Hearing Date: December 21, 2005 at 11:30 a.m. (Prevailing Eastern Time)

Alan W. Kornberg (AK/0756)
Andrew N. Rosenberg (AR/1799)
Elizabeth R. McColm (EM/8532)
PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP
1285 Avenue of the Americas
New York, New York 10019-6064
Telephone: (212) 373-3000
Facsimile: (212) 757-3990

Attorneys for the Unofficial Committee of
Second Lien Debtholders of Calpine Corporation

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	Chapter 11
CALPINE CORPORATION, et al.,	Case No. 05-60200 (SMB)
Debtors.	

OBJECTION OF UNOFFICIAL COMMITTEE OF SECOND LIEN DEBTHOLDERS TO EMERGENCY MOTION FOR, AMONG OTHER RELIEF, ORDERS AUTHORIZING POSTPETITION SECURED FINANCING AND CROSS MOTION FOR ENTRY OF AN ORDER MODIFYING AUTOMATIC STAY

TO: HON. STUART M. BERNSTEIN,
CHIEF UNITED STATES BANKRUPTCY JUDGE:

The Unofficial Committee of Second Lien Debtholders (the "Unofficial Committee") of Calpine Corporation ("Calpine")[1], one of the above-captioned debtors

[1] The second lien debt includes (i) the Second Priority Senior Secured Floating Rate Notes due 2007 issued under that certain Indenture dated as of July 16, 2003, by and between Calpine Corporation, as issuer, and Wilmington Trust Company ("Wilmington Trust"), as trustee; (ii) the 8.5% Second Priority

(collectively, the "Debtors"), by its counsel, Paul, Weiss, Rifkind, Wharton & Garrison LLP,[2] hereby:

> (i) objects to the Debtors' Emergency Motion for, among other relief, interim and final orders authorizing postpetition secured financing (the "DIP Financing Motion") because the Debtors have not provided adequate protection to the Second Lien Debtholders as required by sections 363 and 364 of the Bankruptcy Code; and
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> (ii) cross moves, pursuant to sections 105(a) and 362(d)(1) of the Bankruptcy Code, for relief from the automatic stay for cause, specifically because the Debtors have failed to provide adequate protection to the Second Lien Debtholders, and to permit the Second Lien Debtholders to enforce their rights in the collateral for the Second Lien Debt;

and in support thereof, respectfully sets forth and represents as follows:

I.

PRELIMINARY STATEMENT

1. The Second Lien Debtholders, holders of a majority of the approximately \$3.7 billion of second lien debt issued by Calpine, are the pivotal economic stakeholders in these cases. Prior to their chapter filings, as discussed below, the Debtors ran roughshod over the Second Lien Debtholders' rights; now they seek to

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Senior Secured Notes due 2010 issued under that certain Indenture dated as of July 16, 2003, by and between the Company, as issuer, and Wilmington Trust, as trustee; (iii) the 8.75% Second Priority Senior Secured Notes due 2013 issued under that certain Indenture dated as of July 16, 2003, by and between the Company, as issuer, and Wilmington Trust, as trustee; (iv) the 9.875% Second Priority Senior Secured Notes due 2011 issued under that certain Indenture dated as of November 18, 2003, by and between the Company, as issuer, and Wilmington Trust, as trustee; and (v) the Senior Secured Term Loans due 2007 made under that certain Term Loan Agreement dated as of July 16, 2003, by and between the Company, as borrower, and Goldman Sachs Credit Partners L.P., as administrative agent (collectively, the "Second Lien Debt").

2 The members of the Unofficial Committee (the "Second Lien Debtholders") hold a majority of the outstanding principal amount of the Second Lien Debt. They are: AIG Global Investment Corp., Angelo, Gordon & Co. L.P., Contrarian Capital Management LLC, Avenue Capital Group, Goldman Sachs Credit Partners L.P., Franklin Advisers, Inc., Lehman Brothers Inc. (Global Trading Strategies), Mackay Shields LLC, Oaktree Capital Management, LLC, Satellite Asset Management, L.P. and Wilmington Trust Company, as Indenture Trustee (ex officio member).

layer an additional $2 billion of secured debt on top of the Second Lien Debtholders without providing adequate protection.

