

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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FILER

**CONSOLIDATED NATURAL GAS CO/VA**

CIK: **23738** | IRS No.: **130596475** | State of Incorporation: **DE** | Fiscal Year End: **1231**  
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SIC: **4923** Natural gas transmission & distribution

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SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended June 30, 2001

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-3196

**CONSOLIDATED NATURAL GAS COMPANY**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of incorporation or organization)*

**54-1966737**

*(I.R.S. Employer Identification No.)*

**120 Tredegar Street  
Richmond, Virginia**

**23219**

*(Address of principal executive offices)*

*(Zip Code)*

**(804) 819-2000**

*(Registrant's telephone number)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

**REGISTRANT MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION H(1)(a) AND (b) OF FORM 10-Q AND IS THEREFORE FILING THIS FORM WITH THE REDUCED DISCLOSURE FORMAT.**

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**CONSOLIDATED NATURAL GAS COMPANY**

**PART I. FINANCIAL INFORMATION**

**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS**

**CONSOLIDATED STATEMENTS OF INCOME**  
**(Unaudited)**

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
	(Millions)			
<b>Operating Revenue</b>	<u>\$745</u>	<u>\$721</u>	<u>\$2,480</u>	<u>\$1,890</u>
<b>Operating Expenses</b>				
Purchased gas	267	246	1,326	708

Liquids, pipeline capacity and other purchases	69	73	134	167
Restructuring and other merger-related costs	-	32	-	205
Operations and maintenance	140	129	282	282
Depreciation and amortization	93	112	189	210
Other taxes	<u>33</u>	<u>43</u>	<u>91</u>	<u>98</u>
Total expenses	<u>602</u>	<u>635</u>	<u>2,022</u>	<u>1,670</u>
Income from operations	<u>143</u>	<u>86</u>	<u>458</u>	<u>220</u>
Other income (loss):				
Loss on net assets held for sale	-	(17)	-	(152)
Other	<u>3</u>	<u>12</u>	<u>21</u>	<u>17</u>
Total other income (loss)	<u>3</u>	<u>(5)</u>	<u>21</u>	<u>(135)</u>
			)	
Income before interest and income taxes	146	81	479	85
Interest and related charges	<u>35</u>	<u>39</u>	<u>96</u>	<u>76</u>



Other	182	276
Receivables from affiliated companies	23	18
Inventories	79	96
Commodity contract assets	410	264
Unrecovered gas costs	63	264
Broker margin deposits	51	20
Prepayments	107	154
Deferred income taxes	17	-
Other	83	140
Net assets held for sale	<u>64</u>	<u>57</u>
Total current assets	<u>1,708</u>	<u>2,059</u>
<b>Investments</b>	<u>226</u>	<u>196</u>
<b>Property, Plant and Equipment</b>		
Property, plant and equipment	9,716	9,336
Less accumulated depreciation and amortization	<u>5,023</u>	<u>4,968</u>
Total property, plant and equipment, net	<u>4,693</u>	<u>4,368</u>

**Deferred Charges and Other Assets**

Regulatory assets, net	181	176
Prepaid pension cost	486	434
Commodity contract assets	216	28
Other	<u>31</u>	<u>26</u>
Total deferred charges and other assets	<u>914</u>	<u>664</u>
Total assets	<u>\$7,541</u>	<u>\$7,287</u>

\_\_\_\_\_

The accompanying notes are an integral part of the Consolidated Financial Statements.

\* The Consolidated Balance Sheet at December 31, 2000 has been derived from the audited Consolidated Financial Statements at that date.

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**CONSOLIDATED NATURAL GAS COMPANY****CONSOLIDATED BALANCE SHEETS****(Unaudited)**

June 30,                  December 31,

20012000

\*

**LIABILITIES AND STOCKHOLDER'S EQUITY**

(Millions)



**Current Liabilities**

Short-term debt	\$ 527	\$1,215
Accounts payable, trade	491	688
Payables to affiliated companies	142	33
Estimated rate contingencies and refunds	43	41
Accrued interest	31	26
Accrued payroll	38	52
Accrued taxes	123	178
Deferred income taxes	-	87
Commodity contract liabilities	259	27
Temporary replacement reserve - gas inventory	63	-
Broker margin liabilities	151	-
Other	<u>203</u>	<u>209</u>
Total current liabilities	<u>2,071</u>	<u>2,556</u>

**Long-Term Debt**

2,165                      1,721

**Deferred Credits and Other Liabilities**

Deferred income taxes	929	788
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Deferred investment tax credits	17	18
Commodity contract liabilities	132	40
Other	<u>131</u>	<u>198</u>
Total deferred credits and other liabilities	<u>1,209</u>	<u>1,044</u>
	<u>5,445</u>	<u>5,321</u>
Total liabilities		
<b>Commitments and Contingencies</b>		
(see Note 12)		
<b>Common Stockholder's Equity</b>		
Common stock, no par value	1,816	1,816
Other paid-in capital	40	40
Retained earnings	171	111
Accumulated other comprehensive income (loss)	<u>69</u>	<u>(1</u>
	)	
Total common stockholder's equity	<u>2,096</u>	<u>1,966</u>
Total liabilities and stockholder's equity	<u>\$7,541</u>	<u>\$7,287</u>

The accompanying notes are an integral part of the Consolidated Financial Statements.

\* The Consolidated Balance Sheet at December 31, 2000 has been derived from the audited Consolidated

**CONSOLIDATED NATURAL GAS COMPANY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	Six Months Ended	
	June 30,	
	<u>2001</u>	<u>2000</u>
	(Millions)	
<b>Net Cash Flows From Operating Activities</b>	<u>\$1,028</u>	<u>\$370</u>
<b>Cash Flows From (Used In) Investing Activities</b>		
Plant construction and other property additions	(182)	(221)
Oil and gas properties and equipment	(342)	(141)
Proceeds from dispositions of property, plant and equipment, net	3	10
Cost of other investments	<u>(34)</u>	<u>(8)</u>
Net cash used in investing activities	<u>(555)</u>	<u>(360)</u>
<b>Cash Flows From (Used In) Financing Activities</b>		
Issuance of long-term debt	496	-

Repayment of long-term debt	(84)	-
Issuance (repayment) of short-term debt, net	(688)	24
Dividends paid	<u>(178)</u>	<u>(93)</u>
Net cash used in financing activities	<u>(454)</u>	<u>(69)</u>
Increase (decrease) in cash and cash equivalents	19	(59)
Cash and cash equivalents at beginning of period	<u>58</u>	<u>94</u>
Cash and cash equivalents at end of period	<u>\$ 77</u>	<u>\$ 35</u>

The accompanying notes are an integral part of the Consolidated Financial Statements.

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**CONSOLIDATED NATURAL GAS COMPANY**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**(Unaudited)**

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Net income	<u>\$ 73</u>	<u>\$20</u>	<u>\$238</u>	<u>\$29</u>

(Millions)

Other comprehensive income, net of tax:

Adjustment for foreign currency translation	-	-	-	(1)
Amount reclassified from AOCI to net income	-	-	-	3
Cumulative effect of a change in accounting principle  (net of income taxes of \$57)	-	-	(105)	-
Unrealized derivative gains - hedging activities	85	-	105	-
Reclassification for derivative losses included in net income	<u>12</u>	<u>-</u>	<u>68</u>	<u>-</u>
Other comprehensive income	<u>97</u>	<u>-</u>	<u>68</u>	<u>2</u>
Comprehensive income	<u>\$170</u>	<u>\$20</u>	<u>\$306</u>	<u>\$31</u>

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The accompanying notes are an integral part of the Consolidated Financial Statements.

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## CONSOLIDATED NATURAL GAS COMPANY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### Note 1. Nature of Operations

Consolidated Natural Gas Company is a public utility holding company registered under the Public Utility Holding Company Act of 1935 (1935 Act). On January 28, 2000, Dominion Resources, Inc. (Dominion) and Consolidated Natural Gas Company (the Company) completed the merger of the Company into a subsidiary (New Company) of Dominion. The name of New Company was changed to Consolidated Natural Gas Company at the time of the merger. To give effect to the continuity of the Company and New Company, the term "Company" as used in

this report refers to Consolidated Natural Gas Company both before and after the merger unless the context of a statement requires the use of separate references to each company.

The Company, through its subsidiaries, operates in all phases of the natural gas business, explores for and produces oil and provides a variety of energy marketing services. Its regulated retail gas distribution subsidiaries serve approximately 1.7 million residential, commercial and industrial gas sales and transportation customers in Ohio, Pennsylvania and West Virginia. Its interstate gas transmission pipeline system services each of its distribution subsidiaries, non-affiliated utilities and end use customers in the Midwest, the Mid-Atlantic and the Northeast states. The Company's exploration and production operations are conducted in several of the major gas and oil producing basins in the United States, both onshore and offshore.

The Company evaluates its operations along functional lines rather than legal entities. The principal functional segments include Distribution (representing the retail gas distribution subsidiaries), Transmission (representing the pipeline, storage and by-product operations and the gas and oil production activities of Dominion Transmission, and the activities of the Company's gas marketing subsidiaries, Dominion Field Services and Dominion Retail), and Exploration and Production (representing the exploration and production operations of Dominion Exploration & Production).

## **Note 2. Significant Accounting Policies**

In the opinion of management, the accompanying unaudited Consolidated Financial Statements contain all adjustments, including normal recurring accruals, necessary to present fairly the Company's financial position as of June 30, 2001, the results of operations and comprehensive income for the three and six months ended June 30, 2001 and 2000, and cash flows for the six months ended June 30, 2001 and 2000. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year.

These Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements, and notes thereto, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

The Consolidated Financial Statements represent the accounts of the Company after the elimination of intercompany transactions.

The Consolidated Financial Statements reflect certain estimates and assumptions made by management that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses for the periods presented. Actual results may differ from those estimates.

Certain amounts in the 2000 Consolidated Financial Statements have been reclassified to conform to the 2001 presentation.

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## **CONSOLIDATED NATURAL GAS COMPANY**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

## **Note 3. Recently Issued Accounting Standards**

Business Combination

and Goodwill

In July 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards (SFAS) Nos. 141, *Business Combinations*, and 142, *Goodwill and Other Intangible Assets*. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting, thus eliminating the use of the "pooling" method of accounting. For any business combination, which will be accounted for using the purchase method, initiated before July 1, 2001 and completed before January 2002, the provisions of SFAS No. 141 will also apply. Under SFAS No. 142, goodwill is no longer subject to amortization; instead it will be

subject to new impairment testing criteria. Other intangible assets will continue to be amortized over their estimated useful lives, although those with indefinite lives are not to be amortized but will be tested at least annually for impairment. The new standards also provide new guidance regarding the identification and recognition of intangible assets, other than goodwill, acquired as part of a business combination. The Company will adopt this standard effective January 1, 2002. At June 30, 2001, the Company had no material amounts of goodwill or intangible assets obtained in business combinations on its books.

### **Asset Retirement Obligations**

In July 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligation*, which provides accounting requirements for the recognition and measurement of liabilities for obligations associated with the retirement of tangible long-lived assets. Under this standard, these liabilities will be recognized at fair value as incurred and capitalized as part of the cost of the related tangible long-lived assets. Accretion of the liabilities due to the passage of time will be expensed. Although FASB has not yet published the final standard, the Company's preliminary conclusions are based on previously issued exposure drafts and subsequent deliberations. The Company will adopt this standard effective January 1, 2003. Upon the adoption of this new standard, the Company will discontinue its practice of accruing, as part of depreciation expense, amounts associated with the future costs of removal for its gas utility and oil and gas exploration and production. However, the Company may continue its practice of accruing for future costs of removal subject to cost of service utility rate regulation even when an asset removal obligation does not exist but would do so through the recognition of regulatory assets and liabilities, as appropriate.

