Mike Smith

ANNUAL REPORT

Vermont Hydro-Electric Power Authority

(30 V.S.A. §8059(b))

June 2004 – July 2005

112 State Street, Drawer 20
Montpelier, Vermont 05620-2601

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Mission Statement

To pursue the potential acquisition of hydroelectric power generation resources along the Connecticut and Deerfield Rivers in a way that secures tangible benefits for Vermont's citizens tomorrow and for generations to come.

The Vermont Hydro-Electric Power Authority's statutory mission, found in 30 V.S.A. §8051(b), is to

> finance, purchase, own, operate, or manage any interest in hydroelectric power facilities along the Connecticut and Deerfield Rivers . . . . The purchase and operation of an interest shall be pursued with the following goals:
>
> (1) To promote the general good of the state;
> (2) To stimulate the development of the Vermont economy;
> (3) To increase the degree to which Vermont's energy needs are met through environmentally sound, sustainable and renewable in-state energy sources;
> (4) To lessen electricity price risk and volatility for Vermont ratepayers and increase system reliability;
> (5) Not to compete with Vermont utilities;
> (6) To ensure that the credit rating of the state will not be adversely affected and Vermont taxpayers will not be liable should the project fail because of the failure to produce sufficient revenue to service the debt, the failure of a partner, or for any other reason; and
> (7) To cause the project to be operated in an environmentally sound manner consistent with federal licenses and purposes.

Board of Directors

Brad Aldrich, Chair
The Honorable Jeb Spaulding, Vice Chair
David O'Brien, Secretary/Treasurer
Richard Mallary
Fred Tiballi
Vacant
Vacant

Interim Manager and Staff

John Sayles

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Introduction

The Vermont Hydro-Electric Power Authority ("VHPA") was created by 30 V.S.A. Chapter 90, which became law on June 8, 2004. The VHPA's statutory goals, found at 30 V.S.A. §8051, are to continue the work of the Vermont Renewable Power Supply Acquisition Authority "(VRPSAA"), and take actions towards acquiring hydroelectric facilities along the Connecticut and Deerfield Rivers in Vermont, New Hampshire and Massachusetts that were owned by USGen New England, Inc. Section 8059(b) of Title 30 requires the VHPA to submit a report on its activities to the Governor and the General Assembly prior to February 1 of each year, setting forth a complete operating and financial assessment. This report is being submitted in June 2005, several months after the statutory due date. The VHPA was engaged in intensive activities in February with the facts and circumstances changing rapidly, as described below. A judgment was made to delay releasing the report until a full year had passed and it was clear what path the VHPA is taking. The next report is expected to be released on or before February 1, 2006.

The different phases of the VHPA's work to date have involved many parties with many competing interests: USGen New England, Inc. ("USGen"), the former asset owner and bankrupt entity; the U.S. Bankruptcy Court for the Southern District of Maryland;

investment bankers Lazard Freres & Co.; Brascan Power Corporation ("Brascan") and Emera, Inc. ("Emera"); the Town of Rockingham ("Rockingham" or "Town"), the Bellows Falls Power Company, LLC ("BFPC"); and TransCanada Hydro Northeast, Inc. ("TransCanada"). This report will share publicly available information and analysis, as well as the VHPA's decision-making process and outcomes.

The last year has seen a tremendous amount of activity for the VHPA. The VHPA hit the ground running in June with the Brascan/Emera/VRPSAA collaborative venture (in which the VHPA replaced the VRPSAA) well along in its effort to acquire the hydroelectric facilities on the Connecticut and Deerfield Rivers. Much study and financial analysis had been completed by the VRPSAA's consultant, and USGen's effort to market and solicit bids for the facilities was well under way. Since that time, TransCanada submitted the successful bid in the "stalking horse" auction and has taken ownership of the hydroelectric systems, despite an aggressive and well-executed joint bid by Brascan and Emera in which VHPA had a participation right. After the TransCanada stalking horse bid became public, Brascan, Emera and the VHPA independently undertook economic analyses to determine whether it made sense to participate jointly in the next bidding round and bid against the TransCanada agreement with USGen. There was significant discussion among Brascan, Emera and the VHPA about the benefits and risks of a competing bid. It was decided that making a competing bid for the facilities was not economically advantageous, and, instead, efforts would be directed towards working with Rockingham on acquiring and leasing the Bellows Falls facility. Currently, the VHPA is supporting Rockingham in its effort to purchase the Bellows Falls Hydroelectric Station on the Connecticut River and lease it to the BFPC, a limited liability company jointly formed and owned by Brascan and Emera to lease the Bellows Falls station from Rockingham. The transaction is expected to close by October 2005.