2. The Second Lien Debtholders' collateral consists primarily of liens on the stock of Calpine's "first tier" subsidiaries. The Debtors now seek a $2 billion debtor-in-possession facility (the "Proposed DIP Facility") which would be structurally senior to, and in effect "prime," the Second Lien Debtholders' position. Left unchecked, such proposed financing will fund massive current cash losses at the Debtors' power projects based on the speculative hope that macro-economic conditions in the power industry will one day turn in the Debtors' favor.

3. The Debtors cannot show how the value of the Second Lien Debtholders' collateral would be adequately protected in the face of $2 billion in additional, priming debt. To the contrary, their principal collateral – equity interests in certain of Calpine's subsidiaries – could be subject to substantial erosion in value.

4. Section 363(e) provides that the Court shall condition the Debtors' use of the Second Lien Debtholders' Collateral (as defined below) "as is necessary to provide adequate protection of such [collateral]." Similarly, section 364(d) prohibits the priming of the Second Lien Debtholders' security interests absent the provision of adequate protection. Section 362(d) provides for relief from the automatic stay if the Second Lien Debtholders' interests are not adequately protected. It is the Debtors' burden in each case to demonstrate that the Second Lien Debtholders' interests are so protected.

5. The Debtors simply cannot show how the equity value of their subsidiaries that collateralize the Second Lien Debtholders' claims will be maintained in

light of the proposed $2 billion senior debt. Remarkably, the Debtors apparently have no project-by-project financial information. Consequently, there is no way to determine whether the Debtors will be leveraging profitable projects (and hence diminishing the Second Lienholders' residual equity value therein) to fund losses at insolvent ones (which would not benefit the Second Lien Debtholders' position). Without such information, no meaningful adequate protection arrangement can be implemented, nor has any been offered.

6. The Proposed DIP Facility shifts all of the risks associated with the Debtors' future business prospects to the Second Lien Debtholders, a result that is prohibited by the Bankruptcy Code. The Proposed DIP Facility should not be approved, or alternatively, the Second Lien Debtholders should be granted relief from the stay to pursue rights in their collateral.

II.
BACKGROUND

7. On December 20, 2005 (the "Petition Date"), Calpine and certain of its affiliates each filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code, 11 U.S.C. §§ 101 et seq. (the "Bankruptcy Code"). No trustee has been appointed, and the Debtors continue to operate their businesses and manage their assets and properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

8. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2).

A. **Pre-Petition Capital Structure**

9. Pre-petition, Calpine issued both first and second lien debt.[3] Specifically, Calpine issued \$785 million of First Priority Senior Secured Notes due September 30, 2014, pursuant to an Indenture dated as of September 30, 2004 (the "First Priority Notes"). Approximately \$641 million of First Priority Notes remain outstanding.

10. The Second Lien Debt consists of both secured term loans and notes. Specifically, Calpine issued \$750 million of Senior Secured Term Loans due July 15, 2007 (the "Term Loans") pursuant to a Credit Agreement dated as of July 16, 2003 (the "Term Loan Credit Agreement"). Calpine also issued the following notes (collectively, the "Second Priority Notes" and together with the Term Loans, the "Second Lien Debt"):

- \$500 million Second Priority Senior Secured Floating Rate Notes due July 15, 2007, pursuant to an Indenture dated as of July 16, 2003;
- \$1.15 billion Second Priority Senior Secured 8.500% Notes due July 15, 2010, pursuant to an Indenture dated as of July 16, 2003;
- \$400 million Second Priority Senior Secured 9.875% Notes due December 1, 2011, pursuant to an Indenture dated as of November 18, 2003; and
- \$900 million Second Priority Senior Secured 8.750% Notes due July 15, 2013, pursuant to an Indenture dated as of July 16, 2003.

