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ATTORNEYS FOR KERN RIVER GAS TRANSMISSION COMPANY

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

In re	§	**Chapter 11 Case**
	§	
MIRANT CORPORATION, *et al.*,	§	**Case No. 03-46590 (DML)**
	§	**Jointly Administered**
Debtors.	§	

KERN RIVER GAS TRANSMISSION COMPANY'S POST-TRIAL PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

Kern River Gas Transmission Company ("Kern River") files this its Post-Trial Proposed Findings of Fact and Conclusions of Law:

I. PROPOSED FINDINGS OF FACT

1. Kern River is engaged in the business of transporting natural gas in interstate commerce. Kern River owns and operates a natural gas pipeline that runs from the Rocky Mountain gas supply basin at Opal, Wyoming, to Bakersfield, California, that was placed in service in 1992 and continues in service today. [Morgan Testimony; Exhibit KR-137]

2. Kern River is regulated by the Federal Energy Regulatory Commission ("FERC"). [Morgan Testimony; Smith Testimony]

3. In order to permit Kern River to construct the pipeline, Kern River entered into long term

firm capacity contracts referred to as vintage contracts. Some of the vintage contracts contain most favored nation ("MFN") clauses, which were included in certain vintage contracts (the "MFN Contracts") at the request of shippers and are still in effect today. The MFN Contracts contain rights held by shippers such that Kern River cannot sell capacity on its pipeline at a rate lower than the threshold rates in the MFN Contracts without incurring liability under the MFN Contracts. All of the MFN Contracts permit shippers to change their delivery points and to nominate to alternate delivery points on the Kern River pipeline, including points in Nevada and Utah. None of the MFN Contracts state that liability is triggered only by deliveries to Kern County, California. [Morgan Testimony; Pettinato Deposition at 52-55, 60; Exhibits KR-67, KR-68, KR-69, KR-70, KR-72, KR-73, KR-74, KR-75, KR-76, KR-77, KR-78, KR-79, KR-86]

4. The MFN Contracts were filed with and approved by FERC and were publicly available. [Morgan Testimony, Hogan Testimony, Kilmer Testimony, Makholm Testimony; Exhibit KR-140]

5. On or about May 29, 2001, Kern River and Mirant Americas Energy Marketing, L.P. ("MAEM"; MAEM, collectively with all of the other affiliated debtors in this jointly administered case are referred to as "Debtors") entered into a Firm Transportation Service Agreement, bearing contract number 1712, which was subsequently amended on July 23, 2001 and on April 5, 2002 (as amended, the "Kern River Agreement"). The Kern River Agreement calls for the application of the law of the State of Utah [Morgan Testimony;

Exhibit KR-9[1]]

6. On July 23, 2001, the Kern River Agreement was amended to extend the term of the contract from 10 to 15 years. Service under the Kern River Agreement commenced on May 1, 2003 and was to continue until 2018. [Morgan Testimony; Exhibit KR-9]

7. Prior to entering into the Kern River Agreement, Debtors had knowledge of the MFN provisions contained in the MFN Contracts and their terms. [Morgan Testimony, Hogan Testimony; Exhibits KR-10, KR-10C, KR-10D]

8. Under the Kern River Agreement, Kern River was required to reserve pipeline capacity for MAEM and transport a maximum daily quantity of 90,000 Dth (decatherms) of natural gas per day to certain points on Kern River's gas transportation system – 77,103 Dth per day to the interconnection of the Kern River pipeline with the PG&E pipeline system at Daggett, California, and 12,897 Dth per day to the interconnection of the Kern River pipeline with the SoCal Gas pipeline system at Wheeler Ridge, California. [Morgan Testimony; Exhibits KR-9, KR-137]

9. MAEM wanted 100% of its firm capacity nominated to the Wheeler Ridge delivery point with none to Daggett, because the Wheeler Ridge delivery point is valued higher than the Daggett delivery point. However, the Wheeler Ridge delivery point was oversubscribed, and capacity to Wheeler Ridge had to be allocated among those shippers seeking capacity in Kern River's 2003 Expansion Project. MAEM could have chosen to have secondary delivery rights at Wheeler Ridge; however, MAEM accepted its allocation of capacity at Wheeler

[1] *See* Choice of Law provision at § 7.5 ("This Agreement shall be construed in accordance with the laws of the State of Utah.").

Ridge and requested to have the remaining capacity at Daggett, as reflected in the Kern River Agreement. Accordingly, the former MAEM capacity is less marketable for resale than firm capacity with a delivery point at Wheeler Ridge, because much of the former MAEM capacity cannot be delivered downstream of Daggett and therefore cannot access the large and liquid market served by the SoCal Gas system. [Morgan Testimony, Beach Testimony, Hogan Testimony, Makholm Testimony; Exhibits KR-10, KR-10D]

10. The Kern River Agreement expressly incorporates the General Transportation Terms and Conditions of Kern River's FERC-approved tariff. The tariff provides that late payments made by a Kern River shipper will be assessed interest at the FERC interest rate calculated in accordance with 18 C.F.R. § 154.501(d). [Morgan Testimony; Exhibits KR-9 (at § 2.1), KR-124]

11. Under the Kern River Agreement, MAEM agreed to pay Kern River the FERC-approved tariff rate set forth on schedule KRF-1 for reservation of capacity and all natural gas transportation services rendered under the terms of the Kern River Agreement. The rate schedule set forth on KRF-1 may be changed from time to time in accordance with the Natural Gas Act and with the approval of the FERC. [Morgan Testimony; Exhibits KR-3, KR-9, KR-31, KR-124]

12. The tariff rate used for calculating Kern River's damages consists solely of the reservation charge for pipeline capacity, which as of the date of rejection was \$0.4443 per Dth per day in leap years and \$0.4455 per Dth per day in non-leap years. The reservation charge covers only fixed costs associated with the Kern River pipeline. There are no avoided fixed costs

as a result of MAEM's rejection of the Kern River Agreement. Accordingly, with respect to reservation charges, Kern River's gross profits and net profits are the same. [Morgan Testimony; Exhibits KR-3, KR-9, KR-31, KR-124, KR-136]

13. The Kern River Agreement was part of Kern River's 2003 Expansion Project. In connection with that project, Kern River borrowed $836 million, as of the date the 2003 Expansion Project went into service (May 1, 2003) (this financing is referred to as the "2003 Expansion Financing"). The interest rate on the 2003 Expansion Financing was 4.893%, and the "all-in" cost of the 2003 Expansion Financing (including the associated fees) was 5.14%. FERC issued an order accepting Kern River's tariff sheet that reflected this financing rate, noting that no protests were filed. The weighted average cost of capital underlying Kern River's rates to shippers on its 2003 Expansion Project (which included MAEM) was 7.58%.[2] [Morgan Testimony, Williamson Testimony; Exhibits KR-80, KR-102, KR-110, KR-112, KR-114]

14. Capacity on the Kern River pipeline was trading at a higher price from January 2003 to April 2003 than in July 2003. [Morgan Testimony, Makholm Testimony]

15. The Debtors, including MAEM, filed voluntary Chapter 11 petitions on July 14, 2003, and various dates thereafter (collectively, the "Petition Date").

16. Post-petition, MAEM continued to nominate and ship gas under the Kern River Agreement, and MAEM paid all of the charges for such nomination and use through December 18, 2003.

[2] The weighted average cost of capital computation is (70% x 5.14%) + (30% x 13.25%) = 7.58%. This computation reflects Kern River's 5.14% cost of debt for the 2003 Expansion Project, as previously discussed, and Kern River's FERC-approved debt-equity ratio of 70/30 and return on equity of 13.25%. Kern River's weighted average cost of capital is, by definition, not risk-free.

[*Complaint*, *Mirant Corp. et al. v. Kern River Gas Transmission Company*, Adversary No. 05-04022-dml (February 4, 2005)]

17. On December 4, 2003, MAEM filed a motion to reject the Kern River Agreement. The Kern River Agreement was deemed rejected as of December 18, 2003. [*Motion of Debtors to Reject the Firm Transportation Service Agreement Contract No. 1712 Between Mirant Americas Energy Marketing, LP and Kern River Gas Transmission Company*, December 4, 2003 (Docket No. 2041); *Notice of Effective Date of Rejection of the Firm Transportation Service Agreement Contract No. 1712 Between Mirant Americas Energy Marketing, LP and Kern River Gas Transmission Company*, December 18, 2003 (Docket No. 2311)]

18. On January 13, 2004, Kern River filed a timely Proof of Claim, No. 7573 against MAEM in the amount of $210,210,543, based on the reservation charge damages that resulted from MAEM's rejection. [Morgan Testimony; Exhibit KR-3]

19. Pursuant to the Kern River Agreement and to Kern River's FERC Gas Tariff, MAEM posted a letter of credit to secure its obligations under the Kern River Agreement. The letter of credit posted by MAEM was scheduled to expire during early November of 2003. Pursuant to the terms of the letter of credit, Kern River had the right to draw thereon if MAEM failed to obtain an extension of the letter of credit. On October 30, 2003, Kern River drew on the letter of credit. As the result of that draw, Kern River held $14,751,589 as cash security ("Cash Security") for the obligations of MAEM under the Kern River Agreement. Pursuant to an Order of this Court, Kern River applied 100% of the Cash Security to its claim for damages arising from the rejection of the Kern River Agreement. [*Agreed Order Concerning*

Modification of the Automatic Stay, May 25, 2004 (Docket No. 4060)]

20. On November 12, 2004, Kern River filed Proof of Claim No. 8121, amending Proof of Claim No. 7573 (the "Amended Proof of Claim"). Kern River's Amended Proof of Claim reduced the amount from the Original Kern River Claim by (i) subtracting Kern River's actual mitigation of its damages from the Petition Date through the end of October 2004, in the amount of $1,391,968, and (ii) discounting Kern River's claim to net present value using the FERC interest rate calculated in accordance with 18 C.F.R. § 154.501(d). After accounting for actual mitigation and discounting to net present value, Kern River's rejection damages as asserted in the Amended Proof of Claim total $153,641,087. [Morgan Testimony; Exhibit KR-31]

