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ATTORNEYS FOR THE DEBTORS AND DEBTORS-IN-POSSESSION

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.	)	
	)	

DEBTORS MIRANT CORPORATION'S AND MIRANT AMERICAS ENERGY MARKETING, LP'S AMENDED PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

Mirant Corporation and Mirant Americas Energy Marketing, LP (collectively, "Debtors"), as debtors-in-possession, pursuant to Federal Rule of Civil Procedure 52 and Local Rule 52.1 of this Court, respectfully submit the following amended proposed findings of fact and conclusions of law.

This action came on regularly for trial commencing May 16, 2005, the Honorable D. Michael Lynn, Bankruptcy Court Judge, presiding. Claimant Kern River Gas Transmission Company appeared through its counsel of record Elrod PLLC by David W. Elrod, Esq. and Craig Tadlock, Esq. Debtors appeared through their counsel of record White & Case LLP by Dan

Woods, Esq. and Ron Gorsich, Esq. and Forshey & Prostok LLP by Jeff Prostok, Esq. The issues were duly tried in accordance with the Federal Rules of Bankruptcy Procedure. The Court having considered all the evidence admitted and the cause having been submitted for decision, the Court hereby makes Findings of Fact and Conclusions of Law as follows:

I. FINDINGS OF FACT

A. Parties and Procedural History

1. Mirant Corporation and its subsidiaries, including Mirant Americas Energy Marketing, LP ("MAEM"), comprise a competitive energy concern that generates and sells electricity in North America, the Philippines and the Caribbean and produces, sells and delivers energy products to various governmental and private entities. Mirant Corporation is a Delaware corporation. MAEM is a Delaware limited partnership.

2. Kern River Gas Transmission Company ("Kern River") is a Texas general partnership owned by subsidiaries of MidAmerican Energy Holdings Company, an Iowa corporation. Kern River constructed, owns and operates a natural gas pipeline transmission system extending from Opal, Wyoming to Kern County, California.

3. MAEM and Kern River are parties to a Firm Transportation Service Agreement dated May 29, 2001, as subsequently amended on July 23, 2001 and on April 5, 2002 (collectively, the "Kern River Agreement"). Debtors' Exhibits 24-26.

4. Under the Kern River Agreement, Kern River agreed to provide pipeline capacity for the transportation of natural gas and was obligated to transport a maximum quantity of 90,000 Dth of natural gas per day – 12,897 Dth per day to the interconnection of the Kern River pipeline with the SoCal Gas pipeline at Wheeler Ridge, California, and 77,103 Dth per day to the interconnection of the Kern River pipeline with the PG&E Pipeline at Daggett, California. The term of the Kern River Agreement was for 15 years. It is scheduled to expire April 30, 2018. MAEM agreed to pay a reservation charge in accordance with Kern River's tariff of more than

$14 million per year for the capacity and an additional fuel charge for any gas shipped on the pipeline. The reservation charge is $0.4455 per Dth per day ($0.4443 in leap years).

5. MAEM required the capacity in order to provide natural gas to its planned Apex I and II power plants in Nevada. Apex I is in operation today. Apex II was never built.

6. On July 14, 2003, Debtors, including MAEM, filed voluntary petitions for relief under chapter 11 of the United States Bankruptcy Code, 11 U.S.C. Section 101, *et seq.* Debtors manage and operate their businesses as debtors-in-possession.

7. On December 4, 2003, Debtors moved to reject the Kern River Agreement. Kern River did not oppose the motion. On December 18, 2003, the Kern River Agreement was deemed rejected. MAEM continued to utilize the capacity under the Kern River Agreement and paid all amounts due under the Kern River Agreement through the date of rejection.

8. On December 15, 2003, Kern River filed Proof of Claim No. 6693. The Court expunged that proof of claim. On January 13, 2004, Kern River filed Proof of Claim No. 7573. On October 13, 2004, MAEM filed an objection to that proof of claim. On November 11, 2004, Kern River filed Proof of Claim No. 8121 (the "claim"), amending Proof of Claim No. 7573.

9. On February 4, 2005, MAEM filed an Amended and Restated Objection to the claim.

10. In its claim, Kern River seeks $210,210,543, the amount it would have been paid for the reservation charges under the Kern River Agreement from the date of rejection to the end of the contract term on April 30, 2018. Kern River also asserts that it has been able to mitigate its damages by $1,391,968, reducing its claim to $208,818,575. Kern River reduced that amount to present value using a 4.22% discount rate, leaving a claim of $153,641,087.

11. MAEM's obligations under the Kern River Agreement were secured by two letters of credit in the amount of $14,751,589. Kern River drew on the letters of credit and applied the cash security toward the alleged amounts owed to it, thereby reducing its claim to $138,889,498.

B. <u>Mitigation Issues</u>

12. The person in charge of marketing the former MAEM capacity, Kern River's Manager of Business and Development Greg Snow, never appeared at trial.

13. Kirk Morgan, Kern River's Vice-President of Marketing and Regulatory Affairs, was designated by Kern River as its most knowledgeable person on mitigation efforts. Mr. Morgan was on another assignment from January through May 2004 and was not involved on a day-to-day basis in marketing the MAEM capacity. The person who took his job during that time, John Smith, testified that he was not involved in marketing the MAEM capacity because he was tied up with Kern River's rate case filed before the Federal Energy Regulatory Commission ("FERC").

14. Kern River failed to take active steps to mitigate its damages by selling the MAEM capacity as firm transportation. Once the Kern River Agreement was rejected, Kern River posted the capacity as awardable firm transportation on its electronic bulletin board accessible on Kern River's internet website. Debtors' Exhibits 59, 68, 140, and 142. FERC regulations require that a pipeline post its available firm transportation. Although Kern River posted the MAEM capacity on its electronic bulletin board, it established minimum threshold rates that were artificially high, well above market rate, and at first undisclosed to potential purchasers. Debtors' Exhibits 34, 35 and 139.

15. Mr. Morgan testified that the factors Kern River considered in setting the minimum threshold rates included FERC rate case considerations, pipeline expansion considerations and considerations relating to most favored nations provisions in Kern River's contracts with certain shippers.

16. Mr. Morgan testified that Kern River did not disclose the minimum threshold rates because it was trying to determine the market rates and was afraid that disclosure might discourage shippers from bidding higher than those rates. However, Mr. Morgan also admitted that the minimum threshold rates were above market rates.

17. In response to postings from December 2003 through May 2004, Kern River received numerous bids for all or part of the MAEM capacity. Debtors' Exhibits 2-5, 56-58, 60-67 and 69-71. These bids were valued at various amounts. One bid from BP Energy Company for a period of several years was valued at $28 million. Debtors' Exhibit 60. Kern River rejected all bids in response to the postings except one short-term bid valued at $522,220. Debtors' Exhibits 2-5, 68 and 69.

18. Mr. Morgan testified that when Kern River received bids to purchase the MAEM capacity as firm capacity, it did not inform MAEM about those bids. Kern River, for example, failed to inform MAEM that Sempra Energy Trading Corporation had submitted a bid for the MAEM capacity for approximately $.31 per Dth for a period of several years. Debtors' Exhibit 61.

19. In excerpts from her deposition testimony submitted to the Court, Kern River executive and marketing manager Lynn Dahlberg testified that, if a potential customer inquired about available capacity, Kern River would mention the MAEM capacity, along with capacity available from several other shippers. In presentations to utilities about Kern River's system, Kern River would mention the available MAEM capacity. She admitted that this was the extent of Kern River's active efforts to mitigate its damages by reselling the MAEM capacity. Deposition of Lynn Dahlberg, pp. 123-25.

