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**UNITED STATES BANKRUPTCY COURT**
**SOUTHERN DISTRICT OF NEW YORK**

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| In re | : | Chapter 11 |
| CALPINE CORPORATION, et al., | : | Case No. 05-60200 (BRL) |
| Debtors. | : | (Jointly Administered) |

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**PRELIMINARY OBJECTION OF THE OFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS OF CALPINE CORPORATION TO CONFIRMATION OF THE DEBTORS' FOURTH AMENDED JOINT PLAN OF REORGANIZATION PURSUANT TO CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE**

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The Official Committee of Equity Security Holders (the "Equity Committee") of the above-captioned debtors and debtors-in-possession (collectively, the "Debtors") hereby submits this preliminary objection (the "Objection") to the confirmation of the Debtors' Fourth Amended Joint Plan of Reorganization Pursuant to Chapter 11 of the United States Bankruptcy Code (the "Plan"), and in support thereof respectfully states as follows:

## PRELIMINARY STATEMENT

In enacting the Bankruptcy Code, Congress placed stakeholder democracy at the forefront. Congress created a comprehensive scheme in which stakeholders would have the opportunity to determine their fate by having the right to vote. The Debtors' "waterfall plan" eviscerates Congress' paradigm of stakeholder democracy and replaces it with a paradigm where all decisions are made by the Court, rendering the votes of all stakeholders meaningless. Here the votes were cast before stakeholders could be given any idea what the Plan will look like and what their distributions will be. Likewise, although section 1129 has provisions that may be invoked depending upon whether an individual or a class votes to accept or reject the plan, the Debtors' waterfall plan excises those provisions of section 1129, making all such provisions inapplicable regardless of whether an individual or a class votes to accept the Plan. As such, because the Debtors' Plan seeks to rewrite chapter 11 in a way never contemplated by Congress and in a manner not proscribed by the Bankruptcy Code, the Plan cannot be confirmed.

The Plan has numerous deficiencies that render it unconfirmable, including:

- Stakeholders have no way to determine prior to the voting deadline whether the Plan violates the absolute priority rule under section 1129(b)(2) and/or the best interests test under section 1129(a)(7) because valuation is undetermined.

- The Plan unfairly discriminates against equity holders by permitting holders of section 510(b) subordinated securities claims, whose claims are *pari-passu* with the common stock holders, to receive a "double recovery."

- The Plan includes unlawful, non-consensual third-party releases that automatically bind parties who either vote for the Plan or fail to vote on the Plan.

- The Debtors' Plan impermissibly entrenches Calpine's board of directors, chosen by the Debtors and the Official Committee of Unsecured Creditors (the "Creditors' Committee") without input or oversight by the Equity Committee, even though equity holders will likely receive a substantial portion of Calpine's new common stock.

- The Debtors' Management and Director Equity Incentive Plan (the "M&D Equity Plan") seeks to circumvent section 503(c)'s prohibition of Key Employee Retention Plans ("KERPs") by providing impermissible bonuses to senior executives through the Plan.

- The Plan violates the absolute priority rule by providing more than 100% recoveries to creditors as a result of various settlements of alleged makewhole and other claims.

- The Plan fails to properly account for the value of the Debtors' retained causes of action, and therefore such value will inure to the benefit of unsecured creditors, awarding them well in excess of 100 cents on account of their claims.

Moreover, the Plan cannot be confirmed because it was not filed in good faith. While the Debtors continue to state that they are neutral with respect to how the value of the Debtors' estates is allocated among stakeholders, the Debtors' conduct in prosecuting the valuation underlying the Plan shows that they are determined to try to provide creditors with a windfall and to wipe out billions of dollars of shareholder value.

On November 1, 2007, recognizing that Calpine's prospects continue to improve due to, among other things, the greater likelihood of environmental regulations that favor Calpine and the substantially increasing cost to build new power plants, the Debtors released a revised business plan that provided for $600 million of incremental EBITDAR (i.e., earnings before interest, taxes, depreciation, amortization and restructuring costs) over the Debtors' prior forecasts which were contained in the Disclosure Statement (defined below). Rather than reflecting that substantially increased cash flows translate to an increase in Calpine's value, Miller Buckfire, the Debtors' purported "valuation expert," manipulated its prior valuation methodology so as to reduce Calpine's value by nearly a billion dollars. While the Debtors' projections remain very conservative, they recognize that Calpine is extraordinarily well positioned to benefit from increasingly environmentally-friendly legislation that has a strong presence in high energy use areas such as Texas and California. Rather than factoring this into their valuation, Miller Buckfire absurdly lowered its valuation because Calpine's competitors, each of which has significant coal assets, ***have traded down because those companies stand to be hurt by the very regulations that will help bolster Calpine's profitability, in part.*** Any objective review of Calpine's prospects lead to the inescapable conclusion that Calpine's value is rising, not falling.

Considering Calpine's strategic positioning for emergence, the Debtors' low-ball valuation can only be intended to provide creditors with a substantial windfall at the expense of shareholders and, worse, to provide management with under-priced stock options that will substantially increase in value immediately upon Calpine's emergence from chapter 11.

In light of these fatal flaws, confirmation of the Plan must be denied.

## BACKGROUND

1. On December 20, 2005, the Debtors filed their petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") in the Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court"). The Debtors are operating their businesses and managing their properties as debtors in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed in the Debtors' chapter 11 cases.

2. On January 9, 2006, the Office of the United States Trustee (the "U.S. Trustee") appointed the Creditors' Committee pursuant to section 1102 of the Bankruptcy Code.

3. On May 9, 2006, the U.S. Trustee appointed the Equity Committee pursuant to section 1102 of the Bankruptcy Code.

4. On or about December 19, 2006, the Debtors released their first business plan (the "December Business Plan").

5. On or about April 21, 2007, the Debtors released their second business plan (the "April Business Plan") showing an incremental increase in EBITDAR of approximately $1.17 billion.

6. On June 20, 2007, the Debtors filed the first interration of the Debtors' Plan and Disclosure Statement (as amended, the "Disclosure Statement"). Miller Buckfire's valuation analysis reflected in the Disclosure Statement (the "Disclosure Statement Analysis") estimated that existing equity holders would receive a distribution of the new common stock in the reorganized Debtors (the "New Common Stock") equal to up to $3.01 per share with a midpoint of $1.94 per share. See Disclosure Statement at Article V(C)(2)(d).

7. On July 2, 2007, the Debtors filed their Motion for Entry of an Order (A) Approving the Adequacy of the Debtors' Disclosure Statement; (B) Approving Solicitation and Notice Procedures with Respect to Confirmation of the Debtors' Proposed Plan of Reorganization; (C) Approving the Form of Various Ballots and Notices in Connection Therewith; and (D) Scheduling Certain Dates with Respect Thereto (the "Disclosure Statement Motion").

8. Between August 27, 2007 and September 24, 2007, the Debtors filed the First, Second and Third Amended Joint Plan of Reorganization and Amended Disclosure Statement.

9. On August 29, 2007, the Debtors filed, as Exhibit 17 to the Debtors' Plan, a Term Sheet Regarding Selection of Post-Emergence Board of Directors of Reorganized Calpine

Corporation (the “Board Term Sheet”) outlining the procedures for the selection of a committee (the “Board Selection Committee”) to select the nine members of the Board of Directors (the “Board”) of the reorganized Calpine.

10. On September 18, 2007, the Equity Committee filed its objection to the Disclosure Statement Motion. On September 25, 2007, the Bankruptcy Court held a hearing on and granted the Disclosure Statement Motion, and on September 26, 2007, the Bankruptcy Court entered an order approving the Debtors’ Disclosure Statement.

11. On September 27, 2007, the Debtors filed their Fourth Amended Joint Plan of Reorganization and Fourth Amended Disclosure Statement. A hearing on the confirmation of the Plan is presently scheduled to begin on December 17, 2007 (the “Confirmation Hearing”).

12. On or about November 1, 2007, the Debtors released a revised business plan (the “November Business Plan”) in which they incrementally increased their EBITDAR by over $600 million.

13. On November 16, 2007, the Debtors filed several additional supplements to the Plan including the M&D Equity Plan as Exhibit 13 to the Plan and the Amended and Restated Bylaws of Calpine Corporation (the “Calpine Bylaws”) as Exhibit 14 to the Plan.

14. On November 19, 2007, the Debtors’ filed an Updated Valuation Analysis for Calpine (the “New Valuation Analysis”). The New Valuation Analysis provided by Miller Buckfire estimates that existing equity holders will receive no distribution under the Plan.

15. On November 20, 2007, the Equity Committee filed a Summary of the Equity Committee’s Valuation Analysis (the “Equity Committee’s Summary Valuation”). The Equity Committee’s Summary Valuation provides a realistic and appropriate valuation of the Debtors that is much higher than that proposed by the Debtors’ Valuation Report or the New Valuation

Analysis. Pursuant to the Equity Committee's Summary Valuation, existing equity holders would receive approximately 34% of the common stock in reorganized Calpine.

16. On November 20, 2007, the Debtors filed a Notice Regarding Identification of Members of Post-Emergence Board of Directors (the "Board Composition Notice") in which the Debtors outlined the members that had been selected for the Calpine Board. Pursuant to the Board Composition Notice, the members of the Board are proposed to be: Frank Cassidy, Kenneth Derr (Chairman of Calpine's current Board of Directors), Robert C. Hinkley, Robert P. May (Calpine's Chief Executive Officer), Devid Merritt (a member of Calpine's current Board of Directors), W. Benjamin Moreland, Denise M. O'Leary, William J. Patterson (from SPO Partners & Co., a member of the Creditors' Committee) and J. Stuart Ryan (from SPO Partners & Co., a member of the Creditors' Committee).

