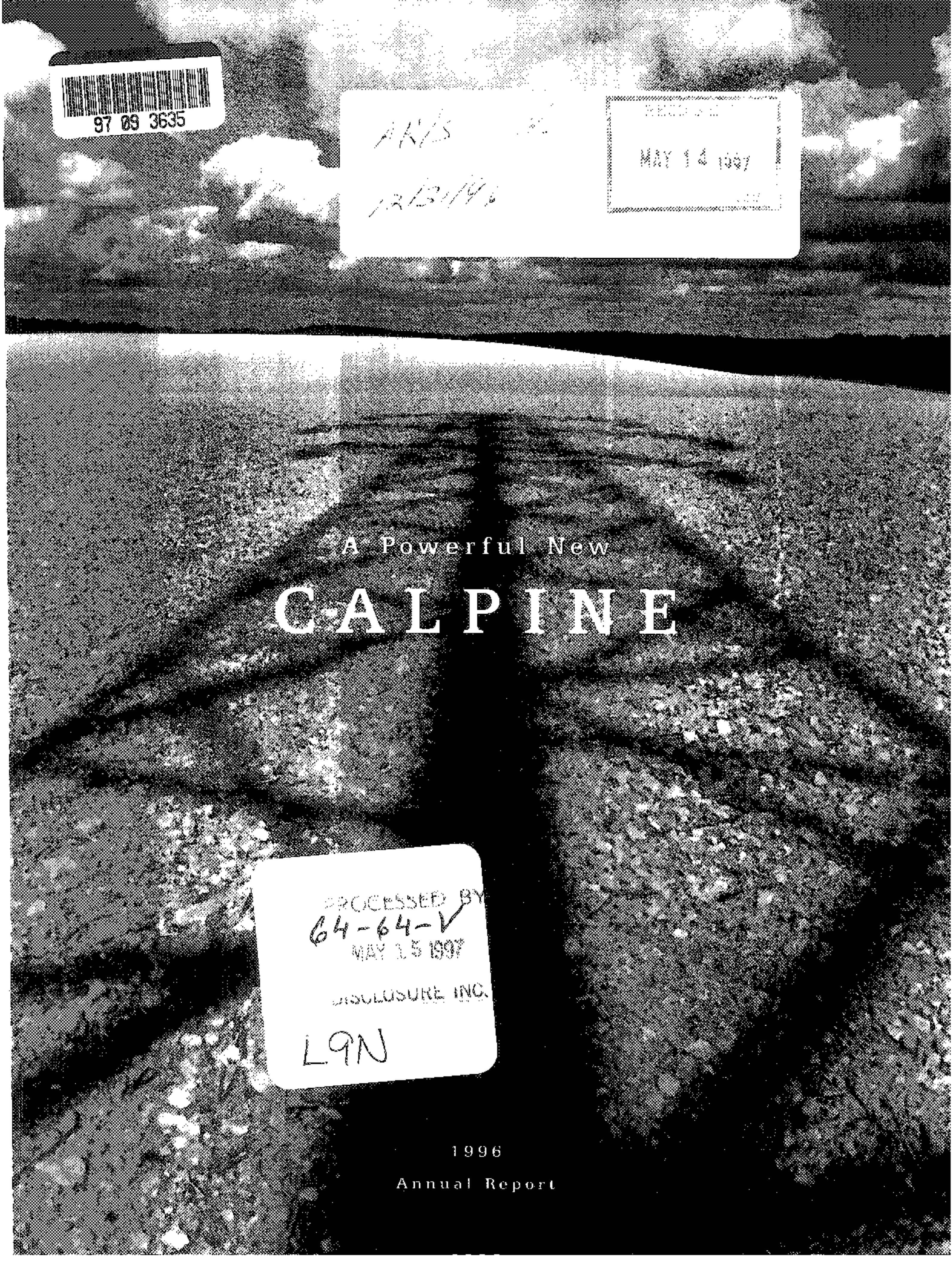


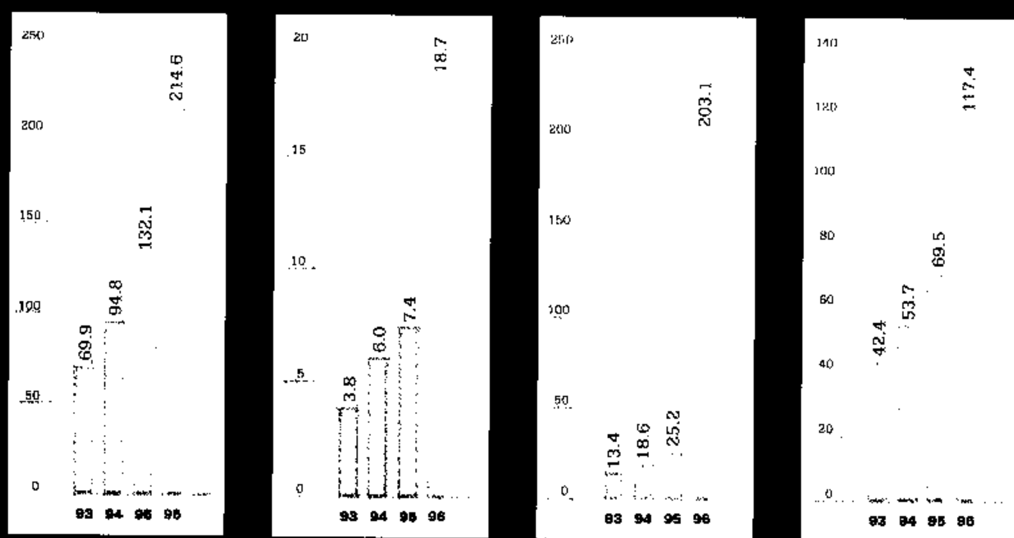
A Powerful New CALPINE

1996

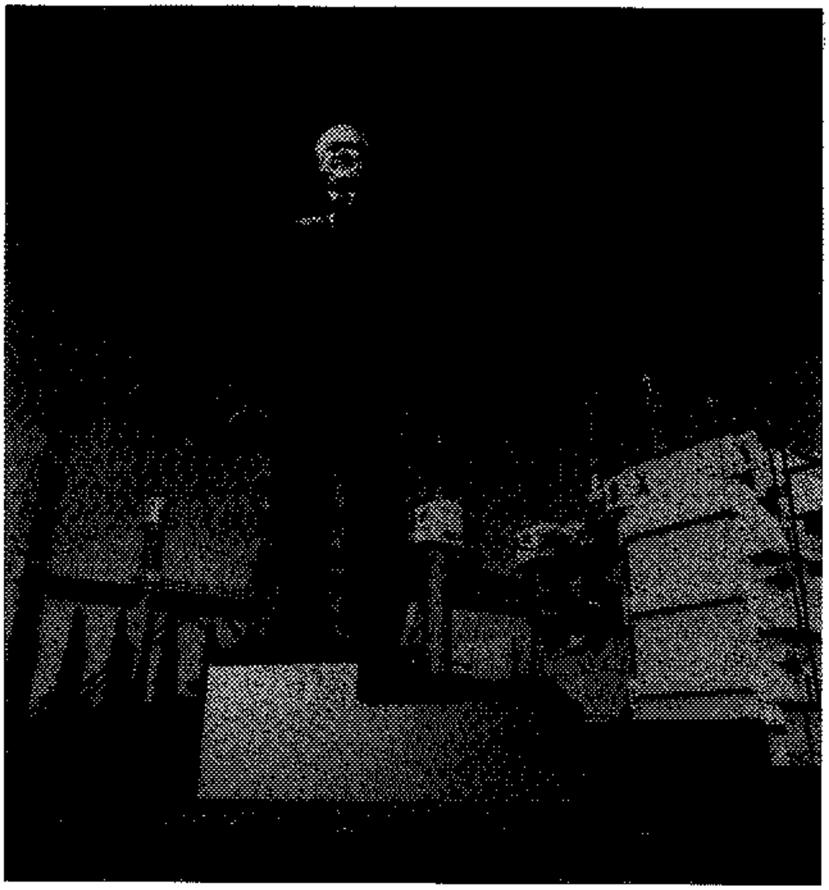
Annual Report

CALPINE is a fully integrated power company providing low-cost electricity and steam to customers in the United States and in selected international markets. We're a hands-on, entrepreneurial organization. Our staff of energy professionals is experienced in every aspect of power generation — engineering, construction, finance, fuel supply, operations and power marketing. We founded Calpine in 1984 to participate in the new power industry as competition was beginning to replace regulation. With our public offering in 1996 we are a new company, poised for growth in the $800 billion worldwide power market.

Dollars in Millions



REVENUE   NET INCOME   STOCKHOLDERS' EQUITY   EBITDA



"We're all proud of the Calpine we've built over
the last 12 years—1,000 megawatts and increasingly profitable.
But this is just the beginning. We entered 1997 as a
powerful new company, committed to
continued growth of revenue and profits."

PETER CARTWRIGHT

TO OUR STOCKHOLDERS

CALPINE ENTERED 1997 AS A NEW COMPANY, with new owners and a renewed commitment to leadership in the deregulated U.S. power industry and the immense worldwide power markets.

