

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;  
Nora Mead Brownell, and Suedeen G. Kelly.

Allegheny Energy, Inc.,  
Monongahela Power Company,  
The Potomac Edison Company,  
Allegheny Energy Supply Company, LLC, and  
Allegheny Energy OVEC Supply Company, LLC

Docket Nos. EC05-104-000  
and  
ER05-1212-000

ORDER AUTHORIZING DISPOSITION OF  
JURISDICTIONAL FACILITIES AND CONDITIONALLY  
ACCEPTING TRANSACTION CONTRACTS

(Issued October 21, 2005)

1. On July 13, 2005, Allegheny Energy, Inc. (Allegheny Energy), Monongahela Power Company (Mon Power), Potomac Edison Company (Potomac Edison), Allegheny Energy Supply Company, LLC (AE Supply), and Allegheny Energy OVEC Supply Company, LLC (AEOS) (collectively, Applicants) filed an application under section 203 of the Federal Power Act (FPA)<sup>1</sup> requesting Commission authorization for a disposition of jurisdictional facilities that is associated with an internal restructuring of generation asset ownership within the Allegheny Energy holding company system (collectively, proposed transaction). They also filed four related contracts pursuant to section 205 of the FPA.<sup>2</sup> As discussed below, the Commission authorizes the proposed transaction under section 203 of the FPA and conditionally accepts the four contracts.

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<sup>1</sup> 16 U.S.C. § 824b (2000).

<sup>2</sup> 16 U.S.C. § 824d (2000).

## **I. Background**

### **A. Applicants**

2. Allegheny Energy is a registered holding company under the Public Utility Holding Company Act of 1935. Mon Power, Potomac Edison, AE Supply and West Penn Power Company (West Penn) are all wholly-owned subsidiaries of Allegheny Energy. Mon Power primarily provides electric service to customers in West Virginia, but also has a small service territory in Ohio. Potomac Edison primarily serves customers in Maryland, but also has a retail service territory in West Virginia. AE Supply is a power marketer that owns most of the generation capacity controlled by Allegheny Energy. Neither Mon Power nor Potomac Edison has wholesale requirements customers, and all of AE Supply's wholesale customers pay market-based rates. Allegheny Energy's transmission system is part of the transmission grid operated by the PJM Interconnection, L.L.C. (PJM).

### **B. Proposed Restructuring of Generation Ownership and Supply Relationships**

3. As part of a restructuring that will realign generation ownership and contractual arrangements within the Allegheny Energy holding company system, Applicants request Commission authorization under section 203 to transfer jurisdictional facilities as part of an exchange of ownership interests in generation facilities between individual Applicants. They also filed four contracts under section 205 that restructure the contractual relationships between Applicants. The jurisdictional facilities to be transferred are step-up transformers associated with the generation facilities involved. The four contracts are: (1) an Amended and Restated Full Requirements Service Agreement between Mon Power and Potomac Edison (Amended PSA), (2) an Amended and Restated Facilities Lease and Assignment Agreement between AE Supply and Mon Power (FLA), (3) a Facilities Lease and Assignment Agreement between Mon Power and Potomac Edison (New FLA), and (4) a Power Sales Agreement between AE Supply and AEOS (AEOS PSA) (collectively, the Transaction Contracts). Applicants state that the Amended PSA and the New FLA are being filed under Mon Power's market-based rate authority and the FLA is being filed under AE Supply's market-based rate authority.

4. When the internal restructuring is completed, AE Supply will have transferred generation ownership interests of 1,249 megawatts (MWs) to Mon Power and Mon Power will have transferred generation ownership interests of 656 MWs to AE Supply. Because the restructuring may have to be implemented in two phases,<sup>3</sup> Applicants are

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<sup>3</sup> See Applicants' filing at 18-29.

filing under section 205 certain agreements, which the Commission is addressing in this order. These include agreements under which AE Supply provides power to Potomac Edison and Potomac Edison leases capacity from AE Supply. AE Supply will assign its supply obligation to Mon Power and Potomac Edison will assign its lease rights to Mon Power. The effect of the restructuring in total will be that Mon Power will acquire both additional capacity and an additional load obligation to serve West Virginia customers.

