;

3. All parties, except Mountaineer and Commission Staff, shall file their prepared direct testimony and their rebuttal to Mountaineer's prepared direct testimony on or before Thursday, March 3, 2005;

4. Mountaineer shall file its rebuttal to the Thursday, March 3, 2005 filings on or before Thursday, March 24, 2004. Additionally, all other parties but Commission Staff may file rebuttal testimony to the prepared direct testimony of any party other than WV-AWC on that date;

5. The Commission Staff Audit Report, the Staff prepared direct testimony and the Staff prepared rebuttal to all other parties' testimony shall be filed on or before Thursday, April 21, 2005;

6. All other parties shall file their prepared rebuttal to the Staff filings of April 21, 2005, on or before Thursday, April 28, 2005;

7. Mountaineer shall publish a copy of the Notice of Hearing, attached as Appendix A, once a week for two (2) consecutive weeks in newspapers duly qualified by the Secretary of State, published and generally circulated in each of the West Virginia Counties of Barbour, Berkeley, Boone, Braxton, Brooke, Cabell, Calhoun, Clay, Doddridge, Fayette, Gilmer, Grant, Greenbrier,

Hancock, Hardy, Harrison, Jackson, Jefferson, Kanawha, Lewis, Lincoln, Logan, Marion, Marshall, Mason, McDowell, Mercer, Mineral, Mingo, Monongalia, Monroe, Ohio, Preston, Putnam, Raleigh, Randolph, Ritchie, Roane, Summers, Tucker, Tyler, Upshur, Wayne, Wetzel, Wirt, Wood and Wyoming, or, in the alternative, in the 19 newspapers used for statewide publication. The first such publication shall be made no sooner than thirty (30) days prior to the May 2, 2005 hearing, and the second such publication shall be made no later than ten (10) days prior to the hearing. Mountaineer shall file publication affidavits at the hearing indicating compliance with this notice requirement;

8. **Deputy Chief Administrative Law Judge Ronnie Z. McCann will convene a hearing in the Howard M. Cunningham Hearing Room, Public Service Commission Building, 201 Brooks Street, Charleston, West Virginia, commencing on Monday, May 2, 2005, at the hour of 9:30 a.m., EST, and continuing each successive weekday until concluded**See FootNote [1];

9. The Reporter shall ***expedite*** preparing the transcript of the hearing and shall file the ***expedited transcript*** no later than 48 hours after the final day of hearing closes; and

10. All parties may file initial briefs and/or proposed findings of fact and conclusions of law, on or before Tuesday, May 31, 2005, and the parties may file replies no later than Friday, June 10, 2005.

Publication requirements for any public protest hearings, which will be scheduled in the near future, will be established in the Procedural Order setting the public protest hearings. It should be noted, at this time, that, while Mountaineer, Commission Staff and the CAD will be expected to appear at all public protest hearings with counsel and technical personnel capable of responding to questions and inquiries from the public, none of the other Intervenors will be required or expected to appear at any of the public protest hearings, although they are free to do so if they choose.

Since no objection was made and the entities appear to have a vested legal interest in the outcome of this proceeding, the October 26, 2004 petitions to intervene filed by West Virginia Community Action Partnership and West Virginia State Building and Construction Trades Council, AFL-CIO, will be granted.

ORDER

IT IS, THEREFORE, ORDERED that the foregoing procedural schedule, **including the May 2 through May 5,** 2004 hearing dates, be, and hereby is, adopted to process and resolve this matter.

IT IS FURTHER ORDERED that Mountaineer Gas Company, doing business as Allegheny Power, shall publish a copy of the Notice of Hearing, attached as Appendix A, once a week for two (2) consecutive weeks in newspapers duly qualified by the Secretary of State, published and generally circulated in each of the West Virginia Counties of Barbour, Berkeley, Boone, Braxton, Brooke, Cabell, Calhoun, Clay, Doddridge, Fayette, Gilmer, Grant, Greenbrier, Hancock, Hardy, Harrison, Jackson, Jefferson, Kanawha, Lewis, Lincoln, Logan, Marion, Marshall, Mason, McDowell, Mercer, Mineral, Mingo, Monongalia, Monroe, Ohio, Preston, Putnam, Raleigh, Randolph, Ritchie, Roane, Summers, Tucker, Tyler, Upshur, Wayne, Wetzel, Wirt, Wood and Wyoming. The first such publication shall be made no sooner than thirty (30) days prior to the May 2, 2005 hearing, and the second such publication shall be made no later than ten (10) days prior to the hearing. Mountaineer shall file a publication affidavit at the hearing indicating compliance with this notice requirement.

IT IS FURTHER ORDERED that the petitions to intervene filed separately with the Commission on October 26, 2004, by West Virginia Community Action Partnership and by West Virginia State Building and Construction Trades Council, AFL-CIO, be, and hereby are, granted.

The Executive Secretary hereby is ordered to serve a copy of this order upon Commission Staff by hand delivery, and upon all parties of record by United States Certified Mail, return receipt requested.

RONNIE Z. McCANN
Deputy Chief Administrative Law Judge

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Appendix A
Page 1 of 1

PUBLIC SERVICE COMMISSION

OF WEST VIRGINIA

AT CHARLESTON

CASE NO. 04-1595-G-42T

MOUNTAINEER GAS COMPANY, doing business as
ALLEGHENY POWER
Rule 42T application to increase rates and charges.

NOTICE OF EVIDENTIARY HEARING

On September 27, 2004, Mountaineer Gas Company (Mountaineer or MGC), doing business as Allegheny Power (AP), tendered for filing revised tariff sheets reflecting increased rates and charges of **approximately 9.6% annually**, or approximately $23,400,000, for furnishing natural gas service to approximately 205,000 customers in the Counties of Barbour, Berkeley, Boone, Braxton, Brooke, Cabell, Calhoun, Clay, Doddridge, Fayette, Gilmer, Grant, Greenbrier, Hancock, Hardy, Harrison, Jackson, Jefferson, Kanawha, Lewis, Lincoln, Logan, Marion, Marshall, Mason, McDowell, Mercer, Mineral, Mingo, Monongalia, Monroe, Ohio, Preston, Putnam, Raleigh, Randolph, Ritchie, Roane, Summers, Tucker, Tyler, Upshur, Wayne, Wetzel, Wirt, Wood and Wyoming, to become effective on October 27, 2004.

By the November 23, 2004 Commission Order, the Commission suspended Mountaineer's use of the proposed natural gas rates and charges until 12:01 a.m., September 8, 2005, unless otherwise ordered by the Commission.

Deputy Chief Administrative Law Judge Ronnie Z. M^c^Cann will convene a hearing in this matter in the Howard M. Cunningham Hearing Room, Public Service Commission Building, 201 Brooks Street, Charleston, West Virginia, commencing on Monday, May 2, 2005, at the hour of 9:30 a.m., EDT, and continuing each successive weekday until concluded.

Any person affected by the proposed rate increase may appear at the hearing and present evidence to be considered by the Administrative Law Judge before he renders a recommended decision in this matter.

MOUNTAINEER GAS COMPANY,
doing business as ALLEGHENY POWER

Footnote: 1

[1] The ALJ initially has reserved the hearing room for May 2 through May 5, 2004, with the understanding that the hearing will conclude in four days.

PUBLIC SERVICE COMMISSION

OF WEST VIRGINIA

CHARLESTON

At a session of the Public Service Commission of West Virginia, in the City of Charleston, on the 23rd day of November, 2004.

CASE NO. 04-1595-G-42T

MOUNTAINEER GAS COMPANY, doing business as
ALLEGHENY POWER, a public utility.
2004 Rate Case filing.

CASE NO. 04-1596-G-PC

MONONGAHELA POWER COMPANY and
MOUNTAINEER GAS COMPANY, both doing business
as ALLEGHENY POWER; and MOUNTAINEER GAS
HOLDINGS LIMITED PARTNERSHIP.
Joint petition for consent and approval of purchase
and sale of common stock of Mountaineer Gas Company
and Gas Utility Assets.

COMMISSION ORDER

The Commission grants a motion to toll the statutory deadline and to extend the Administrative Law Judge's and Staff's due dates, all by 45 days.

BACKGROUND

On September 27, 2004, Mountaineer Gas Company, doing business as Allegheny Power, applied to increase its rates for natural gas utility service. See Case No. 04-1595-G- 42T.

That same day, Monongahela Power Company and Mountaineer Gas Company, both doing business as Allegheny Power, and Mountaineer Gas Holdings Limited Partnership (collectively the Applicants) asked for the Commission's consent and approval of Mon Power's sale of Mountaineer Gas Company's common stock, as well as the utility assets of West Virginia Power Gas Service owned directly by Mon Power. See Case No. 04-1956-G- PC.

On October 19, 2004, the Commission suspended the use of the proposed rates until 12:01 a.m. July 25, 2005. The Commission also referred the rate case to the Division of Administrative Law Judges for a decision to be rendered by May 25, 2005, and set March 7, 2005, as the deadline for Staff's audit report.

In the meanwhile, disputes arose between Staff and the Consumer Advocate Division regarding the sufficiency of the information filed in support of the rate case. Motion for Tolling & to Extend Dates pp. 1-6. Staff and the CAD filed separate motions to dismiss the rate case. Id. p. 3.

On November 16, 2004, the Commission referred the stock/asset acquisition case to the ALJ Division, with the

same decision due date as had been established in the rate case.
The Commission ordered that the matters be consolidated, unless the ALJ Division grants a pending motion to dismiss the rate case.

Despite the pending motions to dismiss, the Applicants worked to resolve their differences with Staff and the CAD and to provide additional information. Id. pp. 3-4. As a result of these efforts, the Applicants, Staff and CAD agreedSee FootNote [1] to the following:

1. The Applicants would ask the Commission to extend deadlines for 45 days, more particularly as follows:

Deadline Affected	*Existing*	*Proposed*
Staff's audit report	March 7, 2005	April 21, 2005
ALJ decision due date	May 25, 2005	July 11, 2005
Statutory period to process case	July 24, 2005	September 7, 2005
Suspension ends 12:01 a.m.	July 25, 2005	September 8, 2005

2. The Applicants would provide a Cost of Service Study to the parties by January 14, 2005.

3. The Applicants would ask the Commission to deem both motions to dismiss as withdrawn.

DISCUSSION

It is reasonable to grant the Applicants' motion and extend the dates as the parties have requested. Further, the Commission will require a cost of service study to be filed, as was represented in the motion. Having granted the motions to extend and required the filing of a cost of service study, the Commission also will deem the Staff and CAD motions to dismiss as withdrawn, as was requested.

FINDINGS OF FACT

1. Disputes arose regarding the sufficiency of the information filed in support of the rate case, and Staff and the CAD filed separate motions to dismiss the rate case. Motion for Tolling & to Extend Dates pp. 1-6.

2. Despite the pending motions to dismiss, the Applicants worked to resolve their differences with Staff and the CAD and to provide additional information. Id. pp. 3-4.

3. The Applicants, Staff and CAD agreed to the following:

a. The Applicants would ask the Commission to extend deadlines for 45 days, more particularly as follows:

Deadline Affected	*Existing*	*Proposed*
Staff's audit report	March 7, 2005	April 21, 2005
ALJ decision due date	May 25, 2005	July 11, 2005
Statutory period to process case	July 24, 2005	September 7, 2005
Suspension ends 12:01 a.m.	July 25, 2005	September 8, 2005

b. The Applicants would provide a Cost of Service Study to the parties by January 14, 2005.

c. The Applicants would ask the Commission to deem both motions to dismiss as withdrawn.

CONCLUSIONS OF LAW

1. It is reasonable to extend the dates and to require that a cost of service study be filed, as was represented in the motion.

2. Having granted the motions to extend and required the filing of a cost of service study, it is also reasonable to deem the Staff and CAD motions to dismiss as withdrawn, as was requested.

ORDER

IT IS THEREFORE ORDERED that the Applicants' Motion to Toll and Extend Dates is granted.

IT IS FURTHER ORDERED the statutory deadline to process Case Number 04- 1595-G-42T is tolled for 45 days. The new deadline is September 7, 2005.

IT IS FURTHER ORDERED that Mountaineer Gas Company's use of the proposed natural gas rates and charges is further suspended until 12:01 a.m., September 8, 2005, unless otherwise ordered by the Commission.

IT IS FURTHER ORDERED that the new deadline for Staff's audit report is April 21, 2005.

IT IS FURTHER ORDERED that the new ALJ decision due date in both cases is July 11, 2005.

IT IS FURTHER ORDERED that the Applicants provide a Cost of Service Study to the parties by January 14, 2005.

IT IS FURTHER ORDERED that the Staff and CAD motions to dismiss are both deemed withdrawn.

IT IS FURTHER ORDERED that, except as modified by this order, all other Commission orders in these cases remain in effect.

IT IS FURTHER ORDERED that the Commission's Executive Secretary serve a copy of this order upon all parties and all parties of record by United States First Class Mail and upon Commission Staff by hand delivery.

CLW/sek
041595ca.wpd

Footnote: 1 [1] *The Applicants represented that this motion had been reviewed by CAD and Staff, who indicated they did not oppose this filing. Motion to Toll & Extend Dates p. 5.*

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As filed with the Securities and Exchange Commission on December 22, 2004

FILE NO. 70-10270

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

AMENDMENT NO. 1

TO

FORM U-1

APPLICATION-DECLARATION

UNDER

THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Allegheny Energy, Inc.
Monongahela Power Company
800 Cabin Hill Drive
Greensburg, PA 15601

Allegheny Energy, Inc.
800 Cabin Hill Drive
Greensburg, PA 15601

(Name of top registered holding company parent of each applicant or declarant)

The Commission is requested to send copies of all notices, orders and communications in connection with this Application to:

Kathryn L. Patton
Deputy General Counsel
Allegheny Energy, Inc.
800 Cabin Hill Drive
Greensburg, PA 15601

Clifford M. Naeve
William C. Weeden
Kathleen Barron
Skadden, Arps, Slate, Meagher & Flom LLP
1440 New York Avenue, NW
Washington, D.C. 20005

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Allegheny Energy, Inc. ("Allegheny") hereby amends its Application/Declaration filed with the Securities and Exchange Commission ("Commission") in File No. 70-10270 on December 1, 2004.

4.1. Time and Place of Closing. Upon the terms and subject to the satisfaction of the conditions contained in Article VIII of this Agreement, the closing of the purchase and sale of the Common Stock and the Related Assets contemplated by this Agreement (the "Closing") will take place at the offices of Sullivan & Cromwell LLP, 125 Broad Street, New York, New York 10004 on the first Business Day of the full calendar month immediately following the date five days after the date on which all of the conditions contained in Article VIII have been satisfied or waived (other than those conditions that by their nature are to be satisfied or waived at the Closing, but subject to the satisfaction or waiver at the Closing of such conditions), subject to the continued satisfaction or waiver of each such condition contained in Article VIII up to and including the Closing, or at such other place or time as the parties may agree. The date on which the Closing actually occurs is hereinafter referred to as the "Closing Date."

4.2. Payment of Purchase Price. Upon the terms and subject to the satisfaction of the conditions contained in this Agreement, the Buyer will pay to Seller at the Closing, or following the Closing in accordance with Section 3.2(c), an amount in United States dollars equal to the Purchase Price (as calculated by Seller pursuant to Section 3.1(d)), by wire transfer of immediately available funds to an account designated by Seller to Buyer at least five (5) Business Days prior to the Closing Date or in the case of payments to be made pursuant to Section 3.2(c)(ii), to an account designated by Seller to Buyer at least five (5) Business Days prior to the date such portion of the Purchase Price is to be paid.

4.3. Deliveries by the Seller. At the Closing, the Seller will deliver the following to the Buyer:

(a) A certificate or certificates evidencing all of the then outstanding shares of Company Common Stock, duly endorsed in blank or accompanied by stock powers duly executed in blank, in proper form for transfer, with any required stock transfer tax stamps properly affixed thereto and any other documents reasonably requested by Buyer to vest in Buyer good and marketable title to such Company Common Stock;

(b) The Related Agreements, duly executed by the Seller;

(c) All consents, waivers or approvals obtained by the Seller with respect to (i) the Related Assets or the Company Common Stock, (ii) the transfer of any Permit or Environmental Permit constituting a Related Asset and (iii) the consummation of the transactions contemplated by this Agreement, to the extent specifically required hereunder;

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(d) All such other instruments of assignment or conveyance as shall, in the reasonable opinion of the Buyer and its counsel, be necessary to transfer to the Buyer the Related Assets and the Company Common Stock in accordance with the terms of this Agreement and, where necessary or desirable, in recordable form;

(e) An opinion of counsel to the Seller, dated the Closing Date, substantially in the form of Exhibit F hereto;

(f) All Transferring Employee Records; and

(g) Such other agreements, documents, instruments and writings as are required to be delivered by the Seller at or prior to the Closing pursuant to the terms of this Agreement or as are otherwise required in connection herewith.