We are now a public company, owned by a prestigious group of investors, including leading financial institutions, private investors, and Calpine management and employees. (An impressive 97% of our employees are now stockholders.) For strategic business reasons, Electrowatt Ltd., the Swiss holding company that had been a shareholder since 1984, sold its entire interest in Calpine in our September 1996 initial public equity offering. The relationship between Calpine and Electrowatt was long and mutually rewarding. Electrowatt's support of Calpine enabled our company to grow into an experienced, well-funded power company poised for powerful growth.

In 1996, we raised over $1 billion—including the sale of $317 million of Calpine common stock, a $180 million debt offering, $95 million in corporate commercial bank financings, a $50 million private placement and $364 million of non-recourse project debt. The $110 million Calpine received from the initial public offering is being used to fund our acquisition and development program.

Some highlights of our 1996 performance include:

- Revenue increased by 62% to $214.6 million.
- Net income rose 153% to $18.7 million.
- Earnings per share increased by 144% to $1.27.
- Plant availability was 96.8%, substantially above the industry average.
- Our assets grew by 86% to over $1 billion.

Calpine continued its dramatic growth by acquiring operating facilities and developing new power plants.

We completed two important transactions in 1996, greatly strengthening our portfolio of low-cost power generating facilities. In April, after an intense competition among many leading power companies, we completed the King City transaction. We were successful, not by offering the highest price, but by structuring an innovative, tax-efficient operating lease that created the greatest value for the lessor and for Calpine. In August, we acquired the Gilroy gas-fired power plant. Again, we were successful in winning this bid by creatively meeting the seller's needs. Each of these 120 megawatt (mw) cogeneration plants supplies steam to a food processing facility and electric power to Pacific Gas and Electric Company. Calpine has assumed management and operation of both power plants. With these additions, our net interest in gas-fired projects increased by 106% to 467 mw.

We entered 1997 with the strongest backlog of new acquisition opportunities in our history.

One significant highlight of our development program in 1996 was closing the $150 million non-recourse project financing for our Pasadena Power Plant in Texas. We are building this 240 mw gas-fired cogeneration facility using the *Calpine Construct* concept we developed for our Sumas plant. Rather than using a turnkey contractor, Calpine is acting as project manager, giving us the ability to achieve the lowest life-cycle plant costs. As a merchant plant, Pasadena is an industry first. It will be a highly-efficient, low-cost power producer designed to sell most of its power into the deregulated electric power market.

Pasadena will be the first plant of a planned $2.5 billion, 4,000 mw merchant plant program. Ten additional low-cost power plants are planned in California, Texas and other high-priced power markets over the next seven years.

We also made significant progress in two new business areas in 1996.

Internationally, we completed our first full year of geothermal well drilling operations at Cerro Prieto in northern Mexico. We are continuing development activities for geothermal projects in Indonesia. At year-end, we also had development activities under way for a large number of additional project opportunities in Asia, Latin America and Europe.

In 1996, there was great progress toward deregulating the $200 billion U.S. electric power industry. California passed legislation which will open the state's $20 billion market to retail competition beginning in 1998. Texas and states in the Northeast moved forward toward an open, deregulated power market.

Deregulation at the wholesale level is already a reality, opening a $90 billion market to competition. In March, we initiated trading power in this market. We began this program as a strategic effort to establish the contracts, information and processes we will need to become a national power company. We signed over 100 contracts that enable us to move power anywhere in the western grid and throughout much of the remaining U.S. market. We bought and sold 5.5 million megawatt hours in 1996.

Later in this report we highlight three important business areas: performance of our power projects, corporate and project financing, and our plans to grow Calpine. We also highlight three people: Dave Farris, Sumas Plant Manager; Gabrielle Krafft, Financial Analyst; and Angelo Urbani, Vice President-Construction. While each is indeed a superstar in a key business area, we are showcasing them as representative of the many superstars at Calpine.

1996 was a remarkable year for all of us. With the dynamic team we have in place, I look forward to a future bright with opportunity and growth.

Peter Cartwright

PETER CARTWRIGHT

Chairman, President and Chief Executive Officer

1996 was a Powerful Year of Growth

March

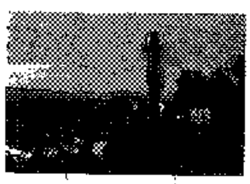
Calpine Initiates Power Trading

May

Calpine Raises $180 Million in Debt Offering

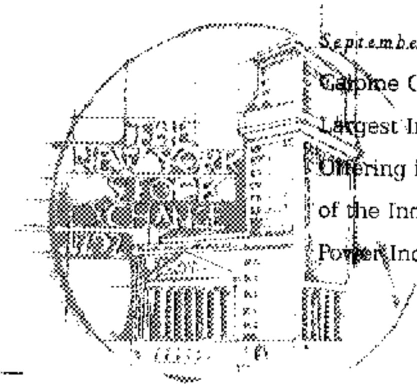
April

Calpine Signs Joint Venture with DATRA for Indonesian Geothermal Project



April

Calpine Completes King City Transaction— Adds 120 mw Power Plant Through Innovative Operating Lease



September

Calpine Completes Largest Initial Public Offering in the History of the Independent Power Industry

September

Calpine Completes $50 Million Corporate Credit Facility With Bank of Nova Scotia

August

Calpine Acquires 120 mw Gilroy Power Plant

September

California Passes Bill to Deregulate State's $20 Billion Electricity Market in 1998

September

Calpine Becomes 100% Publicly Held Company— Electrowatt Sells its Shares in Calpine

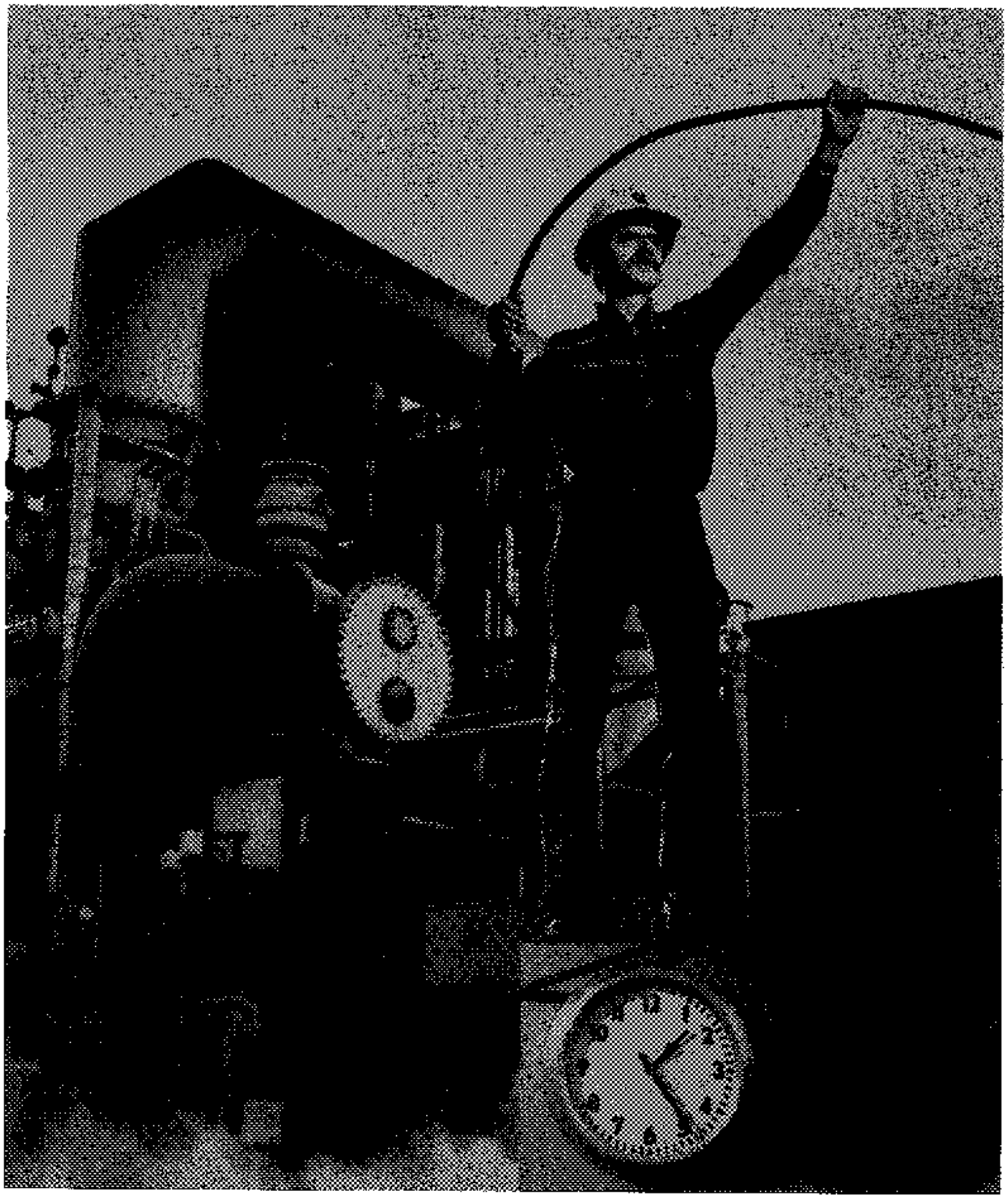
December

Calpine Closes $150 Million Financing for Merchant Power Plant—an Industry First

December

Calpine Achieves Record Results— Revenue Up 62% and Net Income Up 153% Over 1995

JANUARY FEBRUARY MARCH APRIL MAY JUNE JULY AUGUST SEPTEMBER OCTOBER NOVEMBER DECEMBER



"Hard work, dedication and autonomy—that's what goes into successfully operating a power plant. Since start-up, our Sumas team has achieved 97% plant availability."

