GREEN MOUNTAIN POWER CORP
Form DEFM14A
September 20, 2006
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of

the Securities Exchange Act of 1934

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

x Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to §240.14a-12

GREEN MOUNTAIN POWER CORPORATION

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

¨ No fee required

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11

(1) Title of each class of securities to which transaction applies:

---

(2) Aggregate number of securities to which transaction applies:

---

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

---

(4) Proposed maximum aggregate value of transaction:

---

(5) Total fee paid:

---

x Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

---

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

Table of Contents

To Our Shareholders:

On June 21, 2006, Green Mountain Power Corporation entered into an agreement and plan of merger with Vermont-based Northern New England Energy Corporation (NNEEC), and a subsidiary of NNEEC, pursuant to which we will become a wholly-owned subsidiary of NNEEC. Upon completion of the merger, you will be entitled to receive $35.00 in cash for each share of our common stock that you own, without interest. NNEEC is a wholly-owned subsidiary of Gaz Métro Limited Partnership (TSX-GZM.UN), a Québec energy company with a history of investment in Vermont, and the parent company of Vermont Gas Systems, Inc.

Our board of directors, by a unanimous vote, has determined that the agreement and plan of merger and the transactions contemplated thereby, including the merger, are advisable, fair to, and in the best interests of, Green Mountain Power and our shareholders, has approved and adopted the agreement and plan of merger, and recommends that our shareholders approve the agreement and plan of merger.

A special meeting of our shareholders will be held on October 31, 2006, at 10:00 a.m., Colchester, Vermont time, to vote on a proposal to approve the agreement and plan of merger so that the merger can occur. The special meeting of shareholders will be held at Green Mountain Power Corporation, 163 Acorn Lane, Colchester, Vermont 05446. Notice of the special meeting is enclosed. This proxy statement gives you detailed information about the special meeting and the merger and includes the agreement and plan of merger as *Annex A*. We encourage you to read the proxy statement and the agreement and plan of merger carefully and in their entirety.

Your vote is important. We cannot complete the merger unless holders of a majority of all shares of our common stock entitled to vote thereon approve the agreement and plan of merger, which we sometimes refer to in this proxy statement as the merger proposal. Our board of directors recommends that you vote **FOR** approval of the merger proposal. The failure of any shareholder to vote on the merger proposal will have the same effect as a vote against the merger proposal.

Each of our directors and executive officers has indicated that he or she intends to vote his or her own shares in favor of the merger proposal.

Whether or not you plan to attend the special meeting, please vote your shares promptly by completing, signing and dating the accompanying proxy card and returning it in the enclosed prepaid envelope or by voting by telephone or through the Internet by following the instructions on the accompanying proxy or voting instruction card.

Our board of directors and management appreciate your continuing support of Green Mountain Power, and we hope you will approve this compelling transaction.

Nordahl L. Brue
Chair, Board of Directors

Christopher L. Dutton
President and Chief Executive Officer

Table of Contents

GREEN MOUNTAIN POWER CORPORATION

163 Acorn Lane

Colchester, Vermont 05446

NOTICE OF SPECIAL MEETING OF SHAREHOLDERS

To the Shareholders of

GREEN MOUNTAIN POWER CORPORATION

Date and Time	October 31, 2006 at 10:00 a.m.
Place	Green Mountain Power Corporation 163 Acorn Lane Colchester, Vermont 05446
Items of Business	The purpose of the meeting is to consider the following matters: A proposal to approve the agreement and plan of merger, pursuant to which Northstars Merger Subsidiary Corporation will merge with and into Green Mountain Power Corporation; A grant of authority to the proxyholders to vote in their discretion with respect to the approval of any proposal to postpone or adjourn the special meeting to a later date for a reasonable business purpose, including to solicit additional proxies in favor of the approval of the agreement and plan of merger, if there are not sufficient votes for approval of the agreement and plan of merger at the special meeting; and Such other matters as may properly come before the special meeting or any adjournments or postponements of the special meeting.
Record Date	September 21, 2006
Proxy Voting	We urge you to read the accompanying proxy statement carefully as it sets forth details of the merger proposal and other important information related to the merger. We have fixed the close of business on September 21, 2006, as the record date for the determination of shareholders entitled to notice of and to vote at the special meeting and any adjournments or postponements of the special meeting. Accordingly, only shareholders of record as of that date will

be entitled to notice of and to vote at the special meeting and any adjournments or postponements of the special meeting. As of the close of business on September 18, 2006, there were outstanding and entitled to vote 5,288,961.25 shares of our common stock. Holders of our common stock are entitled to dissenters rights under Vermont law in connection with the merger. A list of the shareholders entitled to vote will be available at the special meeting for examination by any shareholder. The list will also be available for any purpose germane to the special meeting

Table of Contents

beginning September 21, 2006, two business days after notice of the special meeting is given, and through the special meeting, at our principal office, 163 Acorn Lane, Colchester, Vermont 05446.

To assure your representation at the special meeting, please fill in your vote, sign and mail the enclosed proxy as soon as possible. We have enclosed a return envelope, which requires no postage if mailed in the United States. Your proxy is being solicited by the Board of Directors.

The Board of Directors of Green Mountain Power Corporation unanimously recommends that you vote FOR approval of the merger proposal.

Donald J. Rendall, Jr.

Secretary

September 19, 2006

Please Vote Your Vote is Important

Table of Contents

PROXY STATEMENT

FOR THE SPECIAL MEETING OF THE

SHAREHOLDERS OF

GREEN MOUNTAIN POWER CORPORATION

The board of directors of Green Mountain Power Corporation provides this proxy statement to you to solicit your vote on the approval of the merger proposal. Pursuant to the agreement and plan of merger, the parties have agreed to merge Northstars Merger Subsidiary Corporation with and into Green Mountain Power Corporation. If our shareholders approve the merger proposal and the other conditions to the merger are satisfied, each shareholder will receive $35.00 in cash, without interest, per share of our common stock owned at the time of the merger.

The merger cannot occur unless the holders of a majority of all shares of our common stock entitled to vote thereon approve the merger proposal. A failure to vote is the same as voting your shares against the merger proposal. The board of directors has scheduled a special meeting of shareholders to vote on the merger proposal as follows:

October 31, 2006 at 10:00 a.m.

Colchester, Vermont time

Green Mountain Power Corporation

163 Acorn Lane

Colchester, Vermont 05446

This document provides you with detailed information about the merger proposal. Please see Where You Can Find More Information on page 56 for additional information about Green Mountain Power Corporation on file with the Securities and Exchange Commission.

This proxy statement and proxy card are being mailed to shareholders beginning on or about September 26, 2006.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the transaction contemplated in this proxy statement, passed upon the merits or fairness of the transaction or passed upon the adequacy or accuracy of the disclosure in this proxy statement. Any representation to the contrary is a criminal offense.

No person has been authorized to give any information or make any representation other than those contained in this proxy statement, and, if given or made, such information or representation must not be relied upon as having been authorized. The information in this proxy statement may only be accurate on the date of this proxy statement.

We urge you to read and consider carefully this proxy statement in its entirety.

The date of this proxy statement is September 19, 2006.

Table of Contents

TABLE OF CONTENTS

SUMMARY	1
The Proposed Merger	1
The Companies	1
The Special Meeting	2
What You Will Be Entitled to Receive upon Completion of the Merger	3
Treatment of Deferred Stock Units	4
Treatment of Options Outstanding under Our Stock Plans	4
Market Price and Dividend Data	4
Recommendations of Our Board of Directors	4
Opinion of Our Financial Advisor	4
Interest of Directors and Executive Officers in the Merger	5
Material United States Federal Income Tax Consequences of the Merger	6
Regulatory Approvals	6
The Agreement and Plan of Merger	7
You are Entitled to Dissenters Rights in the Merger	9
QUESTIONS AND ANSWERS ABOUT THE MERGER	10
SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS	14
THE COMPANIES	15
Green Mountain Power	15
NNEEC and Gaz Métro	15
Northstars Merger Sub	15
THE SPECIAL MEETING	16
Date, Time and Place of the Special Meeting	16
Proposal to be Considered at the Special Meeting	16
Record Date	16
Voting Rights; Quorum; Vote Required for Approval	16
Voting and Revocation of Proxies	17
Postponements and Adjournments	17
Solicitation of Proxies	18
Shareholder List	18
Questions and Additional Information	18
THE MERGER	19
Background of the Merger	19
Recommendation of Our Board of Directors	21
Reasons for the Merger	21
Opinion of Our Financial Advisor	24
Merger Consideration	29
Effect of the Merger on Awards Outstanding under Our Stock Plans	29
Interests of Directors and Executive Officers in the Merger	30
Financing of the Merger	33
Effects of the Merger	34
Regulatory Approvals	34
Material U.S. Federal Income Tax Consequences of the Merger to Our Shareholders	35
Accounting Treatment	36
Delisting and Deregistration of Our Common Stock	36
Dissenters Rights	36

Table of Contents

THE AGREEMENT AND PLAN OF MERGER	40
The Merger	40
Merger Consideration	40
Effect of the Merger on Green Mountain Power Stock Award Plans	40
Dissenters Rights	41
Directors and Officers	41
Payment for the Shares	41
Representations and Warranties	42
Conduct of Business Pending the Merger	43
Efforts to Complete the Merger	45
Conditions to the Merger	46
Indemnification and Insurance	47
No Solicitation of Other Offers	48
Termination of the Agreement and Plan of Merger	49
Termination Fees	50
Amendment, Modification, Extension and Waiver	51
Material Adverse Effect	51
Gaz Métro Agreement	51
Amendment to Rights Agreement	51
MARKET PRICE AND DIVIDEND DATA	52
STOCK OWNERSHIP	53
Principal Shareholders	53
Directors and Executive Officers	53
OTHER MATTERS	55
Other Matters for Action at the Special Meeting	55
SHAREHOLDER PROPOSALS	55
WHERE YOU CAN FIND MORE INFORMATION	56
Annex A Agreement and Plan of Merger	A-1
Annex B Opinion of Banc of America Securities LLC	B-1
Annex C Title 11A: Vermont Business Corporations Act, Chapter 13: Dissenters Rights	C-1

Table of Contents

SUMMARY

This summary summarizes the material information in the proxy statement, but does not contain all of the information that may be important to you. You should carefully read this entire proxy statement and the attached Annexes and the other documents to which this proxy statement refers you for a more complete understanding of the matters being considered at the special meeting. In addition, the proxy statement incorporates by reference important business and financial information about Green Mountain Power Corporation. Unless the context otherwise indicates, the terms Green Mountain Power, we, us or our mean Green Mountain Power Corporation and its subsidiaries. When we refer to shares of our common stock in this proxy statement, we are referring to the shares of our common stock, together with associated share purchase rights under our Rights Agreement, dated as of June 17, 1998, with Mellon Investor Services LLC, formerly known as ChaseMellon Shareholder Services, L.L.C., as rights agent, as amended. You may obtain the information incorporated by reference into this proxy statement without charge by following the instructions in Where You Can Find More Information on page 56.

The Proposed Merger (see page 19)

In the merger, Northstars Merger Subsidiary Corporation, which we refer to in this proxy statement as Northstars Merger Sub, a wholly-owned subsidiary of Northern New England Energy Corporation, which we refer to in this proxy statement as NNEEC, which is a wholly-owned subsidiary of Gaz Métro Limited Partnership, which we refer to in this proxy statement as Gaz Métro, will merge with and into Green Mountain Power, with Green Mountain Power continuing as the surviving corporation.

Upon completion of the merger, each issued and outstanding share of our common stock other than shares held by us or any of our wholly-owned subsidiaries or by NNEEC or Northstars Merger Sub or any direct or indirect wholly-owned subsidiary of NNEEC and shares for which the holder has perfected its right to dissent pursuant to Chapter 13 of the Vermont Business Corporation Act, will automatically be canceled and will be converted into the right to receive $35.00 per share, in cash, without interest, which amount per share we sometimes refer to in this proxy statement as the merger consideration.

As a result of the merger, Green Mountain Power will cease to be an independent, publicly-traded company and will become a direct wholly-owned subsidiary of NNEEC and an indirect wholly-owned subsidiary of Gaz Métro.

The Companies (see page 15)

Green Mountain Power. Green Mountain Power is a public utility operating company that transmits, distributes and sells electricity and utility construction services in the State of Vermont in a service territory with approximately one quarter of Vermont s population. We serve approximately 90,000 customers. We were incorporated under the laws of Vermont on April 7, 1893. Our headquarters are located at 163 Acorn Lane, Colchester, Vermont 05446 and our telephone number is (802) 864-5731.

NNEEC and Gaz Métro. NNEEC is an energy company based in Vermont. A subsidiary of Gaz Métro, NNEEC is the parent company of Vermont Gas Systems, Inc. and Portland Natural Gas Transmission System, which we refer to in this proxy statement as PNGTS. Gaz Métro is a leading Québec energy company and one of Canada s largest natural gas distributors. NNEEC s headquarters are located at c/o Vermont Gas Systems, Inc., 85 Swift Street, P.O. Box 467, Burlington, VT 05402-0467 and its telephone number is (802) 863-4511. Gaz Métro s headquarters are located at 1717 du Havre, Montreal, Québec, H2K 2X3 and its telephone number is (514) 598-3444.

Northstars Merger Sub. Northstars Merger Sub is a Vermont corporation formed for the purpose of merging with and into Green Mountain Power. Northstars Merger Sub is a direct wholly-owned subsidiary of NNEEC. The executive offices of Northstars Merger Sub are located at c/o Vermont Gas Systems, Inc., 85 Swift Street, P.O. Box 467, Burlington, VT 05402-0467 and its telephone number is (802) 863-4511.

Table of Contents

The Special Meeting (see page 16)

Date, Time and Place of the Special Meeting. The special meeting of shareholders is scheduled to be held as follows:

Date:	October 31, 2006
Time:	10:00 a.m., Colchester, Vermont time
Place:	Green Mountain Power Corporation 163 Acorn Lane Colchester, Vermont 05446

Proposal to Be Considered at the Special Meeting. At the special meeting, you will be asked to vote on a proposal to approve the agreement and plan of merger, which we sometimes refer to in this proxy statement as the merger proposal, pursuant to which Northstars Merger Sub will merge with and into Green Mountain Power. A copy of the agreement and plan of merger is attached as *Annex A*. We urge you to read this document carefully as it is the document that governs the merger.

Record Date. Our board of directors has fixed the close of business on September 21, 2006, as the record date for the special meeting and only holders of record of our common stock on the record date are entitled to vote at the special meeting. As of the close of business on September 18, 2006, there were outstanding and entitled to vote 5,288,961.25 shares of our common stock.

Voting Rights; Quorum; Vote Required for Approval. Each share of our common stock entitles its holder to one vote on all matters properly coming before the special meeting. The presence in person or representation by proxy of shareholders entitled to cast a majority of the votes of all issued and outstanding shares entitled to vote on the merger proposal, considered together, constitutes a quorum for the purpose of considering that matter. Abstentions and broker non-votes (as defined below) will be treated as shares present and entitled to vote for purposes of determining a quorum at the special meeting. There must be a quorum for the vote on the merger proposal.

If you hold your shares in an account with a broker or bank, which we refer to in this proxy statement as holding your shares in street name, you must instruct the broker or bank on how to vote your shares. If an executed proxy card returned by a broker or bank holding shares indicates that the broker or bank does not have authority to vote on the merger proposal, the shares will be considered present at the meeting for purposes of determining the presence of a quorum, but will not be voted on the merger proposal. This is called a broker non-vote. Your broker or bank will vote your shares only if you provide instructions on how to vote by following the instructions provided to you by your broker or bank. If you hold your shares of our common stock in street name, you must request a legal proxy from your broker or bank in order to vote in person at the special meeting.

***Required Vote.* Under our articles of incorporation and Vermont law, the approval of the merger proposal requires the affirmative vote of a majority of all shares of our common stock entitled to vote thereon. Abstentions and broker non-votes will have the same effect as a vote against the merger proposal.**

As of the close of business on August 31, 2006, our directors and senior executive officers (as such term is defined below in The Merger Interests of Directors and Executive Officers in the Merger) beneficially owned approximately 213,073 shares of our common stock, or approximately 4.03% of the shares entitled to vote at the special meeting. It is expected that each of our directors and senior executive officers will vote the shares of our common stock owned by him or her in favor of the merger proposal.

Voting and Revocation of Proxies. After carefully reading and considering the information contained in this proxy statement, you should vote your shares as soon as possible so that your shares are represented at the special meeting. You may vote your shares by completing, dating and signing your proxy card and mailing it in the enclosed return envelope or by voting by telephone by calling 1-866-540-5760 or through the Internet at

https://www.proxyvoting.com/gmp. You can also vote in person at the meeting, but we encourage you to submit your proxy card promptly in any event. Unless you specify to the contrary on your proxy card, all of your shares represented by valid proxies will be voted **FOR** the merger proposal and the proposal to permit the proxies to vote, in their discretion, on the postponement or adjournment of the special meeting, if necessary. The persons named as proxies will not have the discretion to vote in favor of any postponement or adjournment as to any shares of our common stock that have been voted against the merger proposal.

If you hold your shares in certificated form, please do not send in your stock certificates with your proxy card. If the merger is completed, a separate letter of transmittal will be mailed to you that will enable you to exchange your stock certificates for the merger consideration. If you hold your shares in book-entry form, you will automatically receive the merger consideration in exchange for your shares following the completion of the merger and you will not receive a letter of transmittal.

Until exercised at the special meeting, you can revoke your proxy and change your vote in any of the following ways:

- by delivering written notification to us at our principal executive offices at 163 Acorn Lane, Colchester, Vermont 05446, Attention: Corporate Secretary;
- by delivering a proxy of a later date by mail in the manner described in this proxy statement; or
- by attending the special meeting and voting in person (your attendance at the meeting will not, by itself, revoke your proxy; you must vote in person at the meeting).

If you voted by telephone or through the Internet, you can also revoke your proxy and change your vote by any of these methods or you can revoke your proxy and change your vote by telephone by calling 1-866-540-5760 or through the Internet at https://www.proxyvoting.com/gmp. If you decide to vote by completing, signing, dating and returning the enclosed proxy card, you should retain a copy of the voter control number found on the proxy card in the event that you later decide to revoke your proxy and change your vote by telephone or through the Internet. If you have instructed a broker or bank to vote your shares, you can revoke your proxy and change your vote by following the directions received from your broker or bank to change those instructions.

Questions and Additional Information. For additional information regarding the procedure for delivering your proxy see The Special Meeting Voting and Revocation of Proxies on page 17 and The Special Meeting Solicitation of Proxies on page 18. If you have more questions about the merger or how to submit your proxy, or if you need additional copies of this proxy statement or the enclosed proxy card or voting instructions, please call our proxy solicitor, Georgeson Inc., toll-free at 1-866-295-1794.

What You Will Be Entitled to Receive upon Completion of the Merger (see page 29)

Holders of shares of our common stock will be entitled to receive $35.00 in cash, without interest, which we refer to in this proxy statement as the merger consideration, in exchange for each share of our common stock that they own at the time of the completion of the merger. After we complete the merger, holders of our common stock will no longer own our common stock and we will become a direct wholly-owned subsidiary of NNEEC. After the merger is completed, you will have the right to receive the merger consideration, but you will no longer have any rights as a Green Mountain Power shareholder and will have no rights as a shareholder of NNEEC. If you hold your shares in certificated form and do not validly elect and perfect your right to dissent from the merger, you will receive the merger consideration after exchanging your stock certificates in accordance with the instructions contained in the letter of transmittal to be sent to you shortly after the completion of the merger. If you hold your shares in book-entry form, you will automatically receive the merger consideration in exchange for your shares following the completion of the merger and you will not receive a letter of transmittal. Shares of our common stock held by us or any of our wholly-owned subsidiaries or by NNEEC or Northstars Merger Sub or any direct or indirect wholly-owned subsidiary of NNEEC will be canceled at the effective time of the merger. See The Merger Merger Consideration.

Treatment of Deferred Stock Units (see page 29)

Each outstanding deferred stock unit granted under our stock plans will be vested on the date of the special meeting if the merger proposal is approved by our shareholders. Each deferred stock unit that is outstanding at the effective time of the merger will be converted in the merger into the right to receive $35.00 in cash per share subject to such deferred stock unit, without interest and less any applicable withholding tax. Holders of deferred stock units will receive the merger consideration after the cancellation of their deferred stock unit agreements in accordance with the terms of our stock plans shortly after the completion of the merger. See The Agreement and Plan of Merger Effect of the Merger on Green Mountain Power Stock Award Plans.

Treatment of Options Outstanding under Our Stock Plans (see page 29)

Each outstanding stock option will automatically accelerate so that each such stock option shall become fully exercisable on the date of the special meeting if the merger proposal is approved by our shareholders. All stock options not exercised prior to the effective time of the merger will be canceled in the merger, with the holder of each stock option becoming entitled to receive, in full satisfaction of the rights of such holder with respect thereto, an amount in cash equal to the excess of $35.00 per share over the exercise price per share of our common stock subject to such stock option, multiplied by the number of shares of our common stock subject to such stock option, less any withholding taxes. Holders of stock options will receive all amounts payable, without interest, as soon as practicable following the effective time of the merger, after the cancellation of their stock option agreements in accordance with the terms of our stock plans shortly after the completion of the merger. See The Agreement and Plan of Merger Effect of the Merger on Green Mountain Power Stock Award Plans.

Market Price and Dividend Data (see page 52)

Our common stock is quoted on the New York Stock Exchange under the symbol GMP. On June 21, 2006, the last full trading day prior to the public announcement of the merger, the closing price for our common stock was $27.99 per share. On September 19, 2006, the last full trading day prior to the date of this proxy statement, the closing price for our common stock was $33.25 per share. See Market Price and Dividend Data.

Recommendations of Our Board of Directors (see page 21)

After careful consideration, our board of directors unanimously:

- determined that the merger proposal is advisable, fair to, and in the best interests of, Green Mountain Power and our shareholders;
- approved and adopted the merger proposal; and
- recommends that our shareholders vote to approve the merger proposal.

Our board of directors unanimously recommends that at the special meeting you vote FOR the merger proposal.

For a discussion of the material reasons considered by our board of directors in reaching its conclusions, see The Merger Reasons for the Merger. The board of directors did not assign relative weight to any of the reasons. In addition, our board of directors did not reach any specific conclusion on each reason considered, but conducted an overall analysis of these reasons. Individual members of the board of directors may have given different weight to different reasons. See The Merger Recommendation of Our Board of Directors.

Opinion of Our Financial Advisor (see page 24)

On June 21, 2006, our financial advisor, Banc of America Securities LLC, which we refer to in this proxy statement as Banc of America Securities, delivered to our board of directors a written opinion to the effect that, as of the date of the opinion and based on and subject to the various assumptions and limitations set forth in its opinion, the merger consideration to be received by the holders of our common stock in the proposed merger was fair, from a financial point of view, to such holders.

4

The full text of Banc of America Securities written opinion, dated June 21, 2006, which describes, among other things, the assumptions made, procedures followed, factors considered and limitations on the review undertaken by Banc of America Securities in connection with its opinion, is attached as *Annex B* to this proxy statement and is incorporated by reference in its entirety into this proxy statement. Banc of America Securities opinion was provided to our board of directors in its evaluation of the merger consideration to be received by holders of our common stock. Banc of America Securities opinion does not address any other aspect of the merger and does not constitute a recommendation as to how our shareholders should vote or act in connection with the merger. We urge you to read the opinion carefully and in its entirety.

Interest of Directors and Executive Officers in the Merger (see page 30)

In considering the recommendation of our board of directors that you vote for the merger proposal, you should be aware that some of our senior executive officers and members of our board of directors have interests in the merger that may be in addition to or different from the interests of our shareholders generally. These interests include the following:

- the vesting and exercisability of options to purchase our common stock held by our employees, including the senior executive officers, will be accelerated in connection with the merger;

- the vesting of deferred stock units subject to deferred stock unit agreements that each of our senior executive officers is a party to with us will be accelerated and all deferred stock units subject to deferred stock unit awards (whether vested or unvested) will be converted into cash in the merger;

- upon completion of the merger, our current officers are expected to be the officers of the surviving corporation;

- existing indemnification arrangements and insurance for our directors and officers will be continued if the merger is completed; and

- directors and officers liability insurance coverage of our directors and officers for matters occurring prior to the completion of the merger, will be continued by NNEEC after the merger is completed for a period of six years.

In addition, Northstars Merger Sub and our senior executive officers entered into new employment agreements which waived the change of control protections of the existing change of control agreements, and provided for certain terms of employment with Northstars Merger Sub commencing at the effective time of the merger and continuing in effect for a period of three years from the effective time of the merger, subject, upon the third anniversary of the effective time of the merger and each subsequent one year anniversary, to automatic renewals for additional one year periods unless notice is provided to the senior executive officer. Upon the effective time of the merger, these employment agreements will become agreements of the surviving corporation. These senior executive officers will be entitled to the following benefits under the employment agreement instead of the benefits under the existing change of control agreements and certain other benefits:

- the following base salaries and bonus opportunities:

Name	Salary	Target Bonus (% of salary)	Long-Term Compensation (% of salary)
Christopher L. Dutton	$ 411,000	50%	90%
Mary G. Powell	$ 300,000	50%	60%
Dawn D. Bugbee	$ 210,000	30%	40%

Donald J. Rendall, Jr.	$ 215,000	30%	30%
Robert J. Griffin	$ 210,000	30%	30%
Robert R. Rogan	$ 190,000	30%	30%
Walter S. Oakes	$ 170,000	30%	30%

and

- other employee benefits that, in the aggregate, are no less favorable than those provided to the senior executive officers by us immediately prior to the effective time of the merger.

The senior executive officers also agreed to certain non-competition, non-solicitation and confidentiality covenants during employment and for a period of at least 12 months after receipt of a severance payment.

In addition, NNEEC has agreed that it will cause five members of our board of directors and our chief executive officer to be elected to the board of directors of the surviving corporation at the effective time, and that it will not remove any such director, except for cause, until at least the second anniversary of the effective time of the merger and has also agreed to offer three additional members of our board positions as members of the board of directors of NNEEC or one of its subsidiaries.

The members of our board of directors were aware of these interests and considered them at the time they approved and adopted the merger proposal and made their recommendation to our shareholders. See The Merger Interests of Directors and Executive Officers in the Merger.

Material United States Federal Income Tax Consequences of the Merger (see page 35)

The merger will be a taxable transaction for all U.S. holders of our common stock. As a result, assuming you are a U.S. taxpayer, the exchange of your shares of our common stock for cash in the merger will be subject to United States federal income tax and also may be taxed under applicable state, local, and other tax laws. In general, you will recognize gain or loss equal to the difference between (1) $35.00 per share and (2) the adjusted tax basis of each of your shares of our common stock. Tax matters are very complicated, and the tax consequences of the merger to you will depend on the facts of your particular situation. You should consult your own tax advisor as to the specific tax consequences to you of the merger, including the applicable federal, state, local and foreign tax consequences.

Regulatory Approvals (see page 34)

To complete the merger, we and NNEEC must obtain approvals or consents from, or make filings with the following U.S. federal, state and local regulatory authorities:

- the Federal Energy Regulatory Commission, which we refer to in this proxy statement as the FERC;
- the Vermont Public Service Board, which we refer to in this proxy statement as the VPSB;
- the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, which we refer to in this proxy statement as the HSR Act; and
- the Committee on Foreign Investment in the United States, which we refer to in this proxy statement as the CFIUS.

In addition, NNEEC filed an application for approval with the Maine Public Utilities Commission, which we refer to in this proxy as the MPUC.

See The Merger Regulatory Approvals for further information.

As of the date of this proxy statement, we and NNEEC are in the process of obtaining the regulatory approvals required by applicable law or regulations.

The Agreement and Plan of Merger (see page 40)

Conditions to the Merger.

The parties obligations to complete the merger are subject to the following conditions:

the approval of the merger proposal by the requisite shareholder vote at the special meeting;

no order, judgment, decree, injunction or ruling of a court of competent jurisdiction or any governmental entity shall have been issued preventing the consummation of the merger;

no statute, rule or regulation enacted, promulgated or deemed applicable to the merger by any governmental entity making the merger illegal or preventing its consummation;

the termination or expiration, or obtainment of, any applicable waiting period, filings or approvals required under antitrust or similar laws to consummate the merger;

performance in all material respects of all covenants and obligations that each party is required to perform under the agreement and plan of merger; and

obtaining required consents.

NNEEC s and Northstar Merger Sub s obligations to complete the merger are subject to the following conditions:

our representations and warranties contained in the agreement and plan of merger must be true and correct, except for inaccuracies that, individually or in the aggregate, would not reasonably be expected to have a company material adverse effect (as such term is defined below under The Agreement and Plan of Merger Material Adverse Effect);

our currently pending rate case shall have been concluded and such approvals and other actions shall have become final orders;

the required consents do not contain any conditions, provision, liabilities or terms that would, individually or in the aggregate and together with any adverse effect as compared to the expected outcome at the level reasonably expected by NNEEC as of June 21, 2006, which we refer to in this proxy statement as the expected outcome, of the petition we filed with the VPSB on April 14, 2006, in which we requested an 11.95% increase in our rates, expected to be effective as of December 29, 2006, which we refer to in this proxy statement as our currently pending rate case, reasonably be expected to

have a company material adverse effect,

materially impair any of the expected benefits of the merger, or

impair, other than in an immaterial manner, the value to NNEEC of any material tax attributes arising out of or related to the merger or the financing of the merger or our operations after the merger;

our receipt of third-party consents under any material contract;

we shall not have suffered a company material adverse effect since December 31, 2005; and

holders of shares representing in excess of 10% of our outstanding shares shall not have exercised rights of dissent under Section 13.02 of the Vermont Business Corporation Act in connection with the merger.

Our obligation to complete the merger is subject to the following conditions:

the representations and warranties of NNEEC and Northstars Merger Sub shall be true and correct in all material respects, in each case as of the date of the agreement and plan of merger and as of the closing date as though made on and as of such date and time; and

the required consents from the VPSB shall not contain any term that is directed solely at holders of shares of our common stock and have the effect of reducing the merger price to be received by the shareholders in their capacity as such.

Termination of the Agreement and Plan of Merger. The agreement and plan of merger may be terminated at any time before the completion of the merger, whether before or after our shareholders have approved and adopted the merger proposal:

by mutual consent of NNEEC and Green Mountain Power;

by either NNEEC or us if:

any court or other governmental entity shall have issued, enacted, entered, promulgated or enforced any order restricting the consummation of the merger and such order shall have become a final order;

the effective time shall not have occurred on or before June 21, 2007, which date we will refer to as the termination date, provided that the termination date may be extended by NNEEC or us until December 21, 2007 if the required consents have not been obtained, but all other conditions to the closing have been satisfied or are capable of being satisfied, provided further that, the right to terminate the agreement and plan of merger pursuant to this bullet point is not available to any party whose material breach of any covenant, agreement or obligation under the agreement or plan of merger is the cause of, or results in, the failure of the agreement and plan of merger to be consummated by the termination date without regard to any extension; or

the requisite vote on the merger proposal is not obtained at a duly held special meeting or at any adjournment or postponement thereof;

by us if:

any of the representations and warranties of NNEEC and Northstars Merger Sub contained in the agreement and plan of merger fails to be true and correct in a manner that would result in the failure of the condition pertaining to NNEEC s and Northstars Merger Sub s representations and warranties,

there is a breach by NNEEC or Northstars Merger Sub of any covenant or agreement of NNEEC or Northstars Merger Sub that would result in the failure of the condition pertaining to NNEEC s or Northstars Merger Sub s covenants and obligations under the agreement and plan of merger, or

we enter into an acquisition agreement, merger agreement or other agreement to consummate a transaction that constitutes a superior proposal before the time that our shareholders vote on whether to approve the agreement and plan of merger and we simultaneously pay any fees due under the agreement and plan of merger;

by NNEEC if:

any of our representations and warranties shall fail to be true and correct in a manner that would result in the failure of the closing condition relating to the accuracy of representations and warranties;

we materially breach any covenant or agreement;

our board of directors withdraws, changes, modifies or qualifies or amends in a manner adverse to NNEEC its adoption or recommendation of the merger or the agreement and plan of merger, or our board of directors recommends an acquisition proposal;

the special meeting does not occur by the fifth business day before the termination date, or December 21, 2007 if the termination date is extended;

we willfully breach the non-solicitation provisions in any material respect; or

we or our subsidiaries suffer a company material adverse effect after December 31, 2005.

Table of Contents

Termination Fees. We will pay an initial termination fee of $3,500,000 to NNEEC upon termination of the agreement and plan of merger in the event that:

- an acquisition proposal has been made or proposed and thereafter the agreement and plan of merger is terminated by:
  - either NNEEC or us for failure to receive the required shareholder vote, or
  - NNEEC in the event our board of directors changes its recommendation in a manner adverse to NNEEC or recommends another acquisition proposal,
- the agreement and plan of merger is terminated by NNEEC in the event we willfully breach the agreement and plan of merger s non-solicitation provisions, or
- the agreement and plan of merger is terminated by us because we accept a superior proposal.