This report will describe in some detail the VHPA's activities from inception to the present.

Overview of the VHPA's Activities from Inception to the Present

Historical Context

The 1990's were a time of tremendous change in the electric energy markets. Many states began transitioning from fully regulated, vertically integrated monopoly systems to retail competition, with (in theory) multiple retail providers of electricity competing to serve customers. The federally-regulated wholesale power markets were also beginning a transition to a market-based approach, where wholesale generation companies, not incumbent monopoly utilities, built electric generation plants and sold the power to retail providers within a structured marketplace. During this time both New Hampshire and Massachusetts "restructured" their electric industries and the former monopoly providers were required to sell their generation assets to wholesale generation companies.

In this context, USGen New England, Inc., a wholesale generation subsidiary of PG&E National Energy Group, purchased all of the electric generation assets of New England Power ("NEP") in 1998 for approximately $1.6 billion. The electric generation plants in that sale included the hydroelectric plants on the Connecticut and Deerfield Rivers in Vermont, New Hampshire and Massachusetts; three fossil-fuel plants in Massachusetts and Rhode Island; and the Bear Swamp pumped storage facility. Certain constituencies in Vermont saw that sale as a missed opportunity for the State to acquire the hydroelectric assets.

The legislative session that began in January 2003 brought with it rumors that the USGen hydroelectric facilities were for sale. Some investigation by the Public Service Department ("PSD") found that indeed USGen had been soliciting interest, but was looking to make a private stock sale of the company and that the sale would include all assets and liabilities, including the fossil fuel fired plants in Massachusetts and Rhode Island and their associated liabilities (which were thought to be substantial). USGen indicated to the PSD that it had no plan to offer individual or groups of assets for sale, nor were bids being considered on just the hydroelectric facilities.

Legislation was introduced in 2003 (H. 161) to create a "Connecticut River Public Power Authority" with broad powers to "function as an electric utility on behalf of ratepayers of the authority in the operation, distribution, generation, transmission, purchase, sale, and lease of electrical energy and facilities." The proposed Authority would also have had specific power to "purchase, maintain, and operate hydroelectric facilities on the Connecticut and Deerfield Rivers." This bill did not move out of committee.

The Vermont Renewable Power Supply Acquisition Authority

Feasibility and Market Analysis

Legislation ultimately was enacted creating the VRPSAA in the 2003 Capital Construction Bill, which was signed and effective on June 11, 2003. (Act 63, Section 38, 2003.) The VRPSAA was charged with conducting two studies: one addressing "the financial and technical issues involved in a purchase of the hydroelectric dams on the Connecticut and Deerfield Rivers," and a second studying "the principal policy issues implicated by such a purchase, if it were authorized . . . ." (The full text of Section 38 of Act 63 is attached in Appendix D). The VRPSAA's members were: Secretary of Administration Michael K. Smith, Chair, State Treasurer Jeb Spaulding, Senators Vincent Illuzzi and Ann Cummings, Representatives Robert Wood and William Johnson, Public Service Commissioner David O'Brien and Richard Mallary (appointed by the Public Service Board). The VRPSAA first met on June 25, 2003.

USGen filed for Chapter 11 bankruptcy protection on July 8, 2003. The Public Service Department ("PSD") intervened in the Bankruptcy Court to monitor the proceedings and preserve any options for the State to participate in a bankruptcy sale of the hydroelectric assets. (Bankruptcy counsel monitored the proceedings through its conclusion.) The bankruptcy also stopped any talks to sell the facilities outside of the

bankruptcy proceedings. The bankruptcy largely was the result of the collapse of the energy trading markets (coincident with the fall of Enron) and the losses USGen's affiliated energy trading subsidiaries sustained, and was not related to the hydroelectric facilities' performance.

USGen's bankruptcy filing created speculation that the Connecticut and Deerfield River hydroelectric systems would be available at a bargain price from a distressed seller. It was proposed that a public entity purchasing the systems at a distressed sale price would give Vermonters access to clean, renewable power at below-market prices, therefore the state should take any action necessary to accomplish the purchase. The bankruptcy did present new opportunities, but also new challenges. By declaring bankruptcy, USGen gave control of the sale process to the creditor committee and the bankruptcy court, ensuring the state access to what would be a public process, but also ensuring that the seller would use all means available to maximize economic value for the assets, instead of focusing on how to return USGen to solvency as an ongoing concern.

