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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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In the Matter of

Case No.
05-60200

CALPINE CORPORATION, et al.,

Debtors.

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April 26, 2006
United States Custom House
One Bowling Green
New York, New York 10004

Hearing Pursuant to Agenda of Matters.

B E F O R E :

HON. BURTON R. LIFLAND,

U.S. Bankruptcy

Judge

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A P P E A R A N C E S :

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1 CALPINE CORPORATION

2 P R O C E E D I N G S :

3 MR. CANTOR: Good morning, your
4 Honor.

5 THE COURT: Good morning, Mr.
6 Cantor.

7 MR. CANTOR: Your Honor, Matthew
8 Cantor of Kirkland and Ellis on behalf of the
9 debtors.

10 There is some negotiations going on
11 in the hall that we expect to want to be contested
12 matters. So if I might flip things just briefly,
13 we can get started and go through some of the
14 uncontested matters while I let that resolve
15 itself.

16 If you turn to page 4 on the agenda,
17 the first uncontested matter is a motion for an
18 order approving a settlement between the debtors
19 and Old World and Celanese. My partner Bennett
20 Spiegel is here to present that to you and describe
21 to you what that settlement is all about. If you
22 remember, originally Mr. Karlan was here at the DIP
23 hearing dip.

14 dollars, with their first month of service
15 approximately 200 thousand dollars, your Honor.

16 THE COURT: The court reserves the
17 right to review the payment of those sums on a
18 rolling basis.

19 MR. STAMER: Understood, your Honor.

20 THE COURT: All right.

21 MR. STAMER: And again, we will
22 attach the guidelines to the proposed order which
23 we will submit at the end of the hearing.

24 THE COURT: Very well.

25 MR. STAMER: Thank you, your Honor.

25

1 CALPINE CORPORATION

2 MR. CANTOR: Your Honor, I can now
3 go back to page 1 where I wanted to start. I
4 appreciate your indulgence in letting us skip
5 around a little bit.

6 Starting with the first contested
7 matter, your Honor, and that's the companies'
8 motion for approval of a compensation program for
9 the board of directors.

10 Your Honor, the motion was filed and
11 served on April 6th. It was served on the United
12 States Trustee, the administrative agent for the
13 prepetition lenders, the unsecured creditors'
14 committee, the parties who filed notice of
15 appearance on the 2002 list, and the ad hoc
16 committees. The only objection we received to the
17 motion, your Honor, is an objection from an
18 attorney at Schiff Hardin representing certain

19 equity holders. The objection requests an
20 adjournment of the matter so that an equity
21 committee can be appointed, and also objects that
22 we are not compensating the board with an equity
23 component.

24 Your Honor, we believe that the
25 motion shouldn't be adjourned. The Schiff Hardin

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1 CALPINE CORPORATION
2 attorney who has been involved in the case and
3 asking for the appointment of an equity committee
4 has been engaged by clients, has had an opportunity
5 to review the motion, participate in the hearing,
6 and in fact has filed an objection to this motion.
7 In view of the substance of the objection that the
8 suggestion is to compensate the board of directors
9 with equity in Calpine, is probably not something
10 that's sustainable. I would like to go forward
11 with that.

12 Your Honor, this motion is tied
13 together with two other motions that you will hear
14 next concerning establishing compensation programs
15 for the management the of the company as well.
16 Your Honor, the standard for approval of this is,
17 moving under Section 363, the standard for approval
18 is business judgment and whether or not the company
19 has done the appropriate job in determining this is
20 appropriate to do.

21 Your Honor, we're here with a
22 witness Mr. Steven Hall. Mr. Hall is the managing
23 director and founding partner of Steven Hall and

24 Partners. I would like to make an offer of proof.
25 He's an expert who has advised the company on what

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1 CALPINE CORPORATION
2 the appropriate procedures and process would be and
3 what the appropriate benchmarking would be for the
4 board process. I would submit here that we have a
5 very talented board; it's a collection of very
6 highly skilled and seasonal professionals of the
7 highest integrity, and these are the people we are
8 counting on to review the role of management in
9 their major decisions in this case. And as you'll
10 see from Mr. Hall's testimony I'm about to read
11 into the record, benchmarked against the
12 compensation that members of boards of other
13 similar companies get, the current compensation is
14 substantially lower than that. We would like to
15 make it normalized against the market.

16 So I like first to make an offer of
17 proof of Mr. Hall.

18 THE COURT: You may.

19 MR. CANTOR: Mr. Hall is here in
20 court today, if you would like to identify
21 yourself.

22 Mr. Hall is the managing director
23 and founding partners of Steven Hall and Partners,
24 an executive compensation and consulting firm that
25 serves as independent outside consultants to

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1 CALPINE CORPORATION
2 boards, compensation committees, and management in
3 matters of executive compensation, director
4 remuneration and corporate governance. Mr. Hall
5 has over 25 years of experience in the field of
6 executive director compensation. He's a member of
7 the faculty of the National Association of
8 Corporate Directors where he teaches courses
9 related to executive and director of compensation
10 and best practices in compensation committee
11 governance.

12 Mr. Hall served as a compensation
13 consultant to Calpine's board of directors for a
14 number of years. And at the request of Calpine's
15 Board of Directors in late 2005, he performed a
16 review of Calpine's compensation for non employee
17 directors. Mr. Hall is engaged to review Calpine's
18 non employee directors compensation for market
19 competitiveness both in terms of levels of
20 compensation and methods of compensation. He was
21 asked to provide recommendations to the board for a
22 compensation program that would enable Calpine to
23 recruit new directors, appropriately compensate the
24 directors for the time commitment and required of
25 them, and to recognize best practices and director

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1 CALPINE CORPORATION

2 compensation.

3 If called to testify, Mr. Hall would
4 also testify that Calpine's current compensation

5 for the non employees is markedly below market
6 ranging from about 120 to 130 thousand dollars
7 below the median level of total compensation for
8 directors in comparable companies, depending upon
9 the directors' respective levels, responsibility
10 and committee participation. As you can see, we'll
11 be proposed, there is some additional compensation
12 for performing on committees. Mr. Hall would also
13 testify that he arrived to the conclusion in
14 performing his comprehensive review of Calpine's
15 compensation to the board and his review of
16 comparable companies, that the -- what he analyzed
17 was the 2004 compensation data disclosed in 2005,
18 proxies for a cross section of general industry,
19 companies with revenue generating from 8.5 to 9.5
20 billion dollars, and from that data Mr. Hall was
21 able to determine the range of market compensation
22 for directors holding various board positions.

23 In addition to ascertaining the
24 total director compensation values, he also
25 analyzed various components of compensation

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1 CALPINE CORPORATION
2 provided to those directors, including base cash
3 retainers, additional cash retainers to the chair
4 and committee positions, stock awards and per
5 meeting fees. As the final step of his analysis
6 from the most current data available, Mr. Hall
7 projected levels of director compensation of 2006
8 based historical changes in current trends. Mr.
9 Hall projected an increase in the total director

10 compensation from 15 to 25 percent, depending on
11 board participation over a two year period, from
12 2004 to 2006.

13 Mr. Hall will testify that the most
14 significant contributing factor to Calpine's below
15 market compensation for non employee directors is
16 that Calpine's financial situation prevented the
17 company from providing the directors with an equity
18 component to the compensation. He would also
19 testify that he advised the board that his
20 recommendation would be to raise the non employee
21 director compensation to the approximate median to
22 the marketplace; specifically he recommended a 140
23 thousand dollar base cash retainer with additional
24 retainers of 125 and 175 thousand dollars for the
25 board chair person. Mr. Hall further recommended

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1 CALPINE CORPORATION
2 adjustments to the additional cash retainers for
3 committee chair persons. He also recommended that
4 Calpine provide a 2 thousand dollar per meeting
5 cash fees to each director. Finally Mr. Hall
6 recommended that Calpine review compensation with
7 its non employee directors again in 2007 and if the
8 financial position of the company stabilize,
9 replace a portion of the cash component of director
10 compensation with a stock award.