DAVE FARRIS

Plant Manager

POWERFUL PERFORMANCE

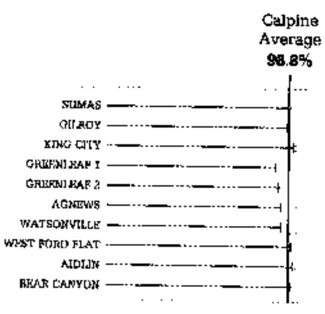
Our power facilities are the building blocks of the new Calpine. We count on them to generate the maximum power at the lowest cost per kilowatt hour.

We achieve this by selecting the best equipment and the best operators. We then give our operations staff at each facility full autonomy, plus the resources to run that facility at maximum efficiency. Each plant is treated as a separate business, and our people take a proprietary interest in obtaining the best possible performance from that business.

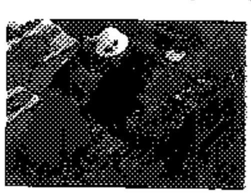
The results are impressive. One measure of performance is availability—the percent of time the plant is delivering, or is capable of delivering, electric power to the grid. In 1996, our plants were available 96.8% of the time. The 3.2% we were down covered all outages, both scheduled maintenance as well as unplanned shutdowns. The industry average for similar gas-fired plants is 89%. The 7.8% difference added directly to Calpine's bottom line. Our operations people are proud of this, and so are we.

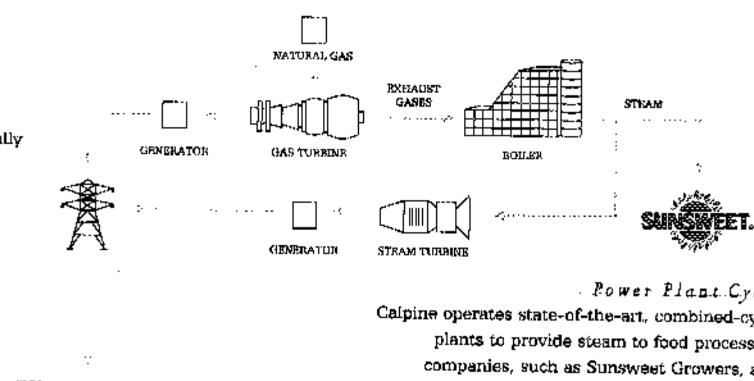
The proprietary interest our operators take in their plants results in reduced operating costs, innovative solutions to problems and fierce determination to keep our plants running. In August 1996, when power line failures throughout the West cut off power for more than 7.5 million utility customers, Calpine plants came back on line in minutes and poured enough power into the northern California grid to supply over half a million customers who would otherwise have been without electricity. At Sumas, our plant operated throughout a northern Washington cold spell when wind chill temperatures dropped to -50°F. And our Geysers geothermal plants and steam fields operated without interruption through the heaviest rains and flooding in decades—floods that washed out access to our Aidlin plant and disrupted transportation throughout The Geysers region.

Competence, autonomy and resources—a winning formula.



High Availability
Calpine operates all of its plants with availabilities that substantially exceed the industry average.





Power Plant Cycle
Calpine operates state-of-the-art, combined-cycle plants to provide steam to food processing companies, such as Sunsweet Growers, and electric power for sale to utility customers.

POWERFUL RETURNS

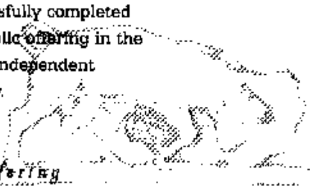
Power generation is a capital-intensive industry—it takes substantial financial resources to build or buy power plants. In 1996 alone, Calpine raised over $1 billion through the largest initial public offering in the history of our industry, through our second public debt offering, and through bank loans at both the corporate and project levels.

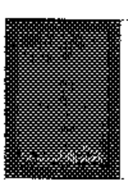
Our goal has always been to provide our investors with high returns on the funds they entrust to us and to provide our lenders with security and certainty of the servicing of our debt. The investors in the new Calpine include some of the most prestigious financial institutions in the United States, Canada, Europe and Asia, as well as many individual investors, including Calpine management and most employees. Calpine lenders include holders of Calpine public debt, and leading international banks and financial institutions who finance our power plants and steam fields.

We use Calpine's capital carefully and creatively to obtain the highest returns. In 1996, we won a competition among 70 bidders to complete the King City transaction. We prevailed not by offering the highest price, but by structuring an innovative, tax-efficient operating lease that created the greatest value for the lessor and for Calpine. We won the Gilroy acquisition against a higher bid by the largest company in our industry, again, by creatively meeting the seller's needs. Finally, we closed a non-recourse project financing for the first merchant plant in the industry, opening the door to a new era of profitable investment opportunities.

Calpine is moving forward as a new public company, with the same commitment we've always had to provide powerful returns for our investors.

IPO
Calpine successfully completed the largest public offering in the history of the independent power industry.

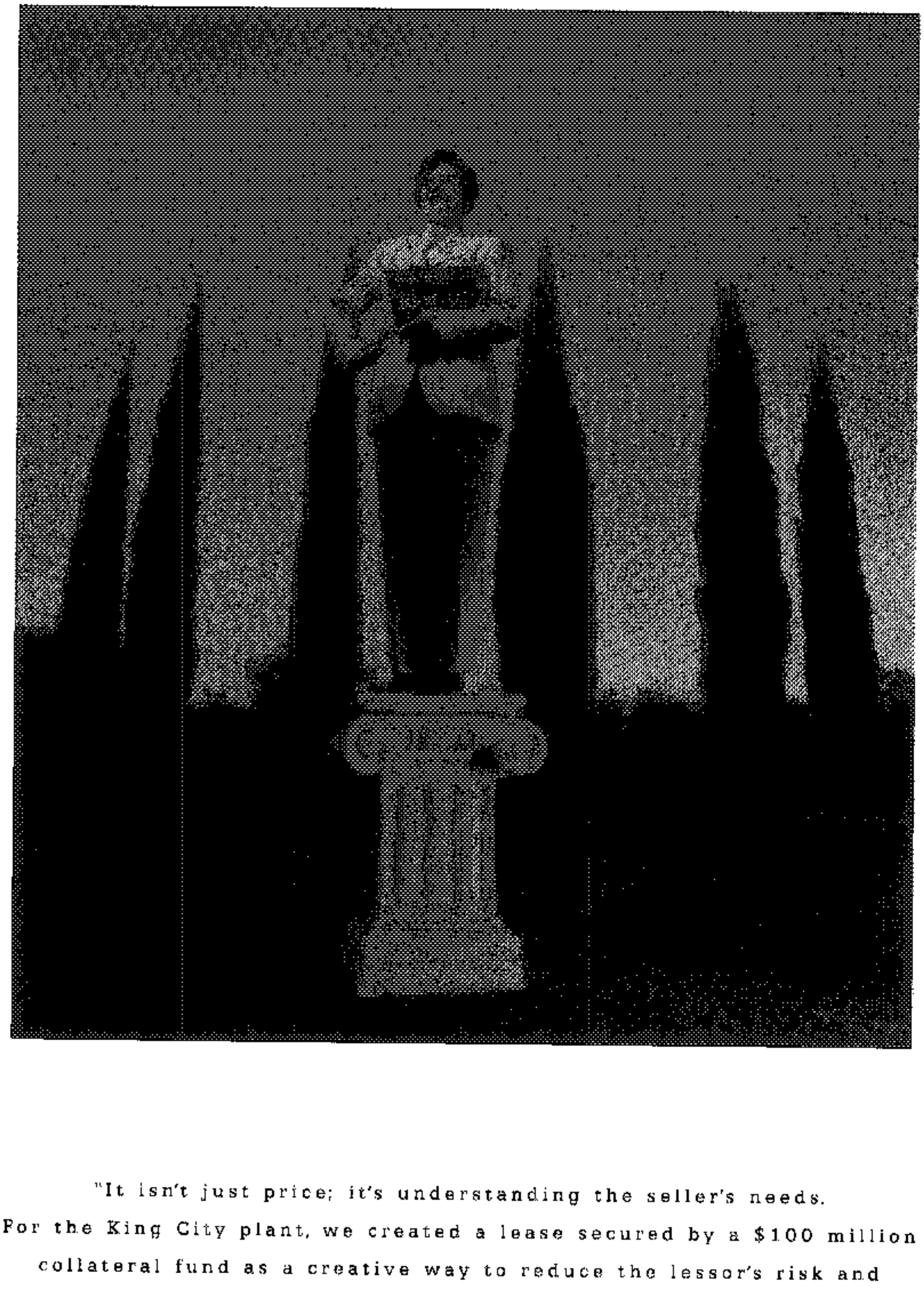




$180 Million Debt Offering
Calpine's second successful public debt offering, completed in 1996, funded our continued growth in the newly competitive power industry.

King City
An innovative operating lease and fully integrated capabilities gave Calpine a competitive edge in completing this strategic transaction.