20. Mr. Morgan testified that he had no more information about any efforts by Kern River to mitigate its damages.

21. Sales of the MAEM capacity as firm transportation would have allowed Kern River to recoup at least 54.3% of its loss. MAEM expert witness Dr. Jeff Makholm, an economist specializing in the energy field and an expert on pipeline capacity issues, testified how Kern River could have sold the MAEM capacity as firm transportation in the secondary market for pipeline capacity and recouped 54.3% of the Kern River Agreement contract price. Debtors' Exhibits 146 and 147, pp. 3 and 8.

22. Dr. Makholm explained in his reports and testified regarding the following: the secondary gas transportation markets refer to the sale of capacity not by pipeline owners themselves, but by those shippers who hold contractual rights to resell, or release, capacity. FERC created a formal secondary market in transportation capacity as a means to increase efficiency in the gas transportation industry and, through regulatory oversight, fosters the fair and efficient operation of the market. The secondary market is genuinely competitive. It supports a robust market in pipeline capacity. The resale of capacity in the secondary markets is at whatever price the market will bear. The drivers of secondary market capacity prices are the expected differences in prices between gas available in the production basins and the major gas consumption centers. Debtors' Exhibit 146, pp. 1-10.

23. Dr. Makholm used the "comparable sales" method to value the long-term services reflected in the Kern River Agreement. This is the most direct indicator of market value of capacity in the secondary markets. FERC requires the electronic posting of released capacity data. Comparable sales data for long-term pipeline capacity is available on the electronic bulletin boards of pipeline companies throughout the country. Dr. Makholm selected sales data from Kern River's own website regarding arms length release transactions for capacity on Kern River's pipeline. Each transaction selected must reflect a permanent release with a contract term greater than five years, and must have taken place between July 14, 2003 and November 11, 2004. Taking into account various up-front discounts and the difference between "vintage" and "expansion" capacity on the Kern River pipeline and using an assumed 10% interest rate, he calculated the average price of long-term release capacity on Kern River's pipeline to be $.2418 per Dth/d. This is 54.3% of the FERC maximum rate for the MAEM capacity of $.4455 per Dth/d, which was effective at the time MAEM rejected the contract. Debtors' Exhibits 146, pp. 11-16; 147, pp. 3 and 8.

24. Dr. Makholm's opinion is corroborated by a report dated April 28, 2003 prepared by Pace Global Energy Services at the request of Kern River and by independent government

studies. Debtors' Exhibit 20 and 146, pp. 16-21. Kern River's claim must be reduced by at least 54.3%, or $114,144,324, the value of the MAEM capacity as of the rejection date.

25. The testimony of Kern River expert witness R. Thomas Beach regarding the value of the MAEM capacity was not credible. Mr. Beach admitted several errors in his valuation and changed his testimony twice concerning the proper amount of mitigation. His testimony was based on many flawed assumptions and on incomplete and inadequate work.

26. Mr. Beach's initial opinion was that Kern River would be able to mitigate only $53.8 million of its damages. That figure was based in part on the existence of most favored nations ("MFN") provisions in some of Kern River's contracts with its shippers. He later increased that amount by $1,976,000 due to his miscalculation of the date on which the MFN clauses would no longer apply. Mr. Beach also admitted during the second day of his trial testimony that he had made an error in his fuel rate assumption that resulted in an increase in his calculation of the amount of mitigation by $3 million. As a result of these errors, Mr. Beach's estimate of the amount of mitigation rose to $58,502,000. Even as corrected, this is not the correct amount of mitigation.

27. Mr. Beach has never previously testified about the value of pipeline capacity, the issue of lost volume, or the effect of MFN provisions and has no economic expertise. He reviewed very few documents in preparing his report and testimony. His testimony is based largely on statements and documents he received from Kern River and its counsel. He drafted his report under the constraint of a very small budget of $11,000, which only allowed him to work 40 hours on the project.

28. Mr. Beach's testimony is based on a number of unreliable assumptions. First, he assumed the date of the valuation should be March 2005, whereas the proper date on which to value the Kern River Agreement is the date of rejection. Second, the supply and demand information in Mr. Beach's report and testimony is incorrect and incomplete because it relies on biased views of market participants such as the California gas utilities and addresses California only and not the other relevant states like Arizona and Nevada. Third, Mr. Beach assumed that

the MFN provisions preclude the sale of the MAEM capacity as firm transportation. He accepted this based on what he was told by Kern River and its counsel. He is not an expert on this issue and his testimony concerning this must be disregarded. On the first day of his testimony, he testified that he spent several hours reviewing the MFN agreements on April 1, 2005; however, his invoice for work on that date, which was produced for the first time by Kern River between the first and second days of his testimony, did not show that review. Debtors' Exhibit 158. Kern River did not provide Mr. Beach with the amendments and waivers to the MFN contracts and never discussed the waivers with him. Fourth, Mr. Beach assumed that the constraint on capacity going to Wheeler Ridge would continue to 2008 to the same extent that it exists today. This is an unreliable assumption because Kern River did not provide him with information about steps being taken to alleviate that constraint, including Debtors' Exhibits 38 through 41. Fifth, Mr. Beach assumed that a liquefied natural gas terminal would be up and running by 2008. This assumption was based on information contained exclusively in Kern River Exhibit 93, which is a report from the California Energy Commission ("CEC") dated February 2, 2005, and on Mr. Beach's opinion that the Costa Azul LNG project was the front runner and likely to be in operation by 2008. The information in Exhibit 93 is outdated and was later updated by the CEC as of May 5, 2005 to state that Costa Azul is not likely to be completed until the end of 2008. Debtors' Exhibit 157, p. 2. Mr. Beach admitted that the information in Exhibit 157 "could cause one to reevaluate" his testimony concerning when the first LNG project will begin operating. Mr. Beach was also not provided with information showing Kern River's view on the likelihood of LNG becoming operational, such as Debtors' Exhibit 21, pages 11, 20 and 34, which states that LNG supplies may have a role but are uncertain due to risks involving licensing, scheduling, construction costs, politics, safety, environmental concerns and related infrastructure. Mr. Beach testified that he disagrees with Kern River's position as stated in that Exhibit. Sixth, Mr. Beach assumed for purposes of his report and testimony that Kern River is a lost volume seller and that resale of the MAEM capacity should be treated as last-through-the-meter. This assumption is undermined by Mr. Beach's own e-mail to Kern River counsel, in

which he suggests that from an economic standpoint, the MAEM capacity should be treated as first-through-the-meter. Debtors' Exhibit 42. Because of the flawed assumptions underlying Mr. Beach's testimony, his testimony about the value of the MAEM capacity is unreliable.

29. Mr. Beach's testimony that the value of the MAEM capacity in 2004 was $.07 per Dth/d is wrong. He did not see the 2004 Kern River website postings, the bids received by Kern River in 2004, or the actual prices at which Kern River sold capacity as interruptible transportation in 2004. As shown on Debtors' Exhibit 127, the prices for interruptible transportation in 2004 ranged from $.13 to $.26 per Dth depending on the month. As a result, Mr. Beach agreed on cross-examination that the $.07 is not a correct price for 2004.

30. Mr. Beach's testimony about near term capacity prices in 2005 to 2007, in which he first opined that prices will be $.04, $.06 and $.08 per Dth, is wrong. His assumption that a $.16 per Dth differential existed between Rocky Mountain natural gas prices at Daggett and prices into the SoCal Gas System at Topac is speculative, as it is based only on a two-year average where one of the years – 2003 – was unusual. Also, his testimony regarding this subject is in conflict with and inconsistent with Kern River's projections for those years in the FERC rate case. Debtors' Exhibit 127.

31. Mr. Beach's testimony that the value of the MAEM capacity in 2008 will be $.0 per Dth/d is wrong because he incorrectly assumed the presence of an operating LNG terminal beginning in that year.