4.4. Deliveries by the Buyer. At or immediately following the Closing (as applicable), the Buyer will deliver the following to the Seller or its designees:

(a) The Purchase Price;

(b) The Related Agreements, duly executed by the Buyer;

(c) An opinion of counsel to the Buyer, dated the Closing Date, substantially in the form of Exhibit G hereto;

(d) All such other instruments of assumption as shall, in the reasonable opinion of the Seller and its counsel, be necessary for the Buyer to assume the Assumed Obligations in accordance with the terms of this Agreement; and

(e) Such other agreements, documents, instruments and writings as are required to be delivered by the Buyer at or prior to the Closing Date pursuant to the terms of this Agreement or as are otherwise required in connection herewith.

ARTICLE V

REPRESENTATIONS AND WARRANTIES OF THE SELLER

Except as set forth in the disclosure schedules attached to this Agreement (the "Disclosure Schedules"), the Seller hereby represents and warrants to the Buyer as follows:

5.1. Organization; Qualification.

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(a) The Seller is a corporation duly organized, validly existing and in good standing under the laws of Ohio, and the Company is a corporation duly organized, validly existing and in good standing under the laws of West Virginia.

(b) The Seller has all requisite corporate power and authority to own, lease, and operate the Related Assets, except where the failure to have such corporate power and authority would be immaterial.

(c) The Company and its Subsidiaries each has all requisite corporate power and authority to own, lease and operate its respective properties and to carry out its respective business as it is now being conducted, except where the failure to have such corporate power and authority would be immaterial.

(d) The Seller has heretofore delivered to the Buyer complete and correct copies of the Company's Articles of Incorporation and By-laws, each as currently in effect.

5.2. Authority Relative to this Agreement. The Seller has full corporate power and authority to execute and deliver this Agreement and the Related Agreements and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and the Related Agreements and the consummation of the transactions contemplated hereby and thereby have been duly and validly authorized by the Board of Directors of the Seller and no other corporate proceedings on the part of the Seller or the Company are necessary to authorize this Agreement or the Related Agreements or to consummate the transactions contemplated hereby and thereby. This Agreement and the Related Agreements have been duly and validly executed and delivered by the Seller, and, assuming that this Agreement and the Related Agreements constitute valid and binding agreements of the Buyer, constitute valid and binding agreements of the Seller, enforceable against the Seller in accordance with their respective terms, subject to bankruptcy, insolvency, fraudulent transfer, reorganization, moratorium and similar laws of general applicability relating to or affecting creditors' rights and to general equity principles (the "Bankruptcy and Equity Exception").

5.3. Capitalization and Other Matters. The Seller owns, beneficially and of record, all of the Company Common Stock, free and clear of all Encumbrances. There are no outstanding contracts or other rights of the Seller or any other Person to subscribe for or purchase, repurchase, redeem or otherwise acquire any capital stock of the Company or any of the Company's Subsidiaries. Except for this Agreement, the Seller has not entered into any contract or granted any warrant, option or similar right for the sale, transfer or other disposition of the Company Common Stock. The Company does not have any equity or other investment interest in any other Person.

23

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5.4. Consents and Approvals; No Violation.

(a) Other than obtaining the consents of third parties set forth on Schedule 5.4 (the "Seller Non-Regulatory Approvals"), the Seller Required Regulatory Approvals and the Buyer Required Regulatory Approvals, neither the execution and delivery of this Agreement and the Related Agreements by the Seller, the sale by the Seller of the Related Assets or the Company Common Stock pursuant to this Agreement nor performance under this Agreement or the Related Agreements will: (i) conflict with or result in any breach of any provision of the Articles of Incorporation or Code of Regulations of the Seller; (ii) require any consent, approval, authorization or permit of, or filing with or notification to, any Governmental Entity or other Persons (including without limitation consents from parties to loans, contracts, licenses, leases and other agreements to which Seller is a party), except for those requirements which become applicable to the Seller as a result of the specific regulatory status of the Buyer (or any of its Affiliates) or as a result of any other facts that specifically relate to the business or activities in which the Buyer (or any of its Affiliates) is or proposes to be engaged; (iii) result in a default (or give rise to any right of termination, cancellation or acceleration) under any of the terms, conditions or provisions of any note, bond, mortgage, indenture, license, agreement or other instrument or obligation to which the Seller, the Company or the Company's Subsidiaries is a party or by which the Seller or the Company may be bound or to which any of the Related Assets may be subject, except for such defaults (or rights of termination, cancellation or acceleration) as to which requisite waivers or consents have been obtained in writing, or (iv) violate any order, writ, injunction, decree, statute, rule or regulation applicable to the Seller.

(b) Except for (i) any necessary approvals of the SEC pursuant to the Holding Company Act with respect to the sale of the Related Assets and the Company and the Transition Services Agreement, (ii) the filings by the Seller required by the HSR Act and the expiration or earlier termination of all waiting periods under the HSR Act, (iii) the approval of the Public Service Commission of West Virginia (the "Public Service Commission"), and (iv) the consent of the Federal Communications Commission to the assignment and transfer, as applicable, of the radio station licenses set forth on Schedule 5.21(b) hereto (the filings and approvals referred to in clauses (i) through (iv) are collectively referred to as the "Seller Required Regulatory Approvals"), no declaration, filing or registration with, or notice to, or authorization, consent or approval of, any Governmental Entity is necessary for the consummation by the Seller of the transactions contemplated hereby or by the Related Agreements.

5.5. Company Reports. Since January 1, 1999, each of the Seller, the Company and the Company's Subsidiaries has filed or caused to be filed with the Public Service Commission all forms, statements, reports and documents (including all exhibits, amendments and supplements thereto) required to be filed by them with respect to the business and operations of the Seller (as it relates to the West Virginia Gas Distribution Business), all of which complied

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in all respects with all applicable requirements of the rules and regulations of the Public Service Commission as in effect on the date each such report was filed, except for such failures to file, cause to be filed or to be in compliance that are immaterial.

Business, taken as a whole, could reasonably be expected to purchase more than 5% of the goods or services to be purchased in connection with the conduct and operation of the West Virginia Gas Distribution Business during the fiscal year 2004 that would not be reasonably likely to be replaced on substantially similar terms and at a substantially similar cost as compared to the terms and cost that would reasonably be expected to be obtained from the previous supplier or group of suppliers absent any material adverse change in the business relationship of the Company, any Company Subsidiary or Seller with respect to the West Virginia Gas Distribution Business with such previous supplier or group of suppliers through the exercise of commercially reasonable efforts by the Company, such Company Subsidiary or Seller with respect to the West Virginia Gas Distribution Business.

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5.34. Company Accounts. Schedule 5.34 sets forth as of the date of this Agreement, the names and locations of all banks, trust companies, savings and loan associations and other financial institutions at which the Company or any Company Subsidiary maintains safe deposit boxes, checking accounts or other accounts of any nature (each, a "Company Account") the available balance of which customarily exceeds $5,000 and the names of all Persons authorized to draw thereon, make withdrawals therefrom or have access thereto.

5.35. No Other Representations or Warranties. EXCEPT FOR THE REPRESENTATIONS AND WARRANTIES EXPRESSLY SET FORTH IN THIS ARTICLE V, THE SELLER IS NOT MAKING ANY OTHER REPRESENTATIONS OR WARRANTIES, WRITTEN OR ORAL, STATUTORY, EXPRESS OR IMPLIED, CONCERNING THE RELATED ASSETS OR THE COMPANY COMMON STOCK (OR THE ASSETS HELD BY THE COMPANY), INCLUDING, IN PARTICULAR, ANY WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE, ALL OF WHICH ARE HEREBY EXPRESSLY EXCLUDED AND DISCLAIMED.

ARTICLE VI

REPRESENTATIONS AND WARRANTIES OF THE BUYER

The Buyer represents and warrants to the Seller as follows:

6.1. Organization. The Buyer is a limited partnership duly organized, validly existing and in good standing under the laws of the State of West Virginia and has all requisite limited partnership power and authority to own, lease and operate its properties and to carry on its business as it is now being conducted except where the failure to have such limited partnership power and authority would be immaterial.

6.2. Authority Relative to this Agreement. The Buyer has full limited partnership power and authority to execute and deliver this Agreement and the Related Agreements and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and the Related Agreements and the consummation of the transactions contemplated hereby and thereby have been duly and validly authorized by the general partners of the Buyer and no other limited partnership proceedings on the part of the Buyer are necessary to authorize this Agreement and the Related Agreements or to consummate the transaction contemplated hereby or thereby. This Agreement and the Related Agreements have been duly and validly executed and delivered by the Buyer, and, assuming that this Agreement and the Related Agreements constitute valid and binding obligations of the Seller, constitute valid and binding agreements of the Buyer, enforceable against the Buyer in accordance with their terms, subject to the Bankruptcy and Equity Exception.

<PAGE>

6.3. Consents and Approvals; No Violation.

(a) Other than obtaining the Buyer Required Regulatory Approvals and the Seller Required Regulatory Approvals, neither the execution and delivery of this Agreement and the Related Agreements by the Buyer, the purchase by the Buyer of the Related Assets or the Company Common Stock, the assumption by the Buyer of the Assumed Obligations pursuant to this Agreement nor performance under the Related Agreements will (i) conflict with or result in any breach of any provision of the Certificate of Incorporation or By-Laws (or other similar governing documents) of the Buyer, (ii) require any consent, approval, authorization or permit of, or filing with or notification to, any governmental or regulatory authority, (iii) result in a default (or give rise to any right of termination, cancellation or acceleration) under any of the terms, conditions or provisions of any note, bond, mortgage, indenture, agreement, lease or other instrument or obligation to which the Buyer or any of its subsidiaries is a party or by which any of their respective assets may be bound, except for such defaults (or rights of termination, cancellation or acceleration) as to which requisite waivers or consents have been obtained.

(b) Except for (i) the "no-action" letter or exemptive order described in Section 8.2(h)(i) and Section 8.2(h)(ii), (ii) the exemptive order described in Section 8.2(h)(iii), (iii) the filings by the Buyer required by the HSR Act and the expiration or earlier termination of all waiting periods under the HSR Act, (iv) the approval of the Public Service Commission of the transfer of the West Virginia Gas Distribution Business and the Tariff Restructuring, and (v) the consent of the Federal Communications Commission to the assignment and transfer, as applicable, of the radio station licenses set forth on Schedule 5.21(b) hereto (the filings and approvals referred to in clauses (i) through (v) are collectively referred to as the "Buyer Required Regulatory Approvals"), no declaration, filing or registration with, or notice to, or authorization, consent or approval of any governmental or regulatory body or authority is necessary for the consummation by the Buyer of the transactions contemplated hereby or by the Related Agreements.

6.4. Availability of Funds. On the Closing Date the Buyer will have available sufficient funds to enable it to pay the Purchase Price on the terms and conditions of this Agreement. The Buyer will have available sufficient funds to pay to Seller any amounts due after the Closing Date pursuant to Sections 3.1(c), 3.2(c) and 3.2(d). Buyer's obligations hereunder are not subject to any conditions regarding Buyer's ability to obtain financing for the consummation of

LONDON ECONOMICS

November 30, 2004

717 Atlantic Ave. Suite 1A
Boston, Massachusetts 02111

Harbert Management
555 Madison Avenue
New York, NY 10022

Harbert Management has asked London Economics International LLC ("LEI") to review the filing to the Pennsylvania Public Utilities Commission ("PAPUC") by Allegheny Power ["Allegheny" or "APS"] with regards to the overall terms and conditions arising out of the request to extend the contract for 2009 and 2010 default supply to customers of its West Penn Power ("WPP") affiliate. WPP is located in the PJM West electricity market area. In the filing, Allegheny Power proposes to supply generation services to West Penn Power customers who do not choose alternative suppliers at a fixed price of $46.90 per MWh for 2009 and $50.80 per MWh for 2010. In return, Allegheny would receive an extension of the period over which it can recover its stranded costs and an increase in default supply rates for 2007 and 2008 compared to those which Allegheny has already guaranteed customers. WPP customers will also receive a two year extension of the existing distribution rate freeze, formerly scheduled to end December 31, 2005.

LEI is a global economic and financial consulting firm specializing in electricity markets. The firm is known for its quantitative electricity market capabilities, as well as its market design expertise. LEI has performed extensive modeling of the PJM West region on behalf of potential purchasers of generating capacity in the region. The firm has also recently performed a survey of available power sales contracts in PJM West through 2010 from a selection of creditworthy sellers. In addition, LEI has helped design default supply provisions in other jurisdictions, as well as recently overseeing default supply auctions in the state of Connecticut on behalf of regulators there. LEI's president, A.J. Goulding, also serves as a professor at Columbia University, where he teaches a course in electricity market design.

LEI's initial review of the proposed APS arrangements for WPP customers shows that the APS proposal is not in the interests of WPP customers. This is true for the following reasons:

- current market rates available for power in WPP's market area from reliable, creditworthy entities are below the rates that APS is proposing;

- modeling using a sophisticated dispatch engine shows that prices are likely to be lower on spot markets in 2009 and 2010 than those offered by APS, meaning that choosing to lock in supplies at a later date is a more rational approach for customers;

- best practice in the Northeast and Mid-Atlantic regarding default supply is for an auction to be held for whatever term the state regulatory commission deems feasible;

- power contracts available in the market today offer credit support and liquidated damages, none of which are offered by Allegheny;

- splitting the load among multiple suppliers would benefit customers by diversifying customer credit and operational exposure;

- entering into long term contracts at a time when fuel prices are abnormally high as they are today can result in overpayment for power;

- power markets become more liquid over shorter terms than those being proposed by Allegheny, meaning a wider variety of suppliers become available;

- a greater degree of market integration over the next five years in the WPP market area means that yet more supplies will become available at economic prices prior to 2009 and 2010, likely putting downward pressure on prices; and

- the distribution rate freeze too may not be to the benefit of customers; it may be that a full cost of service study would show the rates actually should fall.

It is neither necessary nor desirable to lock in generation supplies for these customers at this time, and even if it were, power is available on similar or better terms from other suppliers; indeed, other suppliers are likely to offer significantly better credit support than APS is offering in this filing. The remainder of this report provides further details of our findings.

Power is clearly available in the market for prices at or below those proposed by APS for 2009 and 2010, and with associated credit and liquidated damages provisions better than those currently on offer from APS: Although we believe there is no immediate need for WPP to enter into long term supply arrangements beyond 2008 on behalf of its default supply customers, we have identified more than five alternative suppliers who would be capable of serving WPP default supply customers in 2009 and 2010. Four of the five are investment grade, and as arm's length suppliers could be required to provide credit support and liquidated damages in the event of failure to supply – provisions which APS fails to provide in its filing. In discussions with suppliers, none of the quotes we received for 2009 and 2010 were higher than Allegheny's proposal.

Base case modeling results for the region indicate that prices are likely to be lower than those proposed by Allegheny – Our modeling of likely wholesale electricity price scenarios for the PJM West region for the period covered by the APS filing shows prices of $45.8/MWh in 2009 and $47.4/MWh in 2010, both of which are lower than those proposed by Allegheny. This forecast reflects the fact that prices for underlying fuels (coal and gas) are expected to fall over the forecast horizon from current elevated levels, and that the adjacent Midwest region is currently in an oversupply condition. We have also assumed that no new generation facilities are built over the period despite load growing at historical levels; were new facilities to come on line, prices would be even lower.

