Vermont Renewable Power Supply Acquisition Authority

Study Results and Conclusions

November 13, 2003

Topics for Discussion

- Background and State Objectives
- Focus of the Study
- Bankruptcy Status
- Asset Profile
- Base Case Assumptions
- Financial Structure
- Executive Session
  - Discussions with Municipals, IOUs and Potential Partners
  - Valuation
  - Probabilities of Success
- Risks and Benefits
- Conclusions
- Alternative Paths Forward

Background and State Objectives

- The Vermont Renewable Power Supply Authority was created by the Vermont legislature to:
  - Prepare due diligence and feasibility studies regarding the purchase of hydroelectric dams and related assets on the Connecticut and Deerfield rivers
  - Complete the studies and present its recommendations to Finance, Commerce and Natural Resources and Energy committees by December 1, 2003
  - Enter into negotiations for a potential purchase with the consent of the Governor and submitted to the General Assembly for consideration

- Among the potential advantages of such an acquisition considered were:
  - Securing a stable source of low cost power for the Citizens of Vermont and businesses in or looking to locate in Vermont
  - Supporting a major local source of renewable energy
  - Capitalize on tax advantages, including tax-exempt revenue bonds and a federal-income-tax-free Authority to own the assets

Focus of the Study

- USGen bankruptcy research and monitoring
- Fair Market Valuation
  - Hydrological and generation characteristics
  - Research revenue, expenses, and comparable transactions from public sources
  - Cost of capital estimation by Lexecon and through discussions with investment bankers
- Research power needs
  - In State (municipal and private)
  - Out of State (municipal and cooperatives)
- Obtain indicative interest from potential partners
  - Joint Ownership
  - Power contracts
  - Operating and Marketing Contract
- Financial feasibility of purchase by State entity
  - Tax exempt financing structures and State capability for credit backstop
  - Partnership structures, including taxable scenarios
  - Operating scenario analysis, downside risk and upside potential
- Ongoing evaluation of ability to satisfy State objectives
- Ongoing feedback to VRPSAA

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Bankruptcy Process and Status

- PG&E and six wholly-owned subsidiaries, including USGen New England, filed for Chapter 11 protection on July 8, 2003.
- USGen New England:
  - The entity is income positive but variable, generating $8.0 million in net income in August and $277 thousand in September
  - 90% of revenue is contract based, principally standard offer supply to National Grid affiliates, expiring in 2004
  - current book value of property, plant and equipment is $1.5 billion
- The bankruptcy restructuring plan remains in the development stage
  - Creditors have asked for both an ongoing entity and a liquidation plan, but no decisions will not likely be reached until 1st Quarter 2004.
  - We understand that interest in all of USGen NE's assets has been expressed by at least two acquirors (based on unsolicited interest).
  - Vermont's interest in the hydros has been registered with Alvarez & Marsal and Lazard Freres, who will conduct any asset sales.

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USGen NE Assets

Facility	Capacity (MW)	Fuel	Location
Brayton Point	1,599	Coal /Oil	Somerset, MA
Salem Harbor	745	Coal /Oil	Salem, MA
Bear Swamp	573	Hydro-Pumped Storage	Monroe Bridge, MA
CT and Deerfield River Systems	573	Hydro	VT, NH, MA
Manchester Street	495	Natural Gas	Providence, RI
Total	3,985		

Source: PG&E NEG Website.

Potential Paths for the Hydros

1. USGen-NE emerges from bankruptcy as an ongoing entity, no divestiture
2. Sale of equity in USGen-NE (requires a partner for Vermont)
3. Sale of all assets bundled together (requires a partner for Vermont)
4. Sale of individual assets or asset groups (cleanest option for Vermont)

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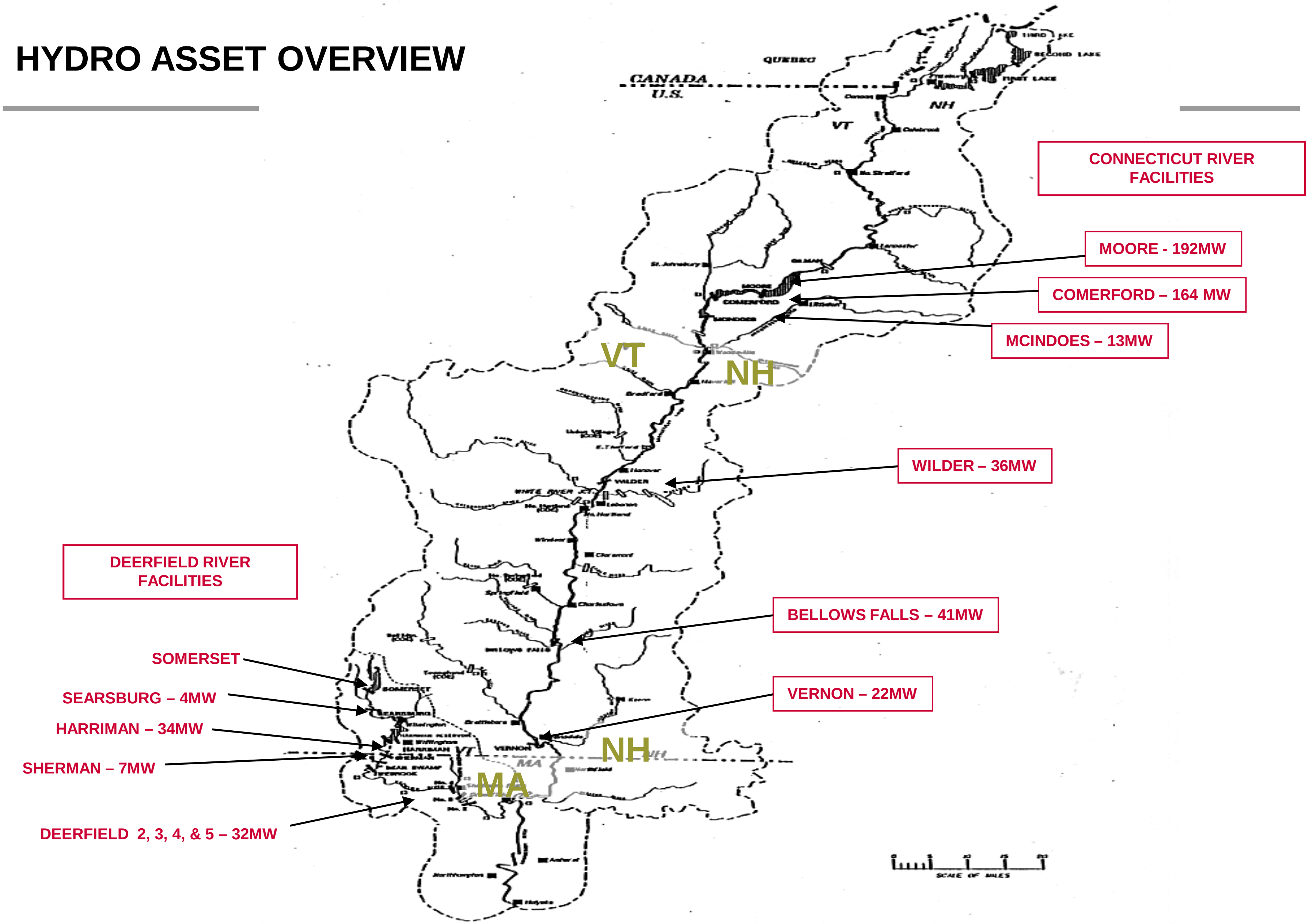
HYDRO ASSET OVERVIEW



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Operating Assumptions for Base Case

<u>Unchanged from October 2 presentation, except:</u>

- Slightly lower Base Case natural gas price forecast
- Lower ISO-NE power prices as a result
- Expense items are substantially unchanged
  - Property Tax study completed
  - Capital Expenditures for lower CT River FERC relicensing updated