32. Mr. Beach's testimony regarding the value of the MAEM capacity in 2009 through 2018 is wrong. His calculations were simply a linear calculation beginning at $.04 and ending at $.4455 per Dth. He incorrectly used the $.4455 rate as the rate that was to reflect the full value of the capacity; however, in 2004 the rate rose to $.5266 per Dth/d. He assumed that there will be no inflation or further increase in the value of capacity for the next 14 years.

33. Prior to constructing its pipeline, Kern River entered into long term firm capacity contracts with certain shippers known as the "vintage" shippers. Six of the contracts with vintage shippers with MFN clauses were received in evidence. Kern River's Exhibits: KR-67,

pp KR001006-1007 and KR001015-1016; KR-69, pp. KR001239-1240; KR-72, pp. KR001418-1419 and KR001421-1422; KR-74, pp. KR001492-1493; KR-76, pp. KR002179-2180; KR-78, pp. KR002365-2366. Kern River claims that it cannot sell capacity on its pipeline at a discount rate or amount lower than that set forth in the MFN clauses without breaching its vintage shipper contracts containing the MFN clauses.

34. Mr. Morgan, who was designated as Kern River's person most knowledgeable on the application of the MFN provisions, testified that he and others at Kern River did not take any actual steps to analyze the effect of the MFN provisions but simply assumed that the provisions precluded the sale of the MAEM capacity as firm transportation. They did not look at the contracts or analyze the potential impact of any of the provisions on any particular bid for the MAEM capacity. Mr. Morgan relied on his recollection of his 1996 review of a summary of the clauses prepared in the 1990s by an in-house lawyer at another company.

35. The MFN provisions contained in Kern River's contracts with the vintage shippers do not restrict the sale of the MAEM capacity. None of them apply to a sale after September 2016. With one exception, the provisions only restrict sales of transportation to Kern County, California. Kern River's Exhibit 74, p. KR001493. Kern River received but rejected bids for delivery points outside Kern County.

36. Mr. Beach admitted during cross-examination that the MFN provisions would not be triggered by a sale of the MAEM capacity for delivery in Utah or Nevada and that if an MFN contract had a Wheeler Ridge, California delivery point, a sale of the MAEM capacity for delivery to Daggett, California would present a "gray area" regarding the application of the MFN clause.

37. Dr. Makholm explained that well known economic principles provide that MFN clauses are included in contracts to enhance the value of what is being sold. He explained that sellers enhance the value of their products by offering these provisions and that pipelines often include such provisions in order to enhance the marketability of contracts and new pipeline ventures.

38. Dr. Makholm further explained that Kern River received a benefit by placing MFN provisions in the contracts at the inception of the pipeline and took on the risks associated with that benefit. Kern River therefore must bear the risk it accepted by putting MFN provisions in its contracts, and cannot transfer the risk of the MFN provisions to MAEM which received no benefit from their inclusion in the original contacts.

39. Even if the MFN provisions do apply, Kern River did nothing to obtain waivers from any affected shipper. Kern River had on many previous occasions obtained waivers of the MFN provisions from its shippers. For example, Union Pacific previously agreed to waive its MFN provision in exchange for $0.01 per Mcf delivered into California. Debtors' Exhibits 72-80, 82-91 and 156. Ms. Dahlberg admitted that Kern River never contacted any shipper about a waiver for the potential resale of the MAEM capacity and could give no explanation for this failure. Deposition of Lynn Dahlberg, pp. 122-126.

40. In excerpts from their deposition testimony submitted to the Court, representatives of the Los Angeles Department of Water and Power and Aera Energy Inc., two Kern River shippers that have contracts containing MFN clauses, testified that since July 11, 2003 no one from Kern River requested that they waive the MFN clauses. Both also testified that they would have considered such a waiver if Kern River had asked. Deposition of Robert Pettinato p. 32; deposition of Harold Orndorff pp 39-41.

41. Dr. Makholm explained that given the context of the ongoing rate case, Kern River has a distinct incentive to shade information to minimize the sales volumes and maximize their costs. The primary goal for shippers, however, is to come out of the rate case with the lowest rates possible. Thus, the rate case may explain why Kern River failed to attempt to get releases of the MFN provisions to sell the MAEM capacity and why shippers would have been likely to agree to such waivers if they believed it would lead to a lower overall rate.

42. When it posted the MAEM capacity for sale, Kern River set the minimum threshold prices higher than it needed to in order to avoid triggering the MFN clauses. Debtors' Exhibits 34, 35 and 139.

43. John Hogan, MAEM's Director of Gas and Fuel Procurement, testified that Kern River never informed MAEM about any of the bids it received for the MAEM capacity. Kern River, for example, failed to inform MAEM that Sempra Energy had submitted a bid for the MAEM capacity for a period of several years. Debtors' Exhibit 61. Mr. Hogan also stated that if Kern River had informed MAEM about the bids it received, MAEM could have entered into release agreements with those shippers. Such release agreements would not have triggered any MFN clauses.

44. Kern River failed to take active steps to mitigate its damages by selling the MAEM capacity in short-term transactions or as interruptible transportation. These sales would have further reduced Kern River's loss.

45. Kern River has made several admissions concerning mitigation it could achieve from sales of the MAEM capacity as short-term or interruptible transportation. In her testimony in the FERC rate case submitted April 30, 2004, Ms. Dahlberg estimated that Kern River would receive $6,100,512 from the sale of the MAEM capacity as interruptible capacity in the 12 months ending October 1, 2004. She calculated this using a rate of $.255 per Dth/d. Debtors' Exhibit 14, pp. 13-14.

46. In his testimony in the FERC rate case submitted April 30, 2004, Kern River executive Bruce Warner testified that Kern River would derive $6,788,438 from the sale of the MAEM capacity during the 12 months ending October 1, 2004. Debtors' Exhibit 16, pp. 14-15 and Schedule G-2.

47. In his testimony in the FERC rate case submitted April 30, 2004, John Smith, Kern River's Director of Regulatory and Governmental Affairs, testified that the expected amount of mitigation of the Kern River Agreement would be less than 50%. Debtors' Exhibit 19, p. 20.

48. In the fourth quarter of 2004, Kern River reported to its parent company MidAmerican Energy Holdings Company that the amount of revenue Kern River would derive

from the sale of interruptible transportation in 2004 was $6.6 million that would partially mitigate MAEM's default. Debtors' Exhibit 12, p. 3.

49. Using the $6.6 million figure for 14.3 years of the remaining term of the contract yields $94.3 million. This amount must be increased by $7.7 million for the final year of the contract in which the MFN provisions would not prohibit full mitigation. Therefore, based on Kern River's admissions in the FERC rate case and its admissions to its parent company, total mitigation should equal $102.8 million.

50. In rebuttal testimony in the FERC rate case submitted in March 2005, Ms. Dahlberg testified that Kern River had actually derived revenue of $5,185,055 from the sale of the MAEM capacity from the date of rejection through October 1, 2004. Debtors' Exhibit 15, ex. KR-90.

51. On June 2, 2005, Mr. Smith testified that the actual mitigation of the MAEM capacity for the 12-month period ending October 1, 2004 was 38%.

52. Kern River has not included all of its mitigation in calculating its claim. Kern River mitigated its damages by $5,185,055 through the 12 months ending October 31, 2004 by selling the MAEM capacity in short-term transactions or as interruptible transportation. Over the life of the Kern River Agreement, Kern River could mitigate its damages by sale of interruptible transportation in the amount of at least $74,145,500, even assuming that the price of interruptible transportation does not increase over the next 14 years.

53. Kern River has not included in the calculation of its claim mitigation from sales of interruptible transportation to MAEM for use at the Apex power plant during the period of July 2003 through the present.

54. The total cost of the capacity used to deliver gas to Apex should be applied to mitigate Kern River's damages. Mr. Hogan testified that after the rejection date, MAEM continued to need natural gas to fuel its Apex power plant. He stated that MAEM attempted to purchase firm capacity for the summer of 2004 from Kern River, but Kern River refused.

