DOMINION VIRGINIA POWER
COMPETITIVE SERVICE PROVIDER
CREDIT METHODOLOGY

S & P Type Model

Dominion Virginia Power's credit estimate model serves to approximate the rating that the evaluated entity would likely receive from Standard and Poor's (AAA, AA, A, etc). This process is completed through selecting financial ratios the Company believes are most indicative of the credit quality, and also the S & P rating of the firm. The first ratio used is the funds from operations to debt ratio. This ratio describes what portion of the firm's liabilities could be recovered from funds provided from the normal course of business. The second ratio used is the funds from operations interest coverage ratio. This ratio describes how much in excess of the firm's interest obligations is earned in the normal course of business. The third ratio is the total debt to total capital ratio. This ratio is used to provide a measure of the firm's leverage. For a given downturn in business activity, a firm with higher leverage will have a greater probability of defaulting on their obligations than a less leveraged firm.

The Company's method of calculation is to assign an S & P rating to each ratio calculated. This is done by matching the computed ratio to the average ratio in each S & P rating grade. The next step is to calculate our rating estimate using a weighted average of all the rating estimates. The ratio that we feel is most indicative of credit quality is the funds from operations interest coverage ratio. This ratio receives a 40% weighting in the calculation. The Company believes the other two ratios are slightly less indicative of credit quality, they each receive a 30% weighting in the calculation.

C-Score Model

The next method the Company uses to serve as an indicator of credit risk is the C-Score model which was developed by Eric Falkenstein at Keycorp bank in 1999, and is prevalent in the finance literature regarding credit scoring. The model is a regression equation where the inputs represent the factors that the model determined to be the most explanatory factors is assessing credit quality.

These input factors are as follows: 1.) net worth / liabilities; this is a measure of the leverage of the firm, with lower leverage having a positive effect on creditworthiness 2.) earnings before extraordinary items/assets; this is a measure of profitability, with more profitable firms receiving a higher score 3.) the natural log of (total assets/CPI deflator); this is a measure of size, with larger firms receiving a higher score. We agree with this assessment because size is generally indicative of management depth and also of the diversity of the firm's business. A larger firm will be less affected by local economic downturns, etc. 4.) natural log of the standard deviation of the prior three years earning before extraordinary items/assets ratios; this is a measure of the volatility of earnings for a firm, with the lower volatility firms receiving a higher rating. The firm that was recently profitable would get a higher credit rating. The last input is 5.) retained earnings/assets; this ratio is a more indirect measure of leverage, because firms with higher levels of retained earnings would finance more of their operations through internally generated funds, rendering them with less need to add leverage.