

# SECURITIES AND EXCHANGE COMMISSION

## FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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### FILER

#### **VIRGINIA ELECTRIC & POWER CO**

CIK: **103682** | IRS No.: **540418825** | State of Incorpor.: **VA** | Fiscal Year End: **1231**  
Type: **10-Q** | Act: **34** | File No.: **001-02255** | Film No.: **1697364**  
SIC: **4911** Electric services

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**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

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**FORM 10-Q**

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(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 1-2255**

***VIRGINIA ELECTRIC AND POWER COMPANY***

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

**VIRGINIA**

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

**54-0418825**

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

**701 East Cary Street  
RICHMOND, VIRGINIA**

*(Address of principal executive offices)*

**23219**

*(Zip Code)*

(804) 771-3000

(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

At July 31, 2001, 171,484 shares of common stock, without par value, of the registrant were outstanding, all of which were held, beneficially and of record, by Dominion Resources, Inc.

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## VIRGINIA ELECTRIC AND POWER COMPANY

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**VIRGINIA ELECTRIC AND POWER 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>	\$1,177	\$1,147	\$2,399	\$2,273
<b>Operating Expenses</b>				
Electric fuel and energy purchases, net	302	256	622	506
Purchased electric capacity	158	181	346	374
Restructuring costs	-	49	-	69
Operations and maintenance	250	242	681	455
Depreciation and amortization	128	139	255	274
Other taxes	<u>42</u>	<u>60</u>	<u>89</u>	<u>116</u>
Total expenses	<u>880</u>	<u>927</u>	<u>1,993</u>	<u>1,794</u>
Income from operations	297	220	406	479
Other income	<u>10</u>	<u>5</u>	<u>17</u>	<u>19</u>
Income before interest and income taxes	<u>307</u>	<u>225</u>	<u>423</u>	<u>498</u>
Interest and related charges:				
Interest expense, net	76	69	150	137
Distributions - preferred securities of subsidiary trust	<u>3</u>	<u>3</u>	<u>6</u>	<u>6</u>
Total interest and related charges	<u>79</u>	<u>72</u>	<u>156</u>	<u>143</u>
Income before income taxes	228	153	267	355
Income tax expense	<u>94</u>	<u>56</u>	<u>108</u>	<u>128</u>
Income before cumulative effect of a change in accounting principle	134	97	159	227

Cumulative effect of a change in accounting principle (net of income taxes of \$11)	—	—	—	<u>21</u>
<b>Net Income</b>	134	97	159	248
Preferred dividends	<u>6</u>	<u>9</u>	<u>13</u>	<u>19</u>
Balance available for common stock	<u>\$ 128</u>	<u>\$ 88</u>	<u>\$ 146</u>	<u>\$ 229</u>

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

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**VIRGINIA ELECTRIC AND POWER COMPANY**  
**CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**

	June 30,	December 31,
<b>ASSETS</b>	<u>2001</u>	<u>2000</u>
		*
		(Millions)
<b>Current Assets</b>		
Cash and cash equivalents	\$ 132	\$ 141
Accounts receivable:		
Customer accounts receivable, net	1,283	1,134
Other	37	82
Receivable from affiliates	84	30
Inventories (average cost method):		
Materials and supplies	136	129
Fossil fuel	100	83

Gas stored	49	19
Commodity contract assets	1,119	1,047
Other	<u>79</u>	<u>164</u>
Total current assets	<u>3,019</u>	<u>2,829</u>

#### **Investments**

Nuclear decommissioning trust funds	873	851
Other	<u>46</u>	<u>63</u>
Total investments	<u>919</u>	<u>914</u>

#### **Property, Plant and Equipment**

Property, plant and equipment	16,420	16,190
Less accumulated depreciation	<u>7,357</u>	<u>7,165</u>
	9,063	9,025
Nuclear fuel, net	<u>133</u>	<u>140</u>
Total property, plant and equipment, net	<u>9,196</u>	<u>9,165</u>

#### **Deferred Charges and Other Assets**

Regulatory assets	215	235
Commodity contract assets	307	79
Other	<u>68</u>	<u>109</u>
Total deferred charges and other assets	<u>590</u>	<u>423</u>
Total assets	<u>\$13,724</u>	<u>\$13,331</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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**VIRGINIA ELECTRIC AND POWER COMPANY**

**CONSOLIDATED BALANCE SHEETS  
(Unaudited)**

	June 30,	December 31,
	<u>2001</u>	<u>2000</u>
		*
<b>LIABILITIES AND STOCKHOLDER'S EQUITY</b>		(Millions)
<b>Current Liabilities</b>		
Securities due within one year	\$ 369	\$ 241
Short-term debt	132	714
Accounts payable, trade	1,136	882
Payable to affiliated companies	118	122
Customer deposits	59	55
Accrued interest	103	94
Accrued payroll	64	88
Accrued taxes	52	60
Commodity contract liabilities	1,123	994
Other	<u>88</u>	<u>100</u>



