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

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

**EMERGENCY MOTION (A) FOR INTERIM AND FINAL ORDERS AUTHORIZING
THE DEBTORS TO (I) CONTINUE TO HONOR PREPETITION TRADING
CONTRACTS; (II) ENTER INTO NEW POSTPETITION TRADING CONTRACTS
AND (III) PLEDGE COLLATERAL UNDER PREPETITION AND POSTPETITION
TRADING CONTRACTS; (B) FOR A FINAL ORDER AUTHORIZING THE
ASSUMPTION OF PREPETITION TRADING CONTRACTS; AND (C) FOR AN
EX PARTE BRIDGE ORDER AUTHORIZING INTERIM
RELIEF PENDING THE “FIRST DAY” HEARING**

The above-captioned debtors (collectively, the “Debtors”) hereby move the Court (the “Motion”) (A) for the entry of an interim order (the “Interim Order”), substantially in the form attached hereto as Exhibit A, and for entry of a final order, authorizing the Debtors to (i) continue to honor prepetition trading contracts; (ii) enter into new postpetition trading contracts and (iii) pledge collateral under prepetition and postpetition trading contracts; (B) for entry of a final order authorizing the assumption of prepetition trading contracts; and (C) for entry of an ex

parte bridge order (the “Bridge Order”), substantially in the form attached hereto as Exhibit B, authorizing interim relief pending the “first day” hearing. In support of this Motion, the Debtors respectfully state as follows:

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, 362, 363, 364, 555, 556, 559, 560 and 561 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”) and Rules 4001(b), (c) and (d) of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”).

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;¹ 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 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

¹ 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.

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.

Statement of Necessity

23. As set forth in the affidavit of Paul Posoli filed in support of this Motion, the Debtors have immediate need for entry of the Bridge Order. The Debtors currently manage approximately 92 power plants, generating approximately 26,000 megawatts of electricity at peak demand. Both the power and gas markets trade on a 24-hour basis. Consequently, the Debtors maintain a 24-hour trading and scheduling desk. The Debtors enter into power and gas transactions throughout the day and night as the desk manages the increases and decreases in the output from the power plants, and the increases or decreases in market prices. It is essential not only for the company, but also for the stability of the North American power grid that the Debtors have the ability to transact and adjust power output through hourly transactions with customers 24 hours a day.

24. As described in greater detail below, absent entry of the Bridge Order as quickly as possible after the filing of these Chapter 11 Cases, the Debtors risk severe disruption to their trading activities. As set forth in the affidavit of Paul Posoli, filed in support of this Motion, entry of the Bridge Order, pending the “first day” hearing and entry of the Interim Order, is essential to the Debtors’ ability to continue to operate their businesses.

Preliminary Statement

25. The Debtors require enormous quantities of natural gas to fuel their power plants. Historically, the Debtors owned natural gas resources, but now rely on third-party transactions to acquire the fuel necessary to run their natural gas power plants. The Debtors’ businesses are

therefore sensitive to fluctuations in energy and energy-related commodities prices. In the ordinary course of business, the Debtors enter into derivative contracts to reduce the risks associated with such fluctuations. As a general matter, derivative contracts are financial contracts whose values are based on, or “derived” from, the price of a traditional security such as a stock or bond, an asset such as a commodity (e.g., natural gas), or a market index (collectively, the “Derivative Contracts”). Derivative Contracts can take a number of different forms, including forward contracts, futures contracts, option contracts or combinations of the foregoing.

26. The Debtors use Derivative Contracts primarily to hedge and optimize their electricity generating assets, and also to take proprietary commodity positions. The Debtors’ primary business activities include their core business of electrical power generation and a traditional commodities, energy and financial product trading business, which is conducted through Debtor Calpine Energy Services, L.P. (“CES”).

27. Historically, the Debtors have pursued an integrated business model whereby CES engages in asset risk management and optimization activities with respect to the operation of the core power generation business. As asset manager, CES is responsible for, among other things, procuring fuel consumed and selling power generated by the Debtors’ power generating assets, scheduling such purchases and sales, maintaining necessary transportation paths and hedging to reduce the risks associated with market volatility. CES has also historically engaged in trading activities (collectively with asset risk management and optimization activities, the “Trading Activities”), from which the Debtors have derived substantial revenue. As a result of the Debtors’ historic Trading Activities, the Debtors maintain a portfolio consisting of active physical commodities and financial products trading positions (the “Existing Positions”). The Debtors’ portfolio represents a valuable and substantial asset of the estates.

28. As integrated business units, the Debtors' power producing and energy trading businesses are integrally intertwined such that the collapse of one could trigger the collapse of the others. The interdependence of the Debtors' businesses is derived from the efficiencies created when each of the Debtors' businesses focuses on one primary aspect of the Debtors' overall enterprise operations. For instance, CES buys and sells fuel and power for the enterprise, including fuel consumed and power generated by the Debtors' power producing business as well as for its own proprietary Trading Activities. CES, in turn, is able to rely on the power producing business as a reliable source of power and consumer of fuel. The Debtors' business configuration has eliminated inefficient overlap of operational functions; however, the continuous uninterrupted operation of one business is dependent upon the continuous uninterrupted operation of the others.

29. To preserve and maximize the value of the Debtors' estates, the Debtors must maintain their Existing Positions and engage in prospective Trading Activities consistent with prior practices. If the Debtors are not able to maintain the Existing Positions and engage in future Trading Activities consistent with prior practice, the Debtors' estates and assets will suffer immediate and irreparable harm and degradation in value.

30. As is typical in the industry, a trader must maintain an acceptable creditworthiness or provide acceptable credit support, generally in the form of letters of credit, collateral or prepayments. Prior to the Petition Date and in connection with their commodity and financial product Trading Activities, as well as the procurement of essential fuels and other materials, the Debtors provided credit support in the form of letters of credit and cash collateral to secure their various counterparties (each individually a "Counterparty" and collectively the "Counterparties") against the risk of the Debtors' non-performance. In addition, given the

Debtors' impaired prepetition creditworthiness, the Debtors sometimes were often compelled to prepay for fuels and to post cash collateral in support of their Trading Activities.