## OBJECTION

### I. The Plan Re-Writes Sections 1125 and 1129 of Bankruptcy Code and is Thus Unconfirmable.

The complex, detailed and comprehensive provisions of the Bankruptcy Code create a system predicated upon stakeholder democracy. Moreover, the Second Circuit has recognized the centrality of stakeholder democracy to the chapter 11 process. Specifically, the Second Circuit has noted that one of the "purposes" in enacting the Bankruptcy Code was to ensure "that equity interests have a greater voice in reorganization plans-***hence, the safeguards of disclosure, voting, acceptance and confirmation present in Chapter 11***." Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983) (emphasis added).

Because these concepts are so fundamental to the chapter 11 process, a plan cannot "modify the requirements of the Bankruptcy Code" nor can it "dramatically reduce notice to creditors of matters that the drafters of the Bankruptcy Code and Rules considered fundamental to bankruptcy due process." In re Beyond.com Corp., 289 B.R. 138, 143 (Bankr. N.D. Cal. 2003). Rather, a chapter 11 plan can only be confirmed if it complies with "the applicable provisions" of the Bankruptcy Code. 11 U.S.C. § 1129(a)(1).

At the heart of this process is the requirement that voting be accompanied by adequate disclosure so that stakeholders understand what they are getting under a plan, the alternatives and the consequences of their vote. Pursuant to section 1125 of the Bankruptcy Code, the bankruptcy court approves a disclosure statement only when it contains adequate information to apprise stakeholders of the consequences of voting on a plan. See 11 U.S.C. § 1125. This scheme ensures that stakeholders have sufficient information to make an informed vote on the reorganization plan. A critical component to the voting process is that stakeholders be provided with sufficient information such that they can "make a conscious decision whether to participate in the process." In re Bryan, 357 B.R. 12, 20 (Bankr. N.D.N.Y. 2006); see In re 50-Off Stores, 231 B.R. 592, 594 (Bankr. W.D. Tex. 1999) (this requirement is intended to protect "one party from ambushing others" and preserve "the integrity of the judicial system[.]"); Mullane v. Cent. Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950) (noting that "any proceeding which is to be accorded finality" requires "notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections"); see also 11 U.S.C. §§ 1125; 1127(c) (requiring that modifications to a reorganization plan must "comply with section 1125").

Flowing from this structure is the Bankruptcy Code's voting scheme – codified in sections 1126 and 1129(a) of the Bankruptcy Code – which provides a mechanism for stakeholders to vote on the plan. A stakeholder's right to vote on a reorganization plan is "one of the most sacred entitlements that a creditor [or interest holder] has in a chapter 11 case." In re

Adelphia Commc'ns Corp., 359 B.R. 54, 56 (Bankr. S.D.N.Y. 2006); see also In re Turner Eng'g, Inc., 109 B.R. 956, 961 (Bankr. D. Mont. 1989) ("An important aspect of Chapter 11 Confirmation is the right of a creditor to vote its preference, because it is the creditor's destiny which is at stake, as well as the equity security holders."). Parties who are deprived of the opportunity to vote on a given plan "*are deprived of their due process rights under the Constitution.*" In re 50-Off Stores, Inc., 231 B.R. at 595 (emphasis added).

The voting scheme embedded in the Bankruptcy Code ensures that each stakeholder's vote has a consequence – both as a class and as an individual. A stakeholder's vote provides the stakeholder with a voice in the reorganization process. A stakeholder can choose to vote to accept impaired treatment under a plan or can choose to vote against the plan. Within a class, the stakeholder understands that its treatment under a plan could be dictated by the consensus votes of the class. If the class votes one way or the other on a plan, the stakeholder will be tied to that vote. Because these concepts are ingrained in the voting structure, stakeholders must consider them when determining how to vote. As such, the voting component to confirmation is integral to the overall chapter 11 reorganization scheme – and cannot be usurped without violating a stakeholder's due process rights.

The Plan throws this entire process out – vitiating Congress' well thought out scheme to protect stakeholders and turning stakeholder democracy on its head. First, because the Plan and Disclosure Statement fail to provide a valuation, they fail to provide adequate information to voters to enable them to make an informed decision. Instead, stakeholders are left with a confluence of valuation statements to sift through – from the Debtors, the Creditors' Committee and the Equity Committee – each telling a different story on valuation from a different perspective. Moreover, the Debtors' New Valuation Analysis, released just days prior to the voting deadline, disclosed a substantial decrease in the Debtors' valuation – yet the Debtors have failed to provide any underlying support for this lowered valuation. Without fully understanding the potential implications that the valuation may have on the waterfall structure of the Plan, stakeholders, many of them unsophisticated parties not represented by counsel, are left only to guess what their treatment will be under the Plan and vote – or not vote – accordingly. This is clearly not the intent of adequate disclosure under Bankruptcy Code section 1125.

Moreover, the Plan's structure – which places the determination of valuation into the hands of this Court after the voting deadline – contravenes the purpose of voting under section 1129 and renders the votes of stakeholders meaningless. Voters who vote according to their perceived treatment may later find that treatment changed – without any recourse to change their prior votes if they so desire. Likewise, voters whose treatment previously deemed them to have accepted or rejected the Plan, may later find themselves entitled to a vote – without the opportunity to do so. See In re Linkous, 990 F.2d 160, 162 (4th Cir. 1993) (indicating that due process requires that affected parties be apprised on the pendency of the action and that they be afforded an opportunity to present their objections). By having this Court determine the value and the allocation of value amongst stakeholders, the stakeholders' votes become irrelevant.

Specifically, the Debtors' plan construct impermissibly rewrites two fundamental provisions of section 1129: the "absolute priority rule" found in section 1129(b)(2) and the "best interests" test found in section 1129(a)(7). The Plan, as written, is unconfirmable in that it provides a mechanism for those stakeholders ***who vote to accept the Plan*** to also contest the Plan pursuant to sections 1129(a)(7) and 1129(b)(2) prior to this Court's determination on valuation. See Plan Ballot at 2. The Debtors' Plan seeks to change the structure of 1129 by allowing those creditors who vote "yes" to still argue that they could do better in a chapter 7 liquidation or that the Plan violates the absolute priority rule. This is prohibited by the plain language of section 1129(b), which is applicable only to stakeholders who ***have not accepted a plan***. See 11 U.S.C. § 1129(b). Further, it is black letter bankruptcy law that stakeholders who vote to accept a reorganization plan are precluded from later objecting on the basis that their treatment is unfair. See U.S. v. Poteet Constr. Co. (In re Poteet Constr. Co.), 122 B.R. 616, 619-20 (Bankr. S.D. Ga. 1990) (noting that "the 'cram-down' provisions of [Bankruptcy Code section 1129] are inapplicable" for classes voting to accept a reorganization plan); In re United Marine, Inc., 197 B.R. 942, 948 (Bankr. S.D. Fla. 1996) (noting that the absolute priority rule is only applicable "when the proponent of the plan seeks to 'cramdown' the plan … on a class that is impaired and has rejected the plan") (emphasis omitted).

Finally, the Debtors cannot use the threat of January 31 to push an unconfirmable plan through confirmation. In an effort to preserve their exit financing commitment, the Debtors are trying to exit chapter 11 as quickly as possible by advancing a flawed plan construct that simply puts it to the Court to determine value, rather than giving stakeholders the right to have a say in their fate. However, this perceived "state of emergency" cannot justify the Debtors' preclusion of fundamental rights of stakeholders. As stated by the Second Circuit, "[t]he need for expedition, however, is not a justification for abandoning proper standards." Comm. of Equity Security Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983).

## II. To the Extent the Court Finds That the Going Concern Value of the Debtors is Below $23.05 Billion, the Plan Violates the "Best Interest" Test as Stakeholders Would Receive a Greater Recovery under a Chapter 7 Liquidation

Section 1129(a)(7)(A) provides that a dissenting stakeholder must receive no less under a plan of reorganization than such holder would receive if the debtor were liquidated under chapter 7. In applying the "best interest" test, "courts must consider the value of the debtor's assets in excess of valid liens and exemptions, and determine (using the payment priorities set out in

Chapter 7 of the Bankruptcy Code) that each non-accepting claimant or interest holder will receive at least as much under the plan as it would if the debtor's assets were liquidated under Chapter 7 at the date of confirmation." In re Best Products Co., Inc., 168 B.R. 35, 71 (Bankr. S.D.N.Y. 1994). (As noted above, in contravention of section 1127(a)(7)(A) of the Bankruptcy Code, the Plan permits any stakeholder to raise the best interest test, even if they voted to **accept** the Plan.)

In an effort to demonstrate that the Plan (assuming Miller Buckfire's midpoint valuation set forth in the Disclosure Statement) meets the "best interest" test, the Debtors filed a liquidation analysis (the "Liquidation Analysis"), which concludes that claim and interest holders would receive a lesser recovery in a chapter 7 liquidation than under the Plan. However, Miller Buckfire's Liquidation Analysis drastically underestimates the value of Calpine's assets. Based on a liquidation analysis conducted by Perella Weinberg Partners LP ("PWP"), the Equity Committee's financial advisor, unless equity holders receive $1.78 per share or more under the Plan, equity holders will recover more in a chapter 7 liquidation than they will in a reorganization, in violation of section 1129(a)(7).

As detailed in PWP's expert rebuttal report, submitted on November 28, 2007, a chapter 7 liquidation of the Debtors' assets would result in between $22.2 billion and $23.9 billion of proceeds distributable to claim and interest holders. After all creditors received 100% on account of their claims, between $3 million and $1.73 billion would be remaining for equity security holders. At the midpoint, equity holders would receive a recovery of $1.78 per share. Were this Court to determine that on a going concern basis, equity holders will receive less then $1.78 per share under the plan, then the Plan would violate section 1129(a)(7)(A). Accordingly, unless the Court determines a going-concern reorganization value for the Debtors that provides a recovery to equity holders of at least $1.78 per share, the Plan cannot be confirmed.

