DOMINION RESOURCES INC /VA/
Form U-1/A
February 09, 2004

File No. 70-9555

As filed with the Securities and Exchange Commission on February 9, 2004

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

POST-EFFECTIVE AMENDMENT No. 5
To
FORM U-1
APPLICATION-DECLARATION
UNDER
THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Dominion Resources, Inc.*
120 Tredegar Street
Richmond, Virginia 23219
*other applicants are listed on Exhibit H

(Name of company filing this statement
and address of principal
executive offices)

Dominion Resources, Inc.

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

James F. Stutts
Vice President and
General Counsel
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(Name and address of agent for service)

The Commission is also requested to send copies of any
communication in connection with this matter to:

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POST EFFECTIVE AMENDMENT NO. 5
TO
APPLICATION-DECLARATION
FOR APPROVAL OF
TAX ALLOCATION AGREEMENT

Amendment No. 4 to the foregoing Application/Declaration is hereby amended and restated to read in its entirety as follows:

Item 1. Description of Proposed Transaction.

BACKGROUND

Dominion Resources, Inc. ("DRI") and its subsidiaries listed on Exhibit H attached hereto (together "Applicants"), amend the foregoing application to supplement the record and to request that the Commission release jurisdiction it reserved over a proposed tax allocation agreement ("Agreement"). The Commission previously reserved jurisdiction over the Agreement in its order dated December 28, 2001 (File No. 70-9555). Applicants respectfully request that the Commission authorize the use of the Agreement as revised to reflect the proposed changes described below ("proposed Agreement").

By order dated December 15, 1999, (File No. 70-9517), the Commission authorized the merger ("Merger") of Consolidated Natural Gas Company ("Old CNG"), also a registered holding company under the Act, into a wholly-owned subsidiary of DRI, which subsidiary as the survivor of the Merger changed its name to Consolidated Natural Gas Company ("CNG"). The Merger was consummated on January 28, 2000.

ACQUISITION INDEBTEDNESS

In the Merger, DRI acquired the outstanding shares of Old CNG common stock for $6.4 billion, consisting of approximately 87 million shares of DRI common stock and approximately $2.9 billion in cash. In addition, in connection with the acquisition, DRI shareholders exchanged approximately 33 million shares of DRI common stock for $1.4 billion. By orders dated December 15, 1999 (File No. 70-9517) and May 24, 2001 (File No. 70-9555), the Commission authorized DRI and its subsidiaries to engage in a program of external financing and intrasystem financing, and other related transactions, through December 31, 2004 (pursuant to the May 24, 2001 order). Pursuant to those orders, DRI issued securities and borrowed money as described below in order to raise funds to pay for the acquisition of CNG.

"Acquisition Indebtedness" means indebtedness incurred by DRI to finance the acquisition (including related costs) by Dominion Resources, Inc. of all of the issued and outstanding stock of CNG and any renewals or extensions thereof. Acquisition Indebtedness also includes indebtedness incurred by DRI for the purpose of refinancing the indebtedness relating to the acquisition (including related costs) of all of the issued and outstanding stock of CNG.

In January 2001, DRI issued $300 million of 8.4% Capital Securities due in January 2031 and $1 billion of 2-year fixed rate 6% notes to refinance the remaining bridge financing.

DRI initially financed the acquisition with bridge financing consisting of a $3.5 billion commercial paper program backed by a short-term credit facility and $1 billion of short-term, privately placed money market notes. At September 30, 2002, DRI issued the following securities, the proceeds of which were used to refinance a portion of the bridge financing:

$700 million of 10-year fixed rate 8.125% notes
$700 million of 5-year fixed rate 7.625% notes
$400 million of 3-year notes fixed rate 7.60% notes
$250 million of 14-year fixed rate 7.82% remarketable notes
$520 million of 10-year fixed rate 5.7% notes
$413 million of Premium Income Equity Securities [1]

The above refinancing included $70 Million in refinancing costs including premiums and fees.

At September 30, 2002 the total ("Acquisition Indebtedness") amounted to $4.3 billion. DRI's projected interest expense related to the Acquisition Indebtedness for the years ended December 31, 2000, 2001 and 2002 is approximately $152 million, $304 million and $308 million, respectively.