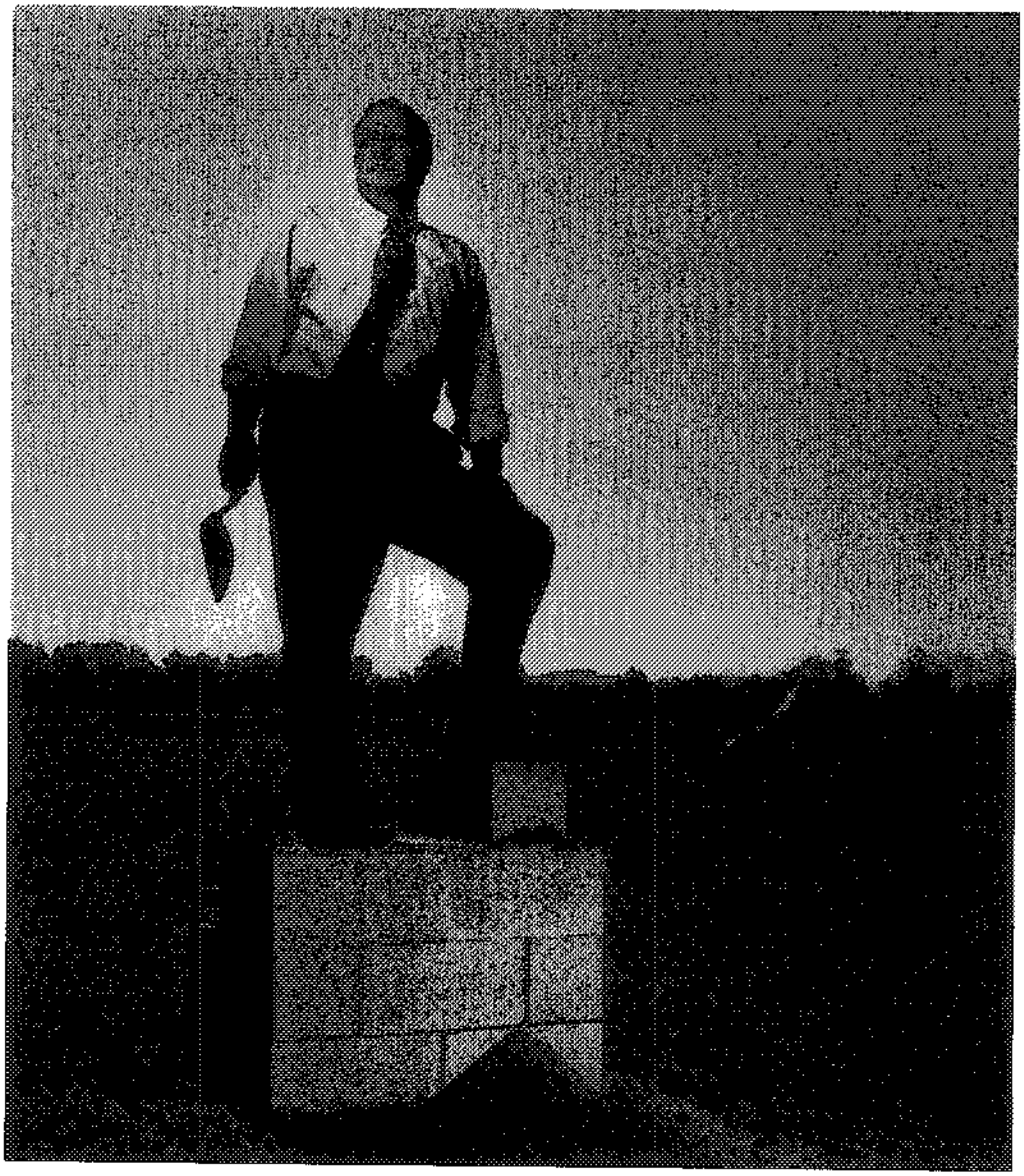
Gilroy
Our creative financing team continued our track record of closing deals with the acquisition of this 120 mw power plant.



"It isn't just price; it's understanding the seller's needs. For the King City plant, we created a lease secured by a $100 million collateral fund as a creative way to reduce the lessor's risk and achieve superior results for our lessor and for Calpine."

GABRIELLE KRAFFT

Financial Analyst



"A traditional turnkey approach for our Sumas plant would have added over $7 million to the cost of the project. We structured a unique alternative, *Calpine Construct*. At Pasadena, we're building on our Sumas success to create the most efficient gas-fired power plant in Texas."

ANGELO URBANI

Vice President-Construction

POWERFUL FUTURE

Calpine will continue to grow by adding to our portfolio of power projects. We will pursue that growth two ways—through acquisition of operating facilities and by development of new power plants.

In the past, we relied most heavily on acquisitions. We have acquired over 800 mw of prime generating facilities through carefully evaluating opportunities, selecting targets that meet our stringent investment criteria, and aggressively and creatively pursuing those that add the most value to Calpine.

As deregulation changes the composition of the U.S. power industry, more and more attractive acquisition opportunities are being presented to Calpine. Opportunities arise from consolidation of the independent power industry and from the sale of power plants owned by process industries. In 1996, we added 240 mw of gas-fired power plants developed by food processing companies. Another area of opportunity for Calpine: many investor-owned utilities are planning to sell their generating assets as they focus on electric power transmission and distribution.

Development of new plants will be increasingly important to Calpine. In 1996, we launched a program to develop highly-efficient, gas-fired power plants to sell electricity to customers in deregulated markets. The Pasadena Power Plant in Texas will be our first entry into this new market. When construction of this 240 mw plant is completed in 1998, it will be an industry first—a merchant plant built to supply steam and electric power to a large industrial customer, Phillips Petroleum Company, and to compete to sell the majority of its power into a deregulated market. We've launched a program to build additional merchant plants in other attractive markets across the country.

Over the last 12 years, we have created a solid foundation of experience and expertise in Calpine. That foundation is enabling us to build a powerful future for our Company.

Calpine manages every element of a power project's development—from design, engineering and finance through construction management, fuel procurement and operations.

Calpine Construct is an innovative alternative to a traditional turnkey approach to project development.

Our competitive edge positions Calpine as a low-cost producer, and our customers, such as Phillips Petroleum, benefit from low-cost, reliable energy.

POWERFUL LEADERSHIP

Today, Calpine is a new company—newly independent and poised for continued growth. In January 1997, we assembled a prestigious new Board of Directors to help guide Calpine into the future. Our directors bring a wealth of leadership and experience in industry, finance, government and academia.

Our new Board is committed to active involvement, providing oversight and guidance to Calpine as we make the transition from a privately held organization to a major publicly owned, worldwide power company.

Our Board now includes five outside directors and two members of senior management.

Calpine's founder, Peter Cartwright, is the new Chairman, replacing Pierre Krafft. Ann B. Curtis, a founding principal of the company who has managed the Board's affairs as Corporate Secretary, joins the Board as a Director (biographical profiles on page 60).

JEFFREY E. GARTEN *is Dean of the Yale School of Management. He has had a distinguished career in international trade and finance, including service as Undersecretary of Commerce for International Trade. In the private sector, he served as Managing Director of Lehman Brothers and the Blackstone Group. His publications on the international arena include two notable books—*A Cold Peace: America, Japan, Germany and the Struggle for Supremacy *and* The Big Ten: The Big Emerging Markets and How They Will Change Our Lives *(forthcoming in May 1997).*

SUSAN C. SCHWAB *is Dean of the School of Public Affairs at the University of Maryland. Before joining the university, she held a number of public and private sector positions in domestic and international trade. She was Motorola's Director, Corporate Business Development, responsible for evaluating and negotiating strategic alliances in domestic and international markets. Her government service included assignment as Assistant Secretary of Commerce for the U.S. & Foreign Commercial Service.*

GEORGE J. STATHAKIS *has had careers as an executive in the energy and semiconductor industries and as an international investment banker. He has held senior positions with General Electric Company, International Capital Corporation (a subsidiary of American Express) and Ramtron. Since 1994, he has been an advisor to Calpine.*

JOHN O. WILSON *is Executive Vice President and Chief Economist at Bank of America. John has enjoyed a rich career in finance, academia and in government service. He was a faculty member at the University of California Berkeley and Yale University. He served in the federal government as Assistant Secretary of the Department of Health, Education and Welfare, and held leadership posts in the Office of Economic Opportunity and the Atomic Energy Commission.*

V. ORVILLE WRIGHT *is one of the country's leading experts on transitioning organizations from highly regulated to deregulated environments. As Vice Chairman and Co-Chief Executive Officer of MCI, he played a prominent role in reshaping the communications landscape in America. He held leadership positions at Xerox, Amdahl, RCA and IBM.*

Board of Directors

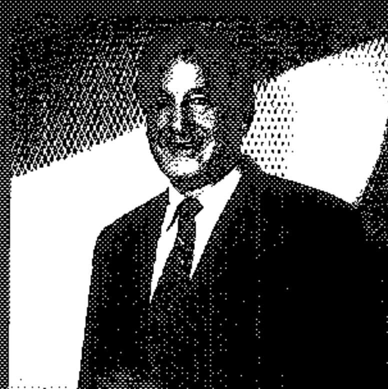
PETER CARTWRIGHT

ANN B. CURTIS

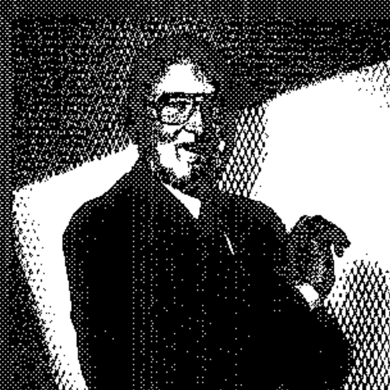
JEFFREY E. GARTEN

SUSAN C. SCHWAB

GEORGE J. STATHAKIS



JOHN O. WILSON



V. ORVILLE WRIGHT

LOOKING AHEAD. An abundant supply of reliable, low-cost electric power is essential for a modern industrial society. Around the world, countries are turning to the free market to meet their power needs. An $800 billion worldwide industry that grew up under government regulation is opening to a new era of competition.