Approximately \$3.7 billion remains outstanding in respect of the Term Loans and Second Priority Notes.

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3 Calpine also issued secured and unsecured debt and preferred stock at subsidiary levels which are structurally senior to the first priority notes and Second Lien Debt.

11. Both the First Priority Notes and the Second Lien Debt are secured pursuant to that certain Collateral Trust Agreement dated July 16, 2003 (the "Collateral Trust Agreement") between, among others, Calpine Corporation, Quintana Minerals (USA), Inc., JOQ Canada, Inc., Quintana Canada Holdings LLC, Wilmington Trust Company, as indenture trustee, Goldman Sachs Credit Partners L.P., as Administrative Agent under the Term Loan Agreement, and the Bank of New York, as Collateral Trustee (the "Collateral Trustee"). The First Priority Notes and Second Lien Debt share common collateral under the Collateral Trust Agreement – only their lien priorities differ. A copy of the Collateral Trust Agreement is attached hereto as **Exhibit A**.

12. In accordance with the Collateral Trust Agreement, Calpine granted to the Collateral Trustee, for the benefit of the Second Lien Debtholders, second priority liens on, among other things, substantially all of the assets owned by Calpine, including its natural gas and power plant assets and the equity in certain directly owned first tier subsidiaries (collectively, the "Second Lien Debtholders' Collateral"). The primary components of this collateral package include:[4]

(a) a second priority pledge of 100% of the equity interests in the following first tier domestic subsidiaries of Calpine (the "Domestic Pledged Stock") – Calpine International Holdings, Inc., Calpine Operations Management Company, Inc., Calpine Fuels Corporation, Calpine Power Company, Calpine Finance Company, Calpine Administrative Services, Inc., Calpine Energy Holdings, Inc., Calpine Northbrook Corporation of Maine, Inc. and Androscoggin Energy, Inc.;

(b) second priority liens on the following five power plants owned directly by Calpine – Santa Rosa Energy Center,

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4 Certain oil and gas reserves were also pledged as collateral, but most of those assets were sold prepetition.

Otay Mesa Project, Washington Parish Energy Center, Fremont Energy Center and Augusta Energy Center;

(c) a second priority pledge of intercompany notes issued to Calpine by certain of its subsidiaries; and

(d) a second priority lien on cash held by Calpine.

13. In addition, Quintana Canada Holdings, LLC, a direct subsidiary of Calpine International Holdings Inc., guaranteed the First Priority Notes and the Second Lien Debt and secured such guarantee by a pledge of 65% of the equity in Calpine Canada Energy Ltd. (the "Foreign Pledged Stock" and together with the Domestic Pledged Stock, the "Pledged Stock").

14. Calpine previously sold certain of the Second Lien Debtholders' Collateral consisting of "Designated Assets".[5] The proceeds of such sale (the "Sale Proceeds") were to be deposited in a designated assets sale proceeds account (the "Designated Assets Sale Proceeds Account") and used for specified purposes. Calpine, however, improperly withdrew approximately $312 million of such proceeds and dissipated them, giving rise to well-publicized litigation in Delaware state court entitled Calpine Corporation v. The Bank of New York and Wilmington Trust Company, C.A. No. 1669-N. A copy of the relevant decision of the Delaware Supreme Court which confirms Calpine's improper handling of such Sales Proceeds is attached as **Exhibit B**. The Collateral Trustee is still holding approximately $400 million of Sale Proceeds in the

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[5] "Designated Assets" is defined in the Collateral Trust Agreement as:

> all geothermal energy assets (including any related extraction, processing or similar equipment and geothermal power plants) and all natural gas assets (including any related extraction, processing or similar equipment, other than natural gas power plants) owned by the Company or any of its Restricted Subsidiaries from time to time, including the equity interests of any Restricted Subsidiary owning any Designated Assets, but excluding (i) any geothermal energy assets that are both unproven and undeveloped and (ii) contracts for the purchase or sale of natural gas and natural gas supplied under such contracts.

