

VIRGINIA ELECTRIC & POWER CO  
Form 10-Q  
August 08, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

\_\_\_\_\_  
**FORM 10-Q**  
\_\_\_\_\_

(Mark one)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended June 30, 2007

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 001-02255

**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.)

**120 TREDEGAR STREET**

**RICHMOND, VIRGINIA**  
(Address of principal executive offices)

**23219**  
(Zip Code)

**(804) 819-2000**

(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject

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to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

At June 30, 2007, the latest practicable date for determination, 198,047 shares of common stock, without par value, of the registrant were outstanding.

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## VIRGINIA ELECTRIC AND POWER COMPANY

## PART I. FINANCIAL INFORMATION

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

## CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(millions)	Three Months Ended		Six Months Ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
<b>Operating Revenue</b>	<b>\$ 1,424</b>	<b>\$ 1,323</b>	<b>\$ 2,867</b>	<b>\$ 2,656</b>
<b>Operating Expenses</b>				
Electric fuel and energy purchases	661	555	1,336	1,112
Purchased electric capacity	107	109	223	226
Other energy-related commodity purchases	8	8	16	18
Other operations and maintenance:				
External suppliers	196	207	402	396
Affiliated suppliers	78	81	156	158
Depreciation and amortization	140	135	274	267
Other taxes	43	43	88	88
<b>Total operating expenses</b>	<b>1,233</b>	<b>1,138</b>	<b>2,495</b>	<b>2,265</b>
Income from operations	191	185	372	391
Other income	17	17	40	41
Interest and related charges:				
Interest expense	75	63	129	133
Interest expense junior subordinated notes payable to affiliated trust	7	7	15	15
<b>Total interest and related charges</b>	<b>82</b>	<b>70</b>	<b>144</b>	<b>148</b>
Income before income tax expense	126	132	268	284
Income tax expense	47	46	100	101
Income before extraordinary item	79	86	168	183
Extraordinary item <sup>(1)</sup>	(158)		(158)	
<b>Net Income (Loss)</b>	<b>(79)</b>	<b>86</b>	<b>10</b>	<b>183</b>
Preferred dividends	4	4	8	8
Balance available for common stock	\$ (83)	\$ 82	\$ 2	\$ 175

(1) Net of income tax benefit of \$101 million for the three and six months ended June 30, 2007.

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



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

	June 30,	December 31,
(millions)	2007	2006 <sup>(1)</sup>
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 25	\$ 18
Customer accounts receivable (less allowance for doubtful accounts of \$8 and \$7)	743	650
Other receivables (less allowance for doubtful accounts of \$8 and \$9)	113	98
Inventories (average cost method)	457	505
Prepayments	54	133
Other	61	51
<b>Total current assets</b>	<b>1,453</b>	<b>1,455</b>
<b>Investments</b>		
Nuclear decommissioning trust funds	1,351	1,293
Other	22	22
<b>Total investments</b>	<b>1,373</b>	<b>1,315</b>
<b>Property, Plant and Equipment</b>		
Property, plant and equipment	21,207	20,771
Accumulated depreciation and amortization	(8,576)	(8,353)
<b>Total property, plant and equipment, net</b>	<b>12,631</b>	<b>12,418</b>
<b>Deferred Charges and Other Assets</b>	<b>452</b>	<b>495</b>
<b>Total assets</b>	<b>\$ 15,909</b>	<b>\$ 15,683</b>

(1) The Consolidated Balance Sheet at December 31, 2006 has been derived from the audited Consolidated Financial Statements at that date. The accompanying notes are an integral part of the Consolidated Financial Statements.

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

(millions)	June 30, 2007	December 31, 2006 <sup>(1)</sup>
<b>LIABILITIES AND SHAREHOLDER S EQUITY</b>		
<b>Current Liabilities</b>		
Securities due within one year	\$ 644	\$ 1,267
Short-term debt	914	618
Accounts payable	458	418
Other	505	638
Total current liabilities	2,521	2,941
<b>Long-Term Debt</b>		
Long-term debt	3,492	2,987
Junior subordinated notes payable to affiliated trust	412	412
Notes payable other affiliates	220	220
Total long-term debt	4,124	3,619
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes and investment tax credits	1,995	2,308
Asset retirement obligations	659	641
Regulatory liabilities	961	430
Other	262	95
Total deferred credits and other liabilities	3,877	3,474
Total liabilities	10,522	10,034
<b>Commitments and Contingencies (see Note 10)</b>		
<b>Preferred Stock Not Subject to Mandatory Redemption</b>	257	257
<b>Common Shareholder s Equity</b>		
Common stock no par, 300,000 shares authorized; 198,047 shares outstanding	3,388	3,388
Other paid-in capital	888	887
Retained earnings	821	955
Accumulated other comprehensive income	33	162
Total common shareholder s equity	5,130	5,392
Total liabilities and shareholder s equity	\$ 15,909	\$ 15,683

(1) The Consolidated Balance Sheet at December 31, 2006 has been derived from the audited Consolidated Financial Statements at that date.