Calpine is moving forward to become a major player in this new power industry.

TABLE OF CONTENTS

CALPINE CORPORATION AND SUBSIDIARIES
SELECTED CONSOLIDATED FINANCIAL DATA

The consolidated financial data set forth below for and as of the five years ended December 31, 1996 have been derived from the audited consolidated financial statements of the Company. The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the related notes thereto appearing elsewhere in this report, and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

YEAR ENDED DECEMBER 31,	1992	1993	1994	1995	1996
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)					
STATEMENT OF OPERATIONS DATA:					
Revenue:					
Electricity and steam sales	$ –	$53,000	$90,295	$127,799	$199,464
Service contract revenue	29,817	16,896	7,221	7,153	6,455
Income (loss) from unconsolidated investments in power projects	9,760	19	(2,754)	(2,854)	6,537
Interest income on loans to power projects	–	–	–	–	2,098
Total revenue	39,577	69,915	94,762	132,098	214,554
Cost of revenue	25,921	42,501	52,845	77,388	129,200
Gross profit	13,656	27,414	41,917	54,710	85,354
Project development expenses	806	1,280	1,784	3,087	3,867
General and administrative expenses	3,924	5,080	7,323	8,937	14,696
Compensation expense related to stock options [1]	1,224	–	–	–	–
Provision for write-off of project development costs [2]	800	–	1,038	–	–
Income from operations	6,902	21,054	31,772	42,686	66,791
Interest expense	1,225	13,825	23,886	32,154	45,294
Other income, net	(310)	(1,133)	(1,988)	(1,895)	(6,259)
Income before provision for income taxes and cumulative effect of change in accounting principle	5,987	8,362	9,874	12,427	27,756
Provision for income taxes	2,527	4,195	3,853	5,049	9,064
Income before cumulative effect of change in accounting principle	3,460	4,167	6,021	7,378	18,692
Cumulative effect of adoption of SFAS No. 109	–	(413)	–	–	–
Net income	$ 3,460	$ 3,754	$ 6,021	$ 7,378	$ 18,692
Primary earnings per share [3]					
Weighted average shares outstanding				–	14,680
Primary earnings per share				–	1.27
Fully diluted earnings per share [3]					
Weighted average shares outstanding				–	15,130
Fully diluted earnings per share				–	1.24
As adjusted primary earnings per share assuming conversion of preferred stock [3]					
Weighted average shares outstanding				14,151	–
Primary earnings per share				$ 0.52	–

(See footnotes on next page.)

YEAR ENDED DECEMBER 31,	1992	1993	1994	1995	1996
(IN THOUSANDS, EXCEPT RATIO DATA)					
OTHER FINANCIAL DATA AND RATIOS:					
Depreciation and amortization	$ 232	$12,540	$21,580	$26,896	$ 40,551
EBITDA [4]	$9,898	$42,370	$53,707	$69,515	$117,379
EBITDA to Consolidated Interest Expense [5]	4.73x	2.98x	2.23x	2.11x	2.41x
Total debt to EBITDA	3.70x	6.24x	6.23x	5.87x	5.12x
Ratio of earnings to fixed charges [6]	3.41x	2.09x	1.52x	1.46x	1.45x

AS OF DECEMBER 31,	1992	1993	1994	1995	1996
(IN THOUSANDS)					
BALANCE SHEET DATA:					
Cash and cash equivalents	$ 2,160	$ 6,166	$ 22,527	$ 21,810	$ 100,010
Property, plant and equipment, net	424	251,070	335,453	447,751	650,053
Total assets	55,370	302,256	421,372	554,531	1,030,215
Total liabilities	44,865	288,827	402,723	529,304	827,088
Stockholders' equity	10,505	13,429	18,649	25,227	203,127

(1) Represents a non-cash charge for compensation expense associated with the grant of certain options under the Company's stock option program.

(2) Represents a write-off of certain capitalized project costs.

(3) The weighted average shares outstanding and earnings per share for the year ended December 31, 1996 gave effect to the issuance of common stock upon the conversion of the Company's preferred stock in connection with the Company's initial public offering (see Note 1 of Notes to Consolidated Financial Statements). The presentation of fully diluted earnings per share for the year ended 1996 is not required by Accounting Principles Board Opinion No. 15, because it results in dilution of less than 3%. As adjusted primary earnings per share assuming conversion of preferred stock for the year ended December 31, 1995 is calculated using average shares outstanding, which includes common share equivalents using the treasury stock method and the assumed conversion of preferred stock to common stock as of January 1, 1995 in accordance with Securities and Exchange Commission staff policy. Earnings per share prior to 1995 have not been presented since such amounts are not deemed meaningful due to the significant change in the Company's capital structure that occurred in connection with its initial public offering.

(4) EBITDA is defined as income from operations plus depreciation, capitalized interest, other income, non-cash charges and cash received from investments in power projects, reduced by the income from unconsolidated investments in power projects. EBITDA is presented not as a measure of operating results, but rather as a measure of the Company's ability to service debt. EBITDA should not be construed as an alternative either (i) to income from operations (determined in accordance with generally accepted accounting principles) or (ii) to cash flows from operating activities (determined in accordance with generally accepted accounting principles).

(5) Consolidated Interest Expense is defined as total interest expense plus one-third of all operating lease obligations, capitalized interest, dividends paid in respect of preferred stock and cash contributions to any employee stock ownership plan used to pay interest on loans incurred to purchase capital stock of the Company.

(6) Earnings are defined as income before provision for taxes, extraordinary item and cumulative effect of change in accounting principle plus cash received from investments in power projects and fixed charges reduced by the equity in income from investments in power projects and capitalized interest. Fixed charges consist of interest expense, capitalized interest, amortization of debt issuance costs and the portion of rental expenses representative of the interest expense component.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Except for historical financial information contained herein, the matters discussed in this annual report may be considered "forward-looking" statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements include declarations regarding the intent, belief or current expectations of the Company and its management. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties; actual results could differ materially from those indicated by such forward-looking statements. Among the important risks and uncertainties that could cause actual results to differ materially from those indicated by such forward-looking statements are: (i) that the information is of a preliminary nature and may be subject to further adjustment, (ii) the possible unavailability of financing, (iii) risks related to the development and operation of geothermal energy resources, (iv) the impact of avoided cost pricing and energy price fluctuations, (v) the impact of curtailment, (vi) risks associated with power project development and acquisitions, (vii) start-up risks, (viii) general operating risks, (ix) the dependence on third parties, (x) risks associated with international investments, (xi) risks associated with the power marketing business, (xii) changes in government regulation, (xiii) the effects of seismic disturbances, (xiv) the availability of natural gas, (xv) the effects of competition, (xvi) the dependence on senior management, (xvii) volatility in the Company's stock price, (xviii) fluctuations in quarterly results and seasonality, and (xix) other risks identified from time to time in the Company's reports and registration statements filed with the Securities and Exchange Commission, including the Annual Report on Form 10-K for the year ended December 31, 1996.

GENERAL

Calpine is engaged in the acquisition, development, ownership and operation of power generation facilities and the sale of electricity and steam in the United States and selected international markets. The Company has interests in 15 power generation facilities and steam fields having an aggregate capacity of 1,047 megawatts. Since its inception in 1984, Calpine has developed substantial expertise in all aspects of electric power generation. The Company's vertical integration has resulted in significant growth over the last five years as Calpine has applied its extensive engineering, construction management, operations, fuel management and financing capabilities to successfully implement its acquisition and development program. During the last five years, Calpine has expanded substantially, from $55.4 million of total assets as of December 31, 1992 to $1.0 billion assets as of December 31, 1996. Calpine's revenue for 1996 increased to $214.6 million, representing a compound annual growth rate of 52.6% since 1992. The Company's EBITDA (see Selected Consolidated Financial Data) for 1996 increased to $117.4 million.