Best regulatory practice in the Northeast and the Mid-Atlantic is to hold an auction for default supply obligations, require stringent credit provisions to be met, and involve multiple suppliers through a competitive bid process: Allegheny's proposal is inconsistent with evolving best practice for default supply in the US Northeast and Mid-Atlantic. In an increasing number of jurisdictions, the price for default supply is set through an auction process, in which multiple suppliers bid for the right to supply default customers. Such auctions are held in Maine, New Jersey, and Connecticut, for example. Only qualified suppliers may participate; stringent credit conditions must be met. In some cases, the supply responsibilities are split among multiple winning bidders; this benefits customers by reducing their exposure to any individual supplier should that supplier encounter financial difficulty. The auctions are generally for one year contracts, and are seldom for more than three years. Longer year contracts would be more expensive for consumers, because longer term markets are less liquid, and have fewer suppliers. Even so, an auction today for long dated contracts in the WPP service territory would likely produce prices lower than those offered by Allegheny.

Following such a process for supply to WPP customers for the years 2009 and 2010 would provide assurance that such customers are receiving the lowest available market prices for default supply. An auction process would in no way preclude APS from participating, provided an independent monitor coordinated the bidding process, and APS participated facing the same credit requirements as other bidders. The auction would not need to be held before 2007 at the earliest, giving further time for the market to mature. However, we believe that even were the auction to be held today for the supplies associated with 2009 and 2010, better terms could be obtained for WPP customers than those on offer from APS in its September 2004 filing. It is already abundantly clear that multiple parties would participate, given the number of suppliers willing to enter a contract to supply the region today.

Pennsylvania regulators have been recognized as having successfully created a framework for introducing competition into wholesale generation markets while providing fair prices to small consumers. Regulators, for instance the FERC and various state agencies, increasingly recognize that inter-affiliate transactions involving affiliated generators require additional scrutiny. An auction process helps to demonstrate to customers that they are in fact receiving the lowest possible price for default service.

Credit provisions are an integral part of any power supply arrangement: The APS filing makes no mention of credit support. When power suppliers go bankrupt, they seek to terminate power supply contracts which are below market. To protect power buyers from the increasing costs they would suffer in such a scenario market terms for contracts today generally require a seller to post collateral or a guarantee from an investment grade parent or third party in amounts sufficient to reimburse the buyer for the value of the below market commitment. If over time market rates for the 2009-2010 period were to rise above those in the APS proposal, the contract should allow WPP to receive such collateral from APS. Also, in return for agreeing to the changes proposed to the default supply agreement by APS, WPP should negotiate the right for collateral on the entire contract period, not just the extension. Given that the existing contract provides below market rates for the beginning period of the contract, providing collateral to support this obligation would be among the best ways of providing WPP customers benefits from re-negotiation.

A recent default supply auction which we oversaw required collateral of $5 million per 625 MW block in the form of a letter of credit to secure transmission, and all below-investment grade entities were required to post performance assurance bonds. Sellers were responsible for liquidated damages equal to the excess costs incurred by customers in the event of seller defaults. Multiple sellers participated in this auction process, which shows that the provisions were in no way extreme. In the WPP service territory, this suggests that customers should be able to obtain a letter of credit of over $30 million to backstop transmission obligations, and that if the supplier falls below investment grade, a letter of credit backing up to $1 billion in annual power sales would be necessary. Neither is provided by APS. Ironically, similar terms are standard for most industrial customers, who will have arranged their own power supplies; WPP default customers will likely be receiving terms worse than an industrial customer situated next door if the APS proposal stands.

Many default supply arrangements allow for multiple suppliers: Default supply arrangements in many jurisdictions are structured to allow for multiple blocks to be bid upon and serviced by separate suppliers. This benefits customers by enabling a broader range of potential bidders, and by diversifying the customers' exposure to the credit of any individual company. Most large trading companies as a matter of sound management have trading limits which determine the maximum exposure that they can take on from any one trading partner. WPP customers will have no such protection if the Allegheny proposal is adapted.

Current market perceptions are distorted by prevailing anomalous fuel prices: The quotes we have received all take into account current high underlying fuel prices. Because fuel prices are the single most important driver of electricity prices, there is a direct linkage between fuel prices and power prices. PJM West is a coal-dominated region; over the past 18 months, spot coal prices have increased substantially. Nonetheless, coal is an abundant resource, and many market participants and industry consultants currently predict that as supply-demand fundamentals return to balance, coal prices are likely to fall. As such, forward power prices are likely to fall as well. This suggests that long term contracting under current market conditions may result in higher prices to consumers than a strategy which delayed such purchases.

Shorter term contracts result in greater liquidity: As we have noted, the shape of the forward curve and our own modeling suggests that contracting for power more than three years forward today is likely to cost customers more money than is necessary. Effectively, it is the equivalent of taking out a fixed rate mortgage in a declining interest rate environment – except that WPP customers will not have the option of refinancing. Although we have noted that at least five potential bidders exist for a five year power supply deal in WPP territory, 12 or more would likely show up for a power supply term of less than three years. The more bidders there are competing, the greater the likelihood that prices will be favorable for consumers. This again suggests that waiting until 2007 or 2008 to contract for 2009 and 2010 on behalf of default supply customers in the WPP territory would be a wise choice.

Changes in market rules likely to result in yet more liquid markets by 2009: PJM is already the largest and most liquid electricity market in the world. It is in the process of expanding further, absorbing several territories to the west and south. In addition, market development in adjacent regions continues, with the creation of the Midwest ISO ("MISO"). MISO is expected to launch wholesale market trading sometime in 2005.

PJM and MISO have been ordered to eliminate "seams" (market rules which increase the cost of trading between the two regions) in a timely fashion, lowering transaction costs between the market areas. The two markets are heavily interconnected, facilitating power imports. As such, while the WPP distribution territory currently has access to a wide array of suppliers, the increased transparency and decreased transaction costs due to further PJM expansion and the evolution of MISO are likely to increase the number of potential suppliers still further. This provides yet another reason that, far from there being any urgency to lock in prices on behalf of WPP default supply customers now, a more deliberate approach to contracting on their behalf may produce lower prices.

Our review demonstrates conclusively that the arrangements proposed by APS for WPP default supply customers are not in their best interests. It is premature to be arranging supplies for 2009 and 2010. If contracts for this period are nonetheless considered necessary, an auction process run by an independent monitor would likely reveal the supplies are available at lower prices. Furthermore, the provisions of such an auction would require, and bidders would agree to, credit and collateral requirements superior to those offered by the proposed arrangement with APS.

Please feel free to contact me should you have any further questions on our research on this matter.

Sincerely,

A. J. Goulding
President
London Economics International LLC

STATE OF NEW YORK
STATE OF CONNECTICUT
STATE OF NEW JERSEY
COMMONWEALTH OF PENNSYLVANIA

May 20, 2004

CERTIFIED MAIL RETURN RECEIPT REQUESTED

Paul J. Evanson, President, Chairman and Chief Executive Officer
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Greensburg, PA 15601

Paul J. Evanson, President, Chairman and Chief Executive Officer
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Hagerstown, Maryland, 21740-1766

David C. Benson, President
Allegheny Energy Supply Company, LLC
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Paul J. Evanson, President, Chairman and Chief Executive Officer
Monongahela Power Co.
1310 Fairmont Avenue
Fairmont, W.Va. 26554

Paul J. Evanson, President, Chairman and Chief Executive Officer
West Penn Power Company
800 Cabin Hill Dr.
Greensburg, PA 15601

RE: Notice of Intent to Sue Pursuant to Clean Air Act § 7604

Dear Sirs:

As explained in more detail below, an investigation that we have undertaken has revealed that Allegheny Energy, Inc., the parent of Allegheny Energy Supply Co., LLP, Monongahela Paul J. Evanson

Power Company, and West Penn Power Company (collectively, the "companies"), modified several power plants in violation of the Prevention of Significant Deterioration ("PSD") provisions of the Clean Air Act (the "Act"). As a result, these plants have emitted excess amounts of nitrogen oxides (NO_X) and sulfur dioxide (SO_2), which have damaged the environment and contributed to the endangerment of public health in downwind locations, including the States of New York, Connecticut, New Jersey and Pennsylvania (the "States").

Therefore, pursuant to § 304 of the Act, 42 U.S.C. §7604, the States' undersigned legal representatives hereby notify the companies, on behalf of the States, of the States' intent to file suit against the companies in federal district court for violations of the Act. Specifically, we will allege that the companies, or their corporate predecessors, violated the Act by constructing, and continuing to operate, a major modification to a major stationary source without obtaining the pre-construction permits required by the PSD provisions of the West Virginia Code of State Regulations § 45-14-1 *et seq.*

Statutory Background

The PSD program requires major sources of air pollution located in areas that meet the national ambient air quality standards ("NAAQS") to undergo pre-construction permit review prior to construction of a major modification at the source and to install more effective pollution controls. As its name indicates, Congress intended the PSD process to protect the public health and welfare from any actual or potential adverse effects that may reasonably be anticipated to occur from air pollution, or from effects of air pollution on other natural resources such as bodies of water. 42 U.S.C. § 7470(1).

In enacting the PSD program, Congress also recognized that the transport of pollutants across State boundaries was a common occurrence that unfairly exposed residents of one State to adverse health effects associated with pollution originating in another State. The PSD program, thus, is intended to ensure that emissions from sources in one State will not interfere with efforts to prevent significant deterioration of air quality in another State. 42 U.S.C. § 7470(4). To effectuate these goals, the PSD provisions of the Act provide that any decision to allow increased air pollution in any area be made only after careful evaluation of all consequences of such a decision, including the interstate effects, and after adequate procedural opportunities for informed public participation in the decision-making process. 42 U.S.C. § 7470(5).

To implement the PSD program, the United States Environmental Protection Agency ("EPA") requires major sources of air pollution to obtain pre-construction approval prior to commencing construction of a major modification. 40 C.F.R. § 52.21 *et seq.* The State of West Virginia has adopted, and EPA has approved, State regulations for implementation of the PSD program. CSR §45-14 *et seq.* Sources subject to PSD review must complete a source impact analysis and install Best Available Control Technology (BACT). 42 U.S.C. § 7475(a); CSR § 45-14-7; CSR § 45-14-8; CSR § 45-14-10. BACT is the maximum degree of emission reduction achievable for each pollutant regulated under the Clean Air Act, taking into consideration energy, environmental and economic impacts of the emission reductions. 40 C.F.R. § 52.21(b)(12); CSR § 45-14-2(2.9).

In addition, the State of West Virginia has adopted regulations to implement the Title V operating permit program. CSR § 45-30 *et seq.* Any source required to have a PSD permit is required to obtain an operating permit. CSR § 45-30-4.1(a)(2). A source operating in violation of applicable requirements, including the PSD requirements, must include a schedule for compliance with those requirements. CSR § 45-30-4.3(h)(1)(C)

Description of Violations

The information available to us indicates that the companies have undertaken major modifications without undergoing preconstruction review as required by the PSD program at the following plants: the **Albright** plant, located in Albright, West Virginia; the **Ft. Martin** plant, located in Maidsville, West Virginia; the **Harrison** plant located in Haywood, West Virginia; the **Pleasants** plant located in Willow Island, West Virginia; and the **Willow Island** plant also located in Willow Island, West Virginia. The specific PSD violations committed by the companies include:

* In or around 1989, the companies undertook major modifications of the **Albright** plant Unit 3 including, but not necessarily limited to, replacement of the primary superheater assembly and associated outlet header, replacement of the economizer, and replacement of the secondary superheater. The information available to us indicates that the companies should have projected a net emissions increase (as defined in CSR § 45-14-2) in emissions of NO_X and SO_2 from those projects, triggering the PSD requirements.

* The companies undertook major modifications of the **Fort Martin** plant including, but not necessarily limited to: (i) at Unit 1, replacement of the pendant superheater assembly and the forced draft fan wheel in or around 1996; and (ii) at Unit 2, replacement of the pulverizers in or around 1987, replacement of the superheater outlet header and reheater pendants in or around 1996, and replacement of the superheater outlet bank, commencing in or around 2001. The information available to us indicates that the companies should have projected a net emissions increase (as defined in CSR §45-14-2) in emissions of NO_X and SO_2 from those projects, triggering the PSD requirements.

* The companies undertook major modifications of the **Harrison** plant including, but not necessarily limited to: (i) at Unit 1, replacement of the upper reheater tube bundles and reheater elbows, and pulverizer upgrades in or around 1996; replacement of reheater pendant tube bundles and platen superheater tube bundles commencing in or around 1998; (ii) at Unit 2, replacement of the upper reheater tube bundles in or around 1996; replacement of the platen superheater tube bundles commencing in or around 1998; and (iii) at Unit 3, replacement of the upper reheater tube bundles in or around 1996; and replacement of pendant reheater tube bundles commencing in or around 1998. The information available to us indicates that the companies should have projected a net emissions increase (as defined in CSR §45-14-2) in emissions of NO_X and SO_2 from

those projects, triggering the PSD requirements.

* The companies undertook major modifications of the **Pleasants** plant including, but not necessarily limited to: (i) at Unit 1, replacement of induced draft fan wheels in or around 1988; replacement of high pressure feedwater heaters in or around 1989; and replacement of the upper and lower reheater tube assemblies in or around 2000; and (ii) at Unit 2, replacement of induced draft fan wheels in or around 1987; replacement of high pressure feedwater heaters in or around 1988; and replacement of the upper and lower reheater tube assemblies in or around 2000. The information available to us indicates that the companies should have projected a net emissions increase (as defined in CSR §45-14-2) in emissions of NO_X and SO_2 from those projects, triggering the PSD requirements.

* In or around 1998, the companies undertook major modifications of the **Willow Island** plant Unit 2 including, but not necessarily limited to, replacement of the secondary superheater outlet pendants and replacements of the cyclones on the boiler. The information available to us indicates that the companies should have projected a net emissions increase (as defined in CSR §45-14-2) in emissions of NO_X and SO_2 from those projects, triggering the PSD requirements.

These modifications were subject to the pre-construction review requirements of the PSD program. However, the record indicates that the companies failed to apply for PSD permits for the modifications, and have not, to this date, installed BACT to control emissions of NOx and SO_2 from the plants or complied with any other substantive requirements of PSD review. Further, the companies failed to assess the impact of the increased emissions on interstate air quality, thereby depriving both environmental regulatory agencies and the public of the opportunity to evaluate the impact of the proposed emissions on air quality in downwind states.

The modifications described above may also constitute continuing violations of the New Source Performance Standards of the Act, 42 U.S.C. § 7411, and the implementing regulations at 40 CFR Part 60. In addition, the companies' continued operation of the plants after the effective date of the Title V requirements (as provided by CSR § 45-30 *et seq.*), constitutes a violation of the Title V requirements of the Act. We believe there may be additional violations at your companies' plants. We, thus, reserve the right to raise additional claims or modify the above violations upon receipt of further information from the companies.

Effect on New York, Connecticut, New Jersey and Pennsylvania

The States on whose behalf this notice is being provided have a compelling interest in abating the violations described above because excess emissions from these plants contribute extensively to damages to public health and the environment throughout the state. The NO_x emissions from these sources contribute to the formation and transport of ozone pollution. It is well documented that the release of ozone-creating pollutants in West Virginia contributes to the formation of ozone in our States. *See, e.g., Finding of Significant Contribution and Rulemaking for Certain States in the Ozone Transport Assessment Group Region for Purposes of Reducing Regional Transport of Ozone*, 63 Fed. Reg. 57356, *et seq.* (Oct. 27, 1998). Ozone contributes to many respiratory health problems, including chest pains, shortness of breath, coughing, nausea, throat irritation and increased susceptibility to respiratory infections such as asthma. The adverse health effects of ozone pollution are particularly severe in urban areas like New York City, Philadelphia, Newark and Hartford, where thousands of children suffer the debilitating effects of asthma.

Emissions of NO_x and SO_2 also lead to the creation of fine nitrate and sulfate particles, which, like ozone, are emitted in West Virginia but are transported to downwind States by prevailing winds. Inhalation of fine particulate matter causes respiratory distress, cardiovascular disease and premature mortality. In urban areas, fine particulate matter actually shortens the lives of hundreds of people each year. *See, National Ambient Air Quality Standards for Particulate Matter; Final Rule*, 62 Fed. Reg. at 38656.