21. After applying the $14,751,589 cash security towards its Amended Proof of Claim, the outstanding amount of Kern River's claim is $138,889,498 (as of November 2004). [*Agreed Order Concerning Modification of the Automatic Stay*, May 25, 2004 (Docket No. 4060); Exhibit KR-31]

22. Kern River has made reasonable efforts since December 2003 to mitigate its damages by marketing and attempting to sell capacity on the Kern River pipeline, including the capacity formerly committed to and rejected by MAEM. Kern River has marketed and attempted to sell such capacity through monthly postings of firm capacity, postings and marketing of interruptible transportation capacity, its 2004 Open Season, customer meetings, regulatory presentations, and its proposal to Southwest Gas in May 2005. [Morgan Testimony; Exhibits KR-60, KR-62, KR-63, KR-83, KR-99, KR-115, KR-116, KR-129, KR-130, KR-131, and

KR-132]

23. Up to the point where Kern River reaches the last 90,000 decatherms ("Dth") of capacity on its pipeline, Kern River has the ability to provide service for all of its actual firm and interruptible sales as well as the capacity formerly contracted to MAEM. [Morgan Testimony; Exhibits KR-138, KR-139]

24. Kern River has two limitations on its sales of natural gas transportation capacity – its design capacity and its operational capacity. Design capacity is the amount of capacity that the pipeline can guarantee for service on every day of the year and reflects the maximum amount of firm capacity that the pipeline can sell. Design capacity is generally a fixed number that changes only with FERC approval and generally with major modifications to the pipeline such as expansions. The design capacity of the Kern River pipeline is approximately 1.755 Dth/day. Operational capacity is the amount of capacity that the pipeline can provide on any given day based on the conditions affecting the pipeline on that day. Operational capacity varies, particularly by season, but is generally predictable within a narrow range on a day-to-day basis. Operational capacity reflects the maximum amount of total capacity (that is, firm plus interruptible) that the pipeline can sell on a particular day. [Morgan Testimony; Exhibits KR-138, KR-139]

25. Kern River has credited actual mitigation to Debtors for all sales of firm capacity that have been into the last 90,000 Dth/day of its design capacity. In fact, Kern River has credited actual mitigation to Debtors for all volumes of the only sale of firm capacity that it has been able to make since the rejection date, which is a short-term firm capacity sale to Western Gas Resources during Summer 2004. [Morgan Testimony, Beach Testimony; Exhibits KR-31,

KR-87, KR-153]

26. Kern River also has credited actual mitigation to Debtors for all sales of total capacity (firm plus interruptible) have been into the last 90,000 Dth/day of its operational capacity. [Morgan Testimony, Beach Testimony; Exhibits KR-31, KR-87, KR-153]

27. Turned-back capacity on the Kern River pipeline, such as the capacity under the rejected Kern River Agreement, when not sold as firm transportation, becomes part of Kern River's entire pool of available interruptible capacity for sale. Such turned-back capacity is of the same quality as other capacity available for sales of interruptible capacity. Kern River has routinely had far more than 90,000 Dth/day available for sales of interruptible capacity. [Morgan Testimony, Beach Testimony; Exhibits KR-87, KR-125, KR-138, KR-139]

28. The damages in Kern River's Proof of Claim are direct damages arising from Debtors' rejection of the Kern River Agreement. Kern River's damages are for the reservation charges for firm transportation capacity on the Kern River pipeline for the 14-plus years remaining on the term of the Kern River Agreement at the time of rejection. As with all firm transportation agreements on the Kern River pipeline, full reservation charges are payable under the Kern River Agreement regardless of whether the shipper actually flows gas through the pipeline. Each component of the calculation of Kern River's damages for the amount due under the contract is known and fixed – the quantity of pipeline capacity reserved each day, times the effective rate for each unit of pipeline capacity reserved, times the number of days remaining on the contract. The total amount of Kern River's claim for rejection damages for breach of contract (exclusive of mitigation) is $210,210,543. [Morgan Testimony, Williamson Testimony; Exhibits KR-3, KR-31]

29. Although Kern River has made reasonable efforts to mitigate its damages, it has only been able to partially mitigate its losses on some days, and it has not been able to mitigate its losses in the future by sales of firm capacity. Kern River continues to make reasonable efforts to mitigate, but that is an ongoing effort subject to the uncertainties of Kern River's fortunes in its business. Kern River at best will be able to mitigate only a portion of its losses through future sales of pipeline capacity. Kern River's stream of potential future mitigation (if any) is uncertain, unliquidated, and not fixed. [Morgan Testimony, Beach Testimony, Williamson Testimony; Exhibits KR-3, KR-87, KR-102, KR-125]

30. The MFN Contracts restrict Kern River from selling discounted firm transportation capacity at rates below the MFN threshold rates, but they do not restrict non-affiliated shippers such as MAEM from reselling their own firm capacity through capacity release transactions at rates below the MFN threshold rates. Debtors were not subject to the additional risks and losses that Kern River would incur because of the MFN rights. [Morgan Testimony, Hogan Testimony; Exhibits KR-67, KR-68, KR-69, KR-70, KR-72, KR-73, KR-74, KR-75, KR-76, KR-77, KR-78, KR-79, KR-86]

31. MAEM, through several of its employees, knew of the MFN Contracts prior to its decision to reject the Kern River Agreement. Specifically with respect to the Union Pacific MFN Contract, John Hogan of MAEM was a former employee of Union Pacific Resources and in that capacity knew of the Union Pacific MFN Contract. The Union Pacific MFN Contract is the most restrictive of the MFN Contracts as to term because it is triggered by a sale of discounted firm capacity for as little as one day. [Morgan Testimony (most restrictive); Hogan Testimony (knowledge); Exhibits KR-10, KR-10C, KR-10D, KR-19, KR-69, KR-70]

32. Debtors knew, as of the Petition Date and continuing up to and including the date of rejection, that the MFN Contracts would impair Kern River's ability to remarket and resell the former MAEM capacity. Before the date of rejection, Mr. Morgan of Kern River and Mr. Hogan of MAEM discussed the MFN Contracts and their impact, and as a result of that conversation Mr. Hogan and MAEM knew before it rejected that it would be extremely difficult for Kern River to resell the capacity under the Kern River Agreement. [Morgan Testimony, Hogan Testimony]

33. Up to and including the date of rejection, including time periods both before and after the Petition Date, Debtors took absolutely no actions to market, release or resell the capacity under the Kern River Agreement. Debtors did not attempt to find a third party to acquire the capacity, and Debtors did not take any steps to mitigate the damages caused by their rejection. During this time period, Debtors had the right to market, release and resell the capacity under the Kern River Agreement and in fact were the only party with the right to do so, because Kern River could not. There exists an active market for capacity release transactions whereby Debtors could have resold all or part of the capacity under the Kern River Agreement prior to rejection. [Morgan Testimony, Hogan Testimony, Makholm Testimony]

34. Debtors knew as of the Petition Date that they would need only 30,000 Dth/day of firm capacity on the Kern River pipeline to serve the needs of their Apex power plant in southern Nevada, substantially less than the 90,000 Dth/day in the Kern River Agreement, yet Debtors took no actions to market, release or resell the capacity under the Kern River Agreement up to and including the date of rejection. [Hogan Testimony]

35. By refusing to take steps to mitigate damages, Debtors have frustrated Kern River's ability to mitigate and prevented it from being able to more fully mitigate its rejection damages without incurring unreasonable risk, expenditures, or loss. Moreover, by rejecting the Kern River Agreement while having knowledge of the MFN Contracts, Debtors took action that they knew would increase the net damages to Kern River. [Morgan Testimony, Hogan Testimony]

36. The MFN rights in the MFN Contracts are rights held by shippers, not by Kern River. Kern River has not ever triggered an MFN clause, and it is against Kern River's established course of conduct to do so. [Morgan Testimony]

37. There is no evidence that shippers would waive their MFN rights in this situation; the evidence is to the contrary. The MFN shippers would not waive their rights under the MFN Contracts without getting something in return. One shipper, Harold Orndorff of Aera, testified that the MFN rights protect the shipper's competitive position such that if a competing shipper received a 20 cent per decatherm discount, Aera would insist on the same level of discount. [Morgan Testimony; Pettinato Deposition at 77; Orndorff Deposition at 54-55]

38. All prior waivers of MFN rights by Kern River shippers have been for value. For example, Aera received a benefit of at least $59 million to waive its MFN rights for the Kern River Extended Term Rate Program. Los Angeles Department of Water and Power received a benefit of at least $10 million to waive its MFN rights for the Kern River Extended Term Rate Program. [Orndorff Deposition at 55-60; Pettinato Deposition at 77-78; Exhibits

KR-72, KR-73, KR-74, KR-75]

39. The MFN threshold rate for firm capacity for a term of less than one year is Kern River's 15-year vintage rate. The MFN threshold rate for firm capacity for a term of one year or more is Kern River's 10-year vintage rate. [Morgan Testimony; Exhibits KR-67, KR-68, KR-69, KR-70, KR-72, KR-73, KR-74, KR-75, KR-76, KR-77, KR-78, KR-79, KR-86]

40. All of the bids for firm capacity that were rejected by Kern River would have triggered MFN refund liability in excess of the revenues that would have been generated by such bids and would have resulted in a net loss to Kern River if such bids had been accepted. [Morgan Testimony; Exhibits KR-127, KR-128]

41. Kern River's 2004 Open Season process and the complete lack of customer interest in response are evidence that there is insufficient market demand to resell the former MAEM Capacity in the near future on a firm basis at any rate that would not violate the MFN provisions. In the Kern River 2004 Open Season, which ended in January 2005, shippers expressed no interest in new expansion capacity on the Kern River pipeline and offered approximately 440,000 Dth/day of firm capacity for turn-back. As a result of the 2004 Open Season, Kern River dropped all plans for an expansion of the Kern River pipeline in 2007. [Morgan Testimony, Beach Testimony; Exhibits KR-62, KR-63]

