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Virginia Hybrid Regulatory Model
(A High Level View)

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Today's Agenda

- Complex Legislation (SB 1416)
- High Level View
- Background
- Opportunity for Change
- Hybrid Regulatory Model Overview
- Adjustment Clause for New Generation
- Questions

Background

- Half of US considering deregulation (1996)
- Restructuring adopted in VA (1999)
- Base rates frozen at 1993 level (1999)
- Base rates capped from 1999 - 2010
- Divestiture / Legal Separation not approved by SCC
- Fuel rates frozen from 2004 - 2007
- IOUs had to make tough decisions

Juncture

- Need to build new baseload generation
  - 4000 MW of capacity needed in VA by 2017
- Virginia Politics
  - Concern about political upheaval (MD, DE, IL, CT)
  - Multiple bills submitted to repeal restructuring and re-regulate
- Deregulation yet to be successful in the Commonwealth of Virginia

So what are the alternatives?

Traditional Ratemaking Formula

- Rate Base
- x Allowed Rate of Return
- = Required Return
- \+ Operating Expenses
- = Operating Income
- \+ (Tax Gross-up)
- = Revenue Requirement

Performance Based Rates (PBR)

- Verizon South Inc: Service quality reports must be filed with metrics on a quarterly basis that include eight key indicators:
  - Commission complaints
  - Trouble reports
  - Repeated trouble reports
  - Network reports
  - Network switching performance
  - Business office accessibility
  - Repair service accessibility
  - Service orders competed

The Hybrid Model

- Take a balanced approach (Best of Both Worlds)
- Return on the value of assets and PBR's
- Affects all Investor Owned Utilities (IOU) in VA

- Rate Base
- x Allowed Rate of Return
- = Required Return
- + Operating Expenses
- = Operating Income
- + (Tax Gross-up)
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Key Elements of the Hybrid Model

- Fuel expense recovery
- Setting the ROE and sharing excess earnings
- Performance incentives
- Going-In rate case
- Biennial reviews
- Adjustment riders (including new generation)
- Renewable portfolio standard (RPS)
- Energy efficiency and conservation

Fuel Expense Recovery

- Fuel rate changes every July 1
- Limit on increase (4% of total residential rates in existence 7/1/07) with deferral of remainder

  2008

  July 1 – increase up to 4% over June 30 level to recover part of deferral

  July 1 – fuel rate for 7/08 – 6/09 takes effect

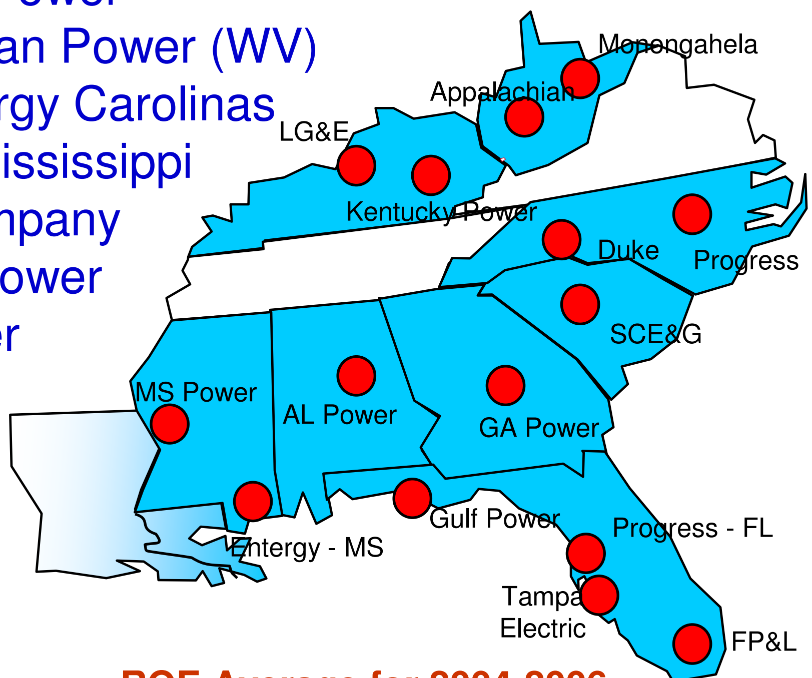
  2009

  July 1 – increase up to 4% over June 30 level to recover part of the deferral

  July 1 – fuel rate for 7/09 – 6/10 takes effect
- Remaining deferred balance recoverable beginning 7/1/2010