11 THE COURT: Go ahead.

12 MR. CANTOR: Lastly, Mr. Hall would
13 testify that he reviewed changes to non employee
14 director compensation approved by the board on

15 February 8th and disclosed in an AK filed on
16 February 15th. He would testify also that the
17 board approved the changes to non employee director
18 compensation along the lines he suggested, your
19 Honor, but at lower levels than he suggested. For
20 example, Mr. Hall recommended a 140 thousand dollar
21 cash retainer, and the board adopted 125 thousand
22 dollar cash retainer. He recommended 2 thousand
23 dollar meeting fees, and the board approved a 2
24 thousand fee for in-person, and 1 thousand dollar
25 fee for participation by phone. And for -- I'm

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CALPINE CORPORATION

2 sorry, the board approved a 2 thousand dollar fee
3 for in person board meetings but reduced the fee to
4 2 thousand per meeting for all other meetings, that
5 would be telephonic meetings.

6 Mr. Hall would testify that further
7 that the changes to the directors compensation by
8 the board of Calpine for the total compensation for
9 non employee directors below the projected median
10 for the director compensation of comparable
11 companies.

12 And that would be Mr. Hall's
13 testimony, and I would submit that to your Honor.

14 THE COURT: Does anyone want to be
15 heard with respect to the proffer?

16 MR. LUBITZ: Your Honor, yes. I
17 appreciate counsel's giving all of that.

18 I'm here basically to introduce
19 Michael Yetnikoff of our Chicago office. But this

20 is one of those issues which go uniquely to the
21 heart of equity holders, and we would simply ask
22 for an adjournment on this.

23 I will introduce Mr. Yetnikoff. Mr.
24 Yetnikoff has -- or I filed on his behalf a pro hac
25 motion. Mr. Yetnikoff advises me that in the

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1 CALPINE CORPORATION
2 context in all of the dollars we've heard, he does
3 have a check for 25 dollars with him if the pro hac
4 motion is granted. We have a proposed order.

5 MR. YETNIKOFF: Your Honor, for the
6 record Michael Yetnikoff of Schiff Hardin LLP
7 Chicago on behalf of certain shareholders of
8 Calpine.

9 These are really the little guys in
10 the case. A lot of the shareholders have a large
11 portion of their net worth tied up in
12 perpetuation purchases of Calpine stock. The U.S.
13 Trustee has determined to appoint an equity
14 committee to represent the interests of those small
15 shareholders and the chance hundreds of thousands
16 of those.

17 We've requested a brief adjournment
18 of three motions: The instant director compensation
19 motion, the Calpine incentive plan motion, and what
20 I call the CEO CFO employment agreement motion.

21 In order to give an official
22 committee of equity security holders the ability to
23 be heard on these issues, which essentially involve
24 directors, top management of the company, which

25 under normal circumstances would be at the election

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1 CALPINE CORPORATION
2 of shareholders. In fact Calpine is not going to
3 hold its annual meeting this year, and shareholders
4 won't be heard as a group, as an entire group,
5 unless it's through the equity committee. It's
6 expected that an equity committee should be
7 appointed shortly, therefore the request of
8 adjournment would be relatively brief, we believe
9 would not prejudice any of the interests of the
10 debtors, being that the debtors did wait
11 approximately four months after the filing of the
12 case to bring these motions before the court.
13 There, on the other hand, would be significant
14 prejudice to the shareholders and to the equity
15 committee to be formed would it not at least given
16 the opportunity to be heard on these matters. It
17 may well be that the equity committee which may or
18 may not include some of the shareholders I
19 represent, I don't know that, might have a
20 different view, might in fact not object to some of
21 these motions or might object to one of the motions
22 that I didn't object to -- that the shareholders
23 didn't object to.

24 So on that basis we would like to
25 request a brief adjournment of docket numbers 1174,

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1 CALPINE CORPORATION

2 75 and 76 for a week to ten days for that
3 committee, when formed, to be heard.

4 MR. CANTOR: Your Honor, if I might
5 respond.

6 We are given to understand that Mr.
7 Yetnikoff had requested the U.S. Trustee to appoint
8 a committee, and we are also given to understand
9 the U.S. Trustee is considering that. I don't
10 believe that any firm decisions to actually appoint
11 a committee; I guess there might be some
12 consideration, just surmising by the U.S. Trustee's
13 office, that there is insufficient interest of
14 participation from large institutional holders,
15 there might not be a committee. I don't know when
16 there will be a committee.

17 I will say with respect to this
18 motion, the objections that were raised, that we
19 should be compensating directors with equity, when
20 I think the goal should be compensating directors
21 fairly in such a way as to keep their interests
22 aligned in helping the company maximize value, than
23 be focused on maximizing return for equity rather
24 than creditors probably is inappropriate. But as
25 it relates to the issue of adjourn, we've come here

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1 CALPINE CORPORATION
2 today on these three motions, as you see, I have a
3 number of witnesses on the next few motions.

4 We've waited a number of months to
5 come forward with this two reasons. First, as
6 you'll see from some of the other testimony, the

7 board of this company spent an awful lot of time
8 trying to ensure that we develop programs of
9 compensation that were fair to all of our
10 constituents, that were going to drive all the
11 people responsible to this company to maximize
12 value, that we are trying to create as much
13 agnosticism toward competing creditor and equity
14 holder and project lender constituencies as
15 possible, and we wanted to keep everything focused
16 toward having each member of the governing
17 structure, whether it be a non employee director,
18 senior management or junior management, driving
19 towards one thing, the highest possible value in
20 the appropriate amount of time.

21 So the board took an awful lot of
22 time in that process, and you'll hear that they
23 relied on a number of professionals to give them
24 advice in that regard. Then, while we were in the
25 first crucial stages of the case when the

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1 CALPINE CORPORATION
2 management was focusing on getting the DIP loan in
3 place, identifying some of the first projects that
4 we needed to begin disposing of to reduce the cash
5 burn, and getting a head count in cost reduction
6 program that we believe has created a 175 million
7 dollars of cost cutting and cash savings, it was
8 now appropriate to move forward with the motion at
9 this point in the case.

10 Lastly, one of the delays has been
11 our attempt to establish a process within the major

12 constituencies to develop some consensus, and that
13 was apologized and one of the reasons for the delay
14 this morning, we were trying to create some
15 consensus. As it relates to Mr. Yetnikoff's
16 objection, again, conjecting an equity component
17 into director compensation, what we are trying to
18 do here is to compensate some of what I consider to
19 be some our extraordinary directors, including Mr.
20 Derr, continuing to be vigilant and work hard as
21 members of the board of this company.

22 So I submit, your Honor, that we
23 should not adjourn the hearing. There is no
24 prejudice to Mr. Yetnikoff or his clients. They
25 have had every opportunity to appear and submit

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1 CALPINE CORPORATION
2 their objections, and, in fact, they have.

3 MR. STAMER: Your Honor, if I may be
4 heard very briefly. Again, Michael Stamer from
5 Akin Gump for the official committee.

6 Your Honor, to state the obvious
7 it's April 26th. The company filed bankruptcy in
8 December of last year. To the companies' credit
9 they have actually held off on going forward with
10 the sensitive and important motions, as Mr. Cantor
11 said, to try to forge consensus; and thus far they
12 have been pretty successful. We believe that one
13 of the companies' most significant assets is its
14 employee base. It is very important for the
15 company to have qualified strong directors, which
16 is what is the subject of the motion that the

17 debtors are currently arguing; it is also critical
18 to have senior management that is qualified and
19 appropriately incentivised. And similarly, it is
20 very important to have an employee base that is
21 working together towards the goal of maximizing
22 value. It is for that reason, which you will hear
23 as this hearing progresses, that the committee is
24 in fact supportive of the three motions that the
25 equity holders currently seek to have adjourned.