31. Despite the fact that the Debtors trade on a nearly fully-collateralized basis, the Debtors believe that most, if not all, of their trading partners will refuse to continue trading relationships absent the relief the Debtors request in this Motion. The commodity and financial product trading sector has been historically and consistently resistant to conducting business with trading entities in financial distress. Counterparties seeking to terminate trading contracts and discontinue trading prospectively will do so because of a fear that a Chapter 11 trading partner is operating outside of the ordinary course of business with respect to sophisticated transactions necessary to conduct the trading business and/or a perception that such trading partner presents an unacceptable level of risk exposure without adequate credit support. Accordingly, the Debtors believe it is necessary and appropriate to obtain from this Court an order that confirms the Debtors' authority to continue their historic trading practices to overcome the initial trepidation displayed by most parties when confronted with a Chapter 11 counterparty. As more fully set forth herein, the Debtors intend to honor their Prepetition Trading Contracts (as defined below); conduct postpetition trading activity in the ordinary course of their businesses and grant requisite credit support consistent with industry standards and prior practices that will provide appropriate downside protection against the unlikely event of the Debtors' non-performance. This relief will enable the Debtors to stabilize their business operations and demonstrate their long-term creditworthiness through, among other things, course of performance.

32. The relief requested in this Motion is not unique. Other major power providers, notably including NRG Energy, Inc. ("NRG"), and Mirant Corporation ("Mirant"), have filed for Chapter 11 protection in recent years, and have sought and obtained substantially the same relief

requested in this Motion. Attached hereto as Exhibit C are orders entered in the NRG and Mirant bankruptcy cases which granted relief that was substantively identical to the relief requested herein. In light of the NRG and Mirant cases, trading counterparties in the energy industry, when faced with the bankruptcy of a trading counterparty, have become accustomed to and rely on motions such as this Motion for assurances that they will not be placed at a disadvantage by foregoing their right to terminate their trading contracts and agreeing to continue to do business with the Debtors.

33. The Debtors fear that if this Motion is not granted and if the Interim Order is not entered immediately, Counterparties will not agree to maintain Existing Positions, continue Trading Activities, or engage in new Trading Activities that expose the Counterparties to the risk of nonpayment.

Relief Requested

A. Authority to Honor and Perform Under Prepetition Trading Contracts -- Including Posting and Maintaining Collateral

34. Prior to the Petition Date, the Debtors utilized and entered into with their Counterparties various industry-standard trading contracts, including, but not limited to, ISDA, EEI, MEPSA, and/or NAESB master agreements, (including all related schedules and credit support annexes), as may have been amended, restated, supplemented, or otherwise modified from time to time (the “Master Agreements”).

35. In connection with the Master Agreements, the Debtors also utilized and entered into with their Counterparties longform confirmations for the purchase, sale and/or exchange of physical commodities, electric power, electric capacity, goods (as such term is defined in the Uniform Commercial Code), swaps, options, derivatives, or any other securities, contract rights, instruments or items (whether similar or dissimilar to the foregoing) that are currently bought,

sold, and/or exchanged or capable of being bought, sold and/or exchanged in the future (the “Longform Confirmations”).

36. The Debtors also routinely entered into exchange-based transactions through a variety of brokers, which typically also required margining and collateral maintenance (the “Exchange Transactions”).

37. The Debtors and their Counterparties also entered into master netting, setoff and security agreements (the “Master Netting Agreements” and collectively with the Master Agreements, the Longform Confirmations and the Exchange Transactions, the “Prepetition Trading Contracts”)² pursuant to which the Debtors, on the one hand, and one or more affiliated Counterparties, on the other hand, agree to aggregate their respective exposures under two or more agreements (physical and/or financial) for purposes of determining exposure thresholds and collateral requirements. As a rule, the Counterparties under a Master Netting Agreement are affiliated entities, usually under the ownership of a common parent company. As with ordinary Master Agreements, Master Netting Agreements that provide triangular offsets permit the Debtors to minimize collateral requirements, and therefore, are an important tool in the efficient management of the Debtors’ businesses. To the extent the Debtors utilize Master Netting Agreements that involve two or more Debtor entities, the Debtors intend to monitor the respective intercompany obligations through the use of intercompany accounts.

² This Motion is without prejudice to any argument available to the Debtors that (i) any Counterparty may be appropriately characterized as a “utility” within the scope of section 366 of the Bankruptcy Code; and (ii) the terms of any Prepetition Trading Contract, course of dealing, and/or course of performance, precludes a Counterparty from altering, refusing or discontinuing service to any of the Debtors solely on the basis of the commencement of the Debtors’ Chapter 11 Cases.

38. The Prepetition Trading Contracts are complex financial transactions that often require the posting and regular maintenance of collateral. Any failure to comply with collateral requirements will almost certainly result in the immediate termination of the relevant Prepetition Trading Contract. Moreover, the universe of the Debtors' potential trading partners, especially fuel suppliers, is relatively small. The Debtors fear that any default under a Prepetition Trading Contract triggered by a failure to post or maintain collateral could cause an immediate ripple effect through the rest of the Debtors' Prepetition Trading Contracts.

39. The Counterparties to the Prepetition Trading Contracts are almost uniformly fully collateralized. Therefore, by posting collateral postpetition, even on a prepetition agreement, the Debtors are not making payment on a prepetition claim. Rather, the Debtors are merely continuing to perform under the terms of the agreement in an effort to continue to receive the benefits of such agreement. If the Debtors did not continue to post and maintain collateral under the Prepetition Trading Contracts, those contracts would be terminated and the Debtors would be forced to scramble to find replacement agreements. Even if the Debtors were able to secure replacement agreements, which there is no assurance they would be able to do, the Debtors would face the same collateral posting and maintenance obligations under the new agreements.