55. Mr. Hogan further testified that from December 2003 through November 2004, MAEM purchased interruptible transportation from Kern River to supply its Apex plant. The amount MAEM paid to Kern River for interruptible capacity during this period was approximately $1,800,000. Debtors' Exhibit 152.

56. In December 2004, Kern River changed its pricing policy and raised the price of interruptible transportation purchased by MAEM for Apex from $.20 to $.52 per Dth/d. Debtors' Exhibit 120, pp. 19-20, 32-33 and 85-86. Mr. Hogan testified that the new price was above the market rate and that Kern River's strategy was to force MAEM to pay higher rates. At the same time, Kern River continued with much lower interruptible transportation rates to other shippers. Debtors' Exhibits 120-124.

57. The December 3, 2004 Results Report, a weekly report prepared for Mr. Morgan, reported that there was a 41% shift of firm transportation sales to interruptible transportation sales at Apex. The report explained that MAEM could not get anyone to sell it firm capacity because of its financial difficulties and therefore had to use its interruptible transportation agreement at the $.52 rate. The paragraph referring to this result was entitled "FYI" and used the exclamation: "The strategy is working !!!" Debtors' Exhibit 9, p. 11.

58. Mr. Hogan testified that Kern River's new policy forced MAEM to purchase capacity released by other shippers and to purchase delivered gas, which includes a built in capacity charge, from other sources at prices higher than MAEM had been paying to Kern River.

59. Mr. Hogan testified that MAEM would have continued to purchase interruptible capacity directly from Kern River if the rate had not been set so high. MAEM paid approximately $1,900,000 for interruptible capacity in 2004, and the amount paid would have increased each year throughout the contract as the value of the capacity went up over time.

60. Mr. Hogan explained that the alternate released capacity as well as capacity utilized by the purchase of delivered gas was on Kern River's pipeline and Kern River received payment for MAEM's use of the capacity. Thus, Kern River received payment for the capacity

while forcing MAEM to pay higher rates. The amount MAEM paid to the other shippers for the released capacity was $1,990,500. Debtors' Exhibit 153.

61. Mr. Hogan testified that the Kern River pipeline is the only means through which natural gas can be transported to Apex. Apex is continuing in operation and will continue each year to use capacity on the Kern River pipeline.

62. Kern River valued the sales of MAEM capacity as interruptible transportation on a "last-through-the-meter" basis and claimed a total of $879,942 in mitigation from such sales through February 28, 2005. Kern River's Exhibit 81. Kern River's purported justification for not counting all of the revenue from the sale of the MAEM capacity is that it is a lost volume seller. It was not appropriate for the sales of MAEM capacity as interruptible transportation to be calculated as "last through the meter."

63. Kern River does not meet the criteria required to be a lost volume seller. Kern River does not have the unlimited resources or production capacity to be able to enter into multiple new contracts regardless of MAEM's rejection of the Kern River Agreement. Prior to and after rejection of the Kern River Agreement, Kern River's pipeline was subscribed at near full firm capacity. Mr. Beach's testimony that Kern River can mitigate at least $58.5 million in damages from sale of the MAEM capacity as interruptible transportation alone demonstrates that Kern River cannot be treated as having unlimited supply and is not a lost volume seller.

64. Mr. Beach's e-mail to Kern River counsel indicated that he did not believe Kern River qualified as a lost volume seller. He only assumed that as a fact after Kern River's lawyers told him to. Debtors' Exhibit 42.

65. The MAEM capacity, when sold as interruptible transportation, provides superior service to customers as compared to standard interruptible service. The MAEM capacity was part of the certificated capacity of Kern River's pipeline, which totals 1,755,000 Dth per day. The capacity was always there for Kern River to sell as interruptible capacity. Unlike other firm capacity that might be sold as interruptible, the MAEM capacity cannot be bumped. Because the MAEM capacity is the only capacity on Kern River's system that is not subscribed on a firm

basis, it is the only capacity that can be sold on an interruptible basis without the purchaser having to worry that the firm service shipper may call up its capacity and stop the purchaser from using it. This means it is the best interruptible capacity available and the most likely to be used. As such it should be treated as the first through the meter, not the last.

66. Sales of MAEM capacity after rejection of the Kern River Contract were substitute, replacement sales, not new independent sales that would have occurred regardless of MAEM's rejection. MAEM's rejection of the Kern River Agreement created the opportunity for Kern River to market the rejected capacity as interruptible capacity. All of this capacity purchased by Debtors was on the Kern River pipeline and could not have been used simultaneously with MAEM's retention of its firm capacity. Ms. Dahlberg in her direct testimony in the FERC rate case testified that the Kern River's pipeline utilization before and after rejection of the Kern River Agreement was nearly the same. She stated that for the period of May 2003 through February 2004, there was 97% utilization of the pipeline capacity by one group of Kern River shippers representing 48% of the pipeline's entire capacity and 85.5% utilization of capacity for the 2003 expansion shippers. Debtors' Exhibit 14, p. 11. This shows that all subsequent sales of the MAEM capacity are substitute, replacement sales rather than new independent sales that would have occurred regardless of MAEM's rejection.

67. Mr. Morgan testified that if MAEM elects to fuel Apex using the firm capacity release of a Kern River shipper or through a delivered gas deal that utilizes the firm capacity of a Kern River shipper, that means the shipper is not providing service to another market and Kern River has the opportunity to sell interruptible capacity in that other market. This also shows that subsequent sales of the MAEM capacity are substitute, replacement sales.

68. When other shippers make their firm capacity available for sale as interruptible capacity, Kern River is paid twice for the capacity because Kern River gets paid once for the reservation charge in the contract and again for the amount for the unused firm transportation sold as interruptible transportation.

69. Kern River is in a very specialized limited market with a known demand and supply among a select group of purchasers. The usage of capacity on the Kern River system remained the same both before and after MAEM's rejection of the agreement. Kern River has not shown any reason why it should not be required to reduce its damages to reflect mitigation.

70. Kern River has taken a position in its FERC rate case inconsistent with the position that it is a lost volume seller. In rebuttal testimony in the FERC rate case, Ms. Dahlberg testified that the MAEM capacity would be treated as first through the meter. Debtors' Exhibit 15, pp. 12-14. In its report to its parent company in the fourth quarter of 2004, Kern River's statement that it would derive $6.6 million from the sale of the MAEM capacity as interruptible transportation in 2004 was based on the assumption that the MAEM capacity would be treated as first through the meter. Debtors' Exhibit 12, p. 3. Kern River reversed its position in the instant case claiming that MAEM's capacity should be treated as last through the meter in determining its claim against MAEM. This change in position resulted in a disadvantage to MAEM and a benefit to Kern River.

71. Kern River assumes that it will be a lost volume seller until 2018 when the Kern River Agreement expires. This assumption is contrary to Kern River's own optimistic projections that it will expand its pipeline capacity to meet growth in demand. Debtors' Exhibits 21, p. KR019013; 98; 130, pp. KR003153-3154; 131, p. KR003161; 132, pp. KR035154, 035165; 151, pp. KR025754-25755.

72. The gas MAEM purchased to supply the Apex power plant following rejection of the Kern River Agreement necessarily traveled over the Kern River pipeline, and sales of capacity representing the volume of gas delivered could not have occurred simultaneously with MAEM's retention of its firm capacity. Therefore, the capacity used to deliver gas to Apex demonstrates that Kern River does not qualify as a lost volume seller.

73. Kern River's allegation that the MAEM capacity going to Daggett, California is difficult to market is unreliable. Opportunities exist to resell the MAEM capacity with delivery point to Daggett or at points upstream from Daggett in Nevada. Debtors' Exhibits 38-41.