On September 9, 1994, the Company acquired Thermal Power Company, which owns a 25% undivided interest in certain steam fields at The Geysers steam fields in northern California ("The Geysers") with a total capacity of 604 megawatts for a purchase price of $66.5 million. In January 1995, the Company purchased the working interest in certain of the geothermal properties at the PG&E Unit 13 and Unit 16 Steam Fields from a third party for a purchase price of $6.75 million. On April 21, 1995, the Company acquired the stock of certain companies that own 100% of the Greenleaf 1 and 2 Power Plants, consisting of two 49.5 megawatt natural gas-fired cogeneration facilities, for an adjusted purchase price of $81.5 million. On June 29, 1995, the Company acquired the operating lease for the Watsonville Power Plant, a 28.5 megawatt natural gas-fired cogeneration facility, for a purchase price of $900,000. On November 17, 1995, the Company entered into a series of agreements to invest up to $20.0 million in the Cerro Prieto Steam Fields. In April 1996, the Company entered into a lease transaction for the 120 megawatt King City Power Plant, which required an investment of $108.3 million, primarily related to the collateral fund requirements. On August 29, 1996, the Company acquired the Gilroy Power Plant, a 120 megawatt gas-fired cogeneration facility, for a purchase price of $125.0 million plus certain contingent consideration, which the Company currently estimates will amount to approximately $24.1 million.

Each of the power generation facilities produces electricity for sale to a utility. Thermal energy produced by the gas-fired cogeneration facilities is sold to governmental and industrial users, and steam produced by the geothermal steam fields is sold to utility-owned power plants. The electricity, thermal energy and steam generated by these facilities are typically sold pursuant to long-term take-and-pay power or steam sales agreements generally having original terms of 20 or 30 years. Nine of these agreements with Pacific Gas and Electric Company ("PG&E") provides for both capacity payments and energy payments for the term of the agreement. During the initial ten-year period of certain agreements, PG&E pays a fixed price for each unit of electrical energy according to schedules set forth in such agreements. The fixed price periods under these power sales agreements expire at various times in 1998 through 2000. After the fixed price periods expire, while the basis for the capacity and capacity bonus payments under these power sales agreements remains the same, the energy payments adjust to PG&E's then avoided cost of energy, which is determined by the California Public Utilities Commission ("CPUC"). The currently prevailing avoided cost of energy is substantially lower than the fixed energy prices under these power sales agreements and is generally expected to remain so. While avoided cost does not affect capacity payments under the power sales agreements, in the event that the avoided cost of energy does not increase significantly, the Company's energy revenues under these power sales agreements would be materially reduced at the expiration of the fixed price period. Such reduction may have a material adverse effect on the Company's results of operations. The Company cannot predict the likely level of avoided cost energy prices at the expiration of the fixed price periods. Prices paid for the steam delivered by the Company's steam fields are based on a formula that partially reflects the price levels of nuclear and fossil fuels, and, therefore, a reduction in the price levels of such fuels may reduce revenue under the steam sales agreements for the steam fields.

Each of the Company's power and steam sales agreements contains curtailment provisions under which the purchasers of energy or steam are entitled to reduce the number of hours of energy or amount of steam purchased thereunder. During 1996, certain of the Company's power generation facilities experienced maximum curtailment primarily as a result of low gas prices and a high degree of precipitation during the period, which resulted in high levels of energy generation by hydroelectric power facilities that supply electricity. The Company expects maximum curtailment during 1997 under its power and steam sales agreements for certain of its facilities.

Many states are implementing or considering regulatory initiatives designed to increase competition in the domestic power generation industry. In December 1995, the CPUC issued an electric industry restructuring decision which envisions commencement of deregulation and implementation of customer choice of electricity supplier by January 1, 1998 (see Note 28 of the Notes to Consolidated Financial Statements). As part of its policy decision, the CPUC indicated that power sales agreements of existing qualifying facilities ("QFs") would be honored. The Company cannot predict the final form or timing of the proposed restructuring and the impact, if any, that such restructuring would have on the Company's existing business or results of operations. The Company believes that any such restructuring would not have a material effect on its power sales agreements and, accordingly, believes that its existing business and results of operations would not be materially adversely affected, although there can be no assurance in this regard.

SELECTED OPERATING INFORMATION

Set forth below is certain selected operating information for the power generation facilities and steam fields, for which results are consolidated in the Company's statements of operations. The information set forth under power plants consists of the results for the West Ford Flat Power Plant, the Bear Canyon Power Plant, the Greenleaf 1 and 2 Power Plants and the Watsonville Power Plant since their acquisitions on April 21, 1995 and June 29, 1995, respectively, the Gilroy Power Plant since its acquisition on August 29, 1996, and the King City Power Plant since the effective date of the lease on May 2, 1996. The information set forth under steam fields consists of the results for the PG&E Unit 13 and Unit 16 Steam Fields, the SMUDGEO #1 Steam Fields and, for 1994 through 1996, the Thermal Power Company Steam Fields since the acquisition of Thermal Power Company on September 9, 1994. The information provided for the other interest included under steam revenue prior to 1995 represents revenue attributable to a working interest that was held by a third party in the PG&E Unit 13 and Unit 16 Steam Fields. In January 1995, the Company purchased this working interest. Prior to the Company's acquisition of the remaining interest in the West Ford Flat Power Plant, Bear Canyon Power Plant, the PG&E Unit 13 and Unit 16 Steam Fields and the SMUDGEO #1 Steam Fields in April 1993, the Company's revenue from these facilities was accounted for under the equity method and, therefore, does not represent the actual revenue of the Company from these facilities for the periods set forth below.

YEAR ENDED DECEMBER 31,	1992	1993	1994	1995	1996
(DOLLARS IN THOUSANDS)					
POWER PLANTS:					
Electricity revenue [(1)]:					
Energy	$ 38,325	$ 37,088	$ 45,912	$ 54,886	$ 93,851
Capacity	$ 7,707	$ 7,834	$ 7,967	$ 30,485	$ 65,064
Megawatt hours produced	403,274	378,035	447,177	1,033,566	1,985,404
Average energy price per kilowatt hour [(2)]	9.503¢	9.811¢	10.267¢	5.310¢	4.727¢
STEAM FIELDS:					
Steam revenue:					
Calpine	$ 33,385	$ 31,066	$ 32,631	$ 39,669	$ 40,549
Other interest	$ 2,501	$ 2,143	$ 2,051	–	–
Megawatt hours produced	2,105,345	2,014,758	2,156,492	2,415,059	2,528,874
Average price per kilowatt hour	1.705¢	1.648¢	1.608¢	1.643¢	1.603¢

(1) Electricity revenue is composed of fixed capacity payments, which are not related to production, and variable energy payments, which are related to production.

(2) Represents variable energy revenue divided by the kilowatt hours produced. The significant increase in capacity revenue and the accompanying decline in average energy price per kilowatt hours since 1994 reflects the increase in the Company's megawatt hour production as a result of acquisitions of gas-fired cogeneration facilities by the Company.

RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 1996 COMPARED TO YEAR ENDED DECEMBER 31, 1995

Revenue. Revenue increased 62% to $214.6 million in 1996 compared to $132.1 million in 1995, primarily due to a 56% increase in electricity and steam sales of $199.5 million in 1996 compared to $127.8 million in 1995. The King City Power Plant and the Gilroy Power Plant contributed revenues of $41.5 million and $14.7 million, respectively, to electric and steam sales revenue during 1996. Revenue for 1996 also reflected a full year of operation at the Greenleaf 1 and 2 Power Plants and the Watsonville Power Plant which contributed increases in electric and steam revenue in 1996 compared to 1995 of $9.1 million and $4.7 million, respectively. During 1996 and 1995, the Company experienced the maximum curtailment allowed under the power sales agreements with PG&E for the West Ford Flat and Bear Canyon Power Plants. Without such curtailment, the West Ford Flat and Bear Canyon Power Plants would have generated an additional $5.7 million and $5.2 million of revenue in 1996 and 1995, respectively. Service contract revenue decreased to $6.5 million in 1996 compared to $7.2 million in 1995, reflecting a $2.8 million loss related to the Company's electricity trading operations, offset by increased revenue during 1996 related to overhauls at the Aidlin and Agnews Power

Plants, and to technical services performed for the Cerro Prieto project. Income from unconsolidated investments in power projects increased to $6.5 million in 1996 compared to losses of $2.9 million during 1995. The increase is primarily attributable to $6.4 million of equity income generated by the Company's investment in Sumas Cogeneration Company, L.P. ("Sumas") during 1996 compared to a $3.0 million loss in 1995. The increase in Sumas' profitability during 1996 is primarily attributable to a contractual increase in the energy price in accordance with the power sales agreement with Puget Sound Power & Light Company. Interest income on loans to power projects was $2.1 million in 1996 as a result of the recognition of interest income on loans to the sole shareholder of the general partner in Sumas.

Cost of revenue. Cost of revenue increased 67% to $129.2 million in 1996 as compared to $77.4 million in 1995. The increase was primarily due to plant operating, depreciation, and operating lease expenses attributable to (i) a full year of operation during 1996 at the Greenleaf 1 and 2 Power Plants which were purchased on April 21, 1995, (ii) a full year of operation during 1996 at the Watsonville Power Plant which was acquired on June 29, 1995, (iii) operations at the King City Power Plant subsequent to May 2, 1996, and (iv) operations at the Gilroy Power Plant subsequent to acquisition on August 29, 1996. Cost of revenue also increased due to service contract expenses related to the Cerro Prieto Steam Fields, partially offset by lower operating expenses at the Company's other existing power generation facilities and steam fields.

Project development expenses. Project development expenses increased to $3.9 million in 1996, compared to $3.1 million in 1995, due to project development activities.

General and administrative expenses. General and administrative expenses were $14.7 million in 1996 compared to $8.9 million in 1995. The increases were primarily due to additional personnel and related expenses necessary to support the Company's expanding operations, including the Company's power marketing operations. The Company also incurred an employee bonus expense of $1.4 million in September 1996 related to the initial public offering.