40. Therefore, since the Debtors have determined that it is in the best interests to maintain the Prepetition Trading Contracts, the Debtors need to be able to continue to perform under those contracts going forward, including collateral posting and maintenance obligations, in order to avoid termination of the agreements by the Counterparties. Likewise, to the extent the Debtors enter into new postpetition Derivate Contracts and conduct post petition Trading

Activities, they will also be compelled to post and maintain collateral in order to secure performance from the contract counterparty.

B. Authority to Enter Into Prepetition and Postpetition Assurance Agreements

41. Prior to the Petition Date, the Debtors and certain Counterparties to the Prepetition Trading Contracts entered into Assurance and Amendment Agreements (the “Prepetition Assurance Agreements”)³, for the purpose of, among other things, limiting the risks and uncertainties that may arise with respect to the Prepetition Trading Contracts after the Petition Date.

42. The Prepetition Assurance Agreements are the result of extensive, arms-length and good-faith negotiations with several of the Debtors’ largest Counterparties. The Prepetition Assurance Agreements generally provide, among other things, the parameters under which the Counterparties will agree to continue their relationships with the Debtors under the Prepetition Trading Contracts. The Prepetition Assurance Agreements affirm the Debtors’ intent to conduct postpetition Trading Activities in the ordinary course of business and grant requisite additional credit support as traditionally provided under industry standards and prior practices. The major terms of the Prepetition Assurance Agreements include the following:

- a commitment by the Debtors to seek immediate entry of the Interim Order authorizing the Debtors to continue to honor the terms of the Prepetition Trading Contracts, including payments for prepetition deliveries, postpetition deliveries on prepetition contracts and monthly settlement payments;
- an agreement by the Counterparty to delay enforcement of safe harbor termination rights for a period of 55 days after the Petition Date while the Debtors seek entry of a final order approving the relief requested in this Motion;

³ The Debtors’ standard form of Prepetition Assurance Agreement is attached hereto as Exhibit D. Copies of executed Prepetition Assurance Agreements shall be available for in camera inspection by the Court.

- an acknowledgement by the Debtors of the “safe harbor” nature of the Prepetition Trading Contracts; and
- an agreement by the Counterparty to modify their contractual right, if any, to terminate the Prepetition Trading Contract as a result of the filing of the Chapter 11 Cases.

43. The Prepetition Assurance Agreements require the Debtors to immediately seek and obtain entry of an interim court order (“Interim Order”) authorizing, among other things, the Debtors to carry out the terms of the Prepetition Assurance Agreements. Like the Prepetition Assurance Agreements, the form and substance of the Interim Order has been discussed and negotiated with the Debtors’ largest Counterparties.

44. Importantly, consistent with the terms of the Prepetition Trading Contracts and industry standards, the Prepetition Assurance Agreements require the Debtors provide to the Counterparties collateral, including, but not limited to, initial, variation or maintenance margin, or similar security in the form of letters of credit and cash (the “Prepetition Collateral”) to secure obligations owing to the Counterparties in connection with the Trading Activities.

45. The Debtors expect that many Counterparties to the Prepetition Trading Contracts, upon entry of the Bridge Order and/or the Interim Order, will be willing to enter into “Postpetition Assurance Agreements”.⁴ The Postpetition Assurance Agreements will set forth the rights and obligations of the parties with respect to Existing Positions and prospective Trading Activity. Any Counterparty entering into a Prepetition Assurance Agreement or Postpetition Assurance Agreement is referred to herein individually as an “Assured Party” and collectively as the “Assured Parties.” Any Assured Counterparty electing to accept the benefits

⁴ The Debtors’ standard form of Postpetition Assurance Agreement is attached hereto as Exhibit E. Upon execution, copies of executed Postpetition Assurance Agreements will be made available for in camera inspection upon request by the Court.

and protections of the Interim Order pursuant to the terms of the Prepetition Assurance Agreement and any Counterparty executing a Postpetition Assurance Agreement is referred to herein individually as a “Protected Counterparty” and collectively as the “Protected Counterparties.”

46. Finally, some of the Counterparties, because of size, position, expense, or other reason, may elect to continue trading under the Prepetition Trading Contracts and accept the benefits of this Interim Order without executing a Postpetition Assurance Agreement. For Counterparties entering into “new” transactions under Prepetition Trading Contracts from and after the Petition Date, after actual notice and delivery of a signed copy of the Interim Order, such Counterparties shall be deemed to have waived the contractual right to cause the liquidation, termination or acceleration of a commodity contract or forward contract as such terms as used in section 556 of the Bankruptcy Code, or liquidation, termination or acceleration of a swap agreement as such terms are used in section 560 of the Bankruptcy Code, or termination, liquidation, acceleration or offset under a master netting agreement as such terms are used in section 561 of the Bankruptcy Code, each because of a condition of the kind specified in section 365(e)(1) of the Bankruptcy Code; provided, however, that such waiver as it relates to such Counterparty shall be deemed null and void and without further effect in the event that (i) a Debtor delivers written notice to a Counterparty of the Debtors’ intent to reject a Prepetition Trading Contract pursuant to section 365 of the Bankruptcy Code, (ii) the Debtors fail to meet any margin or collateral requirements or otherwise fail to make any payments pursuant to the terms of any Prepetition Trading Contract or Postpetition Trading Contract, or (iii) the Interim Order is stayed, modified in a manner adverse to a Counterparty or vacated, or otherwise

terminates. Each of the events listed in clauses (i), (ii) and (iii) immediately above shall be deemed to be a condition of the kind specified in section 365(e)(1) of the Bankruptcy Code.

