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Calpine Corporation – (NYSE: CPN) ★★

Rating Criteria	Star Rating	Point Rating	Highest Possible Rating
1. Areas of Financial Concern & Quality of Earnings	★	4	20
2. Accounting Policies	★	1	5
3. Clarity and Completeness of Footnotes	★★★★	4	5
4. Management Discussion and Analysis	★★★★	4	5
5. Governance	--	0	5
Overall Rating	★★	**13**	**40**

RATING: The Overall Rating for Calpine Corporation has not changed since our last report, at 13 points and 2 stars.

Areas of Financial Concern - Quality of Earnings Summary

Fiscal year end December 31,	6/30/05	2004	2003	2002
GAAP Reported Net Income	**$(467.2)**	**$(242.5)**	**$282.0**	**$118.6**
Adjustments, net of tax:				
Asset Write-down (1)	111.3	158.9	41.9	263.1
One time (gain)/loss (2)	--	(285.9)	(60.3)	(63.8)
Stock option expense	(0.5)	(4.9)	(11.6)	(35.6)
Capitalized Interest (3)	(87.4)	(244.5)	(288.9)	(374.1)
Accounting Change (4)	--	--	(180.9)	--
Other (5)	(98.1)	(160.5)	(180.0)	(76.7)
Total Adjustments, net of tax	**$(74.7)**	**$(536.9)**	**$(679.8)**	**$(287.1)**
Normalized Net Income	**$(541.9)**	**$(779.4)**	**$(397.8)**	**$(168.5)**
Normalized Net Income as % of Reported	116.0%	321.4%	(141.1)%	(142.1)%
Reported Diluted Earnings per share (6)	$(1.04)	$(0.56)	$0.71	$0.33
Normalized Diluted Earnings per share	$(1.21)	$(1.81)	$(0.28)	$(0.47)

($ MM, except per share amounts)
Numbers may not add due to rounding.

(1) Equipment cancellation and asset impairment charges of $171.2MM for the first 6 months of fiscal 2005, and $244.5MM, $64.4MM and $404.7MM for FYE 2004, 2003 and 2002 respectively.

(2) 2004-$187.9 gas and power contract restructuring gains, $251.9MM gain on sale of oil & gas assets and sale of collateral securities. 2003-Gains on asset sales of $131.8MM net of losses on asset sales of $39MM. 2002-$41.5MM gain on termination of power sales agreement and $56.5MM gain on sale of assets from discontinued operations.

(3) Capitalized interest of $134.4 for the first 6 months of fiscal 2005, and $376.1MM, $444.5MM and $575.5MM for FYE 2004, 2003 and 2002, respectively..

(4) 2003-Adoption of FASB Derivatives Implementation Group ("DIG") issue No. C20, "*Scope Exceptions: Interpretation of the Meaning of Not Clearly and Closely Related in Paragraph 10(b) regarding Contracts with a Price Adjustment Feature*". $293.4MM gross cumulative effect of accounting change.

(5) Pre-tax gain on early debt retirement of $150.9MM for the first 6 months of fiscal 2005, and $246.9MM, $278.6MM and $118.0MM for FYE 2004, 2003 and 2002, respectively.

(6) Average diluted shares outstanding of 448.4MM for 6 months ended 6/30/05, and for FYE 2004-430.8MM, 2003-396.2MM, and 2002- 362.5MM..

Key Rating Considerations:

- Calpine Corporation ("CPN" or "the Company") makes the remarkable disclosure that **operational data contained in it's 2004 and 2003 10K is unaudited**. In addition, **material deficiencies in internal controls and procedures** were identified by it's auditors in connection with preparation of it's fiscal 2004 and 2003 audits. The firm has **disclosed disagreements with its auditors** concerning material accounting issues.

- A sustained decline in operating margins for power produced by the Company's plants and the lack of energy purchase agreements for the Company's unused capacity indicates that **material impairment of the Company's fixed assets including construction in progress has occurred, and remains unrecognized**.

- The Company carries substantial asset balances within PPE for **construction-in- progress** ("CIP"); amounts for CIP totaled $4.3B, $5.7B, and $7.1B for 2004, 2003, and 2002 respectively. The **lack of related power sales contracts**, in sufficient amount of future production capacity to provide the net present value required by asset backed lenders as collateral for funding completion, **raises questions with respect to carrying values** on the Company's balance sheet for it's production assets,

- The Company has **understated the cost of gas-fired production** and, thereby, **overstated the profitability of its gas-fired plants**.

- **Management has significant discretion in it's estimation of the values of certain assets and liabilities as well as the timing of recognition of certain income statement items.**

- An adjusted balance sheet reveals a Company that is **dramatically more leveraged than is demonstrated by reported results**. As reported, liabilities equal 4.9X equity; after adjustment leverage increases to 8.1X equity

- The Company had cash margin deposits of $500MM June 30, 2005 up from $442MM at FYE 2004, such deposits totaled $385MM and $152MM at FYE 2003 and 2002, respectively. CPN is subject to margin calls as the result of its derivative trading activity; **increased margin deposits could indicate unrealized derivative losses, deteriorating credit quality or both.**

- The Company **generated negative free cash flow** ("FCF") for the 6 months ended June 30, 2005 of $(1.9B) and FCF was $(1.9B), $(2.9B) and $(3.9B) for the years ended 2004, 2003 and 2002, respectively.

- The Company is **less geographically diversified than it might appear**, though it produced electricity in 22 states and at locations in the UK and Canada in fiscal 2004, 51.9% of its production of electricity was accomplished using plants located in California and Texas. Geographical concentration of critical facilities in a state seeking potentially ruinous redress for price gouging is a cause for concern.

- The Company's **return on shareholders' equity has fallen** from 21.8% in 2000 to (5.3)% in 2004

- CPN's **working capital management has deteriorated over the past three years** as turnover decreased from 75X in 2002 to 16.9X in 2004 and days outstanding increased 16.9 days from 4.8 to 21.6 days.

- **CPN's revenue recognition polices have changed in each of the past three years, are complex, and grant management significant discretion over the timing and amounts of certain revenue items.**

- The Company's **footnotes and Management's Discussion and Analysis are of above average quality**.

- **Governance is poor** at Calpine because, in part, auditors identified material weaknesses in internal controls and procedures, there is a staggered Board, and related party transactions, a poison pill, a combined Chairman and CEO role, and three different audit firms in as many years.

Section I – Detailed Findings

1. Areas of Financial Concern and Quality of Earnings (★)

Positive Aspects

Capital Expenditures

CPN discloses that capital expenditure plans have been scaled back in recent years due to weak market conditions for wholesale power and higher financing costs. Such conservation of cash may be viewed as prudent given the Company's current financial position. CPN's capital expenditures amounted to $1.5B in 2004, down from $1.9B and $4.0B for 2003 and 2002 respectively. The Company cancelled power generating turbine purchase agreements for $1.8B and $1.2B in 2003 and 2002, respectively. Some concern is warranted as to whether the Company is able to make necessary maintenance expenditures. Support for this concern is provided by the disclosure of equipment failure costs of $54.3MM in 2004 up from $11.0MM in 2003.

Capital Markets

The Company has demonstrated an ability to win the confidence of fixed income investors necessary to borrow $9.4B over the three year period ended 2003, including a $3.8B high-yield debt issue in 2003, at the time the largest such issue in 7 years-according to management. Net borrowing in 2004 amounted to just $42.7MM.

Negative Aspects

Un-audited Operational Data

CPN makes the remarkable disclosure that operational data contained in its 2004 and 2003 10K is unaudited. The Company discloses the following with respect to operational data contained within the 10K:

" Operational data including, but not limited to, megawatts ("MW"), megawatt hours ("MWh"), billions cubic feet equivalent ("Bcfe") and thousand barrels ("MBbl"), throughout this Form 10-K is unaudited."