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



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**VIRGINIA ELECTRIC AND POWER COMPANY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

(millions)	Six Months Ended	
	2007	June 30, 2006
<b>Operating Activities</b>		
Net income	\$ 10	\$ 183
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	317	307
Deferred income taxes and investment tax credits, net	(2)	(29)
Deferred fuel expenses, net	69	56
Extraordinary item, net of income taxes	158	
Other adjustments to net income	(23)	(45)
Changes in:		
Accounts receivable	(99)	37
Affiliated accounts receivable and payable	1	25
Inventories	48	(63)
Accounts payable	61	(60)
Accrued interest, payroll and taxes	(18)	152
Prepayments	76	13
Other operating assets and liabilities	79	98
<b>Net cash provided by operating activities</b>	<b>677</b>	<b>674</b>
<b>Investing Activities</b>		
Plant construction and other property additions	(460)	(421)
Purchases of nuclear fuel	(66)	(60)
Purchases of securities	(279)	(267)
Proceeds from sales of securities	263	256
Other	9	22
<b>Net cash used in investing activities</b>	<b>(533)</b>	<b>(470)</b>
<b>Financing Activities</b>		
Issuance (repayment) of short-term debt, net	296	(655)
Issuance (repayment) of affiliated current borrowings, net	(140)	190
Issuance of long-term debt	600	1,000
Repayment of long-term debt	(726)	(612)
Common dividend payments	(142)	(139)
Preferred dividend payments	(8)	(8)
Other	(17)	(14)
<b>Net cash used in financing activities</b>	<b>(137)</b>	<b>(238)</b>
Increase (decrease) in cash and cash equivalents	7	(34)
Cash and cash equivalents at beginning of period	18	54
<b>Cash and cash equivalents at end of period</b>	<b>\$ 25</b>	<b>\$ 20</b>

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**

**(Unaudited)**

**Note 1. Nature of Operations**

Virginia Electric and Power Company (the Company), a Virginia public service company, is a wholly-owned subsidiary of Dominion Resources, Inc. (Dominion). We are a regulated public utility that generates, transmits and distributes electricity for sale in Virginia and northeastern North Carolina. As of June 30, 2007, we served approximately 2.4 million retail customer accounts, including governmental agencies and wholesale customers such as rural electric cooperatives and municipalities. We are a member of PJM Interconnection, LLC (PJM), a regional transmission organization (RTO), and our electric transmission facilities are integrated into the PJM wholesale electricity markets.

We manage our daily operations through three primary operating segments: Delivery, Energy and Generation. In addition, we report our corporate and other functions as a segment. Our assets remain wholly owned by us and our legal subsidiaries.

The terms Virginia Power, we, our and us are used throughout this report and, depending on the context of their use, may represent any of the following: the legal entity, Virginia Electric and Power Company, one of Virginia Electric and Power Company's consolidated subsidiaries or operating segments or the entirety of Virginia Electric and Power Company, including our Virginia and North Carolina operations and our consolidated subsidiaries.

**Note 2. Significant Accounting Policies**

As permitted by the rules and regulations of the Securities and Exchange Commission, our accompanying unaudited Consolidated Financial Statements contain certain condensed financial information and exclude certain footnote disclosures normally included in annual audited consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). These unaudited Consolidated Financial Statements should be read in conjunction with our Consolidated Financial Statements and Notes in our Annual Report on Form 10-K for the year ended December 31, 2006.

In our opinion, our accompanying unaudited Consolidated Financial Statements contain all adjustments, including normal recurring accruals, necessary to present fairly our financial position as of June 30, 2007, our results of operations for the three and six months ended June 30, 2007 and 2006, and our cash flows for the six months ended June 30, 2007 and 2006.

We make certain estimates and assumptions in preparing our Consolidated Financial Statements in accordance with GAAP. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for the periods presented. Actual results may differ from those estimates.

Our accompanying unaudited Consolidated Financial Statements include, after eliminating intercompany transactions and balances, our accounts and those of our majority-owned subsidiaries and those variable interest entities (VIEs) where we have been determined to be the primary beneficiary.

In accordance with GAAP, we report certain contracts and instruments at fair value. Market pricing and indicative price information from external sources are used to measure fair value when available. In the absence of this information, we estimate fair value based on near-term and historical price information and statistical methods. For individual contracts, the use of differing assumptions could have a material effect on the contract's estimated fair value. See Note 2 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2006 for more discussion of our estimation techniques.

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The results of operations for the interim periods are not necessarily indicative of the results expected for the full year. Information for quarterly periods is affected by seasonal variations in sales, electric fuel and energy purchases and other factors.

Certain amounts in our 2006 Consolidated Financial Statements and Notes have been recast to conform to the 2007 presentation.