C. Authority to Enter Into New Postpetition Trading Contracts

47. Out of an abundance of caution, the Debtors hereby seek authority to enter into new Postpetition Trading Contracts in the ordinary course of business and to post and maintain any collateral required thereunder. While the Debtors believe such contracts are routine and do not require prior Court approval, the Debtors seek specific Court authorization to allay any concerns of the various Counterparties who may enter into such Postpetition Trading Contracts with the Debtors.

48. The Debtors and the Counterparties shall also be authorized and permitted to apply any and all collateral that may have been posted prepetition to any obligations arising postpetition, regardless of whether such obligations arise under existing Prepetition Trading Contracts or new Postpetition Trading Contracts.

D. Authority to Assume Prepetition Trading Contracts

49. The Debtors hereby also seek authority, after notice and a final hearing (the “Final Hearing”), to assume the Prepetition Trading Contracts.⁵ While the Debtors seek authority to continue to honor the terms of the Prepetition Trading Contracts, in order to provide additional assurance and comfort to the Counterparties, the Debtors also hereby request that the Court, after notice and a hearing, authorize the assumption of the Prepetition Trading Contracts. Given that the Prepetition Trading Contracts were virtually all fully-collateralized as of the Petition Date, and in light of the Debtors’ intention to continue to honor all obligations under the Prepetition

⁵ Not less than ten (10) days before the Final Hearing, the Debtors intend to file a schedule of Prepetition Trading Contracts to be assumed, along with a the proposed cure amount, if any, associated with each assumption.

Trading Contracts in the ordinary course of business, the Debtors submit that cure obligations, if any, related to the Prepetition Trading Contracts will be insignificant, especially in comparison to the tremendous benefit the Debtors derive from maintaining their portfolio of Prepetition Trading Contracts.

E. Applicability to Subsequent Debtors

50. The Debtors further request that, for judicial economy and administrative convenience, the relief requested hereon continue to apply to any of the Debtors' affiliates and their respective estates that subsequently commence Chapter 11 cases without the need for any further requests or motions.

II. BASIS FOR RELIEF

51. The relief requested in this Motion involving the Prepetition Trading Contracts is authorized under several provisions of the Bankruptcy Code. First, sections 105 and 1107 of the Bankruptcy Code mandate that the Debtors preserve assets and the value of their estates. The unique rights available to the Protected Counterparties to terminate safe harbor contracts upon a bankruptcy filing cannot be modified by the Court. Accordingly, the preservation of the Prepetition Trading Contracts can be achieved only by assuring the Protected Counterparties that the Debtors will perform. The relief request is precisely targeted to do just that. Second, the Protected Counterparties are entitled to performance during the period before assumption or rejection of the Prepetition Trading Contracts. Moreover, where, as here, the Debtors intend to assume the Prepetition Trading Contracts, postpetition performance is a means of demonstrating adequate assurance of future performance required for assumption. Third, section 364 of the Bankruptcy Code allows the relief requested. As discussed, the Prepetition Trading Contracts are subject to price fluctuations requiring, in essence, the Protected Counterparties to provide the Debtors with postpetition credit. Section 364(c) protection should, therefore, be available.

Fourth, as secured creditors, the Protected Counterparties are entitled to adequate protection. The relief requested in this Motion provides adequate protection for the Protected Counterparties.

52. The relief requested pertaining to the Postpetition Trading Contracts is also permitted under several provisions of the Bankruptcy Code. First, section 363 of Bankruptcy Code authorizes the Debtors' entry into the Postpetition Trading Contracts as these transactions are in the ordinary course of the Debtors' business. Second, sections 105 and 363 mandate that the Debtors continue such Trading Activities without further order of the Court.

53. Finally, upon the Final Hearing after adequate notice, section 365 of the Bankruptcy Code allows for the assumption of the Prepetition Trading Contracts.

A. Requisite Authority Exists to Authorize the Debtors to Honor the Prepetition Trading Contracts And Carry out the Terms of the Pre- and Postpetition Assurance Agreements.

1. Sections 105 and 1107 of the Bankruptcy Code Mandate that the Debtors Preserve Assets and the Value of the Estates.

54. The statutory predicate for the Court's power to enter orders granting the relief requested in this Motion is section 105(a) of the Bankruptcy Code. Section 105(a) provides that the "court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." See 11 U.S.C. § 105(a).

55. The Debtors recognize that section 105(a) of the Bankruptcy Code "may be used only to carry out the provisions of Title 11." In re CoServ, L.L.C., 273 B.R. 487, 494 n. 9 (Bankr. N.D. Tex. 2002). The major premise of Chapter 11 is to ensure the continued and uninterrupted operation of the debtor in possession to the greatest extent possible. The Debtors' requested relief is consistent with the "furtherance of the provisions of the Bankruptcy Code." Id. See also In re Southmark Corp., 113 B.R. 280, 281 (Bankr. N.D. Tex. 1990) ("the court may

use [section] 105(a) to fashion orders that are necessary or appropriate to further a substantive provision of the Code”).

56. Such orders are appropriate where they are essential to the Debtors’ reorganization efforts and do not pose a burden on the Debtors’ creditors. See Advisory Info. and Mgmt. Systems, Inc. v. Prime Computer, Inc., 40 B.R. 1001, 1006 (M.D. Tenn. 1984) (“Section 105 [of the Bankruptcy Code] may be applied by a bankruptcy court to avoid termination of contracts or business relations where such relief is indispensable to reorganization and necessary to prevent retaliation for exercising rights under Chapter 11, and where the relief imposes no substantial burden or hardship on those in contractual relations with a debtor.”).

