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

In re:)	
)	
)	Chapter 11
Calpine Corporation, <u>et al.</u> ,)	
)	Case No. 05-____ (____)
Debtors.)	Jointly Administered
)	

**MOTION OF DEBTORS FOR ORDER (A) AUTHORIZING PAYMENT OF
PREPETITION CLAIMS OF CRITICAL VENDORS AND SERVICE PROVIDERS,
AND (B) AUTHORIZING AND DIRECTING FINANCIAL INSTITUTIONS TO HONOR
AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH CLAIMS**

The above-captioned debtors (collectively, the “Debtors”) hereby move the Court (the “Motion”) for the entry of an order, substantially in the form attached hereto as **Exhibit A**, (a) authorizing, but not directing, the Debtors to pay, in the Debtors’ sole discretion, the prepetition claims of certain critical vendors and service providers in an aggregate amount not to exceed \$20 million on the terms described herein, and (b) authorizing and directing financial institutions to honor and process checks and transfers related to such claims. In support of this Motion, the Debtors respectfully state as follows:¹

¹ In further support of the Motion, the Debtors submit the Declaration of Eric Pryor (the “Pryor Declaration”), which is annexed to the Motion as **Exhibit B**.

Jurisdiction

1. The Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2).
2. Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409.
3. The statutory predicates for the relief requested herein are sections 105(a), 363 and 364 of the Bankruptcy Code, 11 U.S.C. §§ 101-1330, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the “Bankruptcy Code”).

Background

4. On the date hereof (the “Petition Date”), the Debtors filed their voluntary petitions for relief (the “Chapter 11 Cases”) under chapter 11 of the Bankruptcy Code. The Debtors are operating their businesses and managing their properties as debtors in possession pursuant to §§ 1107(a) and 1108 of the Bankruptcy Code.

5. Calpine Corporation (“Calpine”), together with its direct and indirect subsidiaries (collectively, the “Company”), is involved in the development, construction, ownership and operation of power generation facilities and the sale of electricity and its by-product, thermal energy, primarily in the form of steam, predominantly in North America. It operates the largest fleet of natural gas-fired power plants in North America, and supplies approximately 3.5% of the electricity consumed in the United States, where the Company has ownership interests in, and operates, gas-fired power generation and cogeneration facilities, pipelines, geothermal steam fields and geothermal power generation facilities.

6. The Company owns, leases and operates 92 power plants in 21 states in the United States and three provinces in Canada. The Company also has interests in an additional five plants under active construction, including an interest in a natural gas-fired facility in Mexico. The Company markets electricity produced by its generating facilities to utilities and

other third party purchasers while thermal energy produced by the gas-fired power cogeneration facilities is sold primarily to industrial users. The Company offers to third parties energy procurement, liquidation and risk management services, combustion turbine component parts, engineering, and repair and maintenance services.

7. The Company is headquartered in San Jose, California, and employs approximately 3,302 people, of whom approximately 65 are represented by collective bargaining agreements.

8. The Company was founded in 1984 to manage energy projects and provide consulting services to power generators. The Company acquired its first megawatt in 1989 and completed its initial public offering in 1996. Since that time, the Company has ambitiously pursued its goal of acquiring and developing the energy industry's leading fleet of efficient, clean and reliable power generation facilities. To that end, between 2001 and 2004, the Company more than doubled the number of its power plants and can presently deliver more than 26,000 megawatts of electricity, with approximately 2,000 megawatts under active construction, or enough power altogether for approximately 28 million households.

9. The advanced technologies and cleaner fuel sources employed by the Company operate at significantly lower heat rates (a measure of efficiency), allowing for reduced fuel costs and strong competitive advantages, assuming free market-based competition. Within its major markets, the Company also seeks to locate its natural gas-fired plants in clusters, or "systems", to gain operational and supply-chain efficiencies.

10. One of the hallmarks of the Company's business model is its commitment to environmental responsibility. By focusing on the construction of modern, natural gas-fired and geothermal power plants – which emit significantly less carbon monoxide and other toxic substances than coal-fired facilities – the Company believes it currently has the largest, cleanest and most fuel-efficient fleet of power plants in the industry. The majority of the Company's

plants use “combined cycle” generation; *i.e.*, natural gas-fired combustion turbines and steam turbines that operate in tandem to generate power. This process requires up to 40% less fuel than older technologies and has a much lower environmental impact. The Company is also one of the world’s largest (if not the largest) producers of renewable and clean geothermal power, a natural energy source that burns no fossil fuels and thus has only negligible air emissions. Located in northern California at The Geysers, the Company has more than 350 active production wells providing steam that is piped into turbines to generate electricity.

11. Among the Company’s principal subsidiaries and affiliates are Calpine Energy Services, L.P., which offers to third parties energy procurement, liquidation and risk management services; Calpine Turbine Services, which sells combustion turbine component parts and repair and maintenance services;² Calpine Power Services, Inc., which provides engineering, procurement, construction management, commissioning and operations and management services; and Calpine Construct, which develops and builds new power facilities.

The United States Electricity Market

12. The energy generation industry is one of the largest segments of the United States economy. Until recently, electricity providers consisted of relatively few utility monopolies operating aged, inefficient, expensive and high-pollution facilities. But various industry trends, including deregulation, have introduced greater competition into energy markets. Most significantly, for the past decade, at the deregulated wholesale level, electric power generators have been able to sell directly to public utilities, municipalities and electric cooperatives.