Peer Utility Group

1. Alabama Power
2. Appalachian Power (WV)
3. Duke Energy Carolinas
4. Entergy Mississippi
5. FP&L Company
6. Georgia Power
7. Gulf Power
8. Kentucky Power (AEP)
9. LG&E
10. Mississippi Power
11. Monongahela Power
12. Progress Energy Carolina
13. Progress Energy Florida
14. SCE&G
15. Tampa Electric



ROE Average for 2004-2006

ROE Avg. after removing two lowest and two highest = 11.39%

Company's requested ROE for SW VA Coal Plant Case filing = 11.75%

Effective with the 2005-2007 peer average, LG&E and Kentucky Power will be removed and Entergy New Orleans will be reinstated

Performance Incentives (PI)

- The SCC may increase or decrease ROE by up to 100 basis points* or 1% based on performance of:
  - Generating Plants
  - Customer Service
  - Operating Efficiency of the Company
- SCC rulemaking will establish performance measures and these metrics will be based on nationally recognized standards

* ***Although Dominion performed very well, the Company did not request PI during SW VA Coal Plant filing, but may in future***

Setting the ROE & Sharing “Excess Earnings”

- SCC may use any methodology in the public interest
- ***Floor*** = 3 year average of Southeastern IOU Peers’ earned ROE
- <u>***Ceiling***</u> = Peer ***Floor*** ROE + 3%
- Consumer Price Index (CPI) limit on change from previous case to current case
- SCC to consider retail customer costs in Peer IOU states

Going-In Rate Case

- There will be a mandatory ***"initial rate case"*** in 2009 based on a 2008 test year
- To the extent there are over-earnings, the SCC may:
  - Order reductions in the base rates; or
  - Order 60% of any excess earnings to customers
- After the initial rate case, the SCC will review the rates and returns every two years
- Any excess earnings will be returned to customers over a 6 to12 month period

Biennial Reviews

- Biennial Reviews will be filed every 2 years
  - First filing in 2011 or 2012
  - SCC has only 9 months after the test period to issue order
  - Possible outcomes:
    - Increase base rates if under-earning
    - Credit / refund if there are "excess earnings" for two previous years
    - Reduce base rates if two consecutive Biennials occur with excess earnings
  - Following rate impact determination, adjustment clauses are combined with all base rate recovery costs
    - Except for New Generation (excluding Simple Cycle CT's)
  - 10 year Integrated Resource Plans (IRP) must be submitted when biennial review is filed

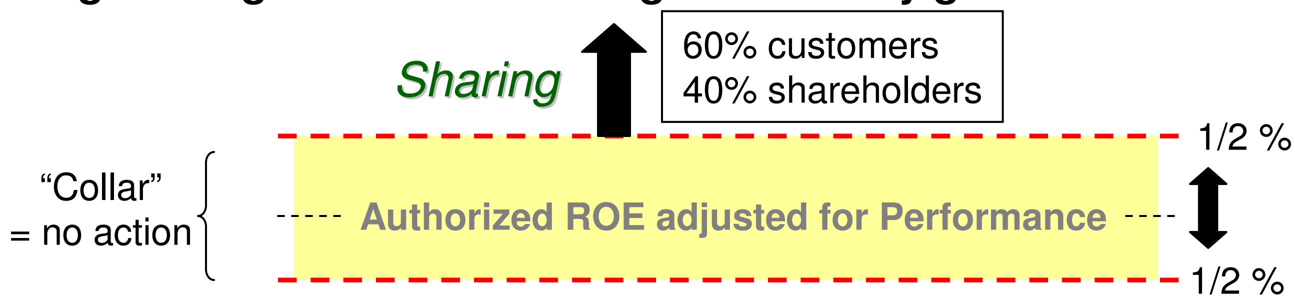
Setting the ROE & Making Adjustments

Step 1: **Set "authorized ROE"**

- SCC may use any methodology in the public interest
- Floor = 3 year average of Southeastern peers' earned ROE
- Ceiling = Peer Floor ROE + 3%
- **CPI limit on change from previous case to current case**
- **SCC to consider retail customer costs in Peer Utility states**