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1 CALPINE CORPORATION
2 Your Honor, just very briefly in
3 response to the motion to request an adjournment,
4 and I say this with all due respect to the equity
5 holders and to counsel for the equity committee.
6 Your Honor, as set forth in correspondence both by
7 the committee and by the debtors to the U.S.
8 Trustee's Office, we feel very strongly that the
9 equity committee, the values currently at play here
10 do not provide for a recovery to the equity
11 holders. We believe that the equity holders are in
12 fact well out of the money, the committee has not
13 formally decided how it will respond to the
14 appointment of an equity committee, if in fact an
15 equity committee is in appointed, but we do not
16 believe the equity committee -- the equity holders
17 who are clearly adequately represented today by
18 counsel, should have the ability to come in and say
19 let's slow the process down further for purposes of
20 allowing the equity holders to participate. They
21 are participating. They are here. They will give

22 the court their input. Our concern is by putting
23 these things off further that it may in fact do
24 some damage to the company, and, again, one of its
25 most valuable assets.

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1 CALPINE CORPORATION

2 THE COURT: Thank you, gentleman.

3 I'm sensitive to the timing issues that are here.

4 And notwithstanding the request for an adjournment,

5 I am going to deny the request.

6 I do note that the shareholders have
7 been able to mount an analytic and appropriate
8 response, so it cannot be said that the
9 shareholders voices are not being heard; they are
10 heard, and for which I appreciate the input.

11 But getting back to the hearing
12 itself, there has been a proffer. Mr. Hall is
13 here. Does anybody want to examine the witness?

14 There's no response. The proffer is
15 accepted, Mr. Cantor.

16 MR. CANTOR: Thank you, your Honor.
17 So based upon Mr. Hall's testimony, I would submit
18 to your Honor that the decision of the company to
19 set the director compensation at the amounts set
20 forth in the motion is the exercise of sound
21 business judgment. The processes, not only the
22 board's process in satisfying the duties and
23 conducting an intelligent review in consideration
24 of these things, but also the process we've driven
25 through the reorganization case also support the

1 CALPINE CORPORATION
2 conclusion that setting the compensation we have in
3 the motion is reasonable and appropriate.

4 THE COURT: Well, I find there's no
5 basis under the present circumstances to have an
6 equity component of the compensation. I don't know
7 what the equity is today; I don't imagine it would
8 be very rewarding to contemplate that, especially
9 at this stage and especially pre-confirmation.

10 But as I understand it, Mr. Cantor,
11 there's been some modification downward with
12 respect to the compensation package as contained in
13 your reply; is that correct.

14 MR. CANTOR: Yes. And it was all
15 set forth in the motion, your Honor. The downward
16 adjustment was the -- each Board member would be
17 getting 125 thousand dollars per year compensation,
18 plus an additional 50 thousand for the chairman. I
19 think more was suggested by Mr. Hall. Mr. Hall had
20 suggested a two thousand dollar meeting fee, and
21 the board determined that two thousand dollars per
22 meeting would be appropriate for in-person board
23 meeting, but for all other board meetings like
24 telephonic, one thousand dollars would be more
25 appropriate. That's 125 plus 50; 175. Other than

1 CALPINE CORPORATION
2 that, the remainder was, I believe, as suggested

3 the members of the audit committee will get an
4 additional 10 thousand dollars plus a 30 thousand
5 dollar for the chair of the audit committee. As
6 you know, the audit committee in companies of this
7 size, public filings, this is quite a big job. And
8 the chairs of the nominating and governance
9 committee and the chair of the compensation
10 committee will also get an additional 15 thousand
11 dollars annually.

12 THE COURT: The application is
13 approved.

14 MR. CANTOR: Thank you, your Honor.
15 I have an order.

16 THE COURT: I'll entertain it.
17 I've approved the order.

18 MR. CANTOR: Thank you, your Honor.
19 Your Honor, may I have two minutes
20 off the record, please?

21 (Pause in proceedings)

22 MR. CANTOR: Your Honor. The next
23 motion is a motion for an order authorizing the
24 implementation of the Calpine executive and
25 management incentive plan.

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1 CALPINE CORPORATION
2 Your Honor, if I might, we have a
3 witness prepared Mr. Scott Davido, who is the chief
4 financial officer and chief restructuring officer
5 at the company. He's going to testify, whereas we
6 prepared a testify in support of both this motion
7 and the next motion, the motion to approve

8 assumption of the CEO's employment agreement and
9 for authority to enter into the agreement for him,
10 for the chief restructuring officer and chief
11 financial officer. And as we go through this, what
12 we would like to do is offer Mr. Davido as proof
13 and see if that's sufficient and avoid putting him
14 on the stand for both motions, if I might, just to
15 save time. Mr. Jeff Powell, who is my partner,
16 he's been preparing Mr. Davido, and I'll ask him to
17 read it into the record at the appropriate time.
18 And if that's acceptable, I would like to use that
19 proof for both motions.

20 THE COURT: That's acceptable.

21 MR. CANTOR: And likewise, we'll
22 have an offer of proof of Mr. Nick Bubnovich, who
23 is a management compensation specialist of Watson
24 Wyatt, and we also have benchmarking testimony from
25 him for both motions.

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1 CALPINE CORPORATION

2 Your Honor, with respect to this
3 motion, like the prior motion, it was filed and
4 served on the same parties on April 6th. We've
5 received one objection to that motion from an
6 individual shareholder, Mr. Alan Ku.

7 Your Honor, the objections are two
8 fold. One, he suggests that there's no sound
9 business judgment for the incentive plan that we
10 propose, and I think we will be able to prove
11 through the testimony of Mr. Davido and Mr.
12 Bubnovich, and then with respect to the employment

13 agreements, Mr. Buckfire, that there has been an
14 appropriate process in place that the board has
15 followed, and that the professional advise that the
16 board has relied on in determining to implement
17 these programs satisfies all the requisites of
18 appropriate corporate governance, and, in fact, it
19 is supported by sound business judgement. WE will
20 prove that through evidence.

21 In addition, as a legal matter,
22 there's been an argument made that the incentive
23 plan is not consistent with Sections 503(c)(1), the
24 prohibition against key employee retention plans.
25 And we will be able to argue, I think, your Honor,

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1 CALPINE CORPORATION
2 that the parts of the plan that have been described
3 as retention that are going to executives who could
4 be considered insiders, these are not retention
5 plans, these are incentive plans, and we will be
6 able to make that distinction clearly.

7 With respect to some of the
8 compensation under the supplemental plan, which,
9 although I don't think it could be retention, we
10 are going to argue its retention, those payments
11 will be going to vice presidents who we contend are
12 not insiders for the purposes of the Code. No
13 decision making authority on major corporate
14 decisions or corporate policy, or effectively,
15 managers at the project levels. And because of
16 those two reasons we do not believe that the
17 incentive plan violates Section 503(c)(1), which is

18 the only objection we've had.

19 So if I might press forward with our
20 presentation, then I'll allow the objector to
21 present his case.

22 THE COURT: Go ahead.

23 MR. CANTOR: Your Honor, we are
24 relying on Section 363 of the Code for approval of
25 the this compensation plan for the companies'

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1 CALPINE CORPORATION
2 management team.

3 We think it's -- as you'll hear,
4 this is being implemented, it's an exercise of
5 sound business judgment, and it is being proposed
6 in good faith. There is absolutely no evidence of
7 self dealing or bad faith here. As you'll see, the
8 methodologies in the plan are intended to, again,
9 drive managers and executives to maximize value to
10 the benefit of all constituencies.

11 Preserving and enhancing the value
12 of these estates, your Honor, will depend on
13 maintaining the focus, morale, and loyalty of the
14 workforce through maintaining market based
15 competitive compensation arrangements. And as
16 you'll also hear what the company has done, I
17 think, an extraordinary job, is developing a
18 program that is objective, competitive with the
19 marketplace, and based on very sound goals, that we
20 will be able to identify the goals that will be
21 tested and people will be held accountable for,
22 they are responsible for, and they will be

23 compensated if they succeed. I think it's a very I
24 think effective program.