5. Applicants state that the purpose of the restructuring is to facilitate the addition of sulphur dioxide scrubbers at the Fort Martin generating station (Fort Martin Station) in West Virginia, and to resolve issues at the state level relating to West Virginia's now-abandoned retail competition program. To use state-authorized securitization for adding scrubbers to the Fort Martin Station, the West Virginia statute requires that the generating station be owned by West Virginia public utilities.<sup>4</sup> The restructuring will effect an exchange of ownership interests in the Fort Martin Station and other generating units so that Mon Power will own all of the Fort Martin Station. Applicants further state that the transfer of capacity and revised contractual arrangements will settle issues related to a West Virginia Public Service Commission (West Virginia Commission) order requiring that Potomac Edison obtain capacity to serve its West Virginia load at historical cost.

6. However, because more generation is being transferred to Mon Power than is being transferred back to AE Supply, Applicants state that they may not be able to obtain the approval of lenders that have a security interest in AE Supply's generation. Applicants further state that the lenders' financing does not terminate until 2012. In the event that the lenders do not give their approval, it would be necessary to phase the proposed transaction in two parts. The first part would be the transfer of AE Supply's 895 MW interest in the Fort Martin Station to Mon Power and the transfer of 895 MWs from Mon Power's interests in other generating units to AE Supply. In the second phase, to occur as late as 2012, an additional 593 MWs will be transferred from AE Supply to Mon Power. Applicants state that this additional transfer will enable Mon Power to meet the additional obligation to serve Potomac Edison load in West Virginia that AE Supply will be assigning to it.

7. As noted above, the Transaction Contracts include four contracts. The Amended PSA provides that Mon Power's obligation to sell power to Potomac Edison is long term, that Potomac Edison's West Virginia load will be served first through Potomac Edison's rights under the New FLA, that the compensation will be based on Mon Power's cost of providing service, and that, barring a default, termination of the agreement will occur

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<sup>4</sup> See W.Va. Code § 24-2-4e (2005) (describing the conditions for alternative financing mechanisms such as securitization).

only when either party is no longer an affiliate of Allegheny Energy, the parties consolidate into one entity or transfer all or substantially all of their assets to a single entity, or retail customer choice is implemented in West Virginia.

8. The FLA provides for the lease of certain facilities to Mon Power. Under the FLA: (1) Mon Power will be entitled to all economic benefits, and be responsible for any economic costs, with respect to its portion of capacity and associated energy and ancillary services from the leased facilities; (2) the lease payments will be based on Mon Power's proportionate share of all fixed and variable operation and maintenance costs (including a return on capital); (3) Mon Power will generally be responsible for the costs of, and enjoy the benefits of, any capital additions in respect to the leased facilities, provided that title to any such capital additions shall reside in AE Supply; (4) any loss of generating capacity will be prorated over the facilities controlled by AE Supply and the facilities leased or otherwise controlled by Mon Power; and (5) the term will continue until the earlier of (i) consummation of the second phase of the proposed transaction or (ii) the tenth anniversary of the effective date of the FLA.

9. The purpose of the New FLA is to minimize cash outlays as permitted under West Virginia tax law. Under the New FLA: (1) Potomac Edison is entitled to the capacity associated with the leased facilities on a first priority basis; (2) Potomac Edison is only entitled to sufficient capacity, associated energy and ancillary services to meet its West Virginia load obligations; (3) the monthly usage charge is based on the average per MWh cost of providing power from the leased facilities for the month (the operation and maintenance costs that determine such usage charge will include a return on Mon Power's capital investment in the leased facilities); (4) Potomac Edison will make a prepayment to Mon Power of costs associated with the installation of environmental control equipment at the Fort Martin generating station; and (5) Mon Power will generally own title to, be responsible for the costs of, and enjoy the benefits of, any capital additions with respect to the leased facilities.

10. Mon Power's interest in Ohio Valley Electric Corporation (OVEC) is being transferred to AEOS, a special purpose entity created to own this interest, and the ownership of AEOS will be transferred to AE Supply. In order for AE Supply to obtain power from AEOS associated with its OVEC ownership, AE Supply and AEOS have entered into the AEOS PSA, which gives AE Supply the right to receive AEOS's share of OVEC power at cost.