57. The Prepetition Trading Contracts by and between the Debtors and the Protected Parties are “forward contracts,” “commodities contracts”, “swaps” and/or “master netting agreements” as such terms are used in sections 556, 560 and/or 561 of the Bankruptcy Code. In re Olympic Natural Gas Co., 294 F.3d 737 (5th Cir. 2002). Congress expressly intended to protect the class of creditors under such “safe harbor” contracts by enacting Bankruptcy Code sections 556 and 560, which allow counterparties to terminate safe harbor contracts notwithstanding the automatic stay.

58. Sections 556, together with sections 555, 559, 560 and 561 of the Bankruptcy Code, contain the safe harbor protections granted to counterparties to forward contracts and other protected forms of agreements. Section 556, for example, in part, provides:

The contractual right of a commodity broker, financial participant, or forward contract merchant to cause the liquidation, termination, or acceleration of a commodity contract, as defined in section 761 of this title, or forward contract because of a condition of the kind specific in section 365(e)(1) of this title, and the right to a variation or maintenance margin payment received from a trustee with respect to open commodity contracts or forward contracts, shall not be stayed, avoided, or otherwise limited by operations of any

provision of this title or by the order of the court in any proceeding under this title...

11 U.S.C. § 556 (2005). Sections 555, 559, 560 and 561 of the Bankruptcy Code each contain similar termination rights with respect to securities contracts, repurchase agreements, swap agreements and master netting agreements, respectively. As noted, notwithstanding the automatic stay or section 365 of the Bankruptcy Code, these safe harbor provisions authorize counterparties of safe harbor contracts to terminate upon the commencement of a bankruptcy case.

59. The Debtors entered into Prepetition Assurance Agreements and are seeking immediate entry of the Interim Order to prevent the disastrous consequences of having their Counterparties terminate safe harbor contracts upon the commencement of the Chapter 11 Cases. The Debtors strongly believe that honoring the Prepetition Trading Contracts and carrying out the terms of the Prepetition and Postpetition Assurance Agreements is essential to the continuance of the Debtors' business operations and to the stability of the organization as a whole.

2. The Protected Counterparties May Be Entitled to Performance During the Period Before Assumption or Rejection of the Prepetition Trading Contracts.

60. Although contracts are not fully enforceable during the period prior to assumption of the agreement, the Supreme Court has held that “[i]f the debtor-in-possession elects to continue to receive benefits from the other party to an executory contract pending a decision to reject or assume the contract, the debtor-in-possession is obligated to pay for the reasonable value of those services...” N.L.R.B. v. Bildisco and Bildisco, 465 U.S. 513, 531 (1984).

61. Here, the Debtors have elected to receive the benefits of performance by the Protected Counterparties under the Prepetition Trading Contracts. Moreover, the Debtors intend to assume the Prepetition Trading Contracts. Accordingly, the Debtors' believe that they are

authorized to continue to perform on the Prepetition Trading Contracts. The Debtors submit that continuing to honor the terms of the Prepetition Trading Contracts in the ordinary course of business is prudent, will maximize the value of the Debtors' estates, and will minimize disruption to the Debtors' businesses resulting from the filing of these Chapter 11 Cases.

3. Section 364 of the Bankruptcy Code Allows the Relief Requested.

a. The Relief Requested Requires The Court's Immediate Entry of An Interim Order.

62. Bankruptcy Rules 4001(b) and 4001(c) provide that a final hearing on a motion to obtain credit pursuant to section 364 of the Bankruptcy Code may not be commenced earlier than fifteen (15) days after the service of such motion. Upon request, however, the Court is empowered to conduct a preliminary expedited hearing on the motion and authorize a debtor to obtain credit to the extent necessary to avoid immediate and irreparable harm to the debtor's estate.

63. The Debtors, particularly CES, will suffer immediate and irreparable harm unless the Debtors obtain immediate relief from the Court. The Assured Counterparties conditioned their agreements to refrain from invoking the safe harbor protections upon the Court's immediate entry of the Interim Order, and the Debtors have received indications that many other Counterparties would immediately terminate their safe harbor contracts if they were not entitled to the benefits of an immediate court order granting them the protections sought herein. Put simply, the lack of the Interim Order and the resulting termination of the Prepetition Trading Contracts would likely destabilize the entire organization and could have a ripple effect on the energy industry as a whole.

64. Pursuant to Bankruptcy Rules 4001(b) and 4001(c), the Debtors request that the Court grant interim relief on an emergency basis with respect to the Motion only as it relates to

the provision of credit support and the granting of security interests, pending the Final Hearing. This interim relief, pending the Final Hearing, will prevent disruption of and maintain the Debtors' ongoing operations, thereby avoiding immediate and irreparable harm and prejudice to the Debtors' respective estates and all parties in interest in these cases.

b. The Circumstances of This Case Warrant the Granting of Superpriority Administrative Claim Status and Liens Under Bankruptcy Code Section 364.

65. This Motion and proposed Interim Order contemplate that the Protected Counterparties will extend credit to the Debtors, whether under new Postpetition Trading Contracts or by continuing to do business under existing Prepetition Trading Contracts, in exchange for certain inducements, such as the granting of superpriority claims and liens to Protected Counterparties pursuant to section 364(c)(1) and (2). Industry practice requires "out of the money" parties to provide credit support in the ordinary course of business based upon net mark-to-market valuations. Given the Debtors' current financial condition, credit support is typically maintained through the posting of collateral, generally in the form of cash. The Debtors have every intention of performing under their prepetition and postpetition trading contracts as permitted by the Court. However, the credit support requested herein is necessary for the uninterrupted and successful operations of the Debtors' trading business.

66. Section 364 of the Bankruptcy Code provides, in pertinent part, as follows:

- (a) If the trustee is authorized to operate the business of the debtor under sections 721, 1108, 1203, 1204, or 1304 of this title, unless the court orders otherwise, the trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business allowable under section 503(b)(1) of this title as an administrative expense.
- (b) The court, after notice and a hearing, may authorize the trustee to obtain unsecured credit or to incur unsecured debt other than under subsection (a) of this section, allowable under section 503(b)(1) of this title as an administrative expense.