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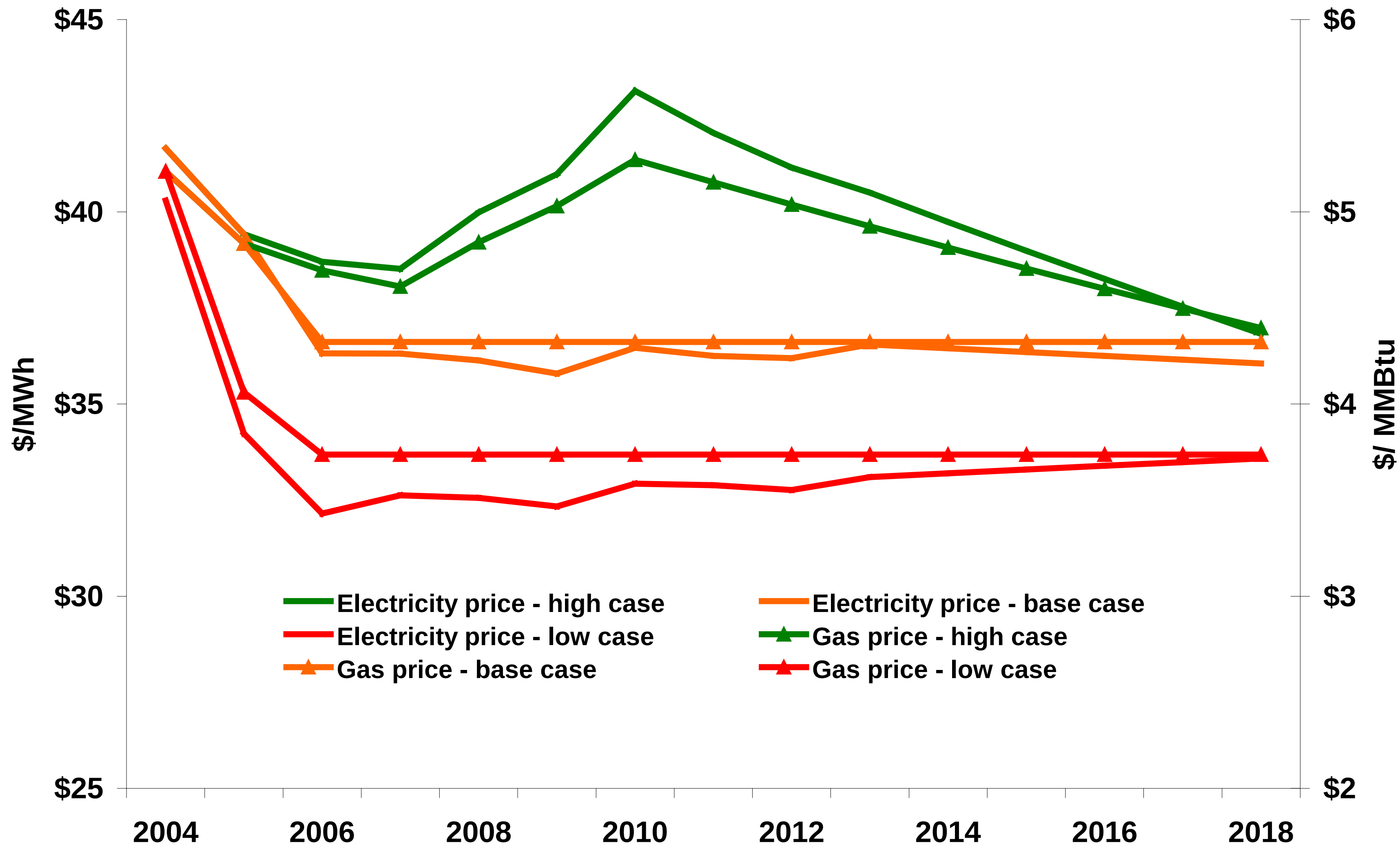
Natural Gas / Electric Price Assumptions
(2003 Dollars)



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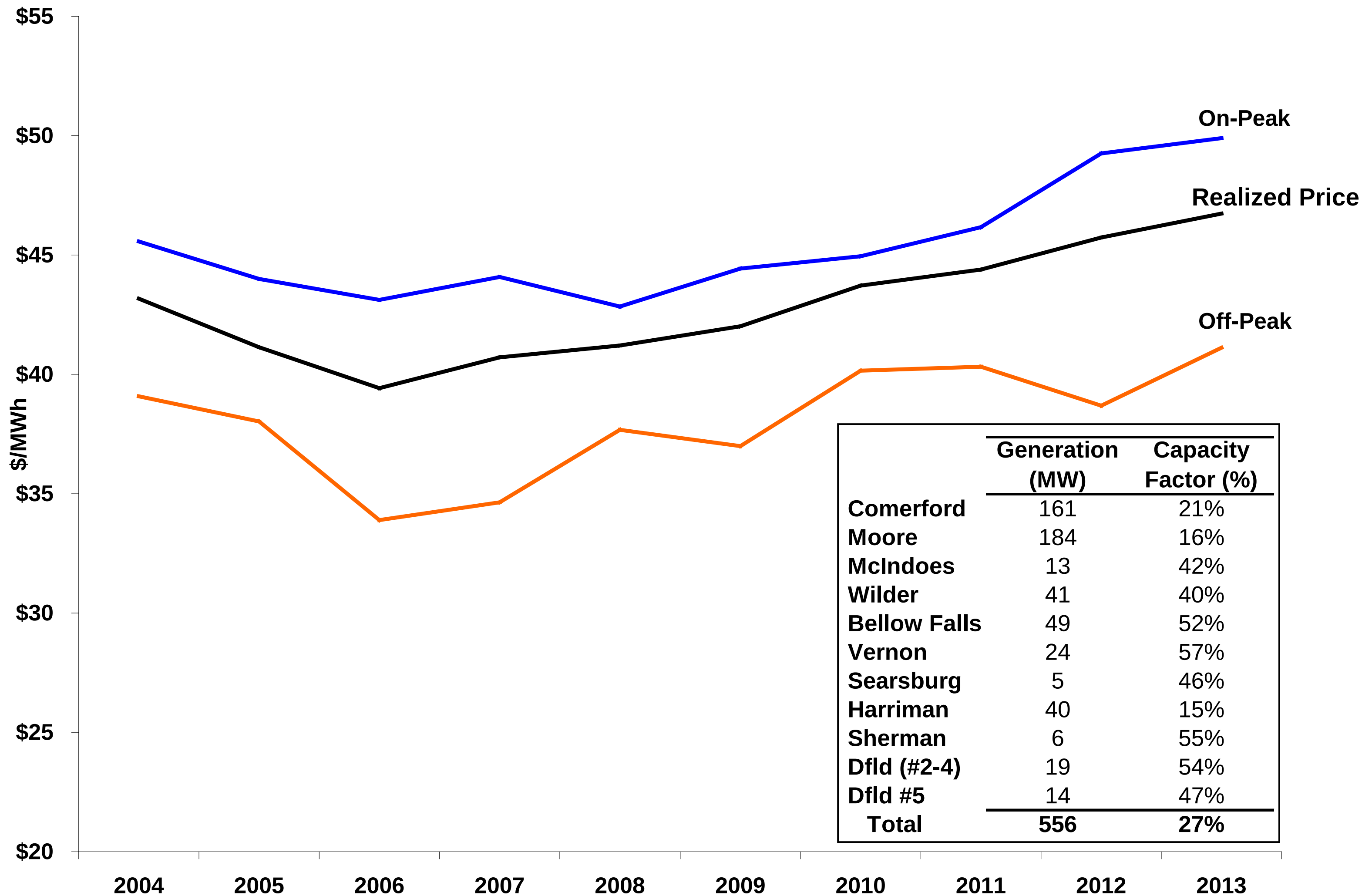
Forecast Energy Price Received by the Project



	Generation (MW)	Capacity Factor (%)
Comerford	161	21%
Moore	184	16%
McIndoes	13	42%
Wilder	41	40%
Bellow Falls	49	52%
Vernon	24	57%
Searsburg	5	46%
Harriman	40	15%
Sherman	6	55%
Dfld (#2-4)	19	54%
Dfld #5	14	47%
Total	**556**	**27%**