Total current liabilities	<u>3,244</u>	<u>3,350</u>
<b>Long-Term Debt</b>	<u>3,900</u>	<u>3,561</u>
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes	1,511	1,494
Deferred investment tax credits	121	130
Commodity contract liabilities	290	87
Other	<u>191</u>	<u>216</u>
Total deferred credits and other liabilities	<u>2,113</u>	<u>1,927</u>
Total liabilities	<u>9,257</u>	<u>8,838</u>

### Commitments and Contingencies

(See Note 8)

<b>Company Obligated Mandatorily Redeemable Preferred Securities of Subsidiary Trust</b>	<u>135</u>	<u>135</u>
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### Preferred Stock

Preferred stock not subject to mandatory redemption	<u>509</u>	<u>509</u>
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**Common Stockholder's Equity**

Common stock	2,738	2,738
Other paid-in capital	16	16
Accumulated other comprehensive loss	(18)	-
Retained earnings	<u>1,087</u>	<u>1,095</u>
Total common stockholder's equity	<u>3,823</u>	<u>3,849</u>
Total liabilities and stockholder's equity	<u>\$13,724</u>	<u>\$13,331</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.

\*\* As described in Note 9, the 8.05% Junior Subordinated Notes totaling \$139 million in principal amount constitute 100% of the Trust's assets.

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**VIRGINIA ELECTRIC AND POWER COMPANY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

Six Months Ended

June 30,

2001                  2000

(Millions)

<b>Net Cash Flows From Operating Activities</b>	\$ 603	\$ 558
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**Cash Flows From (Used In) Investing Activities**

Plant expenditures	(295)	(286)
Nuclear fuel	(35)	(48)
Nuclear decommissioning contributions	(18)	(18)
Other	<u>34</u>	<u>(13)</u>
Net cash used in investing activities	<u>(314)</u>	<u>(365)</u>

**Cash Flows From (Used In) Financing Activities**

Issuance of long-term debt	650	220
Repayment of long-term debt and preferred stock	(190)	(226)
Repayment of short-term debt, net	(582)	65
Common stock dividend payments	(155)	(187)
Preferred stock dividend payments	(12)	(19)
Distribution - preferred securities of subsidiary trust	(3)	(6)
Other	<u>(6)</u>	<u>-</u>
Net cash used in financing activities	<u>(298)</u>	<u>(153)</u>

Increase (decrease) in cash and cash equivalents	(9)	40
Cash and cash equivalents at beginning of period	<u>141</u>	<u>62</u>
Cash and cash equivalents at end of period	<u>\$ 132</u>	<u>\$ 102</u>

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

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**VIRGINIA ELECTRIC AND POWER 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>
	(Millions)			
Net income	<u>\$134</u>	<u>\$97</u>	<u>\$159</u>	<u>\$248</u>
Other comprehensive loss, net of tax:				
Cumulative effect of a change in accounting principle				
(net of income taxes of \$9)	-	-	(14)	-
Unrealized derivative losses - hedging activities	(1)	-	(3)	-
Reclassification for derivative gains included in net income	<u>(1)</u>	<u>-</u>	<u>(1)</u>	<u>-</u>
Other comprehensive loss	<u>(2)</u>	<u>-</u>	<u>(18)</u>	<u>-</u>

Comprehensive income

\$132

\$97

\$141

\$248

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

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**VIRGINIA ELECTRIC AND POWER COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Nature of Operations**

Virginia Electric and Power Company, a wholly-owned subsidiary of Dominion Resources, Inc. (Dominion), a Virginia corporation, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy within a 30,000 square-mile area in Virginia and northeastern North Carolina. It sells electricity to retail customers (including governmental agencies) and to wholesale customers such as rural electric cooperatives, municipalities, power marketers and other utilities. The Virginia service area comprises about 65% of Virginia's total land area, but accounts for over 80% of its population. The Company also engages in off-system wholesale purchases and sales of electricity and purchases and sales of natural gas, and has developed trading relationships beyond the geographic limits of its retail service territory. Within this document, the term "Company" refers to the entirety of Virginia Electric and Power Company, including its Virginia and North Carolina operations, and all of its subsidiaries.

The Company manages its operations along two primary business lines, Energy and Delivery. The Energy segment encompasses the Company's portfolio of generating facilities and power purchase agreements, trading and marketing activities. The Delivery segment includes bulk power transmission, distribution and metering services, and customer service and continues to be subject to the requirements of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*.