13. The majority of United States power plants are coal-fired or nuclear, although most new power plants are fueled by natural gas. Future environmental protection initiatives

² Calpine Turbine Services in turn includes Power Systems Mfg., LLC, in Jupiter, Florida, Thomassen Turbine Systems America, Inc. and Thomassen Turbine Systems B.V., in the Netherlands.

could force many of the oldest and dirtiest coal plants to install costly emission control devices or close. Accordingly, the industry trend is likely to continue to be construction of cleaner and more efficient natural gas-fired facilities.

14. The Company's business model seeks to capitalize on these industry movements towards greater competition and cleaner fuel sources. But although the overall consumption rate of electricity continues to grow, the recent completion of many natural gas-fired combustion turbine projects has led to a sharp increase in power supplies and excess capacity in many of the Company's markets. During 2005, the Company operated at an average baseload capacity factor of approximately 45% through November. At the same time, the presently high cost of natural gas has made the operation of natural gas-fired plants more expensive. The combination of these two factors – an oversupply of electricity and the expensive price of natural gas fuel – has caused severe liquidity challenges for many of the power providers in the United States electricity markets, including the Company.

Summary of Prepetition Indebtedness

15. As set forth in the form 10-K filed by the Company on March 31, 2005, as of December 31, 2004, the Company's total consolidated funded debt was approximately \$18.0 billion, consisting of secured construction/project financing, capital lease obligations, senior notes and institutional term loans, convertible senior notes, preferred interests, trust preferred securities, secured and unsecured notes payable and borrowings under lines of credit. Moreover, as of the Petition Date, the Company had accumulated approximately \$3.9 billion of net operating loss carryforwards and other tax credits.

Events Leading to the Chapter 11 Cases

16. As noted above, the Company more than doubled its installed capacity between 2001 and 2004. This rapid expansion was funded primarily by incurring additional debt. Obligations to service this debt, coupled with challenging market conditions for electricity

providers generally and in certain regional markets for the Company specifically, as well as other recent setbacks faced by the Company, have precipitated these Chapter 11 Cases.

17. The cost of natural gas – needed to fuel the Company’s fleet of mostly natural gas-fired combustion plants – has risen to a historically high level while the cost of coal is relatively much lower. This persisting imbalance places the Company at a severe disadvantage as compared to its competitors that operate coal-fired facilities. The effect was exacerbated when the Company sold substantially all of its remaining oil and natural gas reserves in July 2005. Prior to the sale, the Company’s cost to produce natural gas was significantly lower than natural gas prices in recent years and the sale left the Company in an unhedged, short fixed-price gas position.

18. In addition, excess capacity in the energy market resulted in the Company running at an average baseload capacity factor during the past year of approximately 45%. This has resulted in lower revenues than the Company is capable of generating were it to run at optimal capacity levels. Excess capacity in the energy market (including due to the continued operation of coal-burning facilities) over the past several years has also resulted in a sustained period of low spark spreads (the difference between the cost of fuel and electricity revenues), particularly in the Southeast as well as in certain other markets in which the Company operates. Furthermore, certain contract constraints and other obligations prevent the Company from shutting down facilities that are not generating sufficient power to cover costs.

19. One reason for the presently high cost of natural gas is constrained supplies from traditional drilling programs relative to demand. Although the high prices have led to initiatives to develop alternative supply options such as liquid natural gas or coal gasification, such alternative sources of fuel are not currently available to the Company. So long as the price of natural gas remains high (or increases further), and the Company does not have access to significant sources of alternative fuel supplies, the Company will be adversely affected.

20. The inconsistent transition to deregulated energy markets in North America exposes the Company to varying competitive pressures. In deregulated, highly competitive markets, the Company's natural gas-fired or geothermal merchant capacity competes directly with all other sources of electricity, such as nuclear, coal, oil or gas-fired. In highly regulated, uncompetitive markets, however, a local utility relies largely on its own supply to satisfy its own demand before buying competitively provided power. It is a sizable challenge for the Company to operate within and among these varying environments.

21. The Company relied heavily on debt financing to fund its rapid growth. Satisfying its obligations under its indebtedness, while funding anticipated capital expenditures and working capital requirements during what has been a period of low average baseload capacity factors and depressed spark spreads has left the Company with liquidity shortfalls. Accordingly, the Company launched a strategic initiative to reduce debt in May 2005 that included the possible sale or monetization of certain of the Company's assets. But covenant restrictions in the Company's debt (and certain equity) instruments preclude the Company from undertaking certain of these transactions or restrict the use of proceeds therefrom. Thus, the Company has been prevented from raising the necessary money to fund its debt service and operational needs or, even if such transactions could be completed, using the proceeds to reduce its debt.

22. A number of recent setbacks to the Company's liquidity position culminated in the filing of the Chapter 11 Cases. Most significantly, the Company's use of certain asset sale proceeds to purchase fuel for its power plants resulted in litigation with the trustees representing the holders of the Company's First- and Second-Lien Notes, who alleged that the use of the asset sale proceeds violated the terms of the indentures governing those Notes. Within the last month, the Delaware Chancery Court ruled that the Company's fuel purchases violated those indentures and ordered the Company to repay into a collateral account \$313 million plus interest by January 22, 2006. The Company appealed this decision but, on December 16, 2005, the Delaware

Supreme Court affirmed the decision of the Chancery Court requiring that those funds be repaid. The prospect of having to satisfy such a sizable judgment in such a short period of time – along with the other factors described above – have made it necessary for the Company to commence reorganization cases under the Bankruptcy Code.