NO_x and SO_2 emissions, traveling from West Virginia to New York State, also contribute to the formation of acid deposition, which has caused hundreds of lakes and ponds in the Adirondack Park to become acidic. The percentage of Adirondack lakes that are chronically acidic (a level at which many species of fish can no longer survive) now exceeds 20%. This percentage is expected to increase in years to come, unless midwestern utilities significantly reduce their emissions of NO_x and SO_2. *See, e.g., Acid Rain Program; Nitrogen Oxides Emission Reduction Program; Final Rule,* 61 Fed. Reg. at 67115 (Dec. 19, 1996). Many lakes, particularly those in the western Adirondacks, that were favored destinations of sportsmen just two generations ago are now devoid of fish. NO_x emissions also cause eutrophication of New York, New Jersey and Connecticut coastal waters, such as the Long Island Sound, reducing the diversity of fish and other life in these essential waters. *See, e.g.,National Acid Precipitation Assessment Program, Biennial Report to Congress: An Integrated Assessment* (1998), at 52.

The companies' continuing violation of the PSD and nonattainment NSR requirements exacerbates the harm caused by the transport of emissions from the companies' plants. Therefore, unless the companies abate these violations, we will commence an action against the companies in federal court pursuant to 42 U.S.C. § 7604(a)(3) seeking injunctive relief, penalties and mitigation of the harm caused by the emissions of the companies' West Virginia plants.

Please note that our aim is clean air, not litigation. Therefore, we are willing to discuss a settlement of this matter that would achieve our goal. In that regard, we note that the companies are in the process of installing emission controls at some of the plants identified in this letter. We would be interested in discussing a partial settlement of our claims at those plants that would provide for year round operation of the controls being installed (such as the selective catalytic reduction units being installed at the Harrison and Pleasants plants for control of NO_X emissions).

In addition to the violations we have described at your West Virginia plants, we have identified additional violations of the PSD and nonattainment New Source Review (nonattainment NSR) requirements at your Pennsylvania plants, including the following activities:

* **Armstrong** plant in Adrian, Pennsylvania: In or around 1995, the companies undertook major modifications of the plant including, but not necessarily limited to: (i) at Unit 1,

demolition and complete removal of the number 1 boiler with the exception of the steam drum, downcomer feeder tubes and six downcomers; and (ii) at Unit 2, replacement of all boiler components except the steam drum. The information available to us indicates that the companies should have projected a net emissions increase in emissions of NO_X and SO_2 from those projects, triggering the PSD and nonattainment NSR requirements.

* **Hatfields Ferry** plant in Masontown, Pennsylvania: The companies undertook the following major modifications of the plant including, but not necessarily limited to: (i) at Unit 1, replacement of the secondary superheater outlet header in or around 1996 and replacement of lower slope panels in or around 1997; (ii) at Unit 2, replacement of reheater pendants and roof tubes in or around 1993; replacement of the secondary superheater outlet header in or around 1996; and replacement of lower slope panels in or around 1999; and (iii) at Unit 3, replacement of the secondary superheater outlet header and ash hopper tube panels in or around 1996. The information available to us indicates that the companies should have projected a net emissions increase in emissions of NO_X and/or SO_2 from those projects, triggering the PSD and nonattainment NSR requirements.

* **Mitchell** plant in Courtney, Pennsylvania: Our investigation indicates that the companies may have violated the PSD and nonattainment NSR requirements in or around 1996, when they replaced the ash hopper tube panels and the feedwater heaters. Our investigation into these activities is continuing.

Pursuant to a letter dated April 23, 2004, the Pennsylvania Department of Environmental Protection (DEP) contacted you regarding violations at your Pennsylvania plants. Accordingly, we will postpone any legal action regarding those violations at this time. However, in the event that you do not reach an agreement with DEP that includes a schedule for compliance at the Units described above, we reserve the right to commence a lawsuit against the companies to obtain full compliance.

Conclusion

If you are interested in discussing settlement of our claims regarding your West Virginia plants, we urge you to contact us as soon as possible and be prepared to provide a proposal. You can contact New York Assistant Attorney General Jared Snyder at (518) 474-8010.

Sincerely,

ELIOT SPITZER
ATTORNEY GENERAL OF THE STATE OF NEW YORK

By: ______________________________

J. Jared Snyder
Assistant Attorney General

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Regional Administrator
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Governor Bob Wise (by certified mail)
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Governor Edward G. Rendell (by certified mail)
Governor, Commonwealth of Pennsylvania
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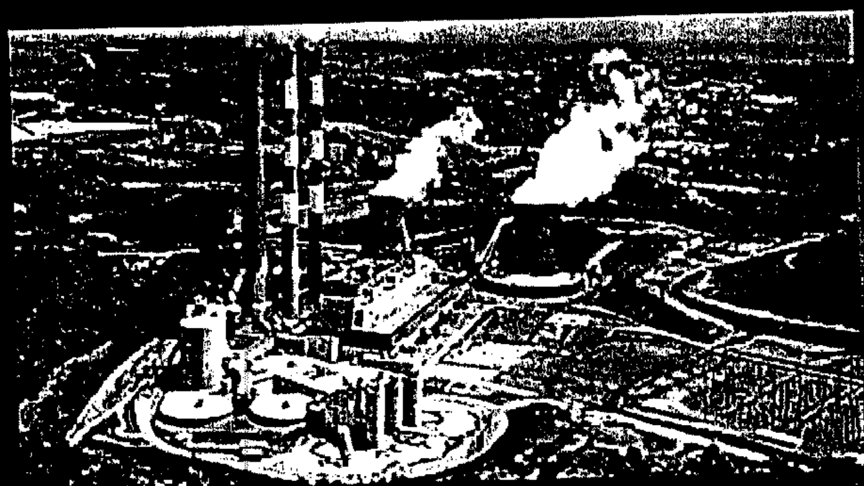
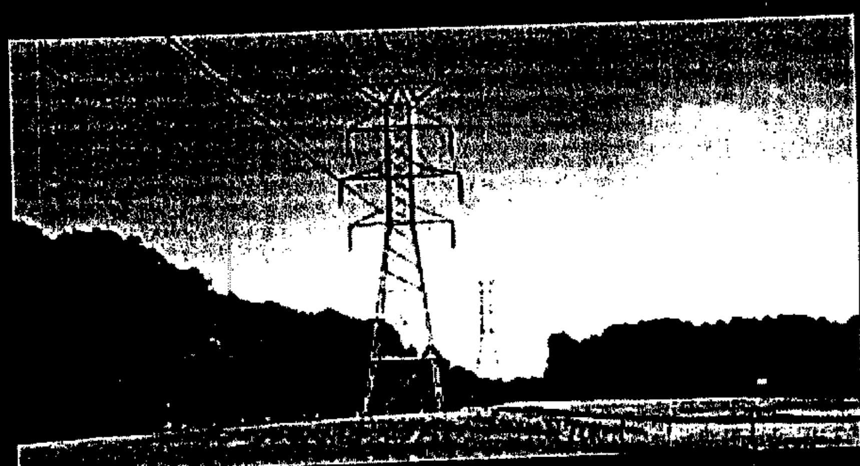


Allegheny Energy, Inc.



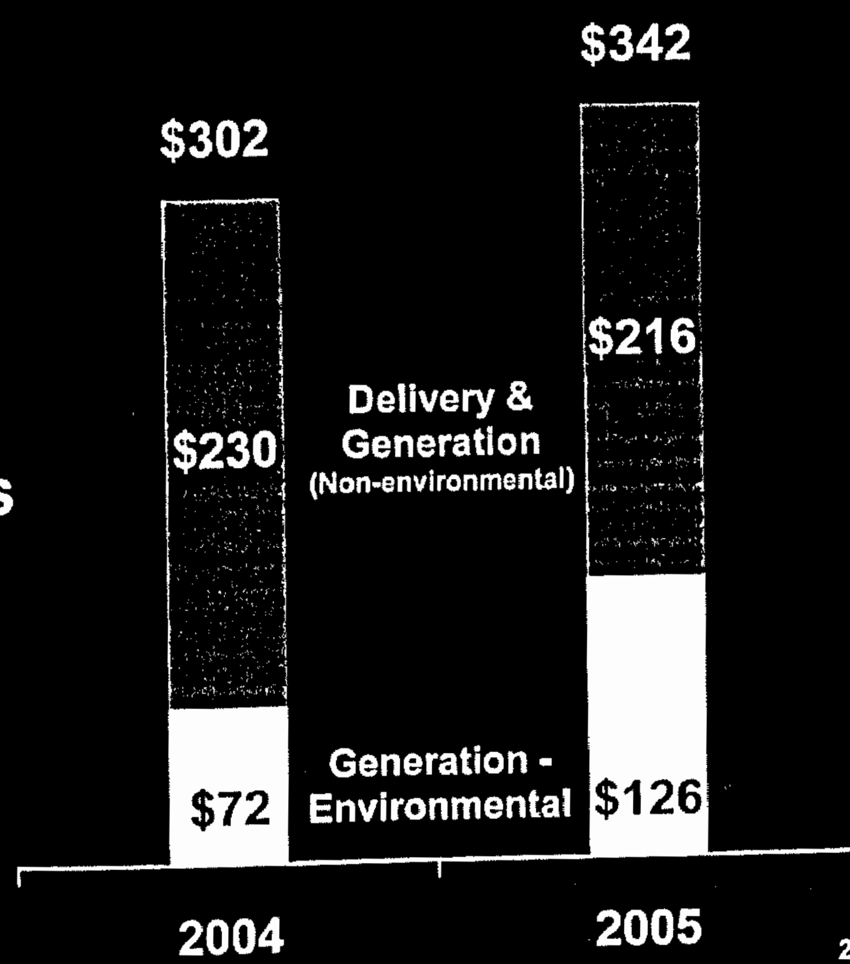
Deutsche Bank
Electric Power Conference

New York
June 14, 2004

Challenge: Environmental Issues

- ➢ Northeast states alleging Clean Air Act violations
- ➢ In compliance with all environmental laws
- ➢ Additional scrubbers, SCRs at 5 remaining units estimated to cost $1.3 billion

Capital Expenditures*
($ millions)



* Estimates.

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December 1, 2004

RE: Evaluation of Emission Compliance at Allegheny Energy Electric Generating Units

Stone & Webster Management Consultants, Inc. ("Stone & Webster Consultants") is pleased to provide this letter report to assist Harbert Management in assessing certain aspects of Allegheny Energy's power generation fleet.

Stone & Webster Consultants has summarized the current emissions, environmental controls and emission allowance position of the Allegheny Energy coal-fired generating fleet, and compared the level of environmental controls installed on these units to Allegheny Energy's competitors in the region. For the competitor analysis, AEP, Cinergy, Constellation, Dominion, First Energy, Mirant Mid-Atlantic, Reliant Mid-Atlantic, and PPL were used.

Allegheny Energy has discussed plans for future environmental controls to further control air emissions from its electric generating fleet, which consists primarily of coal-fired units. Stone & Webster Consultants has not seen any details on the environmental plan but assumes that it is for additional SO_2 and NO_X emissions reductions and possibly for mercury emissions control. The estimated cost given by Allegheny Energy for these capital projects is $1.3 billion. Under current regulations, SO_2 and NO_X emissions are regulated under a "cap and trade" program where electric power facility owners can comply with the regulations either through purchasing emission allowances or installing emissions control devices.

Summary and Conclusions

- At current expected emission levels, it is projected that Allegheny Energy will be required to purchase 50 -100,000 SO_2 allowances annually in 2005 through 2007, and 150,000 or more annually in the following years.
- Price projections for SO_2 allowances are volatile, but a reasonable range would be $500-1,000 per ton, resulting in emission allowance purchases of up to $100 million per year.

- The installation of scrubbers would be an economic investment, given the anticipated expense and volatility of the allowance purchase market.
- The threatened litigation with the AGs makes investing in emission controls much more likely, as evidenced by settlements entered into by other companies that have had recent litigation with the EPA or AGs.
- NO_X emission control technology is also likely to be required due to anticipated volatility in the NO_X allowance prices, likely implementation of year round control requirements, and the threatened litigation with the AGs.
- Total investment for the SO_2 and NO_X emission control technology for the Allegheny Energy fleet is estimated to be $1.1 to $1.3 billion over approximately the next five years.
- Most of Allegheny Energy's competitors in the region have either already made the emission controls investment, or have committed to do so on their larger generating units.

Background Information on Allegheny Energy's Coal-Fired Power Plants

Allegheny Energy's electricity generation business is divided into three companies – Allegheny Energy Supply, Allegheny Generating, and Monongahela Power. As a result of the deregulation of the electricity generation market in Maryland, Ohio, and Pennsylvania, the electricity generating assets previously owned by the Potomac Edison and West Penn Power subsidiaries are now owned by Allegheny Energy Supply. As West Virginia has not deregulated the electricity generation market, the electricity generation assets owned by Monongahela Power are still owned by Monongahela Power.

Key aspects of Allegheny Energy's coal-fired assets are listed below:

Plant	Summer MW	In Service Year
Armstrong Power Station		
Unit 1	172	1958
Unit 2	171	1959
Hatfield's Ferry Power Station		
Unit 1	500	1969
Unit 2	500	1970
Unit 3	500	1971
Mitchell Power Station		
Unit 3	275	1963
Albright Power Station		
Unit 1	73	1952
Unit 2	73	1952
Unit 3	137	1954
Fort Martin Power Station		
Unit 1	552	1968
Unit 2	555	1969
Harrison Power Station		
Unit 1	640	1972
Unit 2	640	1973
Unit 3	640	1974
Pleasants Power Station		
Unit 1	614	1979
Unit 2	614	1980
Rivesville Power Station		
Unit 5	46	1943
Unit 6	91	1951
Willow Island Power Station		
Unit 1	54	1949
Unit 2	181	1960

The major coal-fired generating assets are the Hatfield's Ferry, Fort Martin, Harrison, and Pleasants Power Stations. The units at these stations are all in excess of 500 MW in capacity and were installed between 1968 and 1980. The major coal-fired assets are jointly-owned between the unregulated and regulated companies, with the regulated companies owning 27.5% of these assets.

Under the "cap and trade" regulations discussed previously, capital investments in environmental controls can be balanced against the cost of purchasing emissions allowances. Based on the specific regulations, electric generating units are allocated a specific quantity of emission allowances. Actual NO_X and SO_2 emissions must be matched on a one-to-one basis with the emission allowances, which are then retired. If emissions are in excess of the allowances held, then additional allowances must be purchased. Allowances are freely traded between companies that have excess allowances (as a result of having less emissions than the allowances held) with those that have excess emissions. Allowances prices vary based on the supply and demand for the allowances.

SO_2 emission allowances were allocated in the mid-1990's based on the level of electric generation during a reference period in the 1980's. SO_2 allowances have been allocated through 2034. Generating asset owners can reduce SO_2 emissions through a variety of means ranging from shutting down or curtailing the operation of the electric generating unit, to switching to a lower sulfur coal, and to installing flue gas desulfurization equipment. Flue gas desulfurization equipment ("FGD equipment") comes in two basic types, wet scrubbers and dry scrubbers, with wet scrubbers being more prevalent on coal-fired generating units. For facilities located near sources of low sulfur coal, the most economic option was often to switch to low sulfur coal, particularly coal from the Powder River Basin in Wyoming. For most large coal-fired facilities burning inexpensive high sulfur coals, such as in the Ohio River valley, the most economic option was often to install wet scrubbers. Larger coal-fired units were selected for the installation of wet scrubbers due to economies of scale.

As of May 31, 2004, under the NO_X SIP Call program, many states in the eastern US are required to reduce NO_X emissions during the period from May 1 through September 30 ("ozone season"). NO_X allowances are allocated based on the fuel consumption or electric generation during a reference period using a NO_X emission factor of approximately 0.15 lb NO_X per million Btu ("mmBtu") of fuel consumed. The allowances are allocated for a several year period (each state has slightly different rules related to the NO_X emission allowances) based on a specific reference period which changes over time to reflect more current operation of the unit.

The NO_X emission "cap and trade" program works in a similar manner to the SO_2 emission "cap and trade" program. Options for reducing NO_X emissions are more varied and include a variety of combustion and post-combustion controls. The most cost effective means of NO_X emission reductions was often the installation of low NO_X burners and overfire air. Additional emission reductions can be achieved through injecting ammonia or urea into the furnace, burning a quantity of natural gas along with coal, or doing a combination of both. The most common form of NO_X emissions for large coal-fired units is a post-combustion control called selective catalytic reduction ("SCR"). SCR systems can achieve as much as a 90% reduction in NO_X emissions, which almost always brings the emissions level below the allowance emission factor of 0.15 lb/mmBtu.