**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 the 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 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 could differ from those estimates.

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

**VIRGINIA ELECTRIC AND POWER 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 goodwill or other 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 Obligations*, which provides accounting requirements for the recognition and measurement of liabilities for obligations associated with the retirement of tangible long-lived assets. Under the 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.

The Company has identified retirement obligations associated with the decommissioning of its nuclear generation facilities but has not determined the impact of recognition and measurement of such obligations under the new standard. The Company has not performed a complete assessment of possible retirement obligations associated with its electric utility property.

Also, under the new standard, the realized and unrealized earnings of external trusts available for funding decommissioning activities at the Company's utility nuclear plants will be recorded in other income and other comprehensive income, as appropriate. Currently, the Company records these trusts' earnings in other income with an offsetting charge to expense, also recorded in other income, associated with the accretion of the decommissioning liability. See Note 8 to the Company's Annual Report on Form 10-K for the year ended December 31, 2000. Furthermore, upon adoption of the 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 electric utility. 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.

**VIRGINIA ELECTRIC AND POWER COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Continued)**

### **Adoption of Statement of Financial Accounting Standards 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 charge to accumulated other comprehensive income (AOCI) of approximately \$14 million (net of \$9 million tax benefit) in the first quarter of 2001 in connection with the initial adoption of SFAS No. 133 as the cumulative effect of a change in accounting principle. The Company expects to reclassify approximately \$13 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 may 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, currency exchange and financial market risks of its business operations. The Company manages the price risk associated with purchases of natural gas and oil by utilizing derivative commodity instruments including futures and swaps. The Company manages its foreign exchange risk associated with anticipated future purchases denominated in foreign currencies by utilizing currency forward contracts. The Company manages its interest rate risk exposure, in part, by entering into interest rate swap transactions. All of the Company's derivatives that are designated as hedges at June 30, 2001 represent cash flow hedges of the variable price risk associated with purchases of natural gas and oil, the risk of variability in foreign exchange rates and the risk of variable interest rates on long-term debt.

As part of its strategy to market energy from its generation capacity and to manage related risks, the Company manages a portfolio of derivative commodity contracts held for trading purposes. These contracts are sensitive to changes in the prices of natural gas and electricity. The Company employs established policies and procedures to manage the risks associated with these price fluctuations and uses various commodity instruments, such as futures, swaps and options, to reduce risk by creating offsetting market positions.

Certain of the Company's non-trading derivative instruments, which management believes are economic hedges and mitigate exposure to fluctuations in commodity prices and interest rates, are not designated as hedges for accounting purposes.

### **Accounting Policy**

Under SFAS No. 133, derivatives are recognized on the consolidated balance sheets 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 hedges, 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 the 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.

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## VIRGINIA ELECTRIC AND POWER COMPANY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 statements 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 foreign currency forward contracts designated as cash flow hedges, hedge effectiveness is measured based on changes in the fair value of the contract attributable to changes in the forward exchange rate. 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 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. Net derivative gains and losses associated with the Company's commodity trading activities are reported net of related cost of sales in non-regulated electric sales and non-regulated gas sales. 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 other operation and maintenance expense in the consolidated statements of income.

Certain commodity contracts held by the Company for trading purposes are not derivatives as defined by SFAS No. 133, but are reported at fair value in accordance with Emerging Issues Task Force Issue No. 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, as described above.

#### **Derivatives and Hedge Accounting Results**

For the six months ended June 30, 2001, the Company recognized a pre-tax increase in earnings of approximately \$1



million, principally in the first quarter, for hedge ineffectiveness. This amount is reported as a reduction to cost of sales in the Consolidated Statements of Income.

Approximately \$13 million of net losses 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 may 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 up to five years.

The Financial Accounting Standards Board (FASB) recently cleared guidance that certain option-type contracts for the purchase or sale of electricity, if determined to be derivatives, are eligible for the normal purchases and sales exception available under SFAS No. 133. As a result of this and other guidance issued 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, the Company has determined that certain of its long-term power purchase contracts are subject to the provisions of SFAS No. 133, but such contracts qualify for the normal purchases and sales exception. Under this exception, such contracts are not subject to the fair value accounting required by SFAS No. 133.

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.

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## **VIRGINIA ELECTRIC AND POWER COMPANY**

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

#### **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 made effective as of January 1, 2000.

A cumulative effect of a change in accounting principle of \$21 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 for the six months ended June 30, 2000, other than the cumulative effect of a change in accounting principle, was not material.