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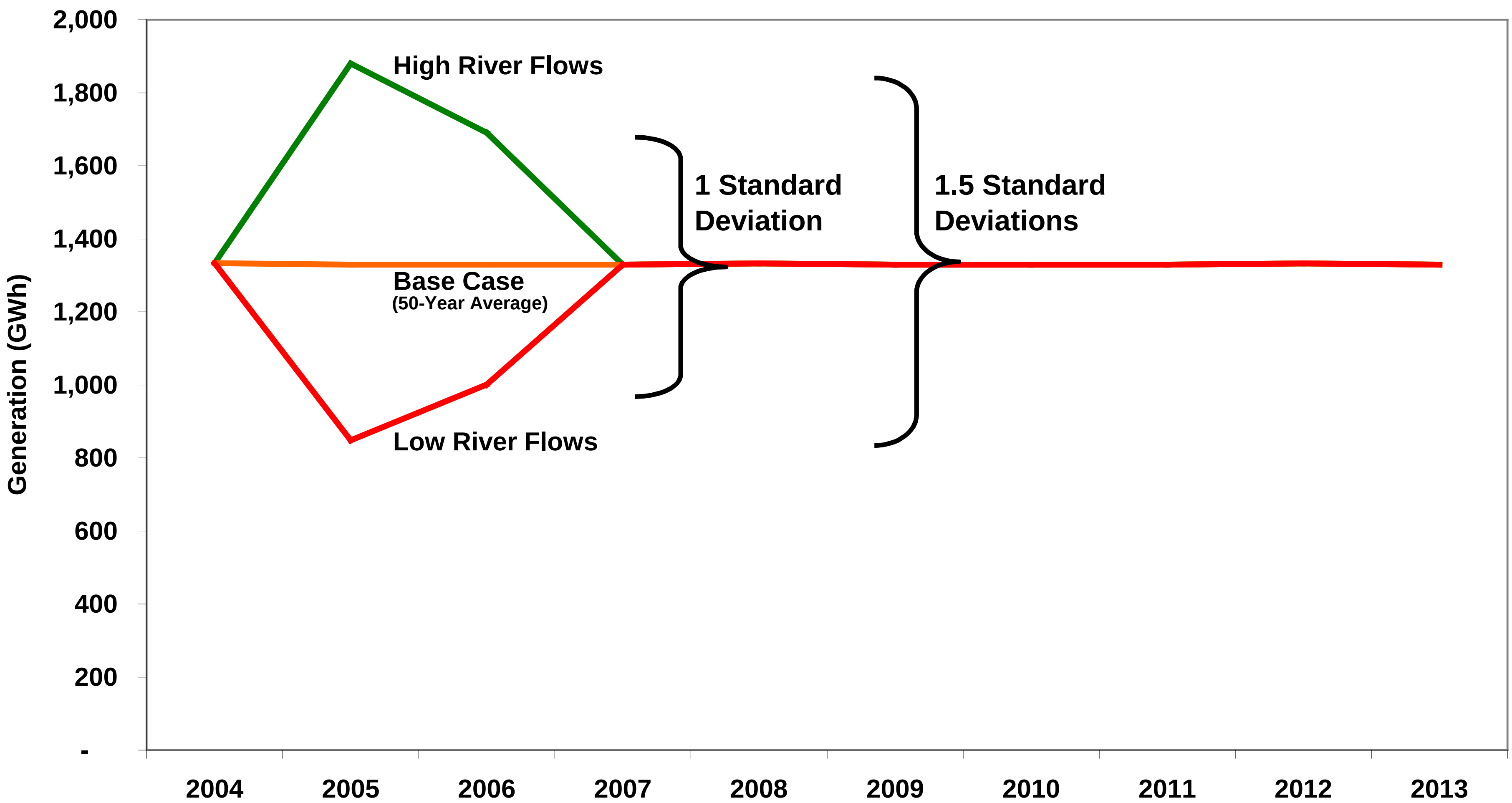
River Flow Assumptions



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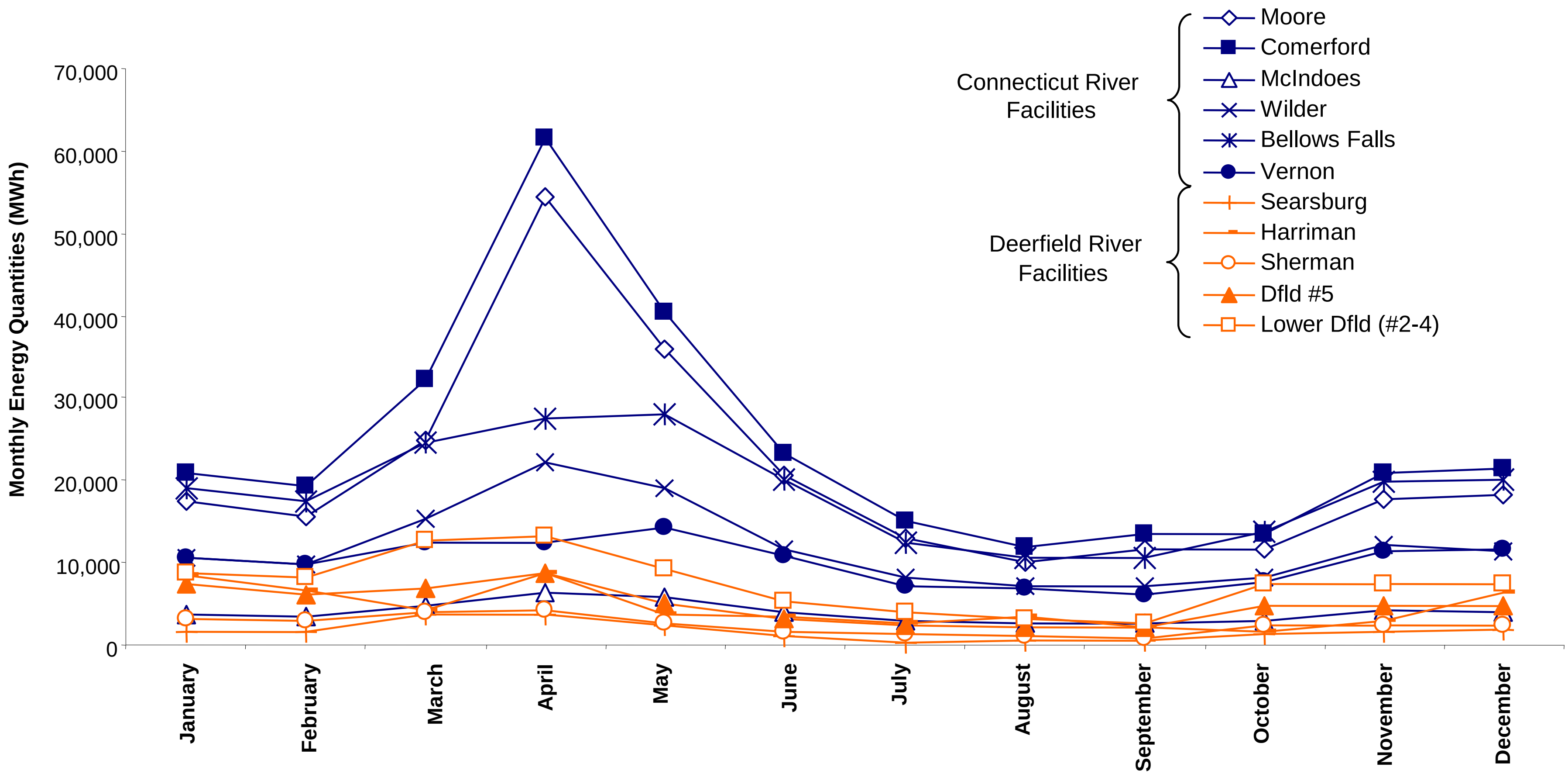
Hydroelectric Generation Profile - Monthly