Filings prior to 2003 do not include such wording. Operational data is clearly critical to any meaningful evaluation of the Company's results and financial position. To the extent the Company's financial statement footnotes and MD&A involve disclosures, discussion or analysis of its operations uncertainty exists as to reliability. The implications for quality of earnings are negative.

Leverage-Driven Business Model

The Company operates with high levels of operating and financial leverage. The Company has incurred $9.5B in net debt over the past four years as it expanded its total gas-fired production capacity by 90.6%. Over the same period, however, gas-fired electricity production became uncompetitive with other production methods as evidenced by production costs in excess of spot market electricity rates. The Company has obtained financing for capacity expansion by leveraging 1) the net present value of its long-term power sales agreements, 2) margin enhancing long-term geothermal energy rights, and 3) internally produced oil and natural gas.

Long-term power sales contracts covering 39.6% of gas-fired production capacity enabled the Company in 2004 to sell its power at an average price of $58.90 per kWH versus an average spot rate of $29.06, the spread of $29.84 has increased from $21.03 and $9.78 in 2003 and 2002 respectively. Additionaly, operating margin is generated by the positive impact of CPN's geothermal plants in California where substantially lower production costs lowered the combined average cost per kWh produced by $2.78, $2.86, and $2.27 in 2004, 2003, and 2002 respectively. In 2004, geothermal plants operating at 113.3% of year-end capacity produced 7.0% of electricty revenue and 149.6% of the Company's operating income per kWh in 2004. Finally, the Company has used energy produced at its oil and gas properties to fuel its gas-fired plants without recognizing an associated fuel expense on its income statement; a policy that improved operating margin per kWh at its gas-fired plants by $2.32, $4.94 and $2.12 in 2004, 2003, and 2002 respectively. The combined impact of these firm-specific items is to increase operating income per kWh by $34.94, $28.83, and $14.17 in 2004, 2003 and 2002, respectively.

Asset Impairment

A sustained decline in operating margins for power produced by the Company's plants and the lack of energy purchase agreements for the Company's unused capacity, indicates that material impairment of the Company's fixed assets including construction in progress has occurred and remains unrecognized. A clearer understanding of the Company's asset value and earnings quality is reached when firm specific factors are adjusted to reflect actual market conditions faced by the Company's gas-fired electricity generators. As shown below actual operating income per kWh for a gas-fired plant has fallen precipitously from $5.54/kWh in 2001 to $(30.95)/kWh in 2004, and an estimated $(42.98)/kWh at June 30, 2005. It is thus understandable that capacity utilization at gas-fired plants was just 39.6% at FYE 2004, respectively, as marginal costs would have exceeded marginal revenue on any production beyond contracted amounts.

When gas–fired production cannot compete with spot electricity prices then the value of a gas-fired power plant to appears to be comprised of two elements 1) the present value of future revenue from power sales agreements less future fuel expense, and 2) the present value of future trading profits or losses generated by derivitaves on unsed capacity. Generally, the Company's lenders largely own any benefits from production while equity investors are the primary beneficiaries or losers from derivative speculation. When gas-fired production can be accomplished at a cost below the spot electicity rate then both equity investors and lenders may benefit. The Company sells power derivatives on the spot and future markets with the option, theoretically at least, of either covering its sales with an off setting trade before delivery or by producing the power itself. Current capacity and future capacity of projects under active construction are the underlying support for the electricity derivatives sold by the Company.

Calpine Corporation Sources of Operating Margin					
Millions of kWh	**6/30/05**	**2004**	**2003**	**2002**	**2001**
Power produced	40.1	96.5	82.4	72.8	42.4
Power derivative sold	24.4	51.2	74.8	75.7	54.8
Total power sold	**64.5**	**147.7**	**157.3**	**148.5**	**97.2**
Revenue/kWh					
Production	$64.27	$58.90	$56.98	$44.28	$56.26
Spot trading	$31.98	$32.28	$36.26	$41.54	$60.79
Cost/kWh					
Production	$68.07	$58.77	$49.30	$40.32	$48.35
Spot trading	$25.26	$29.06	$35.95	$34.50	$54.8
Margin/kWh					
Production	$(3.80)	$0.13	$7.68	$3.96	$7.91
Spot trading	$6.72	$3.22	$0.31	$7.04	$5.99

The biggest expense item is natural gas which, after adjustment for internal production, totalled on average $43.92, $38.82, $29.08, and $33.06 per kWh in 2004, 2003, and 2002, respectively. CPN's actual operating margin per kWh was $(19.16),$(8.62) and $5.54 for 2003, 2002, and 2001 respectively; the benefit of power sales agreements of $21.03, $9.78 and $1.46 enabled the Company to fulfill its obligations at a positve operating margin per kWh of $1.87, $1.16 and $7.00 for 2003, 2002 and 2001 respectively. Operating margin exceeded fuel expense by just 4.8% in 2003 down from 21.2% in 2001. The implication is that the Company would have actually lost money selling power at 58.5% above spot market rates on each kWh had fuel expense been 4.9% higher in 2003.

Calpine's Unique Operating Margins at its Gas-fired Plants					
For fiscal years ended December 31,	**6/30/05**	**2004**	**2003**	**2002**	**2001**
Operating Magin Impact $/kWh					
Revenue					
Powers Sales Agreements	$39.01	$29.84	$21.03	$9.78	$1.46
Expenses					
Geothermal production efficiencies $/kWh	$3.73	$2.80	$2.86	$2.27	$4.18
Understated fuel expense $/kWh	$0.13	$2.32	$4.94	$2.12	$2.79
Operating Income Benefit $/kWh	**$42.87**	**$34.94**	**$28.83**	**$14.17**	**$8.43**
Actual Gas-Fired Plant Margin $/kWh					
As reported (on a combined basis)	$(0.11)	$3.99	$8.74	$5.55	$13.97
Less, Calpine Specific factors	**$(42.87)**	**$(34.94)**	**$(28.03)**	**$(14.17)**	**$(8.43)**
Actual operating margin for Gas-fired	**$(42.98)**	**$(30.95)**	**$(19.16)**	**$(8.62)**	**$5.54**

(1) For both geothermal and gas-fired production, and calculated as Revenue (kWh produced*average sales price per kWh), less Operating Expenses {(Fuel expense+royalty expense+SG&A+plant operating expense+depreciation)}/(kWh produced)}

Production beyond those amounts covered by the sales agreements is clearly not feasible as each kWh would cost more to produce than it was worth.

The Company recognized asset impairments of $124.7MM on 2 plants sold in fiscal 2005, as well as a $45.5MM impairment of capitalized 'project development' on three cancelled power plant projects.

Capacity Utilization

The Company used just 41.3%, 42.4%, 43.0% and 33.5% of its total combined thermal and gas fired production capacity, in fiscal 2004, 2003, 2002, and 2001 respectively. Lenders' willingness to provide funding for projects secured by power sales agreements and plant-operating assets has facilitated the Company's ability to add capacity beyond its production needs. Additionally, the Company's ability to engage in derivative speculation is constrained by its production capacity not actual production. Thus, despite under utilization of existing plants the Company has 10 new facilities under construction that combined will increase gas-fired plant capacity by 21.2%.

Calpine's Electricity Generating Plant Utilization Rates				
	2004	**2003**	**2002**	**2001**
Gas Fired Plants production (maw)	89,734	75,691	66,470	36,251
Gas Fired Plants capacity (MWh)	226,875	187,078	161,788	119,040
Utilization	**39.6%**	**40.5%**	**41.1%**	**30.5%**
Thermal Plants production (MWh)	6,755	6,732	6,296	6,142
Thermal Plants capacity (MWh)	6,570	7,446	7,446	7,446
Utilization	**113.3%**	**90.4%**	**84.6%**	**82.5%**
Total Production (MWh)	**96,489**	**82,423**	**72,766**	**42,393**
Total Capacity (MWh)	**233,445**	**194,524**	**169,234**	**126,486**
Utilization	**41.3%**	**42.4%**	**43.0%**	**33.5%**

Construction In Progress

The Company carries substantial asset balances within PPE for construction-in- progress ("CIP"); amounts for CIP totaled $4.3B, $5.7B, and $7.1B for 2004, 2003, and 2002 respectively. Interest expense on projects under construction is capitalized until a project is completed, suspended, or cancelled. Construction in progress fell $1.4B or 19.7% year over year and capitalized interest expense fell 15.4% to $376.1 in 2004 from $444.5MM in 2003. Capitalized interest represented (155)%, 158%, and 485% of reported net income at FYE 2004, 2003, and 2001, respectively.