As discussed further in Note 5, we reapplied the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation* (SFAS No. 71), to the Virginia jurisdiction of our generation operations upon enactment of reregulation legislation in Virginia on April 4, 2007. In connection with the reapplication of SFAS No. 71 to these operations, we prospectively changed certain of our accounting policies to those used by cost-of-service rate-regulated entities.

**Note 3. Newly Adopted Accounting Standards**

***FIN 48***

We adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), on January 1, 2007. As a result of the implementation of FIN 48, we recorded a \$5 million benefit, primarily attributable to interest, to beginning retained earnings for the cumulative effect of the change in accounting principle.

Unrecognized tax benefits represent those tax benefits related to tax positions that have been taken or are expected to be taken in tax returns that are not recognized in the financial statements because, in accordance with FIN 48, management has either measured the tax benefit at an amount less than the benefit claimed or expected to be claimed or concluded that it is not more-likely-than-not that the tax position will be ultimately sustained. Unrecognized tax benefits may result in an increase in income taxes payable, a reduction of an income tax refund receivable, an increase in deferred tax liabilities, or a decrease in deferred tax assets. Noncurrent income taxes payable related to unrecognized tax benefits are classified in other deferred credits and other liabilities; current payables are included in other current liabilities, except when such amounts are presented net with amounts receivable from or amounts prepaid to taxing authorities in prepayments.

In May 2007, the FASB issued FASB Staff Position No. FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48* (FSP FIN 48-1), to provide guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FSP FIN 48-1 should have been applied in the initial adoption of FIN 48. In light of its delayed issuance, if an enterprise did not implement FIN 48 in a manner consistent with the provisions of FSP FIN 48-1, it is required to retrospectively apply its provisions to the date of its initial adoption of FIN 48. The adoption of FSP FIN 48-1 did not impact the beginning balance of unrecognized tax benefits.

As of January 1, 2007, unrecognized tax benefits totaled \$226 million. For the majority of these tax positions, the ultimate deductibility is highly certain, but there is uncertainty about the timing of such deductibility. For the six months ended June 30, 2007, the activity for unrecognized tax benefits for tax positions taken in prior years included gross increases of \$16 million and reductions of \$14 million due to settlements with taxing authorities. Unrecognized tax benefits as of January 1, 2007, included \$5 million that, if recognized, would lower the effective tax rate. Through June 30, 2007, there have been no significant changes in unrecognized tax benefits that, if recognized, would lower the effective tax rate.

Consistent with our existing policies, we continue to recognize estimated interest payable on underpayments of income taxes in interest expense and estimated penalties that may result from the settlement of some uncertain tax positions in other income. As of January 1, 2007, we had accrued \$17 million for interest receivable and \$1 million for estimated penalties.

We file a consolidated United States (U.S.) federal income tax return and participate in an intercompany tax sharing agreement with Dominion and its subsidiaries. In addition, where applicable, we participate in combined income tax returns with Dominion and its subsidiaries in various states, and we file separate income tax returns in other states.

For Dominion and its subsidiaries, the U.S. federal statute of limitations has expired for tax years prior to 1993.

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The U.S. Congressional Joint Committee on Taxation has recently completed its review of our settlement for tax years 1993-1998 with the Appellate Division of the Internal Revenue Service (IRS). As a result, we will receive a tax refund of approximately \$39 million. Receipt of this refund will not impact our results of operations. We are also currently engaged in settlement negotiations with the Appellate Division of the IRS regarding certain adjustments proposed during the examination of tax years 1999-2001. With settlement negotiations possibly concluding later this year, unrecognized tax benefits could be reduced by approximately \$22 million. At this time, we cannot estimate the impact on unrecognized tax benefits that may result in the next twelve months from settlement negotiations with the IRS for those adjustments remaining in dispute. In addition, the examination of our 2002 and 2003 returns by the IRS was completed in June 2007. In July 2007, we filed protests for certain proposed adjustments with the Appellate Division of the IRS.

Dominion's combined income tax returns filed with Virginia for 2003 and subsequent years remain subject to examination by taxing authorities. We are also obligated to report adjustments resulting from IRS settlements of earlier years to state taxing authorities. In addition, if state net operating losses or credits, generated by Dominion and its subsidiaries in years for which the statute of limitations has expired, are utilized, the determination of such amounts is subject to examination by state taxing authorities.

***EITF 06-3***

Effective January 1, 2007, Emerging Issues Task Force (EITF) Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)*, requires certain disclosures if an entity collects any tax assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between the entity, as a seller, and its customers. We collect sales, consumption and consumer utility taxes but exclude such amounts from revenue.