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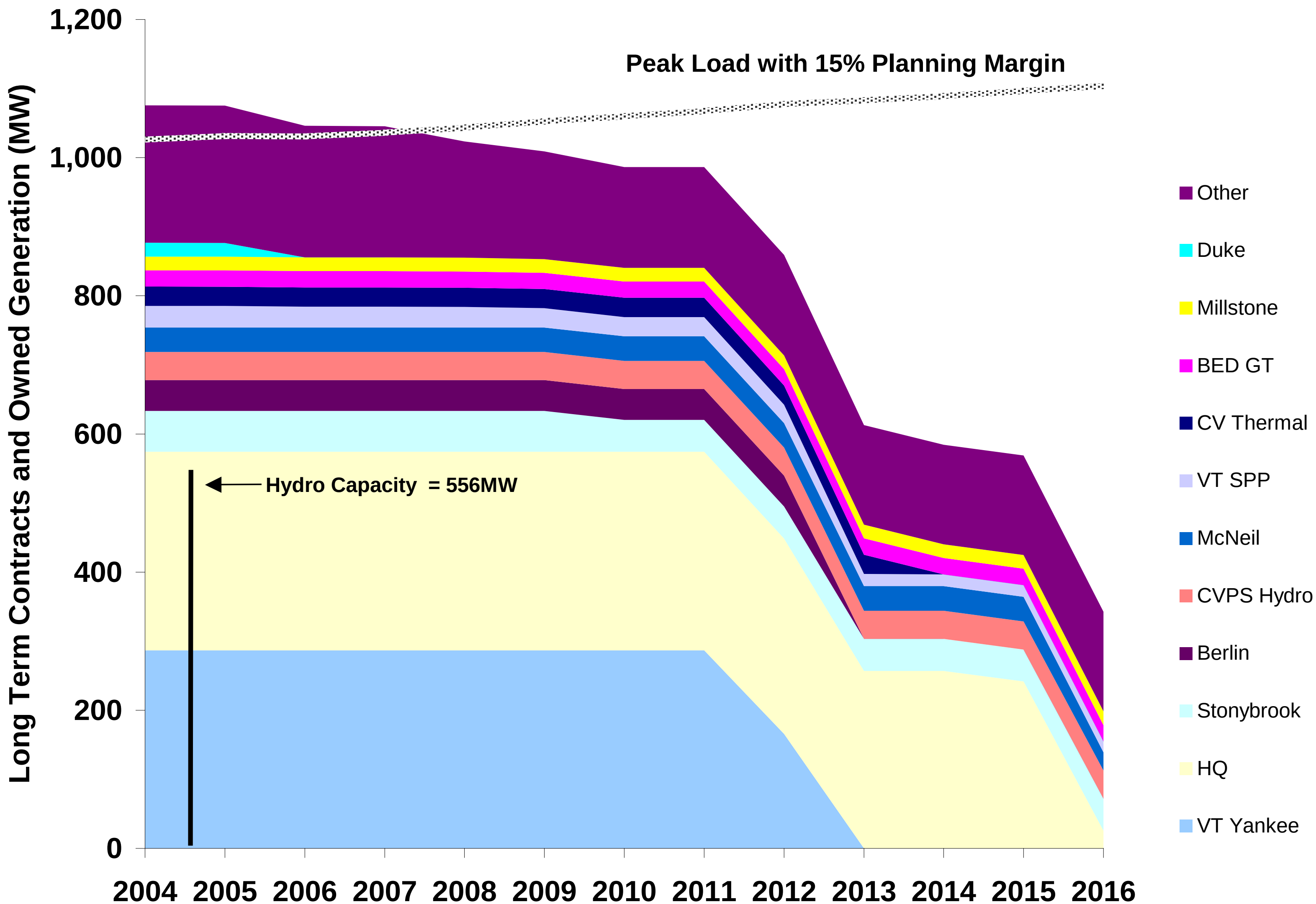
Vermont Supply and Demand Profile - Capacity



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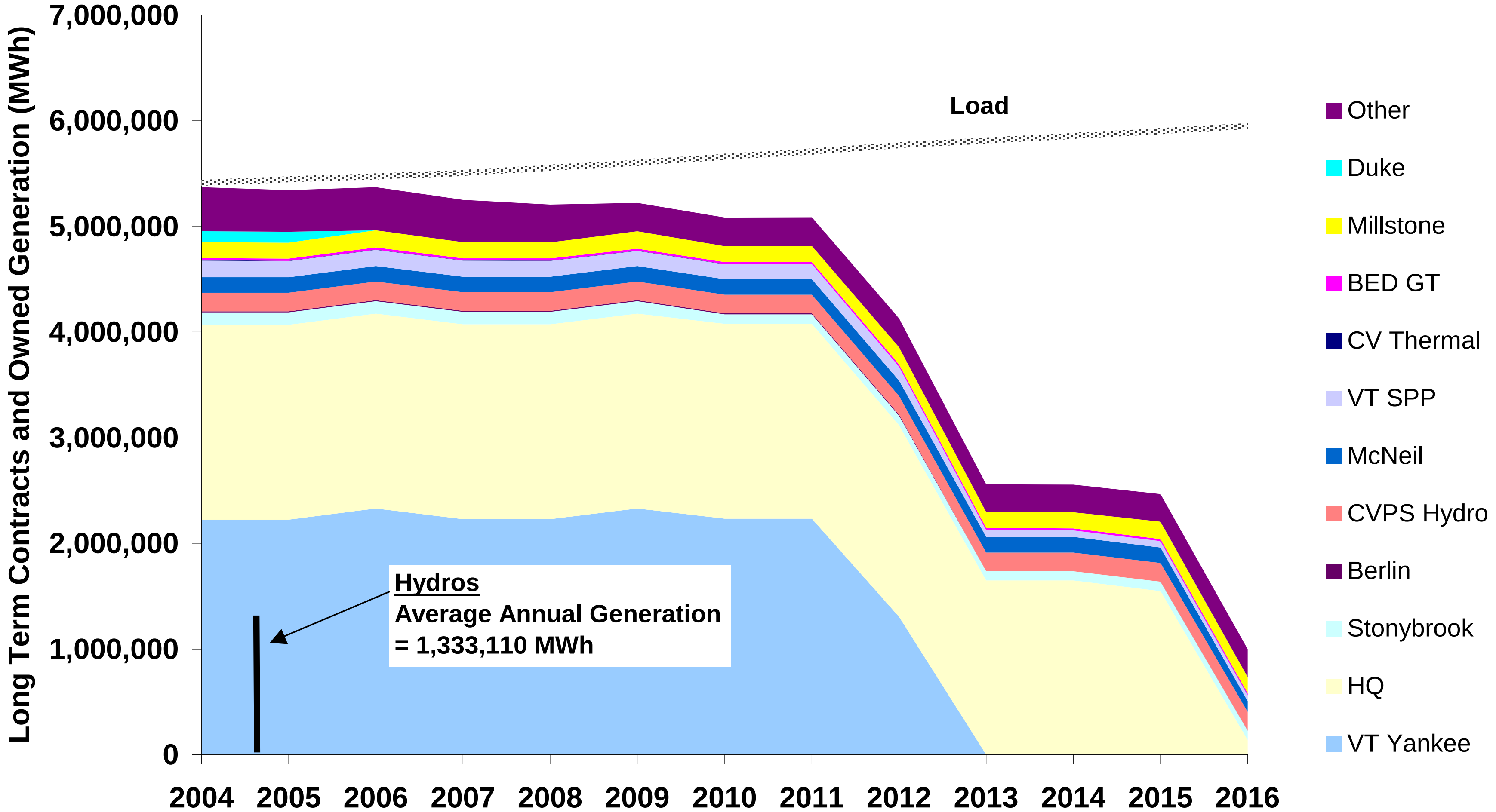
Vermont Supply and Demand Profile - Energy



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Discussions with Potential Private Partners

- Private parties have expressed interest in teaming with Vermont in the following ways:
  - Joint equity participation
  - Power marketing
  - O&M services
  - PPA back to Vermont
- Private parties are interested in partnering with Vermont because:
  - Enhances bid profile
  - Enhances financing
  - Vermont seen as an aggregator of potential load for the facilities
  - Power of a local presence

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Why Own With a Partner?