Designated Asset Sale Proceeds Account. Such cash, along with certain other cash held by Calpine, constitutes the Second Lien Debtholders' cash collateral.

B The Proposed DIP Facility

15. On the Petition Date, the Debtors filed their Emergency Motion For (I) Interim Orders (A) Authorizing the Debtors to (1) Obtain Postpetition Secured Financing Pursuant to 11 U.S.C. §§ 105, 361, 362, 364(c))(1), 364(c)(2), 364(c)(3) and 364(e), (2) Utilize Cash Collateral Pursuant to 11 U.S.C. § 363, and (3) Provide Adequate Protection to Certain Prepetition Lenders Pursuant to 11 U.S.C. §§ 361, 362 and 363 and (B) Scheduling Final Hearing Pursuant to Fed. R. Bankr. P. 4001(b) and (c) and (II) Final Orders (A) Authorizing Debtors to (1) Obtain Postpetition Secured Financing Pursuant To 11 U.S.C. §§ 105, 361, 362, 364(c)(1), 364(c)(2), 364(c)(3) and 364(e), (2) Utilize Cash Collateral Pursuant to 11 U.S.C. § 363, (3) Provide Adequate Protection to Certain Prepetition Lenders Pursuant to 11 U.S.C. §§ 361, 362 And 363, (3) Assume the Purchase Agreement Pursuant to 11 U.S.C. § 365(a) and Consummate the Transactions Contemplated Thereby Pursuant to § 363(b) and (4) Assume the Agnews Lease Documents Pursuant to 11 U.S.C. § 365(a).[6]

16. The DIP Financing Motion proposes, in part, the following financing terms with Credit Suisse First Boston and Deutsche Bank Securities, Inc. (collectively with the syndicate of lenders participating in the DIP Financing, the "DIP Lenders"): The borrower of the DIP Facility would be Calpine and the DIP Facility

[6] Counsel to the Unofficial Committee was served on the eve of filing with a hopelessly incomplete version of the motion and therefore reserves its right to amend and/or supplement this objection after a full review of the final version of the DIP Financing Motion.

would be guaranteed by all other debtors. The DIP Lenders would be given first priority liens on all unencumbered assets and junior liens on all encumbered assets.

B. Indenture Covenants and Bargained-For-Rights

17. The Second Lien Debtholders bargained for and obtained covenants providing significant protection against erosion of the Second Lien Debtholders' Collateral of just the type that Calpine will cause if allowed to proceed with the Proposed DIP Facility. Included in the bargained-for rights were both (i) restrictions on the incurrence of indebtedness by the subsidiaries whose shares were subject to the pledge (as well as by their respective subsidiaries)[7] and (ii) restrictions on such subsidiaries' ability to grant liens on their assets.[8]

18. These limitations were put in place to protect the economic value of the pledged direct and indirect operating subsidiaries. Without such protection, the Second Lien Debtholders' Collateral could be subject to extreme risk or rendered worthless.

19. The Second Lien Debtholders have certain standard remedies in the case of an event of default. For instance, Section 4.4. of the relevant pledge agreement provides that,

> "The Company agrees after any Actionable Default shall have occurred and be continuing, and the Collateral Trustee has notified the Company of the Collateral Trustee's intention to exercise its voting power under this Section 4.4 ...the Collateral Trustee may exercise (to the exclusion of the Company) the voting power and all other incidental rights of ownership with respect to any Pledged Shares or other shares of capital stock

[7] See Section 4.09 of the Indentures; Section 5.09 of the Term Loan Credit Agreement.

[8] See Section 4.12 of the Indentures; Section 5.12 of the Term Loan Credit Agreement.

> constituting the Pledged Collateral and the Company hereby grants the Collateral Trustee an irrevocable proxy, exercisable under such circumstances to vote the Pledged Shares..." (emphasis added).