25 The employees we have, given the

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1 CALPINE CORPORATION
2 nature of this business, the employees are
3 critical. They all have valuable knowledge of the
4 commercial operations, the plant operations, the
5 regulatory environment, their relationships with
6 vendors, and all the counter parties, they are all
7 critical to the operations. The energy markets and
8 particularly the power business, is pretty hot
9 today, and people with skill sets in this arena are
10 highly marketable. In fact, since the commencement
11 of the case, due to a variety of reasons we have
12 had some employee loss. I have a list here of
13 about 50 employees down at our trading operations
14 in Houston who moved on to greener pastures, and we
15 believe it's very important at this time to
16 implement a program like this, and only comports
17 with Section 503, it's not a KERP program, but also
18 is a market based reasonable compensation program.
19 And I don't to make too much of the plight we've
20 had, but we do think we are at a point in time that
21 it's critical; we implemented an incentive plan to
22 compensate our employees fairly and at market based
23 rates.
24 As I said, and now you'll hear, this
25 plan is the culmination of a comprehensive review

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1 CALPINE CORPORATION
2 process by Watson Wyatt, who advises the company,
3 and subsequent process of reviewing the plans with
4 our major creditor constituencies in developing a
5 consensus. And as you'll see, the plan is intended
6 to maximize people of great value without leaning
7 towards secured debt, unsecured debt or equity.
8 The goal will be to create the best enterprise and
9 the most valuable enterprise possible.

10 So on that note, I would like to
11 first introduce Mr. Powell to make an offer of
12 proof to Mr. Davido who will explain the plans,
13 explain how they work, and explain why, from a
14 company management perspective, they are
15 reasonable.

16 MR. POWELL: Good morning, your
17 Honor. Jeff Powell for the debtors. May I
18 approach?

19 THE COURT: Yes.

20 MR. POWELL: I've got a cheat sheet
21 here.

22 Your Honor, if called to testify,
23 Scott Davido would testify as follows: He is the
24 CFO and chief restructuring officer of the company.
25 He's been with the company since early this year.

1 CALPINE CORPORATION
2 He joined the company from NRG, where he held
3 senior executive positions for the last or previous
4 four years.

5 Mr. Davido would testify that
6 Calpine's incentive program has four parts. And
7 those components are on the first page of the dec
8 that I handed your Honor. Those parts are the
9 emergence incentive plan, the management incentive
10 plan, the supplemental bonus program, and the
11 discretionary bonus program. Mr. Davido would
12 testify that this program is absolutely necessary
13 to properly incentivise Calpine employees toward
14 the critical goals of operating the company and
15 getting the company out of bankruptcy, and that
16 these incentives align the employees' interests
17 with the interests of the other constituencies that
18 Mr. Cantor referred to.

19 This program was designed by company
20 management in conjunction with Watson Wyatt. The
21 process took several months, over two to three
22 months. The people at the company involved in
23 designing the program were the head of HR, the CEO
24 of the company, senior management of the company,
25 and Mr. Bubnovich, who is here today from Watson

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1 CALPINE CORPORATION
2 Wyatt. The program was presented to the board on
3 more than one occasion. And it was approved by the
4 board within the last month. The company has
5 presented this program to the various creditor
6 constituencies, and there have been discussions and
7 negotiations over the components of the plan for
8 over a month, your Honor, including as recently as
9 last night and this morning. All critical aspects

10 of the plan were discussed with the creditor bodies
11 and negotiated.

12 The first component is the emergence
13 incentive plan, your Honor, which is the next
14 slide. That component is limited to 20 senior vice
15 presidents and executive vice presidents. There is
16 an incentive pool of roughly 5.5 million dollars
17 that is available to these individuals only if
18 there is a successful consummation of
19 reorganization, and the adjusted enterprise value
20 of the entity exceeds five billion dollars. It is
21 five billion dollars or greater. If the AEV, your
22 Honor, exceeds five billion dollars then that
23 incentive pool scales up from 5.45 million dollars.
24 As I indicated on the dec, the incentive pool
25 increases by 285 thousand for each one hundred

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1 CALPINE CORPORATION

2 million dollars in added AEV.

3 This program, your Honor, has been
4 benchmarked by Watson Wyatt. And Mr. Bubnovich,
5 who is here today, is prepared to testify that this
6 plan is fair and reasonable, and Mr. Bubnovich
7 presented that advice to the board. This AEV
8 formula, your Honor, that's in the emergence
9 incentive plan is also contained in Mr. Davido's
10 contract, as well as the contract of Mr. Robert
11 May, the CEO of the company.

12 This concept, the AEV concept was
13 neither Mr. Davido's nor Mr. May's idea; they had
14 no role in determining that formula or how it

15 scaled upwards. Eligible employees in this plan
16 only get paid upon emergence, if they get paid at
17 all. The expected total cost of the program
18 depends on the value of the company. It could be
19 five roughly 5.5 million dollars or it could scale
20 up. This is a one time program.

21 The second component, your Honor, is
22 the management incentive plan. And I've got a
23 slide on that as well. Mr. Davido will testify
24 that this plan, too, is necessary to properly
25 incentivise employees going forward on critical

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1 CALPINE CORPORATION
2 projects, including the one Mr. Cantor referred to,
3 which is arriving at 170/175 million dollars in
4 cost savings. The plan is available to roughly 600
5 employees, your Honor. It operates as follows:
6 There is a gateway hurdle. This plan is available
7 only if the company meets a specified cash flow
8 target over and above what's implied in the DIP
9 budget. The improvement in cash flow that must be
10 met before this is paid is 430 million dollars,
11 your Honor.

12 This program has been presented to
13 the board, it's been parented to Mr. Bubnovich, who
14 has opined and will opine that it is fair and
15 reasonable. And he's presented that to the board.
16 Even if these this gateway hurdle is met, your
17 Honor, even if it's met, employees do not receive a
18 bonus unless individual goals tailored to their
19 specific positions are met. They include cost

20 cutting, head count reductions and the like. The
21 total cost of this program, if the company hits
22 these targets, the value of the cost of the program
23 cannot exceed 25 to 26 million dollars in 2006.
24 The size of past bonus programs of the company, 55
25 million dollars.

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1 CALPINE CORPORATION
2 The third components, your Honor, is
3 the supplemental bonus plan limited to employees
4 who are flight risks and performing critical
5 functions of the type that Mr. Cantor referred to
6 earlier. The program is limited to vice presidents
7 and below. Those people do not have any
8 significant decision making authority at the
9 company, and we believe, your Honor, would not
10 constitute insiders under Section 503. The
11 expected cost of this program will not exceed 6
12 million dollars. One time program, your Honor.

13 The last component is the
14 discretionary bonus plan, annual bonus pool of half
15 a million dollars to be disbursed at the CEO's
16 discretion, provides flexibility to deal with
17 isolated issues that may arise limited to 25
18 thousand dollars per employee, again, limited to
19 people who do not have significant decision making
20 authority. And, again, we contend that these are
21 not insiders, your Honor.

22 Those are the four components of the
23 incentive program. Mr. Davido would say in
24 response to the objection made that this program

25 was absolutely not designed with inducing employees

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1 CALPINE CORPORATION
2 to remain, it is an incentive program. And the key
3 terms of the emergence incentive pool and the
4 management incentive pool make that clear.
5 Employees only get payments if AEV targets are hit,
6 cash flow target are hit, and personal objectives
7 are met. I've got a slide, your Honor, on total
8 expected cost. Year 2006, total expected cost will
9 not exceed 30 to 35 million dollars in comparison
10 to other financial data that's significant and is
11 on the slide, 20 million dollars in assets, 18
12 million dollars in debt. That's the incentive
13 program, your Honor.

14 Briefly about the contracts. The
15 contracts for both Mr. May and Mr. Davido were
16 entered into, in Mr. May's case in December, in Mr.
17 Davido's case in early 2006. Those contracts have
18 been substantially negotiated and altered since
19 that time as a result of discussions with various
20 competitor groups. The economics between Mr. May
21 and Mr. Davido's contracts differ, but the key
22 compensation components are the same, and I've got
23 a slide on that, your Honor. Salary signing bonus,
24 annual bonus opportunity are standard. There is a
25 base emergence payment that both Mr. May and Mr.