The initial termination fee is not payable to NNEEC pursuant to the provision described in the first bullet above unless and until within 18 months of such termination we enter into an acquisition agreement, merger agreement or other agreement (other than a confidentiality or standstill agreement) with respect to, or shall have consummated or shall have adopted or recommended to our shareholders or otherwise not opposed, an acquisition proposal and, in the case of the clause noted in the first sub-bullet under the first bullet above, such acquisition proposal is from the same party that made an acquisition proposal prior to the termination of the agreement and plan of merger. We shall pay an additional fee of $3,500,000 to NNEEC prior to the consummation of a transaction resulting from an acquisition proposal if such transaction is consummated within 24 months after the payment of the initial termination fee, provided in the case of the clause noted in the first sub-bullet under the first bullet above, such acquisition proposal is from the same party that made an acquisition proposal prior to the termination of the agreement and plan of merger.

Gaz Métro Agreement. In connection with the execution of the agreement and plan of merger, Gaz Métro, the parent entity of NNEEC, entered into an agreement whereby Gaz Métro agreed to cause NNEEC to timely perform all of its obligations under the agreement and plan of merger.

Amendment to Rights Agreement. Also in connection with the agreement and plan of merger, on June 21, 2006, we executed an amendment to our rights agreement, dated as of June 17, 1998, between us and Mellon Investor Services LLC (formerly known as ChaseMellon Shareholder Services, L.L.C.), as rights agent. The amendment provided that the execution of, and the consummation of the transactions contemplated by, the agreement and plan of merger shall not cause (i) NNEEC, its affiliates or its associates to be deemed an acquiring person or (ii) a distribution date, shares acquisition date or triggering event to be deemed to have occurred.

You are Entitled to Dissenters Rights in the Merger (see page 36)

Under the Vermont Business Corporation Act, shareholders who do not vote in favor of the merger proposal will be entitled to exercise dissenters rights in connection with the merger. Shareholders desiring to exercise such dissenters rights will have the rights and duties and must follow the procedures set forth in Chapter 13 of the Vermont Business Corporation Act, the full text of which is set forth in *Annex C* to this proxy statement. Shareholders who wish to exercise dissenters rights must carefully follow the procedures described in Chapter 13 of the Vermont Business Corporation Act and are urged to read *Annex C* in its entirety. See The Merger Dissenters Rights.

Table of Contents

QUESTIONS AND ANSWERS ABOUT THE MERGER

The following questions and answers are intended to address briefly some commonly asked questions regarding the special meeting of shareholders to be held for the purpose of voting on the merger proposal. These questions and answers do not address all questions that may be important to you as a Green Mountain Power shareholder. Please refer to the more detailed information contained elsewhere in this proxy statement, the Annexes to this proxy statement and the documents referred to or incorporated by reference in this proxy statement.

Q1. What is the proposed transaction?

A1. You are being asked to vote to approve the merger proposal. Pursuant to the merger, Northstars Merger Sub, a direct wholly-owned subsidiary of NNEEC, will merge with and into Green Mountain Power with Green Mountain Power being the surviving corporation and becoming a direct wholly-owned subsidiary of NNEEC.

Q2. If the merger is completed, what will I receive for my shares of common stock?

A2. After completion of the merger, you will receive $35.00 in cash, without interest, for each share of our common stock you own, following surrender of your shares of our common stock, regardless of whether you hold such shares in certificated or book-entry form. As a result of the merger, our common stock will cease to be quoted on the New York Stock Exchange, will not be publicly traded and will be deregistered under the Securities Exchange Act of 1934, as amended, which we refer to in this proxy statement as the Exchange Act.

Q3. Why is the board of directors recommending the adoption of the merger proposal?

A3. Upon careful consideration, our board of directors unanimously believes that the merger proposal is advisable, fair to, and in the best interests, of Green Mountain Power and our shareholders. To review the reasons of our board of directors for recommending approval of the merger proposal, see pages 21 through 24.

Q4. When is the merger expected to be completed?

A4. We and NNEEC are working toward completing the merger as quickly as possible. We and NNEEC expect to complete the merger promptly after we receive approval by our shareholders at the special meeting and receive all necessary regulatory approvals. We currently anticipate that the merger will be completed within approximately five to nine months following the date of this proxy. See The Agreement and Plan of Merger Conditions to the Merger.

Q5. Who is entitled to vote at the special meeting?

A5. Holders of record of our common stock as of the close of business on September 21, 2006, are entitled to vote at the special meeting. Each of our shareholders is entitled to one vote for each share of our common stock owned by the shareholder.

Q6. How many shares need to be represented at the meeting?

A6. The holders of a majority of the outstanding shares entitled to vote at the special meeting must be present in person or represented by proxy to constitute a quorum for the transaction of business. As of the close of business on September 18, 2006, there were 5,288,961.25 shares of common stock outstanding. If you vote by proxy card or in person at the special meeting, you will be considered part of the quorum.

Q7. What vote is required for our shareholders to approve the merger proposal?

A7. An affirmative vote of the holders of a majority of all shares of our common stock entitled to vote thereon is required to approve the merger proposal.

Q8. Do I need to attend the special meeting in person?

A8. No. It is not necessary for you to attend the special meeting in order to vote your shares.

Q9. What do I need to do now?

A9. After carefully reading and considering the information contained in this proxy statement and the Annexes attached to this proxy statement, please vote your shares of our common stock as soon as possible. Please vote your shares by returning the enclosed proxy card or by telephone or through the Internet, even if you plan to attend the special meeting, to ensure that your shares are voted. Your proxy card includes detailed information on how to vote.

In order for your shares to be represented at the special meeting:

- you can attend the special meeting in person;
- you can vote by telephone by calling toll-free 1-866-540-5760 on any touch-tone telephone before 11:59 p.m., Colchester, Vermont time, on October 30, 2006, or by following the instructions included on your proxy card;
- you can vote through the Internet by accessing https://www.proxyvoting.com/gmp before 11:59 p.m., Colchester, Vermont time, on October 30, 2006, or by following the instructions included on your proxy card; or
- you can indicate on the enclosed proxy card how you would like to vote and return the proxy card in the accompanying pre-addressed postage paid envelope.

Your proxy card will instruct the persons named on the proxy card to vote your shares of our common stock at the special meeting as you direct. If you are a record holder of shares and you sign and send in your proxy card and do not indicate how you want to vote, your proxy will be voted **FOR** the merger proposal. If you do not sign or send in your proxy card, or if you abstain, the effect will be a vote **AGAINST** the merger proposal. Your vote is very important, regardless of the number of shares that you own.

Q10. If my shares are held for me by my broker, will my broker vote those shares for me with respect to the merger proposal?

A10. Your broker will not have the power to vote your shares of our common stock with respect to the merger proposal unless you provide instructions to your broker on how to vote. You should instruct your broker on how to vote your shares with respect to the merger proposal, using the instructions provided by your broker. If you fail to instruct your broker on how to vote, it will have the effect of a vote **AGAINST** the merger proposal.

Q11. May I vote in person?

A11. Yes. If your shares are not held in street name through a broker or bank you may attend the special meeting and vote your shares in person, rather than signing and returning your proxy card or voting by telephone or through the Internet. If your shares are held in street name, you must get a properly executed proxy card from your broker or bank in order to attend the special meeting and vote in person. Even if you plan to attend the special meeting in person you should still submit your proxy as soon as possible. You will still be able to vote in person if you choose to attend the special meeting.

Table of Contents

Q12. May I vote by telephone or through the Internet?

A12. If you are a registered shareholder (that is, if you hold your stock in certificate form or own shares purchased through the dividend reinvestment stock purchase plan), you may vote by telephone at 1-866-540-5760, or electronically through the Internet at https://www.proxyvoting.com/gmp, and by following the instructions included with your proxy card. The deadline for voting by telephone or electronically is 11:59 p.m., Colchester, Vermont time, on October 30, 2006. If your shares are held in street name, please check your proxy card or contact your broker or nominee to determine whether you will be able to vote by telephone or electronically.

Q13. What happens if I abstain from voting or do not return my proxy card?

A13. If you abstain from voting or do not vote (either in person or by proxy) it will have the same effect as a vote **AGAINST** the merger proposal. Brokers who hold shares of our common stock in street name for customers who are the beneficial owners of those shares may not give a proxy to vote those shares without specific instructions from their customers.

Q14. Can I change my vote after I have mailed my proxy card?

A14. Yes. You can change your vote at any time before your proxy is voted at the special meeting. You may revoke your proxy by notifying us in writing at Green Mountain Power Corporation, 163 Acorn Lane, Colchester, Vermont 05446, Attention: Corporate Secretary, or by submitting a new proxy, in each case, dated after the date of the proxy being revoked. In addition, your proxy may be revoked by attending the special meeting and voting in person. However, simply attending the special meeting without voting will not revoke your proxy. If you voted by telephone or through the Internet, you can also revoke your proxy and change your vote by any of these methods or you can revoke your proxy and change your vote by telephone or through the Internet. If you decide to vote by completing, signing, dating and returning the enclosed proxy card, you should retain a copy of the voter control number found on the proxy card in the event that you later decide to revoke your proxy and change your vote by telephone or through the Internet. If you have instructed a broker to vote your shares, you must follow the instructions received from your broker to change your vote. All properly submitted proxies received by us before the special meeting that are not revoked prior to being voted at the special meeting, will be voted at the special meeting in accordance with the instructions indicated on the proxies or, if no instructions were provided, **FOR** the merger proposal and the proposal to permit the proxies to vote, in their discretion, on the postponement or adjournment of the special meeting, if necessary.

Q15. What happens if I sell my shares of common stock before the special meeting?

A15. The record date for the special meeting is earlier than the expected date of the merger. If you own shares of our common stock on the record date, but transfer your shares after the record date but before the merger, you will retain your right to vote at the special meeting, but the right to receive the merger consideration will pass to the person to whom you transferred your shares.

Q16. Can I exercise dissenters rights in the merger?

A16. Yes. Under the Vermont Business Corporation Act, shareholders who do not vote in favor of the merger proposal will be entitled to exercise dissenters rights in connection with the merger. Shareholders desiring to exercise such dissenters rights will have the rights and duties and must follow the procedures set forth in Chapter 13 of the Vermont Business Corporation Act, the full text of which is set forth in *Annex C* to this proxy statement. Shareholders who wish to exercise dissenters rights must carefully follow the procedures described in Chapter 13 of the Vermont Business Corporation Act and are urged to read *Annex C* in its entirety. See The Merger Dissenters Rights.

Table of Contents

Q17. If I hold my shares in certificated form, should I send in my stock certificates now?

A17. No. After the merger is completed, you will be sent detailed written instructions for exchanging your stock certificates. You must return your stock certificates as described in those instructions to receive the merger consideration. If you hold shares of our common stock in book-entry form, you will automatically receive the merger consideration in exchange for your shares following the completion of the merger and you will not receive instructions for exchanging your shares for the merger consideration.

Q18. Should I send in my stock option agreements and/or deferred stock unit agreements now?

A18. No. After the merger is completed, you will be sent detailed written instructions for exchanging your stock option agreements and/or deferred stock unit agreements for the merger consideration. You must return your stock option agreements and/or deferred stock unit agreements as described in those instructions to receive the merger consideration.

Q19. What other matters will be voted on at the special meeting?

A19. At the special meeting the shareholders may (1) grant to the proxy holders the authority to vote in their discretion with respect to the approval of any proposal to postpone or adjourn the special meeting to a later date for a reasonable business purpose, including to solicit additional proxies in favor of the merger proposal, if there are not sufficient votes for approval of the merger proposal at the special meeting and (2) consider and vote upon such other matters as may properly come before the special meeting or any adjournments or postponements of the special meeting.

Q20. Where can I find more information about Green Mountain Power?

A20. Green Mountain Power files periodic reports and other information with the Securities and Exchange Commission. You may read and copy this information at the Securities and Exchange Commission s public reference facilities. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for information about these facilities. This information is also available on the internet site maintained by the Securities and Exchange Commission at http://www.sec.gov. For a more detailed description of the information available, please refer to Where You Can Find More Information on page 56 of this proxy statement.

Q21. Who can help answer my questions?

A21. If you would like additional copies, without charge, of this proxy statement or have questions about the merger after reading this proxy statement, including the procedures for voting your shares, please call our proxy solicitor, Georgeson Inc., toll-free at 1-866-295-1794. You may also contact us at Attention: Ms. Dorothy Schnure, Manager, Corporate Communications, Green Mountain Power Corporation, 163 Acorn Lane, Colchester, Vermont 05446, Telephone: (802) 655-8418.

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This proxy statement contains forward looking statements about Green Mountain Power. The Securities and Exchange Commission, which we refer to in this proxy statement as the SEC, encourages companies to disclose forward-looking information so that investors can better understand a company s future prospects and make informed investment decisions. These statements may be made directly in this proxy statement and they may also be made a part of this proxy statement by reference to other documents filed by us with the SEC, which is known as incorporation by reference.

Statements that are not historical or current facts, including statements about beliefs and expectations are forward looking statements. These statements often include the words may, could, would, should, believes, expects, anticipates, estimates, intends, plans, targe probably, projects, outlook, objectives, strategies, goals or similar expressions. These forward-looking statements cover, among other thi anticipated future plans and prospects of Green Mountain Power and words and terms of similar substance used in connection with any discussion of future operating or financial performance, or the acquisition of us by NNEEC. Our forward-looking statements are based on management s current views about future events and are subject to a number of factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at which, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and/or management s good faith belief with respect to future events, and is subject to risks and uncertainties that could cause our actual performance or results to differ materially from those expressed in the statements. Important factors that could cause such differences include, but are not limited to: whether we are able to complete the merger; effects of the announcement and pendency of the merger on our business; whether we are fully successful in implementing our financial and operational initiatives; industry conditions, performance and consolidation; legislative and/or regulatory developments; the effects of adverse general economic conditions, both within the United States and globally; energy supply and demand, outages and other power supply volume and price changes; customer concentration; customer service quality; benefit plan cost sensitivity to interest rates and health care cost inflation; changes in regional wholesale energy market and transmission rules; credit risks (including availability, terms and use of capital and counterparty credit quality); changes in technology; the outcome of claims and litigation; natural events such as severe weather, floods and earthquakes and other factors described in our filings with the SEC.

We caution you not to place undue reliance on our forward-looking statements, which speak only as of the date of this proxy statement or the date of the document incorporated by reference in this proxy statement. Except as required by law, we are under no obligation, and expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.

For additional information about factors that could cause actual results to differ materially from those described in the forward-looking statements, please see the filings and reports that we make with the SEC as described under Where You Can Find More Information.

Table of Contents

THE COMPANIES

Green Mountain Power

Green Mountain Power is a public utility operating company that transmits, distributes and sells electricity and utility construction services in the State of Vermont in a service territory with approximately one quarter of Vermont s population. We serve approximately 90,000 customers. We were incorporated under the laws of Vermont on April 7, 1893. Our headquarters are located at 163 Acorn Lane, Colchester, Vermont 05446 and our telephone number is (802) 864-5731.

NNEEC and Gaz Métro

NNEEC is an energy company based in Vermont. NNEEC is the parent company of Vermont Gas Systems, Inc. and PNGTS. Gaz Métro, the parent of NNEEC, is a leading Québec energy company and one of Canada s largest natural gas distributors. Gaz Métro files periodic reports, statements and other information with the Canadian provincial securities administrators, which are available at the Canadian provincial securities administrators public reference rooms. Gaz Métro filings are also electronically available to the public from the Canadian System for Electronic Document Analysis and Retrieval (SEDAR), the Canadian equivalent of the SEC s EDGAR system, at http://www.sedar.com. NNEEC s headquarters are located at c/o Vermont Gas Systems, Inc., 85 Swift Street, P.O. Box 467, Burlington, VT 05402-0467 and its telephone number is (802) 863-4511. Gaz Métro s headquarters are located at 1717 du Havre, Montreal, Québec, H2K 2X3 and its telephone number is (514) 598-3444.

Northstars Merger Sub

Northstars Merger Sub is a Vermont corporation formed for the purpose of merging with and into Green Mountain Power. Northstars Merger Sub is a direct wholly-owned subsidiary of NNEEC. The executive offices of Northstars Merger Sub are located at c/o Vermont Gas Systems, Inc., 85 Swift Street, P.O. Box 467, Burlington, VT 05402-0467 and its telephone number is (802) 863-4511.

Table of Contents

THE SPECIAL MEETING

This proxy statement is furnished in connection with the solicitation of proxies by our board of directors in connection with a special meeting of our shareholders, which we refer to in this proxy statement as the special meeting.

Date, Time and Place of the Special Meeting

The special meeting is scheduled to be held as follows:

Date:	October 31, 2006
Time:	10:00 a.m., Colchester, Vermont time
Place:	Green Mountain Power Corporation 163 Acorn Lane Colchester, Vermont 05446

Proposal to be Considered at the Special Meeting

At the special meeting, you will consider and vote upon a proposal to approve the merger proposal.

Record Date

Our board of directors has fixed the close of business on September 21, 2006, as the record date for the special meeting and only holders of record of our common stock on the record date are entitled to vote at the special meeting. As of the close of business on September 18, 2006, there were issued and outstanding and entitled to vote 5,288,961.25 shares of our common stock.

As of the close of business on August 31, 2006, our directors and senior executive officers beneficially owned and had the right to vote 213,073 shares of our common stock entitling them to exercise approximately 4.03% of the voting power of our common stock.

Voting Rights; Quorum; Vote Required for Approval

Each share of our common stock entitles its holder to one vote on all matters properly coming before the special meeting. The presence in person or representation by proxy of shareholders entitled to cast a majority of the votes of all shares entitled to vote on the merger proposal, considered together, constitutes a quorum for the purpose of considering the merger proposal. Shares of our common stock represented at the special meeting but not voted, including shares of our common stock for which proxies have been received but for which shareholders have abstained and broker non-votes (as defined below), will be treated as present at the special meeting for purposes of determining the presence or absence of a quorum for the transaction of all business. In the event that a quorum is not present at the special meeting, it is expected that the meeting will be adjourned or postponed to solicit additional proxies.

If you hold your shares in an account in street name with a broker or bank, you must instruct the broker or bank on how to vote your shares. If an executed proxy card returned by a broker or bank holding shares indicates that the broker or bank does not have authority to vote on the merger proposal, the shares will be considered present at the meeting for purposes of determining the presence of a quorum, but will not be voted on the merger proposal. This is called a broker non-vote. Your broker or bank will vote your shares only if you provide instructions on how to vote by following the instructions provided to you by your broker or bank. If you hold shares of our common stock in street name, you must request a legal proxy from your broker or bank in order to vote in person at the special meeting.

Under our articles of incorporation, approval of the merger proposal requires the affirmative vote of the holders of a majority of all shares of our common stock entitled to vote on the merger proposal. **Abstentions and broker non-votes will have the same effect as a vote AGAINST the merger proposal.**

Table of Contents

Voting and Revocation of Proxies

Shareholders of record may submit proxies by mail, by telephone or through the Internet. Shareholders who wish to submit a proxy by mail should mark, date, sign and return the proxy card in the envelope furnished. The enclosed proxy card includes detailed information on how to vote by telephone at 1-866-540-5760 or through the Internet at https://www.proxyvoting.com/gmp. Shareholders who hold shares beneficially through a nominee (such as a bank or broker) may be able to submit a proxy by telephone or through the Internet if those services are offered by the nominee.

Proxies received at any time before the special meeting, and not revoked or superseded before being voted, will be voted at the special meeting. Where a specification is indicated by the proxy, it will be voted in accordance with the specification. Where no specification is indicated, the proxy will be voted **FOR** the merger proposal and the proposal to permit the proxies to vote, in their discretion, on the postponement or adjournment of the special meeting, if necessary. No proxy voted against the merger proposal will be voted in favor of any adjournment or postponement.

If you hold your shares in certificated form, please do not send in your stock certificates with your proxy card. When the merger is completed, a separate letter of transmittal will be mailed to you that will enable you to receive the merger consideration.

Until your proxy is exercised at the special meeting, you can revoke your proxy and change your vote in any of the following ways:

- by delivering written notification to us at our principal executive offices at 163 Acorn Lane, Colchester, Vermont 05446, Attention: Corporate Secretary;
- by delivering a proxy of a later date in the manner described in this proxy statement; or
- by attending the special meeting and voting in person (your attendance at the meeting will not, by itself, revoke your proxy; you must vote in person at the meeting).

If you voted by telephone or through the Internet, you can also revoke your proxy and change your vote by any of these methods or you can revoke your proxy and change your vote by telephone by calling 1-866-540-5760 or through the Internet at https://www.proxyvoting.com/gmp. If you decide to vote by completing, signing, dating and returning the enclosed proxy card, you should retain a copy of the voter control number found on the proxy card in the event that you later decide to revoke your proxy and change your vote by telephone or through the Internet. If you have instructed a broker or bank to vote your shares, you can revoke your proxy and change your vote by following the directions received from your broker or bank to change those instructions.

All properly submitted proxies received by us before the special meeting that are not revoked prior to being voted at the special meeting will be voted at the special meeting in accordance with the instructions indicated on the proxies or, if no instructions were provided, **FOR** the merger proposal.

Postponements and Adjournments

The special meeting may be postponed or adjourned for the purpose of soliciting additional proxies or for other reasons as determined in the sole discretion of the chairman of the meeting. Any proposal to postpone or adjourn the special meeting may be made without prior notice, including by an announcement made at the special meeting, by the chairman of the special meeting in his sole discretion. If a proposal for postponement or adjournment is properly presented at the special meeting, or any postponement or adjournment thereof, the persons named as proxies will vote the shares represented thereby in their discretion with respect to such postponement or adjournment if such specification is indicated by the proxy or if no specification is provided in the proxy. If no specification is provided by the proxy, the persons named as proxies will not, however, have discretion to vote in favor of any postponement or adjournment as to any shares of our common stock that have been voted against the merger proposal.

Table of Contents

Solicitation of Proxies

We will bear the expenses in connection with the solicitation of proxies. Arrangements will also be made with brokerage houses and other custodians, nominees and fiduciaries for the forwarding of solicitation material to the beneficial owners of our common stock held of record by those persons, and we may reimburse them for their reasonable transaction and clerical expenses. Solicitation of proxies will be made principally by mail. Proxies may also be solicited in person, or by telephone, facsimile, telegram or other means of communication, by our officers and regular employees. These people will receive no additional compensation for these services, but will be reimbursed for any transaction expenses incurred by them in connection with these services. We have retained Georgeson Inc., a proxy solicitation firm, for assistance in connection with the solicitation of proxies for the special meeting at an anticipated cost not to exceed $7,500 plus reimbursement of reasonable out-of-pocket expenses for such items as mailing, copying, phone calls, faxes and other related items. In addition, we will indemnify Georgeson Inc. against any losses arising out of that firm s proxy soliciting services on our behalf.

Shareholder List

A list of our shareholders entitled to vote at the special meeting will be available for examination by any of our shareholders at the special meeting. From two business days after the date of this proxy statement, this shareholder list will be available for inspection by shareholders, subject to compliance with applicable provisions of Vermont law, during ordinary business hours at our corporate offices located at 163 Acorn Lane, Colchester, Vermont 05446.

Questions and Additional Information

If you have more questions about the merger or how to submit your proxy, or if you need additional copies of this proxy statement or the enclosed proxy card or voting instructions, please call our proxy solicitor, Georgeson Inc., **toll-free at 1-866-295-1794**.

Table of Contents

THE MERGER

Background of the Merger

As part of our strategic planning and review over several years, we have considered from time to time the possibility of strategic transactions, including both being acquired and acquiring other electric distribution utility properties. In addition, we also considered the possibility of remaining independent. In evaluating whether to remain independent, we considered our size, financial profile, and access to capital markets in relation to other electric distribution companies in our region and in the United States. We also considered the risks associated with a decision to remain independent, including the risks associated with the volatility in wholesale power supply markets, failing to maintain strong credit ratings and the impact of credit ratings on our ability to procure power supply resources, and not having the technological and financial resources available to larger utilities.

In the last several years, from time to time, we have received preliminary, informal inquiries from several other enterprises regarding the acquisition of Green Mountain Power and we have engaged financial advisors during this period to determine if there were third parties that wanted to enter into transactions with Green Mountain Power. Preliminary discussions regarding these inquiries did not result in formal proposals. During the same period, we also conducted preliminary discussions with other companies regarding opportunities to acquire electric utilities. These discussions did not result in potential transactions with price, form of consideration and terms that were mutually satisfactory to us and to the other companies with which we conducted such discussions. In connection with these discussions, our board of directors recognized the challenge to Green Mountain Power, as a small electric utility, of pursuing the strategic option of acquiring another investor-owned electric utility in a transaction that would add value to our shareholders.

On March 31, 2006, Robert Tessier, Gaz Métro s chief executive officer, met with Christopher L. Dutton, our chief executive officer, to discuss the possibility of an indirect acquisition of us by Gaz Métro in a cash transaction. Mr. Dutton reported to our board of directors in executive session on April 3, 2006 that this discussion had occurred and received the board of directors approval to pursue discussions with Mr. Tessier.

On April 3, 2006, following our board of directors meeting on that date, Mr. Dutton contacted Mr. Tessier and suggested a transaction in which the outstanding shares of our common stock would be acquired for a cash price of the higher of $35.00 per share or a premium of 25% over the market price of our shares. Mr. Tessier said that Gaz Métro would consider a transaction that would pay our shareholders up to a maximum price of $35.00 per share in cash, subject to due diligence and negotiation of a mutually satisfactory acquisition agreement, and indicated that Gaz Métro would not offer more than that amount. Messrs. Dutton and Tessier agreed to consult with their respective boards of directors regarding the possibility of such a transaction.

On April 25, 2006, our representatives and representatives of Gaz Métro met to discuss potential terms of the acquisition and the process for further discussions. On May 4, 2006, our representatives and representatives of Gaz Métro met again and executed a mutual confidentiality agreement and an exclusivity agreement with Gaz Métro for the period ending July 1, 2006.

On May 5, 2006, Mr. Dutton and our management discussed with our board of directors the status of the discussions with Gaz Métro. At this meeting, Mr. Dutton received the board of directors approval to continue further discussions with Gaz Métro. On May 11, 2006, we contacted Banc of America Securities to discuss possibly retaining Banc of America Securities as our sole financial advisor in connection with this potential transaction. Based on Banc of America Securities expertise and experience in the industry, reputation, ability to meet the board of directors requirements and timelines, and the board s prior experience with Banc of America Securities, we retained Banc of America Securities as our sole financial advisor in connection with the transaction.

On May 12, 2006, Gaz Métro delivered to us a confidential, preliminary, non-binding expression of interest to acquire all of the outstanding shares of our common stock for $35.00 per share, subject to a number of conditions, the undertaking and completion of detailed due diligence, approval of Gaz Métro s board of directors and negotiation of a definitive agreement governing the transaction.

Thereafter Gaz Métro commenced a detailed due diligence review of our business based upon non-public information and the parties began to negotiate the terms of an agreement and plan of merger. In addition, we commenced our due diligence focusing on Gaz Métro s ability to consummate a transaction, its relationship with regulatory authorities and its business reputation.

Table of Contents

At a meeting held on May 22, 2006, our board of directors heard reports from management on the status of discussions with Gaz Métro and discussed the proposed transaction. After considering Mr. Tessier s indication that Gaz Métro would not offer more than $35.00 per share in cash and our management s belief that Gaz Métro would not be willing to negotiate price, our board of directors concluded that we should continue to negotiate with Gaz Métro a definitive agreement governing the transaction.

On May 23, 2006, our representatives made due diligence management presentations to representatives of Gaz Métro and NNEEC and their financial and legal advisors.

On June 7, 2006, our board of directors met and discussed with management the status of our discussions with Gaz Métro. At this meeting, our board of directors was advised by internal legal counsel and our outside legal counsel, Hunton & Williams LLP, regarding the board of directors fiduciary and legal duties in connection with the potential transaction with Gaz Métro. Management reported to the board of directors regarding its review of the character, integrity and business philosophy of Gaz Métro, the projected social, legal and economic effects of the proposed merger on us, our employees, suppliers, customers and others in similar relationships with us, and upon the communities in which we do business. The board of directors also discussed with our financial advisor, Banc of America Securities, the current market environment for mergers and acquisitions in the electric utility industry generally and the financial terms of the proposed transaction with Gaz Métro. The board of directors also received a summary of a draft agreement and plan of merger, based on the parties discussions as of the date of the meeting. Mr. Dutton received the board of directors authority to proceed with due diligence and further negotiations of a definitive agreement governing the transaction.

On June 9, 2006, our representatives and Hunton & Williams LLP, our outside legal counsel, and representatives of Gaz Métro and Sullivan & Cromwell LLP, outside legal counsel to Gaz Métro and NNEEC, met to discuss terms and conditions of a proposed agreement and plan of merger, focusing primarily on the provisions relating to material adverse effect and the potential effect under an agreement and plan of merger of conditions imposed by regulatory authorities from which approval would be required to consummate the merger. The parties also discussed proposals regarding our ability to solicit, consider or approve alternative proposals to the merger after execution of an agreement and plan of merger and the amount and timing of termination fees associated with termination of the agreement and plan of merger, our acceptance of an alternative proposal and our consummation of an alternative proposal. Negotiation of the agreement and plan of merger continued until shortly before such agreement was executed on June 21, 2006.

On June 14, 2006, Mr. Dutton and Mr. Tessier met and discussed the progress of negotiations of an agreement and plan of merger. At this meeting Mr. Dutton and Mr. Tessier discussed our expectation that Gaz Métro undertake to cause NNEEC to perform its obligations under the agreement and plan of merger and expressed the mutual desire to complete negotiations quickly.

On June 15, 2006, our board of directors met and discussed with management the status of due diligence and the parties negotiations and negotiations between management and Gaz Métro regarding employment agreements with our current officers to become effective upon consummation of the proposed merger. Management also discussed with our board of directors the additional due diligence review of Gaz Métro s business reputation. Our financial advisor, Banc of America Securities, reviewed with our board of directors its preliminary financial analysis of the merger consideration. The board considered the proposed merger price of $35.00 in cash per share of our common stock, in relation to the range of market prices of our common stock, other financial analyses, the terms and conditions contained in the proposed agreement and plan of merger and the due diligence conducted by the parties to date. Our internal legal counsel and a representative of Hunton & Williams LLP advised the board of directors regarding Vermont and federal regulatory approvals that would be necessary to complete the merger and reported to the board of directors regarding a revised draft of the proposed agreement and plan of merger and the issues under discussion between the parties relating to the agreement and plan of merger.

On June 21, 2006, following the close of the trading day on the New York Stock Exchange, our board of directors met and reviewed with management and Hunton & Williams LLP a summary of the negotiations of the proposed agreement and plan of merger, the terms and conditions of the proposed agreement and plan of merger, and the interests of officers and certain directors in the proposed merger. In addition, internal legal counsel and representatives of Hunton & Williams LLP and Sheehey Furlong & Behm P.C. reviewed with the board of directors their fiduciary duties in considering and acting on the proposed agreement and plan of merger. At this

Table of Contents

meeting of our board of directors, Banc of America Securities reviewed with the board of directors its financial analysis of the merger consideration and delivered to the board of directors an oral opinion which was confirmed by delivery of a written opinion dated June 21, 2006, to the effect that, as of that date and based upon and subject to various assumptions and limitations described in its opinion, the merger consideration to be received by the holders of our common stock in the merger was fair, from a financial point of view, to such holders. The board of directors unanimously approved and adopted the merger proposal and unanimously recommended that shareholders vote to approve the merger proposal.

Also on June 21, 2006, the compensation committee of our board of directors met to discuss proposed employment agreements between Northstars Merger Sub and our officers, which would provide such officers with three-year employment agreements beginning at the time of consummation of the merger and pursuant to which the officers would waive their rights to exercise the terms of existing change of control agreements between the officers and us. The compensation committee also discussed waivers to be obtained from our officers and directors of their rights to surrender their option agreements and deferred stock unit agreements pursuant to certain provisions under our stock plans and of certain change in control provisions under our supplemental retirement plans that would apply as a result of the approval of the merger proposal and the completion of the merger. At that meeting, the compensation committee unanimously approved these waivers.

Following the June 21, 2006 board of directors meeting, we, NNEEC and Northstars Merger Sub executed and delivered to each other the agreement and plan of merger and Gaz Métro executed and delivered to us its letter agreement to cause NNEEC to perform its obligations under the agreement and plan of merger. In addition, our officers and directors delivered employment agreements and the waivers described above.

On June 22, 2006, prior to the opening of trading on the New York Stock Exchange, we and Gaz Métro issued separate press releases announcing the execution of the agreement and plan of merger.

Recommendation of Our Board of Directors

After careful consideration, at a meeting held on June 21, 2006, our board of directors unanimously:

- determined that the merger proposal is advisable, fair to, and in the best interests of, Green Mountain Power and our shareholders;
- approved and adopted the merger proposal; and
- recommends that our shareholders vote to approve the merger proposal.

Our board of directors recommends that you vote FOR the merger proposal at the special meeting.