42. Kern River faces a challenging and competitive market environment in its service area, including California. Reliable forecasts based on market data demonstrate that Kern River will not be able to sell firm capacity at a rate above the MFN threshold rates before the MFN Contracts expire in 2016, and that capacity on the Kern River pipeline will not be fully

valued (that is, valued at or above the tariff rate) until 2018. Accordingly, the principal means for Kern River to mitigate its loss of the former MAEM reservation charges will be to sell interruptible service. Discounted interruptible service does not trigger the MFN Contracts. [Morgan Testimony, Beach Testimony; Exhibit KR-87]

43. Kern River also faces a constraint marketing interruptible service. The Wheeler Ridge delivery point into the SoCal Gas system is constrained such that interruptible capacity on Kern River can almost never access the SoCal Gas system. This circumstance is not expected to change before 2008. Accordingly, the PG&E market at Daggett is the principal market for interruptible volumes on the Kern River system. [Morgan Testimony, Beach Testimony; Exhibit KR-87]

44. Forecasted future sales by Kern River of the capacity formerly contracted to MAEM are set forth in the "Mitigation" column of Exhibit KR-153, which is attached to these Findings and Conclusions as Exhibit "A". Such forecasted future sales are based on Kern River having the ability to sell all 90,000 Dth/day of the former MAEM capacity during the seven summer months (April-October) and none of the former MAEM capacity during the five winter months (November-March), when large amounts of operational capacity are available and market conditions are weak. This is a very generous allocation to Debtors in comparison to the actual data from 2004 and is the equivalent of more than 50,000 Dth/day if spread out over the entire year. This volume exceeds Debtors' purchases of interruptible capacity on the Kern River pipeline and gives Debtors credit for more volumes than they have historically purchased. [Beach Testimony; Exhibits KR-87, KR-125, KR-153]

45. The forecasted rate for 2005 set forth in Exhibit KR-153 is consistent with the rate being paid by MAEM in its most recent capacity release deals (adjusted for delivery point). [Beach Testimony; Exhibits KR-87, KR-153; Debtors' Exhibit 153]

46. The capacity release transactions that were considered by Debtors' expert Dr. Makholm involving Nevada Power Company, Sempra Energy Trading and Duke Energy Trading that occurred between September 21, 2004, and November 11, 2004, were part of a larger transaction involving a power plant sale. Such capacity release transactions are not reflective of the relevant market for capacity on the Kern River pipeline, for that reason and others, including (a) the fact that these transactions were in the secondary market rather than the primary market; (b) the fact that Kern River could not have entered into similar agreements because of the rights held by shippers under the MFN Contracts; and (c) the fact that the buyer Nevada Power Company had been issued blanket authority to purchase capacity and had to do so to supply a plant designated as a "critical facility" by the Nevada Public Services Commission. There have been no other long term capacity releases by shippers on the Kern River pipeline in the past two years. [Makholm Testimony; Exhibit KR-133]

47. Moreover, Dr. Makholm's calculation of the value of those contracts at 24.18 cents per decatherm is erroneous, because (a) Dr. Makholm considered the capacity release contracts as perpetuities rather than according to their finite terms; (b) Dr. Makholm used a 80% load factor that is too low and inconsistent with the facts of the transactions and all metrics on the Kern River pipeline; (c) Dr. Makholm used a fuel rate that was calculated as of the wrong time and at the wrong location; (d) Dr. Makholm failed to adjust for the fact that most of the

released capacity had a primary delivery point at the more valuable Wheeler Ridge delivery point, compared to the less valuable Daggett delivery point for most of the capacity in the Kern River Agreement; and (e) Dr. Makholm used a simple average of the individual contract rates rather than a volume-weighted average. When such errors are corrected, the effective contract rate for the five capacity release transactions considered by Dr. Makholm is 9.32 cents. This equates to 20.9% of the reservation rate that MAEM was obligated to pay under the Kern River Agreement and is similar to the 18.2% factor resulting from the forecasts and calculations of Kern River's expert, Mr. Beach. [Beach Testimony, Makholm Testimony; Exhibits KR-87, KR-134, KR-153]

48. Kern River receives no additional revenues when Debtors purchase capacity release or delivered gas than Kern River already would have collected from the shipper that released the capacity or delivered the gas. [Hogan Testimony]

49. The potential future mitigation stream of revenues that Kern River may achieve, if any, would result from Kern River's resale of the 2003 Expansion Capacity rejected by Debtors. This potential future mitigation stream would emanate from Kern River's business and is therefore subject to the attendant uncertainties and risks of that business. [Morgan Testimony, Williamson Testimony]

50. Debtors' supply of gas to the Apex plant was not interrupted as a result of the implementation of Kern River's point-to-point pricing policy in December 2004. Kern River provided advance notice to Debtors in November 2004 before implementing the point-to-point pricing policy in December 2004. Debtors had and continue to have other methods

of obtaining gas for the Apex plant, through an active market for capacity release and delivered gas deals. Prior to this pricing change, Debtors had entered into a capacity release transaction to supply the majority of the gas used at the Apex plant during the summer months of 2004 and had thereby demonstrated that they were not reliant on interruptible transportation from Kern River. Further, Debtors secured a delivered gas deal to supply the Apex plant in early December 2004. [Morgan Testimony, Hogan Testimony; Debtors' Exhibits 152 and 153]

51. FERC has exclusive jurisdiction over complaints regarding pricing by natural gas pipeline companies such as Kern River. Debtors have made no complaint to FERC regarding Kern River's point-to-point pricing policy. [Hogan Testimony]

52. The Southern Nevada market (including Las Vegas) is served by pipelines other than Kern River. Nevada Power Company is not captive to Kern River transportation. [Smith Testimony; Exhibit KR-154]

53. Kern River's pending FERC rate case (FERC Docket No. RP-04-274) is a regulatory proceeding by which the FERC determines what costs of service Kern River can recoup through its rates and what return on equity Kern River's owner should recover.[3] [Smith Testimony, Kilmer Testimony]

54. Although Kern River has requested its rates be increased as a result of increased risk factors in its business through a higher allowed return on equity, no increase has been awarded to

[3] Proposed findings of fact and conclusions of law relating to the rate case are submitted subject to and without waiver of Kern River's objections to the appropriateness and relevancy of rate case matters.

date.[4] Kern River has requested a return on equity at the top of its proxy group; however, the positions of the FERC staff and shippers are for a substantially lower return on equity, and FERC precedent is to place returns on equity in the middle of the proxy group range. [Smith Testimony, Kilmer Testimony]

55. The reason for Kern River's rate case and the timing of the rate case are not related to Debtors' rejection of the Kern River Agreement. [Smith Testimony]

56. Kern River was required to file the rate case by its 1999 rate case settlement, and it did so on the very last day permitted by that prior settlement, April 30, 2004. [Smith Testimony, Kilmer Testimony]

57. Before filing the rate case, Kern River had been in extensive settlement discussions with its shippers, including Mirant, during the fall of 2003 – months before Debtors rejected the Kern River Agreement. In those discussions, Kern River already sought an increased return on equity due to heightened risk factors in its business. [Smith Testimony]

58. In the Kern River rate case, FERC and many shippers have opposed Kern River's position and put forth competing positions that FERC is considering. [Smith Testimony, Kilmer Testimony]

59. While the rate case currently is set for hearing before FERC later this year, no FERC decision will occur before 2006, and it could be years before a final decision, including appeals, is reached. [Smith Testimony, Kilmer Testimony]

60. Kern River's rate case proposal for treatment of the costs of service that MAEM has failed

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[4] Rates have been increased but are subject to refund. Kern River's claim does not include any rate increase.

to cover as a result of its rejection of the Kern River Agreement results in a revenue deficiency to Kern River of approximately $12.1 million per year. This is a larger deficiency, on average, than the undiscounted yearly net damage amounts shown by Kern River's expert Mr. Beach. For rate design purposes, MAEM is failing to cover approximately $17.2 million in costs allocated to reservation charges.[5] Kern River proposes to retain the risk for such costs, but offset those costs by $5.1 million, which represents the amount of interruptible transportation revenue Kern River attributes to the former MAEM capacity for rate design purposes. If Kern River did not take this offset, Kern River would not be able to offset any of the costs of service which MAEM has failed to cover. In addition, Kern River's remaining firm transportation shippers would have received not only the $17.2 million from Kern River's retention of the 90,000 Dth per day of billing determinants, but they would also receive an additional $5.1 million, resulting in a double-credit. [Smith Testimony; Beach Testimony (damages and mitigation calculation); Exhibit KR-153 (same)]

61. As of July 2003, the FERC interest rate was 4.25%. [Williamson Testimony; Exhibits KR-102, KR-108, KR-109] As of December 2003, the FERC interest rate was 4.07%. [Exhibits KR-108, KR-109] The current FERC interest rate is 5.77% [*see* http://www.ferc.gov/legal/acct-matts/interest-rates.asp#skipnavsub (July 13, 2005); the Court may take judicial notice of this fact].

62. As of July 2003, the 15-year treasury rate was 4.2381%. [Ma Testimony; Debtors' Exhibit

[5] In addition to the $17.2 million in costs allocated to reservation charges, MAEM is also failing to cover approximately $1.6 million in costs allocated to commodity charges. [Smith Testimony]

148, at Exhibit 1 thereto][6] The current yield on United States treasury bonds maturing in May 2018 (the closest reported date to the expiration of the Kern River Agreement in April 2018) is 4.28%, as of July 5, 2005. [*see Wall Street Journal*, July 6, 2005; the Court may take judicial notice of this fact].