The 10 projects considered 'advanced stage' projects at FYE 2004 will require an estimated $3.0B to complete, project financing needed to fund completion will be sought when energy purchase agreements are signed on attractive terms. Meanwhile interest expense on these projects continues to be capitalized.

Power sales contracts need to be signed for a sufficient amount of future production capacity in order to provide the net present value required by asset-backed lenders as collateral for funding a projects completion. The lack of these contracts raises questions with respect to carrying values on the Company's balance sheet for its production assets, and is of particular concern with respect to the $4.3B carrying value of construction-in-progress, an amount equal to 93% of shareholders equity at December 31, 2004.

The Company includes equipment of $1.8B in its CIP balance, an amount comprising 42% of total CIP of $4.3B at FYE 2003. Equipment is not evaluated for impairment separately from the projects to which it is assigned.

The Company does disclose, however, in its 2002 10K that $547.1MM had been charged to CIP for equipment written down by $407.1MM and remaining balance of $142.4MM transferred to 'other assets' for sale or use in other projects. Another indication of potential equipment impairment is the Company's contribution of two turbines with a book value of $76.0MM in exchange for a 45% interest in the Valladolid Joint Venture Project in Mexico. The Company booked its interest in Valladolid at $67MM and recognized a $9MM note receivable in return for the turbines. Valladolid, however, recognizes the value of the capital contributed (two turbines) by the Company as $36MM, the Company plans to amortize the difference of $31MM over the useful lives of the turbines by netting it against its interest in the projects future net income. It would appear that rather than recognize an impairment of $39MM to the value of its two turbines the Company moved them of its balance sheet in return for a joint venture interest and note receivable.

Understated Fuel Expense

The Company has understated the cost of gas-fired production and, thereby, overstated the profitability of its gas-fired plants. CPN has been able to lower its average production cost with the use of low cost thermal energy plants and the use of its own natural gas production for a portion of its gas fired plant production. The Company did not recognize the cost of internally produced natural gas as fuel expense resulting in understatement of that expense by an estimated $208.2MM, $374.3MM, $180.4MM and $99.9MM for 2004, 2003, 2002, and 2001 respectively. The Company's sale of its natural gas and oil properties in the second half of 2004 had, by June 30, 2005, largely eliminated the impact of internally produced fuel on fuel expense. Average cost per kWh continues to be positively impacted by electricity produced at CPN's geothermal plants at a margin advantage approximating the difference between fuel expense and royalty cost per kWh, or $39.70, $35.24 and $26.29 per kWh in 2004, 2003, and 2002, respectively. The margin advantage of geothermal production increased to $43.95 per kWh for the 6 months ended June 30, 2005.

	6/30/05	2004	2003	2002	2001
Gas-Fired					
Fuel Expense					
Reported	$1,807.8	$3,731.1	$2,564.7	$1,752.9	$1,116.9
Internal use	4.9	208.2	374.3	180.4	99.9
Actual ($)	$1,812.7	$3,939.3	$2,939.0	$1,933.3	$1,216.8
Understated Cost (%)	27bp	5.6%	14.6%	10.3%	8.9%
Gas Fired (kWh)	36.7 MM	89.7MM	75.7MM	66.5MM	36.3MM
Reported cost/kWh	49.26	$41.60	$33.88	$26.96	$30.77
Actual cost/kWh	49.39	$43.92	$38.82	$29.08	$33.56
Geothermal (kWh)	3.4MM	6.8MM	6.7MM	6.3MM	6.1MM
Royalty Cost ($)	$18.5 MM	$28.7 MM	$24MM	$17.6MM	$27.5MM
(1)Royalty Cost/kWh	$5.44	$4.22	$3.58	$2.79	$4.51
SGA /kWh	**$(3.06)**	**$(2.48)**	**$(3.23)**	**$(3.15)**	**$(3.55)**
Plant Opex/kWh	**$(9.58)**	**$(8.25)**	**$(8.24)**	**$(6.95)**	**$(7.64)**
Depreciation/kWh (2)	**$(6.20)**	**$(5.22)**	**$(5.23)**	**$(4.29)**	**$(4.10)**
Operating Exp./kWh	**$(18.84)**	**$(15.95)**	**$(16.70)**	**$(14.39)**	**$(15.29)**
Revenue/kWh	$64.27	$58.90	$56.98	$44.28	$56.26
Less Opex./kWh	$(18.84)	$(15.95)	$(16.70)	$(11.24)	$(15.29)
Op. Inc. per kWh	**$45.43**	**$42.95**	**$40.28**	**$33.04**	**$40.97**
Fuel exp. per kWh	$(49.39)	$(43.92)	$(38.82)	$(29.08)	$(33.06)
Gas Fired op income	**$(3.96)**	**$(0.97)**	**$1.46**	**$3.96**	**$7.91**
Royalty Expense kWh	$(5.44)	$(4.22)	$(3.58)	$(2.79)	$(4.51)
Geotherm op inc	**$39.99**	**$38.73**	**$36.70**	**$30.25**	**$36.46**

(1) (Royalty Cost/Geothermal kWh)
(2) Depreciation of $248.6, $503.5MM, $431.4MM, $312.1MM, and $173.8MM for 2004, 2003, 2002 and 2001 respectively.

Significant Estimates

Management has significant discretion in its estimation of the values of certain assets and liabilities as well as the timing associated with respect to recognition of certain income statement items. The number of items subject to management's estimatimation appears to have increased in recent years.

The Company States for 1999,2000 and 2001:
"The most significant estimates with regard to these financial staements relate to future development costs and useful lives of the generation facilities."

for 2002 and 2003:
"The most significant estimates with regard to these financial statements relate to useful lives and carrying values of assets (including the carrying value of profects in development, construction and operation), provision for income taxes, fair value calculations of derivative instruments and associated reserves, capitalization of interest and depletion, deprecition and impairment of natural gas and petroleum property and equipment."

And for 2004:

"The most significant estimates with regard to these financial statements relate to useful lives and carrying values of assets (including the carrying value of profects in development, construction and operation), provision for income taxes, fair value calculations of derivative instruments and associated reserves, capitalization of interest, primary beneficiary determination for the Company's investment in VIEs, the oycome of pending litagation and estimates of oil and gas reserve quantities used to calculate depletion, deprecition and impairment of oil and gas property and equipment."

To the extent management has significant discretion in determining the values and timing of balance sheet and income statement items earnings quality is degraded.

Cash Flow

The Company generated negative free cash flow ("FCF") for the 6 months ended June 30, 2005 of $(1.9B) and FCF was $(1.9B), $(2.9B) and $(3.9B) for the years ended 2004, 2003 and 2002, respectively. Capital expenditures of $7.5B and maturing debt of $2.5B over the three years ended 2004, exceeded cash from operations ("CFO") of $1.4B by $8.6B over the same period.

FYE December 31,	6/30/05	2004	2003	2002	2001
Net Income, Rptd.	**$(467.2)**	**$(242.5)**	**$282.0**	**$118.6**	**623.5**
Non-cash items:					
Depr., Amort.,Depl	414.5	833.4	735.3	542.2	364.1
Other non cash items	(186.6)	(581.0)	(743.9)	407.7	(564.0)
CFO	**$(239.3)**	**$9.9**	**$290.6**	**$1,068.5**	**$423.6**
Capital Expenditures	(539.6)	(1,545.5)	(1,886.0)	(4,036.3)	(5,832.0)
current debt,	(1,033.9)	(338)	(1,310.4)	(901.2)	(59.0)
Free Cash Flow	$(1,866.8)	$(1,873.6)	$(2,905.8)	$(3.869.0)	$(5,468.0)
FCF as % of CFO	(780)%	(18,925)%	(1,000)%	(34)%	(1,291)%
FCF as % of NI	(400)%	(773)%	(1,030)%	(3,260)%	(877)%

($ MM, except per share amounts)
Numbers may not add due to rounding.