In most liquidation scenarios, the going-concern value of a debtor substantially exceeds the liquidation value, because the company has good will and other intangible assets, including management talent that adds substantial incremental value integral to the successful operation of the business. The reality of these chapter 11 cases is completely different – the value of Calpine is only in its assets. The senior management of Calpine, or what remains of it, has little to no energy industry experience. The chief executive officer ("CEO"), Robert May, has no previous energy experience; the chief financial officer ("CFO"); Lisa Donahue, is an interim CFO from Alix Partners; the head of Calpine's commercial operations; Tom May, recently resigned; and Calpine's head of power operations, Robert Fishman, left the Company to pursue more appealing business opportunities. Finally, as evidenced by the Debtors M&D Equity Plan term sheet, the positions of chief operating officer and chief administrative officer are not filled. Accordingly, there is little accretive value to be gained from management, thereby limiting the value of the Debtors' estates strictly to the value of their assets.

Moreover, although when Calpine filed for chapter 11 it had a trading business, many of the traders left the Company at the beginning of the chapter 11 case. While Calpine undoubtedly has talented executive and plant level management and employees, in a properly run liquidation, the buyers will be able to retain the most critical employees to maintain the value of the assets.

Under a proper chapter 7 liquidating process, the chapter 7 trustee would hire an investment banker who would properly market the Debtors' generating assets. Because the Debtors' assets would be sold individually or by region, as opposed to a sale of the Debtors' entire generating portfolio to one buyer, the value of the assets would be properly captured. In the case of Calpine, the sum of the parts may actually be more valuable than the whole. Very few parties can finance a transaction in excess of $25 billion. However, based on the location of the Debtors' generating assets (in the valuable markets of Texas and California) and the Debtors' ownership of the Geysers, Calpine would realize a significant premium if its assets were sold region by region.

Though the Debtors have included a Liquidation Analysis in the Disclosure Statement, the Debtors created an artificial doomsday scenario under which the Debtors' stakeholders would receive substantially less than they would receive if the Debtors reorganize as a going concern. A proper region-by-region sale would reap tremendous value for Calpine's generating assets. Accordingly, if equity holder recovery under the Plan is less than $1.78 per share, recovery under a chapter 7 liquidation would exceed the recovery under the Plan and the Plan would be unconfirmable as a matter of law under 1129(a)(7).

## III. The Debtors' Plan Unfairly Discriminates Against Existing Equity Holders Because It Does Not Pay Subordinated Securities Claims Through Insurance Proceeds.

The Plan presently provides that claims arising from the purchase and sale of Calpine common stock, which are *pari passu* with common stock pursuant to section 510(b) of the Bankruptcy Code, are to receive New Common Stock (depending upon the valuation). In addition, the Plan provides a "double recovery" to these 510(b) equity claimants, by permitting such holders to receive proceeds of the Debtors' insurance policies ***as well as*** common stock. By providing a double recovery to holders of 510(b) equity claims, the Plan unfairly discriminates against shareholders and is not confirmable.

Pursuant to section 1129 of the Bankruptcy Code, a chapter 11 plan may not "discriminate unfairly." 11 U.S.C. § 1129(b)(1). Stated quite simply, "***[c]reditors with claims of equal rank are entitled to equal distribution***." <u>In re Sentry Operating Co. of Texas, Inc.</u>, 264

B.R. 850, 863 (Bankr. S.D. Tex. 2001) (explaining that "the unfair discrimination provision promotes intra-priority fairness, assuring equitable treatment among creditors who have the same level of priority.") (emphasis added); see also In re Barney & Carey Co., 170 B.R. 17, 25 (Bankr. D. Mass. 1994) (stating that although unfair discrimination is not defined in the Bankruptcy Code, the legislative history implies it is meant to protect creditors against unfair discrimination between classes of claims with the same priority). As such, a plan discriminates unfairly if similar claims are treated differently without a reasonable basis. See In re Hoffinger Indus., Inc., 321 B.R. 498, 505 (Bankr. E.D. Ark. 2005); In re Barney & Carey Co., 170 B.R. at 25 (explaining that discrimination "must be fair and supported by a rationale basis"); In re Tucson Self-Storage, Inc., 166 B.R. 892, 898 (9th Cir. 1994) (finding unfair discrimination where a plan gave 100% to an unsecured trade creditor but only 10% to a deficiency claim).

To prevent unfair discrimination, the Plan must limit the recovery of 510(b) equity claimants to insurance proceeds. Currently, the Plan leaves open the possibility for these claimants to recover insurance proceeds and also share in the common stock to be distributed to shareholders. Such treatment unfairly discriminates between existing equity holders and subordinated securities claimants which – although separately classified – are *pari passu*. Thus, in order for the Plan to be confirmable, it must be modified to provide that 510(b) equity claimants be satisfied solely with insurance proceeds.

## IV. The Plan Provides for Impermissible Non-Consensual Third Party Releases.

The Plan provides for the global release of a multitude of participants in these chapter 11 cases – the so-called "Released Parties"[1] – from claims of the Debtors and third parties. These

[1] Released Party is defined as "[e]ach of: (a) the DIP Lenders in their capacities as such; (b) the New Credit Facility Lenders in their capacities as such; (c) with respect to each of the foregoing Entities in clauses (a) and (b), such Entities' successors and assigns; (d) any statutory committee and the members thereof in their capacity as such; (e) the Second Lien Ad Hoc Committee and the members thereof in their capacity as

broad and unnecessary releases are unlawful and render the Plan unconfirmable under Second Circuit law.

In the Second Circuit, a chapter 11 plan may only release nondebtors from liability when the injunction supporting such releases "plays an important role in the debtors' reorganization plan," In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285, 293 (2d Cir. 1992), or when the release is consensual. See In re Metromedia Fiber Network, Inc., 416 F.3d 136, 143 (2d Cir. 2005) ("Nondebtor releases may also be tolerated if the affected creditors consent."). Third party releases "[are] proper only in rare cases," and "[n]o case has tolerated nondebtor releases absent the finding of circumstances that may be characterized as unique." In re Metromedia Fiber Network, Inc., 416 F.3d at, 142; see also In re Adelphia Commc'ns Corp., 364 B.R. 518, 529 (Bankr. S.D.N.Y. 2007) (applying Metromedia and stating that "the applicable law authorizing the approval of … third party releases has become increasingly restrictive, and now permits such relief only under limited circumstances – most significantly, where they are critical to the reorganization of the debtor."). Furthermore, third party releases must bear "a reasonable relationship to the protection of the estate" and be narrowly tailored so as to "go no further than necessary to protect those interests." Pasquale Cartalemi v. Karta Corp. (In re Karta Corp.), 342 B.R. 45, 57 (Bankr. S.D.N.Y. 2006); see also In re Metromedia, 416 F.3d at 142 (noting that overly broad releases are disfavored for their "potential for abuse" by insiders of the debtor).

such; (f) the ULC1 Noteholders Ad Hoc Committee and the members thereof in their capacity as such; (g) the Indenture Trustees; (h) the Administrative Agents; (i) the Collateral Trustee; (j) with respect to each of the foregoing Entities in clauses (a) through (i), such Entities' affiliates, subsidiaries, officers, directors, principals, employees, agents, financial advisors, attorneys, accountants, investment bankers, consultants, representatives, and other Professionals, in each case in their capacity as such, and only if serving in such capacity; and (k) the Debtors' and Reorganized Debtors' officers, directors, principals, employees, agents, financial advisors, attorneys, accountants, investment bankers, consultants, representatives, and other Professionals, in each case in their capacity as such, and only if serving in such capacity." Plan at Article 1(A)(170).

In fact, courts within the Second Circuit have approved nondebtor releases only under limited circumstances such as where: (i) the estate received substantial financial consideration, see In re Drexel Burnham, 960 F.2d at 293, and the released parties "conditioned their substantial financial participation in the reorganization on protection from lawsuits arising out of their bankruptcy-related activities," In re Karta Corp., 342 B.R. at 56; (ii) the enjoined claims were "channeled" to a settlement fund rather than extinguished, see MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 93-94 (2d Cir.1988); (iii) the plan otherwise provided for the full payment of the enjoined claims, id.; or (iv) the release was consensual. see Debtors' First Amended Plan of Reorganization at 24, § 10.2(b) (emphasis added); see also In re Oneida, Ltd., Case No. 06-10489 (Bankr. S.D.N.Y. July 7, 2006) at Document No. 329.

For example, in In re Oneida, the release provided that only those holders of a claim who had voted to accept the Oneida plan or ***to accept the release set forth in the Oneida plan*** would be deemed to have unconditionally released the debtors and other third parties. Id.; see also In re Oneida Ltd., 351 B.R. 79, 94 (Bankr. S.D.N.Y. 2006) (Gropper, J.) (holding that the release in the Oneida plan fell "directly" into the Second Circuit's category of consensual releases because it "provides for releases of claims held by creditors who affirmatively indicate their willingness to grant such releases… ."); In re Delta Air Lines, Inc., Case No. 05-17923 (Bankr. S.D.N.Y. April 25, 2007) (Hardin, J.) at Document No. 5998, Ex. A (debtors' joint plan unequivocally stated that: "[a] holder of a Claim who does *not* cast a Ballot or who is not entitled to cast a Ballot will be deemed to have opted out of the releases… .").

Here, the Debtors' Plan provides that on and after the effective date of the Plan, claim and interest holders either "(a) voting to accept the Plan or (b) abstaining from voting on the Plan and electing not to opt out of the release contained [in the Plan]" shall be "deemed to have conclusively, absolutely, unconditionally, irrevocably, and forever, released and discharged the Debtors, the reorganized Debtors, and the Released Parties" from *any and all claims and liabilities "whether known or unknown, foreseen or unforeseen, existing or hereafter arising, in law, equity or otherwise*." Plan at Article VIII(F) (emphasis added). As presently constructed, a claim or interest holder is ***automatically bound*** by the third party releases unless they affirmatively act, and even a claim or interest holder who abstains from voting on the Plan is still "deemed to have accepted the release provisions… ." Plan Ballot at Item 3.