### **Note 4. Derivatives and Hedge Accounting**

#### **Adoption of Statement of Financial Accounting Standards (SFAS) No. 133**

The Company adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, on January 1, 2001. The Company recorded an after-tax loss of \$14 million (net of income taxes of \$8 million) during the quarter ended March 31, 2001, representing the cumulative effect of adopting SFAS No. 133 in its Consolidated Statement of Income. The Company also recorded a net after-tax charge to accumulated other comprehensive income (AOCI) of \$105 million (net of income taxes of \$57 million) in the first quarter of 2001 in connection with the initial adoption of SFAS No. 133. The Company expects to reclassify approximately \$117 million of this amount to earnings during the year ending December 31, 2001. The actual amounts that will be reclassified to earnings over the twelve months subsequent to initial adoption will vary from this amount as a result of changes in market conditions. The effect of the charges being reclassified from AOCI to earnings will generally be offset by the recognition of the hedged transactions (e.g., anticipated sales) in earnings, thereby achieving the realization of prices contemplated by the underlying risk management strategies.

#### **Risk Management Policy**

The Company uses derivatives to manage the commodity and financial market risks of its business operations. The Company manages the price risk associated with purchases and sales of natural gas and oil by utilizing derivative commodity instruments including futures, forwards, options, swaps and collars. The Company manages its interest rate risk exposure, in part, by entering into interest rate swap transactions.

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## **CONSOLIDATED NATURAL GAS COMPANY**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company designates a substantial portion of its derivatives as fair value or cash flow hedges. A significant portion of the Company's hedge strategies represents cash flow hedges of the variable price risk associated with purchases and sales of natural gas, oil and other commodities using derivative instruments discussed in the preceding paragraph. However, the Company also engages in fair value hedges by utilizing natural gas swaps, futures and options to mitigate the fixed price exposure inherent in the Company's firm commitments and interest rate swaps to hedge its exposure to fixed interest rates on certain long-term debt. Certain of the Company's derivatives, which management believes are economic hedges and mitigate exposure to fluctuations in commodity prices, are not designated as hedges for accounting purposes.

## Accounting Policy

Under SFAS No. 133, derivatives are recognized on the Consolidated Balance Sheet at fair value, unless a scope exception is available under the standard. Commodity contracts representing unrealized gain positions are reported as commodity contract assets; commodity contracts representing unrealized losses are reported as commodity contract liabilities. In addition, purchased options and options sold are reported as commodity contract assets and commodity contract liabilities, respectively, at estimated market value until exercise or expiration. Cash flows from derivative instruments are presented in net cash flow from operating activities.

For all derivatives designated as a hedge, the Company formally documents the relationship between the hedging instrument and the hedged item, as well as the risk management objective and strategy for the use of the hedging instrument. The Company assesses, both at the inception of the hedge and on an ongoing basis, whether the hedge relationship between the derivative and the hedged item is highly effective in offsetting changes in fair value or cash flows. Any change in fair value of the derivative resulting from ineffectiveness, as defined by SFAS No. 133, is recognized currently in earnings. Further, for derivatives that have ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively.

For fair value hedge transactions in which the Company is hedging changes in the fair value of an asset, liability, or firm commitment, changes in the fair value of the derivative will generally be offset in the consolidated statement of income by changes in the hedged item's fair value. For cash flow hedge transactions in which the Company is hedging the variability of cash flows related to a variable-priced asset, liability, commitment, or forecasted transaction, changes in the fair value of the derivative are reported in AOCI. The gains and losses on the derivatives that are reported in AOCI are reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of the change in fair value of derivatives and the change in fair value of derivatives not designated as hedges for accounting purposes are recognized in current-period earnings. For options designated either as fair value or cash flow hedges, changes in the time value are excluded from the measurement of hedge effectiveness and are, therefore, recorded in earnings.

Gains and losses on derivatives designated as hedges, when recognized, are included in the operating revenue and income, expenses and interest and related charges in the consolidated statements of income. Specific line item classification is determined based on the nature of the risk underlying individual hedge strategies. Changes in the fair value of derivatives not designated as hedges, and the portion of hedging derivatives excluded from the measurement of effectiveness are included in operations and maintenance expense in the consolidated statements of income.

## Derivatives and Hedge Accounting Results

For the three and six-month periods ended June 30, 2001, the Company recognized a total pre-tax increase in earnings of approximately \$1 million for hedge ineffectiveness. This amount, which relates entirely to fair value hedges, is primarily reported as a reduction to cost of sales in the Consolidated Statements of Income. In addition, the Company recognized a pre-tax decrease to earnings of approximately \$1 million during the three month period ended June 30, 2001, representing the change in time value of options not used in the assessment of effectiveness for cash flow hedges. The change in time value of options not used in the assessment of effectiveness for cash flow hedges during the six-month period ended June 30, 2001 was not significant.

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## CONSOLIDATED NATURAL GAS COMPANY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Approximately \$37 million of net gains in AOCI at June 30, 2001 is expected to be reclassified to earnings within the next twelve-month period. The actual amounts that will be reclassified to earnings over the next twelve months will vary from this amount as a result of changes in market conditions. The effect of the charges being reclassified from AOCI to earnings will generally be offset by the recognition of the hedged transactions (e.g., anticipated sales) in earnings, thereby achieving the realization of prices contemplated by the underlying risk management strategies. As of June 30, 2001, the Company is hedging its exposure to the variability in future cash flows for forecasted transactions over periods of one to five years.

As a result of the clearance of additional interpretive guidance by the Financial Accounting Standards Board (FASB) during the second quarter, the Company reviewed certain contracts that were determined not to be subject to fair value accounting upon implementation of SFAS No.



133. Based on this review and the new guidance, certain contracts were determined to be subject to fair value accounting under SFAS No. 133. Effective July 1, 2001, these contracts were incorporated as hedging instruments in appropriate cash flow hedging strategies. The effect of implementing these changes will not have a material impact on the Company's financial position, results of operations or cash flows.

Future interpretations of SFAS No. 133 by the FASB or other standard-setting bodies could result in fair value accounting being required for certain contracts that are not currently being subjected to such requirements. Accordingly, such future interpretations may impact the Company's ultimate application of the standard. However, if future changes in the application of SFAS No. 133 should result in additional Company contracts becoming subject to fair value accounting under SFAS No. 133, the Company would pursue hedging strategies to mitigate any potential future volatility in reported earnings.

## **Note 5**

### **Change in Accounting for Pensions**

The Consolidated Financial Statements for the three and six months ended June 30, 2000 have been restated to reflect a change in the method of calculating the market related value of pension plan assets used to determine the expected return on pension plan assets, a component of net periodic pension cost. The new method was adopted in the third quarter of 2000 and effective as of January 1, 2000.

A cumulative effect of a change in accounting principle of \$31 million (net of income taxes of \$11 million) was included in income for the six months ended June 30, 2000. The overall effect of the change was to increase income before cumulative effect of a change in accounting principle by \$5 million for the six months ended June 30, 2000, and to increase net income for the three and six months ended June 30, 2000 by \$3 million and \$36 million, respectively.

For additional information concerning the cumulative effect of a change in accounting principle for net periodic pension costs, see Note 3 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

## **Note 6. Merger**

On January 28, 2000, Dominion acquired all of the outstanding shares of the Company's common stock for \$6.4 billion, consisting of approximately 87 million shares of Dominion common stock valued at \$3.5 billion and approximately \$2.9 billion in cash. The acquisition was completed by merging the Company into a new subsidiary of Dominion. The name of the new Dominion subsidiary was changed to Consolidated Natural Gas Company at the time of the merger.

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## **CONSOLIDATED NATURAL GAS COMPANY**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Continued)**

## **Note 7. Restructuring and Other Merger-Related Activities**

Following the January 28, 2000 acquisition by Dominion, Dominion and its subsidiaries implemented a plan to restructure the operations of the combined companies. The restructuring plan included an involuntary severance program, a voluntary early retirement program (ERP) and a transition plan to implement operational changes to

provide efficiencies, including the consolidation of post-merger operations and the integration of information technology systems. At December 31, 2000, the Company's restructuring plan was substantially complete.

The Company recorded restructuring and other merger-related costs for the three and six months ended June 30, 2000, as follows:

	Three Months Ended	Six Months Ended
	<u>June 30, 2000</u>	
	(Millions)	
Commodity contract losses	\$ -	\$ 55
ERP	36	36
Settlement of certain employment contracts	2	33
Severance liability accrued	(16)	28
Seismic licensing agreements	-	26
Information technology related costs	8	13
Transaction fees	1	10
Other	<u>1</u>	<u>4</u>
Total	<u>\$ 32</u>	<u>\$205</u>

At June 30, 2001, there remains a severance liability of \$7 million that represents remaining amounts payable to employees already terminated and an accrual for estimated payments related to approximately 21 positions not yet eliminated. The change in the liability for severance and related benefit costs is presented below:

	(Millions)
Balance at December 31, 2000	\$13
Amounts paid	<u>(6)</u>

For additional information on restructuring and other merger-related activities, see Note 6 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

### **Note 8. Impairment of International Investments**

In connection with the Company's decision to end its involvement with international activities, the Company recognized a pre-tax loss of \$35 million (\$23 million after taxes) in the first quarter of 2000 to write down the carrying amount of CNG International's Australian investments to estimated fair value less cost to sell. In addition, the Company believes it is probable that, as part of a sale, it will be required to make a \$100 million equity contribution pursuant to an Equity Contribution Agreement with DBNGP Finance Company LLC. Accordingly, the Company recognized a \$100 million (\$65 million after taxes) charge in the first quarter of 2000.

On July 7, 2000, Sempra Energy International, a subsidiary of Sempra Energy, agreed to purchase CNG International's Argentine investments for \$145 million. Based upon anticipated proceeds from the sale, the carrying amount of these investments was adjusted, resulting in an impairment loss of \$17 million (\$11 million after taxes) in the second quarter of 2000.

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## **CONSOLIDATED NATURAL GAS COMPANY**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Total impairment loss related to CNG International for the six months ended June 30, 2000 was \$152 million (\$99 million after taxes).

For additional information on the write-downs, and on the Company's international investments, see Note 7 to the Consolidated Financial Statements in the

Company's Annual Report on Form 10-K for the year ended December 31, 2000.

### **Note 9. Estimated Rate Contingencies and Refunds**

Certain increases in prices by the Company and other ratemaking issues are subject to final modification in regulatory proceedings. The related accumulated provisions pertaining to these matters, including interest, were \$42 million and \$40 million at June 30, 2001 and December 31, 2000, respectively. These provisions are included in the Consolidated Balance Sheet under "Estimated rate contingencies and refunds" along with \$1 million for both periods as primarily refunds received from suppliers and refundable to customers under regulatory procedures.

### **Note 10. Long-Term Debt**

During the first quarter of 2001, the Company redeemed the \$84 million outstanding of its \$150 million, 8.75% Debentures due October 1, 2019.

On April 11, 2001, the Company issued \$500 million of 2001 Series A, 6.85% Senior Notes due 2011 (Senior Notes). The Company used the net proceeds from the sale of the Senior Notes for general corporate purposes, including repayment of commercial paper. At June 30, 2001, following the issuance of the Senior Notes, the Company had \$1 billion remaining under a shelf registration with the Securities and Exchange Commission.

### Note 11. Dividend Restrictions

At December 31, 2000, one of the Company's indentures relating to its long-term debt contained restrictions on dividend payments by the Company. As of that date, \$19 million of the Company's consolidated retained earnings was free from such restriction. In March 2001, the Company requested and obtained the consent of bondholders to amend the indenture to eliminate certain provisions of the indenture, including such dividend restrictions. On March 19, 2001, the Company received an order from the Securities and Exchange Commission, under the 1935 Act, approving the amendment of the indenture.