Reasons for the Merger

In unanimously determining that the merger proposal is advisable, fair to, and in the best interests of, Green Mountain Power and our shareholders, our board of directors relied on its knowledge of our business and information provided by our officers, as well as the advice of our financial advisors and legal counsel. In making its recommendation and in approving and adopting the merger proposal the board of directors considered a number of reasons, including, but not limited to, the reasons described below.

Financial Considerations. The board of directors also considered the following financial reasons:

- Banc of America Securities financial presentation, including its opinion, dated June 21, 2006, to our board of directors as to the fairness from a financial point of view and as of the date of the opinion of the merger consideration to be received by the holders of our common stock in the proposed merger, as more fully described below under the caption The Merger Opinion of Our Financial Advisor ;

the recent trading prices of our common stock and that the $35.00 per share to be paid under the merger proposal represents a premium of approximately 25%, or $7.01, over the closing sale price of $27.99 for our common stock on the New York Stock Exchange on June 21, 2006 (the last trading day before the public announcement that Green Mountain Power and NNEEC had entered into the agreement and plan of merger) and a premium of approximately 21.9% and 18.4% over the respective 30-day and one-year average closing prices for our common stock before June 21, 2006;

- the relatively high recent stock trading prices for publicly-traded energy companies in general compared to historical valuation parameters, and the possibility that a downturn in market prices in the energy industry could occur in the near future; and

- the form of consideration to be paid to our shareholders under the merger proposal is cash and the certainty of value of cash consideration.

Business Considerations. The board of directors considered the following business reasons:

- our prospects if we were to remain independent and the risks inherent in remaining independent, including competitive risks;

- the current status of the energy industry in which we compete and the risks associated with our status as a small, investor-owned, vertically integrated electric distribution company, including the risks associated with volatile wholesale power supply markets, the importance of strong credit ratings in procuring power supply resources and the technological and financial resources available to our competitors;

- the board of directors view of our financial condition, future business prospects and future value as an independent corporation, including our need, over the next several years, to replace approximately 80 percent of our power supply resources as existing long-term power supply contracts are scheduled to expire over the coming several years and the board of directors view that our financial strength as an affiliate of Gaz Métro will improve our position in dealing with the challenges of securing replacements for such expiring power supply resources on terms favorable to us and our customers;

- the views expressed by our management regarding, among other things:

  - our financial condition, results of operations, cash flows, business and prospects, including the prospects of, and uncertainties facing, us if we were to remain independent;

  - the likelihood of achieving maximum long-term value on a stand-alone basis;

  - the strategic alternatives available to us and the associated advantages and disadvantages; and

  - the recommendation by our management to approve the merger proposal;

- Gaz Métro s anticipated continuing ability to generate cash flows from operations sufficient to cover distributions to its investors, its capital expenditures and our capital expenditures after consummation of the merger;

- the projected social, legal and economic effects of the proposed acquisition on our employees, suppliers, customers and others in similar relationships with us and upon the communities in which we do business; and

- the general desirability of our continuance as a stand-alone operating entity;

Other Transaction Considerations. The board of directors also considered certain transaction-related reasons:

discussions with and among our senior management, including views and advice provided by our senior management and representatives of Hunton & Williams and Sheehey Furlong & Behm P.C., Vermont outside counsel, regarding the merger proposal;

the board of directors judgment, after consultation with management, that an alternative transaction that would provide a greater value to our shareholders was unlikely to be available, while the terms and conditions of the agreement and plan of merger would permit the board of directors to consider an alternative transaction;

the terms and conditions of the agreement and plan of merger, including the parties representations, warranties and covenants, the conditions to their respective obligations, the specified ability of the parties to terminate the agreement and plan of merger and the provision for payment of all cash to our shareholders for their shares, with no financing condition;

provisions in the agreement and plan of merger permitting us under certain circumstances, to provide non-public information to, and engage in discussions with, any third-party that proposes an alternative transaction and to terminate the agreement and plan of merger to accept a superior proposal and the provisions in the agreement and plan of merger permitting our board of directors, in the exercise of its

fiduciary duties to us and our shareholders under applicable Vermont law, to terminate the agreement and plan of merger in favor of a superior proposal, *provided,* that following such termination, we must pay NNEEC a fee of $3,500,000 (representing less than 1.8% of the total value of the consideration to be paid to shareholders under the agreement and plan of merger) and an additional $3,500,000 fee (representing in the aggregate with the initial termination fee a fee of less than 3.6% of the total value of the consideration) if we consummate a transaction resulting from an acquisition proposal within 24 months after the initial termination payment;

the board of directors judgment that, as a percentage of the merger consideration, the potential of a $7,000,000 termination fee was in the reasonable range of termination fees provided for in similar acquisition transactions and that only $3,500,000 of it would generally be payable if no alternative transaction was consummated;

the consideration by the board of directors, after consultation with counsel, of the likelihood that the merger would be approved by the requisite regulatory authorities, without the imposition of material conditions that would prevent or materially delay the merger or cause either party to exercise its right to terminate the agreement and plan of merger and of the required efforts of the parties to obtain such approvals;

the expressed intention of NNEEC and Gaz Métro to utilize the services of our management and employees following the merger and our proposed management arrangements after closing of the merger under which each of our senior executive officers will remain in his or her position as a senior officer of the surviving corporation for at least three years following completion of the merger;

the board of directors view of the character, integrity and business philosophy of Gaz Métro and the management of NNEEC and its parent Gaz Métro, including NNEEC s and Gaz Métro s historical relations with regulatory authorities in Québec and Vermont and NNEEC s history of positive regulatory relationships with Vermont regulatory authorities over almost two decades through its ownership of Vermont Gas Systems, Inc.;

the business and financial conditions and earnings prospects of NNEEC and Gaz Métro, including debt service and other existing or likely financial obligations of NNEEC and Gaz Métro, and the fact that NNEEC will have the ability to finance the acquisition without further encumbering our assets;

NNEEC s commitment to continue our historic levels of charitable contributions and community activities; and

NNEEC s commitment to maintain our headquarters in northwestern Vermont.

In its deliberations, our board of directors also recognized the following considerations associated with the merger:

the difficulties and challenges inherent in completing the merger and obtaining all regulatory and other approvals necessary to consummate the merger without terms or conditions that would prevent or materially delay the merger or cause either party to exercise its right to terminate the agreement and plan of merger or not consummate the merger;

that the merger ultimately may not be completed as a result of conditions imposed by regulatory authorities or otherwise;

that certain provisions of the merger agreement may have the effect of discouraging proposals for alternative transactions with us, including:

the restriction on our ability to solicit proposals for alternative transactions; and

the requirement that we provide NNEEC the right to obtain information with respect to proposals for alternative transactions and to a five-day negotiating period after receipt by us of a superior proposal before the board of directors may terminate the agreement and plan of merger and accept the superior proposal, withdraw its recommendation of the merger or recommend the superior proposal;

Table of Contents

the fact that the agreement and plan of merger prohibits us from soliciting other proposals and obligates us to pay to NNEEC up to a $7 million termination fee if we terminate the agreement and plan of merger to accept and ultimately consummate a superior proposal, which may deter others from proposing an alternative transaction that may be more advantageous to our shareholders;

that we will no longer exist as an independent company and our shareholders will no longer participate in our growth or the pursuit of our stand-alone business plan;

the fact that gains from an all-cash transaction would be taxable to our shareholders for U.S. federal income tax purposes;

the circumstances under which NNEEC may have the right not to consummate the agreement and plan of merger or to terminate the agreement and plan of merger, including the occurrence of a material adverse event on our results of operations, business, or financial condition, taken as a whole and treating us for this purpose as if the rates and other requests included in our currently pending rate case before the VPSB had been granted at least at the level of the expected outcome, or imposition of any regulatory condition of approval of the merger containing any conditions, provisions or terms that would materially impair any of the expected benefits of the merger or impair, other than in an immaterial manner, the value to NNEEC of any material tax attributes arising out of or related to the merger or the financing of the merger or our operations after the merger;

the fact that, pursuant to the agreement and plan of merger, we must generally conduct our business in the ordinary course and we are subject to a variety of other restrictions on the conduct of our business prior to the completion of the merger or termination of the agreement and plan of merger; and

the potential for diversion of management and employee attention and for employee attrition during the period prior to the completion of the merger and the potential effect on our business and relations with customers, service providers and other stakeholders.

During its consideration of the transaction with NNEEC described above, our board of directors was also aware that some of our directors and senior executive officers may have interests in the merger that are different than or in addition to those of our shareholders generally, described under The Merger Interests of Directors and Executive Officers in the Merger.

This discussion of the information and reasons considered and given weight by our board of directors is not intended to be exhaustive, but is believed to address the material information and reasons considered by our board of directors. In view of the number and variety of these reasons, our board of directors did not find it practicable to make specific assessments of, or otherwise assign relative weights to, the specific reasons and analyses considered in reaching its determination. The determination to adopt the merger proposal was made after consideration of all of the reasons and analyses as a whole. In addition, individual members of our board of directors may have given different weights to different reasons.

Opinion of Our Financial Advisor

We retained Banc of America Securities as our financial advisor in connection with the proposed merger. Banc of America Securities is an internationally recognized investment banking firm which is regularly engaged in the valuation of businesses and securities in connections with mergers and acquisitions, negotiated underwritings, secondary distributions of listed and unlisted securities, private placements and valuations for corporate and other purposes. We selected Banc of America Securities on the basis of Banc of America Securities experience in transactions similar to the merger, its reputation in the utilities industry and investment community and its familiarity with Green Mountain Power and its business.

On June 21, 2006, at a meeting of our board of directors held to evaluate the merger, Banc of America Securities delivered to the board an oral opinion, which was confirmed by delivery of a written opinion, dated

Table of Contents

June 21, 2006, to the effect that, as of the date of the opinion and based on and subject to various assumptions and limitations described in its opinion, the merger consideration to be received by holders of our common stock in the proposed merger was fair, from a financial point of view, to such holders.

The full text of Banc of America Securities written opinion, dated June 21, 2006, which describes, among other things, the assumptions made, procedures followed, factors considered and limitations on the review undertaken by Banc of America Securities in connection with its opinion, is attached as Annex B to this proxy statement and is incorporated by reference in its entirety into this proxy statement. The following summary of Banc of America Securities opinion is qualified in its entirety by reference to the full text of the opinion. Banc of America Securities opinion was provided to our board of directors in its evaluation of the merger consideration to be received by holders of our common stock. Banc of America Securities opinion does not address any other aspect of the merger and does not constitute a recommendation as to how our shareholders should vote or act in connection with the merger. We urge you to read the opinion carefully and in its entirety.

For purposes of its opinion, Banc of America Securities:

- reviewed certain publicly available financial statements and other business and financial information of Green Mountain Power;
- reviewed certain internal financial statements and other financial and operating data concerning Green Mountain Power;
- reviewed certain financial forecasts relating to Green Mountain Power prepared by the management of Green Mountain Power;
- discussed the past and current operations, financial condition and prospects of Green Mountain Power with senior executives of Green Mountain Power;
- reviewed the reported prices and trading activity for Green Mountain Power s common stock;
- compared the financial performance and equity market capitalization of Green Mountain Power and the prices and trading activity of Green Mountain Power s common stock with that of certain other publicly traded companies Banc of America Securities deemed relevant;
- compared certain financial terms of the merger to financial terms, to the extent publicly available, of certain other business combination transactions Banc of America Securities deemed relevant;
- reviewed the agreement and plan of merger; and
- performed such other analyses and considered such other factors as Banc of America Securities deemed appropriate.

Banc of America Securities assumed and relied upon, without independent verification, the accuracy and completeness of the financial and other information reviewed by it for the purposes of its opinion. With respect to the financial forecasts, Banc of America Securities assumed, at the direction of Green Mountain Power, that they had been reasonably prepared on bases reflecting the best then available estimates and good faith judgments of the management of Green Mountain Power as to the future financial performance of Green Mountain Power. Banc of America Securities did not make any independent valuation or appraisal of the assets or liabilities of Green Mountain Power, nor was Banc of America Securities furnished with any such valuations or appraisals. Banc of America Securities assumed, with Green Mountain Power s consent, that the merger would be consummated as provided in the agreement and plan of merger, with full satisfaction of all covenants and conditions set forth in the agreement and plan of merger and without any waivers thereof. Banc of America Securities also assumed, with Green Mountain Power s

consent, that all governmental, regulatory or other consents and approvals necessary for the consummation of the merger would be obtained without any adverse effect on Green Mountain Power or the merger.

Banc of America Securities expressed no view or opinion as to any terms or aspects of the merger (other than the merger consideration to the extent expressly specified in its opinion), including, without limitation, the form or structure of the merger or the consideration payable to any security holders of Green Mountain Power other than the merger consideration payable to the holders of Green Mountain Power s common stock. Banc of America Securities was not requested to, and did not, solicit expressions of interest from third parties regarding the acquisition of Green Mountain Power. Banc of America Securities expressed no view or opinion as to the relative merits of the merger in comparison to other transactions available to Green Mountain Power or in which Green Mountain Power might engage or as to whether any transaction might be more favorable to Green Mountain Power as an alternative to the merger, nor did Banc of America Securities express any opinion as to the underlying business decision of the Green Mountain Power s board of directors to proceed with or effect the merger.

Banc of America Securities opinion was necessarily based on economic, market and other conditions as in effect on, and the information made available to Banc of America Securities as of, the date of its opinion. Accordingly, although subsequent developments may affect its opinion, Banc of America Securities did not assume any obligation to update, revise or reaffirm its opinion.

The following represents a summary of the material financial analyses presented by Banc of America Securities to Green Mountain Power s board of directors in connection with its opinion. **The financial analyses summarized below include information presented in tabular format. In order to fully understand the financial analyses performed by Banc of America Securities, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses performed by Banc of America Securities. Considering the data in the tables below without considering the full narrative description of the financial analyses, including the methodologies and assumptions underlying the analyses, could create a misleading or incomplete view of the financial analyses performed by Banc of America Securities.**

Selected Publicly Traded Company Analysis. Banc of America Securities reviewed certain publicly available financial information relating to selected publicly traded companies that focus primarily on the electric utility transmission and distribution sector and compared such information to the corresponding information for Green Mountain Power. The companies included in this analysis were:

Consolidated Edison, Inc.

Energy East Corporation

Northeast Utilities

NSTAR

UIL Holdings Corporation

CH Energy Group, Inc.

Central Vermont Public Service Corporation

Using publicly available information and market data, Banc of America Securities reviewed, among other things, the price per share of each of the selected companies listed above as a multiple of its estimated net income, for fiscal years 2006 and 2007, and enterprise value as a multiple of its estimated earnings before interest, taxes, depreciation and amortization, or EBITDA, for fiscal years 2006 and 2007. Banc of America Securities defined enterprise value to mean: the sum of equity value (defined as the product of the number of fully diluted shares of common stock outstanding for the relevant company multiplied by the market value for such shares), plus total debt, preferred stock and minority interests, less cash and cash equivalents. Estimated data for the selected companies were obtained from First Call consensus and recent publicly available research analysts estimates. Banc of America Securities then applied selected 2006 and 2007 net income and EBITDA multiples derived from the selected companies to corresponding data of Green Mountain Power. Estimated

Table of Contents

financial data for Green Mountain Power were based on internal estimates prepared by the management of Green Mountain Power. This analysis indicated the following implied per share equity reference ranges for Green Mountain Power, as compared to the per share value of the merger consideration:

Implied Per Share Equity Reference Range for the Company Stock				Per Share
2006E EBITDA	2006E Net Income	2007E EBITDA	2007E Net Income	Merger Consideration
$25.55 $38.65	$ 29.15 $36.70	$ 26.40 $38.30	$ 31.35 $36.15	$ 35.00

No company used in this analysis is identical to Green Mountain Power or its business. Accordingly, an evaluation of the results of this analysis is not entirely mathematical. Rather, this analysis involves complex considerations and judgments concerning differences in financial and operating characteristics and other factors that could affect the public trading or other values of the companies to which Green Mountain Power was compared.

Selected Precedent Transactions Analysis. Banc of America Securities reviewed publicly available financial information relating to the following six selected transactions in the transmission and distribution sector:

Completion Date	Acquirer	Target
August 1, 2002	Potomac Electric Power Company	Conectiv
June 28, 2002	Energy East Corporation	RGS Energy Group, Inc.
January 31, 2002	National Grid Group plc	Niagara Mohawk Holdings, Inc.
June 1, 2000	Energy East Corporation	CMP Group, Inc.
April 19, 2000	New England Electric Systems	Eastern Utilities Associates
July 10, 1999	Consolidated Edison, Inc.	Orange and Rockland Utilities, Inc.

Using publicly available information, Banc of America Securities calculated equity values per share as a multiple of net income for such target company for the LTM (last twelve months) preceding the announcement of the transaction as well as enterprise value as a multiple of EBITDA for such target company for the LTM preceding the announcement of the transaction. Banc of America Securities then applied the range of selected net income and EBITDA multiples derived from the selected transactions to corresponding data of Green Mountain Power. Estimated financial data for Green Mountain Power was based on internal estimates prepared by the management of Green Mountain Power. LTM net income and EBITDA for the target companies in the selected transactions were based on public filings and other publicly available information as of the respective announcement date for such transaction. This analysis indicated the following implied per share equity reference ranges for Green Mountain Power, as compared to the per share value of the merger consideration:

Implied Per Share Equity Reference Range for the Company Stock		Per Share
LTM EBITDA	LTM Net Income	Merger Consideration
$36.60 $44.35	$ 32.25 $36.55	$ 35.00

No company used in this analysis is identical to Green Mountain Power or its business. Accordingly, an evaluation of the results of this analysis is not entirely mathematical. Rather, this analysis involves complex considerations and judgments concerning differences in financial and operating characteristics and other factors that could affect the public trading or other values of the companies to which Green Mountain Power was compared.

Discounted Cash Flow Analysis. Banc of America Securities performed a discounted cash flow analysis in which it calculated the estimated present value of the projected unlevered free cash flows, representing tax-effected earnings before interest expense and taxes, plus depreciation and amortization, plus deferred taxes, less changes in net working capital and capital expenditure requirements, that Green Mountain Power is expected to generate during fiscal years 2006 through 2010, based on internal estimates of the management of Green Mountain Power, and Green Mountain Power s terminal value. Banc of America Securities calculated the

terminal value of Green Mountain Power by applying a terminal EBITDA multiple of 5.75x to 7.50x. The projected unlevered free cash flows were discounted to present value using discount rates ranging from 6.50% to 8.50%. This analysis indicated the following implied per share equity reference range for Green Mountain Power, as compared to the per share merger consideration:

Implied Per Share Equity Reference Range for the Company Stock	Per Share Merger Consideration
$26.30 $37.80	$ 35.00

Miscellaneous. As noted above, the discussion set forth above is merely a summary of the material financial analysis presented by Banc of America Securities to Green Mountain Power s board of directors in connection with its opinion and is not a comprehensive description of all analyses undertaken by Banc of America Securities in connection with its opinion. The preparation of a financial opinion is a complex analytical process involving various determinations as to the most appropriate and relevant methods of financial analysis and the application of those methods to the particular circumstances and, therefore, a financial opinion is not readily susceptible to partial analysis or summary description. Banc of America Securities believes that its analyses and the summary above must be considered as a whole. Banc of America Securities further believes that selecting portions of its analyses and the factors considered or focusing on information presented in tabular format, without considering all analyses and factors or the narrative description of the analyses, could create a misleading or incomplete view of the processes underlying Banc of America Securities analyses and opinion. Banc of America Securities did not assign any specific weight to any of the analyses described above. The fact that any specific analysis has been referred to in the summary above is not meant to indicate that such analysis was given greater weight than any other analysis.

In performing its analyses, Banc of America Securities considered industry performance, general business and economic conditions and other matters, many of which are beyond the control of Green Mountain Power. The estimates of the future performance of Green Mountain Power provided by the management of Green Mountain Power in or underlying Banc of America Securities analyses are not necessarily indicative of actual values or actual future results, which may be significantly more or less favorable than those estimates or those suggested by Banc of America Securities analyses. These analyses were prepared solely as part of Banc of America Securities analysis of the financial fairness of the merger consideration to be received by holders of Green Mountain Power s common stock in the merger and were provided to Green Mountain Power s board of directors in connection with the delivery of the opinion of Banc of America Securities. The analyses do not purport to be appraisals or to reflect the prices at which a company might actually be sold or the prices at which any securities have traded or may trade at any time in the future. Accordingly, the estimates used in, and the ranges of valuations resulting from, any particular analysis described above are inherently subject to substantial uncertainty and should not be taken to be Banc of America Securities view of the actual value of Green Mountain Power.

The type and amount of consideration to be received by holders of Green Mountain Power s common stock in the merger were determined through negotiations between Green Mountain Power and NNEEC, rather than by any financial advisor, and were approved by Green Mountain Power s board of directors. Green Mountain Power s decision to enter into the agreement and plan of merger was solely that of Green Mountain Power s board of directors. As described above, Banc of America Securities opinion and analyses were only one of many factors considered by Green Mountain Power s board of directors in making its determination to approve the agreement and plan of merger and should not be viewed as determinative of the views of Green Mountain Power s board of directors or management with respect to the merger or the merger consideration.

Banc of America Securities has acted as sole financial advisor to Green Mountain Power s board of directors in connection with the merger, for which services Banc of America Securities has received or will receive fees in the aggregate of $2,750,000, a portion of which was payable upon the rendering of the opinion and a significant portion of which is contingent upon the consummation of the merger. Green Mountain Power has also agreed to reimburse Banc of America Securities for all reasonable expenses, including reasonable fees

and disbursements of Banc of America Securities counsel, incurred in connection with the Banc of America Securities engagement, and to indemnify Banc of America Securities, any controlling person of Banc of America Securities and each of their respective directors, officers, employees, agents, affiliates and representatives against specified liabilities, including liabilities under the federal securities laws.

Banc of America Securities or its affiliates have provided, and in the future may provide, financial advisory and financing services to Green Mountain Power and NNEEC, and Banc of America Securities or its affiliates have received, or in the future may receive, fees for the rendering of these services, including having acted as a lender for a previously existing line of credit of Green Mountain Power and having acted as an agent and lender for certain retired credit facilities of Green Mountain Power. In addition, in the ordinary course of their businesses, Banc of America Securities and its affiliates may actively trade the debt and equity securities or loans of Green Mountain Power and NNEEC for its own account or for the accounts of customers, and accordingly, Banc of America Securities or its affiliates may at any time hold long or short positions in such securities or loans.

Merger Consideration

As of the effective time of the merger, all shares of our common stock, excluding shares held by us or any of our wholly-owned subsidiaries or by NNEEC or Northstars Merger Sub or any direct or indirect wholly-owned subsidiary of NNEEC, and shares for which the holder has perfected its right to dissent pursuant to the provisions of Chapter 13 of the Vermont Business Corporation Act, will no longer be outstanding and will automatically be canceled and will cease to exist, and each holder of a certificate representing any shares of our common stock at the time of the completion of the merger will cease to have any rights as a shareholder, except the right to receive $35.00 in cash per share, without interest. Shares held by us or any of our wholly-owned subsidiaries or by NNEEC or Northstars Merger Sub or any direct or indirect wholly-owned subsidiary of NNEEC will be canceled at the effective time of the merger.

Effect of the Merger on Awards Outstanding under Our Stock Plans

Each outstanding deferred stock unit granted under our stock plans will be vested on the date of the special meeting if the merger proposal is approved by our shareholders and entitle the holder to an amount in cash equal to $35.00, without interest and less any applicable withholding tax. Holders of deferred stock units that are outstanding at the effective time of the merger will receive the merger consideration after the cancellation of their deferred stock unit agreements in accordance with the terms of our stock plans shortly after the completion of the merger.

Our stock plans provide that each holder of deferred stock units may surrender their deferred stock unit agreements for cancellation in exchange for a cash payment after the date that our shareholders approve the merger proposal and before the effective time of the merger. The amount of cash payable upon the surrender of the deferred stock unit agreements is equal to the change in control price, which our stock plans define to mean the highest trading price of our common stock on the New York Stock Exchange during the sixty day period immediately before the surrender of the deferred stock unit agreements. The amount payable upon surrender of the deferred stock unit agreements will be paid within thirty days after the surrender. Our officers and directors have waived their rights to surrender their deferred stock unit agreements pursuant to these provisions of our stock plans.

Each outstanding stock option will automatically accelerate so that each such stock option shall become fully exercisable on the date of the special meeting if the merger proposal is approved by our shareholders. All stock options not exercised prior to the effective time of the merger will be canceled in the merger, with the holder of each stock option becoming entitled to receive, in full satisfaction of the rights of such holder with respect thereto, an amount in cash equal to the excess of $35.00 per share over the exercise price per share of our common stock subject to such option, multiplied by the number of shares of our common stock subject to such stock option, less any withholding taxes. Holders of stock options will receive all amounts payable, without

interest, as soon as practicable following the effective time of the merger, after the cancellation of their stock option agreements in accordance with the terms of our stock plans, shortly after completion of the merger.

Our stock plans provide that each holder of a stock option may surrender their stock option agreements for cancellation in exchange for a cash payment after the date that our shareholders approve the merger proposal and before the effective time of the merger. The amount of cash payable upon surrender of the stock option agreements is equal to the excess of the change in control price (described above) per share over the exercise price per share of our common stock subject to such option, multiplied by the number of shares of our common stock subject to such stock option, less any withholding taxes. The amount payable upon surrender of the stock option agreements will be paid within thirty days after the surrender of the stock option agreements. Our officers and directors have waived their rights to surrender their stock option agreements pursuant to these provisions of our stock plans.

Interests of Directors and Executive Officers in the Merger

Members of our board of directors and our senior executive officers have various interests in the merger described in this section that may be in addition to, or different from, the interests of our shareholders generally. You should keep this in mind when considering the recommendation of our board of directors for the approval of the merger proposal. The members of our board of directors were aware of these interests and considered them at the time they approved the merger proposal.

The following table sets forth the cash proceeds that each of our directors and Messrs. Dutton, Griffin, Oakes, Rendall, Rogan and Terry and Ms. Powell and Ms. Bugbee, who we refer to in this proxy statement as our senior executive officers, could receive at the closing of the merger based on his or her beneficial ownership as of August 31, 2006:

Interested Party	Shares (#)	Stock Options (#)	Deferred Stock Units (#)	Total Cash Proceeds Consideration ($)
Elizabeth A. Bankowski	1,350	2,000	3,238	$ 230,580
Nordahl L. Brue	16,128	4,000	925	736,855
William H. Bruett	1,100	2,000	925	140,875
Dawn D. Bugbee	0	0	4,385	153,475
Merrill O. Burns	6,214	2,000	2,062	359,660
David R. Coates	9,200	4,000	2,102	535,570
Christopher L. Dutton	21,705(5)	45,500	25,619	3,248,840
Robert J. Griffin	16,475(6)	1,000	4,453	767,480
Kathleen C. Hoyt	2,700	0	925	126,875
Euclid A. Irving	1,999	4,000	925	242,340
Walter S. Oakes	4,352	17,000	3,030	853,370
Mary G. Powell	10,267	3,000	13,850	949,095
Donald J. Rendall	7,200	3,000	5,750	558,250
Robert R. Rogan	0	0	3,333	116,655
Stephen C. Terry[4]	6,056(7)	13,000	1,950	735,210
Marc A. VanderHeyden	3,200	0	925	144,375
Total	107,946(1)	100,500(2)	74,397(3)	$ 9,899,505

(1) 107,946 shares worth approximately $3,778,110, which represents the total value of our shares held by our directors and senior executive officers based on the value of $35.00 per share. On June 21, 2006, the last full trading day prior to the public announcement of the merger, the total value of these shares was $3,021,408.54, based on $27.99, the closing price for our common stock on that date.

(2) 100,500 shares worth approximately $3,517,500.00, which represents the excess of $35.00 per share over the option price per share under options held by our directors and senior executive officers multiplied by the

number of shares covered by the options. On June 21, 2006, the last full trading day prior to the public announcement of the merger, the total amount by which $27.99, the closing price of our common stock on that date, exceeded the option price per share for these options was $2,812,995.00.

(3) 74,397 shares worth approximately $2,603,895.00, which represents the total value of (a) outstanding deferred stock units awarded under our stock plans and (b) the value of stock units deferred by our directors and senior executive officers under our deferred compensation plans that have not yet been paid under the deferral agreements. On June 21, 2006, the last full trading day prior to the public announcement of the merger, the total value of these units and deferrals was $2,082,372.03, based on $27.99, the closing price for our common stock on that date.

(4) Mr. Terry retired from Green Mountain Power on January 6, 2006.

(5) Mr. Dutton owns 21,705 of these shares directly or in his 401(k) plan. Of those shares, 125 are owned by Mr. Dutton s children for whom Mr. Dutton s wife serves as custodian; Mr. Dutton disclaims any beneficial interest in the 125 shares owned by his children.

(6) Mr. Griffin owns 16,475 of these shares directly or in his 401(k) plan. Of those shares, 513 are owned by Mr. Griffin s children; Mr. Griffin disclaims any beneficial interest in the 513 shares owned by his children.

(7) Mr. Terry owns 6,056 of these shares directly. His wife owns 10 of these shares; Mr. Terry disclaims any beneficial interest in the 10 shares owned by his wife.

New Employment Agreements. On June 21, 2006, Messrs. Dutton, Griffin, Rogan, Rendall, and Oakes and Ms. Powell and Ms. Bugbee, entered into new employment agreements with Northstars Merger Sub waiving the change of control protections of the existing change of control agreements with us and providing for certain terms of employment with Northstars Merger Sub commencing at the effective time of the merger and continuing in effect for a period of three years from the effective time of the merger, subject, upon the third anniversary of the effective time of the merger and each subsequent one year anniversary, to automatic renewals for additional one year periods unless notice is provided to the senior executive officer. Upon the effective time of the merger these employment agreements will become agreements of the surviving corporation. Under these new employment agreements, these senior executive officers will be entitled to the following benefits instead of the benefits under the change of control agreements and certain other benefits:

- the following base salaries and bonus opportunities:

Name	Salary	Target Bonus (% of salary)	Long-Term Compensation (% of salary)
Christopher L. Dutton	$ 411,000	50%	90%
Mary G. Powell	$ 300,000	50%	60%
Dawn D. Bugbee	$ 210,000	30%	40%
Donald J. Rendall, Jr.	$ 215,000	30%	30%
Robert J. Griffin	$ 210,000	30%	30%
Robert R. Rogan	$ 190,000	30%	30%
Walter S. Oakes	$ 170,000	30%	30%

and

- other employee benefits that, in the aggregate, are no less favorable than those provided to the senior executive officers by us immediately prior to the effective time of the merger.

Under the employment agreements, if within three years following a change of control of the surviving corporation, the officer s employment is involuntarily terminated without cause or is voluntarily terminated by the officer with good reason, the agreements provide affected individuals with the following benefits:

- For Mr. Dutton, Ms. Powell, Mr. Griffin, Mr. Rendall and Mr. Oakes, payments of 2.99 times, and for Mr. Rogan and Ms. Bugbee, payments of 2.0 times, the individual s base salary plus the target short-term incentive bonus (or if there is no target short-term incentive bonus payable for such year, the actual amount of the individual s most recent short-term incentive bonus) that would be

payable for such year;

Table of Contents

- Continuation of health, medical and other insurance programs for 36 months;

- Payment of an amount equal to the actuarial value of up to 36 months of additional credited service under the Retirement Plan;

- Receipt of all benefits payable under our Retirement Plan, Savings and Thrift Plan, Supplemental Retirement Plan and any other plan or agreement relating to retirement benefits;

- In the case of Mr. Dutton, Ms. Powell, Mr. Oakes, Mr. Griffin and Mr. Rendall, indemnification, up to a maximum dollar amount, for any excise tax imposed on the officer s excess parachute payments. The amount of the indemnification caps for the respective officers are as follows: Mr. Dutton, $903,000; Ms. Powell, $359,000; Mr. Oakes, $343,000; Mr. Griffin, $251,000; and Mr. Rendall, $251,000; and

- Outplacement services for a reasonable period of time and at a reasonable cost.

These benefits will be provided only if the officer complies with a non-compete covenant for a period of 12 months.

As defined in the agreements, a change of control of the surviving corporation will have occurred when:

- A person secures ownership of 20% or more of the voting power of the surviving corporation s outstanding common stock;

- A change occurs in the majority of the board of directors for two consecutive years, which has not been approved by the directors in office at the beginning of the period; or

- Shareholders approve a merger or consolidation of us with another company where our outstanding voting stock does not continue to represent at least 80% of the combined voting power of the surviving corporation or the surviving corporation after such merger or consolidation.

Individuals may terminate employment following a change of control with good reason if:

- The individual is assigned duties inconsistent with his duties before the change of control;

- The failure to maintain offices in the northwest portion of Vermont;

- Compensation or benefits are reduced or adversely affected other than as part of an overall adjustment of executive compensation or benefits;

- The surviving corporation fails to obtain an agreement from its successor that it will perform under the change of control agreements;

The surviving corporation fails to offer the individual any compensation plan provided to other executives of similar responsibility; or

The surviving corporation eliminates or materially reduces or jeopardizes its ability to fulfill its obligations under certain executive benefits plans.