**Note 4. Recently Issued Accounting Standards**

***SFAS No. 157***

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 clarifies that fair value should be based on assumptions that market participants would use when pricing an asset or liability and establishes a fair value hierarchy of three levels that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data. SFAS No. 157 requires fair value measurements to be separately disclosed by level within the fair value hierarchy. The provisions of SFAS No. 157 will become effective for us beginning January 1, 2008. Generally, the provisions of this statement are to be applied prospectively. Certain situations, however, require retrospective application as of the beginning of the year of adoption through the recognition of a cumulative effect of accounting change. Such retrospective application is required for financial instruments, including derivatives and certain hybrid instruments with limitations on initial gains or losses under EITF Issue No. 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*, and SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments*. We are currently evaluating the impact that SFAS No. 157 will have on our results of operations and financial condition.

***SFAS No. 159***

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 provides an entity with the option, at specified election dates, to measure certain financial assets and liabilities and other items at fair value, with changes in fair value recognized in earnings as those changes occur. SFAS No. 159 also establishes presentation and disclosure requirements that include displaying the fair value of those assets and liabilities for which the entity elected the fair value option on the face of the balance sheet and providing management's reasons for electing the fair value option for each eligible item. The provisions of SFAS No. 159 will become effective for us beginning January 1, 2008. We are currently evaluating the impact that SFAS No. 159 may have on our results of operations and financial condition.

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### **Note 5. Reapplication of SFAS No. 71**

In March 1999, we discontinued the application of SFAS No. 71 to the majority of our generation operations upon the enactment of deregulation legislation in Virginia. Our transmission and distribution operations continued to apply the provisions of SFAS No. 71 since they remained subject to cost-of-service rate regulation.

In April 2007, the Virginia General Assembly passed legislation that returns the Virginia jurisdiction of our generation operations to cost-of-service rate regulation. As a result, we reapplied the provisions of SFAS No. 71 to those operations on April 4, 2007, the date the legislation was enacted. The accounting impacts of the reapplication of SFAS No. 71 are described below.

#### ***Extraordinary Item***

The reapplication of SFAS No. 71 to the Virginia jurisdiction of our generation operations resulted in a \$259 million (\$158 million after tax) extraordinary charge and the reclassification of \$195 million (\$119 million after tax) of unrealized gains from accumulated other comprehensive income (AOCI). This was done in order to establish a \$454 million long-term regulatory liability for amounts collected from Virginia jurisdictional customers and placed in external trusts (including income, losses and changes in fair value thereon) for the future decommissioning of our nuclear generation stations, in excess of amounts recorded pursuant to SFAS No. 143, *Accounting for Asset Retirement Obligations*.

#### ***Accounting Policy Changes***

In connection with the reapplication of SFAS No. 71, we prospectively changed certain of our accounting policies for the Virginia jurisdiction of our generation operations to those used by cost-of-service rate-regulated entities. Other than the extraordinary item discussed above, the overall impact of these changes, summarized below, was not material to our results of operations or financial condition.

#### ***Nuclear Decommissioning Trust Funds***

Net realized and unrealized gains and losses are now recorded to the regulatory liability established upon reapplication of SFAS No. 71 as described above. Previously, realized gains and losses and any other-than-temporary declines in fair value were included in other income and unrealized gains were reported as a component of AOCI, net of tax.

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

Early retirements of generation-related utility property are now recorded to accumulated depreciation rather than recognizing gains and losses upon retirement. Cost of removal incurred or salvage proceeds realized in connection with a retirement of generation property, plant and equipment are now recorded to accumulated depreciation rather than being charged to expense as incurred. We discontinued capitalizing interest on all generation construction projects since the Virginia State Corporation Commission (Virginia Commission) has historically allowed for current recovery of construction financing costs.

#### ***Asset Retirement Obligations***

Accretion and depreciation associated with nuclear decommissioning asset retirement obligations, previously charged to expense, are now recorded to a regulatory liability, in order to match the recognition for rate-making purposes.

#### ***Derivative Instruments***

Previously, unrealized gains and losses resulting from changes in the fair value of derivative instruments designated as cash flow or fair value hedges under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, were recorded in AOCI, or long-term debt, respectively. Also, ineffectiveness and gains and losses excluded from the measurement of ineffectiveness were recorded through earnings as incurred. Following the reapplication of SFAS No. 71, changes in the fair value of these derivative instruments will be classified as regulatory assets or regulatory liabilities as these instruments now receive regulatory treatment. Gains or losses on the derivative instruments will be recognized when the related transactions impact net income.