### Note 12. Commitments and Contingencies

There have been no significant developments with regard to commitments and contingencies, including environmental matters, as disclosed in Note 19 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2000, nor have any significant new matters arisen during the six months ended June 30, 2001.

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## CONSOLIDATED NATURAL GAS COMPANY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

### Note 13. Operating Segments

The Company is organized primarily on the basis of products and services sold in the United States. For a detailed description of the Company's operating segments, reference is made to Notes 1 and 22 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2000. In the first quarter of 2001, the Company changed its presentation for the Transmission segment to include the gas and oil production activities of Dominion Transmission, and the activities of Dominion Retail. Prior to 2001, the gas and oil production activities of Dominion Transmission were included in the Exploration and Production segment, and the activities of Dominion Retail were included in Other. As a result of these changes, segment information for the three and six months ended June 30, 2000 has been restated. Corporate and Other include the effects of charges for which the individual segments were not held accountable: 1) the cumulative effect of adopting SFAS No. 133 for the three and six months ended June 30, 2001; 2) the restructuring and other merger-related costs, the cumulative effect of the change in pension accounting and the impairment loss on CNG International's assets for the three and six months ended June 30, 2000; and 3) intersegment eliminations, where applicable.

	Exploration	Corporate			
	and	and	Consolidated		
(Millions)	<u>Distribution</u>	<u>Transmission</u>	<u>Production</u>	<u>Other</u>	<u>Total</u>

Three Months ended June 30, 2001

External customer revenue	\$ 250	\$282	\$203	\$ 10	\$ 745
Intersegment revenue	-	25	19	(44)	-
Net income	2	32	46	(7)	73

Three Months ended June 30, 2000

External customer revenue	\$ 264	\$228	\$224	\$ 5	\$ 721
Intersegment revenue	2	29	11	(42)	-
Net income	-	29	33	(42)	20

Six Months ended June 30, 2001

External customer revenue	\$1,190	\$873	\$405	\$ 12	\$2,480
Intersegment revenue	1	79	44	(124)	-
Net income	98	95	75	(30)	238

Six Months ended June 30, 2000

External customer revenue	\$ 992	\$467	\$426	\$ 5	\$1,890
Intersegment revenue	3	73	20	(96)	-
Net income	106	88	59	(224)	29

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**CONSOLIDATED NATURAL GAS COMPANY**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF**

**RESULTS OF OPERATIONS**

Cautionary Statements Regarding Forward-Looking Information

From time to time the Company makes statements concerning its expectations, plans, objectives, future financial performance and other statements that are not historic facts. These statements are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. In some cases, the reader can identify these forward-looking statements by words such as "anticipate", "estimate", "expect", "believe", "could", "plan", "may" or other words with similar meaning.

Forward-looking statements are issued by the Company with full knowledge that risks and uncertainties exist that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ are often presented with forward-looking statements. In addition, other factors could cause actual results to differ materially from those indicated in any forward-looking statement. These include:

- Factors affecting operations, such as:
  1. unusual weather conditions;
  2. catastrophic weather-related damage;
  3. unusual maintenance or repairs;
  4. unanticipated changes in gas supply costs or availability constraints;
  5. environmental incidents; and
  6. gas pipeline system costs or availability constraints.
- State, federal and international legislative and regulatory developments, including deregulation and restructuring of the gas industry and changes in environmental and other relevant laws and regulations to which the Company is subject;
- The effects of competition, including the extent and timing of the entry of additional competitors in the gas market;
- The pursuit of potential business strategies, including acquisitions or dispositions of assets;
- Regulatory factors such as changes in the policies or procedures that set rates, changes in the ability to recover investments made under traditional regulation through rates, and changes to the frequency and timing of rate increases;
- Financial or regulatory accounting principles or policies imposed by governing bodies;
- Political and economic conditions and developments in jurisdictions where the Company operates. This would include inflation rates and monetary fluctuations;
- Changing market conditions and other factors related to physical and financial energy business activities, including price, basis, credit, liquidity, volatility, capacity, transmission, currency exchange rates, interest rates and warranty risks;
- Financial market conditions, including availability and cost of capital, and the ability to obtain financing on favorable terms;
- The performance of projects and the success of efforts to invest in and develop new opportunities;
- Employee workforce factors, including collective bargaining agreements with union employees.

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## CONSOLIDATED NATURAL GAS COMPANY

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS (Continued)

The Company has based its forward-looking statements on management's beliefs and assumptions using information available at the time the statements were made. The Company cautions the reader not to place undue reliance on its forward-looking statements because the assumptions,

beliefs, expectations and projections about future events may and often do materially differ from actual results. The Company undertakes no obligation to update any forward-looking statements to reflect developments occurring after the statement is made.

## Results of Operations

A major portion of the gas sold or transported by the Company's Distribution and Transmission operations is ultimately used for space heating. As a result, earnings are affected by seasonality and changes in the weather. Because most of the Company's operating subsidiaries are subject to price regulation by federal or state commissions, earnings can be affected by regulatory delays when price increases are sought through general rate filings to recover certain higher costs of operation.

### Operating Segment Results

This section provides a general discussion of contributions to net income by the Distribution, Transmission and Exploration and Production segments, and certain expenses not allocated to those segments are included in Corporate and Other.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
	(Millions)			
Distribution	\$ 2	\$ -	\$ 98	\$106
Transmission	32	29	95	88
Exploration and Production	46	33	75	59
Corporate and other	<u>(7)</u>	<u>(42)</u>	<u>(30)</u>	<u>(224)</u>
Total net income	<u>\$73</u>	<u>\$ 20</u>	<u>\$238</u>	<u>\$ 29</u>

## **Distribution Segment**

The Company's Distribution segment contributed \$2 million to net income in the second quarter of 2001. In the comparable quarter of 2000, the Distribution segment was at a break even level. The operating results for the second quarter for 2001 and 2000 reflect the seasonal nature of space heating business of the Distribution segment. The Distribution segment contributed \$98 million to net income for the six months ended June 30, 2001, compared to \$106 million for the comparable period in 2000. The quarter and year-to-date comparisons are affected by the absence of Virginia Natural Gas (VNG) from the 2001 results. The Company sold VNG in October 2000 pursuant to conditions set forth by the Virginia State Corporation Commission and the Federal Trade Commission in connection with their approval of the acquisition of the Company by Dominion. Excluding the contribution from VNG, the Company's remaining three gas distribution subsidiaries contributed \$2 million to net income in the second quarter of 2000, and \$94 million in the first six months of 2000. The increase in net income during the second quarter of 2001 was attributable to the reductions in purchased gas and other taxes, partially offset by increases in operations and maintenance (O&M), and depreciation expenses. The increase in O&M expense was due principally to a \$16 million provision in uncollectible customer accounts expense for the second quarter of 2001 (\$27 million for the six months ended June 30, 2001). The higher uncollectible customer accounts are primarily the result of the extremely high level of natural gas costs and colder weather experienced during the past winter. The increase in net income in the six months ended June 30, 2001 was due to colder weather in the first quarter, offset partially by higher operating costs, principally in purchased gas.

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## **CONSOLIDATED NATURAL GAS COMPANY**

### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS (Continued)**

Total Distribution throughput was 53 billion cubic feet (Bcf) and 215 Bcf in the three and six months ended June 30, 2001, respectively, down 20 Bcf and 34 Bcf from the comparable periods in the prior year. However, both the quarter and year-to-date comparisons are affected by the absence of Virginia Natural Gas from the 2001 results. Excluding VNG, total throughput was down 14 Bcf in both the second quarter and first six months of 2001. The decreased throughput volumes reflect lower industrial deliveries and warmer weather experienced in the second quarter of 2001 as compared with 2000. The decrease in industrial deliveries were the result of a lower level of industrial activity due to high gas prices, and the bankruptcy reorganization by a major steel producing customer. Residential and commercial gas sales, as well as volumes transported, by the three distribution subsidiaries have declined in 2001. The volumes transported for these customers declined due to milder weather in the second quarter while the decrease in gas sales reflects the switch from sales to transport service for customers participating in the Ohio Energy Choice program. In the fall of 2000, the Energy Choice program was expanded to all 1.2 million customers in the Company's Ohio service territory.

## **Transmission Segment**

The Company's Transmission segment contributed \$32 million and \$95 million to net income for the three and six months ended June 30, 2001, respectively, as compared to \$29 million and \$88 million in the comparable periods of 2000. The results in 2001 benefited from both higher nonregulated gas sales and natural gas by-product revenue. The increased nonregulated gas sales revenue reflects the transfer of certain gas marketing operations from another



Dominion subsidiary in May of 2000, as well as higher gas prices and continued growth in the segment's nonregulated marketing businesses. Natural gas by-product revenue was higher, reflecting increased volumes for all products and higher prices for both propane and butane. Transmission throughput decreased by 18 Bcf and 41 Bcf for the three and six months ended June 30, 2001, respectively, as compared to the comparable periods in 2000.

## **Exploration and Production Segment**

The Company's Exploration and Production segment contributed \$46 million and \$75 million to net income for the three and six months ended June 30, 2001, respectively, as compared to \$33 million and \$59 million in the comparable periods last year. The increase resulted primarily from higher oil and gas prices, offset in part by lower production volumes. The lower production volumes in the second quarter of 2001 also resulted in decreased depreciation and amortization expense in both 2001 periods. Revenues from the Company's brokered oil program were lower in both 2001 periods, as compared to 2000, as the result of lower volumes. However, the lower brokered oil revenues were offset by a decrease in purchased liquids expense.

The Company's average gas wellhead price increased \$.75 to \$3.71 per thousand cubic feet (Mcf) in the second quarter of 2001 and \$.75 to \$3.51 per Mcf for the six months ended June 30, 2001 over the comparable periods in 2000. Gas production was down from the comparable periods in 2000 due primarily to natural production declines at older properties and a scheduled production outage at the Popeye field in the Gulf of Mexico. The Company's average oil price was \$22.95 and \$23.42 per barrel for the three and six months ended June 30, 2001, respectively, compared to \$19.21 and \$16.92 per barrel in the prior year periods. Oil production was down as compared to 2000 levels. The lower oil production volumes reflected natural production declines at the Neptune deepwater field and other older properties, and the sale of the Company's Canadian oil producing properties to another subsidiary of Dominion effective January 1, 2001.

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## **CONSOLIDATED NATURAL GAS COMPANY**

### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS (Continued)**

#### **Corporate and Other**

The activities of Dominion Products and Services, CNG International and other minor subsidiaries are included in the Corporate and Other segment. Corporate and Other also include certain expenses not allocated to the individual operating segments: 1) the cumulative effect of adopting Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133) for the three and six months ended June 30, 2001; 2) the restructuring and other merger-related costs, the cumulative effect of the change in pension accounting and the impairment loss on CNG International's assets for the three and six months ended June 30, 2000; and 3) intersegment eliminations, where applicable.

#### **Future Issues Other Other Information**

The following discussion of future issues and other information includes current developments of previously disclosed matters and new issues arising during the period covered by and subsequent to these financial statements. It is recommended that this section be read in connection with MD&A included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

## **Derivatives and Hedge Accounting**

Future interpretations of SFAS No. 133 by the Financial Accounting Standards Board or other standard-setting bodies could result in fair value accounting being required for certain contracts that are not currently subject to such requirements. If conclusions concerning the applicability of SFAS No. 133 to the Company's existing contracts are adversely affected by any future interpretations of the standard, certain of the existing contracts may become subject to fair value accounting. In that event, if the Company cannot document cash flow or fair value hedging strategies which would utilize such contracts as hedging instruments, the application of fair value accounting to any contract could result in volatility in reported earnings. Such volatility would result from unrealized gains or losses attributable to changes in the contracts' fair value during a particular reporting period. These unrealized gains and losses may not be indicative of actual cash transactions or profitability that would ultimately be realized over the life of a contract. Thus, the Company believes any increased volatility in earnings attributable to fair value accounting in these circumstances would be of a non-cash nature and would not be accompanied by corresponding volatility in cash flows or a change in liquidity.