- (c) If the trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt —
 - (i) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title;
 - (ii) secured by a lien on property of the estate that is not otherwise subject to a lien; or
 - (iii) secured by a junior lien on property of the estate that is subject to a lien.

11 U.S.C. § 364(a) through (c).

67. Section 364 of the Bankruptcy Code “provides bankruptcy courts with the power to authorize post-petition financing for a Chapter 11 debtor-in-possession,” See In re Defender Drug Stores, Inc., 126 B.R. 76, 81 (Bankr. D. Ariz. 1991). “Having recognized the natural reluctance of lenders to extend credit to a company in bankruptcy, Congress designed [section] 364 to provide ‘incentives to the creditor to extend post-petition credit’” Id. The incentives enumerated in section 364 are not intended to be an exhaustive list of the inducements that a court may grant. Id. In fact, it is not uncommon for a court to approve a lending arrangement containing terms that far exceed those authorized by section 364. Id.

68. Generally, courts apply a three-part test to determine whether credit may be obtained under section 364(c). The three-part test includes demonstrating that (a) the debtor cannot obtain credit unencumbered or without superpriority status, (b) the credit transaction is necessary to preserve the assets of the estates, and (c) the terms of the credit agreement are fair, reasonable and adequate given the circumstances of the debtor-borrower and the proposed lender. See In re Crouse Group, Inc., 71 B.R. 544, 549 (Bankr. E.D. Pa. 1987), aff’d, 75 B.R. 553 (E.D. Pa. 1987).

69. Against this statutory backdrop, courts will evaluate the facts and circumstances of a debtor's case and accord significant weight to the necessity for obtaining the financing. See In re Ames Dep't Stores, Inc., 115 B.R. 34, 40 (Bankr. S.D.N.Y. 1990). Debtors are generally permitted to exercise their basic business judgment consistent with their fiduciary duties when evaluating the necessity of proposed protections for a party extending credit under section 364 of the Bankruptcy Code. Id. at 38.⁶

70. The circumstances of these cases require the Debtors to grant their Counterparties superpriority administrative claim status under section 364(c)(1) and liens on free assets under section 364(c)(2) to protect such Counterparties from the risk of the Debtors' nonperformance under the Prepetition and Postpetition Trading Contracts. Shortly, the Debtors intend to seek approval of a debtor in possession financing facility (the "DIP Facility"). The DIP Facility will provide for the posting of collateral in the ordinary course of business.⁷ Assuming the Court approves the Debtors' entry into a DIP Facility, the Debtors will have the necessary resources to perform the obligations contemplated under the Prepetition and Postpetition Assurance Agreements and fully perform under any new postpetition trading contracts.

71. These Chapter 11 Cases provide a unique set of facts and circumstances. The credit that is being provided is not pursuant to a traditional lender/debtor relationship. Accordingly, based upon the circumstances presented in the Debtors' Chapter 11 Cases, seeking

⁶ Notably, as evidenced by the orders attached hereto as Exhibit C, the bankruptcy courts in the NRG and Mirant cases both entered orders authorizing the debtors - as they deemed appropriate, without further order of the court - to pledge collateral, letters of credit, and other similar security under prepetition and postpetition derivative contracts.

⁷ The Debtors expect (and the Interim Order provides) that the administrative claims and liens granted to the Protected Counterparties will be subject to such claims and liens granted to the DIP lenders.

alternative credit would be impossible, as the credit needed by the Debtors is from the parties to the trading contracts themselves. See, e.g., Borne Chemical Co., Inc. v. Lincoln First Commercial Corp. (In re Borne Chemical Co., Inc.), 9 B.R. 263, 269 (Bankr. D. N.J. 1981) (where it would be impossible to obtain credit on the same terms and conditions as set forth in the proposed financing arrangement, granting of a superpriority expense under 364(c) of the Bankruptcy Code was appropriate). Under the existing paradigm, there are no alternative sources from which to seek credit support. It is the Debtors' very relationship with their Counterparties that is integral to the on-going and future success of the Debtors' operations, which the Debtors are seeking to maintain. As discussed above, the transactions contemplated herein are absolutely necessary, not only to preserve and maximize the Debtors' assets, but to assist in the stabilization of the energy industry as a whole.

72. The inducements contained in the Prepetition and Postpetition Assurance Agreements are fully justified in light of the fact that (a) absent the Counterparties' agreement to waive their right to terminate the safe harbor contracts the Debtors' operations likely will not survive, (b) the Debtors are unable to obtain alternative agreements with new Counterparties on acceptable terms, (c) the Counterparties would not agree to less favorable terms than the terms of the Prepetition and Postpetition Assurance Agreements and (d) the relief requested in this Motion and continuing trading relationships with Counterparties is in the best interest of the Debtors' estates and creditors. In re Vanguard Diversified, Inc., 31 B.R. 364 (Bankr. E.D.N.Y. 1983); In re Keystone Camera Prods. Corp., 126 B.R. 177 (Bankr. D.N.J. 1991).

73. The Debtors are concerned that, without the express authority to continue to provide credit support under certain of the trading contracts, Counterparties may terminate Existing Positions and refuse to enter into new trades prospectively with the Debtors. In the

event that approval of a DIP Facility is delayed, the Debtors intend and seek authority to post cash collateral pending approval of a DIP Facility. To preserve the value of the Debtors' estates, therefore, the Debtors request the express authority to provide credit support under Prepetition and Postpetition Trading Contracts, as appropriate.