Critical Vendor Claims

23. The Debtors businesses are comprised of several business segments, including, among others, segments specializing in energy production, energy trading, energy management and consulting services. With respect to the Debtors' core energy production business, the Debtors are an independent power producer with an integrated system of energy centers. By pooling generating facilities into energy systems in strategic power markets, the Debtors supply their customers with customized energy packages from a fleet of more than 90 natural gas-fired and geothermal power plants, which collectively have a capacity of more than 26,000 megawatts.

24. To ensure the continued and uninterrupted operation of the Debtors' businesses and, in particular, to ensure the continuous operation of their core energy production business, the Debtors are seeking relief intended to address potential refusals on the part of certain vendors or service providers with prepetition claims against one or more of the Debtors to provide services after the Petition Date.

25. According to the Debtors' books and records, the total number of vendors to whom the Debtors may owe prepetition amounts is over 10,000 as of the Petition Date. Of this amount, the Debtors currently estimate that only approximately 175 vendors (the "Critical Vendors"), or approximately 1.75% of the Debtors' prepetition trade creditors in the aggregate, provide either "single source" goods or other goods and services that are essential to the uninterrupted functioning of the Debtors' business operations, cannot be obtained elsewhere or

cannot be replaced except at exorbitant costs to the estates.³ As stated in the Pryor Declaration, the Debtors' ability to continue their operations in the aftermath of their commencement of the Chapter 11 Cases will largely depend upon the continued provision of goods and services by the Critical Vendors. As set forth below and as further stated in the Pryor Declaration, the Debtors have implemented a detailed process to determine which vendors are Critical Vendors for the purpose of avoiding disruption to the Debtors' operations. Moreover, to further ensure that the Debtors' business operations will be minimally impacted during the Chapter 11 Cases, only those Critical Vendors who agree to provide reasonable and customary payment terms postpetition will be paid all or a portion of their prepetition claims.

26. The Debtors' Critical Vendors are comprised of, among others, Regulatory Compliance Vendors, Single Source Vendors and Equipment Maintenance/Specialized Labor Vendors, as discussed in greater detail below. The Debtors seek to pay all or part of the prepetition claims (the "Critical Vendor Claims") of these Critical Vendors to ensure that the Critical Vendors provide necessary goods and services to the Debtors on a postpetition basis.

27. Accordingly, the relief requested herein is narrowly tailored to facilitate the Debtors' restructuring efforts. By contrast, the harm suffered by the estates if essential goods and services of the Critical Vendors are postponed or terminated would be irreparable to the Debtors' reorganization efforts and the expeditious and successful emergence from the Chapter 11 Cases.

A. *Regulatory Compliance Vendors*

28. In the ordinary course of their businesses, the Debtors rely on a number of Critical Vendors to assist the Debtors in complying with applicable governmental laws and regulations

³ The Debtors are continuing to review and refine the Critical Vendor data, in accordance with the procedures specified herein, and, to the extent necessary, will provide supplemental information regarding such data.

(collectively, the “Regulatory Compliance Vendors”). For example, the Debtors rely on certain disposal companies to remove regulated waste and chemicals from the Debtors’ facilities for proper disposal, as well as companies who perform emissions testing. Since the Regulatory Compliance Vendors are typically employed and/or licensed by the state or local governments in jurisdictions where the Debtors operate, the Debtors cannot obtain qualified service from any other source.

29. The Debtors believe that some of the Regulatory Compliance Vendors will refuse to perform postpetition services if their prepetition claims are not paid, thereby exposing the Debtors to the risk of noncompliance with applicable governmental laws and regulations. Any such potential violation of applicable governmental laws and regulations could cause governmental entities to attempt to levy fines or penalties against the Debtors or require closing of facilities. In addition, proper disposal of the regulated waste and chemicals on an uninterrupted basis will help to protect the environment and benefit the public health, including the health and safety of the Debtors’ employees.

30. Since the Debtors must comply with applicable governmental laws and regulations on a postpetition basis and cannot afford the potentially irreparable damage to their businesses that would be caused by adverse governmental action for regulatory noncompliance, the Debtors believe that their ability, in their sole discretion, to pay the Regulatory Compliance Vendors is essential to their reorganization efforts.

B. Single Source Vendors

31. In the ordinary course of their businesses, the Debtors rely on a number of Critical Vendors to supply essential raw materials, specialized replacement parts and supplies, operations consumables and certain other goods and services required to operate the Debtors’ plants and ensure continuous business operations (collectively, the “Single Source Goods”). Typically, the

Single Source Goods are available only from the Debtors' existing suppliers that are Critical Vendors (collectively, the "Single Source Vendors").