## **Proposed FERC Rate Settlement - Gas Transmission**

On June 22, 2001, Dominion Transmission (DTI) and its customers filed a broadly-supported settlement with the Federal Energy Regulatory Commission (FERC), regarding DTI's September 2000 transportation cost rate adjustment. The filed settlement would resolve disputes over DTI's proposal to recover \$65 million in system gas requirement costs from its customers, including the costs of gas used as fuel in operating the system, and normal gas losses from pipeline facilities and underground storage formations. DTI has traditionally tracked these costs, billing customers for any under-collections of retained fuel, and refunding any over-collections. In addition, if the settlement is approved as filed, DTI will retain certain fixed percentages of gas receipts and will assume both the risk of under-collections and the reward of any excess gas retained. The settlement would also resolve all remaining transportation and storage customer responsibility for fuel and shrinkage costs for DTI's Hastings gas processing facility. Under the filed settlement, no party can seek a change to the fuel retention mechanism, or the fuel retention percentages, for effectiveness prior to July 1, 2003. DTI will also extend an existing moratorium, so that it cannot make a general rate filing effective prior to July 1, 2003. DTI does not anticipate the FERC ruling on the filed settlement prior to September 2001. The Company does not expect any material impact on its results of operations, financial position or cash flows from implementation of the settlement. However, under the settlement mechanism, management of system gas requirements in the future will have a direct effect on the Company's earnings.

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# **CONSOLIDATED NATURAL GAS COMPANY**

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS**

**(Continued)**

## **Recently Issued Accounting Standards**

### *Business Combination and Goodwill*

In July 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards (SFAS) Nos. 141, *Business Combinations*, and 142, *Goodwill and Other Intangible Assets*. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting, thus eliminating the use of the "pooling" method of accounting. For any business combination, which will be accounted for using the purchase method, initiated before July 1, 2001 and completed before January 2002, the provisions of SFAS No. 141 will also apply. Under SFAS No. 142, goodwill is no longer subject to amortization; instead it will be subject to new impairment testing criteria. Other intangible assets will continue to be amortized over their estimated useful lives, although those with indefinite lives are not to be amortized but will be tested at least annually for impairment. The new standards also provide new guidance regarding the identification and recognition of intangible assets, other than goodwill, acquired as part of a business combination. The Company will adopt this standard effective January 1, 2002. At June 30, 2001, the Company had no material amounts of goodwill or intangible assets obtained in business combinations on its books.

### *Asset Retirement Obligations*

In July 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligation*, which provides accounting requirements for the recognition and measurement of liabilities for obligations associated with the retirement of tangible long-lived assets. Under this standard, these liabilities will be recognized at fair value as incurred and capitalized as part of the cost of the related tangible long-lived assets. Accretion of the liabilities due to the passage of time will be expensed. Although FASB has not yet published the final standard, the Company's preliminary conclusions are based on previously issued exposure drafts and subsequent deliberations. The Company will adopt this standard effective January 1, 2003. Upon the adoption of this new standard, the Company will discontinue its practice of accruing, as part of depreciation expense, amounts associated with the future costs of removal for its gas utility and oil and gas exploration and production. However, the Company may continue its practice of accruing for future costs of removal subject to cost of service utility rate regulation even when an asset removal obligation does not exist but would do so through the recognition of regulatory assets and liabilities, as appropriate.

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## **CONSOLIDATED NATURAL GAS COMPANY**

### **PART II - OTHER INFORMATION**

#### **ITEM 1. LEGAL PROCEEDINGS**

From time to time, the Company and its subsidiaries are alleged to be in violation or in default under orders, statutes, rules or regulations relating to the environment, compliance plans imposed upon or agreed to by us, or permits issued by various local, state and federal agencies for the construction or operation of facilities. From time to time, there also may be administrative proceedings on these matters pending. In addition, in the normal course of business, the Company and its subsidiaries are involved in various legal proceedings. Management believes that the ultimate resolution of these proceedings will not have a material adverse effect on the Company's financial position, liquidity or results of operations. See Item 5 - Other Information for discussion on various regulatory proceedings to which we are a party.

As previously reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2000, Jack

Grynberg has brought suit against a major part of the gas industry, including Consolidated Natural Gas Company (CNG) and several of its subsidiaries. The suit alleges fraudulent mismeasurement of gas volumes and underreporting of gas royalties from gas production taken from federal leases. In April 2001, the U.S. District Court issued an order denying a motion to dismiss. CNG and other defendants in this matter have filed a motion to certify the case for appeal.

## ITEM 5. OTHER INFORMATION

The matters discussed in this Item may contain "forward looking statements" as described in the introductory paragraphs of Part I, Item 2 of this Form 10-Q. See Cautionary Statements Regarding Forward-Looking Information in Part I, Item 2, for discussion of various risks and uncertainties that may affect the future of CNG.

### Regulatory

In June 2001, Dominion East Ohio filed a gas cost recovery filing (GCR) with the Public Utilities Commission of Ohio. Under the GCR proposal, sales customers would pay 29% less for natural gas than they now do under a new rate that will be frozen through April 29, 2002. Dominion East Ohio expects to lock in current lower market prices with a combination of longer-term gas purchase contracts and other hedging techniques, to stabilize winter gas costs for its customers through the coming winter period. Dominion East Ohio does not earn a profit on the gas cost recovery, which represents the cost of securing natural gas supplies; therefore, the Company does not expect to experience any financial statement impact from the filed proposal.

Dominion Peoples lowered its rates about 8 percent, effective July 1, 2001. The change reflects a reduction in the natural gas cost recovery portion of its rates from \$9.99 to \$8.70 per thousand cubic feet. The decrease will not affect customers who buy gas from another supplier as part of Dominion Peoples' Energy Choice program. The lower rate is attributable to the price of natural gas dropping on the national market after record high prices over the past 18 months.

In June 2001, Dominion Transmission (DTI) and its customers filed a rate settlement with the Federal Energy Regulatory Commission (FERC). The filed settlement would resolve disputes over proposed gas cost recoveries from customers, including the costs of gas used as fuel in operating the system, and normal gas losses from pipeline facilities and underground storage formations. If the settlement is approved as filed, DTI will retain certain fixed percentages of gas receipts and will assume both the risk of under-collections and the reward of any excess gas retained. See Future Issues -Dominion Transmission in Management's Discussion & Analysis for additional information.

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## CONSOLIDATED NATURAL GAS COMPANY

### PART II - OTHER INFORMATION (Continued)

In May 2001, FERC also approved DTI's Order No. 637 settlement. The settlement enables DTI to offer several customer-driven enhancements to its services. FERC also revised its gas pipeline regulations under this order to improve the competitiveness and efficiency of the interstate pipeline grid. Order No. 637 requires all pipelines to comply with new policies on various key issues, procedures for customers to schedule gas deliveries, provisions for penalties if customers do not comply with service agreements, tools to correct imbalances that occur when customers take more or less gas than requested, and "segmentation," which gives shippers more flexibility to move gas using pipeline service entitlements.

## Labor Relations

Negotiators for the Natural Gas Workers Union, SEIU Local 555 (Local 555) and Dominion East Ohio reached a tentative agreement for a new five-year contract on July 16, 2001. The agreement has been subsequently approved by Local 555 membership.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits:

- 3.1 Certificate of Incorporation of Consolidated Natural Gas Company (Exhibit (3A)(i) to Form 10-K for the fiscal year ended December 31, 1999, File No. 1-3196, incorporated by reference).
  
- 3.2 Certificate of Amendment of Certificate of Incorporation, dated January 28, 2000 (Exhibit (3A)(ii) to Form 10-K for the fiscal year ended December 31, 1999, File No. 1-3196, incorporated by reference).
  
- 3.3 Bylaws as in effect on December 15, 2000 (Exhibit 3B to Form 10-K for the fiscal year ended December 31, 2000, File No. 1-3196, incorporated by reference).
  
- 10.1 Dominion Resources, Inc. Incentive Compensation Plan, effective April 22, 1997, as amended and restated effective July 1, 2001 (filed herewith).
  
- 10.2 Dominion Resources, Inc. Leadership Stock Option Plan, effective July 1, 2000, as amended and restated effective July 1, 2001 (filed herewith).

#### (b) Reports on Form 8-K:

There have been no Forms 8-K filed which were not previously reported.

**SIGNATURE**

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 thereunto duly authorized.

**CONSOLIDATED NATURAL GAS COMPANY**

Registrant

August 3, 2001

/s/ Steven A. Rogers

Steven A. Rogers  
Vice President and Controller  
(Principal Accounting Officer)

**DOMINION RESOURCES, INC.**

**INCENTIVE COMPENSATION PLAN**

**Restated effective July 20, 2001**

1. *Purpose.* The purpose of this Dominion Resources, Inc. Incentive Compensation Plan is to further the long term stability and financial success of Dominion Resources, Inc. and the Dominion Companies by attracting and retaining employees through the use of cash and stock incentives. It is believed that ownership of Company Stock and the use of cash incentives will stimulate the efforts of those employees upon whose judgment and interests the Employers are and will be largely dependent for the successful conduct of its business. It is also believed that Incentive Awards granted to such employees under this Plan will strengthen their desire to remain employed with the Employers and will further the identification of those employees' interests with those of the Dominion Resources, Inc. shareholders. The Plan is intended to operate in compliance with the provisions of Securities and Exchange Commission Rule 16b-3.

2. *Definitions.* As used in the Plan, the following terms have the meanings indicated:

(a) "*Act*" means the Securities Exchange Act of 1934, as amended.

(b) "*Applicable Withholding Taxes*" means the aggregate amount of federal, state and local income and payroll taxes that an Employer is required to withhold in connection with any Performance Grant, any lapse of restrictions on Restricted Stock, any grant of Goal-Based Stock, or any exercise of a Nonstatutory Stock Option or Stock Appreciation Right.

(c) "*Change of Control*" means the occurrence of any of the following events:

(i) any person, including a "group" as defined in Section 13(d)(3) of the Act becomes the owner or beneficial owner of DRI securities having 20% or more of the combined voting power of the then outstanding DRI securities that may be cast for the election of DRI's directors (other than as a result of an issuance of securities initiated by DRI, or open market purchases approved by the DRI Board, as long as the majority of the DRI Board approving the purchases is also the majority at the time the purchases are made);

(ii) as the direct or indirect result of, or in connection with, a cash tender or exchange offer, a merger or other business combination, a sale of assets, a contested election, or any combination of these transactions, the persons who were directors of DRI before such transactions cease to constitute a majority of the DRI Board, or any successor's board, within two years of the last of such transactions; or

(iii) with respect to a particular Participant, an event occurs with respect to the Employer that employs that Participant such that, after the event, the Employer is no longer a Dominion Company.

(d) "*Code*" means the Internal Revenue Code of 1986, as amended.

(e) "*Committee*" means, effective April 16, 1999, the Organization and Compensation Committee of the DRI Board, provided that, if any member of the Organization and Compensation Committee does not qualify as both an outside director for purposes of Code section 162(m) and a non-employee director for purposes of Rule 16b-3, the remaining members of the committee (but not less than two members) shall be constituted as a subcommittee of the Organization and Compensation Committee to act as the Committee for purposes of the Plan. Prior to April 16, 1999, the Organization and Compensation Committee of Virginia Electric and Power Company had certain functions under the Plan. Any actions taken by that Committee prior to April 16, 1999 shall be treated as if taken by the Committee.



(f) "*Company Stock*" means common stock of DRI. In the event of a change in the capital structure of DRI (as provided in Section 15), the shares resulting from such a change shall be deemed to be Company Stock within the meaning of the Plan.