Supplemental Retirement Plans. We have entered into supplemental retirement plan agreements with seven members of management, including each of our senior executive officers. The agreements provide a benefit at age 65 equal to ten times 33% (or 44% in the case of Mr. Dutton) of the participant s salary during the twelve months preceding retirement. The benefit is pro rated if the participant has completed less than 20 years of service.

The supplemental retirement plan agreements also provide a benefit if the participant s employment terminates, for a reason other than cause, prior to attainment of age 65 but after satisfying the applicable vesting requirement. In that case, the benefit is determined under the formula described above, but is also actuarially reduced for early commencement if the participant has not completed at least 10 years of service and attained age 59.

The supplemental retirement plan agreements provide additional benefits or assurances in the event of a change of control. In that event, the benefit is calculated as if the participant had completed an additional three years of service (or an additional two years of service in the case of participants who are not senior executive officers). The supplemental retirement plan agreements also provide that the benefit payable to our senior executive officers will not be less than a stated percentage of the benefit that would have been payable under prior versions of the supplemental retirement plan agreements. The percentage is 90% if a change of control

occurs before July 31, 2006; 80% if the change of control occurs after July 31, 2006 and before July 31, 2007; and 70% if the change of control occurs after July 31, 2007 and before July 31, 2008. The benefits payable on account of a change of control are not actuarially reduced for early commencement.

Each member of management who is subject to a supplemental retirement plan agreement, including all of our senior executive officers, have agreed to waive the change of control provisions described above as they would apply as a result of the approval of the merger proposal and the completion of the merger.

Stock Options. For more information regarding the terms of our stock options, see The Merger Effect of the Merger on Awards Outstanding under Our Stock Plans.

Deferred Stock Unit Awards. For more information regarding the terms of our deferred stock unit awards, see The Merger Effect of the Merger on Awards Outstanding under Our Stock Plans.

Indemnification and Insurance. Under the agreement and plan of merger, NNEEC agreed that the existing rights to indemnification of all of our and our subsidiaries present and former directors or officers under our or their respective articles of incorporation or bylaws, or under any other indemnification agreement of ours in effect on the date of the agreement and plan of merger, shall continue in full force and effect and shall not be amended, repealed or otherwise modified for a period of six years.

Our existing directors and officers liability insurance policy has an aggregate liability limit of $35 million and the 2006 premium was $335,724. We and NNEEC agree that, NNEEC shall purchase for the benefit of the surviving corporation a tail policy covering a period of six years after the effective time of the merger with respect to acts or omissions prior to the effective time as provided in our directors and officers liability insurance policies and our fiduciary and employee benefit policies, providing substantially the same benefits and levels of coverage as the insurance policies currently in effect and covering the same individuals who are covered on the date of the agreement and plan of merger by such policies. NNEEC s and the surviving corporation s obligation to provide this insurance coverage is subject to a cap of $1,500,000. If NNEEC cannot obtain such insurance coverage without exceeding the $1,500,000 cap, NNEEC is required to use its reasonable best efforts to obtain as much comparable insurance as is reasonably available at a cost of not more than $1,500,000.

Positions with Surviving Corporation and Affiliates. Upon completion of the merger, our current senior executive officers are expected to be the officers of the surviving corporation until their successors have been duly elected, appointed or qualified or until their earlier death, resignation or removal in accordance with the articles of incorporation and bylaws of the surviving corporation and the new employment agreements.

In addition, NNEEC has agreed that it will cause five members of our board of directors and our chief executive officer to be elected to the board of directors of the surviving corporation at the effective time, and that it will not remove any such director, except for cause, until at least the second anniversary of the effective time of the merger. NNEEC has also agreed to offer three additional members of our board positions as members of the board of directors of NNEEC or one of its subsidiaries.

Financing of the Merger

The merger is not conditioned upon any financing arrangements. NNEEC estimates that the total amount of funds required to complete the merger will be approximately $190,150,000. NNEEC currently intends to provide such funds from the sale of debt securities, other borrowings, and equity from its parent company, Gaz Métro. Gaz Métro intends to fund any equity it provides NNEEC from its working capital, the sale of debt and/or equity securities, and other borrowings. As of March 31, 2006, Gaz Métro had Cdn.$2,792,000,000 in total assets and Cdn.$1,033,000,000 in partner s equity. Neither NNEEC nor Gaz Métro has made any decisions concerning which of these sources it will utilize to finance the merger. Such decisions will depend upon a number of factors including prevailing interest rates, financial, economic, and market conditions, and such other factors as NNEEC and Gaz Métro deem advisable and appropriate.

Table of Contents

Effects of the Merger

Subject to the terms and conditions of the agreement and plan of merger and in accordance with Vermont law, at the effective time of the merger, Northstars Merger Sub, a direct wholly-owned subsidiary of NNEEC formed for purposes of the merger, will be merged with and into Green Mountain Power, and Green Mountain Power will survive the merger as a subsidiary of NNEEC and will continue its corporate existence under Vermont law.

Regulatory Approvals

Antitrust Approvals. Under the HSR Act and the rules promulgated thereunder by the FTC, the merger cannot be completed until we and Gaz Métro file a notification and report form under the HSR Act and the applicable waiting period has expired or been terminated. We and Gaz Métro intend to file notification and report forms under the HSR Act with the FTC and the Antitrust Division of the Department of Justice during the fourth quarter of 2006. At any time before or after completion of the merger, notwithstanding the expiration or early termination of the waiting period under the HSR Act, the Antitrust Division or the FTC could take such action under the antitrust laws as it deems necessary or desirable in the public interest, including seeking to enjoin the completion of the merger or seeking divestiture of substantial assets of Green Mountain Power or Gaz Métro. At any time before or after the completion of the merger, and notwithstanding the expiration or early termination of the waiting period under the HSR Act, any state could take such action under the antitrust laws as it deems necessary or desirable in the public interest. Such action could include seeking to enjoin the completion of the merger or seeking divestiture of substantial assets of Green Mountain Power or Gaz Métro. Private parties may also seek to take legal action under the antitrust laws under certain circumstances.

While there can be no assurance that the merger will not be challenged by a governmental authority or private party on antitrust grounds, we and NNEEC believe that the merger can be effected in compliance with federal and state antitrust laws. Under the terms of the agreement and plan of merger, however, NNEEC is not required to agree or consent to any condition, provision, liability or terms, and together with any adverse effect as compared to the expected outcome, would reasonably be expected to have a material adverse effect on us, materially impact NNEEC s expected benefits of the merger or impair, other than in an immaterial manner, the value to NNEEC of any material tax attributes arising out of the merger or the financing of the merger or the operations of the surviving corporation after the merger. See The Agreement and Plan of Merger Efforts to Complete the Merger.

The Exon Florio Amendment to the Defense Production Act of 1950. The Exon-Florio Amendment to the Defense Production Act of 1950, or Exon-Florio provision, provides the President of the United States with the authority to investigate and, where necessary, suspend or prohibit any foreign acquisition, merger or takeover of companies engaged in U.S. interstate commerce, determined to threaten U.S. national security:

- if there is credible evidence that leads the President to believe that the foreign interest exercising control might take action that threatens to impair the national security; and

- if provisions of law, other than the Exon-Florio provision and the International Emergency Economic Powers Act, do not in the President s judgment provide adequate and appropriate authority for the President to protect the national security in the matter before the President.

By executive order, the President has delegated his investigatory powers under the Exon Florio provision to the CFIUS, an interagency committee chaired by the U.S. Treasury Department. We and NNEEC intend to file a voluntary notification of the proposed merger with the CFIUS during the fourth quarter of 2006, seeking confirmation that the transactions contemplated by the agreement and plan of merger do not threaten national security. The CFIUS has 30 days from the date of that filing in which to determine whether to seek a further investigation of the merger. We cannot assure you whether or not the CFIUS will decide to seek such investigation, or what action, if any, the President may decide to take with respect to the transaction. Among other actions, the President could block or otherwise require conditions on the proposed merger.

FERC Approval. Section 203 of the Federal Power Act provides that no public utility may sell or otherwise dispose of its jurisdictional facilities with a value in excess of $10 million, directly or indirectly merge or consolidate its jurisdictional facilities with those of any other person or acquire any security of any other public utility with a value in excess of $10 million without first having obtained authorization from the FERC. Because we own jurisdictional facilities under the Federal Power Act with a value in excess of $10 million, the approval of the FERC under Section 203 is required before we and NNEEC may consummate the merger.

Section 203, as recently amended by the Energy Policy Act of 2005, provides that the FERC is required to grant its approval if the merger is found to be consistent with the public interest and will not result in cross-subsidization of a non-utility associate company, unless the FERC determines that the cross-subsidization, pledge or encumbrance will be consistent with the public interest. The FERC stated in its 1996 Merger Policy Statement that, in analyzing whether a merger is consistent with the public interest under Section 203, it will evaluate the following criteria:

- the effect of the merger on competition in electric power markets;
- the effect of the merger on the applicant s wholesale and transmission rates; and
- the effect of the merger on state and federal regulation of the applicants.

If the FERC finds that the merger would adversely affect competition, wholesale rates or regulation or will result in cross-subsidies, it may, pursuant to the Federal Power Act, deny approval of the merger or impose remedial conditions intended to mitigate such effects; we and NNEEC then could review whether to accept such remedial conditions.

We filed our application under Section 203 on August 9, 2006 and the application is currently pending.

VPSB Approval. We are subject to the jurisdiction of the VPSB. In addition, NNEEC s subsidiary, Vermont Gas Systems, Inc., is subject to the jurisdiction of the VPSB. Under 30 V.S.A. §§ 104, 107, 109 and 311, the approval of the VPSB is required in connection with the amendment to the articles of incorporation of, and with the acquisition of a controlling interest in, or merger involving any company under its jurisdiction. In considering the merger, the VPSB is required to determine that it will promote the general good of the state and will not result in obstructing or preventing competition with respect to any product or service sold, purchased or manufactured by us and NNEEC (including its affiliates, such as Vermont Gas Systems, Inc.). We filed our application for VPSB approval on August 7, 2006 and the application is currently pending.

MPUC Approval. In connection with the merger, NNEEC filed an application on August 17, 2006 with the MPUC pursuant to 35-A M.R.S.A. § 708 to obtain any necessary approvals and the application is currently pending.

Material U.S. Federal Income Tax Consequences of the Merger to Our Shareholders

The following is a summary of U.S. federal income tax consequences of the merger to U.S. shareholders whose shares of our common stock are converted into the right to receive cash in the merger. The discussion does not purport to consider all aspects of U.S. federal income taxation that might be relevant to our shareholders. The discussion is based on current law, which is subject to change, possibly with retroactive effect. The discussion applies only to shareholders who hold shares of our common stock as capital assets, and may not apply to shares of our common stock received in connection with the exercise of employee stock options or otherwise as compensation, or to certain types of shareholders (such as insurance companies, banks, tax-exempt organizations, financial institutions and broker-dealers) who may be subject to special rules. This discussion does not address the tax consequences to any shareholder who, for U.S. federal income tax purposes, is a non-resident alien individual, foreign corporation, foreign partnership or foreign estate or trust, and does not address any aspect of state, local or foreign tax laws.

Table of Contents

The exchange of cash for shares of our common stock in the merger will be a taxable transaction for U.S. federal income tax purposes. In general, a shareholder whose shares of our common stock are converted into the right to receive cash in the merger will recognize capital gain or loss for U.S. federal income tax purposes equal to the difference, if any, between $35.00 per share and the shareholder s adjusted tax basis in each of the shares of our common stock surrendered. Gain or loss will be determined separately for each block of shares (i.e., shares acquired at the same cost in a single transaction). Such gain or loss will be long-term capital gain or loss if a shareholder s holding period for such shares is more than 12 months at the time of the consummation of the merger. Long-term capital gains of individuals are eligible for reduced rates of taxation. There are limitations on the deductibility of capital losses.

Backup withholding will apply to all cash payments to which a shareholder is entitled under the merger proposal, unless the shareholder provides a taxpayer identification number (social security number, in the case of individuals, or employer identification number, in the case of other shareholders), certifies that such number is correct, and otherwise complies with the backup withholding tax rules. Each of our shareholders should complete and sign the Substitute Form W-9 included as part of the letter of transmittal and return it to the paying agent, in order to provide the information and certification necessary to avoid backup withholding tax, unless an exemption applies and is established in a manner satisfactory to the paying agent.

Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules will be allowable as a refund or a credit against a shareholder s U.S. federal income tax liability provided the required information is furnished to the Internal Revenue Service.

The U.S. federal income tax consequences set forth above are not intended to constitute a complete description of all tax consequences relating to the merger. Because individual circumstances may differ, each shareholder should consult the shareholder s tax advisor regarding the applicability of the rules discussed above to the shareholder and the particular tax effects to the shareholder of the merger, including the application of state, local and foreign tax laws.

Accounting Treatment

The merger will be accounted for as a purchase transaction for financial accounting purposes.

Delisting and Deregistration of Our Common Stock

If the merger is completed, our common stock will be delisted from the New York Stock Exchange and will be deregistered under the Exchange Act.

Dissenters Rights

The holders of shares of our common stock at the effective time of the merger will have certain rights pursuant to the provisions of Chapter 13 of the Vermont Business Corporation Act (Title 11A, V.S.A. Section 13.01 et seq.), which we refer to in this proxy statement as Chapter 13, to dissent from the merger and obtain payment of fair value for their shares of our common stock. The fair value is initially determined by Green Mountain Power. Under Chapter 13, dissenting shareholders who comply with the applicable statutory procedures will be entitled to receive a judicial appraisal of the fair value of their shares of our common stock (exclusive of any appreciation or depreciation in anticipation of the merger unless such exclusion would be inequitable) and to receive payment of such fair value in cash, together with interest from the effective date of the merger until the date of payment. Any such judicial determination of the fair value of shares of our common stock could be based upon factors other than, or in addition to, the price per share to be paid in the merger or the market value of the shares of our common stock. The judicially determined value could be more or less than the price per share to be paid in the merger. The foregoing summary of Chapter 13 does not purport to be complete and is qualified in its entirety by reference to Chapter 13. **Failure to follow the steps required by Chapter 13 for perfecting dissenters rights may result in the loss of such rights.**

Pursuant to Chapter 13, any holder of shares of our common stock who objects to the merger is entitled to dissent from the merger and to have the fair value of such shares of our common stock, which we refer to in this proxy statement as dissenting stock, as determined by us or, if necessary, judicially determined, paid to that holder, by complying with the provisions of Chapter 13. Failure to take any steps set forth in Chapter 13 in connection with the exercise of such rights may result in termination or waiver thereof.

The following is a summary of the statutory procedures required to be followed by a holder of dissenting stock, whom we refer to in this proxy statement as a dissenting shareholder, in order to exercise that holder s rights under Vermont law. This summary is qualified in its entirety by reference to Chapter 13, the text of which is attached as *Annex C* to this proxy statement.

If a shareholder elects to exercise dissenters rights with respect to the merger, such shareholder must (i) deliver to us prior to the vote on the approval of the agreement and plan of merger at the special meeting a written notice of intention to demand payment for the holder s shares of our common stock if the merger is effectuated and (ii) not vote in favor of approval of the agreement and plan of merger. The written notice required to be delivered to us by a dissenting shareholder is in addition to and separate from any proxy or vote against the merger proposal. Neither voting against nor failing to vote for the merger will constitute the written notice required to be filed by a dissenting shareholder. Failure to vote against the merger proposal, however, will not constitute a waiver of rights under Chapter 13, provided that a written objection has been properly filed and the shareholder does not vote in favor of the merger proposal. A signed proxy that is returned but which does not contain any instructions as to how it should be voted will be voted in favor of approval of the merger proposal and will be deemed a waiver of dissenters rights. See The Special Meeting Voting and Revocation of Proxies on page 17 of this proxy statement.

A beneficial shareholder may assert dissenters rights as to shares of our common stock held on that shareholder s behalf only if (i) such shareholder submits to us the record shareholder s written consent to the dissent not later than the time that the beneficial shareholder asserts dissenters rights and (ii) such shareholder does so with respect to all shares of our common stock of which that shareholder is the beneficial owner or over which that shareholder has the power to direct the vote. A record holder of shares of our common stock may dissent on behalf of any beneficial owner with respect to all, but not less than all, of the shares of common stock of such owner if the record holder notifies us in writing of the name and address of each such person on whose behalf such record holder asserts dissenters rights. All notices of intention to demand payment should be addressed to: Green Mountain Power Corporation, 163 Acorn Lane, Colchester, Vermont, 05446, Attention: General Counsel.

If the agreement and plan of merger is approved, we are obligated to give written notice of the approval to each dissenting shareholder who timely filed a notice of intention to demand payment and who did not vote in favor of approval of the agreement and plan of merger no later than 10 days after the date that the merger becomes effective. The notice must be accompanied by a copy of Chapter 13 and must:

- state where a demand for payment must be sent and where and when certificates representing dissenting stock must be deposited in order to obtain payment;
- inform holders of uncertificated shares of our common stock to what extent transfer of the shares of our common stock will be restricted after the payment demand is received;
- be accompanied by a form for demanding payment that includes the date of the first announcement to news media or to shareholders of the terms of the proposed merger (June 22, 2006) and requires that the person asserting dissenters rights certify whether or not he or she acquired beneficial ownership of the dissenting stock before that date; and
- set a date by which we must receive the payment demand, which date shall not be less than 30 days nor more than 60 days after the date the notice is delivered.

A dissenting shareholder who fails to demand payment or to deposit certificates for dissenting stock as required shall have no right under Chapter 13 to receive payment for the dissenting stock.

Table of Contents

Unless the merger has been effected within 60 days after the date for demanding payment and depositing certificates for dissenting stock, which 60 day period we refer to in this proxy statement as the demand period, we will return any certificates for dissenting stock so deposited and release any transfer restrictions imposed on uncertificated shares of our common stock. If certificates for such dissenting stock have been returned and such transfer restrictions have been released by us, we must at a later time send a new notice conforming to the requirements herein described if the merger is effected after the demand period.

Upon consummation of the merger, our obligations under Chapter 13 will be assumed by the surviving corporation.

As soon as the merger has been consummated, or upon receipt of demand for payment if the merger has already been consummated, except as set forth in the immediately following sentence, we will remit to each dissenting shareholder who has made proper demand and deposited that shareholder s certificates with us the amount which we deem to be the fair value of that shareholder s dissenting stock, with accrued interest, if any, accompanied by:

- our balance sheet as of the end of a fiscal year ending not more than 16 months before the date of payment;
- an income statement and a statement of changes in shareholders equity for such fiscal year;
- our latest available interim financial statements, if any;
- a statement of our estimate of the fair value of the dissenting stock and how such estimate was calculated;
- an explanation of how interest (if any) was calculated; and
- a statement of the dissenting shareholders right to demand payment pursuant to Section 13.28 of Chapter 13, together with a copy of Chapter 13.

To the extent that a dissenting shareholder acquired dissenting shares after June 22, 2006, shares which we refer to in this proxy statement as after acquired shares, we may offer to pay our estimate of the fair value of after acquired shares, plus accrued interest, to each dissenting shareholder who agrees to accept it in full satisfaction of that shareholder s demand instead of immediately paying such amount. Fair value of dissenting stock means the value of such stock immediately before the effective time of the merger, excluding any change in value in anticipation of the merger unless such exclusion would be inequitable (which fair value may be more, less, or the same as the merger consideration).

If:

- we fail to remit such fair value to a dissenting shareholder or offer to pay fair value to a dissenting shareholder with respect to after acquired shares within 60 days after the date set for demanding payment;
- a dissenting shareholder believes that the amount remitted or offered is less than the fair value of such holder s dissenting stock (or that the interest, if any, is not correct); or
- we do not complete the merger and fail to return any deposited certificates for dissenting stock or release any transfer restrictions imposed on uncertificated shares of our common stock;

the affected dissenting shareholder may reject our offer and send us such shareholder s own estimate of fair value (and interest, if any) and demand payment of the deficiency. If the dissenting shareholder does not file the estimate within 30 days of when we make or offer payment for the dissenting stock, such shareholder shall be entitled to no more than the amount remitted or offered.

If a dissenting shareholder holds dissenting shares at the time that the merger shall be deemed effective, and this dissenting shareholder withdraws the demand for payment for dissenting shares or otherwise loses the right

to payment for shares, pursuant to the Vermont Business Corporation Act, the dissenting shares shall be deemed to be converted into, as of the effective date of the merger, the right to receive payment of the merger price for the shares.

Within 60 days after a demand for payment of a deficiency, if the demand remains unsettled, we will commence a proceeding in the Chittenden, Vermont Superior Court and petition the Court to determine the fair value of the dissenting stock and accrued interest. We will make all dissenting shareholders whose demands have not been settled parties to such action, and all parties shall be served a copy of the complaint. The Court will determine the fair value of the dissenting stock and each dissenting shareholder will be entitled to judgment for the amount, if any, by which the amount previously remitted by us is exceeded by the Court s determination of fair value, plus interest, or for judgment equal to the value of the after acquired shares, plus interest. If we do not file a petition within 60 days, each dissenting shareholder who has made demand and who has not settled his or her claim shall be entitled to receive the amount demanded with interest.

There are no specific valuation methods prescribed under Vermont law to which the Court would be bound in determining fair value. The Court would consider the evidence that it deemed relevant and material and render its decision based on that evidence.

The Company may elect to withhold remittances to any dissenting shareholder who did not own his or her shares of our common stock before June 22, 2006, the day the merger was announced. With respect to these shares of common stock, upon consummation of the merger, we will give our fair value estimate and explain the basis thereof and offer to pay the amount plus accrued interest to such holders who agree to accept it in full satisfaction of their demands. If the dissenting shareholder disagrees, that shareholder may within 30 days mail to us his or her estimate and demand payment. If the dissenting shareholder fails to mail such a response, that shareholder is entitled only to our offer. If demand is made and remains unsettled, further proceedings will follow the procedures for judicial appraisal of shares of our common stock set forth above.

Costs of an appraisal proceeding, including costs and expenses of appraisers appointed by the Court, will be determined by the Court and assessed against us, except that the Court may assess any part of such costs and expenses to all or some of the dissenting shareholders who are parties and whose action the Court finds to be arbitrary, vexatious, or not in good faith in demanding payment under Section 13.28 of Chapter 13. Fees and expenses of counsel and experts for the respective parties may be assessed against us if the Court finds that we failed to comply substantially with the requirements of Chapter 13 or may be assessed against us or all or some of the dissenting shareholders if such party acted arbitrarily, vexatiously, or not in good faith with respect to the rights provided by Chapter 13. If the Court finds that the services of counsel for any dissenting shareholder are of substantial benefit to other dissenting shareholders similarly situated and that the fees for those services should not be assessed against us, the Court may award to those counsel reasonable fees to be paid out of the amounts awarded the dissenting shareholders who were benefited.

The merger is conditioned on the event that shareholders representing over 10% of the outstanding shares of Green Mountain Power do not exercise dissenters rights under Section 13.02 of the Vermont Business Corporation Act in connection with the merger. Any withdrawals of the exercise of dissenters rights are not included in this 10% amount.

Any shareholder wishing to exercise dissenters rights is urged to consult legal counsel before attempting to exercise dissenters rights. Failure to follow the steps required by Chapter 13 of the Vermont Business Corporation Act may result in the loss of a shareholder s dissenters rights.

Table of Contents

THE AGREEMENT AND PLAN OF MERGER

This section of the proxy statement describes the material provisions of the agreement and plan of merger but does not purport to describe all of the terms of the agreement and plan of merger. The following summary is qualified in its entirety by reference to the complete text of the agreement and plan of merger, which is attached as ***Annex A*** *to this proxy statement and incorporated into this proxy statement by reference. We urge you to read the agreement and plan of merger in its entirety because it is the primary legal document that governs the merger.*

The Merger

The agreement and plan of merger provides for the merger of Northstars Merger Sub with and into Green Mountain Power upon the terms, and subject to the conditions, of the agreement and plan of merger. As the surviving corporation, we will survive the merger and continue to survive as a direct wholly-owned subsidiary of NNEEC. The separate corporate existence of Northstars Merger Sub will terminate as of the effective time of the merger. The merger will be effective upon the acceptance by the Secretary of State of the State of Vermont of the articles of merger, or at such later time reflected in the articles of merger as agreed to by NNEEC and us. We expect to complete the merger as promptly as practicable after our shareholders approve the agreement and plan of merger and we receive the required regulatory approvals for the merger.

NNEEC or we may terminate the agreement and plan of merger before the completion of the merger in certain circumstances, whether before or after the approval of the merger proposal by shareholders. Additional details on termination of the agreement and plan of merger are described in Termination of the Agreement and Plan of Merger.

Merger Consideration

Each share of our common stock issued and outstanding immediately before the merger, other than shares owned by NNEEC, Northstars Merger Sub or any direct or indirect wholly-owned subsidiary of NNEEC, shares owned by us and dissenting stock, will be automatically canceled and converted into the right to receive $35.00 in cash per share, without interest. After the merger is effective, each holder of a certificate representing any of these shares of our common stock at the time of the completion of the merger, will no longer have any rights with respect to the shares, except for the right to receive the merger consideration. Shares held by us or any of our wholly-owned subsidiaries or by NNEEC or Northstars Merger Sub or any direct or indirect wholly-owned subsidiary of NNEEC will be canceled at the effective time of the merger.

Effect of the Merger on Green Mountain Power Stock Award Plans

Each outstanding deferred stock unit granted under our stock plans will be vested on the date of the special meeting if the merger proposal is approved by our shareholders and entitle the holder to an amount in cash equal to $35.00, without interest and less any applicable withholding tax. Holders of deferred stock units that are outstanding at the effective time of the merger will receive the merger consideration after the cancellation of their deferred stock unit agreements in accordance with the terms of our stock plans shortly after the completion of the merger.

Our stock plans provide that each holder of deferred stock units may surrender their deferred stock unit agreements for cancellation in exchange for a cash payment after the date that our shareholders approve the merger proposal and before the effective time of the merger. The amount of cash payable upon the surrender of the deferred stock unit agreements is equal to the change in control price, which our stock plans define to mean the highest trading price of our common stock on the New York Stock Exchange during the sixty-day period immediately before the surrender of the deferred stock unit agreements. The amount payable upon surrender of the deferred stock unit agreements will be paid within 30 days after the surrender. Our officers and directors have waived their rights to surrender their deferred stock unit agreements pursuant to these provisions of our stock plans.

Each outstanding stock option will automatically accelerate so that each such stock option shall become fully exercisable on the date of the special meeting if the merger proposal is approved by our shareholders. All stock options not exercised prior to the effective time of the merger will be canceled in the merger, with the holder of each stock option becoming entitled to receive, in full satisfaction of the rights of such holder with respect thereto, an amount in cash equal to the excess of $35.00 per share over the exercise price per share of our common stock subject to such option, multiplied by the number of shares of our common stock subject to such stock option, less any withholding taxes. Holders of stock options will receive all amounts payable, without interest, as soon as practicable following the effective time of the merger, after the cancellation of their stock option agreements in accordance with the terms of our stock plans, shortly after completion of the merger.

Our stock plans provide that each holder of a stock option may surrender their stock option agreements for cancellation in exchange for a cash payment after the date that our shareholders approve the merger proposal and before the effective time of the merger. The amount of cash payable upon surrender of the stock option agreements is equal to the excess of the change in control price per share over the exercise price per share of our common stock subject to such option, multiplied by the number of shares of our common stock subject to such stock option, less any withholding taxes. The amount payable upon surrender of the stock option agreements will be paid within 30 days after the surrender of the stock option agreements. Our officers and directors have waived their rights to surrender their stock option agreements pursuant to these provisions of our stock plans.

Dissenters Rights

Under the Vermont Business Corporation Act, shareholders who do not vote in favor of the merger proposal will be entitled to exercise dissenters rights in connection with the merger. Shareholders desiring to exercise such dissenters rights will have the rights and duties and must follow the procedures set forth in Chapter 13 of the Vermont Business Corporation Act, the full text of which is set forth in *Annex C* to this proxy statement. Shareholders who wish to exercise dissenters rights must carefully follow the procedures described in Chapter 13 of the Vermont Business Corporation Act and are urged to read *Annex C* in its entirety.

Directors and Officers

Upon completion of the merger, the directors of Northstars Merger Sub will be the initial directors of the surviving corporation while our officers immediately before the effective time will be the officers of the surviving corporation and will hold the same positions as they previously did with Green Mountain Power. The surviving corporation will cause five members of our board of directors and our chief executive officer to be elected to its board of directors at the effective time. In addition, NNEEC will not remove any person elected to the board of directors of the surviving corporation who was previously a member of our board of directors, except for cause, until at least the second anniversary of the effective time and until his or her successor is duly qualified and elected and will offer three additional members of our board of directors positions as members of the board of directors of NNEEC or one of its subsidiaries.

Payment for the Shares

Before the completion of the merger, NNEEC will designate (after consultation with us) a paying agent to make payment of the merger consideration as contemplated by the agreement and plan of merger and will deposit in trust with the paying agent the funds appropriate to pay the merger consideration to the shareholders.

As of the effective time our stock ledger with respect to our common stock shall be closed and after that time there will be no transfer of our common stock on the stock transfer books of the surviving corporation.

If you hold your shares of common stock in certificated form, as soon as reasonably practicable after the completion of the merger, the paying agent will send you a letter of transmittal and instructions advising you of the procedure to surrender your certificates in exchange for the merger consideration. The paying agent will pay

you your merger consideration after you have (1) surrendered your certificates to the paying agent and (2) provided to the paying agent your signed and completed letter of transmittal and any other items specified by the letter of transmittal. Interest will not be paid or accrue in respect of the merger consideration. The surviving corporation will reduce the amount of any merger consideration paid to you by any applicable withholding taxes. **If you hold shares in certificated form, you should not forward your stock certificates to the paying agent without a letter of transmittal, and you should not return your stock certificates with the enclosed proxy.** If you hold shares registered in our stock transfer books, but for which no certificates have been issued, you will automatically receive the merger consideration in exchange for your shares following the completion of the merger, and you will not receive a letter of transmittal.

If the paying agent is to pay some or all of your merger consideration to a person other than you, you must have your certificates properly endorsed or accompanied by appropriate stock powers or otherwise in proper form for transfer, and you must pay any transfer or other taxes payable by reason of the transfer to the paying agent or establish to the paying agent s satisfaction that the taxes have been paid or are not required to be paid.

The transmittal instructions will tell you what to do if you have lost your certificate, or if it has been stolen or destroyed. You will have to provide an affidavit to that fact and, if required by NNEEC or the surviving corporation, post a bond in an amount that NNEEC or the surviving corporation, as the case may be, reasonably directs as indemnity against any claim that may be made against them in respect of the certificate.

Representations and Warranties

In the agreement and plan of merger, we, NNEEC, and Northstars Merger Sub each made representations and warranties relating to, among other things:

- corporate organization and existence;
- corporate power and authority to enter into and perform obligations under, and enforceability of, the agreement and plan of merger;
- required regulatory filings and consents and approvals of governmental entities;
- the absence of conflicts with or defaults under organizational documents, debt instruments, other contracts and applicable laws and judgments;
- broker s fees;
- absence of material litigation; and
- information supplied for inclusion in this proxy statement.

In the agreement and plan of merger, NNEEC and Northstars Merger Sub also made representations and warranties relating to NNEEC s ownership of Northstars Merger Sub s common stock and access to cash on hand sufficient to enable NNEEC and Northstars Merger Sub to timely perform their obligations under the agreement and plan of merger.

We also made representations and warranties relating to, among other things:

- capital structure;

subsidiaries;

documents filed with the SEC, the accuracy of certain documents filed with the SEC since December 31, 2003, disclosure controls and procedures and internal control over financial reporting, and that our financial statements fairly present our consolidated financial position and the absence of undisclosed liabilities;

material compliance with the applicable listing and corporate governance rules and regulations of the New York Stock Exchange;

- absence of certain material adverse changes or events since December 31, 2005;
- compliance with applicable laws, including environmental laws and regulations;
- compliance with the Employee Retirement Income Securities Act of 1974, as amended, and other employee benefit matters;
- opinion of our financial advisor;
- employee benefit plans;
- labor relations;
- tax matters;
- intellectual property matters;
- contracts and arrangements;
- inapplicability of state takeover statutes;
- takeover provisions;
- the board of directors authorization of the agreement and plan of merger;
- real property matters;
- insurance matters;
- regulation as a utility; and
- the condition of our assets.

Conduct of Business Pending the Merger

We have agreed in the agreement and plan of merger that unless contemplated, permitted or required by the agreement and plan of merger or set forth in the company disclosure letter, we will, and will cause our subsidiaries to, operate our business in the ordinary course and in a manner consistent with past practice. In particular, we have agreed, as to ourselves and our subsidiaries that we will use commercially reasonable efforts to preserve intact our business organizations, to keep available the services of our current key officers and employees as a group, maintain our

assets and properties in good working order and condition, maintain satisfactory relationships with governmental entities and material suppliers and maintain satisfactory levels of customer service quality and reliability.