- Fills in core competencies
  - O&M services
  - Power marketing
  - Experience in bidding for generation assets
  - Bankruptcy process experience
- Allows better match of VT's ownership share to VT's need for power
- Potentially provides up-front equity to transaction
- Provides a built-in potential source of additional capital if needed

Financing Assumptions

Private Buyer Case

- 12.3% after-tax cost of capital for private buyer; consisting of:
  - 18.0% equity cost; 9.0% debt cost

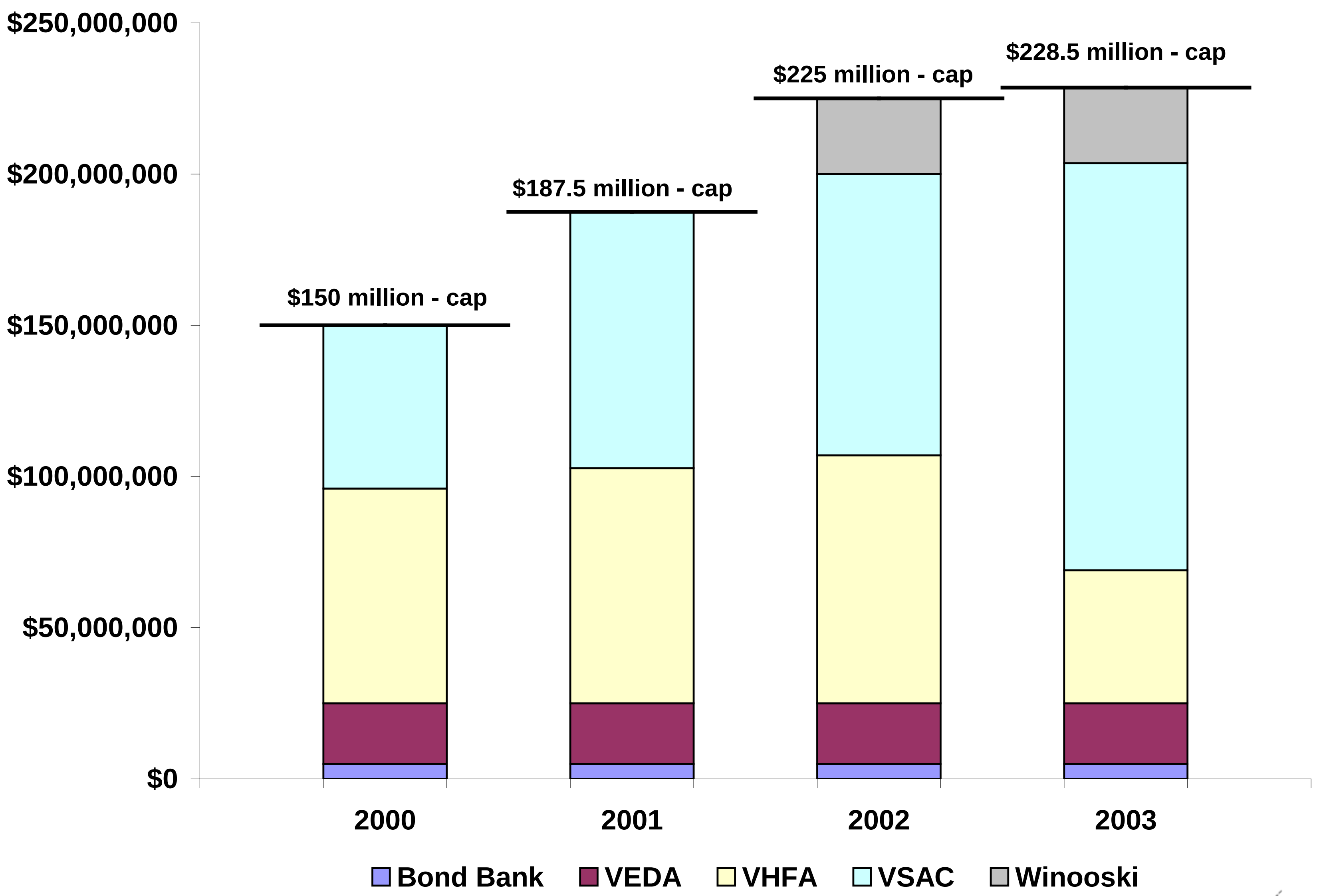
Vermont Buyer Case

- Tax-exempt revenue bonds
  - Output ultimately sold to municipals or to IOUs/spot for limited duration
  - Limited “moral obligation” of State assumed
  - Bond insurance possible but not assumed
- 7.0% debt cost for issuing agency