(g) "*Date of Grant*" means the date on which the Committee grants an Incentive Award.

(h) "*Disability*" or "*Disabled*" means, as to an Incentive Stock Option, a Disability within the meaning of Code section 22(e)(3). As to all other Incentive Awards, the Committee shall determine whether a Disability exists and such determination shall be conclusive.

(i) "*Dominion Company*" means Virginia Electric and Power Company, Dominion Capital, Inc., Dominion Energy, Inc., or another corporation in which DRI owns stock possessing at least 50 percent of the combined voting power of all classes of stock or which is in a chain of corporations with DRI in which stock possessing at least 50% of the combined voting power of all classes of stock is owned by one or more other corporations in the chain.

(j) "*DRI*" means Dominion Resources, Inc.

(k) "*DRI Board*" means the Board of Directors of Dominion Resources, Inc.

(l) "*Employer*" means DRI and each Dominion Company that employs one or more Participants.

(m) "*Fair Market Value*" means the average of the high and low prices of a share of Company Stock, as reported by Bloomberg or other financial reporting service selected by the Company, as of the last day on which Company Stock is traded preceding the Date of Grant or preceding any other date for which the value of Company Stock must be determined under the Plan.

(n) "*Goal-Based Stock*" means Company Stock awarded when performance goals are achieved pursuant to an award as provided in Section 8.

(o) "*Incentive Award*" means, collectively, a Performance Grant or the award of Restricted Stock, Goal-Based Stock, an Option, or a Stock Appreciation Right under the Plan.

(p) "*Incentive Stock Option*" means an Option intended to meet the requirements of, and qualify for favorable federal income tax treatment under, Code section 422.

(q) "*Mature Shares*" means shares of Company Stock for which the holder thereof has good title, free and clear of all liens and encumbrances and which such holder either (i) has held for at least six months or (ii) has purchased on the open market.

(r) "*Nonstatutory Stock Option*" means an Option that does not meet the requirements of Code section 422, or, even if meeting the requirements of Code section 422, is not intended to be an Incentive Stock Option and is so designated.

(s) "*Option*" means a right to purchase Company Stock granted under the Plan, at a price determined in accordance with the Plan.

(t) "*Participant*" means any employee of DRI or a Dominion Company who receives an Incentive Award under the Plan.

(u) "*Performance Criteria*" means any of the following areas of performance of DRI or any Dominion Company: asset growth; utility earnings; generating unit efficiency; combined net worth; debt to equity ratio; earnings per share; revenues; operating income; operating cash flow; net income, before or after taxes; return on total capital, equity, revenue or assets; nonutility generation cost exposure; power generation costs; safety measured in fatalities, lost time,



injuries and vehicle accidents; environmental protection measured in reportable violations, notices of violations, and environmental agency required corrective actions or enforcement actions; or economic value added (net operating profit after tax less a charge for use of capital as determined under a methodology approved by the Committee).

(v) "*Performance Goal*" means an objectively determinable performance goal established by the Committee with respect to a given Performance Grant or grant of Restricted Stock that relates to one or more Performance Criteria.

(w) "*Performance Grant*" means an Incentive Award made pursuant to Section 6.

(x) "*Plan Year*" means January 1 to December 31.

(y) "*Restricted Stock*" means Company Stock awarded upon the terms and subject to the restrictions set forth in Section 7.

(z) "*Rule 16b-3*" means Rule 16b-3 of the Securities and Exchange Commission promulgated under the Act. A reference in the Plan to Rule 16b-3 shall include a reference to any corresponding rule (or number redesignation) of any amendments to Rule 16b-3 enacted after the effective date of the Plan's adoption.

(aa) "*Stock Appreciation Right*" means a right to receive amounts from the Employer granted under Section 10.

(bb) "*Taxable Year*" means the fiscal period used by DRI for reporting taxes on income under the Code.

3. *General.* The following types of Incentive Awards may be granted under the Plan: Performance Grants, Restricted Stock, Goal-Based Stock, Options, or Stock Appreciation Rights. Options granted under the Plan may be Incentive Stock Options or Nonstatutory Stock Options.

4. *Stock.* Subject to Section 15 of the Plan, there shall be reserved for issuance under the Plan an aggregate of thirty million (30,000,000) shares of Company Stock, which shall be authorized but unissued shares. Shares allocable to Options, Restricted Stock or portions thereof granted under the Plan that expire, are forfeited, or otherwise terminate unexercised may again be subjected to an Incentive Award under the Plan. The Committee is expressly authorized to make an Incentive Award to a Participant conditioned upon the surrender for cancellation of an option granted under an existing Incentive Award. However, without prior shareholder approval, the Committees are expressly prohibited from making a new Incentive Award in the form of an Option if the exercise price of the new Option is less than the exercise price of the Option under the existing Incentive Award surrendered for cancellation. No more than one million five hundred thousand (1,500,000) shares may be allocated to the Incentive Awards, including the maximum amounts payable under a Performance Grant, that are granted to any individual Participant during any single Taxable Year. No more than five million (5,000,000) shares may be issued as Restricted Stock, Goal-Based Stock or Performance Grants after April 28, 2000, provided that any shares of Restricted Stock, Goal-Based Stock or that are issuable under Performance Grants that are forfeited shall not count against this limit.

5. *Eligibility.*

(a) All present and future employees of DRI or a Dominion Company (whether now existing or hereafter created or acquired) whom the Committee determines to have contributed or who can be expected to contribute significantly to DRI or a Dominion Company shall be eligible to receive Incentive Awards under the Plan. The Committee shall have the power and complete discretion, as provided in Section 16, to select eligible employees to receive Incentive Awards and to determine for each employee the nature of the award and the terms and conditions of each Incentive Award.

(b) The grant of an Incentive Award shall not obligate an Employer to pay an employee any particular amount of remuneration, to continue the employment of the employee after the grant or to make further grants to the employee at any time thereafter.

## 6. Performance Grants.

- (a) Each Performance Grant shall be evidenced by an agreement (a "Grant Agreement") setting forth the Performance Goals for the award, including the Performance Criteria, the target and maximum amounts payable and such other terms and conditions as are applicable to the Performance Grant. Each Performance Grant shall be granted and administered to comply with the requirements of Code section 162(m). The aggregate maximum cash amount payable under the Plan to any Participant in any Plan Year shall not exceed 0.5% of DRI's consolidated operating income, before taxes and interest, as reported on its annual financial statements for the prior Plan Year. In the event of any conflict between a Grant Agreement and the Plan, the terms of the Plan shall govern.
- (b) The Committee shall establish the Performance Goals for Performance Grants. The Committee shall determine the extent to which any Performance Criteria shall be used and weighted in determining Performance Grants. The Committee may vary the Performance Criteria, Performance Goals and weightings from Participant to Participant, Performance Grant to Performance Grant and Plan Year to Plan Year. The Committee may increase, but not decrease, any Performance Goal during a Plan Year.
- (c) The Committee shall establish for each Performance Grant the amount of cash or Company Stock payable at specified levels of performance, based on the Performance Goal for each Performance Criteria. Any Performance Grant shall be made not later than 90 days after the start of the period for which the Performance Grant relates and shall be made prior to the completion of 25% of such period. All determinations regarding the achievement of any Performance Goals will be made by the Committee. The Committee may not increase during a Plan Year the amount of cash or Common Stock that would otherwise be payable upon achievement of the Performance Goal or Goals but may reduce or eliminate the payments as provided in a Performance Grant.
- (d) The actual payments to a Participant under a Performance Grant will be calculated by applying the achievement of a Performance Criteria to the Performance Goal as established in the Grant Agreement. All calculations of actual payments shall be made by the Committee and the Committee shall certify in writing the extent, if any, to which the Performance Goals have been met.
- (e) Performance Grants will be paid in cash, Company Stock or both, at such time or times as are provided in the Grant Agreement. The Committee may provide in the Grant Agreement that the Participant may make a prior election to defer the payment under a Performance Grant subject to such terms and conditions as the Committee may determine.
- (f) Nothing contained in the Plan will be deemed in any way to limit or restrict any Employer or the Committee from making any award or payment to any person under any other plan, arrangement or understanding, whether now existing or hereafter in effect.
- (g) A Participant who receives a Performance Grant payable in Company Stock shall have no rights as a shareholder until the Company Stock is issued pursuant to the terms of the Performance Grant. The Company Stock may be issued without cash consideration.
- (h) A Participant's interest in a Performance Grant may not be sold, assigned, transferred, pledged, hypothecated, or otherwise encumbered.
- (i) Whenever payments under a Performance Grant are to be made in cash, the Employer will withhold therefrom an amount sufficient to satisfy any Applicable Withholding Taxes. Each Participant shall agree as a condition of receiving a Performance Grant payable in the form of Company Stock, to pay to the Employer, or make arrangements satisfactory to the Employer regarding the payment to the Employer of, Applicable Withholding Taxes. Until such amount has been paid or arrangements satisfactory to the Employer have been made, no stock certificate shall be issued to such Participant. As an alternative to making a cash payment to the Employer to satisfy Applicable Withholding Taxes, if the Grant Agreement so provides, the Participant may elect to (i) deliver Mature Shares (valued at their Fair Market

Value) or (ii) to have the Employer retain that number of shares of Company Stock (valued at their Fair Market Value) that would satisfy all or a specified portion of the Applicable Withholding Taxes.

#### *7. Restricted Stock Awards.*

(a) The Committee may make grants of Restricted Stock to Participants. Whenever the Committee deems it appropriate to grant Restricted Stock, notice shall be given to the Participant stating the number of shares of Restricted Stock granted and the terms and conditions to which the Restricted Stock is subject. This notice, when accepted in writing by the Participant shall become an Grant Agreement between the Employer and the Participant. Restricted Stock may be awarded by the Committee in its discretion without cash consideration.

(b) No shares of Restricted Stock may be sold, assigned, transferred, pledged, hypothecated, or otherwise encumbered or disposed of until the restrictions on such shares as set forth in the Participant's Grant Agreement have lapsed or been removed pursuant to paragraph (d) or (e) below.

(c) Upon the acceptance by a Participant of an award of Restricted Stock, such Participant shall, subject to the restrictions set forth in paragraph (b) above, have all the rights of a shareholder with respect to such shares of Restricted Stock, including, but not limited to, the right to vote such shares of Restricted Stock and the right to receive all dividends and other distributions paid thereon. Certificates representing Restricted Stock shall be held by DRI until the restrictions lapse and the Participant shall provide DRI with appropriate stock powers endorsed in blank.

(d) The Committee shall establish as to each award of Restricted Stock the terms and conditions upon which the restrictions set forth in paragraph (b) above shall lapse. The terms and conditions may include the achievement of a Performance Goal which shall be governed by the provisions of Section 6 to the extent that the award is intended to comply with the requirements of Code section 162(m). Such terms and conditions may also include, without limitation, the lapsing of such restrictions as a result of the Disability, death or retirement of the Participant or the occurrence of a Change of Control.

(e) Notwithstanding the provisions of paragraph (b) above, the Committee may at any time, in its sole discretion, accelerate the time at which any or all restrictions will lapse or remove any and all such restrictions, subject to the restrictions of Section 6 as to any Performance Goal if the award is intended to comply with the requirements of Code section 162(m).

(f) Each Participant shall agree at the time his or her Restricted Stock is granted, and as a condition thereof, to pay to the Employer, or make arrangements satisfactory to the Employer regarding the payment to the Employer of, Applicable Withholding Taxes. Until such amount has been paid or arrangements satisfactory to the Employer have been made, no stock certificate free of a legend reflecting the restrictions set forth in paragraph (b) above shall be issued to such Participant. As an alternative to making a cash payment to the Employer to satisfy Applicable Withholding Taxes, if the grant so provides, the Participant may elect to (i) to deliver Mature Shares (valued at their Fair Market Value) or (ii) to have the Employer retain that number of shares of Company Stock (valued at their Fair Market Value) that would satisfy all or a specified portion of the Applicable Withholding Taxes.