Emission control have also been installed on newer coal-fired units as original equipment required by the environmental permits issued for construction. Another reason for the installation of scrubbers is law suits filed by the US EPA against owners of coal-fired units that are alleged to have modified coal-fired units such that new source review ("NSR") and prevention of significant deterioration ("PSD") requirements were violated.

Current SO_2 and NO_X Emissions

The SO_2 and NO_X emissions from the coal-fired plants in 2003 are summarized below. This information was obtained from the US EPA. The SO_2 emissions are for the full 2003 year. The NO_X emissions are for the ozone season (May through September).

Plant	2003 SO_2 Emissions (tons)	2003 SO_2 Emissions (lb/mmBtu)	2003 NO_X Emissions (tons)	2003 NO_X Emissions (lb/mmBtu)
Armstrong Power Station	34,141	3.10	1,076	0.28
Hatfield's Ferry Power Station	139,424	3.36	5,142	0.31
Mitchell Power Station	1,428	0.18	600	0.21
Albright Power Station	25,425	2.44	2,339	0.52
Fort Martin Power Station	102,522	2.73	4,888	0.31
Harrison Power Station	13,145	0.21	3,936	0.15
Pleasants Power Station	44,396	1.15	1,458	0.09
Rivesville Power Station	5,356	1.66	796	0.65
Willow Island Power Station	12,140	1.94	2,354	0.83
Total/Average	377,976	1.72	22,587	0.25

In reviewing the emissions data, we noted that the Hatfield's Ferry plant had a lower than expected number of operating hours. For a baseloaded coal facility, we would have expected the operating hours to be at least 85% of the year. In 2003, the Hatfield's Ferry units operated, on average, 75% of the year, while they operated 84% of the time in 2002. It is likely that the 2003 operations were limited by a combination of extended planned outages and forced outages that reduced the operating hours for this plant. As Hatfield's Ferry is the largest emitter of SO_2 emissions in the Allegheny Energy fleet, this lower than anticipated utilization resulted in a reduction in SO_2 emissions of approximately 15,000 to 20,000 tons.

The average 2003 SO_2 emissions factor of 1.72 lb SO_2/mmBtu is slightly higher than the average SO_2 emissions factor of 1.56 lb SO_2/mmBtu of the large coal-fired fleets in the region. The average SO_2 emissions factors for the large coal-fired fleets in 2003 in the region are as follows:

Fleet	SO_2 Emissions (tons)	SO_2 Emissions (lb/mmBtu)
Allegheny Energy	378,000	1.72
American Electric Power	934,000	1.46
Cinergy	440,000	1.75
Constellation	96,000	1.37
Dominion	160,000	0.83
FirstEnergy	309,000	1.38
Mirant Mid-Atlantic	172,000	2.07
PPL	214,000	2.40
Reliant MidAtlantic	221,000	2.20
Total/Average		1.56

Most of the companies listed, including Allegheny Energy, have installed scrubbers on some of their larger units. AEP installed scrubbers on its two 1,300 MW units at Gavin Station. This was done in the mid-1990s in response to the Clean Air Act Amendments ("CAAA"). Zimmer Station, which is jointly owned by AEP, Cinergy and Dayton Power & Light, was equipped with a scrubber as original equipment. Dominion had installed scrubbers at its Clover facility in response to the CAAA and recently installed scrubbers at its Mount Storm Station as part of a settlement with the EPA on alleged NSR and PSD violations.

Most of the companies listed above have announced plans for the addition of new scrubbers. AEP is in the process of installing scrubbers at the Mountaineer facility in West Virginia, is permitting scrubbers at the Cardinal facility in Ohio, and is planning to install scrubbers at their Mitchell facility in West Virginia. When these scrubbers are in place, the SO_2 emissions factor for the AEP fleet will drop to 1.2 lb/mmBtu. Cinergy is in the process of installing scrubbers on Gibson Unit 3 and plans to install scrubbers on Gibson Unit 2, Cayuga Unit 2, and Miami Fort Units 7 and 8. When these scrubbers are installed, the SO_2 emissions factor will drop below 1.2 lb/mmBtu. PPL has plans to install scrubbers at the Montour facility, which will lower the SO_2 emissions factor to below 1.1 lb/mmBtu.

The average 2003 NO_X emissions factor of 0.25 lb NO_X/mmBtu for the Allegheny Energy fleet does not reflect the full operation of the SCR systems installed at the Harrison Station. When factoring in these SCRs, the average NO_X emission factor is estimated to be 0.22 lb NO_X/mmBtu. This is close to the NO_X SIP Call target of 0.15 lb/mmBtu.

As compared to other coal-fired fleets, the Allegheny Energy fleet has a lower than average NO_X emission factor. For the 2003 ozone season, AEP had a NO_X emission factor of 0.39 lb/mmBtu. Because of acid mist formation problems with a number of its existing SCR units, AEP did not operate all its SCR units at full capacity during the 2003 ozone season. Assuming the operation issues are resolved and the remainder of the announced SCR units are installed (Amos Units 1 and 2, Muskingum River Unit 5, and Mitchell Units 1 and 2) the NO_X emission factor should fall to 0.22 lb/mmBtu. Cinergy experienced similar problems with several of its SCR units. Cinergy's NO_X emission factor for the 2003 ozone season was 0.29 lb/mmBtu. With the resolution of the operational problems and the installation of the remaining SCRs planned (Cayuga Units 1 and 2), the NO_X emission factor should fall to 0.21 lb/mmBtu. Of the other large coal-fired fleets in the Mid-Atlantic/Midwest, FirstEnergy had an average NO_X emission factor of 0.28 lb/mmBtu during the 2003 ozone season and Dominion had an average NO_X emission factor of 0.21 lb/mmBtu during the 2003 ozone season.

Existing Emissions Controls

Listed below are the major emissions control equipment installed at the Allegheny Energy coal-fired facilities.

Plant	SO_2 Control Equipment	NOx Control Equipment
Armstrong Power Station	Medium Sulfur Coal – No Controls	Low NOx Burners
Hatfield's Ferry Power Station	Medium Sulfur Coal – No Controls	Low NOx Burners
Mitchell Power Station	Medium Sulfur Control – Wet Lime Scrubber	Low NOx Burners and Overfire Air
Albright Power Station	Medium Sulfur Coal – No Controls	Low NOx Burners. Low NOx Burner and Overfire Air on Unit 3.
Fort Martin Power Station	Medium Sulfur Coal – No Controls	
Harrison Power Station	High Sulfur Coal - Wet Lime Scrubbers All Three Units	Low NOx Burners and SCRs. SCRs installed during 2003.
Pleasants Power Station	High Sulfur Coal - Wet Lime Scrubber Both Units	Low NOx Burners and SCRs. SCRs installed during 2002.
Rivesville Power Station	Medium Sulfur Coal – No Controls	
Willow Island Power Station	Medium Sulfur Coal – No Controls	

Most of the coal-fired units burn a medium sulfur Northern Appalachian coal. The two facilities that have scrubbers, Harrison and Pleasants Power Station, burn a high sulfur coal. Additional SO_2 reductions may be possible without installation of scrubbers through fuel switching to lower sulfur eastern coals or to western coals, though this would be difficult for a number of reasons. In order to achieve an SO_2 emission that is close to or below the current SO_2 allowances held, scrubbers at Hatfield's Ferry and Fort Martin are likely the most economical choice. Allegheny Energy has recently been soliciting interest from engineers and constructors of scrubbers.

Scrubbers for the Hatfield's Ferry facility will likely be expensive due to site constraints. Assuming a capital cost of \$300/kW, the capital cost of scrubbers in 2004\$ will be approximately \$450 million. Scrubbers for the Fort Martin facility will be approximately \$250 million. Our understanding is that scrubbers would be installed first on the Fort Martin Station. The installation of a scrubber, from conceptual design, permitting, contracting, construction and commissioning, would take from 3 to 4 years. It is possible for a multi-unit site with a difficult retrofit to require a longer installation period. Given where Allegheny Energy is in the process, scrubbers at Fort Martin would likely be placed on-line in the 2008/2009 time frame. Scrubbers for Hatfield's Ferry would likely come on-line in the 2010/2011 time frame.

In order to bring scrubbers on line between 2008 and 2010, Allegheny Energy will need to begin significant development efforts by the beginning of 2005. The installation of SCR systems, if mandated as part of the NSR/PSD settlement could be complete for the first unit by the beginning of the 2007 ozone season, if much of the development work is already complete. As Allegheny Energy recently installed SCR systems at it Pleasants and Harrison Power Stations, this is likely a good assumption. Even in this case, the SCR installation would be spread over several years. Significant spending on SCR systems would begin mid to late 2005.

Estimated capital spending of $1.1to $1.3 billion would be spread from 2005 through 2010 or 2011. The approximate magnitude of annual spending would be as follows:

Year	Capital (million)
2005	$50
2006	$150
2007	$300
2008	$300
2009	$200
2010	$200

While Allegheny Energy has relatively low NO_X emissions, NO_X emissions are still in excess of the NO_X emissions allowances. Therefore, some form of additional NO_X control will likely be economic for the Hatfield's Ferry and Fort Martin facilities as well. Given the current level of NO_X emissions and NO_X emissions allowance price, it is possible that less capital intensive NO_X controls (such as SNCR systems) could be the most economic choice in the near-term. With the anticipated shift to year-round NO_X emission control by the end of the decade, SCR systems may become economic for either or both Hatfield's Ferry and Fort Martin. SCRs at Hatfield's Ferry would cost between $200 and $250 million (total for all three units). SCRs at Fort Martin would cost between $150 and $175 million (total for both units). An SCR installation can be accomplished in a 2 to 3 year time frame. Less capital intensive NO_X controls can be installed in 1 to 2 years.

Scrubbing technology is well proven. Based on the experience of the large scrubbers installed in the mid-1990s, a number of modifications have been made which reduces the unit cost of the scrubber. The initial round of scrubbers were installed with multiple scrubber vessels and extensive redundant systems. The operating experience of these scrubbers indicated that fewer and larger scrubber vessels are adequate and that the extensive redundant systems were not required. The primary concern in the industry with scrubbers used in conjunction with SCR systems is the formation of sulfuric acid mist plume emitted from the plant stack. The formation of the acid mist plume is highly sensitive to the plant configuration, coal quality, coal sulfur content, and SCR design. A variety of chemicals have been tested to reduce the acid mist formation to an acceptable level. These chemicals have worked in many situations but have also caused operation issues at some plants. The industry is focused on these issues and a more clear-cut solution to this problem should be developed over the next several years.

A side benefit of scrubbers is enhanced mercury emissions control. Separately and in combination with SCR systems, it has been demonstrated that a significant quantity of mercury can be removed in a scrubber, particularly when burning eastern bituminous coal.

Until the mid-1990s, SCR systems on large coal-fired units were largely unproven. Since then, the experience with SCR has been good, with an occasional exception. The biggest issue with SCR installations has been in construction. SCR systems need to be integrated closely with the regenerative air heaters on coal-fired units. The systems often require complex ducting runs and need to be installed in elevated locations. The available space where an SCR needs to be installed is often crowded, making foundation installation and steel erection difficult and costly. From initial estimates, the cost of some SCR systems have been 30% to 50% greater than anticipated.

Given the magnitude of the capital costs presented by Allegheny Energy for its compliance program, we would assume that it includes scrubbers for both Fort Martin and Hatfield's Ferry, and likely SCR systems for all or most of these units.

Allowances – Price, Exposure, and Cost

SO_2 Allowance Analysis

SO_2 emissions allowances have been actively traded since the late-1990s as part of the implementation of the CAAA. Many utilities installed scrubbers in response to the CAAA and took advantage of early reduction credits to build up a substantial bank of allowances. Other utilities switched to lower sulfur coals such that they were able to operate their coal-fired units without having to purchase allowances. With excess supply of allowances and limited demand, SO_2 emissions allowances traded at what is considered to be less than the marginal cost of producing the allowances. Generally, the marginal cost of producing the allowances is the levelized cost of installing and operating a scrubber. For large scrubber installations in the mid-1990s, the cost of generating allowances, as expressed in \$/ton of SO_2 removed, was approximately \$200 to \$250/ton. The SO_2 allowances were being traded until 2003 at between \$100 and \$150/ton. Starting in late 2003 and continuing until the present, the SO_2 allowance prices have risen dramatically. The allowance prices have recently been ranging between \$400 and \$700/ton.

Several factors went into rapid rise in the allowance prices. First, the allowance bank built up through early reduction efforts, has been steadily declining. SO_2 emissions have remained at approximately 11 million tons per year while new allowances that become available each year has fallen to 9 million tons per year. Without additional reduction in SO_2 emissions, the allowance bank will be depleted in 4 to 6 years.

After several years of steady decreases in SO_2 emissions, SO_2 emissions increased in 2003 and are expected to increase again in 2004. The factors driving these increases are: 1) higher utilization of coal-fired generation as a result of high gas prices limiting the generation from new gas-fired generating units; 2) limited supply of low sulfur eastern coal shifting consumption to more readily available higher sulfur eastern coals; and 3) the proposed multi-pollutant regulations that will reduce the availability of SO_2 allowances in the 2010 to 2012 time frame by 50%. EPA projects the marginal cost of SO_2 reductions in 2010 to be approximately \$800/ton (1999\$), with an assumed 3% inflation rate, in 2010\$, the cost of allowances would be approximately \$1,100/ton, due to implementation of the Interstate Air Quality Rule. Forecasts of SO_2 allowance prices show steady increases in the prices as the proposed compliance date is approached, though the reality will likely be more volatile due to the multitude of factors that drive the supply and demand of allowances. Factors such as a reduction in gas prices could reduce the allowance price as more natural gas facilities are brought online, whereas problems supplying Eastern low sulfur coal would likely have the opposite effect, and increase the allowance price. Current industry projections show a range of \$500 to \$1,000/ton.

Shown below are the SO_2 allowances currently held by Allegheny Energy. Without additional SO_2 controls, the SO_2 emissions should be at approximately 395,000 tons per year. Also shown is the net allowances that will need to be purchased in order for Allegheny Energy to remain in compliance with existing regulations.

Year	SO_2 Allowances Held (tons)	Current Condition SO_2 Allowance Requirements (tons)
2004	372,000	23,000
2005	346,000	49,000
2006	286,000	109,000
2007	301,000	94,000
2008	242,000	153,000
2009	220,000	175,000
2010	216,000	179,000

At an allowance price range of $500-$1,000/ton, Allegheny Energy will spend between $50 and $150 million a year between 2005 and 2008. Without additional controls and assuming that new regulations come into place in 2010, the cost of purchasing allowances could range from $150 to $300 million per year.

Our rough estimate of the levelized cost of installing and operating scrubbers for Hatfield's Ferry and Fort Martin is $400/ton of SO_2 removed (2004$). This assumes an installed capital cost of $700 million as indicated above, which is based on a capital cost of $300/kW for Hatfield's Ferry and $230/kW for Fort Martin. We have also assumed an operating cost of $1.5/MWh for the scrubbers. Given the current and forecasted allowance prices, there appears to be good justification for installing scrubbers at both Hatfield's Ferry and Fort Martin.

Aside from a direct economic justification, installing scrubbers will allow Allegheny Energy to better manage its exposure to the SO_2 allowance market. In the lead up to the implementation of the new regulations, there will be increasing volatility in the allowance prices. Installing scrubbers or switching to much lower sulfur coals is a multi-year process that will become more difficult to implement as more utilities realize their exposure and scramble to address their exposure. The downside risk is that allowance prices fall to below the marginal cost of compliance due to oversupply of allowances after the 2010-2012 time frame. However, we believe this risk is limited as the proposed regulations call for a second decrease in the number of SO_2 allowances available after 2015.

Also, note that there are secondary benefits from installing scrubbers such as mercury emissions reductions and ability to burn a broader mix (i.e. more high sulfur) of coals. Recognizing that the levelized cost of installing scrubbers is an approximation based on our experience and the limited information that is publicly available, there is still ample justification for Allegheny Energy pursuing this strategy.