By making the releases applicable without a party affirmatively consenting, the releases are not consensual. Even if an "opt out" could make the releases consensual in some businesses with this plan structure, an "opt out" cannot be consensual. Here stakeholders voted on the Plan prior to knowing valuation and what they will receive under the Plan. As such stakeholders cannot be deemed to be ***knowingly*** consenting to such a release. It would be absurd to believe that a stakeholder would agree to a broad release of claims and liabilities against third parties when its claims or interests may ultimately be wiped out under the Plan. In fact, to the extent that equity security holders receive no distribution under the Plan, the releases will have no force and effect for equity holders because they will not have received any consideration for the releases.

Despite this non-consensual, automatic release, the Debtors have never articulated that the releases are critical to the Debtors' reorganization. Nor can they. The third party releases in the Plan can hardly be classified as critical to the Debtors' reorganization, and nothing in the Plan sets forth the unique circumstances that would justify third party releases in the Debtors' chapter 11 cases.

In fact, the only explanation set forth by the Debtors for these improper and unprecedented releases is found in their Disclosure Statement in which the releases justify that the releases are necessary:

> because of, among other reasons, (a) the ***role*** that the Debtors…and the Released Parties have played in the Debtors' restructuring…(b) the Debtors' current litigation risk-adjusted projections…that Holders of Allowed Interests will obtain a recovery, and (c) the consensual nature of the releases provided in the Plan such that…(iii) an abstention from voting on the Plan and electing not to opt out of the release in the Plan…will release those parties [entitled to releases].

Disclosure Statement at Article IV(L)(6) (emphasis added). However, stating they are justified merely because of the "role" played by the Debtors and the Released Parties is not sufficient to support this Circuit's strict requirements or the immense implications that such releases can have on third parties. Moreover, the list of released parties is broad so as to include numerous parties who may never have played any role in the restructuring, such as affiliates, subsidiaries, officers, directors, principals, employees, agents, financial advisors, attorneys, accountants, investment bankers, consultants, and representatives of certain parties in the cases. See Plan at Article I(A)(170).

Because the releases are not consensual, this Court cannot, under the standards articulated in the Second Circuit, approve of the releases in the Plan. Accordingly, to the extent the releases are not stricken or appropriately modified, the Plan is unconfirmable.

## V. The Plan Improperly Precludes Existing Shareholders from Representation on the Board.

In defending the Debtors' Disclosure Statement, the Debtors and Creditors' Committee repeatedly noted that this Court will determine valuation and may determine that there should be a substantial distribution of New Common Stock to equity holders. Despite the fact that equity holders could own a substantial portion of reorganized Calpine, however, the Plan denies the

Equity Committee any input into the process and procedures for selecting the Board. Rather, the Plan incorporates the Board Term Sheet, which allows only the Debtors and the Creditors' Committee to select the Board – a process these parties have already completed. By selecting the Board without any input from equity, the Debtors and the Creditors' Committee have vitiated the whole purpose of the waterfall plan and are seeking to predetermine the outcome. This pre-judgment is particularly ironic considering that the Debtors have so adamantly argued that their valuation is just a "data point" that this Court should consider in determining the value of the Debtors' estates. See Debtors' Objection to Emergency Motion of the Official Committee of Equity Security Holders of Calpine Corporation to Adjourn the Hearing on the Debtors' Motion for an Order Approving Adequacy of Proposed Disclosure Statement [Document No. 6099] at 9 (noting that valuation will "likely [] be a valuable data point to the Equity Committee and the Debtors' interest holders").

Pursuant to the Board Term Sheet, the Board Selection Committee, comprised of three members chosen by the Debtors and three members chosen by the Creditors' Committee, was charged with selecting the eight members to serve on the Board in addition to Bob May, Calpine's CEO. See Board Term Sheet at 2. In fact, the Board Selection Committee has already chosen the members of the Board and issued a notification of such in the Board Composition Notice. See Board Composition Notice at 2. These members, rather than serving as a transitional board for the reorganized Debtors, will serve a term that ends in 2009. See Calpine Bylaws at 5.

Notably, the Equity Committee is not a member of the Board Selection Committee thus existing equity holders have had no representation with respect to the selection of the Board of reorganized Calpine. This absence speaks volumes and directly conflicts with the requirements of the Bankruptcy Code. By denying the Equity Committee Board selection rights, the Board Term Sheet, and therefore the Plan, improperly assumes that existing equity holders are "out of the money." However, Section 1123(a)(7) requires that the Plan "contain only provisions that are consistent with the interests of creditors ***and equity security holders***" **–** regardless of the treatment of equity holders. 11 U.S.C. § 1123(a)(7) (emphasis added). The Debtors, by denying the Equity Committee a seat on the Board Selection Committee, have failed to take into account the Debtors' equity stakeholders. This is impermissible and a clear violation of section 1123(a)(7) of the Bankruptcy Code.

Moreover, now that the Board has been selected by the Board Selection Committee, the Debtors have entrenched the Board Selection Committee's appointees by providing them with two-year terms. Depending on this Court's determination on valuation, existing equity holders should receive a substantial distribution of New Common Stock, entitling them to all the rights and protections of other shareholders in reorganized Calpine. However, existing equity holders will have no representation on the Board and will be stuck with an entrenched creditor-controlled Board. Notably, two principals from SPO Partners, the chair of the Creditors' Committee, have been selected by the Board Selection Committee.

If the Debtors were being forthright, they would have created a true, neutral waterfall plan. Rather than doing so, the Debtors are pre-judging the outcome of the valuation fight. At the very least, the Equity Committee, as the representative of existing equity holders, should have voting rights with respect to the proposed appointees to the Board. As such, absent a provision permitting the Equity Committee to have voting or veto rights on the Board Selection Committee, to the extent that existing equity holders receive a recovery under the Plan, the Plan should not be confirmed. Otherwise, allowing the Board Selection Committee to retain its current composition of only members of the Debtors and the Creditors' Committee would endorse the Debtors' pre-judgment of valuation. Such a result usurps this Court's jurisdiction over the valuation issue and renders the Plan fatally flawed.

## VI. The Plan's M&D Equity Plan Provides for a Bonus Plan That is Impermissible and Renders the Plan Unconfirmable.

The Debtors' M&D Equity Plan provides for awards and bonuses to management-level executives that are simply additional thinly-veiled KERPs. Because these retention bonus plans would not pass muster during the chapter 11 case outside of a chapter 11 plan, there is no reason that they should be permitted under the Debtors' Plan. The Debtors' attempt to pay these extravagant bonuses, such as the $10.908 million bonus to Bob May (which is in addition to his various bonuses totaling in excess of $40 million under the terms of his employment agreement), must be seen for what it is – a veiled KERP. Congress recently limited the ability of chapter 11 debtors to employ such tactics to award insiders and confidants by amending section 503(c) to disallow such bonus structures. The Debtors cannot attempt a "back-door" implementation of a bonus plan otherwise unacceptable under the Bankruptcy Code, and as such, the Plan is unconfirmable.

Section 1129(a)(1) provides, in relevant part, that a "court shall confirm a plan only if … [t]he plan complies with the applicable provisions of this title." 11 U.S.C. § 1129(a)(1).[2] As such, a chapter 11 plan must not allow for the Debtors to do what they cannot do outside of the other provisions of the Bankruptcy Code. See In re Beyond.com Corp., 289 B.R. at 143. In the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA"),[3] Congress amended section 503(c) of the Bankruptcy Code to prohibit transfers "to an insider of

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[2] This section is also applicable under the "cram down" provisions of the Bankruptcy Code pursuant to section 1129(b)(1). 11 U.S.C. § 1129(b)(1).

[3] The BAPCPA applies to all cases, including the Debtors' bankruptcy cases, filed after October 17, 2005.

the debtor for the purpose of inducing such person to remain with the debtor's business" unless the bankruptcy court finds that (i) the transfer is essential to persuade the insider not to take a "bona fide job offer from another business at the same or greater rate of compensation," (ii) the individual's services are "essential to the survival of the business," ***and*** (iii) the transfer is not greater than (a) ten times the mean transfer of a non-management employee in the same year, or (b) if there are no such transfers, twenty-five times any transfer made to the insider made during the preceding calendar year. 11 U.S.C. § 503(c). Essentially, section 503(c) prohibits retention bonuses which pay high-level managers or executives to "stay" with a company where such compensation has no other metrics tied to performance. See In re Dana Corp., 351 B.R. 96 (Bankr. S.D.N.Y. 2006) (J. Lifland). However, even compensation plans that are titled as other than a "KERP" per se have been held to be in violation of this section. In other words, if a management and director incentive plan "walks like a duck (KERP) and quacks like a duck (KERP), it's a duck (KERP)." Id. at 102 n.3 (denying debtors' motion for authority to institute, for each of its executives, a key management and executive compensation plan that proposed, in pertinent part, to pay a base salary, annual incentive bonuses and "Target Completion Bonuses," not tied to any performance-related goals but tied to the total enterprise value of the debtors six months after the effective date).

In the present case, the M&D Equity Plan provides for a one-time emergence award (the "Emergence Award") on the effective date of the Plan and subsequent and recurring annual awards (the "Annual Awards") that will be made on an annual basis. See M&D Equity Plan at 1. To fund these awards, "[u]p to 3% of the [New Common Stock] issued and outstanding" on the effective date of the Plan will be reserved. M&D Equity Plan at 1. As stated above, pursuant to the M&D Equity Plan, Bob May, the Debtors' current CEO, will receive a compensation award of $10.908 million (based upon the Debtors' artificially low valuation). See M&D Equity Plan at 2. The Plan also provides that if Mr. May "has not entered into a new employment agreement with Reorganized Calpine within six months after the Effective Date" any award to Mr. May "shall be null and void and Mr. May shall not be entitled to any additional compensation on account thereof." Plan at Article IV(O); see also M&D Equity Plan at 2 n.4. Thus, Mr. May's award under the M&D Equity Plan is ***directly*** tied to his retention post-petition.