The VRPSAA determined that it would need energy market and financial analysis expertise, released a Request for Proposals for assistance and proceeded through the competitive bid process. At the August 27, 2003 VRPSAA meeting, Lexecon, Inc. was retained to assist in the research, analysis and study preparation. Six meetings open to the public (other than portions held in executive session) were held between June 2003 and April 2004, two of which were expressly to take public input (one in Montpelier and one in Wilmington).

Two public presentations were prepared and submitted by the VRPSAA to the General Assembly on December 1, 2003. They are attached as Appendix C, and can also be found on the Vermont Legislature's web page at http://www.leg.state.vt.us/reports/04power/power.htm.

The 2004 General Assembly passed a section in the 2004 Budget Adjustment Act providing additional funding and guidance to the VRPSAA. (See Appendix D.) The language manifested support for the VRPSAA's work, authorized the Secretary of Administration to enter into a Memorandum of Understanding ("MOU") with private sector partners, required prior approval by the General Assembly for entering into a binding commitment for a partnership or to purchase assets, and mandated that a state entity owning hydroelectric facilities pay property taxes to municipalities as if it were an entirely private entity.

The Lexecon analysis concluded that Vermont, acting alone, only had a 7.5% chance of success to acquire the facilities. (See Appendix C.) Based on that analysis and other information, the VRPSAA unanimously decided to investigate a public/private collaboration to achieve its goals. A public/private collaboration was pursued because, among other things, the deal was too big, both in terms of cost and amount of generation capacity for the state to pursue alone; the state had no other electric generation portfolio against which to balance the variable generation of these two hydroelectric systems, creating supply and market risks; and the systems' outputs didn't match the state's portfolio needs between now and at least 2012, if not beyond.

At the request of the VRPSAA, Lexecon was directed to investigate what commercial entities might be interested in a collaborative venture with the State. The result was a series of meetings between the VRPSAA and five potential private partners. On April 30, 2004 the VRPSAA chose Brascan and Emera, again unanimously, after careful consideration of the presentations by the potential partners. The VRPSAA chairman then began the process of negotiating a "term sheet," and then a more detailed MOU, outlining the VRPSAA's collaborative relationship with Brascan and Emera. Both the term sheet and the MOU were presented to and approved by the VRPSAA prior to their execution. The MOU was signed on May 5, 2004.

Analysis, consultations with Brascan and Emera, and monitoring of the bankruptcy process continued. In April 2004, USGen determined that it would auction its generation properties using a "stalking horse" process, which would consist of an initial round of confidential bids, and would result in a purchase and sale agreement being signed with the winning bidder. That purchase and sale agreement would then be used as the "stalking horse" against which others would bid in a public auction administered by the bankruptcy court. First round bids were to be for the fossil plant, the hydroelectric plants, or both. Bid comparisons would determine whether the fossils and hydros would ultimately be auctioned separately or together.

The "stalking horse" bidding procedure gave the creditors an opportunity to test the market and determine the level of interest in the assets, and to compare different asset packages in order to maximize the sale price. Wholesale electricity markets were rising, but volatile, during late 2003 and early 2004 potentially increasing both the asset values and the risks associated with purchasing hydroelectric, or any other type of generation, assets. The bidding procedure and market changes made it clear that the assets would not be sold at a distressed price as originally speculated, but would be aggressively pursued and that the creditor would receive full value.

The VRPSAA continued to participate in the process with Brascan and Emera until the VHPA was created in June 2004, at which time the VRPSAA was disbanded and the MOU was assigned to VHPA.

The Vermont Hydro-Electric Power Authority

Connecticut and Deerfield Rivers Hydro Bid

The 2004 General Assembly took the next step necessary to move the process forward by creating the VHPA, an entity with broad powers to finance (including by the issuance of bonds), own, operate, and manage any interest the VHPA may acquire in the facilities. The statutory language includes a purpose and goals that guide the VHPA's activities. The language is in Appendix D.