32. In some cases, other suppliers cannot supply the required Single Source Goods in sufficient quantity, quality or reliability, or they are unable to supply the required Single Source Goods on a cost-efficient and timely basis in the appropriate geographic areas. For example, each power plant is designed to utilize bulk quantities of certain "laboratory grade" chemicals, such as ammonia, hydrogen and specialized diesel fuel, as part of its energy production and pollution control activities. Due to the chemical specifications and quantities involved, the Debtors are dependent on a few Critical Vendors nationwide that can provide such chemicals to their plants in order to keep the plants running and compliant with environmental regulations. Similarly, other Single Source Vendors supply the Debtors with specially fabricated repair and replacement parts for the Debtors' turbines, transformers, boilers and other equipment used in the power generation process. Typically, this equipment is based upon patented designs available only from the manufacturer or is made or provided to the Debtors' exact specifications.

33. Since the Debtors do not have viable alternatives to obtain substitute Single Source Goods from other suppliers, they have determined that they must be able to satisfy the prepetition claims of these Single Source Vendors, in the Debtors' discretion, to ensure the continued delivery of the Single Source Goods to their plants and operational locations without interruption.

C. Equipment Maintenance/Specialized Labor Vendors

34. To ensure that the wide range of specialized equipment required for energy production and pollution control, including, without limitation, boilers, turbines, pumps and other ancillary equipment, operates in an effective, safe and efficient manner, the Debtors rely on specialized maintenance and repair services provided by certain Critical Vendors (collectively the "Equipment Maintenance/Specialized Labor Vendors"). Further, due to the specialized and

often hazardous nature of some of the services involved, certain of the services can only be obtained by the Debtors from the Equipment Maintenance/Specialized Labor Vendors with permits or licenses as required by state or federal laws and regulations. For example, routine maintenance and repair services that can typically be performed by a wide range of vendors (e.g., welding, electrical and waste removal services) can only be performed by certain Equipment Maintenance/Specialized Labor Vendors possessing specialized skills and/or licenses when the services involve specialized or dangerous elements. Specialized or dangerous elements may include, among other things, high speed rotation motors, toxic substances, high voltage electricity and high pressure vessels.

35. Further, the Debtors' plant staffing model places a great deal of importance on the services provided by the Equipment Maintenance/Specialized Labor Vendors. Unlike other energy companies, the Debtors' plants are operated with minimal in-house staffing capable of performing routine maintenance, but supplemented by the specialized maintenance and repair services provided by the Equipment Maintenance/Specialized Labor Vendors on a regular or as-needed basis. For example, the Debtors may operate a 600-megawatt plant with an in-house staff of only 24 people, while the same plant typically requires an in-house staff of 80 people to function without the services provided by the Equipment Maintenance/Specialized Labor Vendors.

36. Due to the limited availability of vendors able to provide the Debtors with these specialized maintenance and repair services, the Debtors believe that some of the Equipment Maintenance/Specialized Labor Vendors will refuse to provide postpetition goods and services to the Debtors if all or a portion of their prepetition claims are not satisfied. Although the Debtors will make every effort to obtain continued performance from the Equipment Maintenance/Specialized Labor Vendors, it is vitally important that the equipment required for energy production and pollution control be maintained in an appropriate manner to reduce the risk of disruption to the Debtors' operations. It is, therefore, crucial that the Debtors have the

authority to satisfy the prepetition claims of the Equipment Maintenance/Specialized Labor Vendors. In addition to a loss of revenue, equipment downtime could result in the Debtors' inability to honor contracts, causing significant harm to the Debtors' efforts to maximize cash flow.

Process for Determining Critical Vendors and the Critical Vendor Cap

37. The Debtors have carefully considered whether the payments on account of the Critical Vendor Claims described here are necessary and whether such payments will ensure that the Debtors will have access to adequate amounts of trade credit on a postpetition basis. Specifically, the Debtors have undertaken a thorough review of their accounts payable and their lists of prepetition vendors to identify those vendors who are essential to the Debtors' operations. In determining the amount of claims to pay pursuant to the Motion, the Debtors consulted with senior management of the various business segments and others throughout the Debtors' management and purchasing operations to identify those creditors that are most essential to the Debtors' operations, using criteria developed by the Debtors. The criteria used to screen which vendor payments would be deemed critical to avoid business interruption are as follows:

- a. Unique or "single source" vendors were identified that supply specific goods or services critical to the Debtors' business operations.
- b. Vendors that provide goods or services required to meet certain quality control requirements of the Debtors' customers, which requirements prevent the Debtors from looking to alternative sources for a vendor's products or services, were identified.
- c. Vendors that provide the Debtors with advantageous pricing, or other terms such that replacing those vendors postpetition would result in significantly higher costs to the Debtors, were identified.
- d. Other known suppliers were identified that may have similar goods and services, but were historically more expensive.
- e. The startup and delayed delivery time associated with changing vendors was considered in order to determine the extent of supply chain and service interruption that would occur.

- f. With respect to vendors meeting the standards of (a), (b) or (c) above, consideration was given to whether such vendors might additionally be forced to cease business operations (due to such vendor's own liquidity constraints) in the event its prepetition claim against the Debtors were not paid within a short time after the Petition Date.
- g. There was an additional consideration given to vendors that provide services or supply products to the Debtors and their non-Debtor affiliates in the Chapter 11 Cases. Additional negative repercussions could occur with respect to one or more of the non-filing Company affiliates if certain vendors decide to interrupt conducting businesses with those entities.
- h. Where there was no problem of discontinued service detected and/or no near term activity with a specific vendor, these vendors were not considered to be critical.