#### *8. Goal-Based Stock Awards.*

(a) The Committee may make grants of Goal-Based Stock to Participants. Whenever the Committee deems it appropriate to grant Goal-Based Stock, notice shall be given to the Participant stating the number of shares of Goal-Based Stock granted and the terms and conditions to which the Goal-Based Stock is subject. This notice, when accepted in writing by the Participant shall become a grant agreement between the Employer and the Participant.

(b) Goal-Based Stock may be issued pursuant to the Plan from time to time by the Committee when performance criteria established by the Committee have been achieved and certified by the Committee.

(c) Whenever the Committee deems it appropriate, the Committee may establish a performance criteria for an award of Goal-Based Stock and notify Participants of their receipt of an award of Goal-Based Stock. More than one award of Goal-Based Stock may be established by the Committee for a Participant and the awards may operate concurrently or for varied periods of time. Goal-Based Stock will be issued only subject to the award and the Plan and consistent with meeting the goal or goals set by the Committee in the award. A Participant shall have no rights as a shareholder until the Committee has certified that the performance objectives of the Goal-Based Stock award have been met and the Goal-Based Stock is issued. Goal-Based Stock may be issued without cash consideration.

(d) A Participant's interest in a Goal-Based Stock award may not be sold, assigned, transferred, pledged, hypothecated, or otherwise encumbered.

(e) The Committee may at any time, in its sole discretion, remove or revise any and all performance criteria for an award of Goal-Based Stock.

(f) Each Participant shall agree at the time of receiving an award of Goal-Based Stock, and as a condition thereof, to pay to the Employer, or make arrangements satisfactory to the Employer regarding the payment to the Employer of, Applicable Withholding Taxes. Until such amount has been paid or arrangements satisfactory to the Employer have been made, no stock certificate shall be issued to such Participant. As an alternative to making a cash payment to the Employer to satisfy Applicable Withholding Taxes, if the grant so provides, the Participant may elect to (i) to deliver Mature Shares (valued at their Fair Market Value) or (ii) to have the Employer retain that number of shares of Company Stock (valued at their Fair Market Value) that would satisfy all or a specified portion of the Applicable Withholding Taxes.

#### *9. Stock Options.*

(a) The Committee may make grants of Options to Participants. Whenever the Committee deems it appropriate to grant Options, notice shall be given to the Participant stating the number of shares for which Options are granted, the Option price per share, whether the Options are Incentive Stock Options or Nonstatutory Stock Options, the extent to which Stock Appreciation Rights are granted (as provided in Section 10), and the conditions to which the grant and exercise of the Options are subject. This notice, when duly accepted in writing by the Participant, shall become a stock option agreement.

(b) The exercise price of shares of Company Stock covered by an Option shall be not less than 100% of the Fair Market Value of such shares on the Date of Grant.

(c) Options may be exercised in whole or in part at such times as may be specified by the Committee in the Participant's stock option agreement; provided that no Option may be exercised after the expiration of ten (10) years from the Date of Grant and provided that the exercise provisions for Incentive Stock Options shall in all events not be more liberal than the following provisions:

(i) No Incentive Stock Option may be exercised after the first to occur of (x) ten years from the Date of Grant, (y) three months following the date of the Participant's retirement or termination of employment with all Employers for reasons other than Disability or death, or (z) one year following the date of the Participant's termination of employment on account of Disability or death.

(ii) An Incentive Stock Option by its terms, shall be exercisable in any calendar year only to the extent that the aggregate Fair Market Value (determined at the Date of Grant) of the Company Stock with respect to which Incentive Stock Options are exercisable for the first time during the calendar year does not exceed \$100,000 (the "Limitation Amount"). Incentive Stock Options granted under the Plan and all other plans of any Employer shall be aggregated for purposes of determining whether the Limitation Amount has been exceeded. The Committee granting the Option may impose such conditions as it deems appropriate on an Incentive Stock Option to ensure that the foregoing requirement is met.

If Incentive Stock Options that first become exercisable in a calendar year exceed the Limitation Amount, the excess Options will be treated as Nonstatutory Stock Options to the extent permitted by law.

(d) Notwithstanding anything in the Plan to the contrary, the Committee may permit a Participant who has received a Nonstatutory Stock Option to make an irrevocable election to defer any and all shares of Company Stock received through exercise of the Nonstatutory Stock Option pursuant to the Dominion Resources, Inc. Deferred Compensation Plan (the "Deferred Compensation Plan"). The deferral election must: (i) be made at least six months prior to the exercise of the Nonstatutory Stock Option, (ii) be made on a form provided by the Committee, and (iii) indicate the number of shares of Company Stock the Participant wishes to defer. Payment of the exercise price of deferred Company Stock must be made by delivery of Mature Shares. Upon such election the subsequent exercise of a Nonstatutory Stock Option, the Company may deliver the shares of Company Stock covered by the exercised Nonstatutory Stock Option to the trust established pursuant to the Deferred Compensation Plan or may deliver the shares at the time of payment provided under the Deferred Compensation Plan. The time and form of payment of the deferred Company Stock to a Participant shall be governed by the Deferred Compensation Plan.

#### 10. *Stock Appreciation Rights.*

(a) Whenever the Committee deems it appropriate, Stock Appreciation Rights may be granted in connection with all or any part of an Option to a Participant or in a separate Incentive Award.

(b) The following provisions apply to all Stock Appreciation Rights that are granted in connection with Options:

(i) Stock Appreciation Rights shall entitle the Participant, upon exercise of all or any part of the Stock Appreciation Rights, to surrender to the Employer unexercised that portion of the underlying Option relating to the same number of shares of Company Stock as is covered by the Stock Appreciation Rights (or the portion of the Stock Appreciation Rights so exercised) and to receive in exchange from the Employer an amount equal to the excess of (x) the Fair Market Value on the date of exercise of the Company Stock covered by the surrendered portion of the underlying Option over (y) the exercise price of the Company Stock covered by the surrendered portion of the underlying Option. The Committee may limit the amount that the Participant will be entitled to receive upon exercise of Stock Appreciation Rights.

(ii) Upon the exercise of a Stock Appreciation Right and surrender of the related portion of the underlying Option, the Option, to the extent surrendered, shall not thereafter be exercisable.

(iii) Subject to any further conditions upon exercise imposed by the Board, a Stock Appreciation Right shall be exercisable only to the extent that the related Option is exercisable and a Stock Appreciation Right shall expire no later than the date on which the related Option expires.

(iv) A Stock Appreciation Right may only be exercised at a time when the Fair Market Value of the Company Stock covered by the Stock Appreciation Right exceeds the exercise price of the Company Stock covered by the underlying Option.

(c) The following provisions apply to all Stock Appreciation Rights that are not granted in connection with Options:

(i) Stock Appreciation Rights shall entitle the Participant, upon exercise of all or any part of the Stock Appreciation Rights, to receive in exchange from the Employer an amount equal to the excess of (x) the Fair Market Value on the date of exercise of the Company Stock covered by the surrendered Stock Appreciation Right over (y) the price of the Company Stock on the Date of Grant of the Stock Appreciation Right. The Committee may limit the amount that the Participant will be entitled to receive upon exercise of Stock Appreciation Rights.



(ii) A Stock Appreciation Right may only be exercised at a time when the Fair Market Value of the Company Stock covered by the Stock Appreciation Right exceeds the Fair Market Value of the Company Stock on the Date of Grant of the Stock Appreciation Right.

(d) The manner in which the Employer's obligation arising upon the exercise of a Stock Appreciation Right shall be paid shall be determined by the Committee and shall be set forth in the Incentive Award. The Incentive Award may provide for payment in Company Stock or cash, or a fixed combination of Company Stock or cash, or the Committee may reserve the right to determine the manner of payment at the time the Stock Appreciation Right is exercised. Shares of Company Stock issued upon the exercise of a Stock Appreciation Right shall be valued at their Fair Market Value on the date of exercise.

#### *11. Method of Exercise of Options and Stock Appreciation Rights.*

(a) Options and Stock Appreciation Rights may be exercised by the Participant giving written notice of the exercise to the Employer, stating the number of shares the Participant has elected to purchase under the Option or the number of Stock Appreciation Rights the Participant has elected to exercise. In the case of the purchase of shares under an Option, such notice shall be effective only if accompanied by the exercise price in full in cash; provided, however, that if the terms of an Option so permit, the Participant may (i) deliver Mature Shares (valued at their Fair Market Value) in satisfaction of all or any part of the exercise price, (ii) cause to be withheld from the Option shares, shares of Company Stock (valued at their Fair Market Value) in satisfaction of all or any part of the exercise price, or (iii) deliver a properly executed exercise notice together with irrevocable instructions to a broker to deliver promptly to the Employer, from the sale or loan proceeds with respect to the sale of Company Stock or a loan secured by Company Stock, the amount necessary to pay the exercise price and, if required by the terms of the Option, Applicable Withholding Taxes.

(b) DRI may place on any certificate representing Company Stock issued upon the exercise of an Option or a Stock Appreciation Right any legend deemed desirable by the DRI's counsel to comply with federal or state securities laws, and DRI may require a customary written indication of the Participant's investment intent. Until the Participant has made any required payment, including any Applicable Withholding Taxes, and has had issued a certificate for the shares of Company Stock acquired, he or she shall possess no shareholder rights with respect to the shares.

(c) Each Participant shall agree as a condition of the exercise of an Option or a Stock Appreciation Right, to pay to the Employer, or make arrangements satisfactory to the Employer regarding the payment to the Employer of, Applicable Withholding Taxes. Until such amount has been paid or arrangements satisfactory to the Employer have been made, no stock certificate shall be issued upon the exercise of an Option or cash paid upon the exercise of a Stock Appreciation Right.

(d) As an alternative to making a cash payment to the Employer to satisfy Applicable Withholding Taxes, if the Option or Stock Appreciation Rights agreement so provides, the Participant may elect to (i) to deliver Mature Shares (valued at their Fair Market Value) or (ii) to have the Employer retain that number of shares of Company Stock (valued at their Fair Market Value) that would satisfy all or a specified portion of the Applicable Withholding Taxes.

*12. Transferability of Options and Stock Appreciation Rights.* Nonstatutory Stock Options and Stock Appreciation Rights may be transferable by a Participant and exercisable by a person other than the Participant, but only to the extent specifically provided in the Incentive Award. Incentive Stock Options, by their terms, shall not be transferable except by will or by the laws of descent and distribution and shall be exercisable, during the Participant's lifetime, only by the Participant.

*13. Effective Date of the Plan.* The effective date of the Plan is January 1, 1997. The Plan shall be submitted to the shareholders of the DRI for approval. Until (i) the Plan has been approved by DRI's shareholders, and (ii) the requirements of any applicable Federal or State securities laws have been met, no Restricted Stock or Goal-Based Stock shall be awarded that is not contingent on these events and no Option or Stock Appreciation Right granted shall be exercisable.

14. *Termination, Modification, Change.* If not sooner terminated by the DRI Board, this Plan shall terminate at the close of business on December 31, 2006. No Incentive Awards shall be made under the Plan after its termination. The DRI Board may amend or terminate the Plan in such respects as it shall deem advisable; provided that, if and to the extent required by the Code, no change shall be made that increases the total number of shares of Company Stock reserved for issuance pursuant to Incentive Awards granted under the Plan (except pursuant to Section 15), materially modifies the requirements as to eligibility for participation in the Plan, or materially increases the benefits accruing to Participants under the Plan, unless such change is authorized by the shareholders of DRI. Notwithstanding the foregoing, the DRI Board may unilaterally amend the Plan and Incentive Awards with respect to Participants as it deems appropriate to ensure compliance with Rule 16b-3 and to cause Incentive Stock Options to meet the requirements of the Code and regulations thereunder. Except as provided in the preceding sentence, a termination or amendment of the Plan shall not, without the consent of the Participant, adversely affect a Participant's rights under an Incentive Award previously granted to him or her.