PROPOSED TAX ALLOCATION AGREEMENT

Applicants request that the Commission authorize Applicants to enter into the proposed Agreement, a draft of which is filed as Exhibit B. Under the proposed Agreement, DRI intends to allocate the consolidated income tax among all associate companies based on each company's separate return tax liability or refund in such a manner as to assure that each subsidiary's share of consolidated income tax does not exceed its "separate return tax" as defined in Rule 45(c)(2). However, the proposed Agreement also provides that any tax benefits associated with all or a portion of the Acquisition Indebtedness, as that term is defined in the proposed Agreement will be allocated to DRI only and not to the subsidiaries as contemplated by Rule 45(c)(5). Although the allocation of the tax benefits to DRI is not in strict compliance with Rule 45(c), DRI believes, for the reasons stated below, that such tax sharing does not violate the original intent of Rule 45(c), that the treatment is consistent with the Commission's treatment of holding company expenses, and as such, the Commission should grant it relief to enter into the proposed Agreement.

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Rule 53 and 54 Analysis

DRI currently meets all of the conditions of Rule 53(a), except for clause (1). At September 30, 2003, DRI's "aggregate investment", as defined in Rule 53(a)(1), in EWG's and FUCO's, was approximately $3,843.0 million (of which approximately $3,834.7 million was in EWGs). With respect to Rule 53 (a) (1), however, the Commission has determined that DRI's financing of its investment in EWGs and FUCOs in an amount not to exceed 100% of its "average consolidated retained earnings" plus $4.5 billion would not have either of the adverse effects set forth in Rule 53 (c).[2] At September 30, 2003, DRI's "average consolidated retained earnings" were $1,692.4 million and, therefore, DRI's investment in EWG's and FUCO's continues to be within the authorized limit.

In addition, DRI and its subsidiaries are in compliance and will continue to comply with the other provisions of Rule 53 (a) and (b), as demonstrated by the following determinations:

(i) The DRI System maintains books and records, and prepares financial statements, in accordance with Rule 53 (a) (2). Furthermore, DRI has undertaken to provide the Commission access to such books and records and financial statements as it may request;

(ii) No more than 2% of the employees of DRI's domestic public utility companies render services at any one time, to its EWGs or FUCOs;

(iii) DRI has submitted (a) a copy of each Form U-1 and Rule 24 certificate that has been filed with the Commission under Rule 53 and (b) a copy of Item 9 of the Form U5S and Exhibits G and H thereof to each state regulator having jurisdiction over the retail rates of DRI's public utility subsidiaries;

(iv) Neither DRI nor any subsidiary has been the subject of a bankruptcy or similar proceeding (unless a plan of reorganization has been confirmed in such proceeding);

(v) DRI's "average consolidated retained earnings" for the four most recent quarterly periods have not decreased by 10% or more from the average for the previous four quarterly periods; and

(vi) In the previous fiscal year, DRI did not report operating losses attributable to its investment in EWGs/FUCOs exceeding 3% of DRI's consolidated retained earnings.

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See Dominion Resources, Inc. Holding Company Act Release No. 35-27485, dated December 28, 2001 (the "Rule 53 (c) Order"). DRI continues to assert that its investment in EWGs and FUCOs will not adversely affect the DRI System.

The proposed transactions, considered in conjunction with the effect of the capitalization and earnings of DRI's EWGs and FUCOs, would not have a material adverse effect on the financial integrity of the DRI System, or an adverse

impact on DRI's public-utility subsidiaries, their customers, or the ability of State commissions to protect such public-utility customers. The Rule 53 (c) Order was predicated, in part, upon an assessment of DRI's overall financial condition which took into account, among other factors, DRI's consolidated capitalization ratio and its retained earnings, both of which have improved since the date of the order. In the aggregate DRI's EWG and FUCO investments have been profitable for the period September 30, 2000 through September 30, 2003. DRI's EWG and FUCO investments also were profitable, in the aggregate, for the period from December 31, 2001 through September 30, 2003. As of September 30, 2001, the most recent period for which financial statement information was evaluated in the Rule 53 (c) Order, DRI's consolidated capitalization consisted of 33.4% common equity, 6.4% preferred stock and 60.2% debt (including long and short-term debt and preferred stock). As of September 30, 2003, the consolidated capitalization ratios of DRI, with consolidated debt including all short-term debt and non-recourse debt of its EWGs and FUCOs, were as follows:

	As of September 30, 2003
	%
Common shareholders' equity	39
Preferred stock	1
Long-term and short-term debt	60