## **II. Notice and Interventions**

11. Notice of Applicants' filing was published in the *Federal Register*, 70 Fed. Reg. 43,687 (2005), with protests and interventions due on or before August 3, 2005. West Virginia Energy Users Group and American Bituminous Power Partners, L.P. filed timely

motions to intervene, and Mittal Steel USA ISG Inc. (Mittal Steel) filed a motion to intervene out-of-time. No protests were filed.

### **III. Discussion**

#### **A. Procedural Issues**

12. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2005), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Mittal Steel has demonstrated an interest in this proceeding that cannot be adequately represented by any other party. Given this fact, the early stage of the proceeding, and the lack of undue prejudice or delay, we will grant the late-filed motion to intervene.<sup>5</sup>

#### **B. Section 203 Analysis**

13. Section 203(a) of the FPA provides that the Commission must approve a disposition of facilities if it finds that the disposition "will be consistent with the public interest."<sup>6</sup> The Commission's analysis of whether a disposition is consistent with the public interest generally involves consideration of three factors: (1) the effect on competition; (2) the effect on rates; and (3) the effect on regulation.<sup>7</sup> As discussed below, we will approve the proposed disposition of jurisdictional facilities as consistent with the public interest.

##### **1. Effect on Competition**

14. Applicants state that the proposed transaction, as an intra-corporate transfer, does not raise horizontal or vertical market power issues. Applicants state that the generation

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<sup>5</sup> 18 C.F.R. § 385.214(d) (2005).

<sup>6</sup> 16 U.S.C. § 824b (2000).

<sup>7</sup> *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595 (Dec. 30, 1996), FERC Stats. and Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 62 Fed. Reg. 33,340 (June 19, 1997), 79 FERC ¶ 61,321 (1997) (Merger Policy Statement); *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, 65 Fed. Reg. 70,983 (Nov. 28, 2000), FERC Stats. & Regs., Regulations Preambles July 1996-Dec. 2000 ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 66 Fed. Reg. 16,121 (Mar.23, 2001), 94 FERC ¶ 61,289 (2001) (Revised Filing Requirements).

transfers are entirely internal to the Allegheny Energy holding company system, and thus there can be no increase in horizontal market power. Furthermore, Applicants state that because Allegheny Energy already has transferred functional control over its transmission system to PJM, and because the transaction is within the holding company system, there are no vertical market power issues raised by the proposed transaction.

15. The Commission finds that the proposed transaction does not present horizontal or vertical market power concerns. Under the Revised Filing Requirements rule, an applicant is not required to file a competitive analysis under §§ 33.3 or 33.4 of the Commission's regulations if a transaction is an internal corporate reorganization.<sup>8</sup> In this instance, the proposed transaction is an intra-corporate transfer of generating facilities and does not increase the total amount of generation capacity owned or controlled by the Allegheny Energy holding company system. Further, the transaction does not increase or change Allegheny Energy's control or ownership of transmission facilities. Therefore, the proposed transaction does not raise horizontal or vertical market power concerns.

## **2. Effect on Rates**

16. Applicants state that the proposed transaction will not have an adverse impact on either transmission rates or on rates for long-term wholesale requirements customers. With respect to wholesale requirements rates, Applicants state that neither Mon Power nor Potomac Edison has any wholesale requirements customers, and AE Supply's customers all pay market-based rates. Furthermore, Applicants state that the transfers of generation units and the installation of a scrubber have no impact on transmission rates because generation-related costs cannot be recovered in transmission rates. Therefore, the Commission finds that the proposed transaction will not adversely affect rates.

## **3. Effect on Regulation**

17. As explained in the Merger Policy Statement and the Revised Filing Requirements rule, the Commission's primary concern with the effect on regulation of a section 203 transaction involves possible changes in the Commission's jurisdiction that would diminish Commission authority to protect ratepayers against affiliate abuse because a registered holding company is formed, thus invoking the jurisdiction of the Securities and Exchange Commission. We are also concerned that a regulatory gap may arise at the

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<sup>8</sup> Revised Filing Requirements at 31,902.

state level should the affected state commission lack authority to act on the proposed merger.<sup>9</sup>

18. Applicants state that neither concern exists here. Applicants state that the proposed transfer will not impair the effectiveness of federal regulation, since the proposed transaction does not change Allegheny Energy's corporate structure. Moreover, Applicants state that they will apply for approval of the proposed transaction at the West Virginia Commission, which will be able to take any necessary steps to protect its own jurisdiction.

