

are not priced at market rates.<sup>30</sup> Applicants state that the intercompany loans from pool participants to Hibernia for the E.ON Nonutility Money Pool should be priced at market rates in order to better meet the transfer pricing and affiliate transactions requirements.<sup>31</sup> Applicants state, furthermore, that changing to market interest rates on money pool deposits is fair to a lender because it provides the lender with an arm's-length interest rate that is better,

<sup>30</sup> The transfer pricing issues were described in E.ON's application in SEC File No. 70-9985, which formed the basis in part for the June 2002 Order. E.ON's application stated that, in transactions between German companies and their foreign subsidiaries, German tax law assumes market rate financing between companies in the same corporate group because market rate pricing assures that intercompany loans will not be used to transfer profits from one related entity to another (including, to transfer profits to entities based outside Germany in jurisdictions with lower tax rates). Section 1 of the German Foreign Tax Law provides: "If the income of a taxpayer resulting from his transaction with the related party is reduced because the taxpayer has, in the transaction with the foreign related party, agreed on terms and conditions which deviate from those which unrelated third parties would have agreed to upon under the same or similar circumstances, then the taxpayer's income shall, not withstanding other provisions, be so determined as if such income would have been earned under terms and conditions agreed upon between unrelated parties."

<sup>31</sup> The Applicants state that German corporations also are required by corporate law to conduct affiliate transactions on an arm's-length basis. German corporate law requires all joint stock companies to provide a dependency statement that addresses affiliate relationships in their annual financial reports. The dependency statement almost always concludes that all transactions with affiliated companies have been conducted on an arm's-length basis and not to the reporting company's disadvantage because a failure to follow arm's-length terms could subject the company to a shareholder suit.

German joint stock company law sets additional specific requirements for the conduct of business between group companies. Any disadvantageous influence of the parent company on its subsidiary is restricted and any damage caused by the parent must be compensated. If not compensated, the parent and its legal representatives (in this context, the management board and the supervisory board), would be subject to damage claims. Under Section 57 of the Joint Stock Company Act (Germany), a German joint stock company may not repay to its shareholders any capital contributed by them. Any payments to shareholders must be made only from company profits as shown in the balance sheet. A prohibited repayment of capital can occur implicitly if a transaction between a company and its shareholder shows a disproportion or incongruity between consideration and performance. This would be the case if there are market prices or rates for the respective consideration and these are not taken into account in the relevant transaction. The legal consequence under the Joint Stock Company Act of any such repayment of capital is that the respective transaction or contract would be legally void, overpayments must be reimbursed and the management board may be subject to damage claims. Interest payments on funds loaned to affiliated companies that are either above or below market can, therefore, raise difficult issues under German law and in many cases would be prohibited.

or equivalent to, what a lender could earn in separate bank account.

The Applicants state that the requirement under German law that affiliate transactions be conducted at arm's length makes it important that Hibernia pay pool depositors interest at market rates. Applicants state that, in addition, new legislation recently introduced in the German parliament will require documentation of all transactions with affiliated companies to substantiate that the transactions are conducted at arm's length. Applicants further state that, operating the E.ON Nonutility Money Pool, as currently authorized, may cause Hibernia to pay interest at above-market rates and may conflict with this proposed legislation. Applicants assert that having Hibernia operate the E.ON Nonutility Money Pool to pay market rates on both sides of the pool transactions will provide a solution consistent with the Market Rate Method financing authorization of the Commission in the June 2002 Order, consistent with current and proposed requirements of German law and be fair to the E.ON Group participants in the pool.

#### **E.ON AG, et al. (70-10176)**

E.ON AG ("E.ON"), E.ON-Platz 1, 40479 Dusseldorf, Germany, a registered holding company, E.ON U.S. Investments Corp. ("EUSIC"), a registered holding company, and LG&E Energy Corp. ("LG&E Energy"), a subsidiary of E.ON and a public utility holding company exempt from registration by order under section 3(a)(1) of the Act, both located at 220 West Main Street, Louisville, Kentucky 40202 (collectively, "Applicants"), have filed an application-declaration ("Application") under sections 3(a)(1), 6(a), 7, 9(a), 10 and 12(d) of the Act and rules 43 and 54 under the Act. Applicants request authority to reorganize LG&E Energy resulting in a change of organizational form from a Kentucky corporation to a Kentucky limited liability company (the "Transaction").

E.ON became a registered holding company under the Act on July 1, 2002, as a result of E.ON's acquisition of Powergen plc ("Powergen"). The Commission approved the acquisition in Holding Company Act Release No. 27539 (June 14, 2002) (the "Acquisition Order"). E.ON owns LG&E Energy, which in turn owns two public utility companies, Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU"). E.ON's interest in LG&E Energy is held indirectly through several intermediate

holding companies with EUSIC being the direct parent of LG&E Energy.

As stated above, LG&E Energy is a wholly-owned, first tier subsidiary of EUSIC. LG&E Energy proposes to change its organizational form from a Kentucky corporation to a Kentucky limited liability company. Applicants state that in order to accomplish the Transaction under Kentucky law and in a tax-efficient manner, the following successive steps must be completed. First, New LG&E Energy will be formed by EUSIC as a Kentucky limited liability company. At this point, EUSIC will be the sole member of New LG&E Energy. Second, LG&E Energy will transfer to New LG&E Energy substantially all of its assets and liabilities in exchange for membership interests in New LG&E Energy. Then, pursuant to an agreement and plan of merger, LG&E Energy will merge with and into New LG&E Energy (the "Merger"), with New LG&E Energy as the surviving entity and as successor to LG&E Energy. To effect the Merger, New LG&E Energy will file Articles of Merger with the Secretary of State of the Commonwealth of Kentucky. The Merger will be effective upon acceptance of such filing by the Secretary of State of the Commonwealth of Kentucky. Thus, when the Transaction is completed, LG&E Energy will continue to be wholly-owned by EUSIC, with the only substantive change being that LG&E Energy will have changed its organizational form from a Kentucky corporation to a Kentucky limited liability company.

In addition to requesting authorization under the Act for the Transaction, Applicants request that the Commission issue an order exempting New LG&E Energy, as the owner of LG&E and KU, from registration under the Act under section 3(a)(1) of the Act. LG&E Energy is exempt from registration under the Act pursuant to section 3(a)(1) of the Act. Applicants state that the proposed Transaction, which merely effects a change of the organizational structure of LG&E Energy, does not change any of the facts underlying the qualification of LG&E Energy for exemption from registration under the Act pursuant to section 3(a)(1) of the Act and, accordingly, that New LG&E Energy, as the successor to LG&E Energy, qualifies for the exemption from registration under the Act pursuant to section 3(a)(1) of the Act.

New LG&E Energy will succeed to LG&E Energy's ownership of LG&E and KU, as well as its nonutility subsidiaries. New LG&E Energy will also be the successor of LG&E Energy with respect to its commitments and authorizations set forth in the