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1 CALPINE CORPORATION
2 Davido get, but only if the company reemerges
3 successfully from Chapter 11. There is an
4 additional emergence bonus which is very similar to
5 the emergence I described with the employee
6 incentive plan, and that is a defined AEV target
7 has to be hit, 5 billion dollars, and then it
8 scales up from there, your Honor.

9 That's the contract components.
10 Those are reached as a result of extensive
11 discussions with the creditors' committee. That's
12 the offer of proof for Mr. Davido.

13 THE COURT: Does anyone want to be
14 heard with respect to the proffers?

15 MR. YETNIKOFF: Your Honor, Michael
16 Yetnikoff. I have very few questions. I'm not
17 sure which witness to ask them of. The questions
18 are regarding how the AEV or adjusted enterprise
19 value bonus was calculated, or particularly how the
20 AEV itself is calculated. I don't know which
21 witness is the best person to ask about it.

22 MR. CANTOR: Your Honor, I was
23 actually going to describe a few of the changes to
24 the AEV; it's actually fairly simple, but I think
25 it would be appropriate for Mr. Yetnikoff to ask

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1 CALPINE CORPORATION
2 Mr. Davido some questions if he thinks it's
3 appropriate. We're okay with that.

4 THE COURT: Okay.

5 MR. DAVIDO: Good morning, your

6 Honor.

7 THE COURT: Good morning.

8 S C O T T D A V I D O, called
9 as a witness, having been first duly sworn by the
10 Notary Public, Denise Nowak, was examined and
11 testified as follows:

12 (Pause in proceedings)

13 EXAMINATION BY MR. YETNIKOFF:

14 Q. Good morning, Mr. Davido. My name
15 is Michael Yetnikoff. I represent certain common
16 shareholders of Calpine Corporation.

17 Can you state your name and current
18 employment position for the record?

19 A. Sure. Scott Davido, chief financial
20 officer and chief restructuring officer for Calpine
21 Corporation.

22 Q. Mr. Davido, in connection with the
23 incentive program, and also in conjunction with Mr.
24 May's contract and your contract, there are bonuses
25 calculated on the basis of a figure called AEV or

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1 CALPINE CORPORATION
2 adjusted enterprise value. Are you familiar with
3 that?

4 A. Yes.

5 Q. Can you tell me how the AEV or
6 adjusted enterprise value is calculated?

7 A. The adjusted enterprise value will
8 be calculated based on a market test of the trading
9 value of those securities that are distributed
10 pursuant to plan of reorganization. In addition,

11 you would add to that the value of any cash
12 distributed pursuant to the plan.

13 Q. Is that answer prudent to the total
14 enterprise --

15 A. Wait a minute, I'm sorry.

16 Q. Please, complete your answer.

17 A. Yes, I'm sorry. We've had a few
18 things go around on this. Let me revise.

19 The adjusted enterprise value is
20 based on the trading value of the securities
21 distributed pursuant to the plan of reorganization,
22 both based on the trading value of the debt
23 securities distributed and the trading value of the
24 equity securities distributed.

25 Q. Does that include cash or not?

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1 CALPINE CORPORATION

2 A. No.

3 Q. Would that figure which you've just
4 described, and I'll paraphrase, total value of
5 equity security distributed under the plan plus
6 total value of debt securities equivalent to total
7 enterprise value as described in the motions?

8 A. The reason we are calling it
9 adjusted enterprise value is that we are only
10 focused on the securities that are distributed in
11 respect of Calpine Corporation -- what is
12 distributed in respect of Calpine Corporation
13 claims. The idea here is to not count either way
14 toward or against enterprise value the claims and
15 the debt that reside at the project level.

16 Q. And that number is generally
17 referred to in your pleadings as project debt?

18 A. Yes.

19 Q. What is the amount of that project
20 debt?

21 A. Approximately 7 billion dollars.

22 Q. And the adjusted enterprise -- so an
23 adjusted enterprise value of say 5 billion dollars,
24 were the bonuses kick in, as it were, that would be
25 equivalent to a total enterprise value of 12

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1 CALPINE CORPORATION

2 billion dollars; is that fair to say?

3 A. Roughly, yes, subject to some minor
4 adjustments.

5 Q. So is it fair to say that the
6 bonuses kick in, as it were, when the total
7 enterprise value of the reorganized Calpine equals
8 12 billion dollars, give or take some adjustment
9 for difference in project debt of approximately 7
10 million dollars or less?

11 A. Approximately, yes.

12 MR. YETNIKOFF: That's all. Thank
13 you.

14 THE COURT: Does anyone else want to
15 make inquiry?

16 MR. POWELL: No.

17 THE COURT: Thank you.

18 (Witness excused)

19 MR. CANTOR: Your Honor, the next
20 witness we would call and make an offer of proof is

21 Mr. Nick Bubnovich. I believe you may have heard
22 from at least an offer of proof of Mr. Bubnovich
23 earlier in the case.

24 Mr. Bubnovich is employed by Watson
25 Wyatt, it's a human resources consulting firm. He

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1 CALPINE CORPORATION
2 has over 20 years of experience in the field of
3 compensation consulting. He's been retained by
4 numerous Chapter 11 debtor to provide advise with
5 respect to compensation plans like this one. He
6 provided advice in and testimony in the Adelphia
7 case recently. He is advising the Delta
8 Corporation, he has advised in Winn-Dixie, Codesco,
9 Federal Mogel, Pays The Murs And other large
10 Chapter 11 cases.

11 If called to testify, Mr. Bubnovich
12 would testify that he was contacted by Mr. Kenn
13 Derr, who was at the time the acting -- in December
14 of 2005 he was Chairman of the Board of Calpine and
15 then acting as the CEO after the existing CEO had
16 left the company. And he had told Mr. Derr to
17 expect about a 6 million dollar aggregate sign on
18 bonus and salary and bonus for the first year to
19 find a CEO for this company. He also advised Mr.
20 Derr to expect a 6 million dollar per year long
21 term incentive plan based on his knowledge of the
22 markets. Mr. Derr was also told and Mr. Bubnovich
23 also advised that because there was no equity
24 opportunities here in view of the companies'
25 situation and likely bankruptcy, that the long term

1 CALPINE CORPORATION
2 incentive would be likely need to be in some sort
3 of emergence bonus rather than an equity component
4 since there would be no prepetition equity
5 component. He also told Mr. Derr that the 12
6 million dollar success fee that was being requested
7 by Mr. May was within the range of competitive
8 practices, that long term incentive of four times
9 base salary, was between the median and the 75th
10 percentile based upon survey data.

11 Subsequently, Mr. Bubnovich was
12 contacted by Mr. May as it relates to Mr. Davido's
13 compensation. And similarly, Mr. Bubnovich
14 reviewed the term sheet proposed, suggested a few
15 changes, not many changes to the salary and bonus,
16 in his view, that what Mr. Davido had requested was
17 in reasonable market terms. He told Mr. May at the
18 time that the compensation to be offered to Mr.
19 Davido was competitive, was in the range of
20 competitive practice based on his experience with
21 the contracts for a number of people in these types
22 of reorganization cases.

23 Mr. Bubnovich also engaged in a
24 benchmarking process for Mr. May's and Mr. Davido's
25 contracts. And although through subsequent

1 CALPINE CORPORATION
2 negotiations with the creditors, the amounts in the

3 contracts have been reduced, both in terms of long
4 term incentives and other bonuses. The benchmark
5 compensation for Mr. May and Mr. Davido are at the
6 threshold and the target adjusted enterprise values
7 are within market competitive comparables.

8 Getting into the emergence incentive
9 plan, Mr. Bubnovich also conducted a benchmarking
10 exercise for the emergence incentive plans. As you
11 heard from Mr. Davido's testimony, it is for the 20
12 executives who can most directly influence the
13 corporation. And Mr. Bubnovich thought it was
14 appropriate to use the same adjusted enterprise
15 values for those managers and executives as were
16 being used for Mr. May and Mr. Davido.