74. Mr. Hogan testified that constrictions on delivery of gas to Daggett will improve in the near future because of new projects and changes in the market.

75. Kern River failed to meet its obligation to use reasonable, active efforts to mitigate its damages.

C. Kern River's FERC Rate Case

76. Kern River is regulated by the Federal Energy Regulatory Commission ("FERC").

77. On April 30, 2004, Kern River filed a rate case before FERC, docket no. RP-04-274. Among other proposals, Kern River proposed that FERC approve a rate increase for shippers on Kern River's pipeline. Kern River claimed that it had experienced an increase in its cost of service by $40.1 million, that a $43 million increase was used for rate design of transportation rates, and that the overall cost of service was $347.4 million, and proposed an increase in Kern River's return on equity investment from 13.25% to 15.1%. Debtors' Exhibit 151, pp. 37-39. The calculation of Kern River's proposals was based in part on the losses Kern River sustained as a result of the rejection of the Kern River Agreement. Some shipper intervenors proposed other methods by which Kern River can recover its costs of service. An initial decision on the rate case is expected in November 2005.

78. Kern River gave FERC six reasons for its proposed increase in return on equity. In his rebuttal testimony to FERC, Mr. Smith testified that these six factors summarized Kern River's entire case about the risks justifying the requested return on equity. Debtors' Exhibit 29, pp. 21-22. Three of the six reasons relate to MAEM. One of the reasons was MAEM's rejection of the Kern River Agreement. Another was Kern River's inability to remarket the MAEM capacity. A third reason was the deterioration of the creditworthiness of Kern River's shippers. There are numerous references to MAEM throughout the testimony of the Kern River witnesses submitted to FERC. Debtors' Exhibits 14, pp. 13, 14 and 20; 15, pp. 12-15; 16, pp. 12-15; 17, pp. 5 and 43-47; 19, pp. 18-20.

79. Mr. Smith testified that Kern River's proposal to increase its return on equity to 15.1% would add $6 million per point to Kern River's revenue, or $11.1 million per year. While Kern River had to file the FERC rate case in 2004, Kern River decided what increase to request and decided how to treat the MAEM capacity in the rate case. Kern River treated the MAEM capacity in the rate case as it did because it was optimistic about its ability to remarket the MAEM capacity through an open season for its next expansion project.

80. Mr. Smith testified that in the FERC rate case Kern River is seeking to recover its total cost of service of $347 million, which includes the entire cost of service for the Kern River Agreement. If Kern River recovers that amount, it will have recovered 100% of its losses due to MAEM's rejection of the agreement.

81. Kern River executives have made numerous optimistic statements about the likely outcome of the FERC rate case. Debtors' Exhibits 10, p. 4; 11, pp. 5-6; and 23, p. 1.

82. FERC will allow Kern River to recover all or part of its costs associated with the loss of the Kern River Agreement.

83. MAEM expert witness Robert Kilmer explained the proposal Kern River made to FERC in its FERC rate case. Kern River proposed that FERC approve rate changes that would allow Kern River to increase its return on equity investment from 13.25% to 15.1%. Kern River also proposed to include the 90,000 Dth/d from the Kern River Agreement in the billing determinants for rate design. This would result in Kern River assuming the risk of loss for the MAEM capacity rather than passing the risk on to its other shippers. Kern River further proposed that it would retain the revenue from the sale of the first 90,000 Dth/d of interruptible transportation rather than sharing it with its shippers. Debtors' Exhibit 150.

84. Mr. Kilmer further explained that in the FERC rate case, BP Energy, one of the intervenors, proposed, among other things, that the 90,000 Dth/d be excluded from the billing determinants for rate design for the 2003 Expansion shippers and that the revenue derived from the sales of the MAEM capacity as interruptible transportation would not be retained by Kern River. Adoption of this proposal would result in other shippers assuming the risk of the loss of

the MAEM capacity. Mr. Kilmer testified that if FERC adopts BP Energy's proposal, Kern River would recover its entire costs for the MAEM capacity. Debtors' Exhibit 150.

85. Mr. Kilmer testified that FERC will provide Kern River with the ability to recover all or a portion of its costs through the FERC rate case. He stated that FERC could allow Kern River to recover its entire costs related to the MAEM capacity by several means. First, FERC could approve a combination of some or all of Kern River's proposals. Second, FERC could also adopt the proposal made by BP Energy and order that the MAEM capacity of 90,000 Dth/d be excluded from the design determinants. Debtors' Exhibit 150.

86. Mr. Smith testified that Kern River believes the BP Energy proposal is acceptable as long as it is calculated correctly. In his rebuttal testimony in the FERC rate case, Mr. Warner testified that the BP Energy proposal would be acceptable if calculated correctly. Debtors' Exhibit 17, pp. 44-46.

87. In his rebuttal testimony to FERC, Mr. Warner admitted that Kern River is seeking a double recovery. He testified that in the event Kern River receives an award of damages from the MAEM bankruptcy estate, it is agreeable to giving those proceeds to the shippers whose rates are increased by virtue of removing the billing determinants from rate design. Debtors' Exhibit 17, p. 45.

88. Kern River will be permitted by FERC to increase its rates to offset its claimed loss due to MAEM's default. The claim must be reduced by 50% to reflect the amount of the FERC offset.

D. <u>Costs Saved by Kern River</u>

89. The claim must be reduced by the amount of expenses Kern River will save as a result of not having to deliver natural gas under the Kern River Agreement. Mr. Morgan testified that the amount Kern River is saving as a result of not having to perform the Kern River Agreement is at least $.01 per Dth/d or about 2% of the claim amount.

E. Discount Rate

90. Kern River's claim must be reduced to net present value as of July 14, 2003.

91. In mid-2003, MAEM faced significant business environment risk, including risk associated with prevailing general energy market conditions and economic environment for energy merchants.

92. Kern River's damages are uncertain and unliquidated because of the uncertain amount of mitigation.

93. MAEM expert witness Dr. Cindy Ma, a CPA and financial analyst, testified that the appropriate discount rate to apply in reducing Kern River's claim to net present value is the risk-adjusted rate of 15.92%. She testified that as of July 13, 2003, the contract breach date, Mirant Corporation's incremental borrowing rate was 15.92% as reflected in its long-term bond. This rate includes a risk free rate of 4.65%, which was the yield of the 20-year U.S. Treasury bond in the week preceding the Petition date, and a non-payment risk premium of 11.28%. Debtors' Exhibits 148 and 149.

94. Dr. Ma explained in her reports and testified regarding the following: Discounting a set of future cash flows should take into account two components: the time value of money and the risk of not being paid fully and on time. The time value of money is calculated by applying a risk free rate such as the yield on U.S. Treasury securities for a particular period of time. For all obligations other than those of the U.S. government, the ability to pay future obligations in full is less than certain and thus a premium should be added to the risk free rate to reflect the non-payment risk. The risk factors associated with an entity's ability to meet payment obligations vary according to the nature of the entity and include market risk, financial risk, management risk, product risk, company sales risk and business environment risk. Credit spreads provide an efficient and effective mechanism to incorporate the impact of the risk factors that are germane to an entity's ability to meet its financial obligations. The credit spread is the difference in promised interest rates or yields between an obligation subject to non-payment risk

and an otherwise identical, default-free, risk-free security. The magnitude of the credit spread dictates the amount of the risk premium. Debtors' Exhibit 148, pp. 4-13.

95. Dr. Ma's opinion is based on and supported by economic and finance principles that the applicable risk-adjusted discount rate should be commensurate with the risk of the cash flows being measured and should be linked to the market-perceived risk of non-payment for cash flows with duration similar to the future cash flows being discounted. In view of those principles, Kern River's damages should be discounted at a rate reflecting MAEM's long-term cost of borrowing. Her opinion is based on and supported by concept 7, which is part of the Generally Accepted Accounting Principles. Debtors' Exhibits 148 and 149.