The VHPA took over where the VRPSAA left off – it took assignment of the MOU between the VRPSAA and Brascan/Emera and continued the contractual

relationship with the VRPSAA's consultant, Lexecon. The marketing process for USGen to sell its assets was already underway, and the VHPA seamlessly continued the work to pursue the facilities. A concise description of the marketing efforts by USGen, the reasons for choosing the TransCanada bid as the "stalking horse," and the bankruptcy auction terms are found in a motion filed with the bankruptcy court, attached as Appendix E.

Extensive analysis and strategic planning took place between June and September, 2004. Lexecon refined and updated the economic model to determine the facilities' current market value and the value to the VHPA under different financing methods (e.g., tax-free or taxable bonds, private financing, joint financing, etc.). Brascan, Emera, and the VHPA were in regular communication regarding developments in the bankruptcy process and to discuss acquisition strategies and possible joint ownership structures. The VHPA hired Government Finance Associates as its financial advisor (using a competitive bidding process) to determine the financial market requirements for raising funds, to assist in thinking creatively about financing options, and, if necessary, to negotiate joint financing packages with Brascan and Emera. The firm of Palmer & Dodge was retained as bond counsel, and the Burlington law firm of Dinse, Knapp & McAndrew, P.C. was retained as legal counsel.

Part of the ongoing analysis was access to all of the technical "due diligence" material made available by USGen in the auction process. The due diligence materials were reviewed by the VHPA's manager and the Lexecon analysts. In July, a full day management presentation took place in Bethesda, Maryland, followed by three days of site visits to each facility on the Deerfield and Connecticut Rivers, attended by the VHPA interim manager and Brascan and Emera technical and management personnel. The stalking horse bidding process was active during this time. Final first round bids were submitted in August 2004.

The VHPA's participation in the established process with Brascan and Emera was governed by the MOU terms, which allowed the VHPA to understand the final terms of a purchase and sale agreement before deciding whether it would participate with a financial investment. Under the MOU terms, Brascan and Emera led participation in the process, giving them the flexibility to respond quickly in the competitive process and protect their commercial interests. The MOU likewise preserved the VHPA's opportunity to fully evaluate and understand the price and terms before committing to participation in the deal, and to assure the transparency and oversight necessary for such a major public financial and policy commitment. It was essential to avoid a situation where the VHPA would be bound to deal terms that were acceptable to private business entities but not to a public entity. The MOU also allowed the VHPA the flexibility to withdrawal from the deal if legislative approval for financing was not forthcoming. Finally, Brascan and Emera agreed to provide initial financing of any acquisition. The VHPA could not participate in an initial financing because a winning bidder would need to provide proof of ability to finance without contingencies, and the VHPA would need a financing contingency because it could not issue bonds to finance an investment until the price and terms were determined.

The VHPA Board of Directors was formally appointed on August 17, 2004. By statute it included the State Treasurer, Jeb Spaulding, and an appointment by the Public Service Commissioner, who took the seat himself. The Governor appointed four of the five remaining seats: Brad Aldrich, Nancy Brock, Richard Mallary, and Fred Tiballi. (A fifth Board member was chosen but was unable to participate, and that seat remains unfilled. Nancy Brock resigned because of a conflict related to new employment.) The first Board meeting took place on September 27, 2004, at which time Brad Aldrich was elected Chair, and Jeb Spaulding Vice Chair. Bylaws and organizational resolutions were passed, as well as ratifications and confirmations of existing contracts. (See Appendix I.) The consultants from Lexecon and Government Finance Associates made detailed presentations to the Board on the background and current status of the project. Much of the initial information supplied to the Board members is attached, including a June 2003 memorandum on the pros and cons of purchasing the facilities (Appendix A), an overview of the hydroelectric facilities (Appendix B), the VRPSAA interim report submitted to the legislature (Appendix C), legislative enactments related to the VHPA and VRPSAA (Appendix D), selected press clippings (Appendix F), selected VHPA correspondence (Appendix G), and background information on Brascan and Emera (Appendix H). At the Board's next meeting David O'Brien was elected Secretary/Treasurer.