DRI's consolidated retained earnings increased from $1,199 million as of March 31, 2000 to $1,437 million as of September 30, 2003 and grew from $922 million as of December 31, 2001 to $1,437 million as of September 30, 2003. DRI's EWGs and FUCOs have made a positive contribution to earnings by contributing approximately $2,400.8 million in revenues from March 31, 2000 through September 30, 2003, and net income of 575.6 million for the same period. DRI's EWG and FUCO contributions to revenues and net earnings from December 31, 2001 to September 30, 2003 were $1,494.2 million and $291.8 million, respectively. Accordingly, since the date of the Rule 53(c) Order, the capitalization and earnings attributable to DRI's investments in EWGs and FUCOs has not had an adverse impact on DRI's financial integrity.

RETENTION OF JURISDICTION

DRI requests that the Commission continue to reserve jurisdiction over the other authority and matters over which it reserved jurisdiction in its order dated December 28, 2001 (File No. 70-9555), including the effect of recharacterization of public utility assets as eligible facilities or their transfer to EWGs and the remaining increased authority to invest in EWGs and FUCOs sought in this proceeding.

Item 2. Fees, Commissions and Expenses

The fees and expenses incurred associated with this amended Application are estimated as $25,000.00.

Item 3. Applicable Statutory Provisions

OVERVIEW

Pursuant to Section 12(b) of the Public Utility Company Holding Act of 1935 (the "Act"), it is unlawful for any registered holding company or subsidiary to lend or in any manner extend its credit to or indemnify any company in the same holding-company system "in contravention of such rules and regulations or orders as the Commission deems necessary or appropriate in the public interest or for the protection of investors or consumers or to prevent the circumvention of the provisions of this title or the rules, regulations, or orders thereunder."[3]

Rule 45(a) of the Act generally prohibits any registered holding company or subsidiary company from, directly or indirectly, lending or in any manner extending its credit to, indemnifying, or making any donation or capital contribution to, any company in the same holding company system, except pursuant to a Commission order. Rule 45(c) provides, however, that approval under Rule 45(a) is not required for the filing of a consolidated tax return pursuant to a tax allocation agreement between eligible associate companies in a registered holding company system that complies with Rule 45(c). To the extent that a tax allocation agreement does not comply with the requirements of Rule 45(c) it must be (and in specific cases, has been) approved by the Commission under Section 12(b) and rule 45(a).

Under Rule 45(c)(2) the consolidated tax may be apportioned among the members of the group in proportion to either the corporate taxable income of each member or the separate return tax of each member, but, in either case, the tax apportioned to any subsidiary shall not exceed the "separate return tax" of that subsidiary. As such, the amount of consolidated tax allocated to any member of the consolidated group cannot exceed the amount of tax that subsidiary would have paid computed as though it were not a member of a consolidated group.

Rule 45(c)(4) provides that an allocation agreement may exclude companies not having positive corporate taxable income for the year (i.e., loss subsidiaries) from the allocation provided for under Rule 45(c)(2), provided that the agreement contains an "appropriate and equitable provision for preserving to each subsidiary company so excluded the equivalent of any rights which such company would have had under the applicable tax law, had it filed a separate return to use in other years any loss or credit availed of by the group through the consolidated return."

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15 U.S.C. Section 791(b); Act of 8/26/35, c. 687 Section 687, Section 12, 49 Stat. 823.

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As an alternative to Rule 45(c)(4), Rule 45(c)(5) provides that a tax allocation agreement may include all members of the group in the tax allocation, recognizing negative corporate taxable income or a negative corporate tax, according to the allocation method chosen. However, Rule 45(c)(5) goes on to provide that "an agreement under this paragraph shall provide that those associate companies with a positive allocation will pay the amount allocated and those subsidiary companies with a negative allocation will receive current payment of their corporate tax credits. In addition, the agreement must also provide a method of apportioning such payments, and for the carrying over of uncompensated benefits, if the consolidated loss is too large to be used in full. Such method may also assign priorities to specific kinds of benefits.