Liquidity

CPN generates insufficient EBIT or cash flow from operations ("CFO") to fund its fixed charges, and thus must rely on additional borrowing or asset sales to fund continuing operations, repay debt, and fund capital expenditures. The Company discloses that it plans to meet its funding shortfall (estimated at $1.7B below) for 2004 with a combination of increased borrowing, restricted cash, asset monetization and sale/ lease back transactions. S&P, Moody's, and Fitch rate the Company's senior unsecured debt as of FYE 2004 CCC+, Caa1, and CCC+, respectively.

Projected Free Cash Flow Sources and Uses	
Sources	**2005**
CFO (2004)	$9.9
Uses	
Previous year current debt	(349.1)
Capital Expenditures (1)	(1,079.0)
Capitalized Interest (2)	(268.8)
Total Uses	$(1,687.0)
Cash Uses in Excess of Cash Sources	**$(1,677.1)**

($ MM, except per share amounts)
Numbers may not add due to rounding
(1) 2X amount reported at 6/30/2005 of $539.6MM.
(2) 2X amount reported at 6/30/2005 of $134.4MM.

The Company as of June 30, 2005 reported balance sheet indebtedness of $18.8B of which $2.3B was classified as current. Additionally, the Company discloses that as of June 30, 2005 it had net derivative liabilities of $409.1MM of which $117.6MM is current. A significant portion of the Company's debt is floating rate debt, increasing the risk associated with rising interest rates. The Company's EBIT coverage of fixed charges has fallen from 1.5X in 2001 to 0.8X in 2003. The Company's cash flow from operations (with cash interest added back) coverage was unchanged at 0.6X. The Company will need to borrow substantial funds in order to remain solvent and continue operations at current levels. CPN's fixed charges have increased 58.7% from $790.9MM in 2001 to $1.26B in 2003; EBIT declined 10.6% over the same period.

Calpine Corporations Fixed Charge Coverage

Year ended December 31,	6/30/05	2004	2003	2002	2001
Reported Interest Expense	658.4	$1,140.8	$726.1	$413.7	$196.6
Capitalized Interest	134.4	376.1	444.5	575.5	498.7
Preferred distributions		-	46.6	62.6	62.4
Operating lease interest	17.6(E)	35.3	37.4	37.0	33.2
Total Fixed Charges	**$810.4**	**$1,552.2**	**$1,255.1**	**$1088.8**	**$790.9**
EBIT	$(27.0)	$672.0	$1,054.4	$580.1	$1,180.0
(Deficit)/Surplus	**$(837.4)**	**$(880.2)**	**$(200.7)**	**$(508.7)**	**$389.1**
Fixed Charge Coverage	**(3.3)%**	**43.3%**	**84.0%**	**53.3%**	**149.2%**
CFO (1)	$(239.3)	$9.9	$753.3	$1,393.9	$466.5
CFO Coverage	**(29.5)%**	**64bp**	**60.0%**	**128.0%**	**59.0%**

($ MM, except per share amounts)
Numbers may not add due to rounding
(1) Includes cash interest of $607.2MM for the first 6 months of fiscal 2005 and $939.2MM, $462.7MM, $325.3 MM, and $42.9MM for FYE 2004, 2003, 2002, and 2001.

Off-Balance Sheet Items

The Company makes significant use of off-balance sheet financing devices such as operating leases, equipment leases, and equipment purchase agreements and tolling agreements. Assuming a discount rate of 8% the present value of the Company's minimum payments due at FYE 2004 under office and equipment leases, and power plant operating leases were $113MM and $1.3B, respectively. In addition, the Company has guaranteed operating lease payments of its subsidiaries of $914MM. The Company has a purchase commitment for 38 turbines the cancellation of which would cost an undisclosed amount (the disclosed cancellation liability for 71 turbines at FYE 2003 was $100MM. Additionally, CPN has two tolling agreements with one of its unconsolidated equity method investees that require minimum future payments with a present value of approximately $624MM-as the Company is a 50% owner of the counter party half the amount or $312MM should be added to the balance sheet.

CPN also discloses it is "… committed under numerous geothermal leases and right of way, easement and surface agreements." Payments take the form of royalties and lease payments, production royalties were $28.7MM, $24.9MM, and $17.6MM for FYE 2004, 2003, and 2002, respectively. Some royalties accrue as a percentage of electricity production, though little detail as to the calculation methodology is provided. Specific data are not provided that would permit proper assessment of these off-balance sheet items.

Other off-balance sheet items include $540MM letters of credit and $13MM of surety bonds issued on behalf of affiliates. The Company also discloses that its pro rata share of the debt carried by unconsolidated equity method investees totaled $43MM at FYE 2004. The following disclosure is made in connection with off-balance sheet items:

"*In the course of its business Calpine and its subsidiaries have entered into various purchase and sale agreements relating to stock and asset acquisitions or dispositions" in connection with which the Company has provided unspecified indemnifications*."

Adjusted Balance Sheet

An adjusted balance sheet reveals a Company that is dramatically more leveraged than is demonstrated by reported results. As reported, liabilities equal 4.9X equity; after adjustment leverage increases to 8.1X equity.

Calpine Corporation Adjusted Balance Sheet December 31, 2004						
	Reported	**(1)**	**(2)**	**(3)**	**(4)**	**Adjusted (5)**
Current Assets	$3,563.6	--	--	--	--	$3,563.6
LT Assets	23,652.5	1,413.0	--	312.0	--	25,377.5
Total Assets	**$27,216.1**	**$1,413.0**	**--**	**$312.0**	**--**	**$28,941.1**
Current Liabilities	3,285.4					3,285.4
LT Liabilities	18,949.6	1,413	914.0	312.0	543.0	22,131.6
Total Liabilities	**$22,235.0**	**$1,413.0**	**$914.0**	**$312.0**	**543.0**	**$25,417.0**
Minority Interest	395.4	--	--	--	--	395.4
S/H Equity	**$4,587.7**	**--**	**(914.0)**	**--**	**(543.0)**	**$3,130.7**
Liabilities + Equity	$27,216.1	$1,413.0	--	$312.0	--	$28,941.1
Assets/Liabilities	1.2					1.1
Liabilities/Equity	**4.9**					**8.1**

($ MM, except percentages, Numbers may not add due to rounding)
(1) Operating and equipment leases of $113MM and $1.3B respectively.
(2) Subsidiary operating lease guarantees of $914MM.
(3) Acadia Tolling agreements 50% of $624MM.
(4) Affiliate letters of credit and surety bonds of $540MM and $13MM, respectively.

Derivatives

Adoption of SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" had, according to management, a 'profound' impact on the manner in which the Company accounts for its energy contracts and transactions. The Company maintains that virtually all of its energy contracts qualify for exemption from SFAS 133 as they may be classified as "normal purchase and sales contracts". Two results of the exemption according to the Company are 1) no requirement to include 'normal' derivative energy contracts on the balance sheet at fair value, and 2) fluctuations in the contracts are not required to be reported in earnings.

The Company entered into cash flow hedges whereby it sold power derivatives on its unused production capacity, such activity is classified as a cash flow hedging. The Company, however, has not been able to produce power for the spot market without losing money for several years raising the question of what if anything is being hedged. The Company sold power that exceeded amounts produced by 53.1% 90.8%, 104.1%, and 229% for the years ended 2004, 2003, 2002, and 2001 respectively.