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Our operating revenue consists of the following:

(millions)	Three Months Ended		Six Months Ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
Regulated electric sales	\$ 1,386	\$ 1,283	\$ 2,797	\$ 2,581
Other	38	40	70	75
<b>Total operating revenue</b>	<b>\$ 1,424</b>	<b>\$ 1,323</b>	<b>\$ 2,867</b>	<b>\$ 2,656</b>

**Note 7. Comprehensive Income**

The following table presents total comprehensive income:

(millions)	Three Months Ended		Six Months Ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
Net income (loss)	\$ (79)	\$ 86	\$ 10	\$ 183
Other comprehensive loss:				
Net other comprehensive loss associated with effective portion of changes in fair value of derivatives designated as cash flow hedges, net of taxes and amounts reclassified to earnings <sup>(1)</sup>	(19)		(12)	(7)
Other <sup>(2)</sup>	(115)	(17)	(117)	(7)
<b>Other comprehensive loss</b>	<b>(134)</b>	<b>(17)</b>	<b>(129)</b>	<b>(14)</b>
<b>Total comprehensive income (loss)</b>	<b>\$ (213)</b>	<b>\$ 69</b>	<b>\$ (119)</b>	<b>\$ 169</b>

- (1) 2007 amounts reflect the impact of the reclassification of derivative-related amounts previously recorded in AOCI to regulatory liabilities, as a result of the reapplication of SFAS No. 71 to the Virginia jurisdiction of our generation operations.
- (2) For the three and six months ended June 30, 2007, the amount primarily reflects the impact of the reclassification of gross unrealized gains on investments held in nuclear decommissioning trusts associated with the Virginia jurisdiction of our generation operations previously recorded in AOCI to regulatory liabilities, as a result of the reapplication of SFAS No. 71. For the three and six months ended June 30, 2006, the amount primarily reflects net unrealized losses on investments held in nuclear decommissioning trusts.

**Note 8. Variable Interest Entities**

Certain variable pricing terms in some of our long-term power and capacity contracts cause them to be considered potential variable interests in the counterparties. As discussed in Note 14 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2006, two potential VIEs with which we have existing power purchase agreements (signed prior to December 31, 2003), had not provided sufficient information for us to perform our evaluation under FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46R).



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As of June 30, 2007, no further information has been received from the two remaining potential VIEs. We will continue our efforts to obtain information and will complete an evaluation of our relationship with each of these potential VIEs if sufficient information is ultimately obtained. We have remaining purchase commitments with these two potential VIE supplier entities of \$1.2 billion at June 30, 2007. We are not subject to any risk of loss from these potential VIEs, other than the remaining purchase commitments. We paid \$24 million for electric generation capacity from these entities in the three months ended June 30, 2007 and 2006. We paid \$23 million and \$19 million for electric energy from these entities in the three months ended June 30, 2007 and 2006, respectively. We paid \$50 million and \$49 million for electric generation capacity and \$49 million and \$37 million for electric energy from these entities in the six months ended June 30, 2007 and 2006, respectively.

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In 2006, we restructured three long-term power purchase contracts with two VIEs, of which we are not the primary beneficiary. The restructured contracts expire between 2015 and 2017. We have remaining purchase commitments with these two VIE supplier entities of \$1 billion at June 30, 2007. We are not subject to any risk of loss from these VIEs, other than the remaining purchase commitments. We paid \$30 million and \$29 million for electric generation capacity from these entities in the three months ended June 30, 2007 and 2006, respectively. We paid \$13 million for electric energy from these entities in the three months ended June 30, 2007 and 2006. We paid \$59 million and \$58 million for electric generation capacity and \$27 million and \$28 million for electric energy from these entities in the six months ended June 30, 2007 and 2006, respectively.

During 2005, we entered into four long-term contracts with unrelated limited liability companies (LLCs) to purchase synthetic fuel produced from coal. Certain variable pricing terms in the contracts protect the equity holders from variability in the cost of their coal purchases, and therefore, the LLCs were determined to be VIEs. After completing our FIN 46R analysis, we concluded that although our interests in the contracts, as a result of their pricing terms, represent variable interests in the LLCs, we are not the primary beneficiary. We paid \$121 million and \$104 million to the LLCs for coal and synthetic fuel produced from coal in the three months ended June 30, 2007 and 2006, respectively, and \$221 million and \$215 million to the LLCs for coal and synthetic fuel produced from coal in the six months ended June 30, 2007 and 2006, respectively. We are not subject to any risk of loss from the contractual arrangements, as our only obligation to the VIEs is to purchase the synthetic fuel that the VIEs produce according to the terms of the applicable purchase contracts. These contracts will terminate on December 31, 2007.

Our Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006 reflect net property, plant and equipment of \$332 million and \$337 million, respectively and \$370 million of debt, related to the consolidation, in accordance with FIN 46R, of a variable interest lessor entity through which we have financed and leased a power generation plant. The debt is non-recourse to us and is secured by the entity's property, plant and equipment. The lease under which we operate the power generation facility terminates in August 2007. We intend to take legal title to the facility through repayment of the lessor's related debt at the end of the lease term, subject to regulatory approval.

**Note 9. Significant Financing Transactions**

***Joint Credit Facilities and Short-term Debt***

We use short-term debt, primarily commercial paper, to fund working capital requirements and as a bridge to long-term debt financing. The level of our borrowings may vary significantly during the course of the year, depending upon the timing and amount of cash requirements not satisfied by cash from operations. Short-term financing is supported by a \$3.0 billion five-year joint revolving credit facility dated February 2006 with Dominion, which is scheduled to terminate in February 2011. This credit facility is being used for working capital, as support for the combined commercial paper programs of Dominion and us and other general corporate purposes. This credit facility can also be used to support up to \$1.5 billion of letters of credit.