In contrast to the vast award provided to Mr. May, the M&D Equity Plan is silent as to any assertion (i) that Mr. May has a competing offer, (ii) that his services are critical to the success of the reorganized Calpine, ***and*** (iii)(a) that the Emergence Award or Annual Awards are within "ten times the mean transfer of a non-management employee in the same year, or (b)… twenty-five times any transfer made to the insider made during the preceding calendar year." 11 U.S.C. § 503(c). Nor does the M&D Equity Plan tie these awards to specific performance metrics of the reorganized Calpine. Likewise, other executive vice presidents and senior vice presidents are entitled to receive Emergence Awards of up to ***300%*** of the "executive's competitive Annual Award." M&D Equity Plan at 2. Providing such exorbitant awards to the reorganized Calpine's executives, while existing equity holders are being treated unfairly and inequitably under the Plan, renders the M&D Equity Plan akin to a KERP – a proposal which would no doubt be prohibited by section 503(c) of the Bankruptcy Code if it had been proposed in the early stages of the Debtors' cases.

Clearly, in implementing Bankruptcy Code section 503(c), Congress intended to limit the misuse of bankruptcy for awarding insiders where there was little benefit to the estate or link to actual performance goals. The M&D Equity Plan intends to do just that. Certainly the drafters of Bankruptcy Code section 503(c) and 1129(a)(1) did not intend for the Debtors to do in the

Plan what they would otherwise not be permitted to do in a bankruptcy case. The Debtors cannot "back-door" a KERP bonus plan near the end of a bankruptcy case under the guise that it is anything other. It is contrary to the Bankruptcy Code's overall policy of fair and equitable distributions to allow such a proposal in a reorganization plan that would otherwise not be allowed in bankruptcy. Thus, since the Plan, includes the M&D Equity Plan, it is unconfirmable.

## VII. The Debtors' Settlement of "Makewhole" Claims Results in Recoveries Over 100% for Makewhole Claimants in Violation of the Absolute Priority Rule.

Section 1129(b)(2) of the Bankruptcy Code, commonly referred to as the "absolute priority rule," "provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization plan]." Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 202 (1988). The "corollary of the absolute priority rule is that a senior class cannot receive more than full compensation for its claims." See In re Granite Broad. Corp. et. al., No. 06-12984, 2007 Bankr. LEXIS 1700, at *58 (Bankr. S.D.N.Y. May 18, 2007) (citing In re Exide Techs., 303 B.R. 48, 61 (Bankr. D. Del. 2003)). Stated another way, after a class of creditors receives 100% on account of its claims, all remaining value must flow down the capital structure.

The absolute priority rule also applies to settlements – whether those settlements are approved in the context of confirmation of a plan or not. See Motorola, Inc. v. Official Comm. of Unsecured Creditors (In re Iridium Operating LLC), 478 F.3d 452, 463 n.18 (2d Cir. 2007) (noting that "[c]ourts often state that the purpose of review under the Rule 9019 factors is to determine whether a settlement is 'fair and equitable,'" a standard which "encompassed conformity with the absolute priority rule"). In re Dalen, 259 B.R. 586, 600 (Bankr. W.D. Mich. 2001) (noting that "settlements and compromises which substantially affect a debtor's reorganization, whether incorporated into the plan itself or reached prior to plan confirmation, must meet the same standards for plan confirmation as any other plan term, including the requirement that each term be 'fair and equitable.'"); see also In re Present Co., Inc., 141 B.R. 18, 22 n.2 (Bankr. W.D.N.Y. 1992) (noting that a settlement must be "fair and equitable"). When "determining whether a settlement is 'fair and equitable' under Rule 9019," the bankruptcy court must "be certain that parties to a settlement have not employed a settlement as a means to avoid the priority strictures of the Bankruptcy Code." In re Iridium, 478 F.3d at 464.

Here, the Plan violates the absolute priority rule because it provides for those parties who have been awarded settlement amounts on account of their makewhole claims to receive more than that to which they are entitled – principal plus accrued interest. To date, the Debtors have settled makewhole claims of various secured and unsecured noteholders for a total of $259.32 million.[4] Notwithstanding the fact that these settlements have been approved by the Court, payment of these settled amounts under the Plan will violate the absolute priority rule because

[4] On August 8, 2007, this Court entered an order Approving Amended Stipulation by and Among The Debtors and Debtors in Possession, The Unofficial Committee of Second Lien Debtholders and Wilmington Trust, as Indenture Trustee (together, the "Second Lien Claimants") for The Second Lien Fixed Rate Notes [Docket No. 5567]; on October 10, 2007, this Court entered an order Approving Stipulation Resolving Objections By Indenture Trustee For The Calpine Unsecured Notes And Calpine Unsecured Noteholders (together, the "Unsecured Claimants") To Debtors' Motion For Entry Of An Order Allowing Limited Objection To Claims And Determining Value Of Claims [Docket No. 6250]; on November 27, 2007, this Court entered an order Approving Stipulation By And Among The Debtors And Debtors In Possession, The Official Committee Of Unsecured Creditors Of Calpine Corporation, Wilmington Trust FSB As Indenture Trustee For Calgen First Priority Floating Rate Notes, Wilmington Trust Company As Administrative Agent For Calgen First Priority Term Notes And Whitebox Advisors LLC And Its Affiliates (together, the "First Lien CalGen Claimants") ([Docket No. 6710]; and on November 28, 2007, this Court entered an order Approving Stipulation Resolving all Claims Asserted Against, by and on behalf of the Holders of the First Lien Debt (the "First Lien Claimants") [Docket No. 6731]. In addition, on November 15, 2007, the Debtors filed the Motion for Entry of an Order Pursuant to Bankruptcy Rule 9019 Approving the ULC2 Settlement Agreement (the "ULC2 Settlement") with the ULC2 Indenture Trustee and the Ad Hoc Committee of Creditors of Calpine Canada Energy Finance II ULC (the "ULC2 Claimants," and together with the Second Lien Claimants, Unsecured Claimants, First Lien CalGen Claimants, and First Lien Claimants, the "Makewhole Claimants") [Docket No. 6627]. The ULC2 Settlement provides, among other things, that the ULC2 Indenture Trustee on behalf of the ULC2 Bondholders is afforded one allowed general unsecured claim in the CCAA Proceedings against ULC2 on account of the Make-Whole Premium Claim for US$17,388,025.

none of the claimants seeking makewhole claims (the “Makewhole Claimants”) have a legitimate claim for makewhole premiums or expectation damages.

As argued in numerous pleadings by the Debtors, Creditors’ Committee and Equity Committee, a noteholder may not recover a premium on account of repayment of debt accelerated by a bankruptcy filing unless the indenture specifically provides for a premium upon involuntary repayment or repayment of accelerated debt. See In re Solutia, Inc., No. 03-17949, 2007 WL 3376900, at *9 n.7 (Bankr. S.D.N.Y. Nov. 9, 2007) (noting that the “court cannot supply what is absent” from an agreement). None of the underlying indentures at issue include such a provision. Therefore, none of the Makewhole Claimants are entitled to claims on account of makewhole settlements.

As this Court has previously held, because prepetition debt automatically accelerates to maturity upon the filing of a bankruptcy petition, payment of accelerated debt is a mandatory *re*payment as opposed to a voluntary *pre*payment. In re Calpine Corp., 365 B.R. 392 (Bankr. S.D.N.Y. 2007); see also In re LHD Realty Corp., 726 F.2d 327, 330-31 (7th Cir. 1984) (“acceleration, by definition, advances the maturity date of the debt so that payment thereafter is not prepayment but instead payment made after maturity”); In re Manville Forest Products Corp., 43 B.R. 293, 297 (Bankr. S.D.N.Y. 1984); United States Trust Co. v LTV Steel Co. (In re Chateaugay Corp.), 150 B.R. 529, 542 (Bankr. S.D.N.Y. 1993). This holding was recently affirmed by the District Court for the Southern District of New York. See Aristeia Capital, L.L.C. v. Calpine Corp. (In re Calpine Corp.), Case No. 07-8493, 21-22 (S.D.N.Y. Nov. 21, 2007) (noting that "[m]aturity refers generally to the time when the [n]otes become due and payable" and holding that the notes became due and payable "by virtue of automatic acceleration upon the [d]ebtors' bankruptcy filing").

Accordingly, in chapter 11 a noteholder cannot recover (i) a premium for optional redemption or voluntary repayment of debt or (ii) damages for breach of a no-call provision. See In re Solutia, Inc., 2007 WL 3376900, at *9 n.7 (noting that claimants cannot have any "dashed expectations for which compensation is due" because bankruptcy accelerates the maturity on the underlying notes and the maturity date becomes the petition date); In re Vest Assocs., 217 B.R. 696, 699 (Bankr. S.D.N.Y. 1998); In re Skyler Ridge, 80 B.R. 500, 502 (Bankr. C.D. Cal. 1987) (prohibition on prepayment "is not enforceable in a bankruptcy case"); Cont'l Secs. Corp. v. Shenandoah Nursing Home P'shp, 193 B.R. 769, 774 (W.D. Va. 1996), aff'd, 104 F.3d 359 (4th Cir. 1996).

In light of the foregoing authority, to the extent the Debtors had litigated the makewhole claims at issue, such claims would have been disallowed. Thus, the Debtors' payment of makewhole settlements pursuant to the Plan violates the absolute priority rule because it provides the Makewhole Claimants more than 100% on their claims, while reducing recovery for creditors and interest holders.

## VIII. The Plan Valuation Impermissibly Excludes Avoidance and Other Actions from Property of the Estate.

Claims are a vital piece of the puzzle in any reorganization case and are directly determinative of the recoveries that stakeholders will receive. This is especially true in the Debtors' cases where the value is yet to be determined and the recoveries to stakeholders are unknown. As an exhibit to the Plan, the Debtors have recently filed a supplement [Docket No. 6633] (the "CofA Supplement") listing tens of thousands of potential causes of actions that they are pursuing or may pursue against former officers and directors of the Company as well as various third parties (the "Retained Causes of Action"), amounting to potentially hundreds of millions of additional dollars of value for the Debtors' estates. While the CofA Supplement lists over 370 pages of retained causes of action that could yield significant value for the Debtors' estates, **the Debtors' valuation and distribution scheme fail to account for the value of these causes of action**. Unless equity holders receive 100% of the proceeds of such actions after creditors are paid in full, the Debtors' Plan violates the absolute priority rule. Recoveries obtained by the Debtors on the Retained Causes of Action will increase the value of the shares distributed to creditors and will thereby allow creditors to obtain recoveries well in excess of 100% on account of their claims.