96. Referring to one bond issued by Mirant Corporation and five debt instruments issued by Mirant Americas Generation LLC, MAEM's sister company, Dr. Ma determined that the credit spread implied in the yield of MAEM's debts as of just before the bankruptcy filing was 11.28%. This percent, added to the risk free rate, is what it would cost MAEM to borrow funds as of that point in time. Debtors' Exhibit 148, pp. 14-17.

97. Dr. Ma's opinion is corroborated by her analysis of incremental borrowing rates of other financially distressed companies. She testified that the 11.28% non-payment risk premium is conservative in comparison with the borrowing costs of other financially distressed companies. Her analysis of Enron Corporation, Adelphia Communications Corporation, United Air Lines Inc., and Federal Mogul Corporation immediately before their bankruptcy filings shows credit spreads above 15.92%. Debtors' Exhibit 148, pp. 21-23 and exhibit 8; 149.

98. Dr. Ma's opinion is further corroborated by her determination of an alternative discount rate, which she calculated using the capital asset pricing model. This model is widely implemented and accepted in the financial community. The model starts with the expected return on risk free assets and adds a premium to reflect the increased market risks faced by equity investors. Using the model, Dr. Ma calculated a base discount rate of 15.51%. Debtors' Exhibit 148, pp. 23-26 and exhibit 9.

99. The rate of 15.92% is market based, supported by sound economic and finance principles, confirmed by empirical evidence, and in compliance with regulatory and accounting guidelines.

100. Kern River expert witness Professor Peter Williamson has never been previously engaged as an expert to opine about the proper discount rate to be used to determine the present value of future damages. None of his writings or publications addresses specifically the method of calculating the appropriate discount rate.

101. Professor Williamson does not have an opinion regarding the appropriate discount rate but only suggests the possible use of one of several rates: the federal judgment interest rate, the FERC refund rate, or the rate Kern River agreed to pay on its notes used to finance the 2003 Expansion project. Professor Williamson offered no appropriate economic rationale, corporate finance principles, empirical evidence, or economic or corporate literature as support for any of these rates. Professor Williamson's suggestions are not logical because one rate is nearly four times the other and their use would produce outcomes that would vary by tens of millions of dollars as applied in this case.

102. The federal judgment interest rate is an interest rate allowed on money judgments recovered in civil cases. Discounting of damages to present value occurs pre-judgment. There is no logic to the use of this interest rate to discount future damages. Professor Williamson testified that he is not aware of any case other than In re United American Financial Corp. that applied the federal judgment interest rate to discount future damages to present value.

103. The FERC refund rate is a short-term interest rate at which banks make short-term business loans to their prime customers. The rate is only applicable to the most creditworthy customers and is not appropriate to discount long-term future damages from an entity with high non-payment risk, such as MAEM as of July 13, 2003. The FERC refund rate may be an appropriate rate for the time value of money, but it contains no premium for the non-payment risk and is not based on MAEM's incremental borrowing rate. Professor Williamson testified that prior to this case, he had never worked with the FERC refund rate on any occasion. He

admitted that he has never seen the FERC refund rate applied to reduce damages to present value.

104. The rate Kern River agreed to pay on its notes to finance the 2003 Expansion project is based on the cost of borrowing by Kern River at the time of the commencement of the contract in 2003. In suggesting this rate, Professor Williamson mistakenly focuses on the creditworthiness of Kern River rather than MAEM and fails to use the cost of borrowing at the time of the breach of the contract. Professor Williamson testified that this rate is based on a secured lending rate for Kern River's 2003 expansion, in which the notes were backed by more quality collateral than the MAEM contract.

F. Letters of Credit

105. Kern River drew on the letters of credit that secured MAEM's obligations under the Kern River Agreement and applied the cash security toward the alleged amounts owed to it.

106. The amount Kern River received by executing on the letters of credit, $14,751,589, must be subtracted from the net present value of Kern River's claim.

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

II. CONCLUSIONS OF LAW

1. The Court has jurisdiction of this matter pursuant to 28 U.S.C. Sections 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. Section 157(b)(2)(B).

2. Venue is proper before this Court pursuant to 28 U.S.C. Sections 1408 and 1409.

3. The Kern River Agreement is an executory contract.

4. The Kern River Agreement was rejected as of December 18, 2003.

5. MAEM has produced sufficient evidence to rebut the amount claimed in Kern River's amended proof of claim no. 8121.

6. Pursuant to the terms of the Kern River Agreement, Utah law governs the case.

7. Kern River is not entitled to any damages that it has avoided as a result of mitigation. Kern River is not entitled to any damages that could have been avoided if it had acted in a reasonably diligent manner in attempting to lessen its losses incurred as a consequence of the breach of the Kern River Agreement. Madsen v. Murrey & Sons Co., Inc., 743 P.2d 1212, 1214 (Utah 1987).

8. Kern River has the active duty to make reasonable efforts to render the injury as light as possible and may not aggravate the injury occasioned by the breach. Madsen v. Murrey & Sons Co., Inc., 743 P.2d 1212, 1214 (Utah 1987); Mahmood v. Ross, 990 P.2d 933, 940 (Utah 1999); Utah Farm Prod. Credit Ass'n v. Cox, 627 P.2d 62, 64 (Utah 1981); Angelos v. First Interstate Bank, 671 P.2d 772, 777 (Utah 1983).

9. Kern River must go beyond showing it was passively receptive to opportunities to resell the MAEM capacity. Kern River must show it took positive steps reasonably calculated to resell the MAEM capacity. Olympus Hills Shopping Center, Ltd. v. Landes, 821 P.2d 451, 455 (Utah 1991); Reid v. Mut. of Omaha Ins. Co., 776 P.2d 896, 905-06 (Utah 1989).

10. Once the Kern River Agreement was rejected, FERC regulations required Kern River to post the capacity as awardable firm transportation on its electronic bulletin board accessible on Kern River's Internet website.

11. Kern River has not made the required reasonable effort to mitigate its damages.

12. Kern River has no legal or equitable right to escape its obligation to mitigate damages based on the existence of MFN provisions in its other contracts with shippers, and they did not constitute good cause for Kern River's failure to resell the MAEM capacity as firm capacity. Landmark Hotel & Casino, Inc. v. Local Joint Executive Board of Las Vegas, 78 B.R. 575, 584 (9th Cir. BAP 1987); In re Sierra Steel Corp., 88 B.R. 337, 340 (Bankr. Colo. 1988); *In re* Electrical Contracting Services Co., 305 B.R. 22, 32 (Bankr. Colo. 2003). Kern River has cited no authority allowing it to escape its obligation to mitigate its damages and no case supporting its position that the MFN clauses relieve it of this obligation.

13. None of the MFN provisions in Kern River's contracts with shippers applies to the resale of the MAEM capacity.

14. Kern River's failure to seek waiver of the MFN provisions from any affected shipper precludes its use of the provisions to justify its failure to mitigate its damages.

15. MAEM was not required to mitigate Kern River's damages from the rejection on its own and had no obligation to enter into any release agreement to avoid the MFN clauses. Notice Of Effective Date Of Rejection Of The Firm Transportation Service Agreement Contract No. 1712, filed December 19, 2003. Kern River's failure to inform MAEM of the existence of shippers who desired to purchase the MAEM capacity on a firm basis prevented MAEM from releasing the capacity to those shippers and avoiding any consequences of the MFN provisions. MAEM's lack of mitigation did not relieve Kern River of its obligation to make reasonable efforts to mitigate its damages.