38. After evaluating the information received in response to these specific and narrowly tailored inquiries, the Debtors estimated the payment amounts necessary to ensure the continued supply of critical goods and services, taking into account whether failure to pay a Critical Vendor would result in that Critical Vendor terminating its provision of goods and/or services to the Debtors and what percentage of the Critical Vendors' claims would need to be paid to induce such Critical Vendors to continue providing goods and/or services to the Debtors.

39. The Debtors have further developed certain procedures for which they seek the Court's approval that, when implemented, will ensure that vendors receiving payment for Critical Vendor Claims will continue to supply trade credit necessary to the Debtors' businesses on a postpetition basis.

Relief Requested

40. By this Motion, the Debtors seek entry of an order (the "Order") pursuant to sections 105(a), 363(b) and 364 of the Bankruptcy Code (a) authorizing, but not directing, the Debtors to pay, in their sole discretion, the prepetition claims of the Critical Vendors (the "Critical Vendor Claims"), and (b) authorizing and directing applicable banks and other financial

institutions to receive, process, and pay any and all checks and other transfers related to such claims.

Proposed Terms and Conditions of Payment of the Critical Vendor Claims

41. The Debtors seek authority to pay Critical Vendor Claims in an aggregate amount not to exceed \$20 million (the “Critical Vendor Cap”). The Critical Vendor Cap represents less than 0.54% of the Debtors’ total unsecured claims against the Debtors’ estates (which unsecured claims are in excess of \$3.8 billion) as of the Petition Date. While the Debtors reserve the right to seek Court authority at a later date to increase the Critical Vendor Cap, payment of the amounts specified here would allow the Debtors to obtain those goods and services most necessary to the Debtors’ postpetition operations.

42. To ensure that the Critical Vendors deal with the Debtors on Customary Trade Terms (as defined herein), the Debtors propose that the Order provide authorization for the Debtors to do one or a combination of the following in order to satisfy the actual Critical Vendor Claims:⁴

- a. The Debtors are authorized, in their sole discretion and in the exercise of their business judgment, to make payment to the Critical Vendors on the conditions that: (i) such a claim is paid by check or via wire transfer; and (ii) the Critical Vendor agrees to continue supplying goods and services (including, but not limited to, credit limits, pricing, cash discounts, timing of payments, allowances, rebates, coupon reconciliation, normal product mix and availability and other applicable terms and programs) to the Debtors on terms that are consistent with the historical trade terms between the parties (the “Customary Trade Terms”) during the Chapter 11 Cases.
- b. The Debtors reserve the right to negotiate trade terms with any Critical Vendor, as a condition to payment of any Critical Vendor Claim, that vary from the Customary Trade Terms (the “Negotiated Trade Terms”) to the extent the Debtors determine that such terms are necessary to procure

⁴ To that end, the Debtors are seeking to implement the terms of a critical trade program with the Critical Vendors in a letter agreement, a copy of which is annexed to the Motion as **Exhibit C**.

essential goods or services or are otherwise in the best interests of the Debtors' estates.

- c. A Critical Vendor's acceptance of payment is deemed to be acceptance of the terms of the Order, and if the Critical Vendor thereafter does not provide the Debtors with Customary Trade Terms or Negotiated Trade Terms during these cases, then any payments of prepetition claims made after the Petition Date may be deemed to be unauthorized postpetition transfers and therefore recoverable by the Debtors in the Chapter 11 Cases.
- d. The Debtors are authorized (but not directed) to obtain written verification of the Customary Trade Terms or the Negotiated Trade Terms, to be supplied by the Critical Vendors, before issuing payment hereunder.
- e. The Debtors further request, for judicial economy and administrative convenience, that to the extent any affiliates of the Debtors subsequently commence chapter 11 cases, the relief requested herein apply to such affiliates and their respective estates; provided, however, that the amount paid by all Debtors in these cases on account of prepetition claims of the Critical Vendors does not exceed \$20 million in the aggregate, absent further order of the Court.

43. Nothing in the Motion should be construed as a waiver by any of the Debtors of their rights to contest any invoices of a Critical Vendor under applicable nonbankruptcy law.

44. If a Critical Vendor refuses to supply goods and/or services to the Debtors on Customary Trade Terms or Negotiated Trade Terms following receipt of payment of its Critical Vendor Claim, the Debtors seek authority to, in their discretion and without further order of the Court, declare that provisional payments made to the Critical Vendors on account of the Critical Vendor Claims be deemed to have been in payment of then-outstanding postpetition claims of such vendors without further order of the Court or action by any person or entity. In the event the Debtors exercise the right set forth in the preceding sentence, the Critical Vendor against which such right is exercised shall immediately return to the Debtors any payments made to it on account of its Critical Vendor Claims to the extent that any such payments exceed the postpetition claims of such vendor then outstanding without giving effect to any rights of setoff, claims, provision for payment of reclamation or trust fund claims, or otherwise. In short, the

Debtors seek to return the parties to their respective positions with respect to all prepetition Critical Vendor Claims in the event a Critical Vendor refuses to supply goods and/or services to the Debtors on Customary Trade Terms or Negotiated Trade Terms following receipt of payment on its Critical Vendor Claim.