Currently, one of the Debtors' Retained Cause of Action is a fraudulent conveyance action brought against Rosetta Resources Inc. ("Rosetta") for the sale of domestic oil and gas assets. In July 2005, Calpine sold substantially all of its remaining oil and gas assets for $1.05 billion to the management team of Rosetta. Calpine subsequently learned that the Rosetta assets were inadequately assessed at the time of the transaction. The Debtors estimate the value of the assets at approximately $400 million higher than the sale price and believe that they have a strong likelihood of success on account of this claim. Miller Buckfire's valuation, however, fails to take this additional value into account. This claim has significant value that must inure to the benefit of to equity holders.

Unlike a preference action that provides the losing preference defender with a claim against the debtor's estate pursuant to section 502(h) of the Bankruptcy Code for the amount recovered by the debtor, the Retained Causes of Action do not entitle defendants in those actions to a claim against the Debtors' estates for amounts recovered. Therefore, these causes of action represent direct value for the Debtors' estates, and Article IV.D. of the Plan provides that such actions will vest in the reorganized Debtors.[5] As such, unsecured creditors receiving New

5 Similarly, Lazard's valuation analysis does not attribute value to the Debtors' Retained Causes of Action. In contrast, PWP's valuation analysis accounts for the fact that there is incremental value to be gained

Common Stock in full satisfaction of their claims will gain another windfall. As the Debtors receive cash on account of the Retained Causes of Action, the value of the Company will increase, causing the value of the New Common Stock to increase. By not providing a mechanism for distributions on account of successful prosecution of these causes of action, the Plan allows unsecured creditors to receive over 100% of their claims in undervalued New Common Stock.

While the Debtors will likely argue that the CofA Supplement was merely filed to reserve their rights to pursue these potential claims and that they have not determined whether they are going to pursue these claims (i.e., that the CofA Supplement was filed as a prophylactic measure), this argument is meritless. The Debtors' counsel are sophisticated, highly competent and experienced attorneys well aware of Bankruptcy Rule 9011's requirement that any filing with the Court must be made "to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances" or counsel face the potential for sanctions for asserting frivolous claims. See Bankruptcy Rule 9011(b). Accordingly, by filing the CofA Supplement listing hundreds of causes of actions that the Debtors' "might" pursue, the Debtors' counsel subjected themselves to the requirements of Bankruptcy Rule 9011 and implicitly asserted that the causes of action listed on the CofA Supplement must have some value. See Bankruptcy Rule 9011(b). See also In re Dubrowsky, 206 B.R. 30, 36 (Bankr. E.D.N.Y. 1997), aff'd, 244 B.R. 560 (E.D.N.Y. 2000) ("Rule 11 sanctions are warranted where 'a pleading has been interposed for any improper purpose [or if] after reasonable inquiry, a competent attorney could not form a reasonable belief that the pleading is well founded in fact

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through, among other things, retained causes of action. See PWP Calpine Corporation Valuation Report, "Additional Considerations" at p. 7.

and is warranted by existing law or a good faith argument for the extension, modification or reversal of existing law.'").

Furthermore, in the CofA Supplement, the Debtors identified additional potential causes of action in the form of preference actions worth approximately $2 billion.[6] Notably, the Plan does not provide a mechanism for preference creditors to assert a claim against the reorganized Debtors for any recovery as they are permitted to do under section 502(h) of the Bankruptcy Code. Typically, upon a Debtors' recovery of amounts returned through a successful litigation of a preference action, the party returning funds to the Debtors' estates will have a pre-petition claim against the Debtors' estates in the amount returned. See 11 U.S.C. § 502(h) (such claim arises "as if such claim had arisen before the date of the filing of the petition"). However, both the Plan and section 1141 of the Bankruptcy Code provide that confirmation of a plan "discharges the debtor from … any debt of a kind specified … in [section 502(h)]." 11 U.S.C. § 1141(d)(1)(A). Plan at Article VIII(A) (stating that confirmation of the Plan will discharge the Debtors of "all debts of the kind specified in section[] … 502(h)"). Thus, not only does the Plan fail to provide for a mechanism for 502(h) claimants to assert their claims against the Reorganized Debtors, but under the present structure of the Plan, such claims terminate upon confirmation of the Plan.

Accordingly, to the extent that the reorganized Debtors recover funds on account of a preference cause of action – or any of the Retained Causes of Action – such funds will revest with the Debtors, which would necessarily result in an increase in the value of the Debtors' estate post-emergence. As discussed above, this would result in an increase in the value of the

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6 See Debtors' Motion Pursuant to Sections 105(A), 107, 108(A)(2), 363, 546(A), 554, and 547 of the Bankruptcy Code and Bankruptcy Rules 7004, 9006, and 9018 for Order (I) Granting Authority to Debtors to Abandon Certain Causes of Action and (II) Establishing Procedures for Commencement of Certain Adversary Proceedings [Docket No. 6617] at ¶¶ 18-20, which was approved by the Courts' Order dated, November 27, 2007 [Docket No. 6711].

New Common Stock. Because unsecured creditors are receiving the lion's share of the New Common Stock under Plan, the Debtors' unsecured creditors would be the largest beneficiary from a rise in the price of the New Common Stock. Although not likely to occur for some time after the effective date, the increase in the value of the New Common Stock is guaranteed if the Debtors faithfully pursue preference claims and the Retained Causes of Action. The known increase in the New Common Stock will result in unsecured creditors receiving in excess of 100% on account of their claims, in violation of the absolute priority rule.

Because the Debtors are reserving the right to pursue preference claims and the Retained Causes of Action, they must attribute value to such causes of action to enhance total enterprise value or provide a mechanism for distribution of recoveries on account of the causes of action to the Debtors' current equity holders.

## IX. To the Extent the Court Sets Valuation Below $24.4 Billion, the Plan Violates the Absolute Priority Rule and the "Good Faith" Filing Requirement.

As discussed *supra* a chapter 11 plan may not be confirmed if it violates the absolute priority rule by paying senior creditors more than 100% recovery on their claims. To determine whether a chapter 11 plan violates the absolute priority rule, one must determine the recoveries to each class of claim or interest holders. If a chapter 11 plan incorporates a "waterfall" structure, pursuant to which new common stock is distributed first to unsecured creditors, until their claims are satisfied in full, and then to equity holders, then the recoveries that flow to each class is based on the enterprise value of the debtor. In that regard, if the debtor undervalues its estate, the common stock of the reorganized debtor is similarly undervalued, causing the senior class of claimants to receive in excess of 100% on account of their claims. To the extent that a debtor purposefully undercuts its valuation to manipulate an outcome to the debtor's liking, the chapter 11 plan cannot be said to have been filed in good faith.

Section 1129(a)(3) requires that a plan of reorganization be "proposed in good faith and not by any means forbidden by law." 11 USC §1129 (a)(3). When determining whether a debtor's plan meets the good faith requirement of 11 U.S.C. §1129(a)(3), the bankruptcy court looks to the debtor's plan and determines whether "in light of the particular facts and circumstances, whether the plan will fairly achieve a result consistent with the bankruptcy code." In re Madison Hotel Associates, 749 F.2d 410, 425 (7th Cir. 1984). "In evaluating the totality of circumstances surrounding a plan a court has 'considerable judicial discretion' in finding good faith, with the most important feature being an inquiry into the 'fundamental fairness' of the plan." In re Coram Healthcare Corp., 271 B.R. 228, 234 (Bankr. D. Del. 2001) (quoting In re American Family Enterprises, 256 B.R. 377, 401 (D.N.J. 2000); In re New Valley Corp., 168 B.R. 73, 80-81 (Bankr. D.N.J. 1994)).

Nothing that the Debtors have done with respect to the treatment of equity holders can be deemed "fair" or in compliance with the statutory requirements set forth in the Bankruptcy Code. As discussed *supra*, the Debtors are violating the fundamental due process requirements of notice and are vitiating stakeholder protections inherent in the chapter 11 process. Moreover, the Debtors' advisor, Miller Buckfire, has created an artificially low valuation of the Debtors in order to provide a windfall to creditors and to provide management with options that will instantaneously increase in value. Where the Plan eliminates the protections for stakeholders and where the Debtors maniputlate the valuation so as to deny a recovery to existing equity holders, the Debtors have not filed the Plan in "good faith."

The Advisors for the Debtors and the Creditors' Committee, Miller Buckfire and Lazard Frères & Co. LLC ("Lazard"), have put forward grossly undervalued valuation reports for the Debtors' estates. Specifically, Miller Buckfire has put forth a midpoint valuation of $19.35

billion, $918 million lower than in the Disclosure Statement, despite improved future cashflows. Lazard has put forth a midpoint valuation of $16.25 billion, a value that is clearly far below liquidation value. Under either scenario, equity holders will receive no recovery under the Plan in the litigation adjusted claims case. In contrast, PWP's midpoint valuation is $24.4 billion, a valuation that addresses the upside that the Debtors will enjoy for their clean, efficient and green energy generating assets. This midpoint valuation provides equity holders with a recovery of $10.42 per share. Because of the various defects, this Court and its retained experts should afford the Debtors and Creditors' Committee valuation analyses little or no weight and instead adopt PWP's valuation in full.

A. Calpine's Business Plans Have Consistently and Continually Shown Marked Improvement in the Debtors' Key Financial Metrics.