NO_X Allowance Analysis

The NO_X allowance market is a more recent development, essentially starting in 2003 with the early compliance of several states to the US EPA's NO_X SIP Call requirements. As of the end of May 2004, all the states involved are participating in the NO_X SIP Call program. Pricing for NO_X allowances has also been volatile, particularly leading up to the 2003 ozone season. A number of utilities had installed SCR and other NO_X control systems between 2000 and 2003. With construction delays and operational issues associated with some of the retrofits, the supply of allowances tightened and drove the allowance price up over \$4,500/ton. The current price for NO_X allowances is \$2,500/ton.

On a simplistic basis, Allegheny Energy's NO_X allowance requirements are the difference between their actual emission factor and 0.15 lb/mmBtu. With the operation of the SCR at the Harrison Station, we estimate Allegheny Energy's NO_X emission factor to be 0.22 lb/mmBtu which results in an emission level of approximately 20,000 tons. The excess allowances held by Allegheny Energy for 2003 and the allowances held for 2004 should cover the 2004 ozone season emissions without having to purchase additional allowances. For 2005 and 2006, Allegheny Energy appears to be short 6,000 to 7,000 tons of allowances. At current allowance prices, Allegheny Energy would need to spend \$15 to \$17 million to meet its obligation in 2005.

Allegheny Energy can reduce its exposure to NO_X allowance purchases by installing additional NO_X controls. Generally, focusing on reducing emissions from the larger units is the most economic. Thus we would assume that Allegheny Energy is evaluating NO_X reduction measures at both Fort Martin and Hatfield's Ferry. Reducing the NO_X emissions for their fleet to below 0.15 lb/mmBtu would likely require installing SCR systems on some of the units at Fort Martin and Hatfield's Ferry. At an allowance price of \$2,500/ton, the installation of an SCR system becomes marginal. Less capital intensive options are available which could further reduce NO_X emissions and would be economically justified at the current allowance prices. However, installing these NO_X control systems would not eliminate the need to purchase allowances, only reduce the total allowance purchase requirements.

An element of the proposed multi-pollutant regulations is the control of NO_X emissions year-round instead of only during the ozone season. Generally, when factoring in year-round operation, SCRs become economic again because of their low operating cost versus most of the alternative control systems.

Conclusion

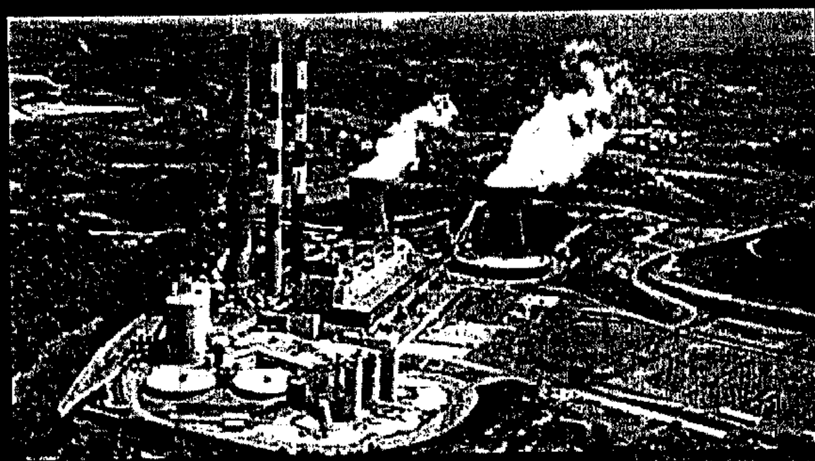
In order to achieve emission compliance that is close to or below the current allowances held, emission controls at Hatfield's Ferry and Fort Martin are likely the most economical choice. This evaluation has been based on the following factors:

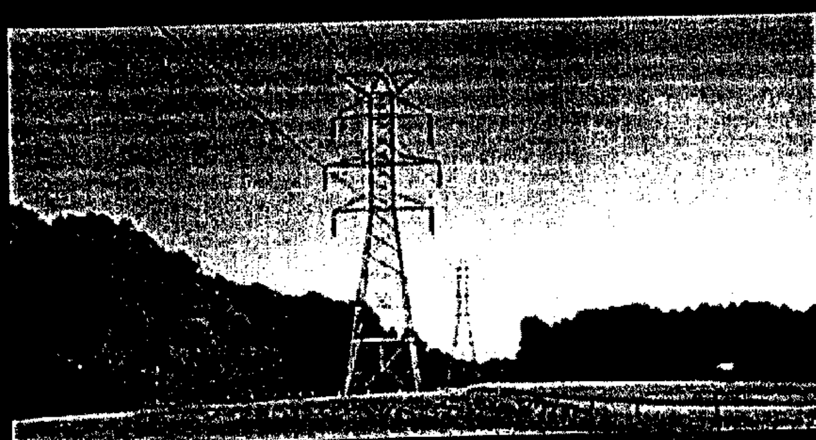
- At current expected emission levels, it is projected that Allegheny Energy will be required to purchase 50 -100,000 SO_2 allowances annually in 2005 through 2007, and 150,000 or more annually in the following years.
- Price projections for SO_2 allowances are volatile, but a reasonable range would be \$500-1,000 per ton, resulting in emission allowance purchases of up to \$100 million per year.
- The installation of scrubbers would be an economic investment, given the anticipated expense and volatility of the allowance purchase market.
- The threatened litigation with the AGs makes investing in emission controls much more likely, as evidenced by settlements entered into by other companies that have had recent litigation with the EPA or AGs.
- NO_X emission control technology is also likely to be required due to anticipated volatility in the NO_X allowance prices, likely implementation of year round control requirements, and the threatened litigation with the AGs.
- Total investment for the SO_2 and NO_X emission control technology for the Allegheny Energy fleet is estimated to be \$1.1 to \$1.3 billion over approximately the next five years.
- Most of Allegheny Energy's competitors in the region have either already made the emission controls investment, or have committed to do so on their larger generating units.

Should you have any questions or comments regarding this evaluation, please do not hesitate to contact me at (617) 589-1440.

Regards,

John Senner
Assistant Vice President





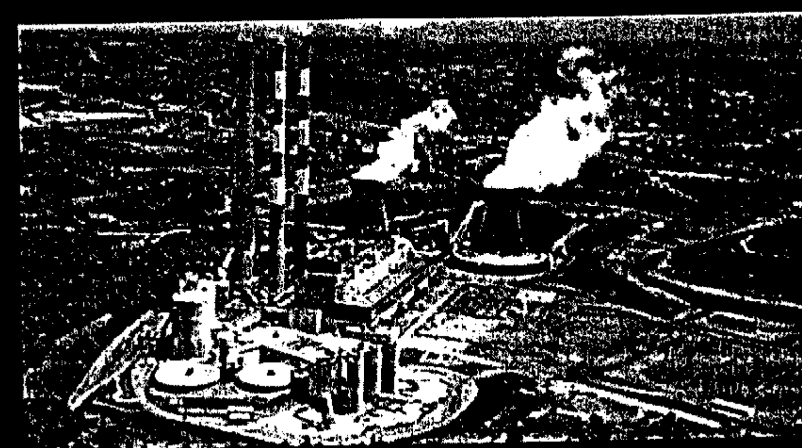
Allegheny Energy, Inc.

Edison Electric Institute Financial Conference

October 24-27, 2004

Challenge: Environmental Issues

- In compliance with all environmental laws
- Evaluating options for the future
- If install scrubbers/SCRs at 5 remaining major units, estimated cost = $1.3 billion
- In discussions with state/federal authorities



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Allegheny Energy

NEWS RELEASE

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FOR IMMEDIATE RELEASE

Allegheny Energy Asks Federal Court to Rule on Environmental Dispute

Greensburg, Pa., January 6, 2005 — Subsidiaries of Allegheny Energy, Inc. **(NYSE: AYE)** today asked a United States court in West Virginia to declare that their coal-fired power plants are in compliance with the federal Clean Air Act.

Allegheny Energy Supply Company, LLC and Monongahela Power Company are seeking a declaratory judgment against the attorneys general of New York, New Jersey and Connecticut, who filed a notice of intent to sue Allegheny in May 2004. In that notice, the attorneys general alleged that the Allegheny companies undertook maintenance projects at power stations in Pennsylvania and West Virginia in violation of the Clean Air Act. Allegheny believes that its actions were within the law. In the action announced today, Allegheny has requested the court to rule in an effort to resolve the matter.

"We believe that over the years we have fully complied with all applicable laws and regulations," said Paul Evanson, Chairman, President and Chief Executive Officer of Allegheny Energy. "After eight months of discussions, we believe it's time to seek the clarity that only a court can provide on these issues.

"We remain committed to reducing absolute emissions at our plants, but our financial condition limits our options. That's why we are working actively with the states of West Virginia and Pennsylvania to find a way to improve the environment sooner than we could on our own," Evanson added.

The Allegheny subsidiaries filed their legal action today in the U.S. District Court for the Northern District of West Virginia because most of the power stations at issue are located there, as are more than 700,000 Allegheny customers.

Allegheny Energy

Headquartered in Greensburg, Pa., Allegheny Energy is an energy company consisting of two major businesses: Allegheny Energy Supply, which owns and operates electric generating facilities, and Allegheny Power, which delivers low-cost, reliable electric service to customers in Pennsylvania, West Virginia, Maryland, Virginia and Ohio. More information about Allegheny Energy is available at www.alleghenyenergy.com.

Forward-Looking Statements

In addition to historical information, this release contains a number of "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Words such as anticipate, expect, project, intend, plan, believe, and words and terms of similar substance used in connection with any discussion of future plans, actions, or events identify forward-looking statements. These include statements with respect to: regulation and the status of retail generation service supply *competition in states served by Allegheny Energy's delivery business, Allegheny Power; the closing of various agreements; execution of restructuring activity and liquidity enhancement plans; results of litigation; financing and plans; demand for energy and the cost and availability of inputs; demand for products and services; capacity purchase commitments; results of operations; capital expenditures; regulatory matters; internal controls and procedures and accounting issues; and stockholder rights plans. Forward-looking statements involve estimates, expectations, and projections and, as a result, are subject to risks and uncertainties. There can be no assurance that actual results will not materially differ from expectations. Factors that could cause actual results to differ materially include, among others, the following: execution of restructuring activity and liquidity enhancement plans; complications or other factors that render it difficult or impossible to obtain necessary lender consents or regulatory authorizations on a timely basis; general economic and business conditions; changes in access to capital markets; the continuing effects of global instability, terrorism, and war; changes in industry capacity, development, and other activities by Allegheny's competitors; changes in the weather and other natural phenomena; changes in technology; changes in the price of power and fuel for electric generation; the results of regulatory proceedings, including those related to rates; changes in the underlying inputs, including market conditions, and assumptions used to estimate the fair values of commodity contracts; changes in laws and regulations applicable to Allegheny, its markets, or its activities; environmental regulations; the loss of any significant customers and suppliers; the effect of accounting policies issued periodically by accounting standard-setting bodies; additional collateral calls; and changes in business strategy, operations, or development plans. Additional risks and uncertainties are identified and discussed in Allegheny Energy's reports filed with the Securities and Exchange Commission.*

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8-K 1 form_8k.htm DECLARATORY JUDGMENT

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

January 7, 2005 (January 6, 2004)
Date of report (Date of earliest event reported)

Commission File Number	Name of Registrant State of Incorporation Address of Principal Executive Offices and Telephone Number	IRS Employer Identification Number
1-267	**ALLEGHENY ENERGY, INC.** (A Maryland Corporation) 800 Cabin Hill Drive Greensburg, Pennsylvania 15601 Telephone (724) 837-3000	13-5531602
333-72498	**ALLEGHENY ENERGY SUPPLY COMPANY, LLC** (A Delaware Limited Liability Company) 4350 Northern Pike Monroeville, Pennsylvania 15601 Telephone (412) 858-1600	23-3020481
1-5164	**MONONGAHELA POWER COMPANY** (An Ohio Corporation) 1310 Fairmont Avenue Fairmont, West Virginia Telephone (304) 366-3000	13-5229392

N/A
(Former name or former address, if changed since last report.)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

[ ] Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

[ ] Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

[ ] Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

[ ] Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 8.01 Other Events

On January 6, 2005, Allegheny Energy, Inc. announced that its subsidiaries, Allegheny Energy Supply Company, LLC and Monongahela Power Company, asked a United States district court in West Virginia to declare that their coal-fired power plants are in compliance with the federal Clean Air Act.

A copy of the press release relating to this announcement is attached as Exhibit 99.1 to this Current Report on Form 8-K and is incorporated herein by reference.

Item 9.01 Financial Statements and Exhibits

(c) Exhibits

Exhibit Number	Description
99.1	Press release issued by Allegheny Energy, Inc. on January 6, 2005.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, each of the registrants has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

ALLEGHENY ENERGY, INC.

Dated: January 7, 2005

BY: /S/ JEFFREY D. SERKES

Name: Jeffrey D. Serkes
Title: Senior Vice President and
Chief Financial Officer

ALLEGHENY ENERGY SUPPLY COMPANY, LLC

Dated: January 7, 2005

BY: /S/ JEFFREY D. SERKES

Name: Jeffrey D. Serkes
Title: Vice President

MONONGAHELA POWER COMPANY

Dated: January 7, 2005

BY: /S/ JEFFREY D. SERKES

Name: Jeffrey D. Serkes
Title: Vice President

EXHIBIT INDEX

Exhibit Number	Description
99.1	Press release issued by Allegheny Energy, Inc. on January 6, 2005 (filed herewith).

this matter can be obtained by contacting the Commission's TDD terminal on 202–205–1810.

SUPPLEMENTARY INFORMATION: The Commission instituted this investigation on June 2. 2003, based on a complaint filed by Energizer Holdings, Inc. and Eveready Battery Company, Inc., both of St. Louis, Missouri. 68 FR 32771 (June 2, 2003). The complaint, as supplemented, alleged violations of section 337 of the Tariff Act of 1930 in the importation into the United States, the sale for importation, and the sale within the United States after importation of certain zero-mercury-added alkaline batteries, parts thereof, and products containing same by reason of infringement of claims 1–12 of U.S. Patent No. 5,464,709 ("the '709 patent"). The complaint and notice of investigation named 26 respondents and were later amended to include an additional firm as a respondent. The investigation has been terminated as to claims 8–12 of the '709 patent. Several respondents have been terminated from the investigation for various reasons.

On June 2, 2004, the ALJ issued his final ID finding a violation of section 337. He also recommended the issuance of remedial orders. A number of the remaining respondents petitioned for review of the ID. Complainants and the Commission investigative attorney filed oppositions to those petitions. On July 9, 2004, the Commission issued a notice that it had determined to review the ALJ's final ID in its entirety. In that notice, the Commission requested written submissions on the issues on review (noting issues and questions it particularly sought briefing on), as well as on remedy, the public interest, and bonding. Complainants, respondents, and the Commission investigative attorney filed written submissions.

Having considered the record in this investigation, including the written submissions on the issues on review and on remedy, the public interest, and bonding, the Commission has determined to terminate this investigation with a finding of no violation of section 337. Specifically, the Commission has determined that the asserted claims are invalid for indefiniteness. The Commission has determined to take no position on the other issues raised in this investigation. Finally, the Commission has determined to deny as moot the May 21, 2004, motion of respondent Ningbo Baowang Battery Co. Ltd. to terminate the investigation as to it, as well as its motion to reopen the evidentiary record.

This action is taken under the authority of section 337 of the Tariff Act of 1930, as amended (19 U.S.C. 1337), and sections 210.41–.51 of the Commission's Rules of Practice and Procedure (19 CFR 210.41–.51).

By order of the Commission.

Issued: October 1, 2004.

Marilyn R. Abbott,

Secretary to the Commission.

[FR Doc. 04–22601 Filed 10–6–04; 8:45 am]

BILLING CODE 7020–02–P

DEPARTMENT OF JUSTICE

Notice of Lodging of Settlement Agreement Under the Comprehensive Environmental Response, Compensation, and Liability Act

Notice is hereby given that on September 23, 2004, a proposed Settlement Agreement (the "Agreement") in In re: Farmland Industries, Inc., *et al.*, Case No. 02–50557, was lodged with the United States Bankruptcy Court for the Western District of Missouri.

In this settlement the United States resolves the Environmental Protection Agency's claim for cost recovery for costs to be incurred remediating environmental contamination at the Obee Road Superfund Site in Hutchinson, Kansas. Farmland Industries, Inc. has been identified as a responsible party under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") in connection with this Site, and civil penalties under CERCLA, the Clean Water Act, and the Clean Air Act against Farmland Industries, Inc. The Settlement Agreement provides that the United States will have an allowed general unsecured claim of $940,000, in settlement of the above-described claim. The United States previously has recovered from Farmland its past costs incurred at the Obee Road Site.