By late August 2004, the VHPA had learned that TransCanada Hydro Northeast, Inc. was selected as the "stalking horse" bidder, at a bid of $505 million. The next step was to determine, along with Brascan and Emera, whether to submit a competing bid. The bankruptcy court public auction rules required a minimum competing bid of $527,750,000, which included the $505 million bid price, a $12,750,000 break-up fee, a $5 million expense reimbursement, and a $5 million minimum additional bid increment. (See Appendix E)

Brascan and Emera concluded that the needed financial returns could not be achieved at the minimum competing bid, considering market forecasts, financing costs and transaction costs. Accordingly, the Brascan/Emera/VHPA group submitted no competing bid in the bankruptcy court auction. The VHPA joined in this determination, relying in great part on Brascan and Emera's extensive business modeling and financial and physical due diligence on the assets. One of the primary reasons for collaborating with Brascan and Emera was their willingness and ability to make the necessary up-front investment in due diligence, business modeling, and expertise in complex purchases of electric generation facilities – investment that the VHPA was unable to make. Also, the VHPA was relying on Brascan and Emera's financial strength to close and initially finance the purchase. If Brascan and Emera did not see sufficient value, the VHPA was not in a position to lead the collaborative effort with its own resources.

Nonetheless, the VHPA performed extensive independent analysis of options for purchasing the facilities at or above $528 million. Lexecon also looked at the feasibility of the VHPA mounting a sole bid within the existing timeframe. The VHPA determined that such a bid was not possible or practical for many reasons, including: that the price

was too high for an entity Vermont's size to finance, given the risks; that the VHPA was unlikely to qualify as a bidder by itself (see Appendix E for bidder qualifications); and that the VHPA had not conducted exhaustive independent due diligence of the facilities, and did not have the resources to do so, even if sufficient time was available.

No qualified bids were submitted by any entity against TransCanada's Purchase and Sale Agreement and $505 million bid on the final bid date. TransCanada won the auction by default. TransCanada closed the transaction and took ownership on April 1, 2005, subject to Rockingham's Option Agreement on the Bellows Falls station pursuant to an Option to Purchase with USGen (and assumed by TransCanada) dated July 13, 2004 (the "Option Agreement").

The Rockingham Transaction

The VHPA is currently working with Rockingham, Brascan, Emera and the BFPC (created by Brascan and Emera to own and manage the leasehold interest in the Bellows Falls facility) to facilitate the Bellows Falls facility's acquisition by the Rockingham, and the lease to the BFPC. Regulatory approvals have been sought from the Federal Energy Regulatory Commission for the operating license transfer and from the Vermont Public Service Board for certificates of public good to purchase, own and operate a Vermont electric generation facility. All regulatory approvals must be in hand and all appeal periods must have run by September 11, 2005. Closing must occur by October 3, 2005 at the latest, pursuant to the terms of the Option Agreement. In the event the facility is not transferred to Rockingham as envisioned, ownership and operation will remain with TransCanada.

Rockingham began pursuing this facility prior to any involvement by the VHPA, Brascan or Emera. During the time that the VHPA, Brascan and Emera were pursing purchase of the entire Connecticut and Deerfield River systems, Rockingham had acquired an option, approved by USGen's creditors and the bankruptcy court, to purchase the Bellows Falls facility for $72,046,000, and had been pursuing strategies to exercise its option. In September 2004, Rockingham announced that it had been working with the Vermont Public Power Supply Authority ("VPPSA") to assist it in financing its option to purchase the Bellows Falls facility, but that VPSSA had determined it would not be able to assist Rockingham with financing. Shortly thereafter, Rockingham and the VHPA discussed finding synergies in their separate pursuits. Rockingham also contacted Brascan, which led to further discussions around structures that would allow Rockingham to exercise its option and purchase the facility and Brascan/Emera to acquire an operating interest in the facility.

The preliminary discussions resulted in a late October 2004 meeting that included representatives from Rockingham, Brascan, Emera and the VHPA, at which the general framework for a mutually advantageous acquisition of the Bellows Falls station was discussed. The transaction's mechanics with USGen were already negotiated between Rockingham and USGen in the Option Agreement. A critical term was the requirement that the entire purchase price be deposited in an escrow account before December 7,

2004, or the option would expire. As discussions continued and the framework between the parties became more detailed, some sticking points arose. One was how to transfer the purchase price (funded by the BFPC as prepaid rent payable under a long-term lease of the facility) to escrow to support Rockingham's purchase of the facility while protecting the funds from any possible collateral attachment or attack by a party that may make a claim, real or imagined, against Rockingham. The solution was to transfer the right to exercise the option for financing purposes, and therefore ownership of any rights to the escrow account, to the VHPA. The agreements between the parties put the VHPA in Rockingham's shoes for financing purposes until closing occurs, at which time ownership is transferred to the Town.