The Company discloses that at FYE 2004 the fair value of its power derivative instruments amounted to a net liability of $(70.5)MM, and that a 10% increase in the price of electric power would increase that liability by 123% or $157.2MM to $(227.6)MM. The fair value of natural gas derivatives is a net asset of $89.0MM, with a 10% price decline increasing the net asset by 5.0% to $4.5MM.

Unrecognized losses on cash flow hedges deferred in other comprehensive income totaled $(217.8MM) at FYE 2004 of which $137.6MM was expected to be reclassified to earnings in 2005. However, unrealized losses increased $188.0MM in the first half of 2005 to $(405.8)MM, and the loss to be recognized in 2005 earnings rose $164.6.MM to $(301.6)MM, $(37.0)MM of which had been recognized in earnings as of June 30, 2005.

Net Pre-Tax Hedge Derivative Contribution to EBT					
	6/30/05	2004	2003	2002	2001
Ineffective Cash flow hedges	$1.3	$9.1	$(2.8)	$(3.6)	$(5.2)
Undesignated non-cash flow hedges	(32.2)	(49.2)	(48.9)	(1.8)	120.7
Cash flow hedges	(37.0)	(89.9)	(55.6)	169.2	126.0
Total	(67.9)	(130.0)	$(107.3)	$163.8	$241.5
EBT	$(685.4)	$(717.4)	$281.7	$103.8	$921.0
Derivative contribution % of EBT	**10.1%**	**12.5%**	**(38.1)%**	**157.8%**	**26.2%**

($ MM, except percentages, Numbers may not add due to rounding)

Margin Deposits

The Company had cash margin deposits of $500MM June 30, 2005 up from $442MM at FYE 2004, such deposits totaled $385MM and $152MM at FYE 2003 and 2002, respectively. CPN is subject to margin calls as the result of its derivative trading activity; increased margin deposits could indicate unrealized derivative losses, deteriorating credit quality or both. During the first six months of fiscal 2005 the Company entered into a forward electric power contract with respect to power to be generated at its Deer Park facility whereby the Company sold discounted power in return for cash of $265.7MM. The rationale and extent to which power was sold at a discount is unclear from the disclosure, however, as shown below the Company's net derivative liabilities increased $347.8MM to $(409.1)MM at June 30, 2005 from $(61.3)MM at FYE 2004.

Current Derivatives	6/30/05	2004	2003	2002	2001
Assets	$383.9	$324.2	$497.0	$330.2	$820.1
Liabilities	501.5	365.0	456.7	189.4	634.5
Net	$(117.6)	$(40.8)	$40.3	$140.8	$185.6
LT Derivatives					
Assets	$714.4	$506.1	$674.0	$496.0	$578.8
Liabilities	1,005.9	526.6	692.1	528.4	862.8
Net	$(291.5)	$(20.5)	$(18.1)	$(32.4)	$(284.0)
Total Net	$(409.1)	$(61.3)	$22.2	$108.4	$(99.0)

Geographical Concentration

The Company is less geographically diversified than it might appear, though it produced electricity in 22 states and at locations in the UK and Canada in fiscal 2004, 51.9% of its production of electricity was accomplished using plants located in California and Texas. In 2004, the Company used gas-fired plants located in two states, at an average capacity utilization rate of 66.0% to produce 51.9% of its electricity; the remaining 48.1% of production was accomplished by plants in 20 states operating at an average capacity utilization rate of 20.7%. Additionally, CPN generated 7.6% of its 2004 power production and 149.6% of its operating income at its leased California-based geothermal plants. Geothermal power production fell as a percentage of total production to 7.6% in

2004 from 14.4% in 2001 yet its contribution to operating margin rose from 43.7% to 149.6% over the same period.

Geographical concentration of these critical facilities in a state seeking potentially ruinous redress for price gouging is a cause for concern. The increased relative contribution was driven by increased production at gas fired plants combining with higher natural gas prices to lower per kWh operating income at those plants from $7.91 in 2001 to $(0.97) in 2004; per kWh operating margin at the geothermal plants rose slightly from $36.46 to $38.73 over the same period. The Company's most lucrative long-term power purchase agreements have been made with the California Department of Water Revenue. However, California's regulators and legislature hope to recover substantial refunds of money it alleges it was overcharged by CPN and other electricity generators. CPN's role in and potential liability for electricity price overcharges in California between 2001 and 2002 has yet to be established. Additionally, the Company discloses that certain of its geothermal plants require recharging with effluent water in order to keep producing steam. Undisclosed, however, is the likelihood if any of geothermal production assets ceasing to be useful, or the costs incurred by the Company in its replenishment efforts.

Estimated Margin Contribution of California Geothermal Plants

California Geothermal	**6/30/05**	**2004**	**2003**	**2002**	**2001**
Production kWh	3.4MM(E)	6.8MM	6.7MM	6.3MM	6.1MM
% Company Total	8.5%	7.0%	8.1%	8.7%	14.4%
Revenue	$218.5	$400.5	$383.6	$279.0	$343.2
Operating Exp. (1)	(82.6)	(137.2)	$(137.7)	$(88.4)	$(120.8)
Operating Income	$135.9	$263.3	$245.9	$190.6	$222.4
% of Total (2)	**1,416.0%**	**149.6%**	**69%**	**42%**	**43.7%**

($ MM, except percentages and kWh. Numbers may not add due to rounding)

(1) Includes royalty expenses of $18.5MM, $28.7MM, $24.0MM, $17.6MM and $27.5MM for 6/30/05 and FYE 2004, 2003, 2002, and 2001, respectively.

(2) Operating Income of $(9.6)MM, $176.0MM, $356.4MM, $453.8MM, $508.9MM for 6/30/05 and FYE 2004, 2003, 2002, and 2001, respectively.

Working Capital

CPN's working capital management has deteriorated over the past three years as turnover decreased from 75X in 2002 to 16.9X in 2004 and days outstanding increased 16.9 days from 4.8 to 21.6 days.

The Company's operating cycle fell slightly from 47.3 days to 47.8 days at FYE 2004.

Accounts receivable days outstanding decreased by 0.6 days from 41.9 days in 2002 to 41.3 days in 2004 while inventory days outstanding increased by 1.2 days from 5.3 to 6.5 days over the same period.

CPN's cash cycle increased by 31.7 days from (23.9) days in 2002 to 7.8 days in 2004 driven by a 31.2 day decrease in payables days outstanding. Decreased days outstanding for accounts payable indicates decreased liquidity and possibly a deteriorating short-term credit profile.

It is important to note that the Company's substantial energy trading operations have been presented in its financial statements on a gross basis through fiscal 2003.

The policy resulted in meaningful overstatement of revenue and cost of goods sold thereby distorting working capital calculations.

Working Capital Management			
	For the year ending December 31,		
($MM)	2004	2003	2002
Average Working Capital (1)	546.7	185.0	98.5
Turns	16.9	48.2	75.0
Days Outstanding	21.6	7.5	4.8
Average Accounts Receivable	1,043.1	867.1	856.0
Turns	8.9	10.3	8.6
Days Outstanding	41.3	35.0	41.9
Average Inventory	158.6	122.0	93.9
Turns	56.0	65.9	68.0
Days Outstanding	6.5	5.5	5.3
Average Accounts Payable	976.5	1,087.8	1,262.0
Turns	9.1	7.4	5.1
Days Outstanding	40.0	48.7	71.2
Operating Cycle	47.8	40.5	47.3
Cash Cycle	7.8	(8.2)	(23.9)

Numbers may not add due to rounding.
Operating Cycle equals accounts receivable days outstanding plus inventory days.
Cash Cycle equals operating cycle minus payable days outstanding.
(1) Working Capital is calculated as current assets-comprised of (accounts receivable +margin deposits and ppd. expense+current derivative assets+inventory) less current liabilities-comprised of (accounts payable + accrued expenses + capital lease obligation current derivative liabilities).