Enforcement of such rights is presently blocked by imposition of the automatic stay.

III.
OBJECTION

20. Calpine's latest attempt to ignore the fundamental rights of the Second Lien Debtholders should not be permitted. The Debtors have not -- and cannot -- demonstrate that they have adequately protected the rights of the Second Lien Debtholders as required by sections 361, 363 and 364 of the Bankruptcy Code.

A. The Second Lien Debtholders are Entitled to the Benefit of Their Bargain

21. Section 363(e) of the Bankruptcy Code mandates the provision of adequate protection if requested by a secured creditor:

> Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used ... or proposed to be used ... by the trustee [or debtor in possession], the court, with or without a hearing, shall prohibit or condition such use ... as is necessary to provide adequate protection of such interest.

11 U.S.C. § 363(e).

22. Adequate protection is not defined in the Bankruptcy Code. Section 361 of the Bankruptcy Code, outlines – in a non-exclusive manner – various forms of adequate protection available to a secured creditor, and provides, in part, that when adequate protection is required under section 363 of the Bankruptcy Code, it may be provided by:

(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that... use, sale, or lease under section 363 of this title... results in a decrease in the value of such entity's interest in such property

* * *

(3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(l) 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. See e.g., 3 Collier On Bankruptcy ¶ 361.02 (15^{th} rev. ed. 2005) ("An entity is entitled to adequate protection *as a matter of right,* not merely as a matter of discretion... when the estate proposes to use, sell or lease property in which the entity has an interest") (citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 340, 343-44 (1977); S. Rep. No. 989, 95th Cong., 2d Sess. 52-53 (1978)) (emphasis added).

23. The purpose of adequate protection is to ensure that the prepetition lender receives the value for which it bargained prepetition. Resolution Trust Corp. v. Swedeland Dev. Group, Inc. (In re Swedeland Dev. Group, Inc.), 16 F.3d 552, 564 (3d Cir. 1994); Martin v. United States (In re Martin), 761 F.2d 472, 476 (8th Cir. 1985). This is true even if the prepetition lender is undersecured. See In re 680 Fifth Ave. Assocs., 154 B.R. 38, 43 (Bankr. S.D.N.Y. 1993); In re Walton, 77 B.R. 617, 618-21 (Bankr. N.D. Oh. 1987).

24. It is well established that adequate protection may be required to maintain a creditor's interest in pledged stock. See e.g., In re Domestic Fuel Corp., 70 B.R. 455, 463 (Bankr. S.D.N.Y 1987) (granting relief from the automatic stay upon a finding that the value of the stock that had been pledged to the creditor had declined and

that the debtor had not established that it had offered adequate protection to the creditor to compensate for the decline in value of the creditor's collateral); In re Munoz, 83 B.R. 334, 337-38 (Bankr. E.D. Pa. 1988) (creditor was entitled to relief from the automatic stay where its interest in pledged stock was not being adequately protected).

25. Finally, it is the Debtors – not their secured creditors – that bear the burden of demonstrating that adequate protection exists. 11 U.S.C. § 363 (p)(l). See In re Elmira Litho, Inc., 174 B.R. 892, 905 (Bankr. S.D.N.Y. 1994) (section 363 "imposes on the trustee 'the burden of proof on the issue of adequate protection'"); In re Saint Peter's Sch., 26 B.R. 589, 591-92 (Bankr. S.D.N.Y. 1983) ("pursuant to Code § 363(e), the debtor has the burden of proof on the issue of adequate protection"); In re Riverwood La Place Assoc., LLC, No. 897-89417-346, 1998 WL 908949, at 2 (Bankr. E.D.N.Y. Dec. 17, 1998) ("[d]ebtor bears the burden of proof on adequate protection"). Here, the Debtors have utterly failed to meet such burden.