The Department of Justice will receive for a period of thirty (30) days from the date of this publication comments relating to the Settlement Agreement. Comments should be addressed to the Assistant Attorney General, Environment and Natural Resources Division, P.O. Box 7611, U.S. Department of Justice, Washington, DC 20044–7611, and should refer to In re: Farmland Industries, Inc., *et al.*, Case No. 02–50557, Bankruptcy Court for Western District of Missouri, D.J. Ref. #90–5–1–1–06976/3.

The Settlement Agreement may be examined at the Office of the United States Attorney, 400 E. 9th Street, Kansas City, MO 64106, and at U.S. EPA Region 7, 901 N. 5th Street, Kansas City, Kansas 66101. During the public comment period, the Settlement Agreement may also be examined on the following Justice Department Web site, *http://www.usdoj.gov/enrd/open.html.* A copy of the Settlement Agreement may also be obtained by mail from the Consent Decree Library, P.O. Box 7611, U.S. Department of Justice, Washington, DC 20044–7611 or by faxing or e-mailing a request to Tonia Fleetwood (*tonia.fleetwood@usdoj.gov*), fax no. (202) 514–0097, phone confirmation number (202) 514–1547. In requesting a copy from the Consent Decree Library, please enclose a check in the amount of $1.00 (25 cents per page reproduction cost) payable to the U.S. Treasury.

Catherine R. McCabe,

Deputy Chief, Environmental Enforcement Section, Environment and Natural Resources Division.

[FR Doc. 04–22525 Filed 10–6–04; 8:45 am]

BILLING CODE 4410–15–M

DEPARTMENT OF JUSTICE

Notice of Lodging of the Proposed Consent Decree Between the United States, The State of Maryland, The Commonwealth of Virginia, Mirant Mid-Atlantic, LLC and Mirant Potomac River, LLC

Notice is hereby given that on Monday, September 27, 2004, a proposed Consent decree ("proposed Decree") in *United States and State of Maryland* v. *Mirant Mid-Atlantic, LLC and Mirant Potomac River, LLC* ("Mirant"), Civil Action No. 1:04CV1136, was lodged with the United States District Court for the Eastern District of Virginia.

In this civil enforcement action under the federal Clean Air Act ("Act"), the United States alleges that in 2003, Mirant, an electric utility, failed to comply with a provision in the Operating Permit for the Potomac River Generating Station that limited that plant's NO_X emissions to 1,019 tons of NO_X during the ozone season. The complaint seeks both injunctive relief and a civil penalty.

The proposed Decree lodged with the Court addresses this violation at the Potomac river Generating Station (located in Alexandria, Virginia) by requiring relief at that plant, as well as at three other Mirant coal-fired electric generating facilities: the Chalk Point Generating Plant (in Prince George's County, Maryland); the Morgantown Generating Plant (in Charles County, Maryland); and the Dickerson Generating Plant (in Montgomery County, Maryland).

The proposed Decree requires the installation of NO_X pollution control equipment at the Potomac River Generating Station and the Morgantown Generating Plant, over a period of several years. In addition, the proposed Decree imposes limitations on the NO_X emissions from all four plants that apply both annually and during the ozone season.

The proposed Decree also requires Mirant to implement a series of environmental projects designed to reduce particulate matter emissions from the Potomac River Plant. They are described in the proposed Decree and are valued at about $1 million. In addition, Mirant also will pay a civil penalty of $250,000 to the United States, and a civil penalty of $250,000 to the Commonwealth of Virginia.

Joining in the proposed Decree as co-plaintiffs are the State of Maryland and the Commonwealth of Virginia.

The Department of Justice will receive for a period of thirty (30) days from the date of this publication comments relating to the proposed Decree. Comments should be addressed to the Assistant Attorney General, Environment and Natural Resources Division, PO Box 7611, U.S. Department of Justice, Washington, DC 20044–7611, and should refer to *United States* v. *Mirant Potomac River LLC, Mirant Mid-Atlantic LLC*, D.J. Ref. 90–5–2–1–07829.

The proposed Decree may be examined at the offices of the United States Attorney, Eastern District of Virginia, 2100 Jamieson Avenue, Alexandria, Virginia, and at the offices of U.S. EPA Region 3, 1650 Arch Street, Philadelphia, PA 19103–2029.

During the public comment period, the proposed Decree may also be examined on the following Department of Justice Web site, *http://www.usdoj.gov/enrd/open.html*. A copy of the proposed Decree may also be obtained by mail from the Consent Decree Library, P.O. Box 7611, U.S. Department of Justice, Washington, DC 20044–7611 or by faxing or e-mailing a request to Tonia Fleetwood (*tonia.fleetwood@usdoj.gov*), fax no. (202) 514–0097, phone confirmation number (202) 514–1547. In requesting a copy from the Consent Decree Library, please enclose a check in the amount of $14.50 (25 cents per page reproduction cost) payable to the U.S. Treasury.

Catherine R. McCabe,

Deputy Section Chief, Environmental Enforcement Section, Environment and Natural Resources Division.

[FR Doc. 04–22524 Filed 10–6–04; 8:45 am]

BILLING CODE 4410–15–M

DEPARTMENT OF JUSTICE

Notice of Lodging of Second Supplement to the Consent Decree Pursuant to the Safe Drinking Water Act

In accordance with 28 CFR 50.7, notice is hereby given that a proposed Second Supplement to the Consent Decree in *United States and State of New York, et al.* v. *City of New York, et al.*, Civil Action No. CV 97–2154 (Gershon J.) (Gold, M.J.), was lodged with the United States District Court for the Eastern District of New York on September 23, 2004. In this action, the United States and the State of New York sought a court order requiring the City of New York to come into compliance with the Safe Drinking Water Act, 42 U.S.C. 300f, *et seq.*, and the Surface Water Treatment Rule, a National Primary Drinking Water Regulation, by installing filtration treatment for its Croton water supply system.

On November 24, 1998, the Court entered a Consent Decree in this action which required the City, among other obligations, to select a site for, design, and construct the Croton filtration plant. The City selected a site for the plant at the Mosholu Golf Course in Van Cortlandt Park in the Bronx. However, on February 8, 2001, the New York State Court of Appeals held that the City could not construct the plant at the Mosholu Golf Course Site without first obtaining approval from the New York State Legislature. The City sought, but did not promptly obtain legislative approval to construct the plant at the Mosholu Golf Course Site.

In view of the lack of legislative approval for the Mosholu Golf Course Site in 2001–2002, the parties to the Consent Decree negotiated in 2001 and the Court entered in 2002 a first Supplement to the Consent Decree ("first Supplement"), which required the City to select a new site and modified the deadlines for construction of the filtration plant. The City identified two alternative sites for construction of the filtration plant, a site in the Town of Mount Pleasant in Westchester County, denominated the Eastview Site, and a site adjacent to the Harlem River in Bronx County, denominated the Harlem River Site. The first Supplement to the Consent Decree required the City to conduct some initial study and design work relating to the Eastview Site and the Harlem River Site and to identify its preferred site in a draft environmental impact statement to be submitted on April 30, 2003. The City was to select one of these two sites or, if legislative approval for the Mosholu Golf Course Site was obtained by April 15, 2003 and other requirements were met, the City could instead select the Mosholu Golf Course Site.

Legislative approval for the Mosholu Golf Course Site was not obtained by April 15, 2003. The City failed to select a preferred site under the requirements of the first Supplement by April 30, 2003. However, on June 20, 2003, the State legislature passed a bill allowing use of the Mosholu Golf Course Site for the Croton filtration plant, which was signed into law on July 22, 2003. The State legislation also required that the City conduct a supplemental environmental impact statement prior to selecting the preferred filtration plant site.

On June 30, 2004, the City completed a final supplemental environmental impact statement and selected the Mosholu Golf Course Site as its preferred site for the Croton filtration plant. The City also selected the Eastview Site as its backup site for the Croton filtration plant.

As a result of the City's failure to comply with the April 30, 2003 deadline for selecting its preferred site and the later enactment of the State legislation, the Parties have negotiated a further modification of the Consent Decree, which is set forth in the Second Supplement to the Consent Decree ("Second Supplement"). The Second Supplement supercedes the first Supplement.

The Second Supplement sets forth a modified schedule for the City to construct filtration facilities. Consistent with the terms of the Second Supplement, the City selected its preferred and backup sites. The Second Supplement requires the City to complete construction of the Croton filtration plant at is preferred site, the Mosholu Golf Course Site, by May 1, 2011, and commence full operation of the Croton filtration plant by October 31, 2011. The Second Supplement also provides that, if the United States, State, or the City determines during the course of implementation of the Second Supplement that the City cannot complete the plant at the preferred site within the schedule set forth in the Second Supplement or within a reasonable time period agreed to by the parties, the City shall construct the plant at its backup site, the Eastview Site. In addition, the Second Supplement provides for continued implementation of interim measures and for payment by the City of stipulated penalties in the amount of $180,000 for its failure to select a preferred site timely in accordance with

Allegheny Energy, Inc.

Presentation to
Citigroup 12th Annual
High Yield/Leveraged Finance Conference

February 9, 2004

Management Is Actively Addressing the Issues

ACTIONS	EXAMPLES
Fix Internal Controls and Financial Reporting Process	• Overhauling reporting policies and procedures • Replacing about two-thirds of accounting staff in 2003-2004 to improve in-house capability • Upgrading accounting and reporting systems
Return to Timely Financial Reporting	• SEC reporting now current: – Filed 2002 10-K in September 2003 – Filed 2003 10-Qs in December 2003-January 2004 • Disclosure review procedure put in place
Improve SEC and Rating Agency Relationships	• Timely and frequent communications • Full disclosure and management access • Moody's affirmed ratings on January 28, 2004 • Received SEC approval to refinance debt on February 4, 2004
Enhance Financial Forecasting	• Improving forecasting tools • Enhancing controls to ensure consistency

Allegheny Energy's Hertzog to Leave, Get $5.6 Mln in Severance
2004-12-09 12:44 (New York)

Allegheny Energy's Hertzog to Leave, Get $5.6 Mln in Severance

By Bradley Keoun

Dec. 9 (Bloomberg) -- Allegheny Energy Inc., a Pennsylvania utility owner, said General Counsel David B. Hertzog resigned and will be paid $5.6 million under a severance agreement.

Hertzog has served just 17 months of a five-year contract, Chief Executive Paul Evanson said in a telephone interview today. The severance agreement was ``mutual and amicable'' and not related to any unfavorable legal or business developments at the company, he said.

Hertzog, 60, joined Allegheny in July 2003, a time when the company had fallen behind on financial filings and faced investor concerns about its ability to avoid bankruptcy. The utility owner has since caught up on its filings, and its stock price has more than doubled. Much of Hertzog's severance package related to gains in the value of stock grants, Evanson said.

``He's made a nice return, but that return could easily have been zero,'' said Evanson, 63.

The severance agreement will result in an expense of about $2 million on the company's income statement, Evanson said. Much of the stock payout already had been accounted for, he said.

Hertzog's, whose last day at Greensburg, Pennsylvania-based Allegheny is tomorrow, couldn't immediately be reached for comment through a message left with the company. A message left on an answering machine at Hertzog's home wasn't immediately returned.

Evanson declined to comment more specifically on the reasons for ending Hertzog's employment.

Severance Package

The severance package is twice as large as Evanson's own base salary and maximum bonus for 2003 of about $2.7 million. Hertzog was one of the first hires after Evanson joined Allegheny from FPL Group Inc.'s Florida Power & Light utility in June of last year.

Hertzog's severance pay comes on top of about $1.32 million in salary, bonus and other benefits he received last year, including an $800,000 ``make-whole'' payment when he was hired and $71,330 in reimbursement for relocation expenses.

Evanson said he didn't believe hiring Hertzog was a mistake. He said he was ``disappointed'' that Hertzog didn't end up serving out his contract.

``He's made significant contributions during that period, and particularly during the period where we were on the edge of bankruptcy and we were behind on'' filings with the U.S. Securities and Exchange Commission, Evanson said.

Hertzog wouldn't have received severance if he resigned solely of his own accord, Evanson said. He would have been paid an additional $5.9 million if he had been terminated without cause, rather than agreeing to resign, Evanson said.

Shares of Allegheny fell 13 cents to $18.42 at 12:40 p.m. in New York Stock Exchange composite trading.

Allegheny's utilities serve about 1.5 million electricity and natural-gas customers in Pennsylvania, Maryland, Ohio, Virginia and West Virginia.

--Editor: Bixby.

Story illustration: See {AYE US <Equity> MGMT <GO>} for data on Allegheny's management. For a series of screens related to the company, click on {AYE US <Equity> CNP11042050105 <GO>}. Press the space bar to pause on a screen, and hit the GO key to resume the slide show.

To contact the reporter on this story:
Bradley Keoun in New York (1) (212) 318-2310 or
bkeoun@bloomberg.net.

To contact the editor responsible for this story:
Robert Dieterich in New York at (1) (212) 893-4485 or
rdieterich@bloomberg.net.

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

December 8, 2004 (December 6, 2004)
Date of Report (Date of earliest event reported)

ALLEGHENY ENERGY, INC.
(Exact name of registrant as specified in its charter)

Maryland	**1-267**	**13-5531602**
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

800 Cabin Hill Drive **Greensburg, Pennsylvania**	**15601-1689**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(724) 837-3000**

N/A
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

[ ] Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

[ ] Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

[ ] Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

[ ] Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 1.01 Entry into a Material Definitive Agreement.

On December 6, 2004, Allegheny Energy Service Corporation (the "Company"), a wholly-owned subsidiary of Allegheny Energy, Inc. ("AYE"), and David B. Hertzog entered into an Agreement (the "Agreement") in connection with Mr. Hertzog's resignation as the Vice President and General Counsel of AYE and from any and all of his positions with any parent, subsidiary or affiliate of the Company (collectively, the "Allegheny Companies").

Pursuant to the Agreement, the Company agreed to make a payment to Mr. Hertzog representing (a) all wages, salary, bonuses, pension and benefit payments and other compensation that currently are owed to him pursuant to the Employment Agreement, dated as of July 18, 2003 and subsequently amended on February 18, 2004 (as amended, the "Employment Agreement"), between the Company and Mr. Hertzog and (b) the value of vested stock options and stock units previously granted to him. In addition, the Company agreed to pay Mr. Hertzog his target bonus for 2004 and approximately $2.95 million in connection with his resignation, representing separation payments and amounts in respect of Mr. Hertzog';s agreement to cancel any and all of his rights under the Employment Agreement. Pursuant to the Agreement, Mr. Hertzog released the Company and the Allegheny Companies from any and all claims relating to his employment or otherwise. The Agreement is subject to a seven calendar day revocation right on the part of Mr. Hertzog and, assuming no revocation, the Agreement will become operative on December 14, 2004.

A copy of the Agreement is attached as Exhibit 99.1 to this Current Report on Form 8-K and is incorporated herein by reference.

Item 1.02 Termination of a Material Definitive Agreement.

Effective December 10, 2004, the Employment Agreement was terminated in connection with Mr. Hertzog's resignation as the Vice President and General Counsel of AYE and from any and all of his positions with the Allegheny Companies. The Employment Agreement was for a five-year term that began on July 28, 2003. Additional details of the Employment Agreement are included in AYE's Definitive Proxy Statement filed with the Securities and Exchange Commission on April 8, 2004.

Item 9.01 Financial Statements and Exhibits.

(c) Exhibits

<u>Exhibit Number</u>	<u>Description</u>
99.1	Agreement, dated as of December 6, 2004, between Allegheny Energy Service Corporation and David B. Hertzog.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

ALLEGHENY ENERGY, INC.

Dated: December 8, 2004

By: /s/ Paul J. Evanson

Name: Paul J. Evanson
Title: Chairman, President and Chief Executive Officer

EXHIBIT INDEX

Exhibit Number	Description
99.1	Agreement, dated as of December 6, 2004, between Allegheny Energy Service Corporation and David B. Hertzog.

AGREEMENT

This Agreement (this " Agreement ") is entered into as of this 6th day of December, 2004 between ALLEGHENY ENERGY SERVICE CORPORATION, a Maryland corporation (the " Company "), for itself and as agent for its parent, affiliates and subsidiaries, and DAVID B. HERTZOG (the " Executive ").