45. The Debtors shall maintain a matrix summarizing (a) the name of each Critical Vendor, (b) the amount each Critical Vendor was paid on account of its Critical Vendor Claims in the Debtors' discretion and in accordance with the Debtors' business practices, and (c) the goods and/or services provided by each Critical Vendor.

46. The Critical Vendor payments the Debtors seek to make pursuant to the Motion are key to a successful reorganization. The Debtors believe it is essential to pay the prepetition claims of the Critical Vendors to ensure that such goods and services continue to be supplied without interruption on a postpetition basis. If the Motion is not granted, it is likely that certain of the Critical Vendors will stop providing goods to the Debtors on Customary Trade Terms, effectively reducing the amount of credit available to the Debtors. Moreover, certain of the Critical Vendors could stop doing business with the Debtors altogether, leaving the Debtors unable to obtain certain essential goods and services and forcing the Debtors to incur higher costs to obtain certain others. As detailed above, such actions would be extremely damaging, if not devastating, to the Debtors, their estates and their creditors. In particular, any interruption in the supply of the services provided by the Regulatory Compliance Vendors, the Single Source Vendors and the Equipment Maintenance/Specialized Labor Vendors would immediately jeopardize the Debtors' ability to maintain their operations and, in turn, generate revenues. Additionally, even a temporary disruption in the Debtors' operations would result in the Debtors' failure to meet their supply commitments, thereby exposing the Debtors to significant claims for damages and jeopardizing the Debtors' critical customer relationships.

47. Further, continued availability of trade credit in amounts and on terms consistent with those the Debtors enjoyed prepetition is vital to the Debtors' businesses because it allows the Debtors to maintain liquidity for operations and production levels consistent with operating profitability. Preserving working capital through the retention or reinstatement of traditional trade credit terms will enable the Debtors to maintain their competitiveness and to maximize the value of their businesses. Conversely, a deterioration of trade credit and a disruption or cancellation of deliveries of goods—many of which are not readily replaceable—would cripple the Debtors' business operations, increase the amount of funding needed by the Debtors postpetition (which funding may not be available), and ultimately impede the Debtors' ability to service their customers, thereby placing their customer base and the successful reorganization of their businesses at risk.

Basis for Relief

A. This Court May Authorize Payment of the Critical Vendor Claims Pursuant to Sections 363 and 364 of the Bankruptcy Code.

48. The relief requested in this Motion is authorized pursuant to sections 363 and 364 of the Bankruptcy Code. *See, e.g., In re UAL Corp.*, Case No. 02-48191 (ERW) (Bankr. N.D. Ill. Dec. 11, 2002) (an essential trade motion generated by section 363 is “completely consistent with the Bankruptcy Code” and such payments have further support where the Debtor seeks “the extension of credit under section 364 on different than usual terms, terms that might include payment of a prepetition obligation”); *In re Conseco, Inc.*, Case No. 02-49672 (CAD) (Bankr. N.D. Ill. Jan. 14, 2003); *In re Armstrong World Indus., Inc.*, 29 B.R. 391, 397 (S.D.N.Y. 1983) (authorizing, pursuant to section 363, a contractor to pay prepetition claims of some suppliers who were potential lien claimants, because the payments were necessary for the general contractors to release funds owed to the debtors, thus benefiting the estate).

49. The relief requested in the Motion contemplates payments to be made to those Critical Vendors who agree to provide goods or services on Customary Trade Terms or

Negotiated Trade Terms. As a result, the transaction between the Debtors and such Critical Vendors is authorized by sections 363 and 364 of the Bankruptcy Code, and not solely by section 105 and the necessity of payment doctrine (as discussed below).

50. The requested relief meets the standards articulated by the Seventh Circuit Court of Appeals in In re Kmart Corp., 359 F.3d 866 (7th Cir. 2004). Although not binding on this Court, the Kmart decision, in which the Seventh Circuit acknowledges the practical business utility of allowing corporate debtors limited authority to make prepetition critical vendor payments, is particularly instructive in that the Seventh Circuit is the only appellate court that has considered the issue.

51. In Kmart, the Seventh Circuit identified section 363(b)(1) of the Bankruptcy Code as a potential source of authority for critical vendor payments. Id., 359 F.3d at 872-73. Section 363(b)(1) of the Bankruptcy Code authorizes a bankruptcy court, after notice and a hearing, to authorize a debtor to “use, sell, or lease, other than in the ordinary course of business, property of the estate.” The court reasoned that “satisfaction of a pre-petition debt in order to keep ‘critical’ supplies flowing is a use of property other than in the ordinary course of administering an estate in bankruptcy,” and thus is within the literal ambit of the statute’s language. Id. at 872. The court, however, cautioned that “it is prudent to read, and use, § 363(b)(1) to do the least damage possible to the priorities established by contract and by other parts of the Bankruptcy Code.” Id.

52. To that end, the Court articulated a dual-pronged requirement that business debtors must satisfy as a condition to honoring prepetition obligations. First, debtors must establish that the creditors whose claims are to be paid will cease dealing with the debtor if not immediately paid for prepetition goods and services. Second, debtors must establish that “the business will gain enough from continued transactions with the favored [creditors] to provide some residual benefit to the remaining . . . creditors, or at least leave them no worse off.” Id. at 868.