In addition, we have agreed that, until the effective time of the merger and subject to certain exceptions set forth in the agreement and plan of merger or set forth in the company disclosure letter, neither we, nor any of our subsidiaries, will:

- amend our articles of incorporation or bylaws;

- merge or consolidate with any other entity, or restructure, reorganize or completely or partially liquidate or otherwise enter into any agreements or arrangements imposing material changes or restrictions on our assets, operations or businesses;

- amend the organizational documents of any subsidiary in a way that that would reasonably be likely to delay or impede our ability to consummate the merger or in any way that would have any adverse effect on NNEEC or Northstars Merger Sub following the merger;

- issue or sell, pledge, dispose of, grant, transfer, encumber or authorize to issue or sell, pledge, dispose of, grant, transfer or encumber any shares of our capital stock;

- issue or sell, or authorize to issue or sell, any securities convertible into or exchangeable for, or options, warrants or rights to purchase or subscribe for, or enter into any arrangement or contract with respect to the issuance or sale of, any shares of our capital stock or any other ownership interests, except for grants of shares or deferred stock units to employees and directors in 2006 at times and in amounts consistent with our past practice, not to exceed 18,800 shares;

reclassify, split, combine or subdivide any of our capital stock;

redeem or purchase or otherwise acquire any shares of our capital stock;

declare, pay or set aside any dividend or other distribution or payment with respect to our capital stock, except quarterly cash dividends on our capital stock at the current quarterly dividend rate of $0.28 per share;

create or incur any material lien;

make or incur capital expenditures in excess of 110% of the amount calculated that may be spent in fiscal year 2006 or in excess of 110% of the amount calculated that may be spent per calendar quarter in each fiscal year after 2006 or other than in the ordinary course of business consistent with past practice;

make any loans or advances to any other person or entity;

transfer, sell, lease, license mortgage, pledge, surrender, encumber, divest, cancel, abandon or allow to lapse or expire or otherwise dispose of or grant rights to any of our properties or assets, except in the ordinary course of business and except for properties or assets with a fair market value not exceeding $1 million in the aggregate;

terminate or amend or waive any provision of any material contract with the exception of secured indebtedness that becomes due as a result of the voluntary sale or transfer of the property or assets securing such indebtedness;

with certain exceptions, enter into any material contract;

incur any indebtedness or guaranty any such indebtedness of another person other than certain specified exceptions;

issue or sell any debt securities or warrants or other rights to acquire any debt security of Green Mountain Power or any of our subsidiaries, subject to certain exceptions;

settle any litigation or other proceedings before a governmental entity for an amount in excess of $500,000 individually or $1 million in the aggregate, or otherwise on terms involving an injunction, restraining order, declaratory relief or other non-monetary relief that would be reasonably likely to have an adverse effect on other litigations, proceedings, obligations or liabilities we or our subsidiaries are involved in;

grant or agree to grant any of our employees, officers, directors or consultants increased wages or bonuses, severance, profit sharing, retirement, deferred compensation, insurance or other compensation or benefits, subject to certain exceptions;

establish any new compensation or benefit plans or arrangements, subject to certain exceptions;

amend or agree to amend or terminate any existing employee benefit plans, subject to certain exceptions;

make any material tax election not required by law or settle or compromise any material tax liability, if the effect of such election, settlement or compromise will increase the present value of any material tax liability;

other than in the ordinary course of business, consistent with our past practice, waive any rights of substantial value or cancel or forgive any indebtedness for borrowed money owed to us or any of our subsidiaries;

change our accounting policies;

take any action that violates any order or regulation of any governmental entity governing us or any of our subsidiaries; or

enter into any agreement that materially restrains, limits or impedes our, or our subsidiaries , ability to compete with or conduct any business or line of business.

Table of Contents

Efforts to Complete the Merger

In the agreement and plan of merger, we have agreed to a number of additional agreements, including agreements relating to:

- recommending, through our board of directors, that our shareholders approve the merger proposal;
- preparing and filing this proxy statement and mailing it to our shareholders;
- calling a meeting of our shareholders to vote on the approval of the merger proposal;
- providing NNEEC and its representatives with reasonable access to information concerning our properties and records;
- obtaining NNEEC s written consent before initiating any general rate case, to consult with NNEEC before making any material changes in our, or our subsidiaries , rates or charges, standards of service or accounting, and to further consult with NNEEC before initiating any proceeding or effecting any agreement, commitment, arrangement or consent with respect thereto;
- not amending or agreeing to any material change or modification of our currently pending rate case without consulting and taking good faith consideration of the recommendation of the regulatory approvals committee;
- granting such approvals and taking such actions as are necessary so that the transactions contemplated by the agreement and plan of merger may be consummated as promptly as practicable should any fair price, moratorium, control share acquisition or other similar anti-takeover statute or regulation be or become applicable to the merger;
- no later than the effective time, terminating and not permitting additional investments in our dividend reinvestment and stock purchase plans and our employee savings and investment plan; and
- unless we obtain a valid waiver that the merger will not be deemed an event of default from Chittenden Bank under a promissory note between us and Chittenden Bank, we will before the closing prepay in full any amounts due under the promissory note and not borrow any further funds under the promissory note.

The agreement and plan of merger also contains a number of mutual additional agreements by NNEEC and Green Mountain Power, including agreements relating to:

- cooperating and using commercially reasonable efforts to take, or cause to be taken, all appropriate action to consummate the merger and associated transactions;
- establishing a joint regulatory approvals committee, developing a regulatory approvals plan, and causing ourselves and our subsidiaries to cooperate and use commercially reasonable efforts to effectuate all necessary consents, waivers, approvals, authorizations, orders, decrees, licenses or permit of, or registration or filing with or notification to any governmental entity or other third-party in connection with the merger;

furnishing notice to each other of any material actions, suits, claims or proceedings in connection with the transactions contemplated by the agreement and plan of merger commenced or threatened or the occurrence or non-occurrence of any fact or event that would cause the representations and warranties in the agreement and plan of merger not to be satisfied; and

cooperating with respect to public statements concerning the transactions contemplated by the agreement and plan of merger.

Additionally, the agreement and plan of merger also contains a number of additional agreements by NNEEC, including agreements relating to:

taking all action necessary to cause Northstars Merger Sub to perform its obligations under the agreement and plan of merger and to consummate the merger on the terms and conditions set forth in the agreement and plan of merger;

Table of Contents

causing the surviving corporation to make annual charitable contributions to the communities we serve consistent with the level of charitable contributions made by us as of the date of the agreement and plan of merger and to otherwise maintain a level of involvement in community activities in the State of Vermont consistent with the level of community involvement and related activities that we carried on as of the date of the agreement and plan of merger;

causing the surviving corporation to act as an owner of the Vermont Electric Power Company, Inc. in accordance with the regulatory orders and other agreements in effect with respect to the Vermont Electric Power Company, Inc. and among the owners of Vermont Electric Power Company, Inc. at the time of the agreement and plan of merger;

not removing any person elected to the board of directors of the surviving corporation who was previously a member of our board of directors, except for cause, until at least the second anniversary of the effective time and until his or her successor is duly qualified and elected;

offering three additional members of our board of directors positions as members of the board of directors of NNEEC or one its subsidiaries;

for a period of one year following the effective time of the merger, agreeing to provide affected employees with compensation (base salary and bonus opportunities but excluding equity based compensation) and benefits that are substantially comparable in the aggregate to the compensation and benefits that are provided to those employees immediately prior to the effective time of the merger;

agreeing to give affected employees full credit for prior service with us for purposes of eligibility, vesting and benefit accrual (but not for purposes of benefit accrual under defined benefit pension plans or qualifying for subsidized early-retirement benefits) under the NNEEC employee benefit plans except to the extent it would result in a duplication of benefits; and

agreeing to honor all employee benefit obligations to our current and former employees under our employee benefit plans existing on the date of the agreement and plan of merger and all employment agreements existing prior to the date of the agreement and plan of merger.

Conditions to the Merger

The parties obligations to complete the merger are subject to the following conditions:

the approval of the merger proposal by the requisite shareholder vote at the special meeting;

no order, judgment, decree, injunction or ruling of a court of competent jurisdiction or any governmental entity shall have been issued preventing the consummation of the merger;

no statute, rule or regulation enacted, promulgated or deemed applicable to the merger by any governmental entity making the merger illegal or preventing its consummation;

the termination or expiration, or obtainment of, any applicable waiting period, filings or approvals required under antitrust or similar laws to consummate the merger; and

obtaining required consents.

NNEEC s and Northstars Merger Sub s obligations to complete the merger are subject to the following conditions:

our performance in all material respects of our covenants and obligations under the agreement and plan of merger required to be performed before the closing date;

that our representations and warranties contained in the agreement and plan of merger that are qualified by reference to company material adverse effect (as such term is defined below under Material Adverse Effect) (with the exception of representations and warranties regarding our capitalization which must be true and correct in all respects) are true and correct as of the date of the agreement and plan of merger and as of the closing date (except to the extent that any such representation and warranty

expressly speaks as of an earlier date, in which case such representation and warranty shall be so true and correct as of such earlier date), except for inaccuracies that, individually or in the aggregate, would not reasonably be expected to have a company material adverse effect;

that required consents shall have been obtained and our currently pending rate case shall have been concluded and such approvals and other actions shall have become final orders;

that the required consents do not contain any conditions, provision, liabilities or terms that would, individually or in the aggregate and together with any adverse effect as compared to the expected outcome, reasonably be expected to

have a company material adverse effect,

materially impair any of the expected benefits of the merger, or

impair, other than in an immaterial manner, the value to NNEEC of any material tax attributes arising out of or related to the merger or the financing of the merger or our operations after the merger;

our receipt of all third-party consents under any material contract;

no threatened, instituted or pending suit, action or proceeding in which a governmental entity of a competent jurisdiction is seeking an order restricting the consummation of the merger;

that we shall not have suffered a company material adverse effect since December 31, 2005; and

that holders of shares representing in excess of 10% of our outstanding shares shall not have exercised rights of dissent under Section 13.02 of the Vermont Business Corporations Act in connection with the merger.

Our obligation to complete the merger is subject to the following conditions:

NNEEC and Northstars Merger Sub shall have performed in all material respects their covenants and obligations under the agreement and plan of merger required to be performed before the closing date;

the representations and warranties of NNEEC and Northstars Merger Sub shall be true and correct in all material respects, in each case as of the date of the agreement and plan of merger and as of the closing date as though made on and as of such date and time; and

that the required consents from the VPSB shall not contain any term that is directed solely at holders of shares of our common stock and have the effect of reducing the merger price to be received by the shareholders in their capacity as such.

Indemnification and Insurance

NNEEC agrees that the existing rights to indemnification of all of our, and our subsidiaries , present and former directors, officers, employees or agents or individuals who at our, or one of our subsidiaries , request served as a director, officer, member, trustee or fiduciary of another

corporation, partnership, joint venture, trust, pension or other employee benefit plan or enterprise, shall survive the merger for a period of six years and shall not be amended, repealed or otherwise modified.

At or before the effective time, NNEEC will purchase for the surviving corporation a tail policy covering a period of six years after the effective time with respect to acts or omissions before the effective time as provided by our directors and officers liability insurance policies and our fiduciary and employee benefit policies providing, in each case, substantially the same benefits and levels of coverage as our insurance policies in effect at the time of the agreement and plan of merger and covering those persons covered on the date of the agreement and plan of merger by our policies. NNEEC is not required to spend more than $1,500,000 to purchase such insurance coverage, however, if the cost of such coverage exceeds that amount, NNEEC will use its reasonable best efforts to obtain as much comparable insurance as is reasonably available at a cost of not more than $1,500,000.

After the effective time, NNEEC and Northstars Merger Sub, jointly and severally, shall indemnify all of our, and our subsidiaries , present and former directors, officers, employees or agents or individuals who at our, or one of our subsidiaries , request served as a director, officer, member, trustee or fiduciary of another corporation, partnership, joint venture, trust, pension or other employee benefit plan or enterprise to the extent permitted by Vermont law, with respect to all acts and omissions arising out of any such individuals services as our, or our subsidiaries , officers, directors or employees or as trustees or fiduciaries of any plan for our, or our subsidiaries , employees occurring before the effective time, including the execution of, and the transactions contemplated by, the agreement and plan of merger.

No Solicitation of Other Offers

We have agreed, before the merger becoming effective, to certain limitations on our ability to take action with respect to other acquisition proposals. Notwithstanding these limitations, we may respond to certain superior proposals. Under the agreement and plan of merger:

- the term acquisition proposal means any offer or proposal from any person:
  - to acquire, in a single transaction or series of transactions by one or more persons, by merger, share exchange, tender offer, stock acquisition, asset acquisition, consolidation, liquidation, business combination or otherwise:
    - at least 20% of any class of our, or one or more of our subsidiaries , equity securities which in the aggregate constitute 20% or more of our, and/or our subsidiaries , net revenues, net income or assets taken as a whole, or
    - our, and/or one or more of our subsidiaries , assets which in the aggregate account for 20% or more of our, and our subsidiaries , net revenues, net income or assets taken as a whole, or
  - contemplating a merger, share exchange, tender offer, stock acquisition, consolidation, business combination or other transaction involving us following which our shareholders immediately before such transaction cease to constitute (without regard to any overlapping ownership) at least 80% of the shareholders of the successor issuer (which may be us) other than, in each case, the transactions contemplated by the agreement and plan of merger; and
- the term superior proposal means any acquisition proposal (substituting for the purposes of the definition of superior proposal 80% for each instance of 20% and 20% for each instance of 80% in the definition of acquisition proposal) on terms which our board of directors, after consultation with its independent financial advisors, determines in good faith to be more favorable to our shareholders (in their capacity as such) from a financial point of view than the transactions contemplated by the agreement and plan of merger (taking into account all legal and financial aspects of such acquisition proposal and the factors set forth in our amended and restated articles of incorporation) and as a result of which our board of directors determines, after consultation with its outside legal counsel, that it is reasonably expected that its fiduciary duties require it to recommend that our shareholders approve or accept such acquisition proposal.

We have agreed:

- to cease, cause our subsidiaries to cease, and use our best efforts to cause our officers, directors and employees and direct our representatives, financial advisors, attorneys, accountants, agents, and other representatives to cease any existing activities, discussions or negotiations with any parties conducted before the date of the agreement and plan of merger with respect to any acquisition proposal; and

not to take, cause our subsidiaries not to take, and use our best efforts to cause our officers, directors and employees and direct our representatives, financial advisors, agents and other advisors or representatives not to take any action to solicit or knowingly encourage or facilitate the making or submission of any proposal or offer that constitutes, or would reasonably be expected to lead to, an acquisition proposal or

- to initiate, solicit or encourage, or participate in any discussions or negotiations with, or furnish or disclose any non-public information to, any person in connection with any acquisition proposal or any proposal or offer that would reasonably be expected to lead to any acquisition proposal.

At any time before our shareholders have voted on the approval of the merger proposal at the special meeting, our board of directors may furnish or disclose any information to, and participate in discussions or negotiations with, any person that makes an acquisition proposal that is unsolicited or that did not otherwise result in a violation of the restrictions set forth in the immediately preceding bullet points if:

- the board of directors receives an executed confidentiality agreement from the person requesting such information;
- reasonably determines in good faith, after consultation with its independent financial advisors and outside legal counsel, that failure to take such action, in light of the acquisition proposal, would be a violation of its fiduciary duties; and
- in the case of our participation in discussions or negotiations:
  - such acquisition proposal would reasonably be expected to result in a superior proposal, and
  - we shall have provided prompt notice to NNEEC of our intent to take such action, the identity of the person making the acquisition proposal and the material terms and conditions of the acquisition proposal.

The agreement and plan of merger provides that neither our board of directors nor any committee thereof shall adopt or recommend or propose to adopt or recommend any acquisition proposal.

Notwithstanding the foregoing, our board of directors may recommend to our shareholders an acquisition proposal or withdraw, change, modify, qualify or amend its recommendation to the shareholders regarding the agreement and plan of merger in a manner adverse to NNEEC and, simultaneously with the termination of the agreement and plan of merger, enter into a contract to consummate a transaction constituting a superior proposal if the board of directors has received an acquisition proposal that it determines in good faith, after consultation with its outside legal counsel and independent financial advisors, is a superior proposal and we notify NNEEC in writing of the terms of the superior proposal and our intent to take such action, and has taken into account any revised proposal made by NNEEC within five business days after delivery to NNEEC of such notice and again has determined in good faith, after consultation with its outside legal counsel and independent financial advisors, that such acquisition proposal remains a superior proposal.

Termination of the Agreement and Plan of Merger

The parties can terminate the agreement and plan of merger under certain circumstances, including:

- by mutual consent of NNEEC and Green Mountain Power;
- by either NNEEC or us, if:
  - any court or other governmental entity shall have issued, enacted, entered, promulgated or enforced any order restricting the consummation of the merger and such order shall have become a final order;

the effective time shall not have occurred on or before the termination date, provided that the termination date may be extended by NNEEC or us until December 21, 2007, if the required consents have not been obtained, but all other conditions to the closing have been satisfied or are capable of being satisfied, provided further that, the right to terminate the agreement and plan of merger pursuant to this bullet point is not available to any party whose material breach of any covenant, agreement or obligation under the agreement or plan of merger is the cause of, or results in, the failure of the agreement and plan of merger to be consummated by the termination date without regard to any extension; or

the requisite vote on the merger proposal is not obtained at a duly held special meeting or at any adjournment or postponement thereof;

by us if:

any of the representations and warranties of NNEEC and Northstars Merger Sub contained in the agreement and plan of merger fails to be true and correct in a manner that would result in the failure of the conditions pertaining to NNEEC s and Northstars Merger Sub s representations and warranties;

there is a breach by NNEEC or Northstars Merger Sub of any covenant or agreement of NNEEC or Northstars Merger Sub that would result in the failure of the conditions pertaining to NNEEC s or Northstars Merger Sub s covenants and obligations under the agreement and plan of merger; or

we enter into an acquisition agreement, merger agreement or other agreement to consummate a transaction that constitutes a superior proposal before the time that our shareholders vote on whether to approve the agreement and plan of merger and we simultaneously pay any fees due under the agreement and plan of merger;

by NNEEC if:

any of our representations and warranties shall fail to be true and correct in a manner that would result in the failure of the closing condition relating to our representations and warranties;

we materially breach any covenant or agreement;

our board of directors withdraws, changes, modifies or qualifies or amends in a manner adverse to NNEEC its approval, adoption or recommendation of the merger or the agreement and plan of merger, or our board of directors recommends an acquisition proposal;

the special meeting does not occur by the fifth business day before the termination date, or December 21, 2007 if the termination date is extended;

we willfully breach the non-solicitation provisions in any material respect; or

we or our subsidiaries suffer a company material adverse effect after December 31, 2005.

Termination Fees

We will pay an initial termination fee of $3,500,000 to NNEEC upon termination of the agreement and plan of merger in the event that:

an acquisition proposal has been made or proposed and thereafter the agreement and plan of merger is terminated by:

- either NNEEC or us for failure to receive the required shareholder vote; or

- NNEEC in the event our board of directors changes its recommendation in a manner adverse to NNEEC or recommends another acquisition proposal;

- the agreement and plan of merger is terminated by NNEEC in the event we willfully breach the agreement and plan of merger s non-solicitation provisions; or

- the agreement and plan of merger is terminated by us because we accept a superior proposal.

The initial termination fee is not payable to NNEEC pursuant to the provision described in the first bullet above unless and until within 18 months of such termination we enter into an acquisition agreement, merger agreement or other agreement (other than a confidentiality or standstill agreement) with respect to, or consummate or adopt or recommend to our shareholders or otherwise not oppose, an acquisition proposal and, in the case of the clause noted in the first sub-bullet under the first bullet above, such acquisition proposal is from the same party that made an acquisition proposal prior to the termination of the agreement and plan of merger. We will pay an additional fee of $3,500,000 to NNEEC prior to the consummation of a transaction resulting from

an acquisition proposal if such transaction is consummated within 24 months after the payment of the initial termination fee, provided in the case of the clause noted in the first sub-bullet under the first bullet above, such acquisition proposal is from the same party that made an acquisition proposal prior to the termination of the agreement and plan of merger.

Amendment, Modification, Extension and Waiver

The agreement and plan of merger may be amended by us, NNEEC, and Northstars Merger Sub at any time before or after any approval of the agreement by our shareholders. The agreement and plan of merger may not be amended except by a written instrument executed by all parties.

Subject to the express limitations contained in the agreement and plan of merger, we, NNEEC and Northstars Merger Sub may, before the effective time,

- extend the time for the performance of any obligations or other acts of the other parties,
- waive any inaccuracies in the representations and warranties contained in the agreement and plan of merger by any other applicable party or in any document, certificate or writing delivered pursuant to the agreement and plan of merger by any other applicable party, or
- waive compliance with any of the agreements or conditions contained in the agreement and plan of merger.

Material Adverse Effect

The representations and warranties in the agreement and plan of merger are qualified by reference to whether the item in question is reasonably likely to have a company material adverse effect on us or a parent material adverse effect on NNEEC. The agreement and plan of merger defines:

- company material adverse effect as any change or effect having a material adverse effect on the results of our, and our subsidiaries, taken as a whole, operations, business, assets, liabilities, regulatory position or condition (financial or otherwise) for this purpose as if the rates and other requests included as of the date of the agreement and plan of merger in our currently pending rate case had been granted at least at the level of the expected outcome, provided that any change in the market price or trading volume of our shares of common stock, in generally accepted accounting principles or the interpretation thereof after the date of the agreement and plan of merger or in general economic or capital markets conditions shall not themselves be deemed to constitute a company material adverse effect or be considered in determining whether a company material adverse effect has occurred; and
- parent material adverse effect as any change or effect having a material adverse effect on the ability of NNEEC and/or Northstars Merger Sub to perform their respective obligations under the agreement and plan of merger or to consummate the transactions contemplated by the agreement and plan of merger.

Gaz Métro Agreement

In connection with the execution of the agreement and plan of merger, Gaz Métro, the parent entity of NNEEC, entered into an agreement whereby Gaz Métro agreed to cause NNEEC to timely perform all of its obligations under the agreement and plan of merger.

Amendment to Rights Agreement

Also in connection with the agreement and plan of merger, on June 21, 2006, we executed an amendment to our rights agreement, dated as of June 17, 1998, between us and Mellon Investor Services LLC (formerly known as ChaseMellon Shareholder Services, L.L.C.), as rights agent. The amendment provided that the execution of, and the consummation of the transactions contemplated by, the agreement and plan of merger shall not cause (i) NNEEC, its affiliates or its associates to be deemed an acquiring person or (ii) a distribution date, shares acquisition date or

triggering event to be deemed to have occurred.

Table of Contents

MARKET PRICE AND DIVIDEND DATA

Our common stock is quoted on the New York Stock Exchange under the symbol GMP. As of the close of business on September 18, 2006, the latest practicable trading day before the printing of this proxy statement, there were approximately 4,447 shareholders of record of our common stock. The following table sets forth the high and low bid quotations of our common stock for the period indicated as reported on the New York Stock Exchange and the dividend declared per share during such period:

Quarter Ended	High	Low	Dividend
2004			
First Quarter	$ 26.29	$	

17

Table of Contents

DISTRIBUTIONS AND PRICE RANGE OF COMMON SHARES

The Series A Convertible Preferred Units rank senior to all common limited partnership units in our operating partnership, including our general partner units, and all common shares. Distributions on the Series A Convertible Preferred Units accrue at a rate of 10.5% of the original issue price. Because we derive our revenue from distributions from our operating partnership, the distribution rights of the common shares are effectively subordinate to the distribution rights of the Series A Convertible Preferred Units. See CNL Strategic Alliance.

The hotel business is seasonal in nature and, therefore, revenues from the hotels in the first and fourth quarters are traditionally lower than those in the second and third quarters and our lease revenue may be lower in these quarters. We expect to use excess cash flow from the second and third quarters to fund distribution shortfalls in the first and fourth quarters. We cannot assure you that we will be able to continue to make quarterly distributions at the current rate.

Our common shares trade on the American Stock Exchange under the symbol HT. As of March 26, 2004, there were 13,571,665 common shares outstanding held by approximately 150 persons of record and 2,000 beneficial owners. The following table sets forth the high and low sale prices of our common shares as reported by the American Stock Exchange and dividends declared on our

common shares for each of the quarters indicated.

	Price Range		Cash Dividend
	High	Low	Per Share
Year ended December 31, 2004			
First quarter (through March 18, 2004)	$ 11.75	$ 9.90	$ 0.18*
Year ended December 31, 2003			
Fourth quarter	$ 10.10	$ 8.41	$ 0.18
Third quarter	$ 9.10	$ 7.93	$ 0.18
Second quarter	$ 8.25	$ 6.54	$ 0.18
First quarter	$ 7.30	$ 6.31	$ 0.18
Year ended December 31, 2002			
Fourth quarter	$ 6.99	$ 5.40	$ 0.18
Third quarter	$ 6.55	$ 5.75	$ 0.18
Second quarter	$ 6.70	$ 6.00	$ 0.18
First quarter	$ 6.70	$ 5.51	$ 0.18
Year ended December 31, 2001			
Fourth quarter	$ 6.25	$ 5.10	$ 0.18
Third quarter	$ 6.90	$ 4.25	$ 0.18
Second quarter	$ 6.09	$ 4.80	$ 0.18
First quarter	$ 6.13	$ 5.50	$ 0.18

* Payable on April 16, 20034 to holders of record on March 31, 2004.

Table of Contents

Description of shares of beneficial interest

The following summary of the terms of our shares of beneficial interest does not purport to be complete and is subject to and qualified in its entirety by reference to our Declaration of Trust and Bylaws, copies of which are exhibits to the Registration Statement of which this Prospectus is a part. See Where You Can Find More Information.

General

Our Declaration of Trust provides that we may issue up to 50,000,000 Class A common shares of beneficial interest, $0.01 par value per share, 50,000,000 Class B common shares of beneficial interest, $0.01 par value per share, and 10,000,000 preferred shares of beneficial interest, $0.01 par value per share. As of March 18, 2004, 13,571,665 Class A common shares were issued and outstanding and no Class B common or preferred shares were issued and outstanding. Effective as of January 26, 2004, the Class B common shares were automatically converted into Class A common shares, any differences between the Class A common shares and Class B common shares disappeared and we now have only one class of common shares. As permitted by the Maryland REIT Law, our Declaration of Trust contains a

provision permitting our Board of Trustees, without any action by our shareholders, to amend the Declaration of Trust to increase or decrease the aggregate number of shares of beneficial interest or the number of shares of any class of shares of beneficial interest that we have authority to issue.

Our Declaration of Trust provides that none of our shareholders is personally liable for any of our obligations solely as a result of his status as a shareholder. Our Bylaws further provide that we shall indemnify each shareholder against any claim or liability to which the shareholder, subject to certain limitations, may become subject by reason of his being or having been a shareholder or former shareholder and that we shall pay or reimburse each shareholder or former shareholder for all legal and other expenses reasonably incurred by him in connection with any claim or liability.

Common Shares

As a holders of common shares, you will receive distributions, or dividends, on the shares you own if the Board of Trustees authorizes a dividend out of our legally available assets. Your right to receive those dividends may be affected, however, by the preferential rights of any other class or series of shares of beneficial interest and the provisions of our declaration of trust regarding restrictions on the transfer of shares of beneficial interest. For example, you may not receive dividends if no funds are available for distribution after we pay dividends to holders of preferred shares. You will also be entitled to receive dividends based on our assets available for distribution to common shareholders if we liquidate,

dissolve or wind-up our operations. The amount you, as a shareholder, would receive in the distribution would be determined by the amount of your beneficial ownership of us in comparison with other beneficial owners. Assets will be available for distribution to shareholders only after we have paid all of our known debts and liabilities and paid the holders of any preferred shares we may issue which are outstanding at that time.

Subject to the preferential rights of the Series A Preferred Shares or of any other shares or series of beneficial interest and to the provisions of our Declaration of Trust regarding the restriction on the transfer of shares of beneficial interest, holders of common shares are entitled to receive dividends on shares if, when and as authorized and declared by our Board of Trustees out of assets legally available therefor and to share ratably in our assets legally available for distribution to our shareholders in the event of our liquidation, dissolution or winding-up after payment of, or adequate provision for, all of our known debts and liabilities.

Table of Contents

DESCRIPTION OF SHARES OF BENEFICIAL INTEREST

Holders of common shares have no preference, sinking fund, redemption or appraisal rights and have no preemptive rights to subscribe for any of our securities. Subject to the provisions of our Declaration of Trust regarding the restriction on transfer of shares of beneficial interest, the common shares have equal voting, dividend, distribution, liquidation and other rights.

Voting Rights of Common Shares

Subject to the provisions of the Declaration of Trust regarding the restriction of the transfer of shares of beneficial interest, each outstanding common share entitles the holder to one vote on all matters submitted to a vote of shareholders, including the election of trustees. There is no cumulative voting in the election of trustees, which means that the holders of a majority of the outstanding common shares, voting as a single class, can elect all of the trustees then standing for election and the holders of the remaining shares are not able to elect any trustees.

Under the Maryland REIT Law, a Maryland REIT generally cannot amend its declaration of trust or merge unless approved by the affirmative vote of shareholders holding at least two-thirds of the shares entitled to vote on the matter unless a lesser percentage (but not less than a majority of all the votes entitled to be cast on the matter) is set forth in the REIT s

declaration of trust subject to the terms of any other class or series of shares of beneficial interest. Our Declaration of Trust provides for approval by a majority of all the votes entitled to be cast on the matter in all situations permitting or requiring action by the shareholders except with respect to: (a) our intentional disqualification as a REIT or revocation of our election to be taxed as a REIT (which requires the affirmative vote of two-thirds of the number of common shares entitled to vote on such matter at a meeting of our shareholders); (b) the election of trustees (which requires a plurality of all the votes cast at a meeting of our shareholders at which a quorum is present); (c) the removal of trustees (which requires the affirmative vote of the holders of two-thirds of our outstanding voting shares); (d) the amendment or repeal of certain designated sections of the Declaration of Trust (which require the affirmative vote of two-thirds of the outstanding shares entitled to vote on such matters); (e) the amendment of the Declaration of Trust by shareholders (which requires the affirmative vote of a majority of votes entitled to be cast on the matter, except under certain circumstances specified in the Declaration of Trust that require the affirmative vote of two-thirds of all the votes entitled to be cast on the matter); and (f) our termination (which requires the affirmative vote of two-thirds of all the votes entitled to be cast on the matter). Under the Maryland REIT Law, a declaration of trust may permit the trustees by a two-thirds vote to amend the declaration of trust from time to time to qualify as a REIT under the Code or the Maryland REIT Law without the affirmative vote or written consent of the shareholders. Our Declaration of Trust permits such action by a majority vote of the trustees. As permitted by the Maryland REIT Law, our Declaration of Trust contains a provision permitting our trustees, without any action by our

shareholders, to amend the Declaration of Trust to increase or decrease the aggregate number of shares of beneficial interest or the number of shares of any class of shares of beneficial interest that we have authority to issue.

Preferred Shares

The Declaration of Trust authorizes our Board of Trustees to classify any unissued preferred shares and to reclassify any previously classified but unissued preferred shares of any series from time to time in one or more series, as authorized by the Board of Trustees. Prior to issuance of shares of each series, the Board of Trustees is required by the Maryland REIT Law and our Declaration of Trust to set for each such series, subject to the provisions of our Declaration of Trust regarding the restriction on transfer of shares of beneficial interest, the terms, the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of

---

DESCRIPTION OF SHARES OF BENEFICIAL INTEREST

redemption for each such series. Thus, our Board of Trustees could authorize the issuance of preferred shares with terms and conditions which could have the effect of delaying, deferring or preventing a transaction or a change in control in us that might involve a premium price for holders of common shares or otherwise be in their best interest.

The Series A Preferred Shares

On April 21, 2003, in connection with the CNL transaction, our Board of Trustees classified and designated 350,000 preferred shares of beneficial interest as Series A Preferred Shares of beneficial interest, par value $.01 per share. The Series A Convertible Preferred Units held by CNL in our operating partnership are exchangeable for our Series A Preferred Shares on a one for one basis. As of the date hereof, no preferred shares are outstanding. The Series A Preferred Shares are senior to the common shares as to payment of dividends, distributions of assets upon liquidation, dissolution or winding-up, whether voluntary or involuntary, or otherwise.

The terms of the Series A Preferred Shares are described in more detail under the heading CNL Strategic Alliance Investment in Series A Convertible Preferred Units of Our Operating Partnership.

Classification or Reclassification of Common Shares or Preferred Shares

Our Declaration of Trust authorizes the Board of Trustees to classify or reclassify any unissued common shares or preferred shares into one or more classes or series of shares of beneficial interest by setting or changing the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or distributions, qualifications or terms or conditions of redemption of such new class or series of shares of beneficial interest.