WHEREAS, the Executive is currently employed by the Company as Vice President and General Counsel; and

WHEREAS, the Company and the Executive entered into an Employment Agreement dated as of July 18, 2003 and subsequently amended on February 18, 2004 (" Employment Agreement ") providing for the employment of the Executive by the Company; and

WHEREAS, the Executive wishes to resign his position as Vice President and General Counsel, and to resign from all employment with the Company, effective as of December 10, 2004 (the " Effective Date "); and

WHEREAS, for the purposes of avoiding the uncertainty, expense and burden associated with any dispute, the Executive and the Company desire to resolve all issues that may arise by virtue of the termination of the existing employment relationship between the Executive and the Company or the termination of the parties' respective rights under the Employment Agreement.

NOW, THEREFORE, in consideration of the mutual promises, covenants, conditions and provisions set forth below, it is agreed as follows:

1. Effective as of the Effective Date, the Executive resigns as an employee of the Company and resigns from his position as Vice President and General Counsel and from any and all other officer, executive or management positions (including any position as a director) with the Company and any parent, subsidiary or affiliate of the Company (collectively, the " Allegheny Companies ").

2. On or before December 23, 2004, the Company shall make a lump-sum payment to the Executive by wire transfer to the account designated by the Executive on Exhibit A hereto in the amount

of $5,600,502.40, less all applicable withholdings and deductions as required by law, except that none of the payments shall become due or payable if the Executive revokes this Agreement within the seven-day revocation period defined in Section 16. Such total payment of $5,600,502.40 represents the sum of:

(a) A cash payment of $350,100, which represents payment of the Executive's target bonus under the 2004 Annual Incentive Plan (" AIP ").

(b) A cash payment of $800,100, which represents a severance payment calculated as the sum of the Executive's annual base salary and the Executive's target bonus under the AIP as in effect immediately prior to the Effective Date.

(c) A cash payment of $14,220, which represents one hundred eighty percent (180%) of the cost to the Executive (based on coverage levels and premiums in effect on the date hereof) of extended medical insurance coverage for the Executive and any of his dependents who are participating in coverage under applicable Company plans on the date hereof pursuant to the Consolidated Omnibus Budget Reconciliation Act of 1985 (" COBRA ") for a period of one year.

(d) A cash payment of $604,167, which represents the sum of (i) 17 months of Pension Benefit (as defined in Section 6(c) of the Employment Agreement) accrued as of the Effective Date and (ii) an additional 12 months of Pension Benefit.

(e) A cash payment of $738,000 in exchange for the Executive's agreement to cancel all rights and interests in any and all stock options granted to the Executive on February 18, 2004, whether or not vested as of the Effective Date. Such cash payment was calculated as 120,000 (representing 60,000 currently vested options and an additional 60,000 options scheduled to vest on the next vesting date) multiplied by the difference between an assumed price per share of Allegheny Energy, Inc. common stock of $19.50 and $13.35 (per share exercise price at the time of original grant). The Executive shall have no further rights with respect to any of such stock options, whether or not vested, and all of such options shall be deemed surrendered in exchange for the payment set forth herein.

(f) A cash payment of $3,041,126.40 in exchange for the Executive's agreement to cancel all rights and interests in any and all stock units granted to the Executive on February 18, 2004, whether or not vested as of the Effective Date. Such cash payment was calculated as 155,955.2 (representing 77,977.6 currently vested units and an additional 77,977.6 units scheduled to vest on the next vesting date) multiplied by an assumed price per share of Allegheny Energy, Inc. common stock of $19.50. The Executive shall have no further rights with respect to any of such stock units, whether or not vested, and all of such stock units shall be deemed surrendered in exchange for the payment set forth herein.

(g) A cash payment of $52,789, which represents payment in full for all of the Executive's accrued and unused vacation as of the Effective Date.

3 In the event the Executive sells his residence at 1221 Twelve Oaks Court in Murrysville, PA on or before the first anniversary of the Effective Date, for net consideration (the consideration received by the Executive determined after deducting all brokerage expenses, transfer taxes, and other expenses of sale) of less than $414,000, the Company shall pay the Executive the amount by which $414,000 exceeds such net consideration; provided , however , that the amount payable to the Executive pursuant to this Section 3 shall not exceed $40,000. Such amount shall be payable in a cash lump-sum payment to the Executive promptly following his submission of evidence reasonably acceptable to the Company of the net consideration received by him in respect of such residence.

4. The Company shall promptly reimburse the Executive for any expenses incurred by him in carrying out his duties through the Effective Date, in accordance with the policies of the Company for reimbursement of employee business expenses. In addition, the Company shall promptly pay the reasonable legal fees and expenses incurred by the Executive in connection with the negotiation and documentation of this Agreement, up to a maximum of $10,000.

5. The Executive acknowledges that the various payments and benefits described in the preceding paragraphs (collectively, the " Benefits ") include and satisfy, and that certain of such Benefits (including incentive payments, severance payments, COBRA medical premiums, Pension Benefits and

payments made in respect of the Executive's stock units and stock options) are in addition to, any and all amounts that may be due to the Executive from the Company in connection with, directly or indirectly, the Executive's employment with the Company and the termination thereof, including without limitation, any wages, salary, bonus, and any other compensation or benefit payment due to the Executive from the Company.

6. As of the Effective Date, the Executive shall cease to be covered as an active employee under the Company's benefit plans. The Executive shall continue to receive his base salary and all benefits through the Effective Date.

7. The Executive will continue to be indemnified to the fullest extent permitted by the present by-laws and certificates of incorporation of the Allegheny Companies, consistent with applicable law. The Executive will continue to be covered to the extent now covered under the present directors and officers liability insurance policies maintained by the Company and/or its parent for actions, or inactions, while a director or officer of the Company, its parent, affiliates or subsidiaries.

8. The Executive agrees to reasonably cooperate with the Company and its counsel in connection with any matter that arises from or relates to the Executive's relationship with the Company and its parent and all of its affiliates and subsidiaries, including, without limitation, by providing information, reviewing documents, answering questions, and/or appearing as a witness in connection with any administrative proceeding, investigation, or litigation. The Company will pay the Executive's reasonable expenses, including travel, incurred in connection with such cooperation.

9. Release .

(a) The Executive agrees, as of the Effective Date, that the Executive fully, finally and unconditionally and forever releases, discharges and forgives, the Allegheny Companies, all of the Allegheny Companies' successors and assigns, and any and all of the Allegheny Companies' past and present officers, directors and employees (whether acting as agents for the Allegheny Companies or in their individual capacities) and its and their employee benefit plans and any administrator, fiduciary, and service provider with respect thereto and any other agents or representatives of the Allegheny Companies (in their capacities as agents or representatives for the Allegheny Companies but not in their individual capacities) (the " Releasees "), from any and all claims, allegations, complaints, proceedings, charges, actions, causes of action, demands, debts, covenants, contracts, liabilities or damages of any nature whatsoever (collectively, "Claims "), against any or all of the Releasees for or by reason of any cause, nature or thing whatsoever up to the Effective Date, known or unknown, including, by way of example and without limiting the broadest application of the foregoing, any Claims under any contract or any federal, state or local decisional law, statutes, regulations or constitutions, any Claims for notice or pay in lieu of notice, or for wrongful dismissal, discrimination, or harassment on the basis of any factor (including, without limitation, any claim pursuant to or arising under Title VII of the Civil Rights Act of 1964, as amended, the Employee Retirement Income and Security Act of 1974, as amended, the Americans with Disabilities Act, as amended, the Age Discrimination in Employment Act, as amended, the Family and Medical Leave Act, and any other federal, state or local legislation concerning employment or employment discrimination), and any Claims, asserted benefits or rights arising by or under contract or implied contract, any Claims arising by or under promissory estoppel, detrimental reliance, or under any asserted covenant of good faith and fair dealing, and any Claims for defamation, fraud, fraudulent inducement, intentional infliction of emotional distress, or any other tortious conduct, including personal injury of any nature and arising from any source or condition, or pursuant to any other applicable employment standards or human rights legislation, or for severance pay, salary, bonus, commission, incentive or additional compensation, vacation pay, insurance or benefits, or attorneys' fees and costs. The Executive and the Company agree that any and all prior agreements relating to the Executive's employment or service with the Allegheny Companies or the termination of such employment or service, are hereby terminated as of the Effective Date and shall thereafter be of no further force or effect, except that Section 10 (including all subparts) of the Employment Agreement shall remain in full force and effect. The Executive understands and agrees that the Company shall not be required to make any further payment, for any reason whatsoever, to him or to any person regarding any claim or right whatsoever which might possibly be asserted by him or on his behalf, that he has released pursuant to this Section 9(a).

(b) The Executive represents and warrants that, as of the Effective Date, the Executive has not asserted any Claim against the Releasees or any of them by reason of any cause, matter or thing known or unknown, existing up to the Effective Date. Further, the Executive represents and warrants that, as of the Effective Date, the Executive has not made or caused to be made, any assignment or transfer of any

Claim herein being released. If the Executive should, after the Effective Date, make, pursue, prosecute, or threaten to make any such Claim or allegation, or pursue or commence or threaten to commence any such Claim against the Releasees, or any of them, for or by reason of any cause, matter or thing existing up to the Effective Date that has been released under this Agreement, this Agreement may be raised as a complete bar to any such Claim; provided , however , that nothing in this Agreement shall limit either the Executive or the Releasees, individually or collectively, from enforcing their respective rights under this Agreement or under Section 10 of the Employment Agreement. The Executive represents that, as of the date hereof, he has no knowledge of any basis for Claims by him against any Releasee.

10. The Executive shall not disparage the Releasees or any of them in any manner whether to the media, or otherwise, and the Executive shall not publish or make any statement which is reasonably foreseeable to become public with respect to the Releasees or any of them, except for statements that the Executive is compelled to make by law or formal legal process. The Company and the Executive shall agree in advance on any press releases or other formal announcements concerning the Executive's termination of employment.

11. The Executive reaffirms his continuing obligations set forth in Section 10 (including all subparts) of the Employment Agreement.

12. Both the Executive and the Company agree to keep this Agreement and its terms and provisions strictly confidential and shall not disclose the same to any person, party or other entity, including, without limitation, to employees of the Company and/or any other of the Allegheny Companies, other than to employees of the Company who administer the provisions of this Agreement, tax advisors, accountants or lawyers for the Executive or the Company, the Executive's family members, the Internal Revenue Service, as the Executive or the Company may be compelled to disclose by law or formal legal process, or as the Company may determine is necessary to satisfy its reporting obligations.

13. The parties acknowledge and agree that the Company shall immediately be released from its obligations hereunder in the event of any material breach of Sections 8, 10, 11, or 12 which the Executive fails to cure following notice from the Company and a reasonable opportunity for the Executive to cure such breach, and, in addition, upon such breach and failure to cure the Company shall be entitled to recover from the Executive any amounts previously paid hereunder. Nothing in this paragraph shall limit or affect the validity or enforceability of the Release provision set forth in Section 9 above.

14. The Executive acknowledges that the Executive has been advised, and been afforded an opportunity, to consult with an attorney prior to signing this Agreement and acknowledges that he has in fact consulted with an attorney prior to signing this Agreement. The Executive and the Company expressly agree that if the Executive revokes his signature within seven days, the Company shall have no further obligations to the Executive pursuant to this Agreement and shall immediately stop doing any of the things and making any of the payments hereunder.

15. This Agreement shall not constitute an admission of any wrongdoing by the Releasees or any of them, or of having caused any injury to the Executive by any acts or omissions on the part of the Releasees or any of them, or a violation of any statutory, regulatory or common law obligations owed to the Executive by any of the Releasees. This Agreement shall not constitute an admission of any wrongdoing by the Executive.

16 The Executive acknowledges that he has been offered the opportunity to consider this Agreement for 21 days before executing it, although the Executive may accept it by execution at any time within such 21-day period. The Executive may revoke this Agreement in writing by delivering notice of revocation to the Company at the address specified in Section 20, within seven calendar days following its execution. This Agreement shall become effective on the eighth day after its execution, and if it has not been revoked in accordance with this Section 16.

17. This Agreement contains the entire agreement between the parties with respect to the subject matter hereof and supercedes all prior agreements, written or oral, with respect thereto, except Section 10 of the Employment Agreement. This Agreement may not be amended, modified or terminated except by express written agreement between the parties.

18. This Agreement shall be binding upon and inure to the benefit of the parties and their respective successors, heirs (in the case of the Executive) and assigns. No rights or obligations of the Company under this Agreement may be assigned or transferred by the Company except that such rights or obligations may be assigned or transferred pursuant to a merger or consolidation in which the Company is not the continuing entity, or the sale or liquidation of all or substantially all of the assets of the Company, provided that the assignee or transferee is the successor to all or substantially all of the assets of the Company and such assignee or transferee assumes the liabilities, obligations and duties of the Company, as contained in this Agreement, either contractually or as a matter of law. No rights or obligations of the Executive under this Agreement may be assigned or transferred by the Executive other than his rights to compensation and benefits, which may be transferred only by will or the laws of descent and distribution.

19. This Agreement may be executed in any number of separate counterparts, all of which taken together shall be deemed to constitute one and the same instrument.

20. All notices, requests, demands and other communications hereunder shall be in writing and shall be deemed to have been duly given if delivered by hand, overnight courier, or mailed within the continental United States by first class certified mail, return receipt requested, postage prepaid, addressed as follows:

(a) to Company, to:

Allegheny Energy Service Corporation
800 Cabin Hill Drive
Greensburg, PA 15601
Attn: Chairman, President and CEO

(b) to the Executive, to:

David B. Hertzog
1221 Twelve Oaks Court
Murrysville, PA 15668

Addresses may be changed by written notice sent to the other party at the last recorded address of that party.

21. No remedy conferred upon either party by this Agreement is intended to be exclusive of any other remedy, and each and every such remedy shall be cumulative and shall be in addition to any other remedy given hereunder or now or hereafter existing at law or in equity. No delay or omission by either party in exercising any right, remedy or power hereunder or existing at law or in equity shall be construed as a waiver thereof, and any such right, remedy or power may be exercised by such party from time to time and as often as may be deemed expedient or necessary by such party in such party's sole discretion.

22. In the event any provision of this Agreement is held to be unenforceable, (a) such enforceability shall in no way affect the other terms and provisions of this Agreement, which shall remain in full force and effect, and (b) such provision shall be enforced to the fullest extent permitted by law.

23. This Agreement shall be interpreted, construed, governed and enforced according to the laws of the Commonwealth of Pennsylvania without regard to the application of choice of law rules. In the event that there is any claim, dispute, or other matter in question arising out of or relating in any way, directly or indirectly, to this Agreement, the enforcement of any provision herein, or the breach of any provision thereof, the parties hereto expressly agree that it shall be submitted to the federal, state or local courts, as appropriate, of Allegheny or Westmoreland County in the Commonwealth of Pennsylvania. This provision to submit all claims, disputes or matters in question to such courts shall be specifically enforceable; and each party, hereby waives any defense of inconvenient forum and waives personal service of process and venue, and consents to jurisdiction in Pennsylvania for all purposes of any other party seeking or securing any legal and/or equitable relief.

24. THE PARTIES IRREVOCABLY WAIVE ANY AND ALL RIGHT THEY MAY HAVE TO A TRIAL BY JURY IN ANY ACTION, PROCEEDING OR CLAIM OF ANY NATURE RELATING TO THIS AGREEMENT, ANY DOCUMENTS EXECUTED IN CONNECTION HEREWITH

OR ANY TRANSACTIONS CONTEMPLATED IN ANY OF SUCH DOCUMENTS. THE PARTIES ACKNOWLEDGE THAT THE FOREGOING WAIVER IS KNOWING AND VOLUNTARY.

25. There shall be no offsets against amounts due to the Executive under this Agreement on account of any remuneration or other benefit attributable to any subsequent employment that he may obtain.

IN WITNESS WHEREOF, the parties have caused this Agreement to be duly executed as of the date first written above.

ALLEGHENY ENERGY SERVICE CORPORATION

By: /s/ Paul J. Evanson

Paul J. Evanson
Title: Chairman, President and CEO

/s/ David B. Hertzog

David B. Hertzog

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