63. The interest rates of 4.893% (face value) and 5.14% ("all-in" cost of financing) of the 2003 Expansion Financing are market-determined rates and reflect Kern River's cost of borrowing for the 2003 Expansion Project. The Kern River Agreement was part of this 2003 Expansion Project. The 2003 Expansion Financing was in place and these rates were in effect at the time Debtors filed for bankruptcy (July 2003), at the time Debtors subsequently rejected the Kern River Agreement (December 2003), and at the time of trial (May-July 2005). [Morgan Testimony, Williamson Testimony; Exhibits KR-80, KR-102, KR-110, KR-112]

64. The rates of the 2003 Expansion Financing also reflect a potential use by Kern River of any funds that it may recover in this bankruptcy case, because Kern River could invest such funds by using them to pay down this debt. [Williamson Testimony]

65. The time horizon of the 2003 Expansion Financing – 15 years, running from May 1, 2003, through April 30, 2018 – precisely matches the term of the Kern River Agreement. [Morgan Testimony, Williamson Testimony; Exhibits KR-80, KR-102]

66. The Court finds as a fact each matter hereinafter set forth in its conclusions of law that may

[6] Debtors' expert witness, Dr. Cindy Ma, testified that this would be the correct discount rate to apply to Kern River's claim, if a "risk-free" rate were appropriate. As Kern River has demonstrated at trial and in its trial brief regarding the discount rate, application of a risk-free rate is indeed appropriate to Kern River's claim for contractual damages (exclusive of mitigation) in this case.

constitute a finding of fact.

II. PROPOSED CONCLUSIONS OF LAW

A. Legal Burdens Related to Proof of Claim

1. Under the Bankruptcy Code, "[a] claim . . ., proof of which is filed under section 501 of [the Bankruptcy Code], is deemed allowed, unless a party in interest . . . objects."[7]

2. "A proof of claim executed and filed in accordance with [the Bankruptcy Rules] shall constitute prima facie evidence of the validity and amount of the claim."[8]

3. The claimant will prevail unless a party who objects to the proof of claim produces sufficient evidence to rebut the claim.[9]

4. A "properly filed" proof of claim, as proscribed by the Judicial Conference in Official Form 10, consists of "(1) a creditor's name and address, (2) basis for claim, (3) date debt incurred, (4) amount of claim, (5) classification of claim, and (6) supporting documents."[10]

5. If a creditor files a proof of claim that meets the standards of Bankruptcy Rule 3001(c) and Official Form 10, Bankruptcy Rule 3001(f) is triggered and:

> the burden of going forward with the evidence then shifts to the objecting party to produce evidence at least equal in probative force to that offered by the proof of claim and which, if believed, would refute at least one of the allegations that is essential to the claim's legal sufficiency. This can be done by the objecting party producing specific and detailed allegations that place the claim into dispute, by the presentation of legal arguments based upon the contents of the claim and its supporting documents,

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[7] 11 U.S.C. § 502(a).

[8] FED. R. BANKR. P. 3001(f).

[9] *In re Fid. Holding Co., Ltd.*, 837 F.2d 696, 698 (5th Cir.1988).

[10] *In re Armstrong*, 320 B.R. 97, 104 (Bankr. N.D. Tex. 2005).

or by the presentation of pretrial pleadings, such as a motion for summary judgment, in which evidence is presented to bring the validity of the claim into question.[11]

6. Kern River's Amended Proof of Claim was executed and filed in accordance with the Bankruptcy Code and Federal Rules of Bankruptcy Procedure and thus constitutes prima facie evidence of the validity and amount of that claim.

7. The burden therefore shifted to MAEM to produce sufficient evidence at least equal in probative force to that offered by Kern River's proof of claim, which, if believed, would refute at least one of the allegations that is essential to the claim's legal sufficiency.[12]

8. Mere conclusory challenges to a proof of claim are insufficient to overcome the prima facie validity of a proof of claim.[13] Moreover, mere allegations, unsupported by evidence, are insufficient to rebut the movant's prima facie case.[14]

9. It is questionable whether Debtors have produced evidence sufficient to overcome the prima facie validity of Kern River's Amended Proof of Claim and therefore shift the burden of proof back to Kern River. If the Debtors failed to present sufficient evidence supporting the Claims Objection, the law requires that Kern River's Amended Proof of Claim be found

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[11] *Id.*; *In re Rally Partners, L.P.*, 306 B.R. 165, 168-69 (Bankr. E.D. Tex. 2003).

[12] *See In re O'Connor*, 153 F.3d 258, 260 (5th Cir. 1998); *In re Fid. Holding Co., Ltd.*, 837 F.2d at 698; *In re Armstrong*, 320 B.R. at 104; *In re Ska! Design, Inc.*, 308 B.R. 777, 780 (Bankr. N.D. Tex. 2004) (explaining that the creditor's proof of claim is prima facie valid unless the debtor produces evidence to rebut the presumption).

[13] *See, e.g., In re O'Connor*, 153 F.3d at 260-61.

[14] *Id.*

presumptively valid that the Claims Objection be overruled.[15]

10. Because the Kern River Agreement contemplates substantial continuing duties, binding both Kern River and MAEM, and because the failure of either party to perform would normally be deemed a material breach, the Kern River Agreement is an executory contract.[16]

11. Pursuant to Bankruptcy Code section 365(g), the rejection of an executory contract constitutes a breach of such contract, and a claimant may assert a general unsecured claim for damages that arise from such breach.[17]

12. Under the Bankruptcy Code, a rejection gives rise to a legal fiction that a breach of the contract occurred immediately prior to the filing of the petition.[18] The purpose of section 365(g)(1) of the Bankruptcy Code is "to establish that the non-debtor party to an executory contract is entitled to be treated the same as an unsecured creditor holding a prepetition claim."[19]

13. MAEM's rejection of the Kern River Agreement is considered and treated the same as a

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[15] *Id.* (trustee failed to rebut presumption of validity where objection relied solely on trustee's unsupported contention); *see also In re McDaniel*, 264 B.R. 531 (8th Cir. BAP 2001) (overruling debtor's objection to properly filed proof of claim where the debtor failed to carry its burden of producing evidence to support its contention that the claim was overstated); *In re Williams*, 190 B.R. 728 (D.R.I. 1996) (objection to claim does not deprive proof of claim of presumptive validity unless objection is supported by substantial evidence).

[16] *See In re Knutson*, 563 F.2d 916, 917 (8th Cir. 1977) (an executory contract is "a contract under which the obligation of both the bankrupt and the other party are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other").

[17] 11 U.S.C. §365(g); *In re Mirant Corp.*, 378 F.3d 511, 519 (5th Cir. 2004).

[18] *Stewart Title Guar. Co. v. Old Republic Nat'l Title Ins. Co.*, 83 F.3d 735, 741 (5th Cir. 1996) (citing 11 U.S.C. §§ 365(g)(1) and 502 (g)).

[19] *R&O Elevator Co. v. Harmon*, 93 B.R. 667, 672 (D. Minn.) 1988).

breach of contract claim. Accordingly, as a result of MAEM's rejection of the Kern River Agreement, a breach of contract occurred immediately prior to the time MAEM filed its bankruptcy petition in July 2003.[20]

14. Kern River's claim is allowable for damages resulting from MAEM's breach of the Kern River Agreement such that the amount of the primary claim (that is, the amount before any offsets for mitigation and discounting) and validity of the claim should be determined as of the date of MAEM's breach.[21]

15. The Kern River Agreement is valid and was legally binding on the parties.[22]

16. Under § 502, to determine the extent of the claim to be allowed, state law governs the issue of the remedies and amount of damages recoverable for breach of contract.[23] In this case, the governing law is Utah law.[24]

B. Proposed Conclusions of Law Related to Mitigation of Damages.

17. Debtors bear the burden of proof that Kern River can reasonably mitigate its rejection damages. Debtors have the burden of proving all matters related to mitigation, including the fact and amount of mitigation.[25] Debtors also have the burden to prove the time at which any

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[20] *See* 11. U.S.C. § 502(g); *see also Stewart Title*, 83 F.3d at 741.

[21] *See* 11. U.S.C. § 502(g); *see also Stewart Title*, 83 F.3d at 741.

[22] Exhibit KR-9.

[23] *See Stewart Title*, 83 F.3d at 741.

[24] Exhibit KR-9, at § 7.5.

[25] *Pratt v. Board of Education*, 564 P.2d 294, 297-98 (Utah 1977) ("Although plaintiff is obligated to minimize his damages, the burden is on the party whose wrongful act caused the damages to prove anything in diminution

potential mitigation should occur.[26] The doctrine of mitigation requires the breaching party to show with specificity why the damages sought are not proper because of either (a) successful efforts to mitigate, or (b) a failure to reasonably mitigate.[27]

18. When the breaching party to a contract fails to take steps to mitigate damages on its own, the non-breaching injured party has no obligation to mitigate damages by taking actions that the breaching party refused to take.[28]

19. Because Debtors had every opportunity for several months to mitigate damages in this case by reselling the capacity under the Kern River Agreement through the active capacity release market and knowledge of the consequences of not doing so, they cannot now complain that Kern River did not take the steps that Debtors refused to take.[29] Under these circumstances,

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thereof."); *Covey v. Covey*, 80 P.3d 553 (Utah App. 2003); *accord* 11 CORBIN ON CONTRACTS §1039 ("[t]he burden of proving that losses could have been avoided by reasonable effort and expense must always be borne by the party who has broken the contract"); 22 AM JUR 2D DAMAGES § 708 (noting that the "[party in default] has the burden of establishing matters asserted in mitigation or reduction of the amount of the plaintiff's damages."); *see also R&O Elevator*, 93 B.R. at 672 ("[I]mposing on the nonbankrupt party to an executory contract the risk of having the claim diminished for failure to mitigate runs contrary to the scheme of protections established by the [Bankruptcy] Code.").

[26] *See R&O Elevator*, 93 B.R. at 673-74 (holding that the bankruptcy court correctly decided that the debtor did not establish the time at which the plaintiff could have mitigated his damages).

[27] *John Call Eng'g, Inc. v. Manti City Corp.*, 795 P.2d 678, 681 (Utah App. 1990).

[28] *Alexander v. Brown*, 646 P.2d 692, 695 (Utah 1982); *Covey v. Covey*, 80 P.3d 553 (Utah Ct. App. 2003) (no mitigation where defendants had the same opportunity as plaintiffs to decrease damages when costs were less, yet declined to do so).

[29] *See Alexander*, 646 P.2d at 695 ("Where the party having the primary duty for performance has the same opportunity to perform and the same knowledge of the consequences of nonperformance as the party to whom the duty is owed, he cannot complain about the failure of the latter to perform this duty for him.") (*citing, inter alia, McCarty v. United States*, 185 F.2d 520 (5th Cir. 1950)).