At June 30, 2007, total outstanding commercial paper supported by the joint credit facility was \$1.1 billion, of which our borrowings were \$914 million. At June 30, 2007, total outstanding letters of credit supported by the joint credit facility were \$238 million, of which approximately \$4 million was issued on our behalf.

At June 30, 2007, capacity available under the joint credit facility was \$1.6 billion.

***Long-term Debt***

In May 2007, we issued \$600 million of 6% senior notes that mature in 2037. We used the proceeds for general corporate purposes, including the repayment of short-term debt.

During the six months ended June 30, 2007, we repaid \$726 million of our long-term debt.

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### **Note 10. Commitments and Contingencies**

Other than the following matters, there have been no significant developments regarding commitments and contingencies as disclosed in Note 21 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2006, or Note 10 to the Consolidated Financial Statements in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, nor have any significant new matters arisen during the quarter ended June 30, 2007.

#### ***Guarantees and Surety Bonds***

As of June 30, 2007, we had issued \$10 million of guarantees primarily to support commodity transactions of our subsidiaries. We had also purchased \$72 million of surety bonds for various purposes, including providing workers' compensation coverage and the posting of security to suspend execution of the judgment during the appeal of the Norfolk Southern matter, as discussed in *Litigation* in Note 21 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2006. Under the terms of surety bonds, we are obligated to indemnify the respective surety bond company for any amounts paid.

#### ***Nuclear Operations***

The Price-Anderson Act provides the public up to \$10.8 billion of liability protection per nuclear incident via obligations required of owners of nuclear power plants. The Price-Anderson Act Amendment of 1988 allows for an inflationary provision adjustment every five years. We have purchased \$300 million of coverage from commercial insurance pools with the remainder provided through a mandatory industry risk-sharing program. In the event of a nuclear incident at any licensed nuclear reactor in the U.S., we could be assessed up to \$100.6 million for each of our four licensed reactors, not to exceed \$15 million per year per reactor. There is no limit to the number of incidents for which this retrospective premium can be assessed. The Price-Anderson Act was first enacted in 1957 and was renewed again in 2005.

Our current level of property insurance coverage (\$2.55 billion each for North Anna and Surry, individually) exceeds the Nuclear Regulatory Commission's (NRC) minimum requirement for nuclear power plant licensees of \$1.06 billion per reactor site and includes coverage for premature decommissioning and functional total loss. The NRC requires that the proceeds from this insurance be used first, to return the reactor to and maintain it in a safe and stable condition and second, to decontaminate the reactor and station site in accordance with a plan approved by the NRC. Our nuclear property insurance is provided by Nuclear Electric Insurance Limited (NEIL), a mutual insurance company, and is subject to retrospective premium assessments in any policy year in which losses exceed the funds available to the insurance company. The maximum assessment for the current policy period is \$51 million. Based on the severity of the incident, the board of directors of our nuclear insurer has the discretion to lower or eliminate the maximum retrospective premium assessment. We have the financial responsibility for any losses that exceed the limits or for which insurance proceeds are not available because they must first be used for stabilization and decontamination.

We purchase insurance from NEIL to cover the cost of replacement power during the prolonged outage of a nuclear unit due to direct physical damage of the unit. Under this program, we are subject to a retrospective premium assessment for any policy year in which losses exceed funds available to NEIL. The current policy period's maximum assessment is \$19 million.

Old Dominion Electric Cooperative, a part owner of North Anna Power Station, is responsible to us for its share of the nuclear decommissioning obligation and insurance premiums on applicable units, including any retrospective premium assessments and any losses not covered by insurance.

**Table of Contents****Note 11. Credit Risk**

We maintain a provision for credit losses based on factors surrounding the credit risk of our customers, historical trends and other information. We believe, based on our credit policies and our June 30, 2007 provision for credit losses, that it is unlikely that a material adverse effect on our financial position, results of operations or cash flows would occur as a result of counterparty nonperformance.

We sell electricity and provide distribution and transmission services to customers in Virginia and northeastern North Carolina. Management believes that this geographic concentration risk is mitigated by the diversity of our customer base, which includes residential, commercial and industrial customers, as well as rural electric cooperatives and municipalities. Credit risk associated with trade accounts receivable from energy consumers is limited due to the large number of customers.

Our exposure to potential concentrations of credit risk results primarily from sales to wholesale customers. Our gross credit exposure for each counterparty is calculated as outstanding receivables plus any unrealized on or off-balance sheet exposure, taking into account contractual netting rights. Gross credit exposure is calculated prior to the application of collateral. At June 30, 2007, our gross credit exposure totaled \$49 million. Of this amount, 73% related to a single counterparty; however, the entire balance is with investment grade entities. We held no collateral for these transactions at June 30, 2007.