Interest expense. Interest expense increased 41% to $45.3 million in 1996 from $32.2 million in 1995. Approximately $11.8 million of the increase was attributable to interest on the Company's 10½% Senior Notes Due 2006 issued in May 1996, $2.7 million of interest expense related to the Gilroy Power Plant acquired on August 29, 1996, and $1.6 million of higher interest expense related to the Greenleaf 1 and 2 Power Plants acquired on April 21, 1995, offset in part by a $3.0 million decrease in interest expense as a result of repayments of principal on certain non-recourse project financings.

Other income, net. Other income, net increased 232% to $6.3 million for 1996 compared with $1.9 million for 1995. The increase was primarily due to $4.5 million of interest income on collateral securities purchased in connection with the King City transaction, $1.4 million of net proceeds for the settlement of the Coso project, and higher interest income for the period due to the investment of the net proceeds of the preferred stock, the 10½% Senior Notes Due 2006, and from the Company's initial public offering of common shares. Offsetting these income items was a $3.7 million loss for uncollectible amounts related to the O'Brien acquisition project (see Note 13 of Notes to Consolidated Financial Statements).

Provision for income taxes. The effective rate for the income tax provision was approximately 33% in 1996 and 41% in 1995. In 1996, the Company decreased its deferred income tax liability by $769,000 to reflect the change in California's state income tax rate from 9.3% to 8.84% effective January 1, 1997. In addition, depletion in excess of tax basis benefits at the Company's geothermal facilities and a revision of prior years' tax estimates reduced the Company's effective tax rate for 1996.

YEAR ENDED DECEMBER 31, 1995 COMPARED TO YEAR ENDED DECEMBER 31, 1994

Revenue increased 39% to $132.1 million in 1995 compared to $94.8 million in 1994, primarily due to a 42% increase in electricity and steam sales to $127.8 million in 1995 compared to $90.3 million in 1994. Such an increase was primarily attributable to the $28.3 million of revenue from the Greenleaf 1 and 2 Power Plants, $5.9 million of revenue from the Watsonville Power Plant, the $5.2 million of additional revenue from the Thermal Power Company Steam Fields as a result of a full year of operation in 1995, and an increase of $3.0 million of revenue from the SMUDGEO #1 Steam Fields attributable to increased production as a result of an extended outage during 1994. Such an increase also reflects a substantial increase in capacity payments for electricity sales from $8.0 million in 1994 to $30.5 million in 1995 as a result of the transactions stated above. This revenue increase was partially offset by a $2.7 million decrease in revenue from the West Ford Flat and Bear Canyon Power Plants as a result of curtailments by PG&E due to low gas prices and high levels of precipitation during 1995 as compared to 1994, offset in part by contractual price increases for 1995. Without such curtailment, the West Ford Flat and Bear Canyon Power Plants would have generated an additional $5.2 million of revenue in 1995. Revenue for 1995 also reflects curtailment of steam production at the Thermal Power Company Steam Fields as a result of higher precipitation and lower gas prices in 1995, and at the PG&E Unit 13 and Unit 16 Steam Fields as a result of hydro-spill conditions. Without curtailment, the Thermal Power Company Steam Fields and the PG&E Unit 13 and Unit 16 Steam Fields would have generated an additional $5.7 million and $800,000 of revenue during 1995, respectively.

Revenue for 1995 and 1994 reflects reversals of $2.7 million and $3.2 million, respectively, of previously deferred revenue. Company revenue from sales of steam was previously calculated considering a future period when steam would be delivered without receiving corresponding revenue. In May 1994, the Company ceased deferring revenue and recognized $4.0 million of its previously deferred revenue. Based on estimates and analyses performed by the Company, the Company no longer expects that it will be required to make these deliveries to SMUD. Concurrently, $800,000 of the revenue increase was reserved for future construction of gathering systems required for future production of the steam fields, with the offset recorded in property, plant and equipment. In October 1995, PG&E agreed to the termination of the free steam provision with respect to the PG&E Unit 13 Steam Fields. During 1995, the Company took additional measures regarding future capital commitments and other actions which will increase steam production and, based on additional analyses and estimates performed, the Company recognized the remaining $2.7 million of previously deferred revenue.

Cost of revenue. Cost of revenue increased 47% to $77.4 million in 1995 compared to $52.8 million in 1994. The increase was due to plant operating, production royalty and depreciation and amortization expenses attributable to (i) a full year of operations at Thermal Power Company, which was purchased on September 9, 1994, (ii) operations at the Greenleaf 1 and 2 Power Plants subsequent to April 21, 1995, and (iii) operations at the Watsonville Power Plant subsequent to June 29, 1995. The increases were partially offset by lower depreciation and production royalty expenses at the West Ford Flat and Bear Canyon Power Plants and the PG&E Unit 13 and Unit 16 Steam Fields due to curtailment by PG&E during 1995.

Project development expenses. Project development expenses increased to $3.1 million in 1995 compared to $1.8 million in 1994, due to new project development activities.

General and administrative expenses. General and administrative expenses were $8.9 million in 1995 compared to $7.3 million in 1994. The increase in 1995 was primarily due to additional personnel and related expenses necessary to support the Company's expanded operations.

Interest expense. Interest expense increased to $32.2 million in 1995 from $23.9 million in 1994. Approximately $3.6 million of the increase was attributable to a full year of interest expense incurred on the debt related to the Thermal Power Company acquisition in September 1994 and $4.1 million of interest expense incurred on the debt related to the Greenleaf transaction in April 1995. In addition, 1995 included a full year of interest expense on the 9¼% Senior Notes Due 2004 issued on February 17, 1994.

Provision for income taxes. The effective rate for the income tax provision was approximately 41% for 1995 and 39% for 1994. The effective rates were based on statutory tax rates, with minor reductions for depletion in excess of tax basis benefits. Due to curtailment of production during 1995, the allowance for statutory depletion decreased in 1995 from 1994.

LIQUIDITY AND CAPITAL RESOURCES

To date, the Company has obtained cash from its operations, borrowings under its credit facilities and other working capital lines, sale of debt and equity, and proceeds from non-recourse project financings. The Company utilized this cash to fund its operations, service debt obligations, fund the acquisition, development and construction of power generation facilities, finance capital expenditures and meet its other cash and liquidity needs.

The following table summarizes the Company's cash flow activities for the periods indicated:

YEAR ENDED DECEMBER 31,	1994	1995	1996
(IN THOUSANDS)			
Cash flows from:			
Operating activities	$ 34,196	$ 26,653	$ 59,881
Investing activities	(84,444)	(38,497)	(326,834)
Financing activities	66,609	11,127	345,153
Total	$ 16,361	$ (717)	$ 78,200

Operating activities for 1996 consisted of approximately $18.7 million of net income from operations, $36.6 million of depreciation and amortization, $2.0 million in deferred income taxes, and $7.8 million net increase in operating assets and liabilities, offset by $5.3 million of undistributed income from unconsolidated investments in power projects.

Investing activities used $326.8 million during 1996, primarily due to $29.9 million of capital expenditures and capitalized project costs, $98.4 million for the purchase of collateral securities, a $12.9 million loan to Coperlasa in connection with the Cerro Prieto project, $138.1 million for the acquisition of the Gilroy Power Plant, and a $41.6 million increase in restricted cash requirements related to the construction of the Pasadena Power Plant.

Financing activities provided $345.2 million of cash during 1996. The Company issued $50.0 million of preferred stock to Electrowatt, borrowed $161.8 million of bank debt and an additional $46.9 million under the credit facilities, received net proceeds of $174.9 million from the 10½% Senior Notes Due 2006, and received $109.2 million upon the issuance of common stock. The Company subsequently repaid $46.2 million of bank debt, all borrowings outstanding under the credit facilities of $66.7 million, and $84.7 million of non-recourse project financing.

As of December 31, 1996, cash and cash equivalents were $100.0 million and working capital was $96.2 million. For the twelve months ended December 31, 1996, working capital increased by $145.2 million and cash and cash equivalents increased by $78.2 million as compared to the comparable period in 1995. The increase in working capital is primarily due to remaining net proceeds from the issuance of common stock in September 1996, and reflects the inclusion of $57.0 million of non-recourse project financing in current liabilities as of December 31, 1995. On May 16, 1996, the

Company issued the 10½% Senior Notes Due 2006. A portion of the funds from the issuance of the 10½% Senior Notes Due 2006 was used to refinance current bank debt and borrowings under the Credit Suisse credit facility, and to repay the $57.0 million non-recourse indebtedness to The Bank of Nova Scotia.

As a developer, owner and operator of power generation projects, the Company may be required to make long-term commitments and investments of substantial capital for its projects. The Company historically has financed these capital requirements with borrowings under its credit facilities, other lines of credit, non-recourse project financing or long-term debt.

The Company currently has outstanding $105.0 million of 9¼% Senior Notes Due 2004 which mature on February 1, 2004 and bear interest payable semi-annually on February 1 and August 1 of each year. In addition, the Company has $180.0 million of 10½% Senior Notes Due 2006 which mature on May 15, 2006 and bear interest semi-annually on May 15 and November 15 of each year. Under the provisions of the applicable indentures, the Company may, under certain circumstances, be limited in its ability to make restricted payments, as defined, which include dividends and certain purchases and investments, incur additional indebtedness and engage in certain transactions.