Under Rule 45(c)(5) therefore, only "subsidiary companies" may be paid for their negative tax allocation. Conversely, any company that does not meet the definition of "subsidiary company" (i.e., the holding company in a holding company system) may not receive "current payment of its corporate tax credits". DRI's proposed Agreement

adopts the Rule 45 (c)(5) allocation method, except that, under the proposed Agreement DRI will retain the benefit (in the form of the reduction in consolidated tax) that is attributable to the interest expense on the acquisition debt, rather than reallocate that tax savings to its subsidiary companies. In this respect, the proposed Agreement does not comply with all of the requirements of Rule 45(c). The proposed Agreement will therefore have the effect of assigning the tax benefit associated with the interest expense on the Acquisition Indebtedness to the entity that is legally obligated for its payment - DRI, as guarantor of the Acquisition Indebtedness. At the same time, in accordance with Rule 45(c)(2), the portion of the consolidated tax allocated to many of DRI's subsidiaries will not exceed the "separate return tax" of such subsidiary (the "separate return limitation"). Thus, the proposed Agreement will not have the effect of shifting a larger portion of the group's tax liability to any member of the group than such company would otherwise pay on a separate return basis.

PROPOSED AGREEMENT DOES NOT VIOLATE THE INTENT AND PURPOSE OF THE 1981 AMENDMENTS TO RULE 45

DRI believes that permitting DRI to keep the tax benefits associated with its Acquisition Indebtedness does not violate the intent and purpose of the 1981 amendments to Rule 45. In its 1981 release, the Commission indicated that the distinction between "associate companies" and "subsidiary companies" was intended to preclude the holding company from sharing in the consolidated return savings. The Commission stated, "[e] xploitation of utility companies by holding companies through asserted misallocation of consolidated tax return benefits was among the abuses examined in the investigations underlying the Act."[4] The Release goes on to explain that "[t] he corporate relationships required by the Act assure that the deductible corporate expenses of the holding company itself will always create a consolidated tax saving, since Section 13(a) of the Act precludes such expenses being passed on to the subsidiaries, through service charges or contract, so as to transform them into corporate deductions of the subsidiaries. In light of the legislative history referred to, an expense reimbursement of the holding company, in the guise of a tax allocation, would seem inconsistent with Section 13(a)." In essence, the Commission based its proposed rule change on the need to counter abusive allocations of expense reimbursements, which are prohibited under Section 13(a).

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HCAR No. 21767, Oct. 29, 1980

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However, abusive expense allocations are not the issue in DRI's case. First of all, DRI's taxable losses result primarily from its interest expense incurred on acquisition indebtedness. In fact on its separate 2000 federal income tax return, DRI interest expense comprised approximately 90% of the total tax deductions. As indicated above, the interest expense was related to debt that was incurred in order to purchase and carry DRI's investments in its subsidiaries, the liability for which is solely DRI's. The subsidiaries have no liability for the debt. The debt was not incurred to fund the operations of any of the subsidiaries and the subsidiaries are not obligated in any manner with respect to the repayment of the debt. The debt is also unsecured. As such, the lenders have no rights to the assets owned by the subsidiaries or any security interest in or claim on the assets (including the common stock of the subsidiaries) owned by DRI. In summary, the Acquisition Indebtedness incurred by DRI was incurred as investment debt, the repayment of which will come from the investment income realized by DRI in the form of dividends paid from current and accumulated retained earnings of its subsidiaries as permitted by Rule 46.[5]

DRI is not seeking to recover its corporate costs from its subsidiaries nor are the subsidiaries reimbursing DRI for its interest expenses. Instead, DRI simply wishes to allocate the tax benefits provided to the appropriate entity that

incurred the costs. The Commission has also indicated that the Act does not dictate the result in Rule 45(c) and that the Commission has discretion in approving tax allocation agreements that do not strictly comply with Rule 45(c), so long as the policies and provisions of the Act are satisfied.[6] In The National Grid Group plc, HCAR No. 27154 (Mar. 15, 2000), the Commission stated that "if a tax allocation agreement does not comply in all respects with the provisions of Rule 45(c), it may nonetheless be approved by the Commission under Section 12(b) and Rule 45(a)". In this respect, if the Commission finds that DRI's proposal to keep the tax benefits associated with its Acquisition Indebtedness expenses are not abusive or exploitative, the Commission has the authority to grant relief.

Finally, the tax allocation method used in the proposed Agreement is consistent with the separate return limitation required under Rule 45(c)(2) and will not impact the rates or revenue requirements of the utility subsidiaries of DRI. As such, the Agreement does not result in the utility subsidiaries subsidizing the operations of non-utility subsidiaries, nor does i