**Note 12. Related Party Transactions**

We engage in related party transactions primarily with other Dominion subsidiaries (affiliates). Our receivable and payable balances with affiliates are settled based on contractual terms or on a monthly basis, depending on the nature of the underlying transactions. We are included in Dominion's consolidated federal income tax return and participate in certain Dominion benefit plans. A discussion of significant related party transactions follows.

**Transactions with Affiliates**

We transact with affiliates for certain quantities of natural gas and other commodities in the ordinary course of business.

Dominion Resources Services, Inc. (Dominion Services) provides accounting, legal and certain administrative and technical services to us. In addition, we provide certain services to affiliates, including charges for facilities and equipment usage.

Presented below are significant transactions with Dominion Services and other affiliates:

(millions)	Three Months Ended		Six Months Ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
Commodity purchases from affiliates	\$ 78	\$ 46	\$ 127	\$ 80
Services provided by affiliates	78	81	156	158

We have borrowed funds from Dominion under both short-term and long-term borrowing arrangements. At December 31, 2006, our outstanding borrowings, net of repayments, under the Dominion money pool for our nonregulated subsidiaries totaled \$140 million. There were no money pool borrowings at June 30, 2007. At June 30, 2007 and December 31, 2006, our borrowings from Dominion under a long-term note totaled \$220 million. Net interest charges incurred by us related to these borrowings were \$1 million for each of the three months ended June 30, 2007 and 2006, respectively, and \$4 million and \$3 million in the six months ended June 30, 2007 and 2006, respectively.

**Table of Contents****Note 13. Operating Segments**

We are organized primarily on the basis of products and services sold in the U.S. The majority of our revenue is provided through tariff rates. Generally, such revenue is allocated for management reporting based on an unbundled rate methodology among our Delivery, Energy and Generation segments. We manage our operations through the following segments:

*Delivery* includes our regulated electric distribution and customer service businesses.

*Energy* includes our regulated electric transmission operations.

*Generation* includes our regulated generation and energy supply operations.

*Corporate* includes our corporate and other functions. The contribution to net income by our primary operating segments is determined based on a measure of profit that management believes represents the segments' core earnings. As a result, certain specific items attributable to those segments have been excluded from the profit measures evaluated by management, either in assessing segment performance or in allocating resources among the segments and are instead reported in the Corporate segment. For the six months ended June 30, 2007 and 2006, we reported net expenses of \$164 million and \$4 million, respectively, in our Corporate segment, attributable to our operating segments.

The net expenses in 2007 related to the following items attributable to our Generation segment:

A \$259 million (\$158 million after-tax) extraordinary charge in connection with the reapplication of SFAS No. 71 to the Virginia jurisdiction of our generation operations;

A \$6 million (\$4 million after-tax) charge resulting from a contract termination settlement; and

A \$3 million (\$2 million after-tax) impairment charge related to other-than-temporary declines in the fair value of securities held as investments in our nuclear decommissioning trusts during the first quarter of 2007.

The net expenses in 2006 related to a \$7 million (\$4 million after-tax) charge resulting from the write-off of certain assets no longer in use at one of our electric generating facilities, attributable to our Generation segment.

The following table presents segment information pertaining to our operations:

	Consolidated				
(millions)	Delivery	Energy	Generation	Corporate	Total
<b>Three Months Ended June 30, 2007</b>					
Operating revenue	\$ 299	\$ 60	\$ 1,064	\$ 1	\$ 1,424
Extraordinary item, net of tax				(158)	(158)
Net income (loss)	68	22	(6)	(163)	(79)
<b>Three Months Ended June 30, 2006</b>					
Operating revenue	\$ 287	\$ 52	\$ 983	\$ 1	\$ 1,323
Net income (loss)	66	16	8	(4)	86
<b>Six Months Ended June 30, 2007</b>					
Operating revenue	\$ 606	\$ 116	\$ 2,142	\$ 3	\$ 2,867
Extraordinary item, net of tax				(158)	(158)
Net income (loss)	145	42	(8)	(169)	10
<b>Six Months Ended June 30, 2006</b>					
Operating revenue	\$ 576	\$ 104	\$ 1,976	\$	\$ 2,656

Net income (loss)	133	33	21	(4)	183
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**VIRGINIA ELECTRIC AND POWER COMPANY**

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

**FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) discusses the results of operations and general financial condition of Virginia Electric and Power Company. MD&A should be read in conjunction with our Consolidated Financial Statements. The terms Virginia Power, Company, we, our and us are used throughout this report and, depending on the context of their use, represent any of the following: the legal entity, Virginia Electric and Power Company, one of Virginia Electric and Power Company's consolidated subsidiaries or operating segments, or the entirety of Virginia Electric and Power Company, including our Virginia and North Carolina operations and our consolidated subsidiaries. We are a wholly-owned subsidiary of Dominion.