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. Restructuring Costs

On January 28, 2000, as a result of the acquisition of Consolidated Natural Gas Company (CNG), Dominion implemented a plan to restructure the operations of the combined companies. During the three and six months ended June 30, 2000, the Company recorded \$49 million and \$69 million, respectively, for charges in connection with consolidation of post-acquisition operations and the integration of information technology systems. At December 31, 2000, the Company's restructuring plan was substantially complete.

At June 30, 2001, the remaining severance liability of \$3 million represents remaining amounts payable to employees already terminated. The change in the liability for severance and related benefit costs is presented below:

	(Millions)
Balance at December 31, 2000	\$6
Amounts paid	<u>(3)</u>
Balance at June 30, 2001	<u>\$3</u>

For additional information on restructuring and other merger-related activities, see Note 5 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

## Note 7. Long-Term Debt

During March 2001, the Company issued \$50 million in aggregate principal amount of Series 2001A, tax-exempt pollution control Revenue Bonds due March 1, 2031, bearing interest at a variable rate. The net proceeds were used to finance qualifying expenditures made during the construction of facilities at the North Anna Power Station. In addition, the Company issued \$600 million of 5.75% Senior Notes due March 31, 2006 (Senior Notes). The net proceeds were used for general corporate purposes including repayment of commercial paper and payments associated with the purchase of three generation facilities from non-utility generators and the termination of related long-term power purchase agreements. (See Note 8 for further discussion.)

In April 2001, the Company repaid \$5 million of Medium-Term Notes, which matured on April 23, 2001 and redeemed \$100 million of its 1991 Series A, 8.75% First and Refunding Mortgage Bonds due April 1, 2021. In addition, the Company repaid two Medium-Term Notes of \$5 million and \$80 million which matured on May 1, 2001 and June 21, 2001, respectively.

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## VIRGINIA ELECTRIC AND POWER COMPANY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Note 8. Commitments and Contingencies

### Restructuring of Contracts with Non-Utility Generating Facilities (NUGs)

In the first quarter of 2001, the Company completed the purchase of three generating facilities and the termination of seven contracts which provided electricity to the Company under long-term purchase agreements with non-utility generators. The Company recorded a charge of \$136 million after-tax in connection with the purchase and termination of the long-term power purchase agreements. Cash payments related to the purchase of the three generating facilities totaled \$207 million. The allocation of the purchase price was assigned to the assets and liabilities acquired based upon estimated fair values and future cash flows as of the date of acquisition. Substantially all of the value was attributed to the long-term purchase agreements which were terminated and resulted in a charge to operations and maintenance expense.

### Environmental Matters

There have been no significant developments with regard to environmental matters, as disclosed in Note 20 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 environmental matters arisen during the six months ended June 30, 2001.

## Note 9. Company Obligated Mandatorily Redeemable Preferred Securities of Subsidiary Trust

In 1995, the Company established Virginia Power Capital Trust I (VP Capital Trust). VP Capital Trust sold 5.4 million Preferred Securities for \$135 million, representing preferred beneficial interests and 97% beneficial ownership in the assets held by VP Capital Trust.

Virginia Power issued \$139 million of its 1995 Series A, 8.05% Junior Subordinated Notes (the Notes) due September 30, 2025 in exchange for the \$135 million realized from the sale of the Preferred Securities and \$4 million of common securities of VP Capital Trust. The common securities, which are owned by the Company, represent the remaining 3% beneficial ownership interest in the assets held by VP Capital Trust. The Notes constitute 100% of VP Capital Trust's assets. The Notes may be extended for up to an additional ten years from date of original maturity if certain conditions are satisfied.

## Note 10. Operating Segments

The Company manages its operations along two primary business lines, Energy and Delivery. The majority of the Company's revenue is provided through bundled rate tariffs. Generally, such revenues are allocated between the two business lines for management reporting based on prior cost of service studies. There were no significant intersegment activities for the three and six months ended June 30, 2001.

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### VIRGINIA ELECTRIC AND POWER COMPANY

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

Corporate and Other include certain expenses for which the Energy and Delivery segments were not allocated: 1) corporate operations and assets; 2) transactions or events not allocated to the segments for internal reporting purposes (including 2001 charge for NUG restructuring, 2000 restructuring costs, 2000 cumulative effect of a change in accounting principle); and 3) intersegment eliminations, where applicable.