Municipal Buyer Case

- 5.0% General Obligation bonds issued at each municipality

Private Activity Bonds - Volume Cap Allocated



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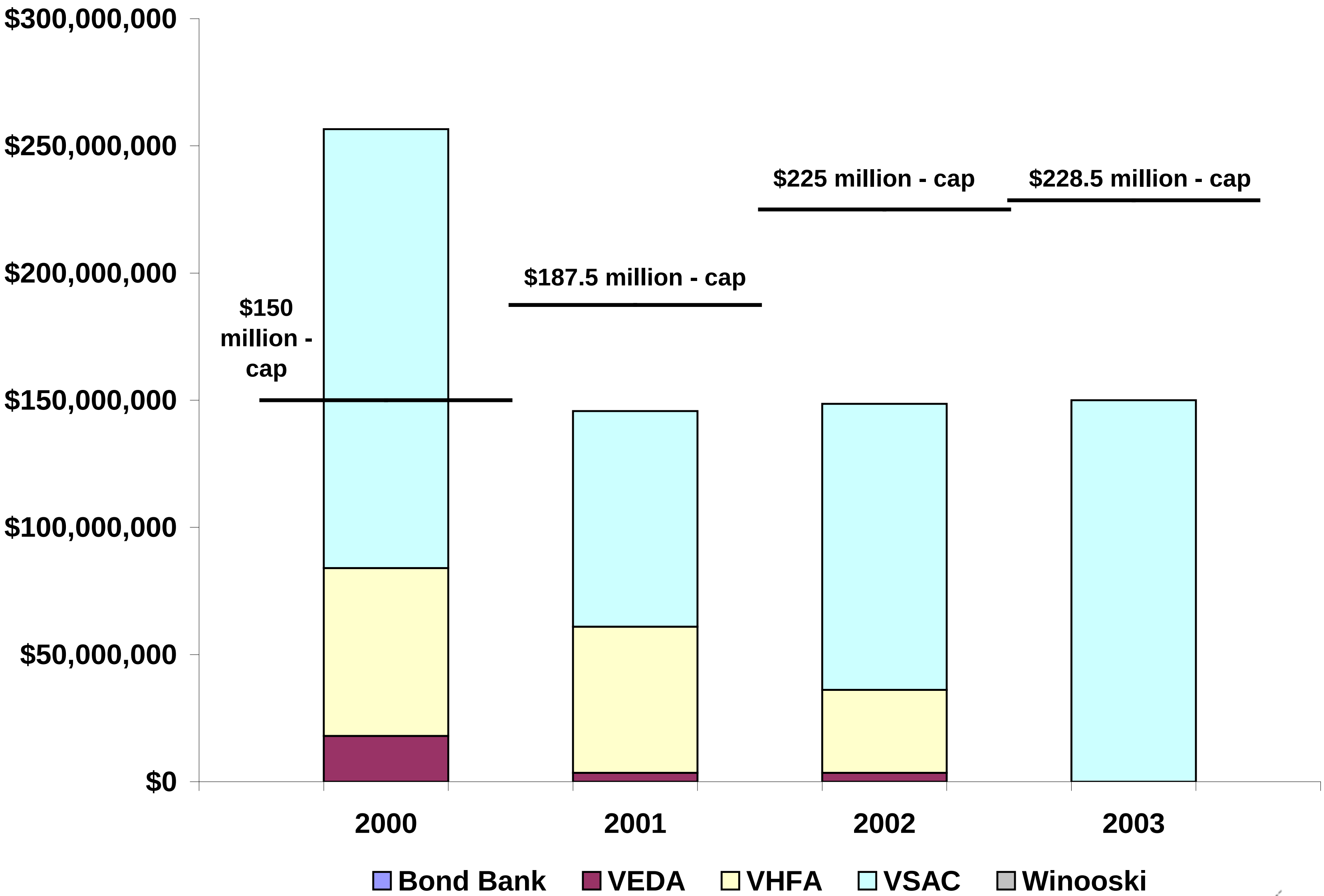
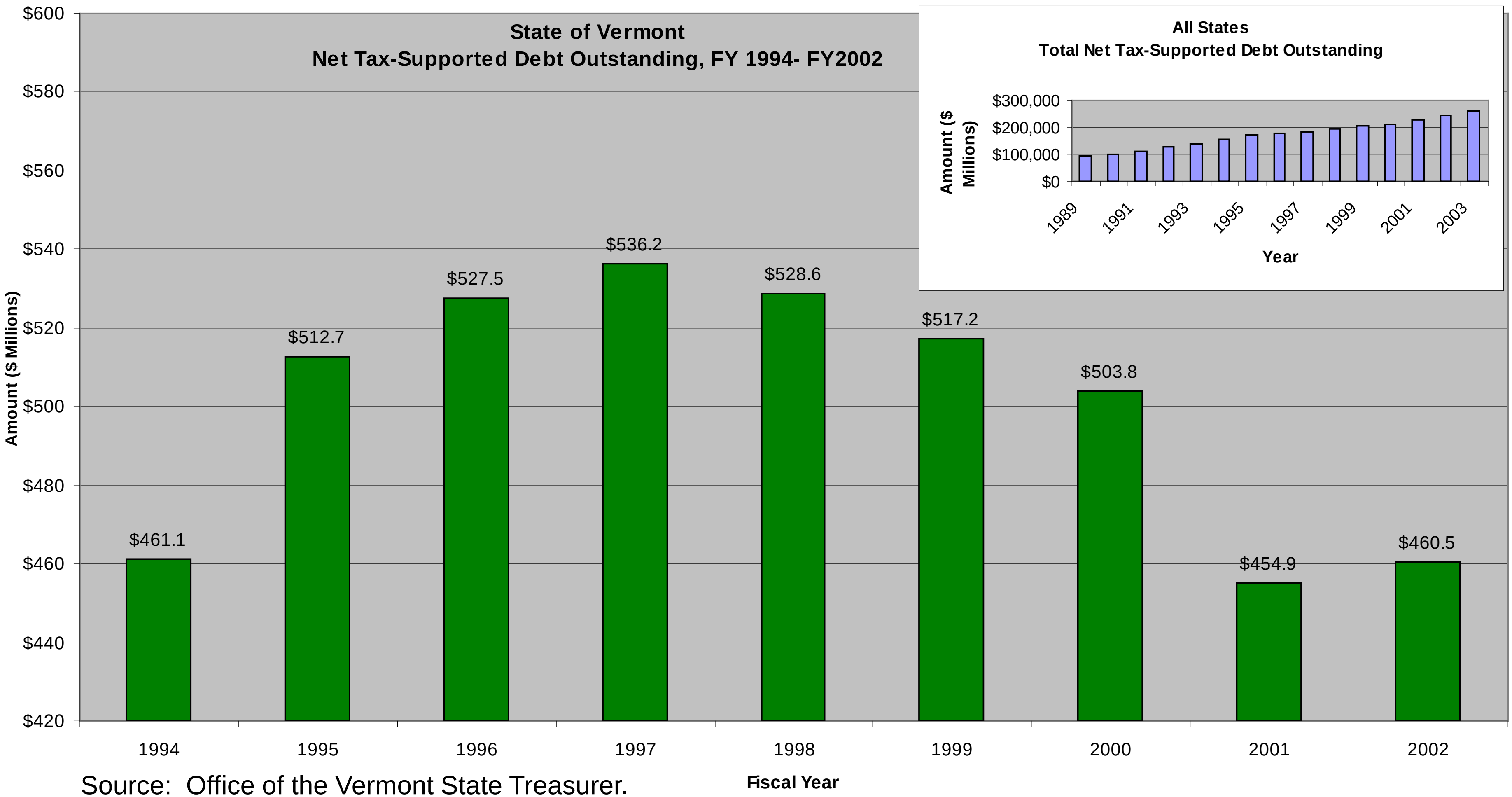
Private Activity Bonds - Volume Cap Used



State of Vermont Net Debt Outstanding



Source: Office of the Vermont State Treasurer.

Total at June 30, 2003: $448.2 Million

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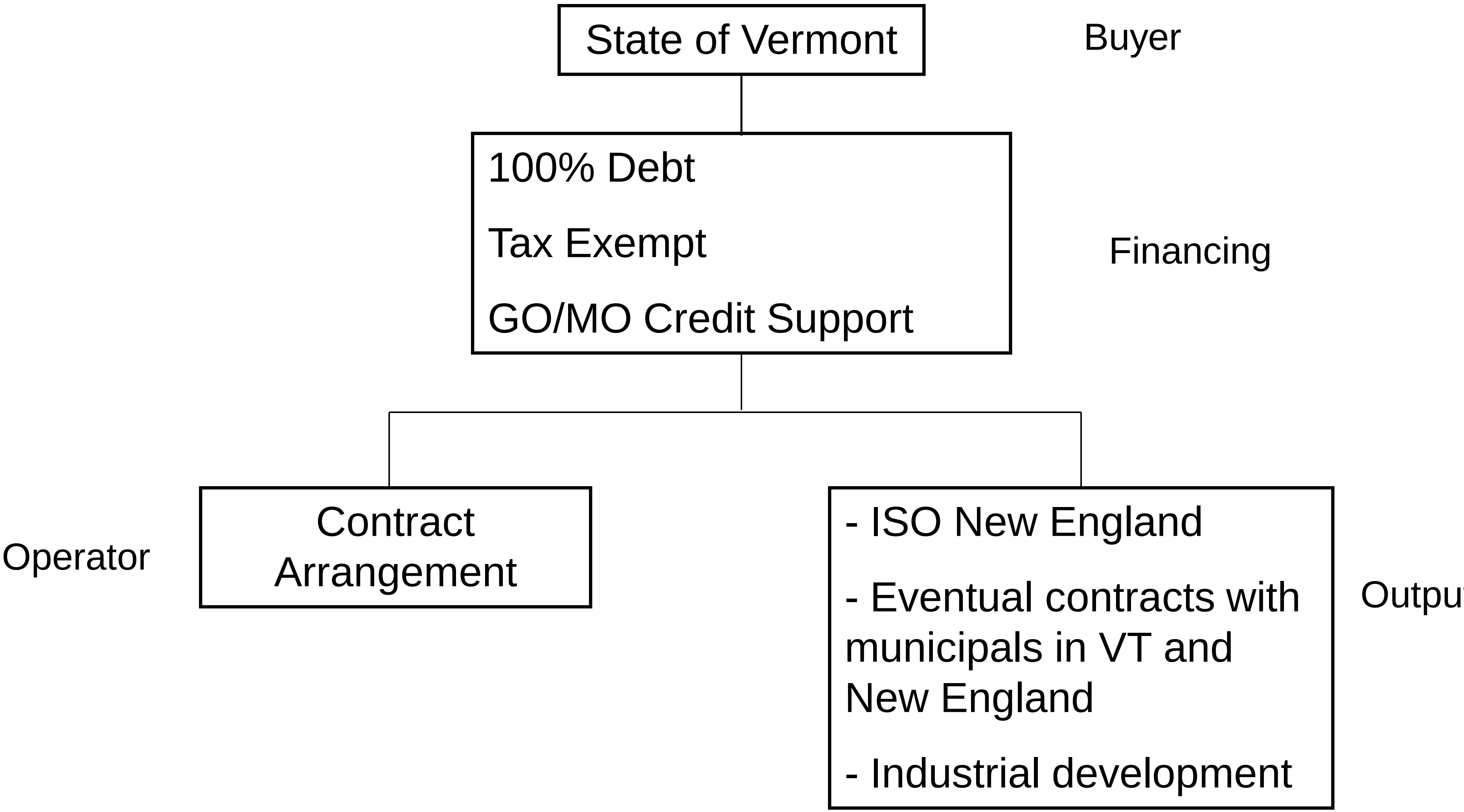
Acquisition Structure #1
Vermont Merchant Model



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Acquisition Structure #2
Vermont Contract Model