Taxes

The Company's effective tax rate has demonstrated volatility over the five year period ended 2004 due to the impact of non-recurring items described as state and foreign taxes, tax credits, and 'other'. Wide variance in effective tax rates lowers the quality of reported earnings. Additional distortion is provided in 2004 by the Company's reclassification of certain operations as discontinued.

Reconciliation of Statutory and Effective Tax Rates					
	2004	2003	2002	2001	2000
Statutory Rate	(35)%	35%	35%	35%	35%
Depletion & other	1.38	0.8	(0.2)	--	--
State Tax	(0.5)	4.8	29.9	2.0	3.8
Foreign tax	--	(83.2)	(102.8)	(3.2)	2.2
Valuation	(4.8)	--	--	--	--
Tax Credits	(0.2)	(2.3)	(9.0)	--	--
Other (1)	0.6	44.8	8.5	--	--
Effective Tax Rate	**(38.6)%**	**(0.1)%**	**(38.6)%**	**33.8%**	**41.0%**

Numbers may not add due to rounding.
(1) Includes U.S. tax on Foreign Income.

Calpine Corporation 5-year Tax Profile

	2004	2003	2002	2001	2000
EBT					
U.S. ($)	(552.9)	42.7	94.6	914.5	529.5
U.S. (%)	77%	39%	244%	104%	94%
Foreign ($)	(164.5)	967.0	(55.9)	(33.9)	34.8
Foreign (%)	23%	61%	(144)%	(4%)	6%
Total	**(717.4)**	**109.6**	**38.7**	**880.6**	**564.3**
Tax Expense					
U.S. ($)	(166.5)	(53.9)	78.0	307.2	212.9
U.S. (%)		5390%	(523)%	103%	92%
Foreign ($)	(110.0)	53.7	(92.9)	(9.6)	18.5
Foreign (%)		(5370)	623%	(3)%	8%
Total Tax Exp.	(276.5)	(.1)	(14.9)	297.6	231.5
Current Portion	**11.2**	**151.9**	**(29.7)**	**233.0**	**254.7**
Deferred Portion	**(287.7)**	**(152.1)**	**14.7**	**64.6**	**(23.3)**
Cash Taxes Paid	**22.9**	**18.4**	**15.5**	**272.0**	**144.4**
Cash as % of Current Taxes	(1256)	12.1%	(52.2)%	117%	56.7

($ MM, except percentages amounts)
Numbers may not add due to rounding.

Return on Equity

The Company's return on shareholders' equity has fallen from 21.8% in 2000 to (5.3)% in 2004. An increased interest burden and deteriorating margins more than erased the benefits derived from lower taxes, increased turnover, and greater leverage.

CPN's tax burden as measured by {1-(NI/EBT)} improved from 38.6% in 2000 to (94.0)% in 2004, as the Company recorded a net tax benefit of $242.0MM in 2004 on EBT of $469.0MM.

Turnover, as measured by (Sales/Average Assets) improved slightly from 0.332X to 0.339X over the five-year period. The turnover figure is likely overstated, however, due to the Company's use off-balance sheet financing devices such as operating leases for power generation plants.

Leverage, as measured by (Average Assets/Average Equity) increased from 4.2X to 5.9X as average assets increased 382% from $7.1B in 2000 to $27.3B in 2004 while average equity rose 272% from $1.7B to $4.6B in 2004.

The Company's interest burden as measured by {1-(EBT/EBIT)} has increased from 17.5% in 2000 to 119.0% in 2004. Interest is understated, however, due to capitalized interest expense. Including capitalized interest in interest expense would increase reported 2004 interest expense by 33% from $1,141MM to $1,517MM, an amount equal to 226% of EBIT. The interest burden has increased over the past 5 years as the result of increased borrowings at increasing rates of interest.

Additionally, reported interest expense has increased as previously capitalized interest is expensed upon completion of construction projects.

The Company's operating margins as measured by (EBT/Sales) have deteriorated from 30.6% in 2000 to 7.3% in 2004. The 2330bp decline is attributable primarily to a shift in the mix of revenue sources towards lower margin sales of purchased power and gas.

Decomposition of Company's Return on Equity						
	Taxes NI/EBT	**Financing** EBT/EBIT	**Operations** EBIT/SALES	**Turnover** SALES/AVG. ASSETS	**Leverage** AVG.ASSETS/ AVG.EQUITY	**ROE**
2000	61.4	82.5	30.6	33.2	422.0	**21.8**
2001	67.7	78.1	17.6	41.6	598.7	**23.1**
2002	80.9	24.0	8.3	32.5	662.4	**3.5**
2003	72.9	34.0	12.9	35.1	596.4	**6.7**
2004	1.94	(19.0)	7.3	33.9	592.1	**(5.3)**

(Figures represent percentages)

Restated Financials

The Company's financial statements were restated for fiscal 2000 and 2001 as the result of improper accounting classifications made by Arthur Andersen ("AA") of $700MM worth of sale/leaseback transactions. The accounting misclassification was discovered by Deloitte and Touche, LLP ("DT") after they were hired to replace AA for fiscal 2002 and involved treatment of sale/leaseback transactions whereby power plants were sold to special purpose vehicles in return for $700MM and execution of a long-term operating lease on the plants. DT argued that the treatment was improper and that rather than treating the transaction as an asset sale and operating lease, it was in fact a financing transaction. The required adjustment put the assets back on the balance sheet with an offsetting increase to debt. The Company disagreed with DT's findings and though they ultimately changed the treatment of those transactions, DT was replaced by PricewaterhouseCoopers ("PWC") for fiscal 2003.

The impact of restating its results to reflect Deloitte's reccomendations was muted to a material extent by including in the restatement the Company's retroactive application of 3 new accounting policies. The Company applied three new accounting standards in restating its results for fiscal 2001 and 2000.

SFAS No.*145 "Accounting for the Impairment of Long-Lived Assets and Long-lived Assets to be disposed of"* with respect to 2002 sales of oil and gas properties and the Depere Energy Center.

SFAS No.145, "*Recission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections"* with respect to reclassification of gains and losses associated with debt retirement in 2001 and 2000.

EITF Issue No. 02-3 *"Issues Related to Accounting for Contracts Involved in Energy Trading".*

Litigation

The Company is subject to numerous lawsuits and potential regulatory sanctions which if not resolved in the Company's favor could have a material impact on its financial position. Litigation and potential regulatory sanctions to which CPN is subject include, 1) Class action and individual lawsuits filed on behalf of or by investors, 2) a breach of contract suit brought by the Nevada Power Corp., and 3) ongoing scrutiny by state and federal authorities of the Company's activities in the California power market.

Stock-based Compensation

The Company has not adopted SFAS No. 123 "Accounting for Stock-based Compensation", and thus does not expense all of its stock-based compensation at fair value, a policy that lowers quality of earnings. The Company's pro-forma stock-based compensation disclosures suffer from the use of varying volatility measures in calculating option values. CPN assigns a lower volatility to options awarded senior management, which results in a lower pro forma option expense calculation.

Stock-Based Compensation Expense			
	For the year ending December 31,		
	2004	2003	2002
Reported Net Income	$(242.5)	$282.0	$118.6
Option Expense, net	(4.9)	(11.6)	(35.6)
Pro Forma Earnings	$(247.3)	$270.4	$83.0
EPS			
Basic, as reported	$(0.56)	$0.72	$0.33
Basic, pro forma	$(0.57)	$0.69	0.23
% Change	(1.8)%	(4.2)%	(30.3)%
Diluted, as reported	$(0.56)	$0.71	$0.33
Diluted, pro forma	$(0.57)	$0.68	$0.23
% Change	**(1.8)%**	**(4.2)%**	**(30.3)%**

($ MM, except per share amounts)
Numbers may not add due to rounding.

2. Accounting Policies (★)

Positive Aspects

Oil & Gas Exploration

CPN has adopted a conservative policy with respect to the costs associated with exploration, choosing to expense rather than capitalize the drilling costs associated with dry holes.