<u>Energy</u>	<u>Delivery</u>	Corporate and <u>Other</u>	Consolidated <u>Total</u>
---------------	-----------------	----------------------------------	------------------------------

(Millions)

Three Months Ended June 30, 2001

Operating revenue	\$ 881	\$291	\$ 5	\$1,177
Net income (loss)	83	52	(1)	134

Three Months Ended June 30, 2000

Operating revenue	\$ 853	\$292	\$ 2	\$1,147
Net income (loss)	73	56	(32)	97

Six Months Ended June 30, 2001

Operating revenue	\$1,801	\$593	\$ 5	\$2,399
Net income (loss)	179	117	(137)	159

Six Months Ended June 30, 2000

Operating revenue	\$1,692	\$588	\$ (7)	\$2,273
Net income (loss)	149	123	(24)	248

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**VIRGINIA ELECTRIC AND POWER COMPANY**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND 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. unscheduled generation outages;
  4. unusual maintenance or repairs;
  5. unanticipated changes in fossil fuel costs, gas supply costs or availability constraints;
  6. environmental incidents; and
  7. electric transmission or gas pipeline system costs or availability constraints.
- State, federal and international legislative and regulatory developments, including deregulation and restructuring of the electric utility industry and changes in environmental and other relevant laws and regulations to which the Company is subject;
- The timing and implementation of the Company's business separation plan currently under consideration with the Virginia State Corporation Commission (Virginia Commission);
- The effects of competition, including the extent and timing of the entry of additional competitors in the electric market;
- The pursuit of potential business strategies, including acquisitions or dispositions of assets or the development of additional power generation facilities;
- 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 standard-setting 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 trading activities, including price, basis, credit, liquidity, volatility, capacity, transmission, currency exchange rates, interest rates and warranty risks;

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## **VIRGINIA ELECTRIC AND POWER COMPANY**

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

- 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.

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 readers 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.

## **Operating Segments**

The Company manages its operations in a manner that requires disclosure of two primary operating segments - Energy and Delivery. The Energy segment includes the Company's portfolio of generating facilities and power purchase agreements, trading and marketing activities. The Delivery segment includes bulk power transmission, distribution and metering services, and customer service.

Currently, the majority of the Company's revenue is provided through bundled rate tariffs. Such revenue is allocated between the Energy and Delivery segments for internal reporting purposes and discussion herein. Certain activities discussed in Liquidity and Capital Resources are currently not managed at the segment level; however, specific references to segments are made as appropriate. All discussion of trends and variations generally applies to the Company as a whole.

## Results Of Operations

This section provides a general discussion of contributions to net income by the Energy and Delivery segments. Certain expenses not allocated to those segments are included in Corporate and Other. The decrease in other taxes in 2001 reflects the change in Virginia State law whereby the Company is now subject to income taxes rather than gross receipts taxes.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
	(Millions)			
Energy	\$ 83	\$ 73	\$179	\$149
Delivery	52	56	117	123
Corporate and other	<u>(1)</u>	<u>(32)</u>	<u>(137)</u>	<u>(24)</u>
Total net income	<u>\$134</u>	<u>\$ 97</u>	<u>\$159</u>	<u>\$248</u>

## VIRGINIA ELECTRIC AND POWER COMPANY

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

## Energy Segment

Net income for the Energy segment increased \$10 million to \$83 million and \$30 million to \$179 million for the three and six months ended June 30, 2001, respectively, as compared to the comparable periods in 2000. The increase in operating revenue reflects higher fuel rate recoveries from regulated electric sales for the second quarter of 2001, offset in part by a decrease in net revenue from electricity and gas marketing and trading activities. While revenue from regulated electric sales and from electricity and gas marketing and trading activities was higher for the first six months of 2001, as compared to 2000, revenue from electricity marketing and trading activities decreased for the second quarter of 2001, as compared to 2000. Regulated electric sales revenue increased primarily due to higher fuel rates and customer growth for the three-month and six-month periods, partially offset by milder weather in the second quarter of 2001. Electric fuel and purchased energy expenses in 2001 were higher primarily as a result of higher levels of recovery of previously deferred fuel costs; however, such expenses were mitigated by the increased fuel rate recoveries. The Energy segment's net income in 2001 also reflects lower purchased electric capacity costs as a result of the restructuring of the long-term power purchase agreements in the first quarter of 2001. The decrease in depreciation expense reflects the anticipated life-extensions of the Company's operating licenses for its nuclear facilities by 20 years as of January 1, 2001. The application was filed with the Nuclear Regulatory Commission on May 29, 2001.

## Delivery Segment

Net income for the Delivery segment decreased \$4 million to \$52 million and \$6 million to \$117 million for the three and six months ended June 30, 2001, respectively, as compared to the comparable periods in 2000. Regulated electric sales revenue was relatively unchanged in 2001, as compared to 2000, except for a slight increase during the first quarter primarily due to customer growth. In addition, the increased sales from customer growth offset the impact of milder weather during the second quarter of 2001. Although service restoration costs were slightly lower in 2001, this decrease was more than offset by moderate increases in other operations and maintenance and depreciation expenses.