If for some reason the Town is unwilling or unable to accept ownership, the Master Agreement (described below) provides the VHPA the right to sell, and the BFPC the right to purchase, the facility for one dollar. This provision gives the BFPC full value for its pre-paid lease payments, and prevents the VHPA from possessing title to a hydroelectric plant which it would not have state or federal regulatory authority to operate. The circumstances that would result in this scenario are complex, and unlikely to occur.* Should Rockingham be unable to take possession at closing, however, the VHPA will make all commercially reasonable efforts to fulfill its obligations under the Master Agreement.

This work achieves the VHPA's statutory goals to promote the public good by financing public ownership of a facility on the Connecticut River. The VHPA's Board considered whether the Rockingham transaction would promote the general good of the State in resolving to work with Rockingham and the BFPC and concluded that it would.

The VHPA's reasons for finding participation to be consistent with the public good are, in part, that the transaction helps accomplish the VHPA's other statutory goals: it helps Vermont meet its energy needs with environmentally sound, sustainable and renewable in-state generation; Rockingham owning the Bellows Falls facility may result in the Town's municipal utility purchasing electricity from the facility for its use; the lessor/lessee relationship between Rockingham and the BFPC, and the VHPA relationship with Brascan and Emera has resulted in the BFPC offering to sell electricity from the plant to Vermont retail utilities, which may bring more in-state renewable generation to more Vermont customers; at some point in the future the Town will take operational control of the facility, and will manage the resource for the benefit of Rockingham which will, in turn, benefit the State, either directly through cost-based power sales, or indirectly through increased economic development potential in Rockingham; Rockingham's ownership of a low operating cost, renewable electric generating plant will help to lessen electricity price risk and volatility, and increase system reliability; and, finally, the agreements ensure that the facility will be operated

* Legal action has been initiated by the Rockingham Dam Facts political action group alleging that the town improperly warned a pre-vote hearing and seeking a court order requiring a revote. The Town is defending the legal action, but will hold an additional vote ordered by the Public Service Board to approve the purchase regardless of the outcome of the legal action. Both the legal action and the additional vote could affect the Town's ability to close the transaction.

consistent with federal licenses and purposes, which in turn requires operation in an environmentally sound manner.

Rockingham Agreements

There are five main agreements governing the relationships between the VHPA, Rockingham, Brascan, Emera, and the BFPC: the Assignment of Option to Purchase; Master Agreement; Lease Agreement; Assignment and Assumption of Lease; Deposit Account Control Agreement; and Security Agreement.

The general structure is as follows: Rockingham exercised its option agreement with USGen by notifying USGen on December 1, 2004 that it intended to purchase the facility. The Option required that the Optionee deposit $72,046,000 in an escrow account within seven days after exercise of the option. On December 7, Rockingham, the VHPA, BFPC, Brascan and Emera executed the agreements, including an assignment of the Option from Rockingham to the VHPA (making the VHPA the optionee), and an assignment of the Lease between Rockingham and BFPC to the VHPA. Immediately thereafter, BFPC provided the $72,046,000 as prepaid rent on a 74-year lease between the VHPA (as assignee of Rockingham) and BFPC. The VHPA, now acting as the optionee, deposited the $72,046,000 into an escrow account pending closing. At closing, the VHPA will transfer title to Rockingham and reassign the Option Agreement and the Lease Agreement to Rockingham.

The Master Agreement sets out all of the rights and obligations between Rockingham, the VHPA, the BFPC, Brascan and Emera, including responsibility among the parties for transaction costs; representations, warranties and covenants; any conditions on the obligations and rights; litigation, indemnification and limitations of liability. The Master Agreement requires that all parties make efforts to complete all necessary transactions and consummate the transfer of the facility. The agreements require the VHPA to return all of the pre-paid lease funds that may be returned to the VHPA to the BFPC, should the lease be terminated. The lease automatically terminates if closing is not completed by October 3, 2005 or the Option Agreement is terminated prior to closing. The VHPA's liability is limited under all circumstances to the amount of funds returned from the escrow account or the deposit return account, including interest, plus a maximum of $100,000 in legal fees in the event the transaction contemplated by the Master Agreement is the subject of any litigation.