Prior to filing the Plan, in April 2007 the Debtors' released their second business plan, the April Business Plan. The April Business Plan provided an incremental increase in EBITDAR throughout the projection period of approximately $1.17 billion over the December Business Plan. The Debtors again revised their business plan in November 2007, and again incrementally increased their EBITDAR projections – this time by over $600 million, citing higher gas prices, increasing construction costs and, perhaps most importantly, the effect of a national program of carbon regulations (all of which will be discussed in more detail below). In total, the Debtors now anticipate an increase of $1.7 billion over their original EBITDAR projections. In addition, in the November Business Plan, the Debtors released projections for an additional year in the projection period – fiscal year 2013. The Debtors' projections predict EBITDAR growth between 2012 and 2013 of 3.785%.

The Debtors' significant increases in EBITDAR projections between December 2006 through November 2007 are consistent with the Equity Committee's long-held views that

Calpine is poised to grow and generate significant cash over the next five to seven years and beyond. Current and pending environmental regulations will cause production costs to rise, particularly for coal generators who produce more than twice as much carbon dioxide per MW as natural gas generators like Calpine. As production costs rise, higher polluting fuel generators will be pushed toward the margin, and, as a result, the price of power, which is set by the marginal fuel price, will rise substantially. The Debtors' 24,732 MW[7] of generating assets, which are all clean, efficient natural gas and geothermal, will greatly benefit from this price increase. In addition, the Debtors are very well positioned in Texas and California, regions with low reserve margins and increasing load demands, and stand to benefit greatly from rising power prices, increased environmental regulation, and tightening reserve margins. Although Calpine acknowledged these positive factors in its November Business Plan, and showed the corresponding increased EBITDAR projections, the Debtors' financial advisor, Miller Buckfire, managed to wipe out all these positive factors by changing its valuation metrics in the New Valuation Analysis.

B. <u>The Analysis Underlying Miller Buckfire's Valuation Reports is Flawed and Undervalues Critical Metrics That Raise the Debtors' Valuation</u>

The Disclosure Statement sets forth the initial valuation analysis conducted by Miller Buckfire (the "Disclosure Statement Valuation Analysis"). Miller Buckfire used two methodologies in its valuation analysis: comparable companies ("Comparable Companies") and discounted cash flow ("DCF"). Within the DCF analysis, Miller Buckfire used the perpetuity method and terminal multiple method. The Disclosure Statement Valuation Analysis resulted in a total enterprise value ("TEV") range of $19.2 billion to $21.3 billion, with a midpoint TEV of $20.268 billion. This included the value of the Debtors NOL carry-forwards. When combined

7 This includes capacity currently under construction.

with excess cash, at the midpoint, the total distributable value to claim and interest holders was $21.697 billion. Interest holders, on a per share basis, were predicted to recover between $0.00 and $3.01, with a midpoint recovery of $1.94 based on the litigation-adjusted value of claims.

Then, five months later, and after the Debtors released new EBITDAR projections that showed well over $600 million of incremental cash flow, the Debtors released the New Valuation Analysis, which, through slight of hand, erased over $900 million dollars of value. The New Valuation Analysis, released on November 19, 2007, had a new TEV range of $18.3 billion to $20.4 billion, with a midpoint TEV of $19.35 billion. When combined with excess cash, at the midpoint, the total distributable value to claim and interest holders was $20.883 billion. Combined with a refined claims analysis, Miller Buckfire predicted that interest holders would recover between $0.00 and $1.77 per share, with ***no recovery*** at the midpoint. In order to achieve this tremendously suppressed valuation at a time when the Debtors have consistently predicted substantially increased cash flows, Miller Buckfire improperly manipulated its valuation methodologies.

1. Miller Buckfire's Comparable Companies Analysis Disregards Critical Distinctions Between the Debtors' Business and Similar Companies.

For the Comparable Companies analysis, the Equity Committee chose the following Comparable Companies: (i) NRG Energy, Inc. ("NRG"); (ii) Mirant Corporation ("Mirant"); (iii) Reliant Energy, Inc. ("Reliant"); and (iv) Dynegy Inc. ("Dynegy," together with NRG, Mirant and Reliant, the "Comparable Companies"). Miller Buckfire and Lazard used a similar set of companies in their Comparable Companies Analysis. However, Miller Buckfire has seized on the decline in the trading value of the comparable companies, that is due, in part, to the fact that these other companies all have significant coal generating assets, which produce more carbon dioxide, and, in part, to the overall decline in the markets arising from the current credit crunch.

The decline in the so-called Comparable Companies allowed Miller Buckfire to tweak its new valuation analysis so as to erase a large portion of the $900 million in value. There are a number of additional serious problems in each of Miller Buckfire's analyses, each of which renders this valuation method largely inaccurate as an indicator of value.

First, Miller Buckfire used the closing prices of the Comparable Companies from a single trading day rather than a range of days. In a volatile market, this method provides a wildly inaccurate snapshot of the Comparable Companies' TEV based on a single day of trading. By way of example, had Miller Buckfire chosen November 7, 2007, the closing price of the shares of common stock of the Comparable Companies all would have been far higher. Miller Buckfire's analysis is skewed downward because the shares of common stock of the Comparable Companies traded at or near their lowest levels in the period in just prior to expert reports being due. To account for market volatility and to normalize the share price, it would have been more appropriate to use a 20 or 30-day average trading price. Miller Buckfire's use of only one-trading day artificially depresses the TEV of the Comparable Companies, resulting in artificially depressed TEV/EBITDAR multiples.

Second, Miller Buckfire changed the projections periods used in its Comparable Companies analysis. In the Disclosure Statement Valuation Analysis, Miller Buckfire used two forward years in its analysis. In the New Valuation Analysis, however, Miller Buckfire used only 2008 instead of 2008 and 2009. By removing one year of projections, and not using 2009 EBITDAR projection in the New Valuation Analysis, none of the significant increase in the Debtors' business plan projections between 2008 and 2009 was captured in the New Valuation Analysis.

Third, none of the "Comparable Companies" are directly comparable to Calpine, which is a unique power company. As a result, determination and application of premium multiples, arguably the most important aspect of the Comparable Companies analysis, do not accurately reflect the value of Calpine. All of the Comparable Companies have significant coal generating assets. Current and pending environmental regulations along with anticipated carbon legislation will add significant incremental costs to the production of power with "dirty" fuels, such as coal and oil, making these forms of energy increasingly expensive when compared to gas-fired power. The Debtors are also well positioned to capitalize on the demand for clean fuel created by these current and expected environmental regulations.

Current sulfur dioxide ("SO2"), nitrogen oxide ("NOx") and mercury regulations disproportionately affect coal-fired generating assets because the burning of coal releases a large amount of these environmental pollutants. The Clean Air Act has enabled a cap and trade regulation for these pollutants and these restrictions are more burdensome each year, increasing the cost of coal-fired power generation. In order to continue to produce power with coal, companies have to outfit their plants with scrubbers to reduce the release of SO2, NOx and mercury or buy credits that allow the company to emit the pollutants. Accordingly, each year, environmental capital expenditures by coal-fired operators increases, increasing the production cost of coal-fired power generation. The total effect is that the price of coal-fired power production will rise above the cost of gas-fired power production (which involves the limited release of environmental pollutants). Producing power with gas will be cheaper than coal, pushing gas-fired generating plants into baseload generation, where they will earn increased revenues margins. This will benefit clean natural gas-fired power producers like the Debtors.

The benefits to gas-fired power producers are augmented even further when you consider carbon regulation. The Clean Air Act does not address carbon - the environmental pollutant most linked to global climate change. There is little dispute that carbon regulation is imminent – there are no less then seven bills proposed in Congress that will limit the release of carbon as an environmental pollutant. Under any system that regulates carbon emissions (either a tax or a cap and trade system), the production costs for dirty generating assets (which release a disproportionately large amount of carbon as compared to gas-fired generating assets) increases. PA Consulting Group cited carbon legislation regulations as one of the key reasons for the increased EBITDAR projections in the November Business Plan. As with other environmental regulations that have a disproportionate effect on coal and oil-fired power production, carbon regulation would increase the production cost of coal and oil-fired power production, pushing gas-fired generation into baseload and increasing the value of gas-fired generating assets.

It is also important to note that existing coal and oil-fired generating assets cannot be retrofitted with "scrubbers" to remove carbon pollution as they can for SO2, NOx, and mercury. Accordingly, because of increased production costs, coal and oil-fired generating assets are less likely to even come online in the future. The effects of this are being seen already. In Florida, 4,400 MW of coal-fired generating assets have been cancelled in 2007 alone; in Kansas, the Secretary of Health and Environment denied air permits for two new large coal plants; in California, the Global Warming Solutions Act effectively precludes coal-based power from entering or serving the state; and, in early 2007, TXU Corporation announced it was canceling plans to build eight new coal plants. The market recognizes that coal-fired generating assets are not economically sensible and that environment regulations will make the cost of coal-fired power far more expensive.

The Debtors have no coal or oil-fired generating assets. 97% of the Debtors' energy comes from gas-fired plants and the remaining 3% from geothermal assets. NRG produces 27% of its power from coal and 14% from oil. Mirant produces 5% of its power solely from coal and another 62% from generators that combine oil, coal and gas. Dynegy produces 25% of its power from coal and 14% from generators that combine oil and gas. Finally, Reliant produces 30% of its power solely from coal and another 17% from generators that combine oil and gas. Based on fuel-mix, the Debtors are better positioned as a company for the pending and upcoming environmental regulations.

The Debtors own one of the most unique power generating assets in the country – the Geysers. The Geysers are a geothermal power generating facility located in California that generate in excess of 700 MW of clean, renewable power in the valuable (and environmentally conscious) California market. In addition to the baseload power produced by the Geysers, the Geysers generate significant revenue from renewable energy credits. Recognizing the value of geothermal, renewable operating assets in the California market, the Debtors have undertaken to significantly increase the generating capacity of the Geysers over the next ten years. Nevertheless, Miller Buckfire and Lazard substantially undervalue the Geysers.