Restrictions on Ownership and Transfer

Our Declaration of Trust, subject to certain exceptions described below, provides that no person may own, or be deemed to own by virtue of the attribution provisions of the Code, more than 9.9% of (i) the number of outstanding common shares of any class or series of common shares or (ii) the number of outstanding preferred shares of any class or series of preferred shares. For this purpose, a person includes a group and a beneficial owner as those terms are used for purposes of Section 13(d)(3) of the Exchange Act. Any transfer of common or preferred shares that would (i) result in any person owning, directly or indirectly, common or preferred shares in excess of the ownership limitation, (ii) result in the common and preferred shares being owned by fewer than 100 persons (determined without reference to any rules of attribution), (iii) result in us being closely held within the meaning of Section 856(h) of the Code, or (iv) cause us to own, actually or constructively, 10% or more of the ownership interests in a tenant of

our or our partnership s real property, within the meaning of Section 856(d)(2)(B) of the Code, will be null and void, and the intended transferee will acquire no rights in such common or preferred shares.

Subject to certain exceptions described below, any common shares or preferred shares the purported transfer of which would (i) result in any person owning, directly or indirectly, common shares or preferred shares in excess of the ownership limitation, (ii) result in the common shares and preferred shares being owned by fewer than 100 persons (determined without reference to any rules of attribution), (iii) result in our being closely held within the meaning of Section 856(h) of the Code, or (iv) cause us to own, actually or constructively, 10% or more of the ownership interests in a tenant of our or our partnership s real property, within the meaning of Section 856(d)(2)(B) of the Code, will be designated as

Table of Contents

DESCRIPTION OF SHARES OF BENEFICIAL INTEREST

shares-in-trust and transferred automatically to a trust effective on the day before the purported transfer of such common shares or preferred shares. The record holder of the common or preferred shares that are designated as shares-in-trust will be required to submit such number of common shares or preferred shares to us for registration in the name of the trust. The trustee will be designated by us, but will not be affiliated with us. The beneficiary of a trust will be one or more charitable organizations that are named by us.

Shares-in-trust will remain issued and outstanding common shares or preferred shares and will be entitled to the same rights and privileges as all other shares of the same class or series. The trust will receive all dividends and distributions on the shares-in-trust and will hold such dividends or distributions in trust for the benefit of the beneficiary. The trust will vote all shares-in-trust. The trust will designate a permitted transferee of the shares-in-trust, provided that the permitted transferee (i) purchases such shares-in-trust for valuable consideration and (ii) acquires such shares-in-trust without such acquisition resulting in a transfer to another trust.

The prohibited owner with respect to shares-in-trust will be required to repay to the record holder the amount of any dividends or distributions received by the prohibited owner (i) that are attributable to any shares-in-trust and (ii) the record date of which

was on or after the date that such shares became shares-in-trust. The prohibited owner generally will receive from the record holder the lesser of (i) the price per share such prohibited owner paid for the common shares or preferred shares that were designated as shares-in-trust (or, in the case of a gift or devise, the market price (as defined below) per share on the date of such transfer) or (ii) the price per share received by the record holder from the sale of such shares- in-trust. Any amounts received by the record holder in excess of the amounts to be paid to the prohibited owner will be distributed to the beneficiary.

The shares-in-trust will be deemed to have been offered for sale to us, or its designee, at a price per share equal to the lesser of (i) the price per share in the transaction that created such shares-in-trust (or, in the case of a gift or devise, the market price per share on the date of such transfer) or (ii) the market price per share on the date that we, or our designee, accepts such offer. We will have the right to accept such offer for a period of 90 days after the later of (i) the date of the purported transfer which resulted in such shares-in-trust or (ii) the date we determine in good faith that a transfer resulting in such shares-in-trust occurred.

Market price on any date shall mean the average of the last quoted sale price as reported by the American Stock Exchange for the five consecutive trading days (as defined below) ending on such date.

Any person who acquires or attempts to acquire common or preferred shares in violation of the foregoing restrictions, or any person who owned common or preferred shares that were

transferred to a trust, will be required (i) to give immediately written notice to us of such event and (ii) to provide to us such other information as we may request in order to determine the effect, if any, of such transfer on our status as a REIT.

All persons who own, directly or indirectly, more than 5% (or such lower percentages as required pursuant to regulations under the Code) of the outstanding common and preferred shares must, within 30 days after December 31 of each year, provide to us a written statement or affidavit stating the name and address of such direct or indirect owner, the number of common and preferred shares owned directly or indirectly, and a description of how such shares are held. In addition, each direct or indirect shareholder shall provide to us such additional information as we may request in order to determine the effect, if any, of such ownership on our status as a REIT and to ensure compliance with the ownership limitation.

22

Table of Contents

DESCRIPTION OF SHARES OF BENEFICIAL INTEREST

The ownership limitation generally does not apply to the acquisition of common or preferred shares by an underwriter that participates in a public offering of such shares. In addition, the trustees, upon receipt of advice of counsel or other evidence satisfactory to the trustees, in their sole and absolute discretion, may, in their sole and absolute discretion, exempt a person from the ownership limitation under certain circumstances. The foregoing restrictions continue to apply until (i) the trustees determine that it is no longer in our best interests to attempt to qualify, or to continue to qualify, as a REIT and (ii) there is an affirmative vote of two-thirds of the number of common and preferred shares entitled to vote on such matter at a regular or special meeting of our shareholders.

We granted limited waivers of these ownership limitations as follows:

- a limited waiver to CNL allows CNL to own 100% of the outstanding Series A Preferred Shares and up to 60% of the outstanding common shares on a fully diluted basis, subject to CNL s compliance with certain representations and warranties (see CNL Strategic Alliance);
- a limited waiver to RREEF America L.L.C., Deutche Asset Management, Inc., and their related mutual funds and accounts, specifically including Scudder RREEF Real Estate Fund Inc., Scudder RREEF

Real Estate Fund II Inc. and Scudder RREEF Securities Trust (collectively, the Scudder RREEF Group) to own 15% of the outstanding common shares, subject to their compliance with certain representations and warranties, including that no single person will own more than 9.9% of the outstanding common shares; and

Ø a limited waiver to K.G. Redding & Associates, and its managed accounts to own 15% of the outstanding common shares, subject to their compliance with certain representations and warranties including that no single person will own more than 9.9% of the outstanding common shares.

All certificates representing common or preferred shares bear a legend referring to the restrictions described above.

This ownership limitation could have the effect of delaying, deferring or preventing a change in control or other transaction in which holders of some, or a majority, of shares of common shares might receive a premium for their shares of common shares over the then prevailing market price or which such holders might believe to be otherwise in their best interest.

Other Matters

Our transfer agent and registrar for our common shares is Wachovia Securities, N.A., Charlotte, North Carolina.

23

Table of Contents

Certain provisions of Maryland law and of our declaration of trust and bylaws

Classification of the Board of Trustees

Our Bylaws provide that the number of our trustees may be established by the Board of Trustees but may not be fewer than three nor more than nine. As of August 31, 2003, we have seven trustees. The trustees may increase or decrease the number of trustees by a vote of at least 80% of the members of the Board of Trustees, provided that the number of trustees shall never be less than the number required by Maryland law and that the tenure of office of a trustee shall not be affected by any decrease in the number of trustees. Any vacancy will be filled, including a vacancy created by an increase in the number of trustees, at any regular meeting or at any special meeting called for that purpose, by a majority of the remaining trustees or, if no trustees remain, by a majority of our shareholders.

Pursuant to our Declaration of Trust, the Board of Trustees is divided into two classes of trustees. Trustees of each class are chosen for two-year terms and each year one class of trustees will be elected by the shareholders. We believe that classification of the

Board of Trustees helps to assure the continuity and stability of our business strategies and policies as determined by the trustees. Holders of common shares have no right to cumulative voting in the election of trustees. Consequently, at each annual meeting of shareholders, the holders of a majority of the common shares are able to elect all of the successors of the class of trustees whose terms expire at that meeting.

The classified board provision could have the effect of making the replacement of incumbent trustees more time consuming and difficult. The staggered terms of trustees may delay, defer or prevent a tender offer or an attempt to change control in us or other transaction that might involve a premium price for holders of common shares that might be in the best interest of the shareholders.

Removal of Trustees

The Declaration of Trust provides that a trustee may be removed with or without cause upon the affirmative vote of at least two-thirds of the votes entitled to be cast in the election of trustees. This provision, when coupled with the provision in the Bylaws authorizing the Board of Trustees to fill vacant trusteeships, precludes shareholders from removing incumbent trustees, except upon a substantial affirmative vote, and filling the vacancies created by such removal with their own nominees.

Business Combinations

Under Maryland law, certain business combinations between us and any person who beneficially owns, directly or indirectly, 10% or more of the voting power of our shares, an affiliate of ours who, at any time within the previous two years was the beneficial owner of 10% or more of the voting power of our shares (who the statute terms an interested shareholder), or an affiliate of an interested shareholder, are prohibited for five years after the most recent date on which they became interested shareholders. The business combinations that are subject to this law include mergers, consolidations, share exchanges or, in certain circumstances, asset transfers or issuances or reclassifications of equity securities. After the five-year period has elapsed, a proposed business combination must be recommended by the Board of Trustees and approved by the affirmative vote of at least:

- 80% of our outstanding voting shares; and
- two-thirds of the outstanding voting shares, excluding shares held by the interested shareholder,

---

Table of Contents

CERTAIN PROVISIONS OF MARYLAND LAW AND OF OUR DECLARATION OF TRUST AND BYLAWS

unless, among other conditions, the shareholders receive a fair price, as defined by Maryland law, for their shares and the consideration is received in cash or in the same form as previously paid by the interested shareholder for its shares.

These provisions do not apply, however, to business combinations that the Board of Trustees approves or exempts before the time that the interested shareholder becomes an interested shareholder.

Pursuant to a resolution of our Board of Trustees, CNL s ownership of our securities are exempt from the Maryland Business Combination Statute.

Control Share Acquisitions

Maryland law provides that control shares acquired in a control share acquisition have no voting rights unless approved by a vote of two-thirds of our outstanding voting shares, excluding shares owned by the acquiror or by officers or directors who are employees of ours. Control shares are voting shares which, if aggregated with all other shares previously acquired by the acquiring person, or in respect of which the acquiring person is able to exercise or direct the exercise of voting power, other than by revocable proxy, would entitle the

acquiring person to exercise voting power in electing trustees within one of the following ranges of voting power:

- one-tenth or more but less than one-third;
- one-third or more but less than a majority; or
- a majority of all voting power.

Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained shareholder approval. A control share acquisition means the acquisition of control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition, upon satisfaction of certain conditions, including an undertaking to pay expenses, may compel our Board of Trustees to call a special meeting of shareholders to be held within 50 days of demand to consider the voting rights of the shares. If no request for a meeting is made, we may present the question at any shareholders meeting.

If voting rights are not approved at the shareholders meeting or if the acquiring person does not deliver the statement required by Maryland law, then, subject to certain conditions and limitations, we may redeem any or all of the control shares, except those for which voting rights have previously been approved, for fair value. Fair value is determined without regard to the absence of voting rights for the control shares and as of the date of the last control share acquisition or of any meeting of shareholders at which

the voting rights of the shares were considered and not approved. If voting rights for control shares are approved at a shareholders meeting, and as a result thereof the acquiror may then vote a majority of the shares entitled to vote, all other shareholders may exercise appraisal rights. The fair value of the shares for purposes of these appraisal rights may not be less than the highest price per share paid by the acquiror in the control share acquisition. The control share acquisition statute does not apply to shares acquired in a merger, consolidation or share exchange if we are a party to the transaction, nor does it apply to acquisitions approved or exempted by our Declaration of Trust or Bylaws.

Our Bylaws contain a provision exempting from the control share acquisition act any and all acquisitions by any person of our shares. There can be no assurance that this provision will not be amended or eliminated at any time in the future.

Table of Contents

CERTAIN PROVISIONS OF MARYLAND LAW AND OF OUR DECLARATION OF TRUST AND BYLAWS

Amendment

Our Declaration of Trust provides that it may be amended with the approval of at least a majority of all of the votes entitled to be cast on the matter, but that certain provisions of the Declaration of Trust regarding (i) our Board of Trustees, including the provisions regarding independent trustee requirements, (ii) the restrictions on transfer of the common shares and the preferred shares, (iii) amendments to the Declaration of Trust by the trustees and our shareholders and (iv) our termination may not be amended, altered, changed or repealed without the approval of two-thirds of all of the votes entitled to be cast on these matters. In addition, the Declaration of Trust provides that it may be amended by the Board of Trustees, without shareholder approval to (a) increase or decrease the aggregate number of shares of beneficial interest or the number of shares of any class of beneficial interest that the Trust has authority to issue or (b) qualify as a REIT under the Code or under the Maryland REIT law. Our Bylaws may be amended or altered exclusively by the Board of Trustees.

Limitation of Liability and Indemnification

Our Declaration of Trust limits the liability of our trustees and officers for money damages, except for liability resulting from:

- actual receipt of an improper benefit or profit in money, property or services; or
- a final judgment based upon a finding of active and deliberate dishonesty by the trustees or others that was material to the cause of action adjudicated.

Our Declaration of Trust authorizes us, to the maximum extent permitted by Maryland law, to indemnify, and to pay or reimburse reasonable expenses to, any of our present or former trustees or officers or any individual who, while a trustee or officer and at our request, serves or has served another entity, employee benefit plan or any other enterprise as a trustee, director, officer, partner or otherwise. The indemnification covers any claim or liability against the person. Our Bylaws and Maryland law require us to indemnify each trustee or officer who has been successful, on the merits or otherwise, in the defense of any proceeding to which he or she is made a party by reason of his or her service to us.

Maryland law permits a Maryland real estate investment trust to indemnify its present and former trustees and officers against liabilities and reasonable expenses actually incurred by them in any proceeding unless:

- the act or omission of the trustee or officer was material to the matter giving rise to the proceeding; and
- was committed in bad faith; or
- was the result of active and deliberate dishonesty; or

Ø in a criminal proceeding, the trustee or officer had reasonable cause to believe that the act or omission was unlawful.

However, a Maryland real estate investment trust may not indemnify for an adverse judgment in a derivative action. Our Bylaws and Maryland law require us, as a condition to advancing expenses in certain circumstances, to obtain:

Ø a written affirmation by the trustee or officer of his or her good faith belief that he or she has met the standard of conduct necessary for indemnification; and

Ø a written undertaking to repay the amount reimbursed if the standard of conduct was not met.

Table of Contents

CERTAIN PROVISIONS OF MARYLAND LAW AND OF OUR DECLARATION OF TRUST AND BYLAWS

Certain Provisions of Maryland Law

Maryland law also provides that Maryland real estate investment trust that are subject to the Exchange Act and have at least three outside trustees can elect by resolution of the Board of Trustees to be subject to some corporate governance provisions that may be inconsistent with the real estate investment trust declaration of trust and bylaws. Under the applicable statute, a board of trustees may classify itself without the vote of shareholders. A board of trustees classified in that manner cannot be altered by amendment to the declaration of trust of the real estate investment trust. Further, the board of trustees may, by electing into applicable statutory provisions and notwithstanding the declaration of trust or bylaws:

- Ø provide that a special meeting of shareholders, will be called only at the request of shareholders, entitled to cast at least a majority of the votes entitled to be cast at the meeting,
- Ø reserve for itself the right to fix the number of trustees,
- Ø provide that a trustee may be removed only by the vote of the holders of two-thirds of the shares entitled to vote, and

- Ø retain for itself sole authority to fill vacancies created by the death, removal or resignation of a trustee.

In addition, a trustee elected to fill a vacancy under this provision will serve for the balance of the unexpired term instead of until the next annual meeting of shareholders. A board of trustees may implement all or any of these provisions without amending the declaration of trust or bylaws and without shareholder approval. A real estate investment trust may be prohibited by its declaration of trust or by resolution of its board of trustees from electing any of the provisions of the statute. We are is not prohibited from implementing any or all of the statute. If implemented, these provisions could discourage offers to acquire the our shares and could increase the difficulty of completing an offer.

Possible Anti-takeover Effect of Certain Provisions of Maryland Law and of our Declaration of Trust and Bylaws

The business combination provisions and, if the applicable exemption in the Bylaws is rescinded, the control share acquisition provisions of the MGCL, the provisions of our Declaration of Trust on classification of the Board of Trustees, the removal of trustees and the restrictions on the transfer of shares of beneficial interest and the advance notice provisions of the Bylaws could have the effect of delaying, deferring or preventing a transaction or a change in the control that might involve a premium price for holders of the common shares or otherwise be in their best interest.

Table of Contents

CNL strategic alliance

The following summary of the terms of the CNL strategic alliance does not purport to be complete and is subject to and qualified in its entirety by reference to the described agreements, which are exhibits to the Registration Statement of which this Prospectus is a part. See Where You Can Find More Information.

In April of 2003, we entered into a strategic alliance with CNL Hospitality Partners, L.P., a subsidiary of CNL Hospitality Properties, Inc. CNL is a public company, which has been one of the most active investors in lodging properties over the past several years. Since its inception in 1996, CNL has invested over $2.2 billion in hotel properties. The strategic alliance positions us as one of CNL s preferred partners for investing in mid-scale hotels. Our agreement with CNL provides that it will invest up to $25 million in our operating partnership and up to $40 million in a newly formed hotel acquisition joint venture. CNL has currently invested $19 million in our operating partnership and $8 million in the joint venture, which acquired its first hotel, the Hampton Inn Chelsea, New York, New York, on August 29, 2003.

Investment in Series A Convertible Preferred Units of Our Operating Partnership

On April 21 and May 21, 2003, CNL purchased a total of 150,000 units of a newly created series of convertible preferred limited partnership units of our operating partnership (the Series A Convertible Preferred Units) in exchange for CNL s payment of $15,000,000 in cash, net of certain transaction costs. CNL purchased an additional 40,266 Series A Convertible Preferred Units on August 29, 2003, for approximately $4 million. CNL may be obligated to purchase up to an additional 59,734 Series A Convertible Preferred Units, also at a per unit price of $100.00.

Dividends

Each Series A Convertible Preferred Unit provides for a quarterly cumulative preferred dividend of 10.5% per annum on the $100 original issue price per share and a liquidation value of $100 per share, plus any accrued but unpaid dividends.

Preemptive Rights

Each Series A Convertible Preferred Unit has preemptive rights during the three-year period after their date of issuance in the event our operating partnership sells additional partnership units, provided that no such approval shall be required in the event of (i) an issuance of common operating partnership units in exchange for a contribution of properties to the operating partnership approved by our Board of Trustees, (b) the issuance of operating partnership units in connection with an approved employee benefit plan, including issuance of partnership units to our company in connection with the issuance of up to 650,000 common shares pursuant to an approved employee

benefit plan, or (c) the issuance of operating partnership units to our company in connection with the issuance of common shares pursuant to a dividend reinvestment plan.

Exchange and Conversion

Each Series A Convertible Preferred Unit is exchangeable or convertible at the option of its holder for either (i) one Series A Preferred Share or (ii) approximately 14.8 common shares or ordinary operating partnership units, based on an initial conversion price of $6.7555 per common share or ordinary operating partnership unit. The initial conversion price represents the volume weighted average closing

price for the common shares for the 20 trading days preceding April 21, 2003. The exchange or conversion price is subject to anti-dilution adjustments upon the occurrence of certain events, including share splits and combinations, reclassifications, reorganizations, mergers, consolidations or asset sales, or the sale of common shares or operating partnership units below 85% of the then effective conversion or exchange price (initially $5.74).

Redemption

Upon a vote of a majority of the members of our Board of Trustees, we may redeem all or any part of the outstanding Series A Convertible Preferred Units for a per Unit redemption price equal to the sum of the original issue price, all accrued but unpaid dividends and a premium which is initially $10.50 per unit and declines annually on a straight line basis over a ten-year period. A Series A Convertible Preferred Unit holder who has received a redemption notice will have the opportunity in lieu of redemption to exchange or convert its Series A Convertible Preferred Units into Series A Preferred Shares, common shares or ordinary operating partnership units.

Voting Rights

The holders of Series A Convertible Preferred Units have the right to vote as a single class

with holders of ordinary operating partnership interests on all matters upon which they are entitled to vote. The holders of operating partnership units are entitled to a number of votes equal to the number of common shares for which their units would then be exchangeable.

Approval Rights

We must obtain the approval of the holders of a majority of the Series A Convertible Preferred Units to effect the following actions:

- any creation, or increase in number of, securities senior to the Series A Convertible Preferred Units;
- the issuance of any class or series of equity interest in our operating partnership prior to the first to occur of (i) the issuance of an aggregate of 250,000 Series A Convertible Preferred Units in accordance with the terms of the CNL strategic alliance or (ii) certain terminating events defined in the agreement pursuant to which CNL purchased its Series A Convertible Preferred Units; provided that no such approval shall be required in the event of (i) an issuance of common operating partnership units in exchange for a contribution of properties to the operating partnership approved by our Board of Trustees, (b) the issuance of operating partnership units in connection with an approved employee benefit plan, including issuance of partnership units to our company in connection with the issuance of up to 650,000 common shares pursuant to an approved employee benefit plan, or (c) the issuance of

operating partnership units to our company in connection with the issuance of common shares pursuant to a dividend reinvestment plan;

- Ø during any period when distributions with respect to the Series A Convertible Preferred Units are in arrears, any purchase, redemption or other acquisition for value (or payment into or setting aside as a sinking fund for such purpose) of any operating partnership units junior to the Series A Convertible Preferred Units;

- Ø during any period when distributions with respect to the Series A Convertible Preferred Units are in arrears, any action that results in the declaration or payment of distributions, direct or indirect on account of any junior units;

Table of Contents

CNL STRATEGIC ALLIANCE

- Ø any action that results in any amendment, alteration, or repeal (by merger or consolidation or otherwise) of any provisions of the amendment to the operating partnership agreement designating the Series A Convertible Preferred Units, any provisions of our Declaration of Trust, as amended, or our By-laws which eliminates, amends or affects any term (adversely or otherwise) of the Series A Preferred Shares and/ or the common shares or shares of any series ranking senior to the Series A Preferred Shares, including, without limitation, the redemption, dividend, voting, preemptive, anti-dilution and other powers, rights and preferences of such shares or adversely affects any holder thereof;
- Ø any action where our company or the operating partnership or any of our or its material subsidiaries files any voluntary, or consents to the filing of any involuntary, petition for relief under title 11 of the United States Code or any successor statute or under any reorganization, arrangement, insolvency, readjustment of debt, dissolution or liquidation law with respect to our company, the operating partnership or any of our or its subsidiaries;
- Ø any action where our company, the operating partnership or any of our material subsidiaries appoints or consents to, or acquiesces in, the appointment of a receiver, conservator, trustee or other similar official charged with the

administration, control, management, operation, liquidation, dissolution or valuation of our company, the operating partnership or any of our or its material subsidiaries, or any of their respective businesses or assets; and

- any agreement to do any of the transactions set forth above.

We are also required to obtain the approval of the holders of a majority of the Series A Convertible Preferred Units to effect the following actions, but only for so long as the holders of Series A Convertible Preferred Units hold in the aggregate that number of Series A Convertible Preferred Units, common shares and any other class or series of our equity that represents, on an as converted or exchanged basis, at least five percent of the common shares then outstanding on a fully diluted basis, assuming the conversion or exchange for common shares of all convertible or exchangeable securities of our company and our operating partnership:

- any action where our company or the operating partnership merges with or into or consolidates with any other entity, but excluding any merger effected exclusively for the purpose of changing the domicile of our company or the operating partnership;

- any action where the operating partnership or any of its subsidiaries directly or indirectly sells, leases, transfers, conveys or assigns (whether in a single transaction or series of related transactions) all or substantially all of its assets, other than transactions involving leases by the operating partnership of its hotel properties in the ordinary

course of its business;

Ø all transactions involving our company or the operating partnership of the type referred in paragraph (a) of Rule 145 under the Securities Act of 1933, as amended, and all transactions involving our company or the operating partnership constituting a change-in-control within the meaning of Rule 14(f) under the Securities Exchange Act of 1934, as amended;

Ø any action where our company, the operating partnership or any of our or its subsidiaries, or HHMLP, on the one hand, engages in any transaction with an affiliate of our company or the operating partnership on the other hand, provided, however, to the extent such transactions are of the type which, but for their affiliated nature, would fall within the ordinary course of business and day-to-day affairs of the operating partnership, such actions need not be approved on a transaction-by-transaction basis but may be entered into pursuant to annual budgets and purchase plans approved by the holders of the Series A Convertible Preferred Units. For purposes of these provisions, affiliate has the meaning set forth in Rule 12b-2 of the Exchange Act and includes, without limitation, (a) the trustees and senior officers of our company, the operating partnership or any of our or its subsidiaries,

---

Table of Contents

CNL STRATEGIC ALLIANCE

his or her spouse, parent, sibling, mother-in-law, father-in-law, brother-in-law, sister-in-law, aunt, uncle, or first cousin, (b) any person directly or indirectly owning, controlling or holding the power to vote 5% or more of the outstanding voting securities of our company, the operating partnership or any of our or its subsidiaries, and (c) any person 5% or more of whose outstanding voting securities are directly or indirectly owned, controlled or held with power to vote by our company, the operating partnership or any of our or its subsidiaries;

- for our company, the operating partnership or any of our or its subsidiaries to engage in any business where either the operation of such business or ownership of the assets related to such business will result in our company failing to satisfy the provisions of Section 856 of the Internal Revenue Code;

- conducting any business activities or the ownership of any asset of our company (other than operating partnership interests) in each case other than through the operating partnership or one or more subsidiary partnerships as contemplated by the operating partnership agreement; and

- admission of a substitute or additional general partner of the operating partnership.

We are not required to obtain the approval of the Series A Convertible Preferred Unit holders regarding any of the foregoing actions if such action provides that

all holders of Series A Convertible Preferred Units shall as a result of and simultaneously with such action receive no less than the liquidation preference plus the applicable premium to which such Units are entitled under the operating partnership agreement.

Series A Preferred Shares

The Series A Preferred Shares, into which the Series A Convertible Preferred Units are exchangeable, entitle the holders thereof to substantially similar rights as those attendant to the Series A Convertible Preferred Units in our operating partnership with respect to dividends, preemptive rights and redemption by us. In addition, holders of the Series A Preferred Shares have substantially similar approval rights as those held by holders of the Series A Convertible Preferred Units.

Each Series A Preferred Share is convertible at the option of its holder into approximately 14.8 common shares, based on an initial conversion price of $6.7555 per common share and subject to anti-dilution adjustments upon the occurrence of certain events, including share splits and combinations, reclassifications, reorganizations, mergers, consolidations or asset sales, or the sale of common shares or limited partnership units below 85% of the then effective conversion price (initially $5.74).

Subject to the terms of the standstill agreement described below, holders of Series A Preferred Shares have the right to vote, on an as converted basis, and as a single class, with holders of our common shares on all matters other than the designation,

election or removal of trustees. The holders of a majority of the outstanding Series A Preferred Shares have the right to nominate an observer to our Board of Trustees. For so long as the holders of Series A Preferred Shares hold at least five percent of the common shares on an as-converted and fully diluted basis, a majority of the Series A Preferred Share holders will have the right, voting as a separate class, to nominate and elect at least one member of our Board of Trustees, and in no event less than 11.1% of the total members of the Board of Trustees, if (i) they receive a favorable ruling from the Internal Revenue Service which permits CNL to continue to qualify as a REIT under certain circumstances, (ii) there is a change in the law providing for relief comparable to that sought from the IRS as described in clause (i) above, (iii) they receive an opinion of counsel consistent with such relief or (iv) there is a transfer of the Series A Convertible Preferred Units whereby the holder of a majority of the Series A Preferred Shares was a transferee of Series A Convertible Preferred Units which were converted into Series A Preferred Shares and could hold such shares without causing such holder to

Table of Contents

CNL STRATEGIC ALLIANCE

violate certain IRS rules relating to qualifying as a REIT. In addition, upon the failure of our company or our operating partnership to pay two consecutive dividends or distributions on the Series A Preferred Shares or the Series A Convertible Preferred Units, or our failure to maintain its status as a REIT, the holders of the Series A Preferred Shares will have the right to nominate and elect 40% of the members of our Board of Trustees.

Excepted Holder Agreement

In connection with the strategic alliance, we and CNL entered into an Excepted Holder Agreement pursuant to which we exempted CNL from compliance with the 9.9% ownership limitation regarding any class or series of our equity securities set forth in our Declaration of Trust. Under the Excepted Holder Agreement, and in compliance with its terms, CNL may own up to 100% of the outstanding Series A Preferred Shares and up to 60% of the outstanding common shares (assuming redemption of the outstanding common limited partnership units for common shares), provided that the 60% ownership limit will rise to 100% if our company or our operating partnership fails to pay in full for two consecutive calendar quarters the dividends or distributions due on the Series A Preferred Shares and Series A Convertible Preferred Units or if we fail to maintain our status as a real estate investment trust.

Standstill Agreement

We have entered into a Standstill Agreement with CNL pursuant to which CNL and its affiliates have agreed not to acquire any additional securities of ours other than as contemplated by the CNL transaction, participate in any solicitation of proxies, call meetings of our shareholders, seek representation on our Board of Trustees or vote its securities in excess of 40% of the total issued and outstanding voting shares. Securities of ours owned by CNL in excess of the 40% limit are voted by proxy in the same manner and proportion as the common shares held by all other holders. The Standstill Agreement provides that it will remain in effect until April 21, 2009 unless terminated earlier by CNL upon:

- the failure by our company or our operating partnership to pay two consecutive quarterly dividends or distributions on the Series A Preferred Shares or the Series A Convertible Preferred Units;
- our failure to maintain our status as a REIT;
- another person acquiring beneficial ownership in excess of 9.9% of our equity shares that are issued and outstanding;
- our Board of Trustees authorizing certain business combinations involving us;
- another person s submission of a proposal to us relating to such business combinations that is not rejected by our Board as not in the best interests of our shareholders;

- Ø in connection with any business combination, our removal of any impediments in our Declaration of Trust or Bylaws to any business combination;

- Ø CNL s ownership of our securities, on a fully diluted basis, decreases to less than 9.9% of the common shares then outstanding, on a fully diluted basis and the termination of the Excepted Holder Agreement or other exception to the ownership limit set forth in our Declaration of Trust applicable to CNL and its affiliates; and

- Ø the material failure by our company or our operating partnership to comply with any of the terms of the Series A Preferred Shares or the Series A Convertible Preferred Units.

Table of Contents

CNL STRATEGIC ALLIANCE

Upon the occurrence of any of the aforementioned events, the 60% ownership limit on CNL s ability to acquire common shares set forth in the Excepted Holder Agreement and the restrictions set forth in the Standstill Agreement on CNL s ability to acquire additional securities of our company will terminate and CNL will be permitted to acquire any amount of additional securities of our company or our operating partnership.

Registration Rights

We have also entered into a Registration Rights Agreement with CNL pursuant to which CNL may, subject to certain cutbacks and restrictions, cause us to register the common shares and Series A Preferred Shares owned by CNL under the Securities Act of 1933, as amended, and under state securities laws of any jurisdiction requested by CNL.

Hotel Acquisition Joint Venture

We have also have formed a joint venture limited partnership with CNL, in which our operating partnership is serving as the sole general partner and in which CNL is the sole limited partner. The joint venture agreement provides that CNL will invest up to $40 million, and HT will invest up to $20 million in the joint venture to acquire hotel real estate assets approved by an investment committee comprised of an equal

number of representatives from Hersha and CNL. The investments in the joint venture will be subject to satisfaction of the conditions to closing set forth in the joint venture agreement.

On August 29, 2003, the joint venture made its first acquisition, the Chelsea Hampton Inn, New York, New York and accepted a $4 million capital contribution from us and an $8 million capital contribution from CNL.

Net cash flow from operations of the joint venture will be distributed: first, to CNL to provide a 10.5% per annum return on its unreturned capital contributions; second, to us to provide an annual administrative fee of .35% of the cost of the joint venture s assets; third, to us to provide a 13% per annum return on our unreturned capital contributions; and thereafter to CNL and us in proportion to our respective capital contributions to the joint venture. Proceeds from a sale of a joint venture property or other capital event for the joint venture will be distributed: first, to CNL to return its capital contributions; second, to us to return our capital contributions; third, to CNL to provide a 10.5% annual return on its unreturned capital contributions; fourth, to us to provide a 13% annual return on our unreturned capital contributions; and thereafter to CNL and us according to our respective capital contributions.

CNL s limited partnership interest in the joint venture generally will be exchangeable, at CNL s option, for common limited partnership units of our operating partnership or common shares, based on an initial exchange price of $6.7555 per share, subject to adjustment.

As part of the joint venture, until April 21, 2004, we must present all of our proposed acquisitions to the investment committee of the joint venture, and we may only acquire such acquisition directly if the investment committee or CNL fails to approve that acquisition for the joint venture.

33

Table of Contents

Federal income tax consequences of our status as a REIT

This section summarizes the federal income tax issues that you, as a shareholder, may consider relevant. Hunton & Williams LLP has acted as our counsel, has reviewed this summary and is of the opinion that the discussion contained herein fairly summarizes the federal income tax consequences that are likely to be material to a holder of common shares. Because this section is a summary, it does not address all of the tax issues that may be important to you. In addition, this section does not address the tax issues that may be important to certain types of our shareholders that are subject to special treatment under the federal income tax laws, such as insurance companies, tax-exempt organizations (except to the extent discussed in Taxation of Tax-Exempt Shareholders below), financial institutions or broker-dealers, and non-U.S. individuals and foreign corporations (except to the extent discussed in Taxation of Non-U.S. Shareholders below).