The agreements also require the VHPA to convey the property to the Town upon closing, and to reassign the Option Agreement and the Lease Agreement to the Town. The Town agrees to accept conveyance and reassignment, and agrees that the VHPA can seek specific performance of this provision. This paragraph is crucial to the VHPA. Its participation in the transaction is solely to facilitate the financing, and it is important that it be required to convey and reassign at closing and that the Town be obligated to take conveyance of the property and reassignment of the other agreements at closing, regardless of circumstances. If the Town, for any reason, cannot take title and reassignment of the Option Agreement and Lease Agreement, the Master Agreement

requires VHPA to sell the facilities to the BFPC for one dollar, including any of the VHPA's interest in the Lease. This results in full value to BFPC for its prepaid lease payment and protects the VHPA from any adverse consequences of ownership, including obligations to BFPC for the escrowed funds. Consummation of a direct transfer to BFPC would require the appropriate federal and state regulatory approvals within the timeframes required by the Option Agreement.

In recognition of the VHPA's limited financing role, the BFPC and the Town agree to limit the VHPA's liability to them under the agreements to the right to seek specific performance of the VHPA's obligations. After conveying and reassigning the Bellows Falls Station, the VHPA has no further liability to the BFPC or the Town under the agreements with regard to these transactions. In the event the escrow agent returns the funds to the VHPA, the funds are immediately directed to a "Deposit Return Account" controlled by the BFPC. The account is further controlled by two separate agreements, the Deposit Account Control Agreement and the Security Agreement, which provide that the BFPC may direct disposition of the account funds without any further consent from the VHPA. The Deposit Account Control Agreement also references the "Security Agreement" between the VHPA and the BFPC, which identifies as "Collateral" all funds in the Escrow Account and the Deposit Return Account and all of the VHPA's right, title and interest to the two accounts as well as its right to receive any funds as returned Deposit under the Option Agreement from the escrow agent. It then grants an irrevocable secured interest to the BFPC in the Collateral. Together, these agreements provide an additional level of protection to the BFPC that its $72 million prepaid rent payment, which serves as the deposit under the Option, will be returned if refunded under the Option.

In sum, the VHPA is working hard to facilitate the financing of the Rockingham transaction. Rockingham will own, and eventually control and operate a local, renewable, low-operating cost electric generation facility with very little risk. The transaction is complex, but the benefits are real and achievable.

Current Activities

The VHPA is a co-petitioner with Rockingham before the Public Service Board ("PSB") in Docket No. 7047 seeking the necessary state regulatory approvals to acquire the Bellows Falls facility and transfer ownership to the Town. The BFPC has also petitioned for the authority to lease and operate the Bellows Falls facility, which has been consolidated in the same docket. Public Service Board orders granting the necessary approvals were issued on June 6, 2005. Transfer of the FERC operating license is expected to follow. The parties seek to close the deal by October, 2005.

Financial Report

The VHPA received a $500,000 legislative appropriation to fulfill its mission. It has not requested nor received additional funding. Current funding should be sufficient to pay expenses through closing of the Rockingham transaction. Under the Master Agreement with Rockingham and the BFPC, the BFPC is obligated to reimburse the VHPA for legal expenses that are directly related to facilitating the transaction. There continues to be additional VHPA-related work that is billed directly to the Authority. Also, expenses paid by the Public Service Department, primarily bankruptcy counsel expenses, have not yet been reimbursed by the VHPA. Because the VHPA must operate with a fixed appropriation, the PSD is waiting to be paid until all outside contractors and other expenses have been paid as required by statute.

VHPA FINANCES

VHPA BUDGET					
			REVENUE	PAYABLES	Notes
	Legislative Appropriation (Less Admin fees)		$495,821.00		
ENCUMBRANCES					
	Lexecon, Inc.		$200,000.00		
		Amendment 1, 2/1/05	$70,000.00		
				$270,000.00	(Final, No Additional Funds)
	Dinse, Knapp & McAndrew, P.C.		$50,000.00		
		Amendment 1, 2/1/05	$50,000.00		
				$83,895.04	(Through June 8, 2005)
	Government Finance Associates, Inc.		$100,000.00		
				$35,859.30	(Through January 25, 2005)
	Palmer & Dodge, LLP.		$150,000.00		
				$16,613.99	(Balance of contract cancelled, this is final expenditure)
	Board of Directors Per Diems & Mileage			$1,237.25	
	Department of Public Service				
		(Billbacks)		$40,943.05	(travel, bankruptcy counsel, postage)
Total Expended				$448,548.63	
Total Remaining			$42,272.37		