26. The Debtors seek to layer $2 billion of debt which would be structurally senior to and will substantially impair the Second Lien Debtholders' liens. Incredibly, the Debtors have provided little ascertainable protection for this massive priming. While the Debtors have offered a$75 million interest payment as adequate protection – this does little to address the primary risk to the Secured Debtholders' Collateral posed by the Proposed DIP Facility. Without clear and definitive safeguards the Proposed DIP Facility may be used to fund operating losses at the Debtors' power projects based on the speculative hope that the macro-economic conditions in the power industry will improve. Speculation is not protection. Absent meaningful adequate

protection appropriately fashioned to protect the Second Lien Debtholders' Collateral, the relief sought in the DIP Financing Motion should be denied.

B. <u>The DIP Financing Motion Should be Denied</u>

27. The Second Lien Debtholders' Collateral consists in large measure of stock pledges of Calpine's so-called "first tier" subsidiaries. The value of the Pledged Stock is of course entirely dependant on the equity value of the underlying subsidiaries. There are almost 100 power projects residing in these subsidiaries. It is highly probable that some of these projects are profitable, others are not. Similarly, some are solvent when taking into account project level debt, while others are not. The most valuable of the Debtors' assets are most likely the "geysers".[9] The geysers have little project level debt, are readily saleable, and if sold could substantially reduce the Second Lien Debt.

28. The Proposed DIP Facility would encumber the valuable geyser assets with $2 billion of debt while the Debtors could use the proceeds to fund insolvent or unprofitable subsidiaries. This risk is present and very real because, by their own admission, the Debtors simply don't know which projects make money and which do not. All that the Debtors have shown is that the projects "need" funding.

29. The Debtors must demonstrate adequate protection by proving that the value of the Debtors' subsidiaries will not diminish as a result of the $2 billion in additional leverage being interposed. <u>See</u> <u>In re Swedeland Dev. Group, Inc.</u>, 16 F.3d at 566 ("[t]hose cases which have considered improvements to be adequate protection have done so only when the improvements were made in conjunction with the debtor's

providing additional collateral beyond the contemplated improvements"); In re Chicago, Missouri & W. Ry. Co., 109 B.R. 308, 315 (N.D. Ill. 1989) (declining to find adequate protection because the "question of adequate protection is a factual matter" and trustee's argument that state loans would increase the value of the lenders' collateral was merely speculative); In re Windsor Hotel, LLC, 295 B.R. 307, 310-16 (Bankr. C.D. Ill. 2003) (holding that debtor failed to carry its burden of proof under 11 U.S.C. § 364(d) because among other reasons, debtor failed to show that hotel property securing creditors' claims had value in excess of these claims, debtor had no unencumbered assets with which to provide creditors with a replacement lien, and debtor's contract was a "mere hope, not a fact" and a finding of adequate protection should be premised on facts, or on projections grounded in firm evidence); In re Mosello, 195 B.R. 277, 292-93 (Bankr. S.D.N.Y. 1996) (speculative benefit to undersecured creditor if chapter 11 debtors were able to develop the real property securing its claim did not constitute adequate protection); In re Plabell Rubber Prod., Inc., 137 B.R. 897, 900-01 (Bankr. N.D. Oh. 1992) (denying debtor's motion for authority to obtain credit secured by a senior lien pursuant to section 364(d) because although an increase in the value of the collateral generated by improvements resulting from the superpriority financing could constitute adequate protection, the court was not persuaded by the testimony that such an improvement was realistic, the debtor failed to present projections or other documentation establishing these figures, and even using the debtor's highest projections, the debtor does not gain any ground against financial loss); In re Stacy Farms, 78 B.R. 494, 498 (Bankr. S.D. Oh. 1987) (holding that promise to satisfy bank's superpriority lien out of proceeds was "too

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[9] The Debtors, through a statutory trust, hold interests in 19 geothermal leaseholds in Lake and Sonoma Counties, California, that produce steam that is supplied to geothermal power generation facilities

speculative to constitute adequate protection upon the record before the Court"); In re St. Petersburg Hotel Assocs., Ltd., 44 B.R. 944, 946 (Bankr. M.D. Fla. 1984) (declining to find adequate protection; noting "an examination of the assumptions relied upon by the debtor . . . reveals that the assumptions are mere expectations, many of which are highly speculative and unrealistic").