19. Based on the facts set forth in the application, we are satisfied that the proposed transaction will not adversely affect state or the Commission's regulation.

#### **4. Two-Phase Transaction**

20. Applicants indicate that if they cannot secure the approval of lenders for the proposed transaction because more generation capacity is being transferred to Mon Power than will be transferred back to AE Supply, it will be necessary to conduct the transaction in two phases. The first part would be the transfer of AE Supply's entire interest in the Fort Martin Station and the transfer of an equivalent amount of capacity from Mon Power's interest in other generating units to AE Supply and would occur in the near term. The second part would entail the transfer of additional generation from AE Supply to Mon Power. However, the second part might not occur until 2012, when the financing of current lenders terminates.

21. The Commission is not prevented from authorizing a section 203 transaction that may involve an extended period of time to complete. Based on the facts set forth in the application, we recognize that some flexibility should be provided to Applicants, and therefore, we will authorize the proposed transaction, thus allowing it to move forward. However, we remind Applicants that section 203(b) of the FPA allows the Commission to issue supplemental orders as appropriate. To assist us in determining whether such orders may be necessary in this case, we direct Applicants to seek additional authorization if there is any material change in the facts or circumstances underlying this transaction. Also, if a two-phase transaction is necessary, Applicants are required to notify the Commission when each phase is consummated.

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<sup>9</sup> See Merger Policy Statement, ¶ 31,044 at 30,124-25, and Revised Filing Requirements, ¶ 31,111 at 31,914-15.

**C. Section 205 Analysis**

22. The proposed Transaction Contracts filed under section 205 of the FPA provide for the internal realignment of generation assets, entitlements, obligations and responsibilities. Applicants state that this realignment is intended to provide for an integrated approach to resolving both the environmental issues and the outstanding long-term supply issues at the state level arising from West Virginia's move away from retail competition.

23. The proposed Transaction Contracts are not designated.<sup>10</sup> Applicants state, however, that the contracts will not be effective until the restructuring receives approval from the West Virginia Commission. Applicants estimate that these approvals will be obtained in 2006. Applicants commit to making a compliance filing submitting designated Transaction Contracts before the effective date of the Transaction Contracts.

24. Accordingly, we find the proposed Transaction Contracts just and reasonable, and will conditionally accept the proposed Transaction Contracts for filing subject to the submission of a compliance filing that refiles the Transaction Contracts designated in accordance with the requirements of Order No. 614; the compliance filing shall be submitted before the effective date of the proposed Transaction Contracts.

The Commission orders:

(A) The Transaction Contracts are hereby conditionally accepted, as discussed in the body of this order. Applicants are hereby directed to make a compliance filing designating the Transaction Contracts, as discussed in the body of this order.

(B) The proposed disposition of jurisdictional facilities is hereby authorized, as discussed in the body of this order.

(C) The foregoing authorization of the disposition of jurisdictional facilities is without prejudice to the authority of the Commission or any other regulatory body with respect to rates, service, accounts, valuation, estimates, or determinations of cost, or any other matters whatsoever now pending or which may come before the Commission.

(D) Nothing in this order shall be construed to imply acquiescence in any estimate or determination of cost or any valuation of property claimed or asserted.

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<sup>10</sup> *Designation of Electric Rate Schedule Sheets*, Order No. 614, FERC Stats. & Regs. Regulations Preambles July 1996-December 2000 ¶ 31,096 (2000).

(E) The Commission retains authority under sections 203(b) and 309 of the FPA to issue supplemental orders as appropriate.

(F) If the transaction results in changes in the status or the upstream ownership of Applicants' affiliated Qualifying Facilities, if any, an appropriate filing for recertification pursuant to 18 C.F.R. § 292.207 shall be made;

(G) Applicants shall make appropriate filings under section 205 of the FPA, as necessary, to implement the transaction;

(H) Applicants shall notify the Commission within 10 days of the date that the disposition of the jurisdictional facilities is consummated.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.