State of Vermont — Buyer

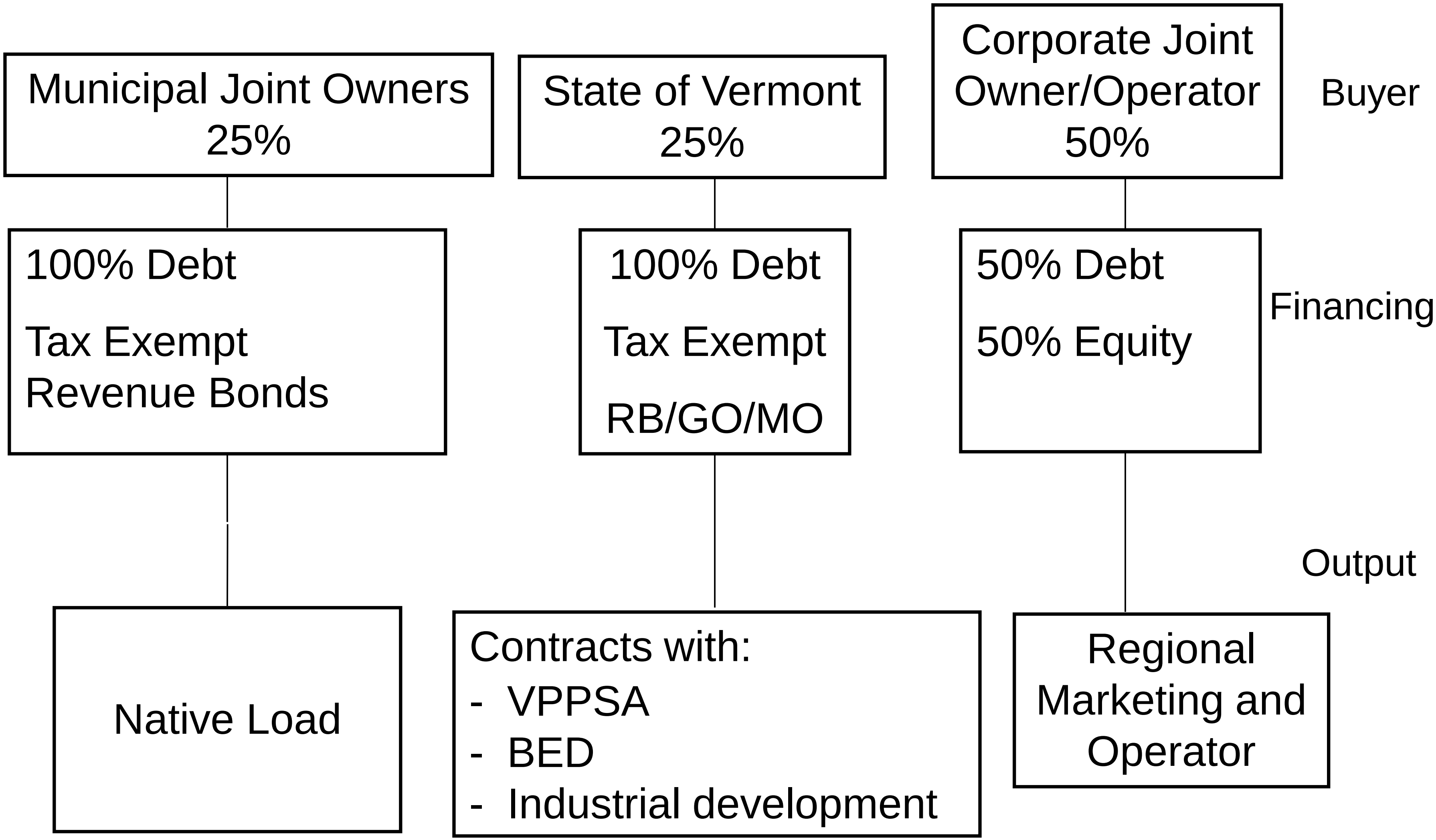
100% Debt
Tax Exempt
— Financing

Operator — Contract Arrangement

Contracts with:
- VT municipals
- NE municipals
- Industrial development

Surplus : ISO NE
— Output

Acquisition Structure #3a
Joint Ownership Model



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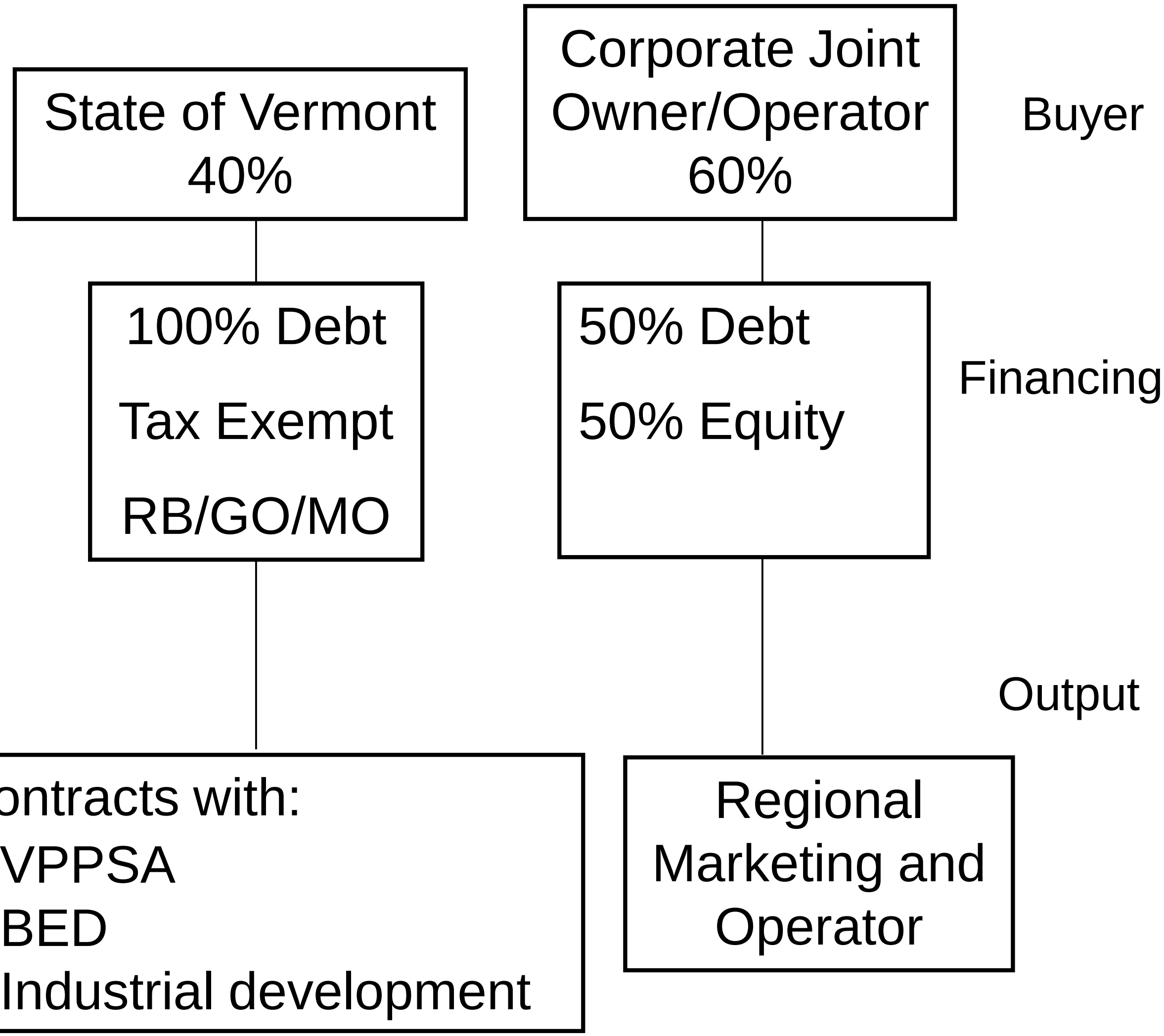
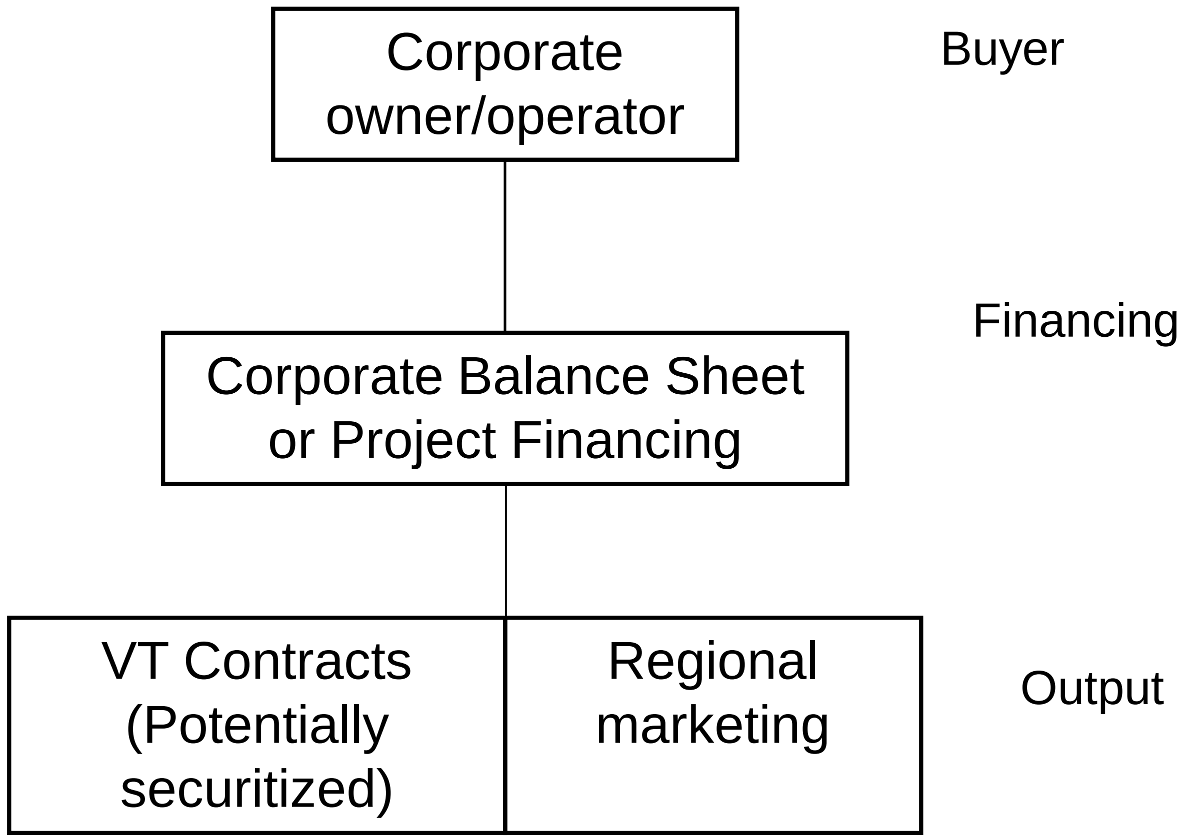
Acquisition Structure #3b
Joint Ownership Model