Step 2: **Performance Incentive (Generation, Operations, Customer Service)**

Step 3: **Sharing – recognizes and encourages efficiency gains**



* Earnings shared at 100% to customers in certain circumstances

Adjustment Clause for New Generation

- Cost of new generating plants recovered through rider on stand-alone basis, w/o consideration of other costs, revenues, earnings, etc.
- Right to recover Funds (AFUDC*) and return on projected Construction Work In Progress (CWIP)
- Rider to begin during development/construction phase
- Enhanced return applies during construction and the “first portion” of the unit’s service life
- Filed for 1st Adjustment Clause on July 13, 2007 for SW VA Coal Plant

* **Allowance for Funds Used During Construction (AFUDC)**

Adjustment Clause for New Generation

Type of Unit	Basis Pts.	First Portion of Of Service Life
Nuclear-powered	200	12 – 25 years
Carbon capture compatible	200	10 – 20 years
Clean coal powered	200	10 – 20 years
Renewable powered	200	5 – 15 years
Conventional coal	100	10 – 20 years
Combined cycle CT	100	10 – 20 years

Other Adjustment Clauses

- FERC-approved charges
  - Transmission and ancillary services
  - RTO administrative fees
  - Demand Response program costs charged by PJM
- Demand-side management (DSM), conservation, energy efficiency, and load management
- Renewable Portfolio Standard (RPS) program
- State and Federal environmental laws or regulations applicable to generation facilities
  - Eligible for enhanced return and treatment under new generation clause provisions

Voluntary RPS

Renewable Energy Portfolio Standard (RPS)

- "Renewable energy" means energy derived from sunlight, wind, falling water, sustainable biomass, energy from waste, wave motion, tides, and geothermal power, and does not include energy derived from coal, oil, natural gas or nuclear power.

- IOU must apply to SCC and demonstrate reasonable expectation to meet goal in 2022

- Electricity Sold in Base Year = 2007 sales to Virginia retail jurisdictional customers less energy produced by nuclear units
  - Nuclear units average output from 2004 through 2006

Voluntary RPS

Incentives:

- When RPS Goals are met, IOU earns 50 basis points ROE incentive (when PI not received)
- Options: build or buy renewable power, or buy Renewable Energy Credits (RECs)
- Double credit for sunlight or wind MWhrs
- IOU can recover all incremental costs

Goals	**Year Due**
4% of base year	2010
7% of base year	2016
12% of base year	2022