74. Finally, although these cases provide a unique scenario under which the Debtors are seeking treatment under section 364(c) of the Bankruptcy Code, none of the evils that courts are routinely concerned with in determining whether it is appropriate to grant section 364(c) relief exist in these Chapter 11 Cases. The Debtors are not seeking a priming lien under section 364(d) of the Bankruptcy Code, as the property on which they are seeking to grant a lien is unencumbered. In re Ames Dept' Stores, 115 B.R. at 37. There are no clauses that require the Debtors to retain exclusivity to file and solicit a plan. Id. Nor is the purpose of the financing to benefit any particular creditor. Id. at 39. Simply stated, the relief sought herein serves to benefit all of the Debtors' creditors by maintaining the Debtors' operations and maximizing the value of the Debtors' estates. Accordingly, the Debtors believe that the relief sought herein represents a fair and efficient mechanism for preserving the viability of the trading business, while providing Protected Counterparties with appropriate protections and inducements to continue trading with the Debtors.

4. As Secured Creditors, the Protected Counterparties Are Entitled to Adequate Protection.

75. Substantially all of the Debtors' obligations under the Prepetition Trading Contracts are secured by the Prepetition Collateral. Moreover, the property rights requiring adequate protection include the Prepetition Trading Contracts themselves. That is, the loss (or delay) of the Protected Counterparties' right to terminate the Prepetition Trading Contracts is a

property right entitled to adequate protection. Accordingly, each of the Protected Counterparties is a secured creditor entitled to adequate protection.

76. Bankruptcy Code section 361 embodies the concept of adequate protection:

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by -

- (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant or a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;
- (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or
- (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

11 U.S.C. § 361. Given that adequate protection is mandated by certain provisions of the Bankruptcy Code, the Protected Counterparties are entitled to adequate protection as a matter of right, not merely as a matter of discretion.

77. Although section 361 describes three means by which adequate protection may be provided, these means are not mandatory, but rather are suggestions. Adequate protection can and should differ among cases and between proceedings. It “must...be determined on a case-by-case basis, permitting the debtors ‘maximum flexibility in structuring a proposal for adequate protection.’...[i]n order to encourage reorganization...” In re Martin, 761 F.2d 472, 474, 476 (8th Cir. 1985), quoting In re American Mariner Industries, Inc., 734 F.2d 426, 435 (9th Cir. 1984). Nonetheless, in every case, adequate protection ““should as nearly as possible under the

circumstances of the case provide the creditor with the value of his bargained for rights.’...[I]ts requirement of indubitable equivalence remains constant” Id. at 476.

78. The relief requested in this Motion provides a package sufficient to adequately shield Protected Counterparties with respect to the Prepetition Collateral and from the loss of rights (i.e., delay of the right to terminate) provided under the Prepetition Trading Contracts and permitted by the Bankruptcy Code. This package of relief was not created in a vacuum. To the contrary, the relief requested in the Motion is the produce of days of meeting, discussions, and negotiations with the Debtors’ most significant Protected Counterparties. Where, as here, the adequate protection has been negotiated and discussed and is beneficial to the estates, the proposed adequate protection should be provided significant deference.

B. The Court Should Authorize the Debtors’ Entry Into the Postpetition Trading Contracts.

79. The Court should find that the Debtors’ entry into the Postpetition Trading Contracts is within the Debtors’ ordinary course of business. Although the Debtors believe that entering into the Postpetition Trading Contracts is within the ordinary course of their businesses, as discussed in more detail below, if the Court does not find that the Debtors’ entry into postpetition trading contracts is within the ordinary course of business, alternatively the Debtors request that they be permitted under either Bankruptcy Code sections 105 or 363 to enter into Postpetition Trading Contracts, without further order of the Court.

1. Entry Into the Postpetition Trading Contracts Is In the Debtors’ Ordinary Course of Business.

80. The Debtors are concerned that many Counterparties will be reluctant to conduct business with them through trading contracts absent explicit authorization from the Court allowing the Debtors to enter into the Postpetition Trading Contracts. Thus, out of an abundance of caution, the Debtors are seeking an order authorizing them (a) to continue ordinary trading

activity, including entering into the Postpetition Trading Contracts and (b) to perform all such other actions as may be necessary or appropriate to implement, execute and perform such transactions, including, but not limited to, posting letters of credit, entering into escrow agreements, opening and funding escrow accounts, posting collateral or margin, prepayment and delivery of settlement payments on account of the Postpetition Trading Contracts.

81. Section 363 of the Bankruptcy Code provides, in relevant part, that a debtor in possession “may enter into transactions...in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.” 11 U.S.C. § 363(c)(1).

82. The two tests ordinarily applied by the courts to determine the ordinary course of business are the “horizontal” test and the “vertical” test. Denton County Elec. Co-Op., Inc. v. Eldorado Ranch (In re Denton County Elec. Coop., Inc.), 281 B.R. 876, 882 and n.12 (Bankr. N.D. Tex. 2002). “The ‘horizontal test’ focuses on the way businesses operate within a given industry. The ‘vertical test’ focuses on the expectations of creditors.” Denton County Elec. Co-Op., 281 B.R. at 882 n.12.

83. All asset management and trading activities conducted through the use of trading contracts are in the ordinary course of the Debtors’ businesses. See Medical Malpractice Ins. Assoc. v. Hirsch (In re Lavigne), 114 F.3d 379, 384 (2d Cir. 1997) (finding that “ordinary course of business” is meant “to embrace the reasonable expectations of interested parties of the nature of transactions that the debtor would likely enter in the course of its normal, daily business”) (quoting In re Watford, 159 B.R. 597, 599 (M.D. Ga. 1993)); In re Roth American, Inc., 975 F.2d 949, 952 (3rd Cir. 1992) (stating that section 363 of the Bankruptcy Code is designed to allow a debtor in possession “flexibility to engage in ordinary transactions without

unnecessary...oversight”); In re Coordinated Apparel, Inc., 179 B.R. 40, 43 (Bankr. S.D.N.Y. 1995).