The statements in this section and the opinion of Hunton & Williams LLP are based on the current federal income tax laws governing qualification as a REIT. We cannot assure you that new laws, interpretations of law or court decisions, any of which may take effect retroactively, will not cause

any statement in this section to be inaccurate.

We urge you to consult your own tax advisor regarding the specific tax consequences to you of investing in our common shares and of our election to be taxed as a REIT. Specifically, you should consult your own tax advisor regarding the federal, state, local, foreign and other tax consequences of such investment and election, and regarding potential changes in applicable tax laws.

Taxation of Our Company

We elected to be taxed as a REIT under the federal income tax laws beginning with our taxable year ended December 31, 1999. We believe that we have operated in a manner qualifying us as a REIT since our election and intend to continue to so operate. This section discusses the laws governing the federal income tax treatment of a REIT and its shareholders. These laws are highly technical and complex.

In the opinion of Hunton & Williams LLP, we qualified to be taxed as a REIT under the federal income tax laws for our taxable years ended December 31, 2000 through December 31, 2003, and our organization and current and proposed method of operation will enable us to continue to qualify as a REIT for our taxable year ending December 31, 2004 and in the future. You should be aware that the opinion is based on current law and is not binding on the Internal Revenue Service or any court. In addition, the opinion is based on customary assumptions and on our representations as to factual matters, all of which are described in the opinion. Our qualification as

a REIT depends on our ability to meet, on a continuing basis, qualification tests in the federal tax laws. Those qualification tests involve the percentage of income that we earn from specified sources, the percentages of our assets that fall within specified categories, the diversity of our share ownership and the percentage of our earnings that we distribute. Hunton & Williams LLP will not review our compliance with those tests on a continuing basis. Accordingly, no assurance can be given that the actual results of our operation for any particular taxable year will satisfy such requirements. For a discussion of the tax consequences of our failure to qualify as a REIT, see Failure to Qualify.

If we qualify as a REIT, we generally will not be subject to federal income tax on the taxable income that we distribute to our shareholders. The benefit of that tax treatment is that it avoids the double

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

taxation, or taxation at both the corporate and shareholder levels, that generally results from owning shares in a corporation. However, we will be subject to federal tax in the following circumstances:

- Ø We will pay federal income tax on taxable income, including net capital gain, that we do not distribute to shareholders during, or within a specified time period after, the calendar year in which the income is earned.
- Ø We may be subject to the alternative minimum tax on any items of tax preference that we do not distribute or allocate to shareholders.
- Ø We will pay income tax at the highest corporate rate on:
  - Ø net income from the sale or other disposition of property acquired through foreclosure (foreclosure property) that we hold primarily for sale to customers in the ordinary course of business, and
  - Ø other non-qualifying income from foreclosure property.
- Ø We will pay a 100% tax on net income from sales or other dispositions of property, other than foreclosure property, that we hold primarily for sale to customers in the ordinary course of business.

- If we fail to satisfy the 75% gross income test or the 95% gross income test, as described below under Requirements for Qualification Income Tests, and nonetheless continue to qualify as a REIT because we meet other requirements, we will pay a 100% tax on:

  - the gross income attributable to the greater of (1) the amount by which we fail the 75% gross income test, and (2) the amount by which 90% of our gross income exceeds the amount of income qualifying under the 95% gross income test, in each case, multiplied by

  - a fraction intended to reflect our profitability.

- If we fail to distribute during a calendar year at least the sum of:

  - 85% of our REIT ordinary income for the year,

  - 95% of our REIT capital gain net income for the year, and

  - any undistributed taxable income from earlier periods,

  we will pay a 4% nondeductible excise tax on the excess of the required distribution over the amount we actually distributed.

- We may elect to retain and pay income tax on our net long-term capital gain. In that case, a U.S. shareholder would be taxed on its proportionate share of our undistributed long-term capital gain (to the extent that we made a timely designation of such gain to the shareholders) and would

receive a credit or refund for its proportionate share of the tax we paid.

- We will be subject to a 100% excise tax on transactions with a taxable REIT subsidiary that are not conducted on an arm s-length basis.

- If we acquire any asset from a C corporation, or a corporation that generally is subject to full corporate-level tax, in a merger or other transaction in which we acquire a basis in the asset that is determined by reference either to the C corporation s basis in the asset or to another asset, we will pay tax at the highest regular corporate rate applicable if we recognize gain on the sale or disposition of the asset during the 10-year period after we acquire the asset provided no election is made for the

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

transaction to be taxable on a current basis. The amount of gain on which we will pay tax is the lesser of:

- Ø the amount of gain that we recognize at the time of the sale or disposition, and
- Ø the amount of gain that we would have recognized if we had sold the asset at the time we acquired it.

Requirements for Qualification

A REIT is a corporation, trust, or association that meets each of the following requirements:

1. It is managed by one or more trustees or directors.
2. Its beneficial ownership is evidenced by transferable shares, or by transferable certificates of beneficial interest.
3. It would be taxable as a domestic corporation, but for the REIT provisions of the federal income tax laws.
4. It is neither a financial institution nor an insurance company subject to special provisions of the federal income tax laws.

5. At least 100 persons are beneficial owners of its shares or ownership certificates.

6. Not more than 50% in value of its outstanding shares or ownership certificates is owned, directly or indirectly, by five or fewer individuals, which the federal income tax laws define to include certain entities, during the last half of any taxable year.

7. It elects to be a REIT, or has made such election for a previous taxable year, and satisfies all relevant filing and other administrative requirements established by the Internal Revenue Service that must be met to elect and maintain REIT status.

8. It meets certain other qualification tests, described below, regarding the nature of its income and assets and the amount of its distributions to shareholders.

We must meet requirements 1 through 4 during our entire taxable year and must meet requirement 5 during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of less than 12 months. If we comply with all the requirements for ascertaining the ownership of our outstanding shares in a taxable year and have no reason to know that we violated requirement 6, we will be deemed to have satisfied requirement 6 for that taxable year. For purposes of determining share ownership under requirement 6, an individual generally includes a supplemental unemployment compensation benefits plan, a private foundation, or a portion of a trust permanently set aside or used exclusively for charitable purposes. An individual, however, generally does not include a trust that is a qualified employee pension or profit sharing trust under the

federal income tax laws, and beneficiaries of such a trust will be treated as holding our shares in proportion to their actuarial interests in the trust for purposes of requirement 6. We have issued sufficient common shares with sufficient diversity of ownership to satisfy requirements 5 and 6. In addition, our Declaration of Trust restricts the ownership and transfer of our shares of beneficial interest so that we should continue to satisfy these requirements.

A corporation that is a qualified REIT subsidiary (i.e., a corporation that is 100% owned by a REIT with respect to which no TRS election has been made) is not treated as a corporation separate from its parent REIT. All assets, liabilities, and items of income, deduction, and credit of a qualified REIT subsidiary are treated as assets, liabilities, and items of income, deduction, and credit of the REIT. A

36

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

qualified REIT subsidiary is a corporation, all of the capital stock of which is owned by the REIT. Thus, in applying the requirements described herein, any qualified REIT subsidiary that we own will be ignored, and all assets, liabilities, and items of income, deduction, and credit of such subsidiary will be treated as our assets, liabilities, and items of income, deduction, and credit.

An unincorporated domestic entity, such as a limited liability company, that has a single owner, generally is not treated as an entity separate from its parent for federal income tax purposes. An unincorporated domestic entity with two or more owners is generally treated as a partnership for federal income tax purposes. In the case of a REIT that is a partner in a partnership that has other partners, the REIT is treated as owning its proportionate share of the assets of the partnership and as earning its allocable share of the gross income of the partnership for purposes of the applicable REIT qualification tests. Thus, our proportionate share of the assets, liabilities and items of income of our operating partnership and any other partnership, joint venture, or limited liability company that is treated as a partnership for federal income tax purposes in which we have acquired or will acquire an interest, directly or indirectly (a subsidiary partnership), will be treated as our assets and gross income for purposes of applying the various REIT qualification requirements.

A REIT may own up to 100% of the stock of one or more taxable REIT subsidiaries, or TRSs. A TRS is a fully taxable corporation that may earn income that would not be qualifying income if earned directly by the parent REIT. However, a TRS may not directly or indirectly operate or manage any hotels or health care facilities or provide rights to any brand name under which any hotel or health care facility is operated. The subsidiary and the REIT must jointly elect to treat the subsidiary as a TRS. A TRS will pay income tax at regular corporate rates on any income that it earns. In addition, the TRS rules limit the deductibility of interest paid or accrued by a TRS to its parent REIT to assure that the TRS is subject to an appropriate level of corporate taxation. Further, the rules impose a 100% excise tax on transactions between a TRS and its parent REIT or the REIT s tenants that are not conducted on an arm s-length basis. We currently have four TRSs, (i) 44 New England Management Company, which leases four of our hotels, (ii) HHM Leasehold Interests, Inc., which leases 14 of our hotels, (iii) Hersha CNL TRS, Inc., which is owned by our joint venture with CNL and leases the one hotel owned by that joint venture, and (iv) Hersha PRA TRS, Inc., which is owned by our joint venture with PRA Glastonbury, LLC and leases the hotel owned by that joint venture. See Taxable REIT Subsidiaries.

Income Tests

We must satisfy two gross income tests annually to maintain our qualification as a REIT. First, at least 75% of our gross income for each taxable year must consist of defined types of income that we derive, directly or indirectly, from investments relating to real property or mortgages on real property or qualified temporary

investment income. Qualifying income for purposes of that 75% gross income test generally includes:

- rents from real property;
- interest on debt secured by mortgages on real property, or on interests in real property;
- dividends or other distributions on, and gain from the sale of, shares in other REITs;
- gain from the sale of real estate assets; and
- income derived from the temporary investment of new capital that is attributable to the issuance of our stock or a public offering of our debt with a maturity date of at least five years and that we receive during the one-year period beginning on the date on which we received such new capital.

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

Second, in general, at least 95% of our gross income for each taxable year must consist of income that is qualifying income for purposes of the 75% gross income test, other types of interest and dividends, gain from the sale or disposition of stock or securities, income from hedging instruments or any combination of these. Gross income from our sale of property that we hold primarily for sale to customers in the ordinary course of business is excluded from both the numerator and the denominator in both income tests. The following paragraphs discuss the specific application of the gross income tests to us.

Rents from Real Property. Rent that we receive from our real property will qualify as rents from real property, which is qualifying income for purposes of the 75% and 95% gross income tests, only if the following conditions are met:

Ø First, the rent must not be based, in whole or in part, on the income or profits of any person, but may be based on a fixed percentage or percentages of receipts or sales.

Ø Second, neither we nor a direct or indirect owner of 10% or more of our shares may own, actually or constructively, 10% or more of a tenant from whom we receive rent other than a TRS. If the tenant is a TRS, such TRS may not directly or indirectly operate or manage the related property. Instead,

the property must be operated on behalf of the TRS by a person who qualifies as an independent contractor and who is, or is related to a person who is, actively engaged in the trade or business of operating lodging facilities for any person unrelated to us and the TRS. See Taxable REIT Subsidiaries.

Ø Third, if the rent attributable to personal property leased in connection with a lease of real property is 15% or less of the total rent received under the lease, then the rent attributable to personal property will qualify as rents from real property. However, if the 15% threshold is exceeded, the rent attributable to personal property will not qualify as rents from real property.

Ø Fourth, we generally must not operate or manage our real property or furnish or render services to our tenants, other than through an independent contractor who is adequately compensated and from whom we do not derive revenue. However, we need not provide services through an independent contractor, but instead may provide services directly to our tenants, if the services are usually or customarily rendered in connection with the rental of space for occupancy only and are not considered to be provided for the tenants convenience. In addition, we may provide a minimal amount of noncustomary services to the tenants of a property, other than through an independent contractor, as long as our income from the services does not exceed 1% of our income from the related property.

Pursuant to percentage leases, our lessees lease the land, buildings, improvements, furnishings and equipment comprising our hotels, for terms of five years, with

options to renew for terms of five years. The percentage leases provide that the lessees are obligated to pay (1) the greater of a minimum base rent or percentage rent and (2) additional charges or other expenses, as defined in the leases. Percentage rent is calculated by multiplying fixed percentages by gross room revenues and gross food and beverage revenues for each of the hotels. Both base rent and the thresholds in the percentage rent formulas are adjusted for inflation. Base rent and percentage rent accrue and are due monthly or quarterly.

In order for the base rent, percentage rent and additional charges to constitute rents from real property, the percentage leases must be respected as true leases for federal income tax purposes and not treated as service contracts, joint ventures or some other type of arrangement. The determination of whether the percentage leases are true leases depends on an analysis of all the surrounding facts and

38

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

circumstances. In making such a determination, courts have considered a variety of factors, including the following:

- the intent of the parties;
- the form of the agreement;
- the degree of control over the property that is retained by the property owner, or whether the lessee has substantial control over the operation of the property or is required simply to use its best efforts to perform its obligations under the agreement; and
- the extent to which the property owner retains the risk of loss with respect to the property, or whether the lessee bears the risk of increases in operating expenses or the risk of damage to the property or the potential for economic gain or appreciation with respect to the property.

In addition, federal income tax law provides that a contract that purports to be a service contract or a partnership agreement will be treated instead as a lease of property if the contract is properly treated as such, taking into account all relevant factors, including whether or not:

- the service recipient is in physical possession of the property;

- the service recipient controls the property;
- the service recipient has a significant economic or possessory interest in the property, or whether the property s use is likely to be dedicated to the service recipient for a substantial portion of the useful life of the property, the recipient shares the risk that the property will decline in value, the recipient shares in any appreciation in the value of the property, the recipient shares in savings in the property s operating costs or the recipient bears the risk of damage to or loss of the property;
- the service provider bears the risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract;
- the service provider uses the property concurrently to provide significant services to entities unrelated to the service recipient; and
- the total contract price substantially exceeds the rental value of the property for the contract period.

Since the determination whether a service contract should be treated as a lease is inherently factual, the presence or absence of any single factor will not be dispositive in every case.

Hunton & Williams LLP is of the opinion that the percentage leases will be treated as true leases for federal income tax purposes. Such opinion is based, in part, on the

following facts:

- we and the lessees intend for our relationship to be that of a lessor and lessee and such relationship is documented by lease agreements;
- the lessees have the right to the exclusive possession, use and quiet enjoyment of the hotels during the term of the percentage leases;
- the lessees bear the cost of, and are responsible for, day-to-day maintenance and repair of the hotels, other than the cost of maintaining underground utilities, structural elements and capital improvements, and generally dictate how the hotels are operated, maintained and improved;
- the lessees bear the costs and expenses of operating the hotels, including the cost of any inventory used in their operation, during the term of the percentage leases, other than real estate and personal property taxes and property and casualty insurance premiums;

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

- the lessees benefit from any savings in the cost of operating the hotels during the term of the percentage leases;
- the lessees generally have indemnified us against all liabilities imposed on us during the term of the percentage leases by reason of (1) injury to persons or damage to property occurring at the hotels, (2) the lessees use, management, maintenance or repair of the hotels, (3) any environmental liability caused by acts or grossly negligent failures to act of the lessees, (4) taxes and assessments in respect of the hotels that are the obligations of the lessees or (5) any breach of the percentage leases or of any sublease of a hotel by the lessees;
- the lessees are obligated to pay substantial fixed rent for the period of use of the hotels;
- the lessees stand to incur substantial losses or reap substantial gains depending on how successfully they operate the hotels;
- we cannot use the hotels concurrently to provide significant services to entities unrelated to the lessees; and
- the total contract price under the percentage leases does not substantially exceed the rental value of the hotels for the term of the percentage leases.

Investors should be aware that there are no controlling Treasury regulations, published rulings or judicial decisions involving leases with terms substantially the same as the percentage leases that discuss whether such leases constitute true leases for federal income tax purposes. If the percentage leases are characterized as service contracts or partnership agreements, rather than as true leases, part or all of the payments that our operating partnership and its subsidiaries receive from the lessees may not be considered rent or may not otherwise satisfy the various requirements for qualification as rents from real property. In that case, we likely would not be able to satisfy either the 75% or 95% gross income test and, as a result, would lose our REIT status unless we qualify for relief, as described below under Failure to Satisfy Gross Income Tests .

As described above, in order for the rent that we receive to constitute rents from real property, several other requirements must be satisfied. One requirement is that the percentage rent must not be based in whole or in part on the income or profits of any person. The percentage rent, however, will qualify as rents from real property if it is based on percentages of receipts or sales and the percentages:

- Ø are fixed at the time the percentage leases are entered into;
- Ø are not renegotiated during the term of the percentage leases in a manner that has the effect of basing percentage rent on income or profits; and
- Ø conform with normal business practice.

More generally, the percentage rent will not qualify as rents from real property if, considering the percentage leases and all the surrounding circumstances, the arrangement does not conform with normal business practice, but is in reality used as a means of basing the percentage rent on income or profits. Since the percentage rent is based on fixed percentages of the gross revenue from the hotels that are established in the percentage leases, and we have represented that the percentages (1) will not be renegotiated during the terms of the percentage leases in a manner that has the effect of basing the percentage rent on income or profits and (2) conform with normal business practice, the percentage rent should not be considered based in whole or in part on the income or profits of any person. Furthermore, we have represented that, with respect to other hotel properties that we acquire in the future, we will not charge rent for any property that is based in whole or in part on the income or profits of any person, except by reason of being based on a fixed percentage of gross revenues, as described above.

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

Second, we must not own, actually or constructively, 10% or more of the stock or the assets or net profits of any lessee (a related party tenant) other than a TRS. The constructive ownership rules generally provide that, if 10% or more in value of our shares is owned, directly or indirectly, by or for any person, we are considered as owning the stock owned, directly or indirectly, by or for such person. We do not own any stock or any assets or net profits of any lessee directly or indirectly, other than indirect ownership of our TRS lessees, 44 New England Management Company, HHM Leasehold Interests, Inc., Hersha CNL TRS, Inc., and Hersha PRA TRS, Inc. In addition, our Declaration of Trust prohibits transfers of our shares that would cause us to own actually or constructively, 10% or more of the ownership interests in a lessee (other than a TRS). Based on the foregoing, we should never own, actually or constructively, 10% or more of any lessee other than a TRS. Furthermore, we have represented that, with respect to other hotel properties that we acquire in the future, we will not rent any property to a related party tenant (other than a TRS). However, because the constructive ownership rules are broad and it is not possible to monitor continually direct and indirect transfers of our shares, no absolute assurance can be given that such transfers or other events of which we have no knowledge will not cause us to own constructively 10% or more of a lessee other than a TRS at some future date.

As described above, we may own up to 100% of the stock of one or

more TRSs. A TRS is a fully taxable corporation that is permitted to lease hotels from the related REIT as long as it does not directly or indirectly operate or manage any hotels or health care facilities or provide rights to any brand name under which any hotel or health care facility is operated. However, rent that we receive from a TRS will qualify as rents from real property as long as the property is operated on behalf of the TRS by an independent contractor who is adequately compensated, who does not, directly or through its stockholders, own more than 35% of our shares, taking into account certain ownership attribution rules, and who is, or is related to a person who is, actively engaged in the trade or business of operating qualified lodging facilities for any person unrelated to us and the TRS lessee (an eligible independent contractor). A qualified lodging facility is a hotel, motel, or other establishment more than one-half of the dwelling units in which are used on a transient basis, unless wagering activities are conducted at or in connection with such facility by any person who is engaged in the business of accepting wagers and who is legally authorized to engage in such business at or in connection with such facility. A qualified lodging facility includes customary amenities and facilities operated as part of, or associated with, the lodging facility as long as such amenities and facilities are customary for other properties of a comparable size and class owned by other unrelated owners. See Taxable REIT Subsidiaries.

We have formed several TRSs to lease our hotels. Our TRSs have engaged an eligible independent contractor, HHMLP, to operate the related hotels on behalf of such TRSs. Furthermore, we have represented that, with respect to properties that we lease to our TRSs in the future, each such TRS will engage an eligible

independent contractor to manage and operate the hotels leased by such TRS.

Third, the rent attributable to the personal property leased in connection with the lease of a hotel must not be greater than 15% of the total rent received under the lease. The rent attributable to the personal property contained in a hotel is the amount that bears the same ratio to total rent for the taxable year as the average of the fair market values of the personal property at the beginning and at the end of the taxable year bears to the average of the aggregate fair market values of both the real and personal property contained in the hotel at the beginning and at the end of such taxable year (the personal property ratio). With respect to each hotel, we believe either that the personal property ratio is less than 15% or that any rent attributable to excess personal property will not jeopardize our ability to qualify as a REIT. There can be no assurance, however, that the Internal Revenue Service would not challenge our calculation of a personal property ratio, or that a court would not uphold such assertion. If such a challenge were successfully asserted, we could fail to satisfy the 75% or 95% gross income test and thus potentially lose our REIT status.

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

Fourth, we cannot furnish or render noncustomary services to the tenants of our hotels, or manage or operate our hotels, other than through an independent contractor who is adequately compensated and from whom we do not derive or receive any income. However, we need not provide services through an independent contractor, but instead may provide services directly to our tenants, if the services are usually or customarily rendered in connection with the rental of space for occupancy only and are not considered to be provided for the tenants convenience. Provided that the percentage leases are respected as true leases, we should satisfy that requirement, because we do not perform any services other than customary ones for the lessees. In addition, we may provide a minimal amount of noncustomary services to the tenants of a property, other than through an independent contractor, as long as our income from the services does not exceed 1% of our income from the related property. Finally, we may own up to 100% of the stock of one or more TRSs, which may provide noncustomary services to our tenants without tainting our rents from the related hotels. We will not perform any services other than customary ones for our lessees, unless such services are provided through independent contractors or TRSs. Furthermore, we have represented that, with respect to other hotel properties that we acquire in the future, we will not perform noncustomary services for the lessee of the property to the extent that the provision of such services would jeopardize our REIT status.

If a portion of the rent that we receive from a hotel does not qualify as rents from real property because the rent attributable to personal property exceeds 15% of the total rent for a taxable year, the portion of the rent that is attributable to personal property will not be qualifying income for purposes of either the 75% or 95% gross income test. Thus, if such rent attributable to personal property, plus any other income that is nonqualifying income for purposes of the 95% gross income test, during a taxable year exceeds 5% of our gross income during the year, we would lose our REIT status. If, however, the rent from a particular hotel does not qualify as rents from real property because either (1) the percentage rent is considered based on the income or profits of the related lessee, (2) the lessee either is a related party tenant or fails to qualify for the exception to the related party tenant rule for qualifying TRSs or (3) we furnish noncustomary services to the tenants of the hotel, or manage or operate the hotel, other than through a qualifying independent contractor or a TRS, none of the rent from that hotel would qualify as rents from real property. In that case, we might lose our REIT status because we would be unable to satisfy either the 75% or 95% gross income test. In addition to the rent, the lessees are required to pay certain additional charges. To the extent that such additional charges represent either (1) reimbursements of amounts that we are obligated to pay to third parties, such as a lessee s proportionate share of a property s operational or capital expenses, or (2) penalties for nonpayment or late payment of such amounts, such charges should qualify as rents from real property. However, to the extent that such charges do not qualify as rents from real property, they instead will be treated as interest that qualifies for the 95% gross income test.

Interest. The term interest generally does not include any amount received or accrued, directly or indirectly, if the determination of such amount depends in whole or in part on the income or profits of any person. However, an amount received or accrued generally will not be excluded from the term interest solely by being based on a fixed percentage or percentages of receipts or sales. Furthermore, to the extent that interest from a loan that is based on the profit or net cash proceeds from the sale of the property securing the loan constitutes a shared appreciation provision, income attributable to such participation feature will be treated as gain from the sale of the secured property.

Prohibited Transactions. A REIT will incur a 100% tax on the net income derived from any sale or other disposition of property, other than foreclosure property, that the REIT holds primarily for sale to customers in the ordinary course of a trade or business. We believe that none of our assets are held

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

primarily for sale to customers and that a sale of any of our assets will not be in the ordinary course of our business. Whether a REIT holds an asset primarily for sale to customers in the ordinary course of a trade or business depends, however, on the facts and circumstances in effect from time to time, including those related to a particular asset. Nevertheless, we will attempt to comply with the terms of safe-harbor provisions in the federal income tax laws prescribing when an asset sale will not be characterized as a prohibited transaction. We cannot assure you, however, that we can comply with the safe-harbor provisions or that we will avoid owning property that may be characterized as property that we hold primarily for sale to customers in the ordinary course of a trade or business.

Foreclosure Property. We will be subject to tax at the maximum corporate rate on any income from foreclosure property, other than income that otherwise would be qualifying income for purposes of the 75% gross income test, less expenses directly connected with the production of that income. However, gross income from foreclosure property will qualify under the 75% and 95% gross income tests. Foreclosure property is any real property, including interests in real property, and any personal property incident to such real property:

- that is acquired by a REIT as the result of the REIT having bid on such property at

foreclosure, or having otherwise reduced such property to ownership or possession by agreement or process of law, after there was a default or default was imminent on a lease of such property or on indebtedness that such property secured;

- for which the related loan was acquired by the REIT at a time when the default was not imminent or anticipated; and
- for which the REIT makes a proper election to treat the property as foreclosure property.

We have no foreclosure property as of the date of this prospectus. Property generally ceases to be foreclosure property at the end of the third taxable year following the taxable year in which the REIT acquired the property, or longer if an extension is granted by the Secretary of the Treasury. However, this grace period terminates and foreclosure property ceases to be foreclosure property on the first day:

- on which a lease is entered into for the property that, by its terms, will give rise to income that does not qualify for purposes of the 75% gross income test, or any amount is received or accrued, directly or indirectly, pursuant to a lease entered into on or after such day that will give rise to income that does not qualify for purposes of the 75% gross income test;
- on which any construction takes place on the property, other than completion of a building or any other improvement, where more than 10% of the construction was completed before default

became imminent; or

Ø which is more than 90 days after the day on which the REIT acquired the property and the property is used in a trade or business which is conducted by the REIT, other than through an independent contractor from whom the REIT itself does not derive or receive any income.

Hedging Transactions. From time to time, we or our operating partnership may enter into hedging transactions with respect to one or more of our assets or liabilities. Our hedging activities may include entering into interest rate swaps, caps, and floors, options to purchase such items, and futures and forward contracts. To the extent that we or our operating partnership enters into an interest rate swap or cap contract, option, futures contract, forward rate agreement, or any similar financial instrument to hedge our indebtedness incurred to acquire or carry real estate assets, any periodic income or gain from the disposition of such contract should be qualifying income for purposes of the 95% gross income test, but not the 75% gross income test. To the extent that we or our operating partnership hedges with

---

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

other types of financial instruments, or in other situations, it is not entirely clear how the income from those transactions will be treated for purposes of the gross income tests. We intend to structure any hedging transactions in a manner that does not jeopardize our status as a REIT.

Failure to Satisfy Gross Income Tests. If we fail to satisfy one or both of the gross income tests for any taxable year, we nevertheless may qualify as a REIT for that year if we qualify for relief under certain provisions of the federal income tax laws. Those relief provisions generally will be available if:

- our failure to meet such tests is due to reasonable cause and not due to willful neglect;
- we attach a schedule of the sources of our income to our tax return; and
- any incorrect information on the schedule was not due to fraud with intent to evade tax.

We cannot predict, however, whether in all circumstances we would qualify for the relief provisions. In addition, as discussed above in Taxation of Our Company, even if the relief provisions apply, we would incur a 100% tax on the gross income attributable to the greater of (1) the amount by which we fail the 75% gross income test and (2) the

amount by which 90% of our income exceeds the amount of income qualifying under the 95% gross income test, in each case, multiplied by a fraction intended to reflect our profitability.

Asset Tests

To maintain our qualification as a REIT, we also must satisfy the following asset tests at the end of each quarter of each taxable year. First, at least 75% of the value of our total assets must consist of:

- cash or cash items, including certain receivables;
- government securities;
- interests in real property, including leaseholds and options to acquire real property and leaseholds;
- interests in mortgages on real property;
- stock in other REITs; and
- investments in stock or debt instruments during the one-year period following our receipt of new capital that we raise through equity offerings or offerings of debt with at least a five-year term.

Second, of our investments not included in the 75% asset class, the value of our interest in any one issuer s securities may not exceed 5% of the value of our total assets.

Third, we may not own more than 10% of the voting power or value of any one issuer s outstanding securities.

Fourth, no more than 20% of the value of our total assets may consist of the securities of one or more TRSs.

Fifth, no more than 25% of the value of our total assets may consist of the securities of TRSs and other non-TRS taxable subsidiaries and other assets that are not qualifying assets for purposes of the 75% asset test.

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

For purposes of the second and third asset tests, the term securities does not include stock in another REIT, equity or debt securities of a qualified REIT subsidiary or TRS, mortgage loans that constitute real estate assets, or equity interests in a partnership. The term securities, however, generally includes debt securities issued by a partnership or another REIT, except that certain straight debt securities are not treated as securities for purposes of the 10% value test (for example, qualifying debt securities of a partnership or REIT in which neither we nor any TRS of ours owns an equity interest or of a partnership if we own at least a 20% profits interest in the partnership).

We believe that our existing assets are qualifying assets for purposes of the 75% asset test. We also believe that any additional real property that we acquire and temporary investments that we make generally will be qualifying assets for purposes of the 75% asset test. We will monitor the status of our acquired assets for purposes of the various asset tests and will manage our portfolio in order to comply at all times with such tests. If we fail to satisfy the asset tests at the end of a calendar quarter, we will not lose our REIT status if:

- we satisfied the asset tests at the end of the preceding calendar quarter; and
- the discrepancy between the value of our assets and the asset

test requirements arose from changes in the market values of our assets and was not wholly or partly caused by the acquisition of one or more non-qualifying assets.

If we did not satisfy the condition described in the second item, above, we still could avoid disqualification by eliminating any discrepancy within 30 days after the close of the calendar quarter in which it arose.

Distribution Requirements

Each taxable year, we must distribute dividends, other than capital gain dividends and deemed distributions of retained capital gain, to our shareholders in an aggregate amount at least equal to:

- Ø the sum of
  - Ø 90% of our REIT taxable income, computed without regard to the dividends paid deduction and our net capital gain or loss, and
  - Ø 90% of our after-tax net income, if any, from foreclosure property, minus
- Ø the sum of certain items of non-cash income.

We must pay such distributions in the taxable year to which they relate, or in the following taxable year if we declare the distribution before we timely file our federal income tax return for the year and pay the distribution on or before the first regular dividend payment date after such declaration.

We will pay federal income tax on taxable income, including net capital gain, that we do not distribute to shareholders. Furthermore, if we fail to distribute during a calendar year, or by the end of January following the calendar year in the case of distributions with declaration and record dates falling in the last three months of the calendar year, at least the sum of:

- 85% of our REIT ordinary income for such year,
- 95% of our REIT capital gain income for such year, and
- any undistributed taxable income from prior periods,

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

we will incur a 4% nondeductible excise tax on the excess of such required distribution over the amounts we actually distribute. We may elect to retain and pay income tax on the net long-term capital gain we receive in a taxable year. See Taxation of Taxable U.S. Shareholders. If we so elect, we will be treated as having distributed any such retained amount for purposes of the 4% nondeductible excise tax described above. We have made, and we intend to continue to make, timely distributions sufficient to satisfy the annual distribution requirements and to avoid corporate income tax and the 4% nondeductible excise tax.

It is possible that, from time to time, we may experience timing differences between the actual receipt of income and actual payment of deductible expenses and the inclusion of that income and deduction of such expenses in arriving at our REIT taxable income. For example, we may not deduct recognized capital losses from our REIT taxable income. Further, it is possible that, from time to time, we may be allocated a share of net capital gain attributable to the sale of depreciated property that exceeds our allocable share of cash attributable to that sale. As a result of the foregoing, we may have less cash than is necessary to distribute taxable income sufficient to avoid corporate income tax and the excise tax imposed on certain undistributed income or even to meet the 90% distribution requirement. In such a situation, we may need to borrow funds or issue additional common or preferred shares.

Under certain circumstances, we may be able to correct a failure to meet the distribution requirement for a year by paying deficiency dividends to our shareholders in a later year. We may include such deficiency dividends in our deduction for dividends paid for the earlier year. Although we may be able to avoid income tax on amounts distributed as deficiency dividends, we will be required to pay interest to the Internal Revenue Service based upon the amount of any deduction we take for deficiency dividends.

Taxable REIT Subsidiaries

As described above, we may own up to 100% of the stock of one or more TRSs. A TRS is a fully taxable corporation that may earn income that would not be qualifying income if earned directly by us. A TRS may provide services to our lessees and perform activities unrelated to our lessees, such as third-party management, development, and other independent business activities. However, a taxable REIT subsidiary may not directly or indirectly operate or manage any hotels or health care facilities or provide rights to any brand name under which any hotel or health care facility is operated.