Acquisition Structure #4
Purchased Power Model



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Acquisition Model Comparisons

Structure	Pro's	Con's
#1 Vermont Merchant	•Most flexibility for directing the output and benefits to Vermont •Execution simplified (ex. financing)	•Requires State credit support •IOU contracts limited to 3 years •Uncertain of tax-exempt status •Most commercial risk •State's credit rating may be impacted
#2 Vermont Contract	•Committed contracts support financing •Reduced commercial risk •Vermont share sized to contractual commitments	•Developing contractual agreements adds to transaction complexity •Vermont benefits may be diluted with PPA agreements •Counterparty credit risks
#3 Joint Ownership	•Credit of the joint owners supports financing •Reduced commercial risk •Vermont share sized to ownership commitments •Joint owners share execution risks/costs	•Developing joint ownership agreements adds to transaction complexity •Interests of the joint owners can diverge over time and be wieldy to manage
#4 Purchased Power	•Least commercial risk •Vermont share sized to contractual commitments •Buyer assumes all execution risks/costs	•Benefits may be diluted with PPA agreements •Securitization of the contract introduces counterparty credit risk

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Probabilities of Success

Bankruptcy Outcome	Structure and Financing	Prevailing in Bid	Combined
Ongoing Entity 25%	NA	NA	0%
Equity or All Assets Combined 25%	50%	20%	2.5%
Asset Groups including Hydro breakout 50%	50%	20%	5%
		TOTAL	**7.5%**

Risks of Ownership

- Market price risk
  - Risk of price decline in New England power market
  - Scenarios quantify loss of value
- Marketing and operating Risk
  - Inability to fulfill contracted power supplies
  - Mechanical failure causes power loss and cost of repair
  - Scenarios quantify loss of value
- FERC license renewal risk
  - 80% of MW are under license until 2037 and 2042
  - FERC license expires 2018 for the remaining 20% (lower CT)
  - License renewals may contain flow restriction and/or required capital additions
- State ownership risks
  - Reduction in State credit rating if MO or GO is used
  - Operational suboptimization
- Counterparty credit risk
  - Purchase power agreements
  - Partnership agreement
  - O&M and marketing agreements

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Benefits of Ownership

- Potential for significant net economic benefits to the State
- Price hedge for participating utilities and their customers – operating expenses and financing costs are relatively fixed
- Source of non-fossil and renewable energy
- Environmental / watershed control
- Industrial development through favorable power sale arrangements or indirect support mechanisms (eg: power price offset)

Execution Considerations

- Assets are encumbered in an uncertain bankruptcy process
  - Bankruptcy process does not ensure availability
  - If available, part of larger integrated asset portfolio
  - Auction will be competitive with an uncertain outcome
- Negotiating agreements with partners or power purchasers adds to transaction complexity (will vary with structure)
  - Joint ownership agreement terms
  - Power purchase agreements
  - Operating and marketing agreements
- Financing will require State credit support or contracts with credit worthy entities for most or all output
  - State reluctant to place taxpayers at risk (GO or MO) or forego other programs (volume cap)
  - Tax-exempt options have requirements that may be difficult to achieve

Conclusions

- There is a low probability of Vermont assembling a viable transaction, having the opportunity to bid on the assets it desires, and prevailing in a competitive auction.
- The capacity of the hydro assets is large in relation to Vermont's total electric capacity requirements (52%), but more reasonable from an energy perspective (25%) and smaller than the existing Hydro Quebec or Vermont Yankee energy component.
- Existing interest from Vermont's utilities is insufficient to support a 100% purchase, but a purchase could potentially be structured through joint ownership or a State-level investment.
- The analysis indicates a substantial net economic benefit to the State of Vermont from ownership, largely derived through its lower cost financing. Some of this benefit may also be realized through contracting at a lower level of commercial risk.
- Once purchased, the risks of ownership are manageable
  - Primary risks are power price risk and FERC relicensing risk
  - Scenario analysis projects that these risks are within quantified benefits
- The contract approach (Model # 2) is the basis for successful public power agencies, but would require Vermont to get out in front of the bankruptcy process and bring together a portfolio of suitable PPA's matched to 75% or more of the capacity to proceed.
- The most manageable commercial options for Vermont are either joint ownership or purchasing the output from the eventual owner (Models 3 and 4).

Alternative Paths Forward

I. Discontinue activity at the State level
  – Leave it to the Vermont municipal and investor-owned utilities to pursue contract or ownership options at their discretion
  – Provide complete information to Vermont's municipal and investor-owned utilities from the study
  – Monitor the USGen bankruptcy process and report back to the Legislature if a change in circumstances improves the probability for a successful acquisition

II. Pursue a path forward to improve the probabilities of success
  – Continue discussions with commercial partners and municipalities (Structures 2, 3 and 4), and work toward a definitive structure and commercial terms (MOU)
  – Develop an acceptable financing plan
  – Proactively monitor the USGen bankruptcy process
  – Re-estimate the costs and benefits based on a firm structure and report back to the Legislature