84. Creditors’ reasonable expectations of a debtor’s “ordinary course of business” are based on the debtor’s specific prepetition business practices and norms, and the expectation that the debtor will conform to those practices and norms while operating as a debtor in possession. In re Garofalo’s Finer Foods, Inc., 185 B.R. 414, 425 (N.D.Ill. 1995). Thus, a fundamental characteristic of an “ordinary” postpetition business transaction is its similarity to a prepetition business practice. Marshack v. Orange Commercial Credit (In re National Lumber & Supply, Inc), 184 B.R. 74, 79 (9th Cir. B.A.P. 1995); In re James A. Phillips, Inc., 29 B.R. 391, 394 (S.D.N.Y. 1983). The size, nature and type of business, and the size and nature of the transactions in question, are all relevant to determining whether the transactions at issue are ordinary. U.S. ex rel. Harrison v. Estate of Deutscher, 115 B.R. 592, 598 (M.D. Tenn. 1990); In re Johns-Manville Corp., 60 B.R. 612, 617 (Bankr. S.D.N.Y. 1986).

85. “Accordingly, a postpetition transaction undertaken by the debtor that is similar in size and nature to prepetition transactions undertaken by the debtor would be within the ordinary course of business.” Garofalo’s, 186 B.R. at 426. The Postpetition Trading Contracts which the Debtors anticipate entering into are virtually identical to the Prepetition Trading Contracts, with many of the same Counterparties.

86. In fact, some of the Postpetition Trading Contracts which the Debtors anticipate entering into are with the very same parties and in the same form as certain Prepetition Trading Contracts. Here, the application of the vertical test requires the Court to address whether a Counterparty would expect notice and hearing before the Debtors entered into a Postpetition Trading Contract. See Denton County Elec. Coop., 281 B.R. at 882. The answer is no.

87. Businesses in the Debtors' industry routinely enter into trading contracts similar to the Debtors, suggesting that the Debtors' entry into Postpetition Trading Contracts is within the Debtors' ordinary course of business. See In re Johns Manville Corp., 60 B.R. at 618 (suggesting that "a comparison of this debtor's business to other like businesses" is the appropriate inquiry concerning ordinary course transactions). See also In re Atlanta Retail, Inc., 287 B.R. 849, 856 (Bankr. N.D. Ga. 2002). Companies in the Debtors' industry routinely enter into such transactions, as evidenced again by the NRG and Mirant orders attached hereto as Exhibit C. Moreover, as described more fully above, the Debtors routinely entered into such transactions in the past.

2. Alternatively, the Court Should Authorize Entry into Postpetition Trading Contracts Outside of the Ordinary Course of Business Under Sections 105 or 363.

88. Even if the Court does not find that the Debtors' entry into Postpetition Trading Contracts is in the ordinary course of business, the Debtors should still be permitted to enter into Postpetition Trading Contracts consistent with past practices and without further order of the Court. Such relief is appropriate under the Court's equitable powers under Bankruptcy Code section 105(a) and authority to approve non-ordinary course transactions under section 363(b).

89. To effectively manage the risks inherent in their businesses, the Debtors must be able to enter into Postpetition Trading Contracts and must be able to maintain the confidentiality of the basic terms of the Postpetition Trading Contracts. Given the confidential nature of and immediate need to enter into Postpetition Trading Contracts, as well as the sheer volume of the transactions that are required to operate businesses as complex as these, it would be impracticable and counterproductive to require the Debtors to seek approval of each Postpetition Trading Contracts. It is, thus, essential to the Debtors' continuing business operations that the

Court enter the Interim Order authorizing the Debtors to enter into Postpetition Trading Contracts.

C. Upon Entry of a Final Order Affirming the Interim Order, the Debtors May Assume the Prepetition Trading Contracts Under Section 365.

90. At the conclusion of the Final Hearing, the Debtors' request that the court approve the assumption of the Prepetition Trading Contracts. The Debtors' request for approval to assume the Prepetition Trading Contracts is fully justified based on the facts, circumstances, and applicable law. The Prepetition Trading Contracts are "executory contracts" as the term is used in section 365 of the Bankruptcy Code. Section 365 provides that a Chapter 11 debtor, subject to Bankruptcy Court approval, may assume or reject executory contracts at any time prior to plan confirmation. 11 U.S.C. § 365(a) and (d)(2). The debtor's decision to assume or reject an executory contract is an exercise of the debtor's business judgment. See Richmond Leasing Co. v. Capital Bank, N.A., 762 F.2d 1303, 1309 (5th Cir. 1985). The business judgment test is not a strict standard, but merely requires a showing that either assumption or rejection of the contract at issue will benefit the debtor's estate. See In re Bildisco, 682 F.2d 72, 79 (3d Cir. 1982), aff'd sub nom., N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513 (1984).

91. Assumption of the Prepetition Trading Contracts is in the best interest of the Debtors and their estates because these contracts are, as set forth above, essential to the operation of the Debtors' businesses both during the course of these cases and after their exit from Chapter 11. Moreover, given the fact that the Prepetition Trading Contracts are virtually all fully collateralized, the Debtors face very few cure obligations in relation to their proposed assumption of the Prepetition Trading Contracts.

Memorandum of Law

92. 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

93. 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) counsel to the administrative agents for the Debtors' prepetition secured lenders; (d) counsel to the Ad Hoc Committees; (e) the indenture trustees pursuant to the Debtors' secured indentures; (f) counsel to the Debtors' proposed postpetition lenders; (g) the Securities and Exchange Commission; (h) the Internal Revenue Service; and (i) 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

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

WHEREFORE, the Debtors respectfully request that the Court enter an Order, substantially in the form attached hereto as Exhibit A, authorizing the Debtors to (i) continue to honor prepetition trading contracts; (ii) enter into new postpetition trading contracts and (iii) pledge collateral under prepetition and postpetition trading contracts.

Dated: December 20, 2005
New York, New York

Respectfully submitted,

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