## Corporate and Other

Corporate and Other includes certain expenses for which the Energy and Delivery segments were not allocated: 1) corporate operations and assets; 2) transactions or events not allocated to the segments for internal reporting purposes (including 2001 charge for NUG restructuring, 2000 restructuring costs, 2000 cumulative effect of a change in accounting principle); and 3) intersegment eliminations, where applicable.

*NUG Restructuring* - During the six months ended June 30, 2001, the Company recorded a charge of \$219 million in operations and maintenance expense in connection with the purchase and termination of long-term power purchase agreements. The charge reduced net income by approximately \$136 million for the six months ended June 30, 2001. For further information on restructuring of power purchase agreements, see Note 8 to Consolidated Financial Statements.

*Restructuring Costs* - During the three and six months ended June 30, 2000, the Company incurred restructuring costs of \$49 million and \$69 million, respectively, in connection with the implementation of a plan to restructure the operations of the subsidiaries of Dominion Resources, Inc. (Dominion), the Company's parent company, following Dominion's acquisition of Consolidated Natural Gas Company (CNG). These charges related primarily to costs

associated with work-force reduction activities. See Note 6 to the Consolidated Financial Statements for further information.

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## VIRGINIA ELECTRIC AND POWER COMPANY

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

*Cumulative Effect of a Change in Accounting Principle* - Effective January 1, 2000, as a result of its acquisition of CNG, Dominion adopted a new company-wide standard method of calculating the market related value of plan assets for all pension plans of Dominion and its subsidiaries. The market related value of plan assets is used to determine the expected return on plan assets, a component of net periodic pension cost. The cumulative effect of this accounting change as of January 1, 2000 was \$21 million (net of income taxes of \$11 million). See Note 5 to the Consolidated Financial Statements for further discussion.

#### Liquidity and Capital Resources

##### Internal Sources of Liquidity

Cash flow from operating activities provided approximately \$603 million and \$558 million during the six months ended June 30, 2001 and 2000, respectively. The increase in cash flow from operating activities was attributable to continued growth in regulated electric sales as compared to the prior year. After dividend payments, cash flow from operating activities for the six months ended June 30, 2001 was sufficient to cover all plant and nuclear fuel expenditures during each of the quarters and, on average, covered approximately 59% of the Company's total cash requirements. Short-term cash requirements not met by the timing or amount of cash flow from operations are generally satisfied with proceeds from the short-term borrowings. Long-term cash needs are met through the sale of securities.

##### External Sources of Liquidity

During the six months ended June 30, 2001, the Company issued the following securities:

- \$50 million in aggregate principal amount of Series 2001A, variable rate tax-exempt pollution control Revenue Bonds due March 1, 2031. The net proceeds were used to finance qualifying expenditures made during the construction of facilities at the North Anna Power Station; and
- \$600 million of 5.75% Senior Notes due March 31, 2006. The net proceeds were used for general corporate purposes including repayment of commercial paper and payments associated with the purchase of three generation facilities and the termination of related long-term power purchase agreements. See Note 8 to Consolidated Financial Statements for further discussion.

In April 2001, the Company repaid \$5 million of Medium-Term Notes, which matured on April 23, 2001 and redeemed



\$100 million of its 1991 Series A, 8.75% First and Refunding Mortgage Bonds due April 1, 2021. In addition, the Company repaid two Medium-Term Notes of \$5 million and \$80 million which matured on May 1, 2001 and June 21, 2001, respectively.

The Company has a commercial paper program which is supported by a \$1.75 billion credit facility established by Dominion to support the combined commercial paper programs of Dominion, the Company and CNG. The \$1.75 billion credit facility was established in June 2000 and matures on May 30, 2002. The Company has full access to the \$1.75 billion credit facility; however, it operates with an internal allocation that may vary depending upon the needs of the three participating entities. The Company's commercial paper program was also supported by a \$300 million credit facility, but it was not renewed after its expiration on June 7, 2001.

Net borrowings under the commercial paper program were \$132 million at June 30, 2001, a decrease of \$582 million from amounts outstanding at December 31, 2000. Borrowings under these facilities are used primarily to fund working capital requirements and may vary significantly during the course of the year depending upon the timing and amount of cash requirements not satisfied by cash provided from operations.

In addition to commercial paper, the Company may also issue up to \$200 million in aggregate principal of extendible commercial notes (ECNs) to meet working capital requirements. ECNs are unsecured notes expected to be sold in private placements. All ECNs would have a stated maturity of 390 days from issuance and may be redeemed, at the option of the Company, within 90 days or less from issuance. There were no ECNs outstanding at June 30, 2001.

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## **VIRGINIA ELECTRIC AND POWER COMPANY**

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

As of June 30, 2001, the Company had available \$1 billion of remaining principal amount under currently effective shelf registrations with the Securities and Exchange Commission to meet capital requirements.