17 Mr. Bubnovich determined that the
18 pool of 14 million dollars for target adjusted
19 enterprise value, which is basically an 8 million
20 dollar target value, is based on the sum of the two
21 year annual bonus opportunities for similar
22 participants and at comparable companies. The
23 amount of the pool is adjusted up and down based
24 upon the adjusted enterprise value, but Mr.
25 Bubnovich would testify that the 5 billion dollar

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1 CALPINE CORPORATION
2 threshold that must be met before any bonus is paid
3 would be reasonable.

4 So based upon Mr. Bubnovich's
5 benchmarking process, and the process consistent of
6 following: He assumed that relatively equal
7 distributions to participants based on levels. He

8 determined that the levels of individual
9 compensation provided to participants would be
10 within a range of competitive practice for long
11 term incentive. And then he compared the projected
12 total cost of the program at the threshold and
13 target, 8 billion for estimates here, for the
14 emergence incentive plan and for Mr. May's and Mr.
15 Davido's emergence bonuses to a data base that
16 Watson Wyatt maintains related to plans adopted in
17 other Chapter 11 cases, that he determined that the
18 total emergence bonuses to be paid by Calpine at
19 the various adjusted enterprise values measured
20 within the range of the aggregate cost plans
21 adopted in other Chapter 11 cases when measured
22 both against the total assets here and the total
23 revenues.

24 Lastly with respect to the
25 management incentive plan, and that's the plan for

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1 CALPINE CORPORATION
2 the 6 hundred or so employees, Mr. Bubnovich
3 benchmarked the management incentive bonus
4 opportunities for participants also by level. He
5 compared the opportunities as a percentage of
6 salary against the market opportunity as a
7 percentage of salary, and he determined that the
8 bonus targets are at market or at the median for
9 annual bonus's and this is an appropriate program
10 to put in place. And that would be the end of Mr.
11 Bubnovich's testimony. In sum, he would testify
12 that he provided benchmarking tests against

13 comparable companies both in Chapter 11 and outside
14 of Chapter 11 of similar size, and determined that
15 these programs are both appropriate programs to
16 implement at this time.

17 As a footnote, your Honor, some of
18 the targets in the management incentive plan are
19 still subject to the final review by the
20 committee's advisers. I think we have every reason
21 to believe that we will be able to come to terms on
22 some of the fine points in those targets, if not,
23 we stipulate we will come back before your Honor to
24 discuss those issues, but I view that as highly
25 unlike. Given I said that, I suspect we'll be

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1 CALPINE CORPORATION

2 here.

3 Your Honor, that's the ends of Mr.
4 Bubnovich's testimony, and I guess we can see if
5 there's any questions.

6 THE COURT: Does anyone want to be
7 heard with respect to the proffer?

8 MR. KU: Your Honor, my name is Alan
9 Ku.

10 THE COURT: You want to examine the
11 witness.

12 MR. KU: No. I thought you said any
13 more comments.

14 THE COURT: The proffer is accepted.

15 Now do you want to be heard?

16 MR. KU: Thank you. I'm Alan Ku.

17 Good morning, Judge. I'm here representing myself

18 as an individual shareholder.

19 Just some background. I was a
20 former employee of Calpine for over a year and a
21 half. I worked in the legal department, and many
22 of the people left, the 50 or so I actually knew
23 while I was working there.

24 While Calpine filed bankruptcy, I
25 helped initiate a group of little guys who combined

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1 CALPINE CORPORATION

2 now are 200 individual retail shareholders who
3 represent approximately 19 million shares, so we
4 are actually the largest block of shareholders,
5 even among the institutions. There's been a lot of
6 comments made today, and I guess I just want to
7 clear some of those first before I get to my main
8 objection.

9 First of all, Mr. Stamer of Akin
10 Gump made a comment that he believes there is no
11 equity at this time. I feel that is somewhat
12 presumptuous since we are still very early in this
13 bankruptcy, and a comment like that should just be
14 taken for what it's worth. Mr. Cantor from the
15 debtors' counsel indicated that a shareholder
16 equity committee is still potentially to be
17 selected by the trustee's office. I would like to
18 say that the debtor was requested a list of top 50
19 shareholders, and the debtors' counsel delayed in
20 returning that list. So any delay or any inability
21 to find these institutional holders necessary for a
22 committee, I think, rests in part upon the debtors'

23 own actions in this case.

24 My objection really raises two
25 points, that the Calpine incentive plan does not

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2 meet either 363 or 503. I think I also requested a
3 delay in the approval until a shareholders
4 committee is actually appointed to look at it. In
5 the event that delay is not granted, I am ready to
6 argue on the facts and the law that under 363 --

7 THE COURT: I've read your request
8 for a delay. It's consistent with the request made
9 by the other group, and it's denied.

10 MR. KU: Right. Then I'm ready to
11 original under 363.

12 THE COURT: Sure.

13 MR. KU: Sound business judgment,
14 that it is definitely not met by the debtor. The
15 debtor indicates throughout that there is consensus
16 and there is building a consensus among all
17 parties, but they often fail to recognize any
18 shareholder component as part of any of the
19 negotiations. My contention is that the threshold
20 given, the AEV value, is really without merit;
21 because from what the testimony indicates, Watson
22 Wyatt appears to go backwards in determining an
23 appropriate bonus and working up to what it
24 believes the total enterprise value ought to be.
25 And my opinion is that until a shareholder

1 CALPINE CORPORATION
2 committee is actually formally convened and we
3 approximately judge what the metric should be for
4 the enterprise value, we should hold off, or at
5 least revise it pending shareholder approval, of a
6 target bonus.

7 My strongest argument I feel though
8 is that the executives are being rewarded for
9 things absolutely out of their control. Now, Mr.
10 Davido said that this is absolutely necessary, the
11 EIP plan, to help maximize the value of the estate,
12 but I think anyone in the courtroom will
13 acknowledged that Calpine's bankruptcy was forced
14 in part by natural gas price and the
15 undercapitalization of the plan assets. Neither of
16 those are going to be improved by the select 20
17 executives that are targeted by the AEV plan.

18 Now these are the 20 executives who
19 benefit the most from any increase in total
20 enterprise value. I don't believe any evidence can
21 be or has been presented that would show why these
22 individuals can effectuate macroeconomic changes to
23 their benefit. To me the CIP plan is basically
24 Calpine Corporation's status quo 2006 bonus plan,
25 with the additional kicker to the EIP to the top 20

1 CALPINE CORPORATION

2 selected executives.

3 It's interesting to note that in Mr.

4 Powell's presentation, he mentioned that CIP plan
5 was created by senior executives, Watson Wyatt and
6 the CEO. I would like to say that no consensus or
7 no input seems to have been taken from the lower
8 level employees in the company. And if we only
9 focus on those senior executives, Watson Wyatt, and
10 the CEO, we can see that this group of individuals
11 really we have to wonder if they have a full
12 concerns of all the employees and shareholders on
13 their mind.

14 One comment was made by the creditor
15 committee attorney that the employee base is very
16 important to the Calpine Corporation, that the
17 employee base needs to be strong and needs to be
18 maintained as good moral, but they also acknowledge
19 that 50 or so very important individuals left the
20 company recently. And this was at the probability
21 that the 2006 bonus plan was canceled for these
22 employees; most notably, Mr. Papascilly, who was in
23 the Houston trading office left, and all of his
24 traders left primarily because the 2006 bonus plan,
25 the default status quo plan was cancelled, and in

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1 CALPINE CORPORATION
2 its place the debtor put the CIP plan. So from my
3 perspective the debtor is fixing a problem that
4 they created and doesn't really show any business
5 judgement as far as valuing its employees.

6 And one interesting anecdotes remark
7 when Mr. Papascilly and his trading group left, the
8 spokesperson from Calpine said we have a strong

9 bench warming group of traders, and it won't effect
10 our business that much. So the debtor itself
11 indicates that employees come and employees go,
12 it's okay. But they this plan where they need to
13 retain employees for fear they would actually leave
14 the company. And so I think the debtor has some
15 inconsistent argument on its case under 363.