Debtors cannot contend that Kern River failed to mitigate.[30] Moreover, the award of damages to Kern River shall not be reduced on account of damages the Debtor could have avoided as easily as Kern River.[31]

20. Kern River is only required to make reasonable efforts to mitigate its damages.[32] An injured party is not required to make every effort possible to mitigate damages, but need only take reasonable steps to mitigate avoidable damages.[33] It is not reasonable to require an injured party to undertake "significant and financially risky efforts" in an attempt to mitigate its damages.[34] "Although an injured party is required to use reasonable diligence to minimize his losses, he is not required to 'make unreasonable personal outlays of money' or to 'sacrifice a substantial right of his own.'"[35] Rather, "an injured party is required to incur

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[30] *Shea-S&M Ball v. Massman-Kiewit-Early*, 606 F.2d 1245, 1249 (D.C. Cir. 1979) ("Where both the plaintiff and the defendant have had equal opportunity to reduce the damages by the same act and it is equally reasonable to expect the defendant to minimize damages, the defendant is in no position to contend that the plaintiff failed to mitigate.").

[31] *Id.* (*citing, inter alia,* Dobbs, Handbook on the Law of Remedies § 3.7 at 186 (1973); 22 Am.Jur.2d Damages § 37 (1965); 25 C.J.S. Damages § 34 (1966)).

[32] *John Call Eng'g*, 795 P.2d at 680.

[33] *Anesthesiologists Assoc. of Ogden v. St. Benedict's Hosp.*, 852 P.2d 1030, 1040 (Utah App. 1993, rev'd on other grounds, 884 P.2d 1236 (Utah 1994)); *Eastman Kodak Co. v. Westway Motor Freight, Inc.*, 949 F.2d 317, 320 (10th Cir. 1991).

[34] *Anesthesiologists Assoc.*, 852 P.2d at 1040.

[35] *Bank One, Texas, N.A. v. Taylor*, 970 F.2d 16, 29 (5th Cir. 1992) (*quoting Halliburton Oil Well Cementing Co. v. Millican*, 171 F.2d 426, 430 (5th Cir. 1948) and *Fid. & Deposit Co. v. Stool*, 607 S.W.2d 17, 25 (Tex. Civ. App.–Tyler 1980, no writ)); *see also* 22 AM JUR 2D DAMAGES §353 ("Damages may not be recovered for a loss that the injured party could have avoided without undue risk, burden, or humiliation, but the injured party is not precluded from recovery to the extent that he or she has made reasonable but unsuccessful efforts to avoid the loss. An innocent party is not required to take extraordinary efforts to avoid losses from a breach of contract, nor must he or she incur risks or spend substantial sums of money to protect the person in default under the contract. It is also not necessary that he or she sacrifice any substantial right in order to minimize the loss.").

'only slight expense and reasonable effort' in mitigating his damages."[36]

21. Debtors have not shown that Kern River failed to take reasonable efforts to mitigate its damages. Although Kern River has not been able to sell all of the capacity formerly contracted to MAEM by the Kern River Agreement, the actions of Kern River are more than sufficient to fulfill the "reasonable efforts" standard for mitigation of damages.[37]

22. Because Kern River has made reasonable but unsuccessful efforts to avoid loss, it is not precluded from recovery.[38]

23. Kern River's duty to mitigate, and thus the starting point for calculating the amount of any potential mitigation, begins as of the date of rejection when Kern River first had the opportunity to mitigate. A creditor such as Kern River does not incur a responsibility to mitigate while the debtor is accepting the benefit of the contract. Accordingly, Kern River was not required to anticipate rejection and begin efforts to mitigate prior to the date of rejection.[39]

24. Debtors have not shown that Kern River could have mitigated its losses for the entire term of the Kern River Agreement by the time of trial. Kern River has fulfilled its duty to reasonably mitigate up to the time of trial; however, since all of the former MAEM capacity has not been sold for the entire term of the Kern River Agreement despite Kern River's

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[36] *Bank One*, 970 F.2d at 29.

[37] RESTATEMENT 2ND OF CONTRACTS §350(2) (1981).

[38] *Id.*

[39] *See R & O Elevator*, 93 B.R. at 672 (a party to an executory contract with a petitioner in bankruptcy will not be responsible for mitigating damages until a court approves the rejection of the contract).

reasonable efforts, Kern River has a continuing duty to attempt to mitigate its losses.[40] Because Kern River could not have fully mitigated its losses as of the time of trial and it has a continuing duty to attempt to mitigate, potential future mitigation should be determined and valued as of the time of trial.[41]

25. Through its reasonable efforts to mitigate its damages, Kern River has been able to resell some of the capacity formerly contracted to MAEM under the Kern River Agreement, thereby reducing the amount of its claim by $1,391,968 as of October 31, 2004.[42]

26. Kern River is restricted in its ability to sell firm capacity at discounted rates because of MFN rights held by third party shippers (the "MFN Shippers") under the terms of certain vintage contracts between Kern River and those shippers.[43] Under the MFN Contracts, MFN Shippers are entitled to refunds if Kern River sells firm capacity at a rate lower than the rate

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[40] *See Reid v. Mutual of Omaha Ins. Co.*, 776 P.2d 896, 909 (Utah 1989) (commercial landlord has continuing duty to mitigate damages for rents accruing in the future).

[41] *See Id.* (potential future mitigation to offset damages for breach of commercial lease not valued in advance but rather to be determined in subsequent proceedings at the time mitigation might be achieved); *see also* AmJur Landlord § 791 ("Damages for advance rent for a full term are the difference between the stipulated [contractual] rental and the *present* rental value.") (emphasis added); *Lakewood Leasing Corp. v. Kirkwood Atrium Office Park Phase 3*, 750 S.W.2d 847, 852 (Tex. App – Houston [14th Dist.] 1988, no writ) (where there has been an anticipatory breach of a commercial lease, landlord's "measure of damages is the difference between the present value of the future rentals under the contract diminished by the reasonable *current* market value of the premises.") (emphasis added); *R&O Elevator*, 93 B.R. at 673-74 (holding that the debtor did not prove that creditor failed to mitigate, but implying that if debtor had proved failure to mitigate, amount of mitigation would have been determined as of the time the creditor, who was a former executive of the debtor, obtained subsequent employment and not at some earlier date such as the date the petition was filed).

[42] *See* Exhibit KR-3 (Kern River's Amended Proof of Claim No. 8121), at Exhibit A thereto.

[43] *See* Exhibit KR-86 (summary of MFN contracts and terms); *see also* Exhibits KR-68, KR-70, KR-73, KR-75, KR-77 and KR-79 (relevant contracts containing MFN provisions).

being paid by that MFN Shipper, for a term that triggers the MFN clause.[44]

27. To mitigate damages by selling firm capacity at discounted market rates that would trigger MFN liability, Kern River would have to violate the MFN rights held by the MFN Shippers and thereby incur substantial losses by reducing the rates for the MFN Shippers to match the lower market rates on the sale of the former MAEM Capacity.[45]

28. There is no case law or other legal authority to support Debtors' contention that Kern River should have to bear the risk of incurring additional losses as a result of violating the MFN rights. It is irrelevant to this analysis whether Kern River received some benefit when it entered into the MFN Contracts. The MFN Contracts were in force and effect at the inception of the Kern River Agreement and as of the Petition Date and date of rejection, and Kern River's potential mitigation and duties to mitigate should be evaluated in light of the MFN Contracts and the restrictions contained therein.

29. Because the Kern River Agreement was negotiated at arm's length and MAEM knew about the MFN Contracts and their terms before it entered into the Kern River Agreement and before it rejected the Kern River Agreement, Debtors are estopped or precluded from asserting that the MFN Contracts should be disregarded in assessing Kern River's ability to mitigate.

30. In mitigating its breach of contract damages, Kern River is not required to sacrifice any of

[44] *Id.*

[45] *Id.*; *see also* Exhibits KR-127 and KR-128.

its substantial rights.[46] The MFN Shippers also are not required to sacrifice any of their substantial rights to mitigate damages in this case. There is no case law or other legal authority that requires a third party to sacrifice its legal rights in order to allow other parties to mitigate. Accordingly, Kern River is not required to sell discounted firm capacity under terms that would trigger MFN refund liability.

31. In light of the testimony of the MFN Shipper representatives and Mr. Morgan, the Court concludes that it is not commercially reasonable and it would be unreasonable to require Kern River to obtain waivers of the MFN Contracts from the MFN Shippers. Debtors have not proved that Kern River had any opportunity to achieve mitigating revenues by obtaining waivers of MFN Contracts. To the contrary, Kern River has shown that each and every bid for firm capacity that it received but rejected would have subjected Kern River to MFN refund liability in excess of the revenues that would have been generated by acceptance of the bid.[47]

32. Under the "lost volume" rule, the doctrine of mitigation may not be imposed to deprive Kern River of the benefit of subsequent contracts that would have been available to it irrespective of Debtors' breach.[48] Contractual damages are not reduced by accepting other contracts, if no showing is made that the non-defaulting party could not have performed those contracts

[46] *Bank One*, 970 F.2d at 29.

[47] *See* Morgan Testimony; Exhibits KR-127 and KR-128.

[48] *John Call Eng'g*, 795 P.2d at 681; *see generally, Stewart v. Hansen*, 218 P. 959 (Utah 1923).

had there been no breach.[49]

33. Kern River, which has the ability to sell other capacity on its system, is not required to forego its benefit from other contracts as a consequence of Debtor's breach.[50] Up to the point where Kern River reaches the last 90,000 decatherms of capacity on its pipeline, Kern River would have the ability to provide service for all of its actual sales as well as the capacity formerly contracted to MAEM. In such a situation, Kern River's actual sales are therefore not required to be treated as mitigation of Kern River's damage claim. When Kern River entered into additional contracts, such contracts do not reduce Kern River's damages resulting from Debtors' breach unless the Kern River pipeline was filled to within 90,000 decatherms of capacity.[51] When Kern River sells firm capacity, the measure of whether the Kern River pipeline is filled to within 90,000 decatherms of capacity is based on the design capacity of the Kern River pipeline. When Kern River sells interruptible capacity, the measure of whether the Kern River pipeline is filled to within 90,000 decatherms of capacity is based on a comparison of (a) the total of firm plus interruptible sales on that day, to (b) the operational capacity of the Kern River pipeline on that day.