30. Here, there has been no showing that the proposed financing will protect and enhance, rather than diminish or dissipate the Second Lien Debtholders' Collateral. Ironically, the Second Lien Debtholders did obtain prepetition the covenants needed to protect the value of the Pledged Stock from exactly this type of threat. Now, the $2 billion Proposed DIP Facility would eviscerate these bargained-for debt and lien caps. Unfettered access by Calpine to the proceeds of such senior secured financing would be the antithesis of adequate protection which the Bankruptcy Code demands. See In re Cash Currency Exchange, Inc., 52 B.R. 577, 581 (N.D. Ill. 1985) (creditor whose claim was secured by stock pledge possessed certain bargained-for property interests, including right to sell debtor's stock and apply proceeds to claim and to utilize collateral by voting stock to take control of debtor's affairs and possession of its assets).

31. In sum, the Debtors must satisfy their burden under section 363(e) by demonstrating that the Second Lien Debtholders' equity value in the Pledged Stock will be at least the same as it was prior to the imposition of the Proposed DIP Facility. Unfortunately, there is no basis upon which the Debtors can make such a showing.

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owned by certain of the Debtors for use in producing electricity.

C. The Second Lien Debtholders are Effectively Being Primed Without Adequate Protection in Violation of Section 364(d)

32. The Proposed DIP Facility also violates section 364(d). Section 364(d) provides that the Court "…may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if …there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted." See 11 U.S.C. § 364(d)(1). As one court noted,

> The language of § 364(d)(1)(B) of the Bankruptcy Code could not be any plainer: there can be no "superpriority" lien unless "there is adequate protection of the interest of the holder of the [prior] lien…" 11 U.S.C. § 364(d)(1)(B). The legislative history for this section offers no elaboration or alternative interpretation of this clear and direct language.

In re T.M. Sweeny & Sons LTL Serv., Inc., 131 B.R. 984, 990 (Bankr. N.D. Ill. 1991).

33. "The ability to prime an existing lender is extraordinary." In re Seth Co. Inc., 281 B.R. 150, 153 (Bankr. D. Conn. 2002) (citing 3 Collier On Bankruptcy ¶ 364.05 (15th rev. ed. 2002)) (emphasis added). What is even more extraordinary is the Debtors' request here that this Court permit them to layer $2 billion of debt above the Second Lien Debt with no meaningful protection at all.

34. The Debtors claim that the Proposed DIP Facility does not prime the Second Lien Debtholders because a senior lien is not being imposed on the Pledged Stock itself. Instead, the Second Lien Debtholders are being structurally primed by the Debtors issuing secured guarantees at the subsidiary level. The Debtors' argument that they do not seek relief under section 364(d) of the Bankruptcy Code elevates form over

substance to an unheard of degree. For starters, the Debtors would simply ignore for all purposes the debt and lien incurrence covenants obtained by the Second Lien Debtholders to protect their collateral package. In the case of a stock pledge, such rights are essential and should be respected.

35. As noted above, the Debtors have not – because they cannot – show how the proposed $2 billion financing will not erode the value of the Second Lien Debtholders' Collateral. The Debtors have failed to satisfy their burden under section 364(d)(1) of the Bankruptcy Code in seeking to, as a substantive matter, prime the Second Lien Debtholders without providing adequate protection for the diminution in value they are likely to suffer. Accordingly, for the reasons stated above, the relief sought by the DIP Financing Motion should be denied.

IV.
CROSS MOTION

36. By this Cross-Motion the Unofficial Committee seeks entry of an order modifying the automatic stay. The statutory predicates for the relief sought herein are sections 105(a) and 362(d)(1) of the Bankruptcy Code.