16 Just briefly under the 503 objection
17 that I have regarding the retentive nature of its
18 plan. Throughout the presentation and throughout
19 motion itself, the debtor refers to flight risks,
20 refers to the need to reincentivise its employees.
21 But again, my argument is that these are payments
22 to retain them for a problem that they created and
23 they reduced under the 2006 bonus plan.

24 And when they remark that the
25 current employees are under paid by the market by

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1 CALPINE CORPORATION
2 over 70 percent or so, it's because the 2006 bonus
3 plan was taken out, and that is why they are being
4 under paid. So again I find them fixing a problem
5 of their open creation.

6 I think that is my presentation.
7 And again, I'm a novice at this, but I often hear
8 the debtor and the creditor mention consensus being
9 built on all parties in fairness, but I really
10 think there has been no consensus because the
11 shareholders have not been heard. Notwithstanding
12 the creditors committee's opinion that there is no
13 equity, I still feel that a shareholders committee

14 should be appointed and eventually heard and
15 participate in these negotiations, so when they say
16 census and fairness for all they really mean it.

17 THE COURT: Does anyone else want to
18 be heard?

19 MR. CANTOR: Your Honor, if I might
20 respond.

21 THE COURT: All right.

22 MR. CANTOR: Just in summation
23 first, then I'll respond to the objection.

24 You've heard evidence from the chief
25 financial officer and from the company's expert

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1 CALPINE CORPORATION
2 that the incentive plans were reasonable, both
3 based upon the market comparables and to the extent
4 they would be effective. The board has undertaken
5 a very cautious process in considering these plans
6 and approving them. Likewise, we've circulated the
7 plans and tried to build, and in fact have built a
8 consensus with the constituencies -- with the major
9 constituencies in the case.

10 As it relates to -- and what is
11 interesting, we tried real hard to do here, is to
12 create a plan and incentive plan based upon values
13 where the company would not be driven towards any
14 one value but manage to be driven to create value.
15 And whether or not the equity holder feels that its
16 interests have been protected, I actually feel
17 pretty comfortable that what we've done is here is
18 create a paradigm, at least for the managers in

19 control, that we are driving to create maximum
20 value.

21 As it relates to retention, without
22 getting caught and evolving into debate about what
23 constitutes retention and premiums, these plans are
24 designed an incent managers to perform and reach
25 goals. They are not payments that are paid upon

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2 emergence from bankruptcy or being with the company
3 for some period of time without regard to any
4 performance.

5 You'll see in the motion what we
6 haven't done is maintain the status quo. The
7 company had an awful lot of bonus plans that I
8 think were, at the end of the day, more expensive
9 than the plan that we are proposing. We are less
10 focused on objective criteria in determining
11 whether or not someone should get an incentive
12 payment. I think what the company has done, its
13 done a real good job in focusing the intent of the
14 plans of the company and actually breaking the
15 status quo at Calpine.

16 As it relates to the departures of
17 Mr. Pizzoli, who you've met, and some of the other
18 traders in Houston, I think the companies'
19 statement that we have a strong bench is true. We
20 would never want to lose people, and that's why we
21 want to create an incentive plan. Having lost some
22 people, it's even that much more important to get
23 the incentive plan in now so we don't lose that

24 strong bench and continue and go and be successful.

25 I don't think it's absolutely

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2 necessary to respond to all of Mr. Ku's comments,
3 other than to say there was no delay on the part of
4 the company in responding to the U.S. Trustee's
5 office and their request for information, and the
6 U.S. Trustee can affirm that if you need to hear
7 that. I don't think we need to get into that.

8 As it relates to Section 503, I
9 mentioned that, and Mr. Powell mentioned that those
10 parts the plan, the supplemental plan that arguably
11 have less identifiable objective criteria that
12 someone could suggest our retention in nature,
13 insiders are not getting payments under the
14 supplemental plan, so the violation of the 503(c)
15 as it relates to supplemental plans should not be
16 an issue. Likewise 503(c) is not violated by the
17 emergence incentive plan or management incentive
18 plan, although I think we've made pretty clear on
19 the record that these are incentive plans based on
20 reaching objective goals and criteria and based
21 upon value, which is ultimately what the FAA is
22 going to need this company to create if they are
23 going to get a recovery in this reorganization.

24 So in sum, I would suggest to your
25 Honor that we have satisfied the requirements of

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2 Section 363. The evidence is uncontroverted that
3 the business judgment behind these plans are
4 reasonable and supported by the facts and
5 circumstances of the case. And before I sit down,
6 I just want to make sure there wasn't one last
7 point I wanted to make. I think that's it.

8 Thank you, your Honor.

9 MR. STAMER: Your Honor, just very
10 briefly. Consistent with my prior remarks, the
11 creditors' committee supports approval of the
12 incentive compensation programs outlined in the
13 debtors' presentation and in the May and Davido
14 contracts.

15 Your Honor, the creditors' committee
16 was an active participant in the negotiations that
17 lead to the presentation or request for the
18 approval of these plans. From when these
19 negotiations started, the final product represents
20 a number of changes. One is dramatic reduction in
21 the cost to the estate. And two, and as important,
22 a modification of incentives not just related to an
23 emergence from bankruptcy, which was what the
24 original trigger was, but a bonus structure
25 principally tied to the value that's achieved

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2 through these reorganizations for the benefit of
3 creditors and potentially shareholders.

4 There have been discussions
5 regarding what the appropriate triggers are for

6 value, and I believe they would be evidenced in the
7 order that is ultimately presented, there being
8 two. One being a gateway that the plan of
9 reorganization in order for, at least the May and
10 Davido contracts, for them to be eligible for the
11 incentive bonus, that the enterprise value must be
12 at a minimum of 5 billion dollars. And then it
13 will be governed by, as Mr. Cantor discussed, the
14 trading value of the securities issued under the
15 plan.

16 One statement with respect to the
17 position taken by the equity holders, and that is,
18 your Honor, there is no cap or disincentive by the
19 new CEO, the new CFO/CRO, or the other managers
20 that are the beneficiaries of these programs. The
21 more value they are able to create, the more money
22 they earn. And it was designed that way purposely.
23 It doesn't plateau once you pay a certain group of
24 creditors in full. The senior management team is
25 incentivised to maximize value for all

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2 constituents. We have a view of where that will
3 likely end up in terms of where it will not likely
4 end up, but I think it's inappropriate and not fair
5 to characterize this as being slanted for or
6 against any one constituency.

7 Thank you, your Honor.

8 MR. YETNIKOFF: Your Honor, I just
9 want to be clear on what we arguing. I did not
10 file an objection to the incentive program motion,

11 but did file one to the CEO/CFO employment
12 agreement. If we are arguing that second motion at
13 this point, I have some remarks. I'm not clear
14 where we are in the order of things.

15 THE COURT: I'm assuming that the
16 CEO application is before me at this point.

17 MR. STAMER: I believe that's
18 correct, your Honor.

19 MR. YETNIKOFF: I would like to be
20 heard very briefly on that, if I might.

21 THE COURT: Sure.

22 MR. YETNIKOFF: Michael Yetnikoff on
23 behalf of certain shareholders.

24 Your Honor, we had two major
25 objections to the CEO/CFO agreement motion.

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2 According to the this slide, it appears that these
3 may have been addressed, but I'm not sure. The
4 first objection was with respect to components
5 which we called the UCC incentive bonus, that is
6 for both Mr. May and Mr. Davido, a 4 million dollar
7 pool for Mr. May and a lesser amount for Mr. Davido
8 to be paid at the sole discretion of unsecured
9 creditors committee.

10 MR. CANTOR: Mr. Yetnikoff is
11 correct, that it's no longer part of the
12 compensation package. And Mr. Fishman has agreed,
13 by the way, which was originally part of the
14 motion, has been withdrawn also. The 4 million
15 dollar discretionary bonus has been withdrawn.