15. *Change in Capital Structure.*

(a) In the event of a stock dividend, stock split or combination of shares, recapitalization or merger in which DRI is the surviving corporation or other change in DRI's capital stock (including, but not limited to, the creation or issuance to shareholders generally of rights, options or warrants for the purchase of common stock or preferred stock of DRI), the number and kind of shares of stock or securities of DRI to be subject to the Plan and to Options then outstanding or to be granted thereunder, the maximum number of shares or securities which may be delivered under the Plan, the maximum number of shares or securities that can be granted to an individual Participant under Section 4, the exercise price, the terms of Incentive Awards and other relevant provisions shall be appropriately adjusted by the Committee, whose determination shall be binding on all persons. If the adjustment would produce fractional shares with respect to any unexercised Option, the Committee may adjust appropriately the number of shares covered by the Option so as to eliminate the fractional shares.

(b) If DRI is a party to a consolidation or a merger in which DRI is not the surviving corporation, a transaction that results in the acquisition of substantially all of DRI's outstanding stock by a single person or entity, or a sale or transfer of substantially all of DRI's assets or if a Change of Control as defined in Section 2(c)(i) or (ii) otherwise occurs (a "Corporate Event"), then

(i) Except as provided in (ii) below, the Committee may take such actions with respect to outstanding Incentive Awards as the Committee deems appropriate.

(ii) For all Options that are outstanding at the time of a Corporate Event, the Committee shall ensure that Participants will receive with respect to those Options a value per Option that is determined by using one of the generally recognized option pricing models (each of which take into account the difference between the option exercise price and the market price of the stock, if any, plus other factors and assumptions which in combination produce an option value), including, but not limited to, the Black-Scholes or the Roll, Geske & Whaley formulae for option valuation, that is the most favorable to Participants in the aggregate. Within the option valuation models, the Committee will use the acquisition price of DRI stock as the measure of its market price (if the Corporate Event involves the acquisition of DRI stock), and will utilize any other reasonable factors and assumptions, including assumptions regarding stock volatility, risk free interest rates and dividend yield that, taken together, produce the largest value for each Option.

The payments under this Section may be made in the form of cash or in DRI stock or of another publicly traded entity involved in the Corporate Event.

(c) Notwithstanding anything in the Plan to the contrary, the Committee may take the foregoing actions without the consent of any Participant, and the Committee's determination shall be conclusive and binding on all persons for all purposes.

16. *Administration of the Plan.*

(a) Subject to the provisions of Section 16(b), the Plan shall be administered by the Committee. The Committee shall have general authority to impose any limitation or condition upon an Incentive Award the Committee deems appropriate to achieve the objectives of the Incentive Award and the Plan and, without limitation and in addition to powers set forth elsewhere in the Plan, shall have the power and complete discretion to determine:

(i) which eligible employees shall receive Incentive Awards and the nature of each Incentive Award, (ii) the terms and conditions of any Performance Grant, (iii) whether all or any part of an Incentive Award shall be accelerated upon a Change of Control, (iv) the number of shares of Company Stock to be covered by each Incentive Award, (v) whether Options shall be Incentive Stock Options or Nonstatutory Stock Options, (vi) when, whether and to what extent Stock Appreciation Rights shall be granted, (vii) the time or times when an Incentive Award shall be granted, (viii) whether an Incentive Award shall become vested over a period of time and when it shall be fully vested, (ix) when Options and Stock Appreciation Rights may be exercised, (x) whether a Disability exists, (xi) the manner in which payment will be made upon the exercise of Options or Stock Appreciation Rights, (xii) conditions relating to the length of time before disposition of Company Stock received upon the exercise of Options or Stock Appreciation Rights is permitted, (xiii) whether to authorize a Participant (A) to deliver Mature Shares to satisfy Applicable Withholding Taxes or (B) to have the Employer withhold from the shares to be issued upon the exercise of a Nonstatutory Stock Option or Stock Appreciation Right the number of shares necessary to satisfy Applicable Withholding Taxes, (xiv) the terms and conditions applicable to Restricted Stock awards, (xv) the terms and conditions on which restrictions upon Restricted Stock shall lapse, (xvi) whether to accelerate the time at which any or all restrictions with respect to Restricted Stock will lapse or be removed, (xvii) the terms and conditions applicable to Goal-Based Stock awards, (xviii) notice provisions relating to the sale of Company Stock acquired under the Plan, (xix) the extent to which information shall be provided to Participants about available tax elections, and (xx) any additional requirements relating to Incentive Awards that the Committee deems appropriate. Notwithstanding the foregoing, no "tandem stock options" (where two stock options are issued together and the exercise of one option affects the right to exercise the other option) may be issued in connection with Incentive Stock Options. The Committee shall have the power to amend the terms of previously granted Incentive Awards that were granted by that Committee so long as the terms as amended are consistent with the terms of the Plan and provided that the consent of the Participant is obtained with respect to any amendment that would be detrimental to him or her, except that such consent will not be required if such amendment is for the purpose of complying with Rule 16b-3 or any requirement of the Code applicable to the Incentive Award.

(b) All grants of Incentive Awards made or approved by the Committee shall be submitted to the DRI Board for such consideration as the DRI Board deems appropriate.

(c) The Committee may adopt rules and regulations for carrying out the Plan with respect to Participants. The interpretation and construction of any provision of the Plan by the Committee shall be final and conclusive as to any Participant. The Committee may consult with counsel, who may be counsel to the Employer, and shall not incur any liability for any action taken in good faith in reliance upon the advice of counsel.

(d) A majority of the members of the Committee shall constitute a quorum, and all actions of the Committee shall be taken by a majority of the members present. Any action may be taken by a written instrument signed by all of the members, and any action so taken shall be fully effective as if it had been taken at a meeting.

17. *Notice.* All notices and other communications required or permitted to be given under this Plan shall be in writing and shall be deemed to have been duly given if delivered personally or mailed first class, postage prepaid, as follows (a) if to DRI-at the principal business address of DRI to the attention of the Corporate Secretary of DRI; and (b) if to any Participant-at the last address of the Participant known to the sender at the time the notice or other communication is sent.

18. *Interpretation.* The terms of this Plan are subject to all present and future regulations and rulings of the Secretary of the Treasury of the United States or his or her delegate relating to the qualification of Incentive Stock Options under



the Code. If any provision of the Plan conflicts with any such regulation or ruling, then that provision of the Plan shall be void and of no effect. The terms of this Plan shall be governed by the laws of the Commonwealth of Virginia.

19. *Grants To Outside Directors.* In addition to the Awards otherwise provided under the Plan, the Plan also permits the award of Nonstatutory Stock Options and Restricted Stock to directors on the DRI Board or the board of any Dominion Company if such directors are not employees of DRI or a Dominion Company ("Outside Directors"). The DRI Board shall have the power and complete discretion to select Outside Directors of DRI or any Dominion Company to receive Awards. The DRI Board shall have the complete discretion, under provisions consistent with Section 12 as to Participants, to determine the terms and conditions, the nature of the award and the number of shares to be allocated as part of each Award for each Outside Director of DRI or a Dominion Company. The grant of an Award shall not obligate DRI or any Dominion Company to make further grants to the Outside Director at any time thereafter or to retain any person as a director for any period of time.

**DOMINION RESOURCES, INC.**  
**LEADERSHIP STOCK OPTION PLAN**  
**FOR SALARIED EMPLOYEES**

**Effective July 1, 2000**  
**Amended and Restated Effective July 20, 2001**

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**DOMINION RESOURCES, INC.**

**LEADERSHIP STOCK OPTION PLAN**

**FOR SALARIED EMPLOYEES**

**Amended and Restated effective July 20, 2001**

1. *Purpose.* The purpose of this Dominion Resources, Inc. Leadership Stock Option Plan for Salaried Employees is to encourage ownership of Company Stock by all salaried employees of Dominion Resources, Inc. and the Dominion Companies through the grant of nonstatutory stock options. It is believed that giving salaried employees an opportunity to acquire Company Stock under this Plan will motivate those employees to continue to promote the best interests of the Employers and enhance the Employers' long-term stability and financial success. It is also believed that the grant of Options to salaried employees under this Plan will strengthen the Employers' ability to attract and retain the best available personnel.

2. *Awards.* Awards shall be made in the form of stock Options.

3. *Participation.*

(a) Eligibility. Options may be granted under the Plan to any full-time or part-time salaried employee of DRI or a Dominion Company. The Committee shall have the power and complete discretion to determine the employees who shall be granted Options under the Plan and the time or times at which Options shall be granted.

(b) Ineligible Persons. "Employee" shall not include a person whose employment is covered by a collective bargaining agreement, or a person hired as an independent contractor, leased employee, consultant or a person otherwise designated by an Employer at the time of hire as not eligible to participate in or receive benefits under the Plan, even if such ineligible person is subsequently determined to be an "employee" by any governmental or judicial authority.

(c) No Employment Rights. The grant of an Award shall not obligate an Employer to pay an employee any particular amount of compensation, to continue the employment of the employee after the grant or to make further grants to the employee at any time thereafter. Nothing in the Plan or in any Award shall affect the right of the Company to terminate the employment of any employee

for cause or otherwise. Further, the adoption of this Plan shall not be deemed to give any employee or any other individual any right to be selected as a Participant or to be granted an Award.

4. *Stock Options.* The Committee may make grants of Options to Participants. Each Option granted under the Plan shall be evidenced by a Stock Option Agreement, in a form approved by the Committee. A Stock Option Agreement shall have the following terms and other terms and conditions specified by the Committee:

(a) Number of Option Shares Granted. The Stock Option Agreement shall state the number of shares of Company Stock covered by the Option.

(b) Expiration Date. The Stock Option Agreement shall specify the date on which the Option expires.

(c) Vesting Schedule. The Stock Option Agreement shall specify when the Options will be vested and may be exercised in whole or in part.

(d) Grant Price. The per share exercise price of each Option shall be at least 100% of the Fair Market Value of such shares on the Grant Date.

(e) Change of Control. An Option shall become fully vested and exercisable in the event of a Change of Control.

5. *Treatment of Options Upon Termination of Employment.* Except as provided below, an Option may not be exercised after the Participant's termination of employment with the Employer:

(a) Termination Due to Retirement. If the Participant takes Retirement, the Option becomes fully vested and exercisable and may be exercised until the earlier of (x) the third anniversary of the Participant's Retirement, or (y) the expiration date of the Option. Retirement means termination of employment with receipt of early or normal retirement benefits under the Dominion Resources Retirement Plan or another defined benefit retirement plan sponsored by the Employer.

(b) Termination Due to Long-Term Disability. If the Participant incurs a Long-Term Disability, the Option becomes fully vested and exercisable and may be exercised until the earlier of (x) the first anniversary of the Participant's Long-Term Disability date (as described below), or (y) the expiration date of the Option. A Participant's Long-Term Disability date is the date of the Participant's eligibility for long-term disability benefits under the Employer's applicable long-term disability plan.

(c) Termination Due to Death. If the Participant dies while employed by the Employer, the Option becomes fully vested and exercisable and may be exercised by the personal representative of the Participant's estate until the earlier of (x) the first anniversary of the Participant's death, or (y) the expiration date of the Option. If the Participant dies within three years after his or her Retirement or within one year after his or her Long-Term Disability date, the personal representative of his or her estate may exercise the Option until the earliest of (x) 90 days after the Participant's death, (y) the third anniversary of the Participant's Retirement or the first anniversary of his or her Long-Term Disability date, or (z) the expiration date of the Option.