#### **Capital Expenditures**

During the six months ended June 30, 2001, the investing activities resulted in a net cash outflow of \$314 million. These activities included plant expenditures of \$295 million and nuclear fuel expenditures of \$35 million. Total plant expenditures included generation-related projects totaled approximately \$107 million and payments related to construction of two combustion turbines, environmental upgrades, and routine capital improvements. In addition, the Company spent approximately \$173 million on transmission and distribution-related projects reflecting routine capital improvements and expenditures associated with new connections. The remaining capital expenditures of \$15 million related to other general and information technology projects.

There have been no significant changes in the planned levels of spending for capacity and other capital projects and maturities of securities as disclosed in Management's Discussion and Analysis of Financial Condition and Results of

Operations (MD&A) included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000. The Company expects to fund its capital requirements and maturities with cash flow from operations and a combination of sales of securities and short-term borrowings.

## **Future Issues and Other Information**

The following discussion of future issues and other information includes significant developments relating to 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.

### **Electric Retail Access Pilot Program and Transition to Retail Competition**

As of June 30, 2001 approximately 82,000 customers have volunteered for the retail access pilot program. Over 24,000 customers are using a competitive energy supplier, decreasing from approximately 30,000 customers reported in the first quarter of 2001. New suppliers continue to apply to be licensed by the Virginia State Corporation Commission (Virginia Commission) to serve customers in the pilot.

During 1998 and 1999, legislation was enacted in Virginia that established a plan to restructure Virginia's electric utility industry and provided for a phased-in transition to a fully competitive retail electric market during the period January 1, 2002 through January 1, 2004. However, in April 2001, the Virginia Commission announced a shorter phase-in schedule, which would require retail choice to all customers in the Company's service territory by January 1, 2003.

The Virginia Commission approved the final rules designed to advance a competitive energy supply market in Virginia and to protect Virginians who participate in retail access beginning January 1, 2002. The rules are effective August 1, 2001 and applicable to competitive retail energy services beginning January 1, 2002.

### **Separation of Electric Generation and Delivery Operations in Virginia**

In May 2001, the Company supplemented a plan for its functional separation by filing a request for approval of an index-based fuel recovery mechanism based on the forecasted generation by fuel type and projected fuel price indices and unbundled rates to reflect the separation and deregulation of generation. The projected fuel price indices are to be updated to actual price indices on an annual basis. The Company also pre-filed the direct testimony and exhibits of company witnesses in support of its functional separation plan. The Virginia Commission has established a hearing date in October 2001 to consider the Company's application. In addition, the Company anticipates making a filing with the North Carolina Commission during the third quarter of 2001 concerning separation of electric generation and delivery operations in North Carolina.

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## **VIRGINIA ELECTRIC AND POWER COMPANY**

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

### **Alliance Regional Transmission Organization (RTO)**

In May 2001, an application was filed with the Virginia Commission as required under its order issued in March 2001. Hearings will be scheduled to consider the Company's application to transfer control of its transmission facilities to the Alliance RTO.

In March 2001, in connection with the application of Illinois Power Company to join the Alliance RTO, a settlement agreement was filed with the FERC involving the Alliance Companies, the Midwest ISO, certain transmission owners in the Midwest ISO and other parties. The settlement agreement provided for two RTOs in the Midwest region with single super-regional rates, an agreement to negotiate a joint rate with PJM and the approval of certain transmission owners to withdraw from the Midwest ISO and join the Alliance RTO. FERC approved that settlement in May 2001.

In July 2001, FERC issued an order conditionally approving the Alliance Companies' RTO filing subject to further filings by the Alliance Companies. Also, FERC initiated mediation for the purpose of facilitating the formation of a single RTO for the Northeastern United States and for a single RTO for the Southeastern United States. In the Northeast, PJM Interconnection, Allegheny Power, the New York ISO, and the New England ISO were directed to participate in the mediation. In the Southeast, FERC directed GridSouth RTO, Southwest Power Pool, Southern Company and Entergy to participate in the mediation.

## **Environmental Matters**

There have been no significant developments with regard to environmental matters disclosed in MD&A and notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000 nor have any significant new environmental matters arisen during the first six months of 2001.

## **Nuclear Relicensing**

The Company filed an application in May 2001 with the Nuclear Regulatory Commission (NRC) to renew the operating licenses of the North Anna and Surry nuclear power stations for an additional 20 years. The NRC is in the process of completing their review of the applications for completeness. Over the next two years, the NRC will perform site visits and review the application in detail.

## **Derivatives and Hedge Accounting**

Future interpretations of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, (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.