16 MR. YETNIKOFF: Has that been
17 replaced by with any other bonus?

18 MR. CANTOR: No.

19 MR. YETNIKOFF: Okay. Then that
20 does address and in fact respond, as we had hoped,
21 to that objection.

22 The second objection, and I believe
23 this has also been addressed because I see it in
24 the slide, under Section 503(c)(1) of the
25 Bankruptcy Code, the new section. Let me get my

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2 Sections right. I believe it's actually 503.

3 THE COURT: There is 1, 2 and 3.

4 MR. YETNIKOFF: I believe it's 2
5 regarding severance payments it's clear the
6 severance I an agreement agreements violated in
7 that provision no showing has sought to be made
8 regarding that section. And if I may ask, is
9 correct, that that severance provision has been
10 eliminated?

11 MR. CANTOR: Your Honor, the
12 agreements contain severance provisions that will
13 be effective only after the case emerges from
14 Chapter 11. If Messrs May and Davido continue to
15 be with the company after the Chapter 11, the
16 company has severance provisions. What we've done
17 is taken the severance agreements out of the
18 agreement, and what was negotiated with Messrs May
19 and Davido is a guaranteed success fee based upon
20 results that have been achieved to date, which I

21 can explain to you in detail what they are and what
22 the basis for that is. And we are treating that in
23 advance as a success fee. So what happens, and I'm
24 going to go slowly so I don't mess it up, but
25 there's the emergence bonus for May and Davido if

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2 they are with the company upon emergence. It's
3 based upon the targets based upon adjusted
4 enterprise value. And assuming that the adjusted
5 enterprise value exceeds the five million billion
6 dollar base line, we will pay that, and in fact
7 there's a detail in the agreement that if for some
8 reason Messrs May and Davido are terminated without
9 reason or cause or leave within good cause, they
10 will have the entitlement to earn their emergence
11 bonus. If there's a determination more than 12
12 months before there is a guaranteed success fee,
13 that will be payable based upon work that's been
14 done and results that have been achieved to date.
15 And we do not believe that's a severance within the
16 Second Circuit definition of severance in the
17 Strauss duParte case which makes it clear severance
18 payments were are to compensate one for the cost of
19 dismissal for some future unearned benefit, but the
20 guaranteed success fee is based on amounts we
21 believe, and the board had believed, has been
22 earned already and should at least be guaranteed.

23 I'll let Mr. Yetnikoff finish his
24 argument because I have some legal arguments while
25 I don't necessarily believe 503(c)(2) applies here

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2 as a prohibition anyway. But you are right, the
3 contract has been changed so that the severance
4 papers are not in there, nor are 4 million dollar
5 severance bonus.

6 MR. YETNIKOFF: All we is ask is to
7 be served with the new agreements and the proposed
8 orders so it's a fairly large amount of information
9 to swallow and it's new, and I would appreciate
10 being served with the new orders.

11 THE COURT: Most of it is not new,
12 much of it is contained in the reply apparently
13 served on you and received in the court.

14 MR. YETNIKOFF: I have not yet seen
15 the reply, but in the event it's not new but very
16 recent.

17 THE COURT: I have one problem, Mr.
18 Cantor before I rule.

19 There is a provision for the CEO and
20 Mr. David, I believe, to receive some compensation
21 if they leave for a good reason. I don't know what
22 good reason is. It's a very subjective term that I
23 can anticipate good reason being something very
24 favorable to Mr. May and Mr. Davido but not
25 favorable to others. It's very subjective and I

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2 don't know, unless you can define it better, I
3 would have a problem with that because the trigger
4 for the payment for good reason could be a good
5 reason being bad health, that's one thing. A good
6 reason could be an opportunity to take over General
7 Motors, and that's another thing.

8 MR. CANTOR: Your Honor, on page 7
9 of my black line version of the agreement, would
10 you like me to hand it up. It will be a very
11 specific definition and I can summarize it for you.
12 It means the occurrence of any of the following
13 facts, or occurrences: That a material adverse
14 change in the executive's duties, reporting
15 responsibilities, titles, or elected or appointed
16 officers, including but not limited to the
17 appointment of any person to an executive position
18 at the company that is co equal or senior to that
19 of the executive, other than the CEO. We have any
20 reduction for failure to pay when due the base
21 salary, the minimum 06 and 07 signing bonuses, a
22 reduction in the company executive's target bonuses
23 basically a reduction in the time and material, and
24 I'm also reading on a black line. Do you have a
25 cleaner copy?

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2 THE COURT: Is that list limiting or
3 is it precatory?

4 MR. CANTOR: It means the things set
5 forth in the agreement, I believe, your Honor.

6 THE COURT: And then it's infinity.

7 MR. CANTOR: Yes. I can read the
8 remainder of them. The companies' failure to
9 timely renew agreement. There is a renewal period,
10 I think it's 100 or 150 days near the end. The
11 companies breach of any material term of the
12 agreement that is not corrected within 10 days of
13 delivery or service of notice, or the failure of
14 the company to obtain the assumption in writing of
15 this agreement by any successor or acquirer of all
16 the substantial assets. And there's a limitation
17 on even that says for purposes of the definition,
18 none of the actions described in clauses A through
19 F, what I just describe, shall constitute good
20 reason with respect to the executive, if it was an
21 isolated, an inadvertent action, not taken in bad
22 faith by the company, and if it is remedied within
23 10 days after the receipt of notice.

24 THE COURT: Does anyone else want to
25 be heard?

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2 Well, based upon this record, and
3 it's certainly clear to the court that these plans
4 and agreements are proposed in good faith and based
5 upon appropriate business judgment. Further, the
6 record before me validates that the focus of the
7 plans and agreement is to maximize value for all
8 the estates; the plans are apparently designed as
9 incentive plans as opposed to retention or KERP's.
10 The argument that you were going to
11 make under Section 503, if you want to make it, you

12 can. If you want me to rule, I can.

13 MR. CANTOR: Your Honor, I pass on
14 the argument.

15 THE COURT: I do find, based upon
16 this record, that the prohibitions of Section 503
17 have, if not been avoided, are not applicable based
18 upon the structure of these plans and the
19 agreements. To the one area where there might be
20 potentially an argument to be made that 503(c)
21 would be applicable, that would be in the
22 supplemental plan, but that does not involve
23 insiders, and I think 503(c)(3) is appropriately
24 analyzed to agree with that.

25 In short, I do agree that these are

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2 incentive plans to bring enhanced value into the
3 estate. They are not retention plans, although
4 anyone can always make an argument that if people
5 are made happier than they were before, then they
6 are excited enough to stay with the company, but
7 that's not the focus of these plans. And this
8 would be clearly, based upon this record, not
9 KERP's and they are not in violation of 503(c).
10 And I will approve the appropriate orders submitted
11 to the court and according to this record.

12 MR. CANTOR: Thank you, your Honor.
13 We will submit an order. Have we prepared an
14 order?

15 MR. STAMER: Yes.

16 MR. CANTOR: Thank you.

17 Your Honor, going forward on the
18 agenda, this is probably one of the longest agendas
19 we've had on page 4, it's number 5, and my
20 colleague, Katherine Piper, who has been focusing
21 Calpine Construction Management Company will take
22 this motion. It's a motion of Reynolds Corporation
23 for an order compelling Calpine to assume or reject
24 certain contracts.

25 MR. FOSTER: And, your Honor, with

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2 your permission may we withdraw?

3 THE COURT: Certainly.

4 MR. CANTOR: Your Honor, I'm being
5 asked to clarify, it's pretty clear to me, you
6 approved both the incentive plan and the Mr. May
7 and Mr. Davido compensation agreements also?

8 THE COURT: When I use the word
9 agreements in my rulings, I did intend to
10 accomplish those things.

11 MR. ECKSTEIN: Good morning, your
12 Honor.

13 THE COURT: Good morning.

14 MR. ECKSTEIN: Andrew Eckstein of
15 Blank Rome, counsel for subcontractor to Calpine
16 construction management company, Reynolds, Inc. on
17 the Mankato Minnesota project.

18 Your Honor, Reynolds seeks an order
19 to compel the debtor to assume or reject its
20 construction contract with Reynolds. Reynolds
21 continues to advance money and continue expenses