53. As detailed above and stated in the Pryor Declaration, maintaining the products and services provided by the Critical Vendors is vital to the Debtors' ongoing business operations and the success of the Chapter 11 Cases. In addition, and as detailed above, certain of the Debtors' employees who have been responsible for maintaining, and have intimate knowledge of, the Debtors' trade relationships and who have been responsible for knowing, understanding and responding to the needs and inner workings of the Debtors' vendors, have conducted an exhaustive analysis and review of the Debtors' immediate trade needs and vendor base. The Debtors have thereby concluded that the Critical Vendors at issue will cease doing business with the Debtors, or become unable to do business with the Debtors, unless they receive some payment of prepetition debt. Such an outcome would devastate the Debtors' businesses and cost the estates and their creditors far more than the costs associated with paying some portion of the Debtors' prepetition obligations to such vendors. Thus, the Debtors' other creditors will be no worse off, and in fact will fare far better, if the Debtors are empowered to negotiate such payments to achieve a smooth transition into bankruptcy with minimal disruption to their operations. In light of the above, the proposed Critical Vendor Payments are plainly in the best interests of the Debtors' creditors.

54. Other courts have granted similar relief in other cases both before and after the Seventh Circuit's decision in Kmart. See In re Tower Automotive, Inc., Case No. 05-10578 (ALG) (Bankr. S.D.N.Y., Feb. 4, 2005 and March 2, 2005); In re Jays Foods, L.L.C., Case No. 04-08681 (Bankr. N.D. Ill., March 5, 2004); In re FV Steel and Wire Co., Case No. 04-22421 (SVK) (Bankr. E.D. Wis., Feb. 27, 2004); In re National Equipment Services, Inc., Case No. 03-27626 (PSH) (Bankr. N.D. Ill., July 2, 2003); In re Hayes Lemmerz Int'l, Inc., Case No. 01-11490 (MFW) (Bankr. D. Del., Dec. 27, 2001). Accordingly, ample authority exists to support the Debtors' request to pay the Critical Vendor Claims up to the Critical Vendor Cap.

55. The Debtors believe the payment of the Critical Vendor Claims is necessary and appropriate under the circumstances. In some cases, the Critical Vendors may, absent the

payments contemplated herein, refuse to deliver the Single Source Goods and/or perform necessary maintenance or other services or refuse to deliver such goods on reasonable credit terms. Prompt payment of the Critical Vendor Claims is therefore necessary to both ensure that the Debtors continue to receive essential raw materials and other goods and services that are actually or practically unavailable from other sources, and preserve critical relationships with the Debtors' key vendors and customers.

56. As stated above and in the Pryor Declaration, the Debtors strongly believe that the uninterrupted supply of goods and services, on Customary Trade Terms, and the continuing support of their customers, are imperative to the ongoing operations and viability of the Debtors. The Debtors only seek to pay the Critical Vendor Claims where nonpayment of such claims would lead to the interruption of the delivery of goods and services or would seriously disrupt the Debtors' operations. Moreover, the sums involved are insignificant in relation to the potential disruption that would occur if relationships with these vendors were to be terminated. Specifically, the \$20 million aggregate cap on the Critical Vendor Claims is less than 0.54% of the total unsecured debt in the Chapter 11 Cases. Thus, the Debtors submit that the requested relief is narrowly tailored to facilitate the Debtors' chapter 11 reorganization process.

B. The Court May Also Rely on Its General Equitable Powers to Grant the Motion.

57. The Court's general equitable powers are codified in section 105(a) of the Bankruptcy Code. Section 105(a) of the Bankruptcy Code empowers the Court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). A bankruptcy court's use of its equitable powers to "authorize the payment of prepetition debt when such payment is needed to facilitate the rehabilitation of the debtor is not a novel concept." In re Ionosphere Clubs, Inc., 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989) (citing NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984)). Under section 105(a) of the Bankruptcy Code, a court "can permit pre-plan payment of a prepetition obligation when

essential to the continued operation of the debtor.” In re NVR L.P., 147 B.R. 126, 127 (Bankr. E.D. Va. 1992). Maintaining favorable trade terms and credit is critical to the Debtors’ reorganization and in the best interests of all of the Debtors’ creditors. The payment of the prepetition Critical Vendor Claims is essential to assure such terms and credit. The Court should therefore exercise its equitable powers to grant the relief requested in the Motion.

C. The Court May Rely on the “Necessity of Payment” Doctrine to Grant the Relief Requested Herein.

58. The “Necessity of Payment” doctrine further supports the relief requested herein. The “Necessity of Payment” doctrine “recognizes the existence of the judicial power to authorize a debtor in a reorganization case to pay prepetition claims where such payment is essential to the continued operation of the debtor.” See In re UNR Indus., Inc., 143 B.R. 506, 519-20 (Bankr. N.D. Ill. 1992), rev’d on other grounds, In re UNR Indus., Inc., 173 B.R. 149, 158-59 (Bankr. N.D. Ill. 1994); In re Lehigh & New England Rec., 657 F.2d 570, 581 (3rd Cir. 1981) (payment of creditors’ claims authorized under “Necessity of Payment” doctrine); Ionosphere Clubs, 98 B.R. at 176; In re Chateaugay Corp., 80 B.R. 279, 285-87 (S.D.N.Y. 1987); In re Columbia Gas Sys., Inc., 171 B.R. 189 (Bankr. D. Del. 1994) (internal citations omitted). This doctrine is consistent with the paramount goal of chapter 11—namely, “facilitating the continued operation and rehabilitation of the debtor.” Ionosphere Clubs, 98 B.R. at 176. See also Dudley v. Mealey, 147 F.2d 268, 271 (2nd Cir.), cert. denied, 325 U.S. 813 (1945) (“Let [the debtor] once be shut down, and it will lose much of its value Some priority to the debtor’s prepetition suppliers may be essential to preservation of the business”); In re Gulf Air, Inc., 112 B.R. 152, 153-54 (Bankr. W.D. La. 1989) (allowing payment of prepetition claims under the “Necessity of Payment” doctrine).