(d) Termination Other Than For Cause. If the Participant voluntarily terminates employment with the Employer or the Participant's employment is involuntarily terminated by the Employer for reasons other than "cause" (as defined below), the Participant may exercise the vested portion of the Option until the earlier of (x) 30 days after the Participant's termination of employment, or (y) the expiration date of the Option.

(e) Termination for Cause. If the Participant's employment is terminated by the Employer for "cause," the Option (both vested and unvested) shall terminate as of the date of notice of termination of employment and shall no longer be exercisable. The Committee determines whether a Participant has incurred an involuntary termination of employment for "cause," and the Committee's determination shall be binding for all purposes. "Cause" means:

- (i) fraud or material misappropriation with respect to the business or assets of DRI or a Dominion Company;
- (ii) persistent refusal or willful failure of the Participant to perform substantially his or her duties and responsibilities to the Employer, which continues after the Participant receives notice of such refusal or failure;
- (iii) conviction of a felony or crime involving moral turpitude; or
- (iv) the use of drugs or alcohol that interferes materially with the Participant's performance of his or her duties.

6. *Method of Exercise of Options.*

(a) Payment Upon Exercise.

An Option shall be considered exercised under the Plan on the date written notice is given to DRI, advising of the exercise of a particular Option and transmitting payment in full of the Grant Price for the shares involved. The Grant Price shall be paid in cash or by delivery of instructions to a broker for a broker-assisted exercise under procedures established by the Committee.

(b) No Rights as Shareholder. Until the Option exercise is complete, including any Applicable Withholding Taxes, and DRI has issued a certificate for the shares of Company Stock acquired, the Participant shall have no shareholder rights with respect to the shares.

(c) Withholding of Taxes. Each Participant shall agree as a condition of the exercise of an Option, to make arrangements satisfactory to the Employer regarding the payment of Applicable Withholding Taxes. The Applicable Withholding Taxes may be paid in cash or the Employer may retain shares of Company Stock (valued at their Fair Market Value) equal to the Applicable Withholding Taxes.

**7. Transferability of Options.** Options shall not be transferable by a Participant except at death and may be exercised only by the Participant, except after the Participant's death. No Option may be assigned or subject to any encumbrance, pledge or charge of any nature.

#### **8. Stock.**

(a) Subject to subsection (b), an aggregate of ten million (10,000,000) shares of Company Stock, which shall be authorized, but unissued shares, is reserved for issuance under the Plan. Shares allocable to Options that expire, are forfeited, or otherwise terminate unexercised may again be added to the remaining number of shares of Company Stock available for grant as an Option under the Plan. Any shares of Company Stock withheld to pay Applicable Withholding Taxes will be added to the aggregate shares of Company Stock available for grant as an Option under the Plan.

(b) In the event of a stock dividend, stock split or combination of shares, recapitalization or merger in which DRI is the surviving corporation or other change in DRI's capital stock (including, but not limited to, the creation or issuance to shareholders generally of rights, options or warrants for the purchase of common stock or preferred stock of DRI), the number and kind of shares of stock or securities of DRI that are subject to the Plan and to Options then outstanding or to be granted under the Plan, the maximum number of shares or securities which may be delivered under the Plan, the Grant Price, the terms of Awards and other relevant provisions shall be appropriately adjusted by the Committee, whose determination shall be binding on all persons. If the adjustment would produce fractional shares with respect to any unexercised Option, the Committee may adjust appropriately the number of shares covered by the Option so as to eliminate the fractional shares.

(c) If DRI is a party to a consolidation or a merger in which DRI is not the surviving corporation, a transaction that results in the acquisition of substantially all of DRI's outstanding stock by a single person or entity, or a sale or transfer of substantially all of DRI's assets or if a Change of Control as defined in Section 16(c)(i) or (ii) otherwise occurs (a "Corporate Event"), then

(i) Except as provided in (ii) below, the Committee may take such actions with respect to outstanding Incentive Awards as the Committee deems appropriate.

(ii) For all Options that are outstanding at the time of a Corporate Event, the Committee shall ensure that Participants will receive with respect to those Options a value per Option that is determined by using one of the generally recognized option pricing models (each of which take into account the difference between the option exercise price and the market price of the stock, if any, plus other factors and assumptions which in combination produce an option value), including, but not limited to the Black-Scholes or the Roll, Geske & Whaley formulae for option valuation, that is the most favorable to Participants in the aggregate. Within the option valuation models, the Committee will use the acquisition price of DRI stock as the measure of its market price (if the Corporate Event involves the acquisition of DRI Stock) and will utilize any other reasonable factors and assumptions, including assumptions regarding stock volatility, risk free interest rates and dividend yield that, taken together, produce the largest value for each Option.

The payment under this Section 8(c)(ii) may be made in the form of cash or in DRI stock or of another publicly traded entity involved in the Corporate Event.

(d) Notwithstanding anything in the Plan to the contrary, the Committee may take the actions set forth in Subsections (a) and (b) above without the consent of any Participant, and the Committee's determination shall be conclusive and binding on all persons for all purposes.

**9. Effective Date of the Plan.** The effective date of the Plan is July 1, 2000. The effective date of this restatement is July 20, 2001.

**10. Termination, Modification, Change.** The DRI Board may amend, modify or terminate the Plan or any Option granted under the Plan. A termination or amendment of the Plan shall not, without the consent of the Participant, adversely affect a Participant's rights under an Award previously granted to him or her.

#### 11. *Administration of the Plan.*

(a) The Committee shall administer the Plan. The Committee shall have general authority to impose any limitation or condition upon an Award that the Committee deems appropriate to achieve the objectives of the Award and the Plan. Without limitation and in addition to powers otherwise in the Plan, the Committee shall have the power and complete discretion to determine:

(i) whether all or any part of an Award shall be adjusted upon a Change of Control;

(ii) whether a Long-Term Disability exists and when a Long-Term Disability begins;

(iii) conditions relating to the length of time a Participant must hold Company Stock received upon the exercise of an Option before disposing of it;

(iv) notice requirements relating to the sale of Company Stock acquired under the Plan; and

(v) any additional requirements relating to Awards that the Committee deems appropriate.

The Committee shall have the power to amend the terms of previously granted Awards so long as the terms as amended are consistent with the terms of the Plan and provided that the consent of the Participant is obtained with respect to any amendment that would be detrimental to him or her.

(b) The Committee may adopt rules and regulations for carrying out the Plan with respect to Participants. The interpretation and construction of any provision of the Plan by the Committee shall be final, binding and conclusive as to any Participant. The Committee may consult with counsel, who may be counsel to the Employer, and shall not incur any liability for any action taken in good faith in reliance upon the advice of counsel. The Committee may delegate some or all of its authority under the Plan to any person or persons so long as such delegation is in writing.

(c) No member of the Committee shall be liable for any action or determination made in good faith with respect to the Plan or any Option awarded under it. To the maximum extent permitted by applicable law, each member of the Committee shall be indemnified and held harmless by DRI and the Dominion Companies against any cost or expense (including legal fees) or liability (including any sum paid in settlement of a claim with the approval of DRI) arising out of any act or omission to act in connection with the Plan unless arising out of such member's own fraud or bad faith. Such indemnification shall be in addition to any other rights of indemnification these individuals may have under the bylaws of DRI.

12. *Compliance with Other Laws and Regulations.* The Plan, the Stock Option Agreements, the exercise of Options and the obligation of DRI to deliver shares of Company Stock under the Options, shall be subject to all applicable federal and state laws, rules and regulations and to such approvals by any government or regulatory agency as may be required.

13. *Notice.* All notices and other communications under this Plan shall be in writing unless the Committee provides otherwise and shall be deemed to have been given if mailed first class, postage prepaid, as follows (a) if to DRI-at the principal business address of DRI (120 Tredegar Street, Richmond, VA 23219) to the attention of the Corporate Secretary of DRI; and (b) if to any Participant-at the last address of the Participant known to the sender at the time the notice or other communication is sent.

14. *Interpretation.* The terms of this Plan and all Awards shall be governed by the laws of the Commonwealth of Virginia, without regard to its conflict of laws rules.

15. *Severability.* In the event that any provision of the Plan shall be determined to be invalid or unenforceable for any reason, the remaining provisions of the Plan shall be unaffected and shall remain in full force and effect in such jurisdiction. Any such invalid or unenforceable provision shall not be considered invalid or unenforceable in any other jurisdiction.

16. *Definitions.* As used in the Plan, the following terms have the meanings below:

(a) "*Applicable Withholding Taxes*" means the aggregate amount of federal, state and local income and payroll taxes that an Employer is required to withhold in connection with any exercise of an Option.

(b) "*Award*" means the award of a stock Option under the Plan.

(c) "*Change of Control*" means the occurrence of any of the following events:

(i) any person, including a "group" as defined in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended becomes the owner or beneficial owner of DRI securities having 20% or more of the combined voting power of the then outstanding DRI securities that may be cast for the election of DRI's directors (other than as a result of an issuance of securities initiated by DRI, or

open market purchases approved by the DRI Board, as long as the majority of the DRI Board approving the purchases is also the majority at the time the purchases are made);

(ii) as the direct or indirect result of, or in connection with, a cash tender or exchange offer, a merger or other business combination, a sale of assets, a contested election, or any combination of these transactions, the persons who were directors of DRI before such transactions cease to constitute a majority of the DRI Board, or any successor's board, within two years of the last of such transactions; or

(iii) with respect to a particular Participant, an event occurs with respect to the Employer that employs that Participant such that, after the event, the Employer is no longer a Dominion Company.

(d) "*Code*" means the Internal Revenue Code of 1986, as amended.

(e) "*Committee*" means the Dominion Resources Administrative Benefits Committee.

(f) "*Company Stock*" means common stock of DRI. In the event of a change in the capital structure of DRI (as provided in Section 8), the shares resulting from such a change shall be deemed to be Company Stock within the meaning of the Plan.

(g) "*Dominion Company*" means any corporation in which DRI owns stock possessing at least 50 percent of the combined voting power of all classes of stock or which is in a chain of corporations with DRI in which stock possessing at least 50% of the combined voting power of all classes of stock is owned by one or more other corporations in the chain.

(h) "*DRI*" means Dominion Resources, Inc.

(i) "*DRI Board*" means the Board of Directors of Dominion Resources, Inc.

(j) "*Employer*" means DRI and each Dominion Company that employs one or more Participants.

(k) "*Fair Market Value*" means the average of the high and low prices of a share of Company Stock, as reported by Bloomberg or such other financial reporting service selected by DRI, as of the last day on which Company Stock is traded preceding the date for which the value of Company Stock must be determined under the Plan.

(l) "*Grant Date*" means the date on which the Committee grants an Option.

(m) "*Grant Price*" means the per share exercise price of each Option.

(n) "*Long-Term Disability*" means a total and permanent disability as determined under the Employer's applicable long-term disability plan.

(o) "*Option*" means a right to purchase Company Stock granted to a Participant under the Plan, at a price determined in accordance with the Plan. Each Option shall be a "nonstatutory stock option." A "nonstatutory stock option" is an option that does not meet the requirements of Code section 422, or, even if meeting the requirements of Code section 422, is not intended to be an incentive stock option and is so designated.

(p) "*Participant*" means any salaried employee of DRI or a Dominion Company who receives an Award under the Plan. The Committee may exclude any employee who receives an award under the Dominion Resources, Inc. Incentive Compensation Plan.

(q) "*Plan*" means the Dominion Resources, Inc. Leadership Stock Option Plan for Salaried Employees, as amended from time to time.

(r) "*Stock Option Agreement*" means the agreement between DRI and the Participant under which DRI grants Options to a Participant, subject to the terms and conditions of the agreement and the Plan. Each Stock Option Agreement shall include certain terms and conditions as the Committee may determine to be necessary or desirable, in its sole discretion.