2. Miller Buckfire's DCF Analysis Undervalues the Debtors' Tremendous Future Growth Prospects

Miller Buckfire similarly changed essential elements of its valuation methodologies without explanation in the DCF Analysis. Under the terminal multiple method in the Disclosure Statement Valuation Analysis, Miller Buckfire employed a terminal multiple of 9.5x to10.5x and a discount rate ("WACC") range of 8.25% to 8.75%. In its New Valuation Analysis, Miller Buckfire lowered its terminal multiple range and raised its WACC rate range. Based solely on the change in the terminal multiple, Miller Buckfire erased nearly $2.47 billion from the

Debtors' terminal value. Had it applied the midpoint terminal multiple consistently, the terminal value of the Debtors given the new EBITDAR projections would have been $26.05[8], versus $22.63 billion based on the previous EBITDAR projections. Miller Buckfire gave no explanation as to why it decreased its terminal multiple by one full turn. Given the tremendous growth prospects of the Debtors, as evidenced by the Company's own ever increasing EBITDAR projections, the terminal multiple should have remained the same, if not increased, from the Disclosure Statement Valuation Analysis to the New Valuation Analysis.

In addition to the terminal multiple method, Miller Buckfire employed a perpetuity growth method. The perpetuity growth method attempts to estimate the growth of a company's cash flows into perpetuity. This method is useful for mature companies, whose growth rates are very consistent over time. Such a method for Calpine, however, is inappropriate.

While the perpetuity method is inappropriate, Miller Buckfire's choice of the perpetuity growth rate in the New Valuation Analysis is also perplexing. In the Disclosure Statement Valuation Analysis, Miller Buckfire used a perpetuity growth rate of 1.75% to 2.25%. This set the baseline for the applicable perpetuity growth rate of the Debtors' cash flows based off the Debtors' predicted cash flows from their April Business Plan. However, in the November Business Plan, as discussed above, the Debtors greatly increased their cash flows projections. The logical conclusion from this increase, as demonstrated from the high rate of cash flow growth discussed above, is that into perpetuity it could be expected that the Debtors' cash flows would grow at a higher rate. Accordingly, in its New Valuation Analysis, to the extent that the perpetuity growth rate is a proper valuation method for Calpine, Miller Buckfire should have increased the perpetuity growth rate.

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8 This terminal value is based off the 2013 EBITDAR projections.

C. <u>Lazard's Valuation Report is Flawed and Undervalues Critical Metrics That Govern a Proper Valuation of the Debtors</u>

Lazard, financial advisor to the Creditors' Committee, also released a valuation report (the "Lazard Valuation Analysis"). Lazard used the same valuation techniques employed by PWP and Miller Buckfire, but tortured and stretched the valuation metrics to put forth a value far out of touch with the reality of the market. Lazard conducted six analyses – each of which produced a range of value completely different from the other analyses. Lazard's range of values is all over the map – there is no consistency in its analyses. As a result, because Lazard cannot produce consistent results, either its techniques are flawed or the metrics it has used were chosen specifically to gerrymander a low result. Furthermore, where there was overlap in value ranges, it was always in ranges that are excess of the final observed value. Because Lazard gives no indication as to how it weighed its results, it is clear that Lazard chose its midpoint value out of thin air and in a manner that best suited its client.

Lazard utilized a number of the same valuation techniques employed by Miller Buckfire and PWP, in particular, the Comparable Company analysis and the DCF analysis. Lazard also used Comparable Companies. In its Comparable Companies analysis, Lazard explicitly recognizes that additional value would be realized if a 30-day trading average was utilized, nonetheless, it actually uses a single day trading price. That it utilized a different day than Miller Buckfire highlights the vagaries of using a single day trading price. Utilizing a 20 or 30-day trading average (or even longer) eases the risk that the markets have not fully digested news or have over or under reacted to new or changing market conditions.

As has been recognized by nearly everyone in these chapter 11 cases, in the industry and by analysts, Calpine is poised for significant growth in the upcoming years because of the geographic location of its generating assets, the fuel mix of its generating assets, its environmental position relative to coal-fired generating assets, its ownership of the Geysers, and its significant NOLs. Given the facts laid out above regarding the fundamental differences between Calpine and the Comparable Companies, and a host of other issues that will be the subject of many hours of confirmation hearings, including underestimating the impact of environmental regulations, the Creditors' Committee valuation analysis is fatally flawed.

D. The Equity Committee's Valuation Analysis Properly and Conservatively Considers the Debtors' Future Value

Based on an analysis conducted by the Equity Committee and its financial advisor, PWP, the actual new Calpine TEV is significantly higher than the Debtors' estimated new Calpine TEV. Based upon an analysis prepared by PWP, the Equity Committee believes the total distributable value is between $24.8 billion and $26.9 billion, with a midpoint value of $25.8 billion. Accordingly, based upon the Debtors' estimates of high claims and low claims from the Disclosure Statement, the Equity Committee believes that equity holders should receive New Common Stock with a value between $8.54 and $10.56 per share, with a midpoint value of $9.82[9] per share. At this mid-point value, equity holders would receive 35% of the shares of New Common Stock.

PWP's valuation analysis was conducted much in the same way that Miller Buckfire conducted its valuation analysis, without the errors in methodology. PWP used both the Comparable Companies and DCF Analysis. In its Comparable Company analysis, PWP used a 20-day trading average in order to normalize fluctuations in the trading price in the common stock of the Comparable Companies, utilized two projection periods, and applied an appropriate multiple premium - based on the factors outlined above. In addition, PWP, recognizing that the Debtors cash flow growth rates were not stable and that the Debtors would not be a stable

9 These distributions are based on the Debtors revised claims estimates.

company, did not apply the perpetuity growth method. Finally, in applying the DCF analysis, PWP used an appropriate terminal multiple – one that closely mirrors the multiple applied in the Comparable Company analysis and applied the appropriate WACC rate.

In addition to its Comparable Companies and DCF analyses, PWP employed a replacement cost analysis that estimates the present value cost to replace the Debtors' fleet of operating assets. Miller Buckfire, for no logical reason, did not utilize a replacement cost analysis even though such a tool for valuing the Debtors' generating assets is well-recognized within the Company. Replacement cost, or construction cost, estimates what it would cost to build a new generating plant based on current market conditions. The nationwide demand for power is constantly growing and is not predicted to decrease in the future. In order to meet the growing demand for power, and to avoid blackouts, brownouts and shortages, power markets must meet the additional capacity requirements. Throughout each of the NERC regions there is currently sufficient capacity to meet demand. However, the point of equilibrium, when demand equals capacity, is quickly approaching.[10] At the point of equilibrium, either new capacity must be available or shortages will occur. The current value of a generating fleet is often derived from the present value of the future costs to build new generating facilities when the market reaches equilibrium.

During the last three to four years, the costs of labor and raw materials and the price of equipment used in the construction of utility infrastructure, including generation, have increased at rates greater than historically experienced or anticipated in the industry. The cost of the main raw materials needed to build a generating facility – copper, nickel, iron-steel, and heavy

10 Pursuant to the NERC 2007 Long-Term Reliability Assessment (the "NERC Assessment"), additional capacity is assumed to be added as follows: New England 2009, New York 2011, RFC 2012, SPP 2015, MRO 2010, WECC 2009, ERCOT 2009, AZ/NM/SNV 2009. See NERC Assessment at 11. A copy of the NERC Assessment can be accessed through the NERC website at www.nerc.com.

construction – have all increased significantly. Accordingly, the cost to replace the Debtors' current generating fleet is very high.

Replacement cost analysis predicts what it would cost to rebuild the Debtors' current fleet of generating assets in today's market, which will be required as the energy market moves towards equilibrium. Because of increased construction costs and the fact that coal-fired generating assets are unlikely to enter the market due to tightening environmental regulations meant to push polluting producers from the market, the replacement cost of the Debtors' gas-fired generating assets is estimated to be between $880/kW and $1,050/kW, depending on the region, with a midpoint value total replacement cost of $23.75 billion. Discounted to the present, exclusive of the Geysers, the midpoint value is $18.95 billion. Add in the estimated value of the Geysers ($4.9 billion at the midpoint), the present value of the replacement cost of the Debtors' generating fleet is $23.85 billion. This estimate is for 2007 and does not account for increasing construction costs, which could add additional significant value in terms of replacement costs.

In light of the foregoing, it is clear that the Debtors' and Creditors' Committees have undervalued the Company due to flaws in Miller Buckfire's and Lazard's valuation methodologies, misleading its constituents and manipulating the market.

## RESERVATION OF RIGHTS

Considering that the Debtors filed the Debtors' Valuation Report a mere eleven days prior to the deadline for objecting to confirmation of the Plan and that discovery is on-going, the Equity Committee reserves its rights to amend or supplement this Objection to add additional legal or factual arguments prior to or at the Confirmation Hearing.

## **CONCLUSION**

For all of the foregoing reasons, the Debtors' Plan, in its current form, is unconfirmable and, accordingly, the Equity Committee respectfully requests that the Court deny the Debtors' request for confirmation of the Plan.

Dated: New York, New York
November 30, 2007

Respectfully submitted,

FRIED, FRANK, HARRIS, SHRIVER
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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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|---|---|---|
| In re: | : | Chapter 11 |
| Calpine Corporation, et al., | : | Case No. 05-60200 (BRL) (Jointly Administered) |
| Debtors. | : | |

**CERTIFICATE OF SERVICE**

I, Michael Birnbaum, certify under penalty of perjury pursuant to 28 U.S.C. § 1746 that on November 30, 2007, I caused to be served by Federal Express and electronic mail transmission the Preliminary Objection of the Official Committee of Equity Security Holders of Calpine Corporation to Confirmation of the Debtors' Fourth Amended Joint Plan of Reorganization Pursuant to Chapter 11 of the United States Bankruptcy Code (the "Objection") upon the parties listed on Service List A.

Dated: New York, New York
November 30, 2007

/s/ Matthew M. Roose
Michael Birnbaum

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