Energy Efficiency & Conservation

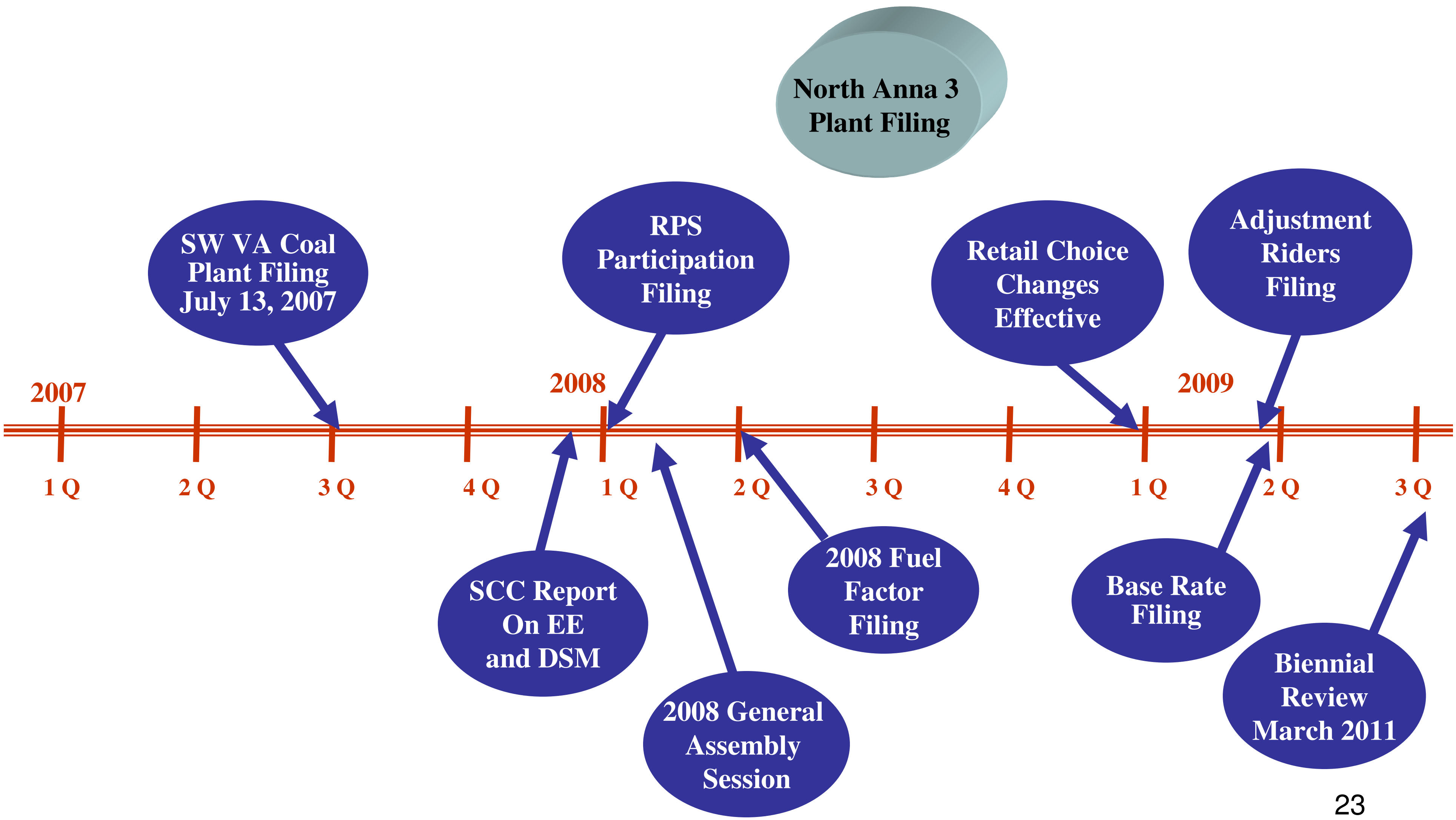
- SCC conducting a proceeding to
  - Determine if a 10% reduction in energy consumption can be cost effectively achieved by 2022
  - Identify the best mix of programs
  - Determine what entity should administer
  - Estimate the cost of attaining the goal
  - Develop and implement a plan

- A public benefit fund may be considered

Energy Efficiency & Conservation

- SCC Proceeding Underway
  - Comments filed July 13, 2007
  - Workgroup meetings began July 19, 2007
  - Five subgroups identified and are actively meeting
    - General
    - Consumption Reduction (kWhr)
    - Peak Demand Reduction (kW)
    - Financial
    - Information
- SCC to report to Governor and General Assembly by December 15, 2007

Significant Dates



Summary

- New Legislation is complex, but intended to reduce rate uncertainty
- Provide the best of both regulatory worlds
- ROE in line with Peer IOU Group
- Adjustments encourage environmentally friendly **new generation** to meet growth
- SCC to report to Governor and General Assembly by December 15, 2007

Thank You

Any Questions?