Negative Aspects

Un-audited Operational Data

CPN makes the remarkable disclosure in its 2003 and 2004 10Ks that operational data contained in that report is unaudited. The Company discloses the following with respect to operational data contained within the 10K:

" Operational data including,, but not limited to , megawatts ("MW"), megawatt hours ("MWh"), billions cubic feet equivalent ("Bcfe") and thousand barrels ("MBbl"), throughout this Form 10-K is unaudited."

Prior year statements do not include such wording. Operational data is clearly critical to any meaningful evaluation of the Company's results and financial position. To the extent the Company's financial statement footnotes and MD&A involve disclosures, discussion or analysis of its operations that information uncertainty exist as to reliability.

Revenue Recognition

CPN's revenue recognition polices have changed in each of the past three years, are complex, and grant management significant discretion over the timing and amounts of certain revenue items. The Company's recognized two types of revenue in fiscal 2004, recognition policies for which are stated

2004--"*This includes electricity and steam sales, transmission sales revenue and sales of purchased power for hedging, balancing and optimization. Subject to market and other conditions, the Company manages the revenue stream for the portfolio of its electric generating facilities. The Company markets on a system basis both power generated by its plants in excess of amounts under direct contracts between the plant and a third party, and power purchased from third parties, through hedging, balancing and optimization transactions*

2003-Electric Generation and Marketing Revenue-"*This includes electricity and steam sales and sales of purchased power for hedging, balancing and optimization. Subject to market and other conditions, the Company manages the revenue stream for the portfolio of its electric generating facilities. The Company markets on a system basis both power generated by its plants in excess of amounts under direct contracts between the plant and a third party, and power purchased from third parties, through hedging, balancing and optimization transactions. CES performs a market-based allocation of total electric generation and marketing revenue to electricity and steam sales (based on electricity delivered by the Company's electric generating facilities) and the balance is allocated to sales of purchased power".*

2001- Electric Generation and Marketing Revenue-"*This includes electricity and steam revenue, sales of purchased power and mark-to-market gains from electric power derivatives. Electrical energy revenue is recognized upon transmission to the customer, and capacity and ancillary revenue is recognized when contractually earned. In accordance with EITF Issue No. 91-6, revenues from contracts entered into or acquired since May 1992 are recognized at the lesser of amounts billable or amounts recognizable at an average rate over the term of the contract. The Company's Power sales agreements related to Calpine Geysers Company ("CGC") were entered into prior to May 1992. Had the Company applied the methodology described above to the CGC power sales agreements the revenues recorded for the years ended December 31, 2001, 2000, and 1999 would have been approximately $133,00 lower, $8.1million lower, and $24.2million higher, respectively. Net gains or losses from qualified hedges of electricity positions are included in electricity and steam revenues."*

2004- Oil and Gas Production and Marketing Revenue--*"This includes sales to third parties of oil, gas and related products that are produced by the Company's Calpine Natural Gas and Calpine Canada Natural Gas subsidiaries and, subject to market and other conditions, sales of purchased gas arising from hedging balancing and optimization transactions. Oil and Gas sales for produced products are recognized pursuant to the sales method, net of royalties. If the Company has recorded gas sales on a particular well or field in excess of its share of remaining estimated reserves, then the excessive gas sales imbalance is recognized as a liability. If the Company is under-reduced on a particular well or field, and if it is determined that an over-produced partner's share of remaining reserves is insufficient to settle the gas imbalance, the Company will recognize a receivable to the extent collectible, from the over produced partner."*

2003-Oil and Gas Revenue-*"This includes sales to third parties of oil, gas and related products that are produced by the Company's Calpine Natural Gas and Calpine Canada Natural Gas subsidiaries and, subject to market and other conditions, sales of purchased gas arising from hedging* *balancing and optimization transactions. Oils and Gas sales for produced products are recognized pursuant to the sales method, net of royalties. If the Company has recorded gas sales on a particular well or field in excess of its share of remaining estimated reserves, then the excessive gas sales imbalance is recognized as a liability. If the Company is under-reduced on a particular well or field, and if it is determined that an over-produced partner's share of remaining reserves is insufficient to settle the gas imbalance, the Company will recognize a receivable to the extent collectible, from the over produced partner."*

2001-Oil and Gas Production and Marketing Revenue-*This includes sales to third parties of oil, gas and related products that are produced by the Company's Calpine Natural Gas and Calpine Canada Natural Gas subsidiaries and also sales of purchased gas. Oil and gas revenues are recognized pursuant to the sales method.*

2003-Investments in Power Projects and Oil and Gas Properties-*The Company uses the equity method to recognize its pro rata share of net income or loss of an unconsolidated investment until such time, if applicable, that the Company's investment is reduced to zero, at which time losses are only recognized if there is a legal requirement to fund such losses. Once an investment is written down to zero equity income income is generally recognized only upon receipt of cash distributions from the investee. "For equity method investments the Company's share of income is calculated according to the Company's ownership or according to the terms of the appropriate partnership agreement."*

2001-Unconsolidated Investments in Power Projects-"*The Company uses the equity method to recognize as revenue its pro rata share of the net income or loss of the unconsolidated investment until such time, if applicable, that the Company's investment is reduced to zero, at which time equity income is generally recognized only upon receipt of cash distributions from the investee." "For equity method investments the Company's share of income is calculated according to the Company's ownership or according to the terms of the appropriate partnership agreement."*

2003-Mark-to-Market Activity, net- "*This includes realized settlements of and unrealized mark-to-market gains and losses on both power and gas derivative instruments undesignated as cash flow hedges, including those held for trading purposes. Gains and losses due to ineffectiveness on hedging instruments are also included in unrealized mark-to-market gains and losses."*

2001-Mark-to-Market Activity, net- No specific policy.

Project Development Costs

The Company carried capitalized project development costs of $150.2MM, $140.0MM, and $116.8MM on its balance sheets for fiscal 2004, 2003, and 2002, respectively. Operating items such as salaries are included in these amounts and thus may provide a mechanism for smoothing earnings. Upon completion of a particular construction project, a portion of project development costs is reclassified as PP&E. To the extent capitalized expenses include operating items the policy is not conservative in our opinion.

Disagreement With Auditor

The Company discloses that their independent auditors Deloitte & Touche LLP ("Deloitee") had resigned its audit relationship and that PWC had been appointed auditor for fiscal 2003. CPN also describes a disagreement with Deloitte involving the accounting treatment of sale/leaseback transaction which occurred during fiscal 200 and 2001 when Arthur Anderson had served as the firms auditors. The issues raised by Deloitte resulted in restatement of the consolidated financial statements for fiscal 2000 and 2001. Additionally, the restatement resulted in a number of yet-to-be-resolved shareholder suits.

Equity Method Investments	**The Company had investments in unconsolidated power projects of $374MM and $444.2MM at FYE 2004 and 2003, respectively.** The assets and liabilities of these subsidiaries should, for analytical purposes, be proportionately consolidated into CPN's financial statement to more accurately present the Company's results and financial position.