59. Relief similar to that requested in this Motion also has been granted in comparable chapter 11 cases in this District. See, e.g., In re Delphi Corp., Case No. 05-44481 (RDD) (Bankr. S.D.N.Y. Oct. 13, 2005) (see Docket No. 197); In re Delta Air Lines, Inc., Case

No. 05-17923 (PCB) (Bankr. S.D.N.Y. Sept. 16, 2005) (see Docket No. 155); In re Northwest Airlines Corp., Case (Bankr. S.D.N.Y. Sept. 15, 2005) (see Docket No. 73); In re WorldCom, Inc., Case No. 02-13533 (AJG) (Bankr. S.D.N.Y. July 22, 2002) (see Docket No. 63); In re Enron Corp., Case No. 01-6034 (AJG) (Bankr. S.D.N.Y. Dec. 3, 2001) (see Docket No. 35); In re AI Realty Marketing of NY, Inc., Case Nos. 01-40252 through 01-40290 (Bankr. S.D.N.Y. Feb. 6, 2001) (see Docket No. 17).

D. The Court Should Authorize and Direct Financial Institutions to Honor and Process Checks Related to Critical Vendor Payments.

60. The Debtors pay their Critical Vendors with funds drawn by checks (the “Checks”) or by means of electronic fund transfers (the “Electronic Transfers”). Before the Petition Date, the Debtors remitted Checks or Electronic Transfers on account of certain claims that may not have cleared as of the Petition Date. To the extent any of the Checks or Electronic Transfers have not cleared their respective banks or financial institutions (the “Banks”) as of the Petition Date, the Debtors request that the Court authorize and direct the Banks, in the Debtors’ sole discretion, to receive, process, honor and pay the Checks or Electronic Transfers, without the need for further Court approval. If the Critical Vendors have not received payment for amounts in connection with the Critical Vendor Claims, the Debtors seek authority to issue replacement Checks, resubmit Electronic Transfers or otherwise make payment to such prepetition vendors on account of the Critical Vendor Claims, without the need for further Court approval. The Debtors represent that each of the Checks and Electronic Transfers can be readily identified as relating directly to the authorized payment of amounts owed on account of the Critical Vendor Claims. Accordingly, if the relief requested herein is granted, the Checks and Electronic Transfers, other than those relating to authorized payments, will not be honored inadvertently.

61. Nothing in this Motion should be construed as: (a) an admission as to the validity or priority of any claim against the Debtors; (b) a waiver of the Debtors’ rights to dispute any

claim; or (c) an approval or assumption of any agreement, contract or lease pursuant to section 365 of the Bankruptcy Code.

Memorandum of Law

62. This Motion includes citations to the applicable authorities and a discussion of their application to this Motion. Accordingly, the Debtors respectfully submit that such citations and discussion satisfy the requirement that the Debtors submit a separate memorandum of law in support of this Motion pursuant to Rule 9013-1 of the Local Bankruptcy Rules for the Southern District of New York.

Notice

63. No trustee, examiner or creditors' committee has been appointed in these chapter 11 cases. Notice of this Motion has been provided to: (a) the United States Trustee for the Southern District of New York; (b) the Debtors' 80 largest unsecured creditors on a consolidated basis, as identified in their chapter 11 petitions; (c) the Taxing Authorities known to the Debtors as of the Petition Date; (d) counsel to the administrative agents for the Debtors' prepetition secured lenders; (e) counsel to the Ad Hoc Committees; (f) the indenture trustees pursuant to the Debtors' secured indentures; (g) counsel to the Debtors' proposed postpetition lenders; (h) the Securities and Exchange Commission; (i) the Internal Revenue Service; and (j) the United States Department of Justice. In light of the nature of the relief requested herein, the Debtors submit that no other or further notice is required. A copy of the Motion is also available on the website of the Debtors' notice and claims agent, Kurtzman Carson Consultants LLC, at <http://www.kccllc.net/calpine>.

No Prior Request

64. No prior motion for the relief requested herein has been made to this or any other court.

WHEREFORE, the Debtors respectfully request an entry of an order, substantially in the form attached hereto as **Exhibit A**, (a) authorizing, but not directing, the Debtors to pay, in the Debtors' sole discretion, the prepetition claims of certain critical vendors and service providers in an aggregate amount not to exceed \$20 million on the terms described herein, (b) authorizing and directing financial institutions to honor and process checks and transfers related to such claims, and (c) granting such other further relief as is just and proper.

Dated: December 20, 2005
New York, New York

Respectfully submitted,

/s/ Richard M. Cieri

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