34. Kern River's damages should not be reduced for future mitigation because Debtors failed

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[49] *John Call Eng'g*, 795 P.2d at 681 (*quoting* 22 AM JUR 2D DAMAGES §644 (1988)).

[50] *See id.*; *see also* RESTATEMENT (SECOND) OF CONTRACTS §350, *comment d.* (noting that "[t]he mere fact that an injured party can make arrangements for the disposition of the goods or services that he was to supply under the contract does not necessarily mean that by doing so he would avoid loss").

[51] *See John Call Eng'g*, 795 P.2d at 680-82; *see also* RESTATEMENT (SECOND) OF CONTRACTS §347, *comment f.* (noting that "[i]f the injured party could and would have entered into the subsequent contract, even if the contract had not been broken, and could have had the benefit of both, he can be said to have 'lost volume' and the subsequent transaction is not a substitute for the broken contract").

to satisfy their burden of proof of demonstrating that Kern River will be able to sell sufficient capacity in the future under the "lost volume" rule to result in mitigation of the rejection damages caused by Debtors.

35. Debtors' purchases of capacity release and delivered gas from other Kern River shippers do not constitute mitigation, because such purchases did not result in any additional revenue to Kern River. In addition, such purchases as well as Debtors' purchases of interruptible transportation capacity directly from Kern River do not constitute mitigation because "there is no obligation to mitigate damages if it involves dealing with the breaching party."[52]

36. Any potential rate increase that may result from Kern River's pending FERC rate case (FERC Docket No. RP-04-274) does not constitute mitigation of Kern River's damages resulting from Debtors' rejection of the Kern River Agreement. Regardless of whether the damages resulting from Debtors' rejection of the Kern River Agreement might be passed on to Kern River's remaining shippers through the Kern River rate case, Debtor receives no credit for mitigation based on Kern River's potential recovery in its rate case. This "pass-through" defense asserted by Debtors has been soundly rejected on strong public policy grounds because it would allow parties to breach their contracts with utility companies with impunity.[53]

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[52] *See, e.g., W-V Enterprises, Inc. v. Federal Sav. & Loan Ins. Corp.*, 673 P.2d 1112, 1122 (Kan. 1983) (after defendant bank breached commitment to make loan, plaintiff not required to mitigate damages by accepting defendant's later offer to make smaller loan and seek alternative financing for shortfall).

[53] *Orange and Rockland Utils., Inc. v. New England Petroleum Corp.*, 400 N.Y.S.2d 79, 81-82 (N.Y. App. Div. 1977) (refusing "pass on" defense to petroleum company when utility passed on costs of overcharges for fuel oil to its customers); *see also Cobble Hill Nursing Home, Inc. v. Henry and Warren Corp.*, 601 N.Y.S.2d 334, 339 (N.Y. App. Div. 1993) (refusing to allow a "pass on" defense when plaintiff was reimbursed for part of its damages because the

37. The result of Kern River's rate case and any potential recovery of costs of service therein is also irrelevant and does not constitute mitigation in this case because it is analogous to situations subject to the collateral source rule. Under the collateral source rule, a plaintiff is not forced to transfer to a wrongdoer a benefit that the plaintiff has received through another source independent of the wrongdoer's procuration or contribution.[54] "The fact that [a creditor] may receive assistance from some collateral source is wholly irrelevant to the bankruptcy proceedings."[55]

38. Kern River's rate case proposal is not inconsistent with the mitigation Kern River shows in this case. The rate case requires an allocation of loss among parties (Kern River and its shippers) that were not responsible for that loss, whereas this case requires an allocation of loss between the party responsible for that loss (MAEM) and a party not responsible for the loss (Kern River). Kern River's rate case proposal and the associated FERC regulatory procedures do not in any way affect the Court's analysis of breach of contract and mitigation

defense would allow parties to breach their contracts with utility companies with impunity); *Northern Arizona Gas Service, Inc. v. Petrolane Transport, Inc.*, 702 P.2d 696 (Ariz. Ct. App. 1984) (disallowing "pass on" defense to gas supplier who overcharged gas retailer, even where regulations permitted retailer to pass on increased costs to its customers); *Accord Central States Elec. Co. v. City of Muscatine*, 324 U.S. 138, 145 (1945) (stating in dictum that if a natural gas distribution utility sued a natural gas producer utility to recover excessive rates, the producer could not defend on the ground that the distributor had passed on the excess to its consumers); *Southern Pacific Co. v. Darnell-Taenzer Lumber Co.*, 245 U.S. 531 (1918) (plaintiff was entitled to recover overpayments made to the defendant even though the plaintiff was able to pass on the damage it sustained by collecting the amounts from its customers); *Commonwealth Edison Co. v. Allis-Chalmers Mfg. Co.*, 335 F.2d 203 (7th Cir. 1964) (manufacturers could not assert defense to antitrust case that utilities had passed on to their customers the purported excess charges paid to the manufacturers for the equipment at issue); *see also Atlantic City Electric Co. v. General Electric Co.*, 226 F.Supp. 59 (S.D.N.Y. 1964); *Ohio Valley Electric Corp. v. General Electric Co.*, 244 F.Supp. 914 (S.D.N.Y. 1965); *Public Utility Dist. No. 1 of Chelan County, Washington v. General Electric Co.*, 230 F.Supp. 744 (D.C.D.C. 1964).

[54] *See generally, Amwest Savings Ass'n v. Statewide Capital, Inc.*, 144 F.3d 885, 889 (5th Cir. 1998); *Manguno v. Turner-Newall Ltd.*, 1987 WL 10459 (E.D. La. 1987).

[55] *In re Hulen Park Place Ltd.*, 130 B.R. 39, 42 (N.D. Tex. 1991) (McBryde, J.), *overruled on other grounds.*

principles under state law, which applies in this case.[56] Accordingly, Kern River's rate case proposal has no application to the determination of damages in this case.

39. Under these legal principles, the report and testimony of Kern River's expert Mr. Beach provide the proper measure of mitigation in this case. Mr. Beach's report and testimony show the mitigation that Kern River has achieved and will be able to achieve in the future with reasonable efforts. Such mitigation is set forth in the "Mitigation" column of Exhibit KR-153, which is attached to these Findings and Conclusions as Exhibit "A".

40. The report and testimony of Debtors' expert Dr. Makholm cannot be utilized as measure of mitigation because it ignores the effect of the MFN Contracts and thus is not consistent with reasonable efforts to mitigate on the part of Kern River. In addition, the capacity release transactions analyzed by Dr. Makholm are not reflective of the relevant market for capacity on the Kern River pipeline for purposes of assessing mitigation. Accordingly, Debtors have not proven that Kern River could have mitigated at the rate asserted by Dr. Makholm with reasonable efforts. Moreover, even if Dr. Makholm's analysis were relevant and reflective of reasonable efforts to mitigate, the mitigation asserted by Dr. Makholm, once it is corrected to square with the actual facts of this case, approximates the mitigation value offered by Mr. Beach.

C. Proposed Law Regarding Discounting Damages for Breach of Contract and Potential Future Mitigation.

41. Damages for amounts payable in the future are generally discounted to present value.

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[56] *See Stewart Title*, 83 F.3d at 741.

Different types of future streams or payments, however, are treated differently for discounting purposes, because they involve different levels of uncertainty.

42. Future damages for breach of contract that are direct, known, liquidated and fixed are discounted based on the time value of money on a non-risk-adjusted basis,[57] whereas future damages that are uncertain and unliquidated must be discounted on a risk-adjusted basis depending on the level of uncertainty and riskiness associated with the venture with which those damages are associated.[58]

43. Examples of future damages that are direct, known, liquidated and fixed include payments under a long-term lease,[59] and future payments of known amounts under a deferred executive compensation plan.[60] Kern River's contractual damages in this proceeding constitute this type of damages.

44. By contrast, an example of future damages that are uncertain and unliquidated would be the anticipated lost profits constituting consequential damages under a breach of contract claim.[61] Kern River's potential mitigation from future sales of pipeline capacity, which depend on the future success of Kern River as a business venture, are generally analogous to this latter type of damages.

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[57] *See, e.g., In re Highland Superstores, Inc.*, 154 F.3d 573 (6th Cir. 1998); *In re Stone & Webster, Inc.*, 279 B.R. 748 (Bankr. D. Del. 2002); *Kucin v. Devan*, 251 B.R. 269 (Bankr. D. Md. 2000).

[58] *See, e.g., Energy Capital Corp. v. U.S.*, 302 F.3d 1314 (Fed. Cir. 2002).

[59] *See, e.g., In re Highland Superstores*, 154 F.3d 573; *In re United Am. Fin. Corp.*, 55 B.R. 117 (Bankr. E.D. Tenn. Bankr. 1985).

[60] *See, e.g., Kucin v. Devan*, 251 B.R. 269.

[61] *See, e.g., Energy Capital Corp. v. U.S.*, 302 F.3d 1314.

45. Under either of these scenarios in a breach of contract case, to the extent that a court determines that it must look beyond a "legal" or contractual rate to determine the appropriate discount, the law looks to the circumstances of the non-breaching party rather than the breaching party to determine the appropriate discount rate.[62]

46. In awarding damages for breach of contract, the non-breaching party is entitled to damages sufficient to place the non-breaching party in as good a position as it would have been had the contract been performed.[63] Discounting direct, fixed, liquidated damages at a non-risk-adjusted rate squares with this principle, because such damages are a legal certainty. The non-breaching party in this situation is absolutely entitled to judgment for such damages – and such amounts cannot be further discounted for the risk of nonpayment.[64]

47. In cases involving direct, known, liquidated damages for breach of contract, courts utilize a "legal" or contractual rate or look to the circumstances of the non-breaching party to determine an appropriate discount rate.[65] No courts have looked to the circumstances of the breaching party to determine an appropriate discount rate in a breach of contract case,

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[62] *See, e.g., Kucin v. Devan*, 251 B.R. at 273 (expressly rejecting breaching party's argument that discount rate should be based on the risk of nonpayment and creditworthiness of the breaching party).