16. MAEM's rejection of the Kern River Agreement did not terminate the contract. Eastover Bank for Sav. v. Sowashee Venture (In re Austin Dev. Co.), 19 F.3d 1077, 1082-83 (5th Cir. 1994); In re Continental Airlines, 981 F.2d 1450, 1459-61 (5th Cir. 1993). Kern River could have but failed to communicate to MAEM bids from other shippers to purchase the MAEM capacity on a firm basis.

17. The doctrine of quasi-estoppel bars a party from asserting a subsequent position inconsistent with a prior statement, if the change results in a disadvantage to another. Bott v. J.F. Shea Co., 299 F.3d 508, 512 (5th Cir. 2002); Stinnett v. Colorado Interstate Gas Co., 227 F.3d 247, 258 (5th Cir. 2000).

18. Kern River has the burden of proving it qualifies as a lost volume seller. Bill's Coal Co. v. Board of Public Utilities of Springfield, 887 F.2d 242, 245 (10th Cir. 1989).

19. In order to establish it is a lost volume seller, Kern River is required to prove that it had such unlimited resources or unlimited production capacity that it could enter into multiple new contracts regardless of MAEM's rejection of the Kern River Agreement. See U.C.C. § 2-

708; Bill's Coal Co. v. Board of Public Utilities of Springfield, 887 F.2d 242, 245 (10th Cir. 1989); In re El Paso Refinery, L.P., 196 B.R. 58, 66 (Bank. W.D. Tex. 1996).

20. Kern River must further demonstrate that the potentially mitigating sales of capacity are not substitute or replacement sales, but are entirely independent events that would have occurred regardless of MAEM's rejection of the Kern River Agreement. To make this determination, three important variables should be examined. First, as to the seller, the court should determine that the breach of the original contract did not provide the opportunity to make the resale (establishing that the resale is not merely a replacement sale). Second, the court should examine the resale buyer's particular needs in order to determine whether the resale buyer would have bought from the seller even if the original buyer had not breached. Finally, the trier of fact should examine the characteristics of the particular goods involved in the breach and that the resale buyer ultimately purchased, keeping in mind that the more specialized the particular item, the more likely it is that its subsequent sale is merely a replacement sale. In re El Paso Refinery, L.P., 196 B.R. 58, 66 (Bank. W.D. Tex. 1996); R.E. Davis Chemical Corp. v. Diasonics, Inc., 924 F.2d 709, 711 (7th Cir. 1991).

21. General damages may be reduced by the amount of gains the nonbreaching party receives by performing another contract which could not have been entered into but for the breach of the prior contract and the party being thereby left free to perform the second contract. John Call Eng'g Inc. v. Manti City Corp., 795 P.2d 678, 681 (Utah Ct. App. 1990).

22. A company such as Kern River that sells one very specialized product with a known limited supply to a small and select group of purchasers is not meant to fall within the definition of a lost volume seller. The doctrine typically applies in the sale of goods, and even then only where the seller can demonstrate that it should not be required to reduce its damages to reflect mitigation. In re El Paso Refinery, L.P., 196 B.R. 58, 66 (Bank. W.D. Tex. 1996).

23. Kern River does not meet the requirements to be a lost volume seller.

24. Damages awarded for breach of contract must place the nonbreaching party in as good a position as if the contract had been performed. Anesthesiologists Associates of Ogden v.

St. Benedict's Hosp., 884 P.2d 1236, 1238 (Utah 1994); Alexander v. Brown, 646 P.2d 692, 695 (Utah 1982).

25. The proper measure of damages in a breach of contract case is the contract price less any expenses saved by Kern River when it was excused from its performance. Anesthesiologists Associates of Ogden v. St. Benedict's Hosp., 884 P.2d 1236, 1236 (Utah 1994); Sawyers v. FMA Leasing Co., 722 P.2d 773, 774 (Utah 1986).

26. Kern River is only entitled to recover its lost net profits. Kern River has the burden to produce a sufficient evidentiary basis to permit the Court to determine with reasonable certainty the amount of lost net profits. Kern River is not entitled to recover any damages unless it presents sufficient evidence of its lost net profits. Sawyers v. FMA Leasing Co., 722 P.2d 773, 774 (Utah 1986); Green v. Nelson, 232 P.2d 776, 783 (Utah 1951).

27. According to Utah law, net profits are determined by computing the difference between the gross profits and the expenses that would be incurred in acquiring such profits. Proof of lost gross profits does not afford a court a proper basis for a damage award, where there is no evidentiary basis on which to calculate net profits with reasonable certainty. Reasonable certainty requires more than a mere estimate of net profits. In addition to proof of gross profits, there must generally be supporting evidence of overhead expenses, or other costs of producing income from which a net figure can be derived. Sawyers v. FMA Leasing Co., 722 P.2d 773, 774 (Utah 1986); Carlson Distributing Co. v. Salt Lake Brewing Co. L.C., 95 P.3d 1171, 1177 (Utah. App. 2004).

28. Kern River has not presented evidence sufficient to show its lost net profits or sufficient evidence from which the court could reasonably calculate Kern River's lost net profits. Kern River therefore cannot recover anything on its claim.

29. Duplicative damages are not permitted in civil litigation and courts are careful not to allow the plaintiff to receive excessive compensation. Hawaii v. Standard Oil Co. of California, 405 U.S. 251 (1972). According to Utah law, in determining damages for breach of contract, the court must reduced the defendant's liability to the plaintiff by the amount the

plaintiff received from a third party. Gibbs M. Smith, Inc., v. United States Fidelity & Guaranty Co., 949 P.2d 337, 346 (Utah 1997).

30. The Supreme Court and the Fifth Circuit have long recognized that the prime purpose of bankruptcy law has been to distribute the debtor's assets ratably between the creditors and to provide equality of distribution. Young v. Higbee Co., 324 U.S. 204 (1945); Kuehner v. Irving Trust Co., 299 U.S. 445 (1937); Gaudet v. Babin (In re Zedda), 103 F.3d 1195, 1203 (5th Cir. 1997); Schimmelpenninck v. Byrne (In re Schimmelpenninck), 183 F.3d 347, 351-52 (5th Cir. 1999) (recognizing that equal treatment of all like-situated creditors as "the equitable foundation on which bankruptcy is built").

31. This Court has also recognized that equal distribution to similarly situated creditors is a fundamental principle of bankruptcy law. In re Craft, 321 B.R. 189, 195 (Bankr. N.D. Tex. 2005) (stating that a major goal of Congress includes the equal treatment of creditors); In re Mirant Corp., 316 B.R. 234, 242-43 (Bankr. N.D. Tex. 2004) (observing that the quantification of numerous claims against Mirant via arbitration would frustrate the bankruptcy law's policy of equal treatment of creditors because it would not guarantee equality of treatment for similarly situated creditors).

32. To prevent Kern River from receiving excessive recovery prohibited in breach of contract cases, as well as to ensure that all creditors are treated equally and prevent Kern River from receiving more of its damages than similarly situated creditors who will not be able to recover a significant portion of their claim from a third party, any recovery of costs for the Kern River Agreement Kern River achieves through the FERC rate case must be applied to reduce Kern River's claim in addition to the reductions for mitigation and expenses saved.

33. Section 508 of the Bankruptcy Code does not prohibit the Court from reducing Kern River's Claim to offset the amount it will receive through FERC. Section 508(a) applies only if a creditor receives payment or transfer of property in a "foreign proceeding." 11 U.S.C.A. § 508(a). The term, "foreign proceeding," is a legal proceeding outside of the United States. H.R. REP. NO. 95-989, at 358 (1977); In re Maxwell Communication Corp., 186 B.R.

807, 819 n.7 (Bankr. S.D.N.Y. 1995). Section 508(b) governs only preferential transfers in the context of partnerships. 11 U.S.C.A. § 508(b).