**Contents of MD&A**

Our MD&A consists of the following information:

Forward-Looking Statements

Accounting Matters

Results of Operations

Segment Results of Operations

Liquidity and Capital Resources

Future Issues and Other Matters

**Forward-Looking Statements**

This report contains statements concerning our expectations, plans, objectives, future financial performance and other statements that are not historical facts. These statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In most cases, the reader can identify these forward-looking statements by such words as anticipate, estimate, forecast, expect, believe, should, could, plan, may or other similar words.

We make forward-looking statements with full knowledge that risks and uncertainties exist that may cause actual results to differ materially from predicted results. Factors that may cause actual results to differ are often presented with the forward-looking statements themselves. Additionally, other factors may cause actual results to differ materially from those indicated in any forward-looking statement. These factors include but are not limited to:

Unusual weather conditions and their effect on energy sales to customers and energy commodity prices;

Extreme weather events, including hurricanes and winter storms, that can cause outages and property damage to our facilities;

State and federal legislative and regulatory developments and changes to environmental and other laws and regulations, including those related to climate change, to which we are subject;

Cost of environmental compliance, including those costs related to climate change;

Risks associated with the operation of nuclear facilities;

Fluctuations in energy-related commodity prices and the effect these could have on our earnings, liquidity position and the underlying value of our assets;

Capital market conditions, including price risk due to marketable securities held as investments in nuclear decommissioning trusts;

Fluctuations in interest rates;

Changes in rating agency requirements or credit ratings and the effect on availability and cost of capital;

Changes in financial or regulatory accounting principles or policies imposed by governing bodies;

Employee workforce factors including collective bargaining agreements and labor negotiations with union employees;

The risks of operating businesses in regulated industries that are subject to changing regulatory structures;

Changes in rules for RTOs in which we participate, including changes in rate designs and new and evolving capacity models; and

Political and economic conditions, including the threat of domestic terrorism, inflation and deflation.

Additionally, other risks that could cause actual results to differ from predicted results are set forth in Item 1A. Risk Factors in this report, in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, and in our Annual Report on Form 10-K for the year ended December 31, 2006.



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Our forward-looking statements are based on our beliefs and assumptions using information available at the time the statements are made. We caution the reader not to place undue reliance on our forward-looking statements because the assumptions, beliefs, expectations and projections about future events may, and often do, differ materially from actual results. We undertake no obligation to update any forward-looking statement to reflect developments occurring after the statement is made.

**Accounting Matters****Critical Accounting Policies and Estimates**

As of June 30, 2007, there have been no significant changes with regard to critical accounting policies and estimates as disclosed in MD&A in our Annual Report on Form 10-K for the year ended December 31, 2006. The policies disclosed included the accounting for: asset retirement obligations, regulated operations, unbilled revenue and income taxes.

**Other**

See Notes 3 and 4 to our Consolidated Financial Statements for a discussion of newly adopted and recently issued accounting standards, and Note 5 related to the reapplication of SFAS No. 71 to the Virginia jurisdiction of our generation operations.

**Results of Operations**

Presented below is a summary of our consolidated results for the quarter and year-to-date periods ended June 30, 2007 and 2006:

(millions)	Second Quarter			Year-To-Date		
	2007	2006	\$ Change	2007	2006	\$ Change
Net income (loss)	\$ (79)	\$ 86	\$ (165)	\$ 10	\$ 183	\$ (173)

**Overview****Second Quarter 2007 vs. 2006**

We reported a net loss of \$79 million in 2007, as compared to net income of \$86 million in 2006. Unfavorable drivers include an extraordinary charge in connection with the reapplication of SFAS No. 71 to the Virginia jurisdiction of our generation operations, and an increase in electric fuel and energy purchases resulting primarily from increased consumption of fossil fuel and higher purchased power costs due to an increase in the number of heating and cooling degree days. Favorable drivers include an increase in regulated electric sales resulting from weather and customer growth.

**Year-To-Date 2007 vs. 2006**

Net income decreased 95% to \$10 million. Unfavorable drivers include an extraordinary charge in connection with the reapplication of SFAS No. 71 to the Virginia jurisdiction of our generation operations, an increase in electric fuel and energy purchases resulting primarily from increased consumption of fossil fuel and higher purchased power costs due to an increase in the number of heating and cooling degree days, and increased outage costs due to scheduled outages at certain of our electric generating facilities. Favorable drivers include an increase in regulated electric sales resulting from weather and customer growth.

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**Analysis of Consolidated Operations**

Presented below are selected amounts related to our results of operations:

(millions)	Second Quarter			Year-To-Date		
	2007	2006	\$ Change	2007	2006	\$ Change
Operating Revenue	\$ 1,424	\$ 1,323	\$ 101	\$ 2,867	\$ 2,656	\$ 211
Operating Expenses						