A. If the Second Lien Debtholders are Not Provided With Adequate Protection the Automatic Stay Should be Modified

37. Section 362(d)(1) of the Bankruptcy Code provides that the automatic stay may be lifted:

> (1) "for cause, including the lack of adequate protection of an interest in property . . ."

11 U.S.C. § 362(d)(1).

38. It is well established that a decline in the value of pledged stock or other collateral is grounds for stay relief. See In re Domestic Fuel Corp., 70 B.R. 455 (Bankr. S.D.N.Y 1987) (granting relief from the automatic stay upon a finding that the value of the stock that had been pledged to the creditor had declined and that the debtor had not established that it had offered adequate protection to the creditor to compensate for the decline in the value of the creditor's collateral); In re Munoz, 83 B.R. 334 (Bankr. E.D. Pa. 1988) (creditor was entitled to relief from the automatic stay where creditor's interest in pledged stock was not being adequately protected). If market decline in the value of pledged stock is "cause" for stay relief, value erosion engineered by the Debtors' improvident financing schemes undoubtedly is as well.

39. The Second Lien Debtholders bargained for the right to take control of the Pledged Stock upon a default. They now are prevented by the automatic stay from doing so. The Debtors are using the imposition of the automatic stay to hold the Second Lien Debtholders hostage while they gamble with the value of the Second Lien Debtholders' Collateral by incurring massive borrowings for which subsidiaries will be liable. Rather than let the Debtors take this gamble with the Second Lien Debtholders' Collateral the Court should grant stay relief. See In re Domestic Fuel Corp., 70 B.R. 455; In re Munoz, 83 B.R. 334. Accordingly, this Court should modify the stay imposed by section 362(a) of the Bankruptcy Code to allow the Second Lien Debtholders to enforce their rights in the collateral granted to them.

V.
RESERVATION OF RIGHTS

40. The Unofficial Committee expressly reserves its right to amend or supplement this Objection and Cross Motion, to introduce evidence at the interim and

final hearings with respect to the DIP Financing Motion, and to file additional and supplemental objections.

VI.
NOTICE

41. Notice of this Objection and Cross Motion has been given to (i) the Debtors, (ii) the United States Trustee, (iii) the Indenture Trustees for the First Priority Notes and the Second Lien Debt, the Collateral Trustee and the Term Loan Agent and (iv) the Debtors' proposed DIP Lenders. In light of the relief requested herein, the Unofficial Committee submits that no other or further notice is required.

VII.
WAIVER OF MEMORANDUM OF LAW

42. The Unofficial Committee submits that this Objection and Cross Motion includes citations to applicable authorities and a discussion of their application to this Objection and Cross Motion. The Unofficial Committee therefore requests that the requirement of the service and filing of a memorandum of law under Rule 9013-1(b) of the Local Rules for the United States Bankruptcy Court for the Southern District of New York be deemed satisfied.

43. No previous request for the relief sought herein has been made to this or any other court.

VIII.
<u>CONCLUSION</u>

44. For the foregoing reasons, the Unofficial Committee respectfully requests that this Court enter an order: (a) sustaining its objection, (b) granting the Second Lien Debtholders appropriate adequate protection pursuant to section 363(e) of the Bankruptcy Code; and/or (c) modifying the automatic stay pursuant to section 362(d)(1) of the Bankruptcy Code to permit the Second Lien Debtholders to exercise rights and remedies with respect to their collateral; and granting such other relief as may be just and proper.

Dated: New York, New York
December 21, 2005

PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

By: /s/ Alan W. Kornberg
Alan W. Kornberg
(A Member of the Firm)
Alan W. Kornberg (AK/0756)
Andrew N. Rosenberg (AR/1799)
Elizabeth R. McColm (EM/8532)
1285 Avenue of the Americas
New York, New York 10019-6064
Telephone: (212) 373-3000
Facsimile: (212) 757-3990

Attorneys for the Unofficial Committee of Second Lien Debtholders of Calpine Corporation