34. The amount of Kern River's claim must be reduced to net present value after mitigation and any other reductions. Bridas S.A.P.I.C. v. Gov't of Turkmenistan, 345 F.3d 347, 364 (5th Cir. 2003); Energy Capital Corp. v. United States, 302 F.3d 1314, 1332-33 (Fed. Cir. 2002); In re CSC Industries, Inc., 232 F.3d 505, 508 (6th Cir. 2000).

35. The amount of Kern River's claim must be reduced to net present value as of the petition date. 11 U.S.C. section 502(b); In re Stembridge, 394 F.3d 383, 387-88 (5th Cir. 2004); In re Loewen Group Int'l, Inc., 274 B.R. 427, 434-35 (Bankr. D. Del. 2002).

36. The purpose for discounting future damages to present value is to prevent unjust enrichment. Chesapeake & Ohio Railway Co. v. Kelly, 241 U.S. 485, 491 (1916).

37. The appropriate discount rate by which future damages should be reduced to present value is a question of fact based on the circumstances of the particular case. Bridas S.A.P.I.C. v. Gov't of Turkmenistan, 345 F.3d 347, 364 (5th Cir. 2003); Energy Capital Corp. v. United States, 302 F.3d 1314, 1332-33 (Fed. Cir. 2002).

38. 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. Till v. SCS Credit Corp., 541 U.S. 465, 478-80 (2004); Douglass v. Hustler Magazine, Inc., 769 F.2d 1128, 1143 (7th Cir. 1985).

39. Determination of the discount rate requires the determination of a base rate and an increase of that rate, or premium, to account for risk. Till v. SCS Credit Corp., 541 U.S. 465, 480-83, 508 (2004). The appropriate discount rate must be determined on the basis of the rate of interest that is reasonable in light of the risks involved. In re Lambert, 194 F.3d 679, 681 (5th Cir. 1999); Douglass v. Hustler Magazine, Inc., 769 F.2d 1128, 1145 (7th Cir. 1985); King Resources Co. v. Baer, 651 F.2d 1326, 1336 n. 7 (10th Cir. 1980).

40. It is not the sole purpose in discounting to account for the time value of money but rather "the discount rate performs two functions: (i) it accounts for the time value of money;

and (ii) it adjusts the value of the cash flow stream to account for risk." Energy Capital Corp. v. United States, 302 F.3d 1314, 1333 (Fed.Cir. 2002); Franconia Associates v. United States, 61 Fed. Cl. 718, 763-65 (2004); Eastern Minerals Int'l, Inc. v. United States, 39 Fed. Cl. 621, 628 (Ct. Cl. 1997).

41. The purpose for discounting applies with even greater force in bankruptcy where the bankruptcy court must achieve equality of distribution among creditors. 11 U.S.C. section 502(b); In re Loewen Group Int'l, Inc., 274 B.R. 427, 434-35 (Bankr. D. Del. 2002).

42. The appropriate base rate is the rate of return on a relatively risk-free investment during the period the damages accrued. In re Stone & Webster, Inc., 279 B.R. 748, 806 (Bankr. D. Del. 2002); In re O'Connor, 145 B.R. 883, 894 (Bankr. W.D. Mich. 1992).

43. The proper method to be used in adjusting for risk is that which most closely represents the value of damages. Energy Capital Corp. v. United States, 302 F.3d 1314, 1334 (Fed.Cir. 2002).

44. The Court must consider at least the risk inherent in the venture and potential inflation. Bridas S.A.P.I.C. v. Gov't of Turkmenistan, 345 F.3d 347, 365 (5th Cir. 2003). Other risk factors to consider include illiquidity, unfavorable contractual obligations, and excessive debt. see Dunn, Robert L. and Harry, Everett P., Modeling and Discounting Future Damages, J. Acc. (1-02 J.A. 49) (January 2002).

45. In assessing the risk, the Court should look to the risk of MAEM's nonpayment, not Kern River's creditworthiness. Till v. SCS Credit Corp., 541 U.S. 465, 478-79, 124 S.Ct. 1951, 158 L.Ed.2d 787 (2004).

46. Courts have applied rates ranging as high as 30% when adjusting for risk. See, e.g., In re McCook Metals, L.L.C., 2005 Bankr. Lexis 49, * 25 (Bankr. N.D. Ill. Jan. 14, 2005); Olson v. Nieman's, Inc., 579 N.W. 2d 299 (Iowa 1998); Kool, Mann, Coffee & Co. v. Coffey, 300 F.3d 340 (3d Cir. 2002).

47. Kern River suggests that the use of a risk adjusted discount rate may be appropriate in profits damages but is not appropriate in a case seeking damages for nonpayment

of a fixed or liquidated amount. No authority supports such a distinction and Till is an example of a case involving a fixed payment stream and the use of a risk-adjusted rate. Furthermore, this case does not involve a fixed, undisputed, liquidated amount of payments because Kern River's claim is subject to mitigation in an as-yet undetermined amount. In both a lost profits case and a case involving fixed payments, the purpose of awarding damages is to put the nonbreaching party in the same position as it would have been had the contract been performed; in both, the award of damages is to protect the nonbreaching party's expectation interest. See Restatement (Second) of Contracts §§ 344(a), 347; Glendale Federal Bank v. United States, 239 F.3d 1374, 1380 (Fed. Cir. 2001).

48. The appropriate discount rate to apply in reducing Kern River's claim to net present value is the risk-adjusted rate of 15.92%.

49. The discount rates proposed by Kern River are artificially low and legally incorrect and are therefore inappropriate. There is no legal authority for the use of the FERC interest rate provided for in 18 C.F.R. section 154.501(d) to calculate the net present value of damages. The parties never agreed to use that rate for purposes of calculating net present value of future damages. Mr. Williamson testified that he has never seen the FERC interest rate used for the purpose of determining net present value. There is no support in economic literature or corporate accounting and finance principles for the use of this rate for this purpose.

50. There is no legal authority for the use of the federal judgment interest rate to calculate the net present value of damages. There is no support in economic literature or corporate accounting and finance principles for the use of this rate for this purpose.

51. The only case cited by Kern River in support of the use of the federal judgment interest rate is In re United American Financial Corp., 55 B.R. 117 (E.D. Tenn. 1985), which mentions the rate in the last paragraph of the opinion. There is no indication that the use of that rate was contested in that case or that there was any expert testimony on the issue in the case. No case has ever followed United American on that issue, presumably because the rate of

interest as of the date of the decision would have been substantially higher than the rate as of July 2003.

52. There is no legal authority for the use of the interest rate Kern River agreed to pay on its $836 million in notes used to finance the 2003 Expansion Project to calculate the net present value of damages. There is no support in economic literature or corporate accounting and finance principles for the use of this rate for this purpose.

53. Under Utah law the legal rate of interest is 10%. Utah Code Ann. § 15-1-1(2) (2002).

54. Based on the testimony of Dr. Makholm regarding mitigation and valuation and applying the discount rate identified by Dr. Ma of 15.92%, the amount of Kern River's damages is no more than $39.58 million. Subtracting from that amount the amount Kern River received by executing on the letters of credit of $14,751,589, the total amount of Kern River's claim is $24,828,411.

55. The application of a second discount rate to reduce the amount Kern River derived from mitigation to present value is not appropriate. In re Highland Superstores, Inc., 154 F.3d 573 (6th Cir. 1998).

56. The Court makes as a further conclusion of law anything found herein as a fact that is a conclusion of law.

DONE AND ORDERED at Fort Worth, Texas.

Dated:________________________ ____________________________________

Honorable D. Michael Lynn
United States Bankruptcy Judge

Respectfully submitted this 22nd day of July, 2005.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing Debtors Mirant Corporation's and Mirant Americas Energy Marketing, LP's Amended Proposed Findings of Fact and Conclusions of Law was served upon all parties listed below via email, if available, or United States first class mail on the 22nd day of July 2005:

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