[63] *See* Restatement (Second) of Contracts, §§ 344, 347 (1981); *see also Anesthesiologists Assoc.*, 884 P.2d at 1238 ("Damages awarded for breach of contract should 'place the nonbreaching party in as good a position as if the contract had been performed.'").

[64] *Kucin v. Devan*, 251 B.R. at 273.

[65] *See, e.g., In re Stone & Webster, Inc.*, 279 B.R. 748 (applying 3.6% discount rate based on the nonbreaching party's rate of return for its invested funds, which the court concluded was the rate of return that the nonbreaching party expected to receive on its investment of the funds from the judgment).

because doing so would be contrary to fundamental principles of contract law.[66]

48. The regulated FERC interest rate is an appropriate "legal" rate for discounting purposes and the rate contractually agreed by Kern River and the Debtor.[67]

49. The FERC interest rate is established in 18 C.F.R. § 154.501(d) as an appropriate regulated rate for the time value of money in the context of natural gas pipelines.[68]

50. The FERC interest rate is the parties' contractual interest rate. The FERC interest rate is the rate specified in section 5.5 of the General Terms and Conditions of Kern River's Tariff approved by the FERC.[69] The General Terms and Conditions of the tariff are expressly incorporated into and made a part of the Kern River Agreement.[70]

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[66] *See Kucin v. Devan*, 251 B.R. at 273 (expressly rejecting breaching party's argument that discount rate should be based on the risk of nonpayment and creditworthiness of the breaching party).

[67] *See* Exhibits KR-9 and KR-124.

[68] 18 C.F.R. 154.501 provides, "Any natural gas company that collects rates or charges pursuant to this chapter must refund that portion of any increased rates or charges either found by the Commission not to be justified, or approved for refund by the Commission as part of a settlement, together with interest as required under paragraph (d) of this section.... Interest on the refund balance must be computed ... [a]t an average prime rate for each calendar quarter on all excessive rates or charges held .... The applicable average prime rate for each quarter must be the arithmetic mean, to the nearest one-hundredth of one percent, of the prime rate values published in the Federal Reserve Bulletin, or in the Federal Reserve's 'Selected Interest Rates' (Statistical Release G, 13), for the fourth, third, and second months preceding the first month of the calendar quarter." *See* 18 C.F.R. 154.501(a), (d) (Exhibit KR-106).

[69] Section 5.5 of the General Terms and Conditions of Kern River's Tariff (Exhibits KR-107, KR-124) provides, in pertinent part: "Failure to Pay Invoices. Should Shipper fail to pay any of the amount of any invoice when such amount is due, ... Shipper will pay a late charge[.] ... Such late charge will be determined by multiplying (a) the unpaid portion of the invoice by (b) the ratio of the number of days from the due date to the date of actual payment to 365 or by the annual interest rate as determined in accordance with 18 C.F.R. Section 154.501(d)(1)[.]" Note that there appears to be a typographical error in Section 5.5 – to reach an appropriate interest calculation, this Section would better read: "... by multiplying (a) the unpaid portion of the invoice by (b) the ratio of the number of days from the due date to the date of actual payment to 365 ***by (c)*** the annual interest rate as determined in accordance with 18 C.F.R. Section 154.501(d)(1)[.]" (emphasis added).

[70] *See* Exhibit KR-9, at § 2.1 ("This Agreement shall be subject to the provisions of such Rate Schedule and the General Transportation Terms and Conditions applicable thereto on file with the FERC and as amended from time to time, which by this reference are incorporated herein and made a part hereof.").

51. As the parties' contractual interest rate, the FERC Interest Rate is the "legal" post-judgment rate applicable to this dispute under Utah law.[71]

52. Utah law provides that "[t]he parties to a lawful contract may agree upon any rate of interest for the loan or forbearance of any money, goods, or chose in action that is the subject of their contract."[72] Utah law further provides that post-judgment interest shall be paid at the contractual rate.[73]

53. Application of the FERC interest rate is also fair and realistic in this case because it works in both directions between the pipeline and its shippers. As set forth on the face of the regulation, it is the rate that Kern River must pay to its shippers when it owes refunds, and it is also used by the FERC as the source for the interest rate to be paid by a shipper on late payments. Nothing about the FERC interest rate limits the time period in which it may be applied. Pipeline rate cases can go on for many years before refunds are ordered by FERC, and the FERC interest rate would apply in such a situation.[74]

54. The Chapter 13 cram-down case of *Till v. SCS Credit Corp.* 541 U.S. 465, 124 S.Ct. 1951 (2004), does not apply to this case. First, *Till* is a plurality opinion and has little if any precedential value. Moreover, *Till* involved the interest rate to be paid to creditors on future

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[71] The Kern River Agreement is governed by and calls for the application of Utah law. *See* Exhibit KR-9, at § 7.5 ("This Agreement shall be construed in accordance with the laws of the State of Utah.").

[72] UTAH CODE ANN. § 15-1-1(1).

[73] UTAH CODE ANN. § 15-1-4(2) (Any "judgment rendered on a lawful contract shall conform to the contract and shall bear the interest agreed upon by the parties, which shall be specified in the judgment.").

[74] *See* Morgan Testimony, Williamson Testimony, Smith Testimony; Exhibits KR-102, KR-107, and KR-124.

payments to be made by the debtor pursuant to a Chapter 13 cram down proceeding. *Till*, 124 S.Ct. at 1955-56. As *Till* makes clear, in such a situation the Court should look to the creditworthiness of the debtor and the risk that the debtor will default in establishing an appropriate interest rate to be paid to creditors. But that situation is entirely different than determining a proper discount rate for breach of contract damages, which is governed by state law, including the foundational principle that damages for breach of contract must be sufficient to place the non-breaching party in as good as a position as it would have been had the contract been performed.[75]

55. As of July 2003, the FERC interest rate was 4.25%.[76] The Court determines that Kern River's claim for breach of contract damages (exclusive of mitigation) and any mitigation that has actually been achieved by Kern River should be discounted to present value at this annual rate, with discounting to be done on a month-by-month basis.[77] Discounting on this basis, the net present value, as of July 2005, of Kern River's claim for breach of contract damages (exclusive of mitigation) is approximately $167.0 million.

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[75] The Court also notes that both Debtors and the Unsecured Creditors' Committee in this case have advocated a similarly limited reading of *Till*. *See* Debtors' Memorandum of Law in Regard to Relevance of *Till v. SCS Credit Corporation* to Valuation of Debtors (June 6, 2005) ("The precise delineation of *Till*'s application in Chapter 11 thus remains unclear. However, it is absolutely clear that such application, if any, should be limited to the context of plans of reorganization which provide for deferred payments to creditors and interest holders."); Memorandum by the Official Committee of Unsecured Creditors of Mirant Corporation *et al.* Regarding *Till v. SCS Credit Corp.* (June 6, 2005) ("*Till* (which, itself is a plurality decision that contains vastly inconsistent language in the opinion) has no applicability to a solvency analysis conducted for an ongoing enterprise in Chapter 11 – and, indeed, by its own terms and logic, may not even be applicable for determining a cram down rate of interest in a corporate Chapter 11 case.").

[76] Williamson Testimony; Exhibits KR-102 and KR-107.

[77] Williamson Testimony (May 31, 2005 p.m. Transcript, at 70-72).

<u>Paragraphs 56 through 60 are alternatives to Paragraphs 48 through 55.</u>

56. *The 4.893% interest rate on the \$836 million note Kern River used to finance the 2003 Expansion Project and the 5.14% "all-in" cost of that borrowing is an appropriate discount rate.*

57. *This rate is a market-determined rate and reflects Kern River's then-present cost of borrowing for the 2003 Expansion Project involving the Kern River Agreement at the time Debtors filed for bankruptcy (July 2003) and subsequently rejected the contract at issue (December 2003). This financing is still in effect at the time of trial (May-July 2005).*

58. *This rate is also appropriate and realistic because it reflects a potential use by Kern River of any funds that it may recover in this bankruptcy case, because Kern River could invest such funds by using them to pay down this debt. In addition, the time horizon of this financing – 15 years, running from May 1, 2003, through April 30, 2018 – precisely matches the term of the Kern River Agreement.*

59. *The Chapter 13 cram-down case of Till v. SCS Credit Corp. 541 U.S. 465, 124 S.Ct. 1951 (2004), does not apply to this case. First, Till is a plurality opinion and has little if any precedential value. Moreover, Till involved the interest rate to be paid to creditors on future payments to be made by the debtor pursuant to a Chapter 13 cram down proceeding. Till, 124 S.Ct. at 1955-56. As Till makes clear, in such a situation the Court should look to the creditworthiness of the debtor and the risk that the debtor will default in establishing an appropriate interest rate to be paid to creditors. But that situation is entirely different than determining a proper discount rate for breach of contract damages, which is governed by*

state law, including the foundational principle that damages for breach of contract must be sufficient to place the non-breaching party in as good as a position as it would have been had the contract been performed.[78]

60. *As previously noted, the "all-in" cost of Kern River's 2003 Expansion Financing was 5.14%, and this financing has been in place throughout the relevant time period. The Court determines that Kern River's claim for breach of contract damages (exclusive of mitigation) and any mitigation that has actually been achieved by Kern River should be discounted to present value at this annual rate, with discounting to be done on a month-by-month basis. Discounting on this basis, the net present value, as of July 2005, of Kern River's claim for breach of contract damages (exclusive of mitigation) is approximately $159.7 million.*

61. Debtors' position on the discount rate is contrary to relevant law regarding discount rates applicable in cases such as this, because no court has looked to the creditworthiness of the breaching party in discounting in a breach of contract case.[79] Debtors' discounting approach

[78] The Court also notes that both Debtors and the Unsecured Creditors' Committee in this case have advocated a similarly limited reading of *Till*. *See* Debtors' Memorandum of Law in Regard to Relevance of *Till v. SCS Credit Corporation* to Valuation of Debtors (June 6, 2005) ("The precise delineation of *Till*'s application in Chapter 11 thus remains unclear. However, it is absolutely clear that such application, if any, should be limited to the context of plans of reorganization which provide for deferred payments to creditors and interest holders."); Memorandum by the Official Committee of Unsecured Creditors of Mirant Corporation *et al.* Regarding *Till v. SCS Credit Corp.* (June 6, 2005) ("*Till* (which, itself is a plurality decision that contains vastly inconsistent language in the opinion) has no applicability to a solvency analysis conducted for an ongoing enterprise in Chapter 11 – and, indeed, by its own terms and logic, may not even be applicable for determining a cram down rate of interest in a corporate Chapter 11 case.").