3. Clarity and Completeness of Footnotes (★★★★)

Positive Aspects

Restated Financial Statements	**The Company provides good detail with respect to the restatement of its FYE 2001 and 2000 financial statements.** The Statements were restated as a result of misclassification of sale/leaseback transactions in both years.
New Accounting Policies	**The many new accounting policies adopted by CPN and the financial statement impact are described in detail.**
Derivatives	**The Company provides clear and useful disclosure of its derivative positions and policies.** Counter-party credit quality data is also provided.
Oil & Gas Properties	**The Company provides extensive, though un-audited data on its oil and gas operations.**
Outstanding Debt	**Disclosure of the Company's outstanding debt obligations is detailed and helpful generally.** Detail is lacking on the deferred financing expenses associated with various debt issues.
Litigation	**CPN provides extensive detail with respect to the many legal and regulatory actions to which its subject, especially helpful were disclosures regarding the California energy market.**

Negative Aspects

Equity Method Investments	**Footnote disclosures are insufficient to perform an accurate proportionate consolidation of the Company's equity method investments.**

4. Management's Discussion and Analysis (★★★★)

Positive Aspects

Business Activities	**The MD&A provides a detailed discussion of its operating performance.** Useful information on operating trends and their impact on revenue and expenses is provided. Helpful additional information would include details with respect to CPN's captive insurance operation.
Capital Requirements	**CPN provides a thorough discussion of issues impacting its liquidity and the capital resources it hopes to utilize in meeting its funding needs.**

Risks — **Risks facing the Company are clearly described and include commodity price volatility, regulatory actions, legal actions, and competition from lower-cost electricity producers.**

Accounting Changes — **Management provides a good discussion of the numerous accounting changes it has adopted in recent years and often provides detail as to their financial statement impact.**

<u>Negative Aspects</u>

Capacity Utilization — **The MD&A does not address the implications of the Company's low capacity utilization at its plants with respect to its competitive position and its plans to add substantial capacity over the next three years.**

5. Governance (--)

<u>Positive Aspects</u>

Audit Committee — **The Audit Committee met 10 times in 2004 and is comprised entirely of outside Directors, one of whom appears to possess the required financial expertise.** The Company discloses, however, that the individual with the apparent financial expertise also serves concurrently on the Audit Committees of three other companies.

<u>Negative Aspects</u>

Committee Members — **The Board of Directors has established an Indenture Committee that "is empowered to take actions on behalf of the Board with respect to certain indentures and debt facilities of the Company." The powers given this Committee are vaguely described leaving unclear its actual function.** The Company's Chairman chairs the Committee; its one other member is also an insider. The Committee did not meet in 2004 and acted by unanimous written consent three times in 2004. Governance would be enhanced if the Committee were not comprised entirely of insiders.

Controls & Procedures — **Material deficiencies in CPN's controls and procedures were identified by its auditors in connection with preparation of its fiscal 2004 and 2003 audits.** CPN discloses in its 10K filing for 2003 the following with respect to its controls and procedures:

"…our independent auditors reviewed our information systems control framework and identified to us certain significant deficiencies in the design of such systems. These design deficiencies generally related to the number of persons having access to certain of our information system databases, as well as the segregation of duties of persons with such access. The Company has concluded that, in the aggregate, these deficiencies constituted a material control weakness…"

The Company goes on to state that after review they determined that no material errors had been made in their financial statements and that they had corrected the problems raised by their auditors PriceWaterhouseCoopers, LLC. The exrent and scope of the deficiencies is not described nor is any mention made of any impact on on prior years results.

CPN discloses in its 10K filing for 2004 the following with respect to its controls and procedures:

" As of December 31, 2004, the Company did not maintain effective controls over the accounting for income taxes and the determination of current income taxes payable, deferred income tax assets and liabilities and the related tax provision (benefit) for continuing and discontinued operations."

The Company goes on to state that the deficiency resulted in restatement of its September 30, 2004 consolidated financial statements and could result in future misstaements of the Company's tax position. And that:

"Because of this material weakness , we have concluded that the Company did not maintain effective internal control over financial reporting as of December 31. 2004."

Related Party Transactions

The Company has disclosed several related party transactions. In June of 1999, the Company made an interest free five-year loan of $500M to an executive vice president of the Company.

The Company has had an annual consulting agreement with one of its Directors since fiscal 2000 under which the Director *"…provides advice and guidance on various management issues to the Chief Executive Officer and members of the Chief Executive Officers senior staff."* Under the terms of the agreement, the Director (a former employee of the Company) received payment of $5M per month in 2004 as well as 14M options. Related party transactions detract from corporate governance.

CFTC Fine

CPN discloses that in January 2004 it paid a fine of $1.5MM to the Commodities Futures Trading Commission to settle a complaint stemming from inaccurate reporting of trading information during 2001 and 2002.

Directors

The Company has established three classes of Directors, with staggered elections occurring for one class each year; corporate governance is enhanced by annual election of all Directors. The Company's Board of Directors is comprised of 9 members, three of whom are insiders. Directors are equally split between the three classes and each class has one inside Director. To the extent staggered elections and separate classes of Directors prevent a change in control from occuring they are negative for corporate governance.

The Company's Directors are well compensated with an initial allotment of 20,000 options and annual compensation of $42M and 3,500 options. Governance is enhanced when Directors are compensated with equity rather than cash.

Chairman & CEO

The positions of Chairman and CEO are combined at the CPN, which detracts from the quality of corporate governance.

Poison Pill

The Company has adopted a shareholders' rights plan and various other 'poison pill' provisions, such as accelerated options vesting, designed to inhibit a hostile takeover; such provisions detract from the quality of corporate governance. In the event of a change in control (defined by CPN as acquisition of 15% of the Company's shares) all outstanding option awards will vest and be redeemed in cash in an amount equal to fair market value less the strike price. 'Fair value' for calculating the cash to be exchanged for options will equal the 'takeover price' defined as the highest per share price paid during the tender offer. The Company makes the following statement with respect to the exchange: *"No approval of the Board or any program administrator is required in connection with such surrender and cash distribution"*. Such a policy seems to hold the potential for a ruinous cash payout with no apparent system of control.

Special Bonus

The Board of Directors authorized payment of a special bonus of $100M to the Chairman of its Audit Committee, "…for his outstanding efforts as chairman of the Audit Committee during 2002 and 2003". As no detail is provided as to how the bonus was earned it is not possible to evaluate its propriety.

Disagreement With Auditors

The Company has had three audit firms in as many years. Arthur Andersen was replaced by Deloitte and Touche for fiscal 2002, and PriceWaterhouseCoopers replaced DT in 2003. DT was replaced by PWC due in part to a disagreement with management over "…interpretation of several provisions in power sales agreements associated with two plants for which the Company utilized sale/leaseback transactions". Disagreements with auditors over accounting issues that result directly or indirectly in a change of auditors are not considered positive for corporate governance.

Audit Fees

Fees paid by the Company to its auditor for audit and audit-related services totaled $12MM for fiscal 2004; the Company does not disclose whether PWC was paid fees for any other services.

Shareholder Proposals

According to the Company's 2003 10K, shareholders at the 2003 shareholders' meeting approved two proposals that would improve corporate governance; however, there appears to be no evidence of implementation in fiscal 2004. One proposal opposed by management but approved by shareholders called for the elimination of the Company's shareholders rights plan:

"*RESOLVED, that the shareholders of Calpine Corporation request the Board of Directors to redeem the shareholders rights plan that was adopted in 1997 unless such plan is approved by a majority vote of shareholders to be held as soon as may be practicable.*"

The second proposal opposed by management and approved by shareholders called for declassification of the Company's Board of Directors:

"RESOLVED, that the shareholders of the Calpine Corporation urge that the Board of Directors take the necessary steps to declassify the Board of Directors for the purpose of establishing annual elections for directors. The Board of Directors declassification shall be done in a manner that does not affect the unexpired terms of directors previously elected."

Unresponsiveness by a corporate Board to the results of shareholder votes is, in our opinion, negative for corporate governance.

<u>Section II - The Company</u>

Calpine Corporation owns and operates electric power generation facilities in the United States, Canada, and the United Kingdom. The Company is also engaged in oil and gas exploration and production in the United States and Canada. CPN reported revenue of $9.2B, net income of $(242.5)MM, and diluted EPS of $(0.56) for its fiscal year ended December 31, 2004. For the six month period ended June 30, 2005 the Company reported revenue of $4.3B, net loss of $(467.2)MM, and diluted EPS of $(1.04).

<u>Sources:</u>
SEC forms 10-K-2004, 2003, 2002, 2001 and 2000; 10-Q June 30, 2005; March 31, 2005; 8-K June 14, 2004, May 26, 2004, May 6, 2004; U-57 October 5, 2001, August 31, 2001Proxy Statement 2005, 2003, 2002 and 2001; Company website.

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<u>Note:</u>
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