We and our corporate subsidiary must elect for the subsidiary to be treated as a TRS. A corporation of which a qualifying TRS directly or indirectly owns more than 35% of the voting power or value of the stock will automatically be treated as a TRS. Overall, no more than 20% of the value of our assets may consist of securities of one or more TRSs, and no more than 25% of the value of our assets may consist of the securities of TRSs and other taxable

subsidiaries and other assets that are not qualifying assets for purposes of the 75% asset test.

Rent that we receive from our TRSs will qualify as rents from real property as long as the property is operated on behalf of the TRS by a person who qualifies as an independent contractor and who is, or is related to a person who is, actively engaged in the trade or business of operating qualified lodging facilities for any person unrelated to us and the TRS lessee (an eligible independent contractor). A qualified lodging facility is a hotel, motel, or other establishment more than one-half of the dwelling units in which are used on a transient basis, unless wagering activities are conducted at or in connection with such facility by any person who is engaged in the business of accepting wagers and who is legally authorized to engage in such business at or in connection with such facility. A qualified lodging facility includes customary amenities and facilities operated as part of, or associated with, the lodging facility as long as such amenities and facilities are customary for other properties of a comparable size and class owned by other unrelated owners.

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

We have formed four TRSs to lease hotels in which we own interests. We lease four of our hotels to 44 New England Management Company, a TRS owned by our operating partnership. A subsidiary of HHMLP, HHM Leasehold Interests, Inc., which is a TRS in which HHMLP owns a 99% interest and in which our operating partnership owns a 1% interest, leases 14 of our hotels. Our joint venture with CNL has formed Hersha CNL TRS, Inc., which is one of our TRSs and leases the hotel owned by that joint venture. Similarly, our joint venture with PRA Glastonbury, LLC has formed Hersha PRA TRS, Inc., which is one of our TRSs and leases the hotel owned by that joint venture. We may form new TRSs in the future. Each of these existing TRSs has engaged HHMLP, an eligible independent contractor, to operate the related hotels on its behalf. Furthermore, we have represented that, with respect to properties that we lease to our TRSs in the future, each such TRS will engage an eligible independent contractor to manage and operate the hotels leased by such TRS.

The TRS rules limit the deductibility of interest paid or accrued by a TRS to us to assure that the TRS is subject to an appropriate level of corporate taxation. Further, the rules impose a 100% excise tax on certain transactions between a TRS and us or our tenants that are not conducted on an arm s-length basis. We believe that all transactions between us and each of our existing TRSs have been and will be conducted on an

arm s-length basis.

Recordkeeping Requirements

We must maintain certain records in order to qualify as a REIT. In addition, to avoid a monetary penalty, we must request on an annual basis information from our shareholders designed to disclose the actual ownership of our outstanding shares of beneficial interest. We have complied, and we intend to continue to comply, with these requirements.

Failure to Qualify

If we fail to qualify as a REIT in any taxable year, and no relief provision applies, we would be subject to federal income tax and any applicable alternative minimum tax on our taxable income at regular corporate rates. In calculating our taxable income in a year in which we fail to qualify as a REIT, we would not be able to deduct amounts paid out to shareholders. In fact, we would not be required to distribute any amounts to shareholders in that year. In such event, to the extent of our current and accumulated earnings and profits, distributions to most domestic non-corporate shareholders would generally be taxable at capital gains tax rates. Subject to certain limitations of the federal income tax laws, corporate shareholders might be eligible for the dividends received deduction. Unless we qualified for relief under specific statutory provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year during which we ceased to qualify as a REIT. We cannot predict whether in all circumstances we would qualify for such statutory relief.

Taxation of Taxable U.S. Shareholders

The term U.S. shareholder means a holder of common shares that, for United States federal income tax purposes, is:

- a citizen or resident of the United States,
- a corporation or partnership (including an entity treated as a corporation or partnership) for U.S. federal income tax purposes created or organized under the laws of the United States or a political subdivision of the United States,

---

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

- an estate whose income from sources outside the United States is includible in gross income for United States federal income tax purposes regardless of its source, or
- any trust with respect to which
  - a United States court is able to exercise primary supervision over its administration, and
  - one or more United States persons have the authority to control all of its substantial decisions.

As long as we qualify as a REIT, a taxable U.S. shareholder must generally take into account as ordinary income distributions made out of our current or accumulated earnings and profits that we do not designate as capital gain dividends or retained long-term capital gain. A U.S. shareholder will not qualify for the dividends received deduction generally available to corporations. In addition, dividends paid to a U.S. shareholder generally will not qualify for the new 15% tax rate for qualified dividend income. The Jobs and Growth Tax Relief Reconciliation Act of 2003 reduced the maximum tax rate for qualified dividend income from 38.6% to 15% for tax years 2003 through 2008. Without future congressional action, the maximum tax rate on qualified dividend income will move to 35% in 2009 and 39.6% in 2011. Qualified dividend income generally includes dividends paid to most U.S. noncorporate

taxpayers by domestic C corporations and certain qualified foreign corporations. Because we are not generally subject to federal income tax on the portion of our REIT taxable income distributed to our shareholders (see Taxation of Our Company above), our dividends generally will not be eligible for the new 15% rate on qualified dividend income. As a result, our ordinary REIT dividends will continue to be taxed at the higher tax rate applicable to ordinary income. Currently, the highest marginal individual income tax rate on ordinary income is 35%. However, the 15% tax rate for qualified dividend income will apply to our ordinary REIT dividends (i) attributable to dividends received by us from non-REIT corporations, such as our TRSs, and (ii) to the extent attributable to income upon which we have paid corporate income tax (e.g., to the extent that we distribute less than 100% of our taxable income). In general, to qualify for the reduced tax rate on qualified dividend income, a shareholder must hold our common shares for more than 60 days during the 120-day period beginning on the date that is 60 days before the date on which our common shares become ex-dividend.

A U.S. shareholder generally will take into account distributions that we designate as capital gain dividends as long-term capital gain without regard to the period for which the U.S. shareholder has held our common shares. A corporate U.S. shareholder, however, may be required to treat up to 20% of certain capital gain dividends as ordinary income.

A U.S. shareholder will not incur tax on a distribution in excess of our current and accumulated earnings and profits if the distribution does not exceed the adjusted basis of the U.S.

shareholder s common shares. Instead, the distribution will reduce the adjusted basis of such common shares. A U.S. shareholder will recognize a distribution in excess of both our current and accumulated earnings and profits and the U.S. shareholder s adjusted basis in his or her common shares as long-term capital gain, or short-term capital gain if the shares of common shares have been held for one year or less, assuming the common shares are a capital asset in the hands of the U.S. shareholder. In addition, if we declare a distribution in October, November, or December of any year that is payable to a U.S. stockholder of record on a specified date in any such month, such distribution shall be treated as both paid by us and received by the U.S. stockholder on December 31 of such year, provided that we actually pay the distribution during January of the following calendar year.

Shareholders may not include in their individual income tax returns any of our net operating losses or capital losses. Instead, these losses are generally carried over by us for potential offset against our future

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

income. Taxable distributions from us and gain from the disposition of the common shares will not be treated as passive activity income and, therefore, shareholders generally will not be able to apply any passive activity losses, such as losses from certain types of limited partnerships in which the shareholder is a limited partner, against such income. In addition, taxable distributions from us and gain from the disposition of common shares generally will be treated as investment income for purposes of the investment interest limitations. We will notify shareholders after the close of our taxable year as to the portions of the distributions attributable to that year that constitute ordinary income, return of capital and capital gain.

Taxation of U.S. Shareholders on the Disposition of Common Shares

In general, a U.S. shareholder who is not a dealer in securities must treat any gain or loss realized upon a taxable disposition of his or her common shares as long-term capital gain or loss if the U.S. shareholder has held the common shares for more than one year and otherwise as short-term capital gain or loss. However, a U.S. shareholder must treat any loss upon a sale or exchange of common shares held by such shareholder for six-months or less as a long-term capital loss to the extent of capital gain dividends and other distributions from us that such U.S. shareholder treats

as long-term capital gain. All or a portion of any loss that a U.S. shareholder realizes upon a taxable disposition of the common shares may be disallowed if the U.S. shareholder purchases other common shares within 30 days before or after the disposition.

Capital Gains and Losses

The tax rate differential between capital gain and ordinary income for non-corporate taxpayers may be significant. A taxpayer generally must hold a capital asset for more than one year for gain or loss derived from its sale or exchange to be treated as long-term capital gain or loss. The highest marginal individual income tax rate currently is 35%. The maximum tax rate on long-term capital gain applicable to most domestic non-corporate taxpayers currently is 15% for sales and exchanges of assets held for more than one year. A 20% rate applies to sales and exchanges of capital assets after December 31, 2008. The maximum tax rate on long-term capital gain from the sale or exchange of section 1250 property, or depreciable real property, is 25% to the extent that such gain would have been treated as ordinary income if the property were section 1245 property. With respect to distributions that we designate as capital gain dividends and any retained capital gain that we are deemed to distribute, we generally may designate whether such a distribution is taxable to our non-corporate shareholders at a 15% or 25% rate. In addition, the characterization of income as capital gain or ordinary income may affect the deductibility of capital losses. A non-corporate taxpayer may deduct capital losses not offset by capital gains against its ordinary income only up to a maximum annual amount of $3,000. A non-corporate taxpayer may carry forward unused capital losses indefinitely. A corporate

taxpayer must pay tax on its net capital gain at ordinary corporate rates. A corporate taxpayer can deduct capital losses only to the extent of capital gains, with unused losses being carried back three years and forward five years.

Information Reporting Requirements and Backup Withholding

We will report to our shareholders and to the Internal Revenue Service the amount of distributions we pay during each calendar year, and the amount of tax we withhold, if any. Under the backup withholding rules, a shareholder may be subject to backup withholding at a rate of up to 28% with respect to distributions unless the holder:

- Ø is a corporation or comes within certain other exempt categories and, when required, demonstrates this fact; or
- Ø provides a taxpayer identification number, certifies as to no loss of exemption from backup withholding, and otherwise complies with the applicable requirements of the backup withholding rules.

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

A shareholder who does not provide us with its correct taxpayer identification number also may be subject to penalties imposed by the Internal Revenue Service. Any amount paid as backup withholding will be creditable against the shareholder s income tax liability. In addition, we may be required to withhold a portion of capital gain distributions to any shareholders who fail to certify their non-foreign status to us. For a discussion of the backup withholding rules as applied to non-U.S. shareholders. See Taxation of Non-U.S. Shareholders.

Taxation of Tax Exempt Shareholders

Tax-exempt entities, including qualified employee pension and profit sharing trusts and individual retirement accounts, generally are exempt from federal income taxation. However, they are subject to taxation on their unrelated business taxable income. While many investments in real estate generate unrelated business taxable income, the Internal Revenue Service has issued a ruling that dividend distributions from a REIT to an exempt employee pension trust do not constitute unrelated business taxable income so long as the exempt employee pension trust does not otherwise use the shares of the REIT in an unrelated trade or business of the pension trust. Based on that ruling, amounts that we distribute to tax-exempt shareholders generally should not

constitute unrelated business taxable income. However, if a tax-exempt shareholder were to finance its acquisition of common shares with debt, a portion of the income that it receives from us would constitute unrelated business taxable income pursuant to the debt-financed property rules. Furthermore, social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts and qualified group legal services plans that are exempt from taxation under special provisions of the federal income tax laws are subject to different unrelated business taxable income rules, which generally will require them to characterize distributions that they receive from us as unrelated business taxable income. Finally, in certain circumstances, a qualified employee pension or profit sharing trust that owns more than 10% of our shares must treat a percentage of the dividends that it receives as unrelated business taxable income. Such percentage is equal to the gross income we derive from an unrelated trade or business, determined as if we were a pension trust, divided by our total gross income for the year in which we pay the dividends. That rule applies to a pension trust holding more than 10% of our shares only if:

- Ø the percentage of our dividends that the tax-exempt trust must treat as unrelated business taxable income is at least 5%;
- Ø we qualify as a REIT by reason of the modification of the rule requiring that no more than 50% of our shares of beneficial interest be owned by five or fewer individuals that allows the beneficiaries of the pension trust to be treated as holding our shares of beneficial interest in proportion to their actuarial interests in the pension trust; and

- either
  - one pension trust owns more than 25% of the value of our shares of beneficial interest; or
  - a group of pension trusts each individually holding more than 10% of the value of our shares of beneficial interest collectively own more than 50% of the value of our shares of beneficial interest.

Taxation of Non-U.S. Shareholders

The rules governing U.S. federal income taxation of nonresident alien individuals, foreign corporations, foreign partnerships, and other foreign shareholders are complex. This section is only a summary of such rules. We urge non-U.S. shareholders to consult their own tax advisors to determine the impact of federal, state, and local income tax laws on ownership of the common shares, including any reporting requirements.

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

A non-U.S. shareholder that receives a distribution that is not attributable to gain from our sale or exchange of U.S. real property interests, as defined below, and that we do not designate as a capital gain dividend or retained capital gain will recognize ordinary income to the extent that we pay the distribution out of our current or accumulated earnings and profits. A withholding tax equal to 30% of the gross amount of the distribution ordinarily will apply unless an applicable tax treaty reduces or eliminates the tax. However, if a distribution is treated as effectively connected with the non-U.S. shareholder s conduct of a U.S. trade or business, the non-U.S. shareholder generally will be subject to federal income tax on the distribution at graduated rates, in the same manner as U.S. shareholders are taxed on distributions and also may be subject to the 30% branch profits tax in the case of a corporate non-U.S. shareholder. We plan to withhold U.S. income tax at the rate of 30% on the gross amount of any distribution paid to a non-U.S. shareholder unless either:

- a lower treaty rate applies and the non-U.S. shareholder files an IRS Form W-8BEN evidencing eligibility for that reduced rate with us, or
- the non-U.S. shareholder files an IRS Form W-8ECI with us claiming that the distribution is effectively connected income.

A non-U.S. shareholder will not incur tax on a distribution in excess of our current and accumulated earnings and profits if the distribution does not exceed the adjusted basis of its common shares. Instead, the distribution will reduce the adjusted basis of those common shares. A non-U.S. shareholder will be subject to tax on a distribution that exceeds both our current and accumulated earnings and profits and the adjusted basis of its common shares, if the non-U.S. shareholder otherwise would be subject to tax on gain from the sale or disposition of its common shares, as described below. Because we generally cannot determine at the time we make a distribution whether or not the distribution will exceed our current and accumulated earnings and profits, we normally will withhold tax on the entire amount of any distribution at the same rate as we would withhold on a dividend. However, a non-U.S. shareholder may obtain a refund of amounts that we withhold if we later determine that a distribution in fact exceeded our current and accumulated earnings and profits. We must withhold 10% of any distribution that exceeds our current and accumulated earnings and profits. Consequently, although we intend to withhold at a rate of 30% on the entire amount of any distribution to a non-U.S. shareholder, to the extent that we do not do so, we will withhold at a rate of 10% on any portion of a distribution not subject to withholding at a rate of 30%.

For any year in which we qualify as a REIT, a non-U.S. shareholder will incur tax on distributions that are attributable to gain from our sale or exchange of U.S. real property interests under special provisions of the federal income tax laws known as FIRPTA. The term U.S. real property interests includes interests in real property and shares in corporations at least 50% of whose assets consist of interests in real property during a

specified period. Under those rules, a non-U.S. shareholder is taxed on distributions attributable to gain from sales of U.S. real property interests as if the gain were effectively connected with a U.S. business of the non-U.S. shareholder. A non-U.S. shareholder thus would be taxed on this distribution at the normal capital gain rates applicable to U.S. shareholders, subject to applicable alternative minimum tax and a special alternative minimum tax in the case of a nonresident alien individual. A non-U.S. corporate shareholder not entitled to treaty relief or exemption also may be subject to the 30% branch profits tax on such a distribution. We must withhold 35% of any distribution that we could designate as a capital gain dividend. A non-U.S. shareholder may receive a credit against its tax liability for the amount we withhold.

A non-U.S. shareholder generally will not incur tax under FIRPTA as long as at all times non-U.S. persons hold, directly or indirectly, less than 50% in value of our shares of beneficial interest. We cannot

---

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

assure you that that test will be met. However, a non-U.S. shareholder that owned, actually or constructively, 5% or less of the common shares at all times during a specified testing period will not incur tax under FIRPTA if the common shares are regularly traded on an established securities market. Because our common shares are regularly traded on an established securities market, a non-U.S. shareholder will not incur tax under FIRPTA unless it owns more than 5% of the common shares. If the gain on the sale of the common shares were taxed under FIRPTA, a non-U.S. shareholder would be taxed on that gain in the same manner as U.S. shareholders subject to applicable alternative minimum tax, a special alternative minimum tax in the case of nonresident alien individuals, and the possible application of the 30% branch profits tax in the case of non-U.S. corporations. Furthermore, a non-U.S. shareholder generally is not subject to FIRPTA if:

- the gain is effectively connected with the non-U.S. shareholder s U.S. trade or business, in which case the non-U.S. shareholder will be subject to the same treatment as U.S. shareholders with respect to such gain, or

- the non-U.S. shareholder is a nonresident alien individual who was present in the U.S. for 183 days or more during the taxable year and has a tax home in the United States, in which case the non-U.S. shareholder will incur a 30% tax on his or her capital gains.

Tax Aspects of Our Investments in Our Operating Partnership and the Subsidiary Partnerships

The following discussion summarizes certain federal income tax considerations applicable to our direct or indirect investments in our operating partnership and any subsidiary partnerships or limited liability companies that we form or acquire (each individually a Partnership and, collectively, the Partnerships). The discussion does not cover state or local tax laws or any federal tax laws other than income tax laws.

Classification as Partnerships. We are entitled to include in our income our distributive share of each Partnership s income and to deduct our distributive share of each Partnership s losses only if such Partnership is classified for federal income tax purposes as a partnership (or an entity that is disregarded for federal income tax purposes if the entity has only one owner or member) rather than as a corporation or an association taxable as a corporation. An unincorporated entity with at least two owners or members will be classified as a partnership, rather than as a corporation, for federal income tax purposes if it:

- Ø is treated as a partnership under the Treasury regulations relating to entity classification (the check-the-box regulations); and
- Ø is not a publicly traded partnership.

Under the check-the-box regulations, an unincorporated

entity with at least two owners or members may elect to be classified either as an association taxable as a corporation or as a partnership. If such an entity fails to make an election, it generally will be treated as a partnership (or an entity that is disregarded for federal income tax purposes if the entity has only one owner or member) for federal income tax purposes. Each Partnership intends to be classified as a partnership for federal income tax purposes and no Partnership will elect to be treated as an association taxable as a corporation under the check-the-box regulations.

A publicly traded partnership is a partnership whose interests are traded on an established securities market or are readily tradable on a secondary market or the substantial equivalent thereof. A publicly

---

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

traded partnership will not, however, be treated as a corporation for any taxable year if 90% or more of the partnership s gross income for such year consists of certain passive-type income, including real property rents, gains from the sale or other disposition of real property, interest, and dividends (the 90% passive income exception). Treasury regulations (the PTP regulations) provide limited safe harbors from the definition of a publicly traded partnership. Pursuant to one of those safe harbors (the private placement exclusion), interests in a partnership will not be treated as readily tradable on a secondary market or the substantial equivalent thereof if (1) all interests in the partnership were issued in a transaction or transactions that were not required to be registered under the Securities Act of 1933, as amended, and (2) the partnership does not have more than 100 partners at any time during the partnership s taxable year. In determining the number of partners in a partnership, a person owning an interest in a partnership, grantor trust, or S corporation that owns an interest in the partnership is treated as a partner in such partnership only if (1) substantially all of the value of the owner s interest in the entity is attributable to the entity s direct or indirect interest in the partnership and (2) a principal purpose of the use of the entity is to permit the partnership to satisfy the 100-partner limitation. Each Partnership qualifies for the private placement exclusion. We have not requested, and do not intend to request, a ruling from the Internal Revenue Service that the Partnerships will be classified as

partnerships for federal income tax purposes.

If for any reason a Partnership were taxable as a corporation, rather than as a partnership, for federal income tax purposes, we likely would not be able to qualify as a REIT. See Federal Income Tax Consequences of Our Status as a REIT Requirements for Qualification Income Tests and Requirements for Qualification Asset Tests. In addition, any change in a Partnership s status for tax purposes might be treated as a taxable event, in which case we might incur tax liability without any related cash distribution. See Federal Income Tax Consequences of Our Status as a REIT Requirements for Qualification Distribution Requirements. Further, items of income and deduction of such Partnership would not pass through to its partners, and its partners would be treated as shareholders for tax purposes. Consequently, such Partnership would be required to pay income tax at corporate rates on its net income, and distributions to its partners would constitute dividends that would not be deductible in computing such Partnership s taxable income.

Income Taxation of the Partnerships and their Partners

Partners, Not the Partnerships, Subject to Tax. A partnership is not a taxable entity for federal income tax purposes. Rather, we are required to take into account our allocable share of each Partnership s income, gains, losses, deductions, and credits for any taxable year of such Partnership ending within or with our taxable year, without regard to whether we have received or will receive any

distribution from such Partnership.

Partnership Allocations. Although a partnership agreement generally will determine the allocation of income and losses among partners, such allocations will be disregarded for tax purposes if they do not comply with the provisions of the federal income tax laws governing partnership allocations. If an allocation is not recognized for federal income tax purposes, the item subject to the allocation will be reallocated in accordance with the partners interests in the partnership, which will be determined by taking into account all of the facts and circumstances relating to the economic arrangement of the partners with respect to such item. Each Partnership s allocations of taxable income, gain, and loss are intended to comply with the requirements of the federal income tax laws governing partnership allocations.

Tax Allocations With Respect to Contributed Properties. Income, gain, loss, and deduction attributable to appreciated or depreciated property that is contributed to a partnership in exchange for an interest in

---

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

the partnership must be allocated in a manner such that the contributing partner is charged with, or benefits from, respectively, the unrealized gain or unrealized loss associated with the property at the time of the contribution. The amount of such unrealized gain or unrealized loss (built-in gain or built-in loss) is generally equal to the difference between the fair market value of the contributed property at the time of contribution and the adjusted tax basis of such property at the time of contribution (a book-tax difference). Such allocations are solely for federal income tax purposes and do not affect the book capital accounts or other economic or legal arrangements among the partners. The U.S. Treasury Department has issued regulations requiring partnerships to use a reasonable method for allocating items with respect to which there is a book-tax difference and outlining several reasonable allocation methods.

Under our operating partnership s partnership agreement, depreciation or amortization deductions of our operating partnership generally will be allocated among the partners in accordance with their respective interests in our operating partnership, except to the extent that our operating partnership is required under the federal income tax laws governing partnership allocations to use a method for allocating tax depreciation deductions attributable to contributed properties that results in our receiving a disproportionate share of such deductions. In addition, gain or loss on the sale of

a property that has been contributed, in whole or in part, to our operating partnership will be specially allocated to the contributing partners to the extent of any built-in gain or loss with respect to such property for federal income tax purposes.

Basis in Partnership Interest. Our adjusted tax basis in our partnership interest in our operating partnership generally is equal to:

- the amount of cash and the basis of any other property contributed by us to our operating partnership;
- increased by our allocable share of our operating partnership s income and our allocable share of indebtedness of our operating partnership; and
- reduced, but not below zero, by our allocable share of our operating partnership s loss and the amount of cash distributed to us, and by constructive distributions resulting from a reduction in our share of indebtedness of our operating partnership.

If the allocation of our distributive share of our operating partnership s loss would reduce the adjusted tax basis of our partnership interest below zero, the recognition of such loss will be deferred until such time as the recognition of such loss would not reduce our adjusted tax basis below zero. To the extent that our operating partnership s distributions, or any decrease in our share of the indebtedness of our operating partnership, which is considered a constructive cash distribution to the partners, reduce our adjusted tax basis below zero, such distributions will constitute

taxable income to us. Such distributions and constructive distributions normally will be characterized as long-term capital gain.

Depreciation Deductions Available to Our Operating Partnership. To the extent that our operating partnership acquired its hotels in exchange for cash, its initial basis in such hotels for federal income tax purposes generally was or will be equal to the purchase price paid by our operating partnership. Our operating partnership depreciates such depreciable hotel property for federal income tax purposes under the modified accelerated cost recovery system of depreciation (MACRS). Under MACRS, our operating partnership generally depreciates furnishings and equipment over a seven-year recovery period using a 200% declining balance method and a half-year convention. If, however, our operating partnership places more than 40% of its furnishings and equipment in service during the last three months of a taxable year, a mid-quarter depreciation convention must be used for the furnishings and equipment placed in service during that year. Recently enacted tax legislation provides a first-year

Table of Contents

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

bonus depreciation deduction equal to 50% of the adjusted basis of qualified property placed in service after May 5, 2003, which includes qualified leasehold improvement property and property with a recovery period of less than 20 years, such as furnishings and equipment at our hotels. Qualified leasehold improvement property generally includes improvements made to the interior of nonresidential real property that are placed in service more than three years after the date the building was placed in service. Under MACRS, our operating partnership generally depreciates buildings and improvements over a 39-year recovery period using a straight line method and a mid-month convention. Our operating partnership s initial basis in hotels acquired in exchange for units in our operating partnership should be the same as the transferor s basis in such hotels on the date of acquisition by our operating partnership. Although the law is not entirely clear, our operating partnership generally depreciates such depreciable hotel property for federal income tax purposes over the same remaining useful lives and under the same methods used by the transferors. Our operating partnership s tax depreciation deductions are allocated among the partners in accordance with their respective interests in our operating partnership, except to the extent that our operating partnership is required under the federal income tax laws governing partnership allocations to use a method for allocating tax depreciation deductions attributable to contributed properties that results in our receiving a disproportionate share of such deductions.

Sale of a Partnership s Property

Generally, any gain realized by a Partnership on the sale of property held by the Partnership for more than one year will be long-term capital gain, except for any portion of such gain that is treated as depreciation or cost recovery recapture. Any gain or loss recognized by a Partnership on the disposition of contributed properties will be allocated first to the partners of the Partnership who contributed such properties to the extent of their built-in gain or loss on those properties for federal income tax purposes. The partners built-in gain or loss on such contributed properties will equal the difference between the partners proportionate share of the book value of those properties and the partners tax basis allocable to those properties at the time of the contribution. Any remaining gain or loss recognized by the Partnership on the disposition of the contributed properties, and any gain or loss recognized by the Partnership on the disposition of the other properties, will be allocated among the partners in accordance with their respective percentage interests in the Partnership.

Our share of any gain realized by a Partnership on the sale of any property held by the Partnership as inventory or other property held primarily for sale to customers in the ordinary course of the Partnership s trade or business will be treated as income from a prohibited transaction that is subject to a 100% penalty tax. Such prohibited transaction income also may have an adverse effect upon our ability to satisfy the income tests for REIT status. See Federal Income Tax Consequences of Our Status as a REIT Requirements for

Qualification Income Tests. We, however, do not presently intend to acquire or hold or to allow any Partnership to acquire or hold any property that represents inventory or other property held primarily for sale to customers in the ordinary course of our or such Partnership s trade or business.

State and Local Taxes

We and/or you may be subject to taxation by various states and localities, including those in which we or a shareholder transacts business, owns property or resides. The state and local tax treatment may differ from the federal income tax treatment described above. Consequently, you should consult their own tax advisors regarding the effect of state and local tax laws upon an investment in our common shares.

Table of Contents

Plan of distribution

This prospectus covers the resale of shares of common shares by CNL and its pledgees, donees, assignees and other successors in interest. The common shares offered by CNL may be issued to it by us upon exchange of Series A preferred units in our operating partnership. These common shares may be issued to CNL pursuant to an exemption from the registration provisions of the Securities Act. We are registering the common shares to which this prospectus relates to provide CNL with freely tradable securities, but registration of these shares does not necessarily mean that any of these shares will be issued by us or offered or sold by CNL. CNL may sell its common shares on the American Stock Exchange or through any other facility on which the shares are traded, or in private transactions. These sales may be at market prices or at negotiated prices. CNL may use the following methods when selling common shares:

- ordinary brokerage transactions and transactions in which the broker or dealer solicits purchasers;
- block trades in which the broker or dealer attempts to sell the common shares as agent, but may position and resell a portion of the block as principal to facilitate the transaction;
- underwritten offerings;

- purchases by a broker or dealer as principal and resale by the broker or dealer for its account pursuant to this prospectus;
- privately negotiated transactions;
- any combination of these methods of sale; or
- any other legal method.

CNL may engage in short sales of the common shares and deliver common shares to close out their short positions. CNL may also enter into put or call options or other transactions with broker-dealers or others which require delivery to those persons of common shares covered by this prospectus.

If securities are sold in an underwritten offering, the securities will be acquired by the underwriters for their own accounts and may be resold from time to time in one or more transactions, including negotiated transactions, at a fixed public offering price or prices at the time of the sale or at negotiated prices. Any initial public offering price and any discounts or commissions allowed or reallowed or paid to dealers may be changed from time to time. Underwriters may sell securities to or through broker-dealers, and such broker-dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters or the purchasers of shares for whom such broker-dealers may act as agents or to whom they sell as principal, or both (which compensation as to a particular broker-dealer might be in excess of customary commissions).

Brokers, dealers, underwriters or other agents participating in the distribution of the common shares may receive compensation in the form of discounts, concessions or commissions from CNL, as well as the purchaser if they act as agent for the purchaser. The discount or commission in a particular transaction could be more than the customary amount. We know of no existing arrangements between CNL and any underwriter, broker, dealer or agent relating to the sale or distribution of the common shares.

CNL and any brokers or dealers that participate in the sale of the common shares may be deemed to be underwriters within the meaning of the Securities Act. Any discounts, commissions or other compensation received by these persons and any profit on the resale of the common shares by them as

---

Table of Contents

PLAN OF DISTRIBUTION

principals might be deemed to be underwriters compensation. CNL may agree to indemnify any broker, dealer or agent that participates in the sale of the common shares against various liabilities, including liabilities under the Securities Act of 1933, as amended.

To the extent required by law, at the time a particular offer of common shares is made, we will file a supplement to this prospectus which identifies the number of common shares being offered, the name of any participating broker or dealer, the amount of discounts and commissions, and any other material information.

CNL and any other person participating in a distribution will be subject to the applicable provisions of the Exchange Act and its rules and regulations. For example, the anti-manipulative provisions of Regulation M may limit the ability of CNL or others to engage in stabilizing and other market making activities.

This offering will terminate upon the earlier of:

- Ø the date that all of the common shares under this prospectus may be sold in accordance with Rule 144 under the Securities Act of 1933, as amended; or
- Ø the date on which all shares offered hereby have been sold

by CNL.

CNL may also sell the common shares from time to time pursuant to Rule 144 under the Securities Act, rather than pursuant to this prospectus, so long as they meet the criteria and conform to the requirements of the rule.

We will not receive any of the proceeds from the sale of the common shares by CNL. We will pay the registration and other offering expenses related to this offering, but CNL will pay all underwriting discounts and brokerage commissions incurred in connection with the offering. We have agreed to indemnify CNL against various liabilities, including liabilities under the Securities Act.

In order to comply with some states securities laws, if applicable, the common shares will be sold in those states only through registered or licensed brokers or dealers. In addition, in some states the common shares may not be sold unless they have been registered or qualified for sale or an exemption from registration or qualification is available and is satisfied.

Table of Contents

Experts

Our consolidated balance sheet as of December 31, 2003 and our consolidated statements of operations, cash flows and shareholders equity for the year ended December 31, 2003 incorporated by reference in this prospectus, have been audited by Reznick Fedder & Silverman P.C., independent certified public accountants, whose report is incorporated by reference in this prospectus and given upon their authority as experts in accounting and auditing. The balance sheet of Hersha Hospitality Management L.P. as of December 31, 2003, and the related statements of operations, partners equity (deficit), and cash flows for the year ended December 31, 2003, incorporated by reference in this prospectus have been audited by Reznick Fedder & Sliverman, P.C., independent certified public accountants, whose report is incorporated by reference in this prospectus and given upon their authority as experts in accounting and auditing.

Our consolidated balance sheet as of December 31, 2002 and our consolidated statements of operations, cash flows and shareholders equity for each of the years ended December 31, 2002 and 2001 incorporated by reference in this prospectus, have been audited by Moore Stephens, P.C., independent certified public accountants, whose reports are incorporated by reference in this prospectus and given upon their authority as experts in accounting and auditing. The consolidated balance sheet of Hersha Hospitality Management L.P. as of December 31, 2002, and the

related statements of operations, partners equity (deficit), and cash flows for each of the two years in the period ended December 31, 2002, incorporated by reference in this prospectus have been audited by Moore Stephens, P.C., independent certified public accountants, whose reports are incorporated by reference in this prospectus and given upon their authority as experts in accounting and auditing.

Legal matters

Certain legal matters in connection with this offering will be passed upon for us by Hunton & Williams LLP. In addition, the summary of legal matters contained in the section of this Prospectus under the heading Federal Income Tax Consequences of Our Status as a REIT is based on the opinion of Hunton & Williams LLP.

Table of Contents