[79] The court in *In re Highland Superstores*, a case involving a stream of future payments under a lease, gave an excellent hypothetical illustrating the absurdity of discounting fixed contractual damages based on the creditworthiness of the debtor:

> "[T]he Committee's position would turn existing principles of contract law on their head. Suppose a lessor of an apartment building leases identical apartments to Bill Gates, reputed to be the wealthiest person in the United States, and to a destitute individual. Assume both persons default under their leases on the same day and vacate the apartments. Further assume that the apartment owner cannot

is further improper because it would subject Kern River to double-discounting.[80]

62. The holding and rationale of *Kucin v. Devan* and the hypothetical from *In re Highland Superstores*, both of which are bankruptcy cases, demonstrate that: (1) Debtors' approach to the discount rate in this case is flawed; (2) Kern River's damages for its breach of contract claim should be discounted at a non-risk-adjusted rate (that excludes the risk of nonpayment by Debtors); and (3) the discount rate in this case cannot be based on the creditworthiness of Debtors.

63. Future streams of mitigation revenues that have been proven by Debtors in this case are to

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relet either apartment. The lessor thereafter sues both persons for breach of the lease, requesting actual damages. Under the traditional approach advanced by [the creditor] and hornbook contract law, the actual damages would be the same: both persons must pay the rent remaining on the lease term, reduced to present value using the rate at which the apartment owner can invest those funds to be placed in the same position as if both persons had performed the lease. The Committee's approach leads to a radically different result. Bill Gates's damages would be reduced to present value using an extremely low discount rate, reflecting the minimal risk that an individual possessing a large net worth would be unable to pay rent on an apartment; accordingly, the damages awarded against Gates would be quite high. In contrast, the award of damages against the destitute individual would be quite low because it would have been discounted at a very high rate, reflecting the higher nonpayment risk associated with that individual. Under basic contract law, however, the ability of a breaching promisor to pay does not affect the promisee's award of damages. While the lessor's ability to collect a judgment against Bill Gates would be greater, contract law does not distinguish between the two individuals in determining the value of the lessor's award of damages. In short, collectibility is simply not factored into the calculation of damages for breach of contract. *In re Highland Superstores*, 154 F.3d at 580 n. 9.

[80] *See Kucin v. Devan*, 251 B.R. 269, 270 (Bankr. D. Md. 2000). The court in *Kucin* expressly rejected Debtors' approach. In that case, certain former executives of a bankrupt company made claims under Deferred Compensation Agreements for benefits that were fixed at $100,000 per year for life commencing at age sixty-five, adjusted annually for increases in the cost-of-living. The expert for the Trustee asserted that "the value of the unfunded promise to make future retirement payments should have been discounted based on [the debtor's] creditworthiness, just as Debtors assert here. *Id.* at 273. The court flatly rejected this analysis, stating that the methodology of the Trustee's expert "completely ignores fundamental principles of contract law." *Id.* (*citing In re Highland Superstores*, 154 F.3d at 579-80). The court went on to conclude: "Here, the Executives expected to receive from [the debtor] their retirements benefits upon reaching the age of sixty-five (age sixty for Rice). Therefore, their claims for retirement benefits, discounted to present value, are a legal certainty and need not be further discounted for the risk of nonpayment. Otherwise, the risk of nonpayment would be accounted for twice since the Executives stand to receive only a fraction of their claims." *Id.* Likewise, here, Kern River would be subject to double-discounting if the Court were to apply Debtors' approach and further apply a percentage reduction to the payout of claims against the relevant Debtor, MAEM.

be discounted separately from Kern River's direct damages resulting from MAEM's breach of contract (exclusive of mitigation). The future streams of mitigation should be discounted at a rate equivalent to Kern River's weighted average cost of capital for the 2003 Expansion Project.

64. Future damages that are uncertain and unliquidated must be discounted on a risk-adjusted basis depending on the level of uncertainty and riskiness associated with the venture with which those damages are associated. The future stream of mitigation to Kern River's claim is uncertain and unliquidated and must therefore be discounted at a risk-adjusted rate that reflects the uncertainties associated with the business venture from which those potential revenue streams will be generated.[81]

65. Discounting Kern River's stream of potential mitigation using a weighted average cost of capital associated with the 2003 Expansion Project would properly account for the uncertainty associated with this revenue.

66. FERC allows Kern River to incorporate a weighted average cost of capital in its rates to shippers that is consistent with the risk in its regulated activities.[82]

67. The weighted average cost underlying Kern River's rates to shippers on its 2003 Expansion Project (which included MAEM) was 7.58%.[83] This weighted average cost of capital reflects

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[81] *See Energy Capital*, 302 F.3d 1314.

[82] *See* Exhibit KR-102 (Expert Report of J. Peter Williamson), at 16.

[83] *See id.* The weighted average cost of capital computation is (70% x 5.14%) + (30% x 13.25%) = 7.58%. This computation reflects Kern River's 5.14% cost of debt for the 2003 Expansion Project, as previously discussed, and Kern River's FERC-approved debt-equity ratio of 70/30 and return on equity of 13.25%.

the risks inherent in the relevant portion of Kern River's business and is a risk-adjusted (non-risk-free) rate. The Court determines that the potential future streams of mitigation that have been shown in this case should be discounted to present value at this annual rate, with discounting to be done on a month-by-month basis.[84] Discounting on this basis, the net present value, as of July 2005, of the actual and potential future mitigation stream shown by Kern River's expert Mr. Beach is approximately $31.1 million.

68. Kern River's allowed claim for damages is a net amount determined by subtracting the discounted potential future stream of mitigation from the discounted breach of contract damages (net of actual mitigation).[85] Determined on this basis, Kern River's allowed claim for damages is approximately $135.9 million.[86]

69. The Court makes as a further conclusion of law anything found here in as a fact that is a conclusion of law.

[84] Williamson Testimony (May 31, 2005 p.m. Transcript, at 70-72).

[85] *Id.*

[86] *See* Conclusions of Law 55 and 67 herein. If the Court adopts alternative Conclusions 56 through 60 rather than Kern River's primary Conclusions 48 through 55, so that the discount rate applied to Kern River's claim for breach of contract damages (exclusive of mitigation) is 5.14% rather than 4.25%, then Kern River's allowed claim for damages is approximately $128.6 million.

Dated: July 22, 2005

Respectfully submitted,

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ATTORNEYS FOR KERN RIVER GAS TRANSMISSION COMPANY

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 22nd day of July, 2005, he provided a true and correct copy of the foregoing to Debtors' counsel, Thomas E. Lauria and J. Christopher Shore, WHITE & CASE LLP, Wachovia Financial Center, 200 South Biscayne Blvd., Miami, FL 33131, via email as follows: tlauria@whitecase.com and cshore@whitecase.com and Robin Phelan and Stephen M. Pezanosky, HAYNES AND BOONE, LLP, 901 Main Street, Suite 3100, Dallas, Texas 75202 via email as follows: stephen.pezanosky@haynesboone.com and robin.phelan@haynesboone.com and to Craig H. Averch, Dan Woods, Susan Chandler and Elizabeth Kim, WHITE & CASE LLP, 633 West Fifth Street, Los Angeles, CA 90071-2007 via email as follows: caverch@whitecase.com, dwoods@whitecase.com, schandler@whitecase.com and ekim@whitecase.com, and Counsel to the Official Committee of Unsecured Creditors of Mirant Corporation, et al, Monica S. Blacker, Andrews Kurth LLP, 1717 Main Street, Suite 3700, Dallas, Texas 75201 via e-mail at monicablacker@andrewskurth.com.

/s/ Craig Tadlock
Craig Tadlock

Table 3 (amended 5/30/2005)

Calculation of Damages for Mirant's Rejection of its Contract with Kern River Pipeline

Year	Kern Value *$/MMBtu*	Mirant Quantity *MDth*	Mitigation *$000*	Reservation *$000*	Damages *$000*
2003	$0.00	1,260	$0	$511	$511
2004	$0.07	19,260	$1,392	$14,635	$13,243
2005	$0.08	19,260	$1,499	$14,635	$13,135
2006	$0.09	19,260	$1,825	$14,635	$12,809
2007	$0.11	19,260	$2,178	$14,635	$12,456
2008	$0.01	19,260	$138	$14,635	$14,497
2009	$0.05	19,260	$983	$14,635	$13,652
2010	$0.09	19,260	$1,827	$14,635	$12,808
2011	$0.14	19,260	$2,671	$14,635	$11,964
2012	$0.18	19,260	$3,515	$14,635	$11,120
2013	$0.23	19,260	$4,359	$14,635	$10,275
2014	$0.27	19,260	$5,204	$14,635	$9,431
2015	$0.31	19,260	$6,048	$14,635	$8,587
2016	$0.36	24,750	$8,856	$14,635	$5,779
2017	$0.40	32,850	$13,195	$14,635	$1,440
2018	$0.45	10,800	$4,811	$4,811	$0
Total	$0.19	18,799	$58,502	$210,211	$151,708

Changes:

1. Corrected leap year rates; total reservation charges match proof of claim.
2. 2016 mitigation reflects end of MFN restrictions on September 30, 2016.
3. Analysis now uses IT fuel rate (1.95% based on 2004 actuals).

EXHIBIT
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