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## VIRGINIA ELECTRIC AND POWER COMPANY

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND 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 goodwill or other 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 Obligations*, which provides accounting requirements for the recognition and measurement of liabilities for obligations associated with the retirement of tangible long-lived assets. Under the 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.

The Company has identified retirement obligations associated with the decommissioning of its nuclear generation facilities but has not determined the impact of recognition and measurement of such obligations under the new standard. The Company has not performed a complete assessment of possible retirement obligations associated with its electric utility property.

Also, under the new standard, the realized and unrealized earnings of external trusts available for funding decommissioning activities at the Company's utility nuclear plants will be recorded in other income and other comprehensive income, as appropriate. Currently, the Company records these trusts' earnings in other income with an offsetting charge to expense, also recorded in other income, associated with the accretion of the decommissioning liability. See Note 8 to the Company's Annual Report on Form 10-K for the year ended December 31, 2000. Furthermore, upon adoption of the 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 electric utility. 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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## VIRGINIA ELECTRIC AND POWER COMPANY

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information presented in this Item contain "forward looking statements" as described in the introductory paragraphs of Part I, Item 2 of this Form 10-Q. Your attention is directed to those paragraphs for discussion of various risks and uncertainties that may affect future operations and financial condition.

#### **Market Risk Sensitive Instruments and Risk Management**

On a quarterly basis, an updated sensitivity analysis is presented to disclose quantitative information about the Company's exposure to commodity price risk as the portfolio of derivative commodity contracts held for trading purposes may change significantly each quarter. The Company does not present quarterly updates to the quantitative information regarding interest rate and equity price risk disclosed in *Market Risk Sensitive Instruments and Risk Management* under MD&A included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000. Generally, changes in the portfolio of securities subject to such risks do not give rise to significant changes in the quantitative information reported on an annual basis. At present, the Company's exposure to foreign currency risk associated purchases denominated in foreign currencies is minimal and therefore the Company has not presented quantitative information about foreign currency risk.

The Company has determined a hypothetical loss on the portfolio of derivative commodity contracts held for trading purposes by calculating a hypothetical fair value for each contract assuming a 10% unfavorable change in the market prices of the related commodity and comparing it to the fair value of the contracts based on market prices at June 30, 2001 and December 31, 2000. This hypothetical 10% change in commodity prices would have resulted in a hypothetical loss of approximately \$1 million and \$3 million in the fair value of the commodity contracts as of June 30, 2001 and December 31, 2000, respectively.

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## VIRGINIA ELECTRIC AND POWER 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.

#### **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 the Company.

## **Regulatory**

In June 2000, the Company filed an application with the Virginia State Corporation Commission (Virginia Commission) to make a number of changes to the Possum Point Power Station designed to improve air quality and to meet existing and proposed air emission limitations in Northern Virginia. The plan includes the retirement of two existing coal fired units, the conversion of two existing coal-fired units to gas, and the addition of one new combined cycle unit to be operational by May 2003. The Virginia Commission approved the Company's application in March 2001.

In connection with the above application to modify and add generating units to its Possum Point site, the Company also applied to the Virginia Commission in December 2000 to construct a fourteen-mile gas pipeline for the purpose of supplying natural gas to the site. The Virginia Commission approved the application for the gas pipeline in June 2001.

## **Rates**

In June 2001, the Virginia Commission issued a Final Order in the Company's fuel factor case. The Virginia Commission approved the fuel factor of 1.613 per kWh, which had been in effect on an interim basis since January 1, 2001.

## **Rules Governing Retail Access to Competitive Energy Services**

The Virginia Commission has also established separate proceedings to issue rules and regulations for (1) competition in the provision of metering and billing services; (2) minimum stay periods for customers returning to the Company after having purchased competitive electricity supply service; and (3) the determination of market prices for generation and associated wires charges. Such wires charges are to provide the company with a method to recover any just and reasonable net stranded costs.

See Future Issues in Management's Discussion and Analysis for additional information concerning Separation of Electric Generation and Delivery Operations in Virginia, Alliance Regional Transmission Organization and Nuclear Re-Licensing.

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## **VIRGINIA ELECTRIC AND POWER COMPANY**

### **PART II. OTHER INFORMATION**

**(Continued)**

### **Item 6. Exhibits and Reports on Form 8-K**

**(a) Exhibits:**

- 3.1 Restated Articles of Incorporation, as amended, as in effect on May 6, 1999 (Exhibit 3.1), Form 10-Q for the period ended March 31, 1999, File No. 1-2255, incorporated by reference).
  
- 3.2 Bylaws, as amended, as in effect on April 28, 2000 (Exhibit 3, Form 10- Q for the period ended March 31, 2000, File No. 1-2255, 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.

**VIRGINIA ELECTRIC AND POWER 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.