At December 31, 1996, the Company had $309.3 million of non-recourse project financing associated with power generating facilities and steam fields at the West Ford Flat Power Plant, the Bear Canyon Power Plant, the PG&E Unit 13 and Unit 16 Steam Fields, the SMUDGEO #1 Steam Fields, the Greenleaf 1 and 2 Power Plants and the Gilroy Power Plant. As of December 31, 1996, the annual maturities for all non-recourse project financing were $30.6 million for 1997, $32.7 million for 1998, $24.2 million for 1999, $24.8 million for 2000, $24.6 million for 2001 and $170.5 million thereafter.

The Company currently has a $50.0 million revolving credit agreement with a consortium of commercial lending institutions led by The Bank of Nova Scotia, with borrowings bearing interest at either LIBOR or at The Bank of Nova Scotia base rate plus a mutually agreed margin. At December 31, 1996, the Company had no borrowings outstanding and $5.9 million of letters of credit outstanding under the revolving credit facility (see Note 16 of Notes to Consolidated Financial Statements). The Bank of Nova Scotia credit facility contains certain restrictions that significantly limit or prohibit, among other things, the ability of the Company or its subsidiaries to incur indebtedness, make payments of certain indebtedness, pay dividends, make investments, engage in transactions with affiliates, create liens, sell assets and engage in mergers and consolidations.

The Company has a $1.2 million working capital line with a commercial lender that may be used to fund short-term working capital commitments and letters of credit. At December 31, 1996, the Company had no borrowings under this working capital line and $900,000 of letters of credit outstanding. Borrowings are at prime plus 1%.

The Company also has outstanding a non-interest bearing promissory note to Natomas Energy Company in the amount of $6.5 million representing a portion of the September 1994 purchase price of Thermal Power Company. This note has been discounted to yield 8% per annum and is due September 9, 1997.

The Company intends to continue to seek the use of non-recourse project financing for new projects, where appropriate. The debt agreements of the Company's subsidiaries and other affiliates governing the non-recourse project financing generally restrict their ability to pay dividends, make distributions or otherwise transfer funds to the Company. The dividend restrictions in such agreements generally require that, prior to the payment of dividends, distributions or other transfers, the subsidiary or other affiliate must provide for the payment of other obligations, including operating expenses, debt service and reserves. However, the Company does not believe that such restrictions will adversely affect its ability to meet its debt obligations.

At December 31, 1996, the Company had commitments for capital expenditures in 1997 totaling $4.0 million related to various projects at its geothermal facilities. The Company intends to fund capital expenditures for the ongoing operation and development of the Company's power generation facilities primarily through the operating cash flow of such facilities. Capital expenditures for 1996 were $30.2 million compared to $17.4 million for 1995, primarily due to the purchase of new equipment. For 1996, capital expenditures included $12.5 million related to the Pasadena Power Plant, $4.0 million for the purchase of geothermal leases for the Glass Mountain project, $3.1 million for the new rotor at the PG&E Unit 13 facility, $3.2 million for geothermal well drilling, $2.1 million for a reinjection pipeline at the Company's geothermal steam fields, and $5.4 million of capital expenditures at various cogeneration facilities.

The Company continues to pursue the acquisition and development of new power generation projects. The Company expects to commit significant capital in future years for the acquisition and development of these projects. The Company's actual capital expenditures may vary significantly during any year.

The Company believes that it will have sufficient liquidity from cash flow from operations and borrowings available under the lines of credit and working capital to satisfy all obligations under outstanding indebtedness, to finance anticipated capital expenditures and to fund working capital requirements.

IMPACT OF RECENT ACCOUNTING PRONOUNCEMENT

In February 1997, the Financial Accounting Standards Board ("FASB") issued SFAS No. 128, *Earnings Per Share*, which simplifies the standards for computing earnings per share previously found in Accounting Principles Board Opinion ("APBO") No. 15. SFAS No. 128 replaces the presentation of primary earnings per share with a presentation of basic earnings per share, which excludes dilution. SFAS No. 128 also requires dual presentation of basic and diluted earnings per share on the face of the income statement for all entities with complex capital structures and requires a reconciliation. Diluted earnings per share is computed similarly to fully diluted earnings per share pursuant to APBO No. 15. SFAS No. 128 must be adopted for financial statements issued for periods ending after December 15, 1997, including interim periods; earlier application is not permitted. SFAS No. 128 requires restatement of all prior-period earnings per share data presented. The Company has not yet quantified the effect of adopting SFAS No. 128.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

TO THE BOARD OF DIRECTORS OF CALPINE CORPORATION:

We have audited the accompanying consolidated balance sheets of Calpine Corporation (a Delaware corporation) and subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Sumas Cogeneration Company, L.P. ("Sumas"), the investment in which is reflected in the accompanying financial statements using the equity method of accounting. The investment in Sumas represents approximately 1% of the Company's total assets at December 31, 1996 and 1995. The Company has recorded income of $6.4 million and losses of $3.0 million and $2.9 million representing its share of the net income or loss of Sumas for the years ended December 31, 1996, 1995 and 1994, respectively. The financial statements of Sumas were audited by other auditors whose report has been furnished to us and our opinion, insofar as it relates to the amounts included for Sumas, is based solely on the report of other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Calpine Corporation and subsidiaries as of December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

Arthur Andersen LLP

ARTHUR ANDERSEN LLP
San Jose, California
March 7, 1997

CALPINE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS)

DECEMBER 31,	1996	1995
ASSETS		
Current assets:		
Cash and cash equivalents	$ 100,010	$ 21,810
Accounts receivable		
From related parties	2,826	2,177
From others	39,962	17,947
Acquisition project receivables	791	8,805
Collateral securities, current portion	5,470	–
Interest receivable on collateral securities	1,065	–
Prepaid operating lease	12,668	–
Other current assets	8,395	5,491
Total current assets	171,187	56,230
Property, plant and equipment, net	650,053	447,751
Investments in power projects	13,937	8,218
Collateral securities, net of current portion	89,806	–
Notes receivable from related parties	18,182	19,391
Notes receivable from Coperlasa	17,961	6,394
Restricted cash	55,219	9,627
Other assets	13,870	6,920
Total assets	$1,030,215	$554,531
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of non-recourse project financing	$ 30,627	$ 84,708
Notes payable and short-term borrowings	6,865	1,177
Accounts payable	18,363	6,876
Accrued payroll and related expenses	3,912	2,789
Accrued interest payable	7,332	7,050
Other accrued expenses	7,870	2,657
Total current liabilities	74,969	105,257
Long-term line of credit	–	19,851
Non-recourse project financing, net of current portion	278,640	190,642
Notes payable	–	6,348
Senior Notes	285,000	105,000
Deferred income taxes, net	100,385	97,621
Deferred lease incentive	78,521	–
Other liabilities	9,573	4,585
Total liabilities	827,088	529,304
Commitments and contingencies (Note 28)		
Stockholders' equity		
Common stock, $0.001 par value per share; authorized 100,000,000 shares in 1996 and 33,760,000 shares in 1995; issued and outstanding 19,843,400 shares in 1996 and 10,387,693 shares in 1995	20	10
Additional paid-in capital	165,412	6,214
Retained earnings	37,726	19,034
Cumulative translation adjustment	(31)	(31)
Total stockholders' equity	203,127	25,227
Total liabilities and stockholders' equity	$1,030,215	$554,531

The accompanying notes are an integral part of these consolidated financial statements.

CALPINE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

FOR THE YEARS ENDED DECEMBER 31,	1996	1995	1994
Revenue:			
Electricity and steam sales	$199,464	$127,799	$90,295
Service contract revenue	6,455	7,153	7,221
Income (loss) from unconsolidated investments in power projects	6,537	(2,854)	(2,754)
Interest income on loans to power projects	2,098	–	–
Total revenue	214,554	132,098	94,762
Cost of revenue:			
Plant operating expenses	61,894	33,162	14,944
Depreciation	39,818	26,264	21,202
Production royalties	10,793	10,574	11,153
Operating lease expense	9,295	1,542	–
Service contract expenses	7,400	5,846	5,546
Total cost of revenue	129,200	77,388	52,845
Gross profit	85,354	54,710	41,917
Project development expenses	3,867	3,087	1,784
General and administrative expenses	14,696	8,937	7,323
Provision for write-off of project development costs	–	–	1,038
Income from operations	66,791	42,686	31,772
Other (income) expense:			
Interest expense			
Related party	894	1,663	375
Other	44,400	30,491	23,511
Other income, net	(6,259)	(1,895)	(1,988)
Income before provision for income taxes	27,756	12,427	9,874
Provision for income taxes	9,064	5,049	3,853
Net income	$ 18,692	$ 7,378	$ 6,021
Earnings per share:			
Weighted average shares outstanding	14,680	–	–
Earnings per share	$ 1.27	–	–
As adjusted earnings per share assuming conversion of preferred stock:			
Weighted average shares outstanding	–	14,151	–
Earnings per share	–	$ 0.52	–

The accompanying notes are an integral part of these consolidated financial statements.

CALPINE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(IN THOUSANDS)

FOR THE YEARS ENDED DECEMBER 31, 1996, 1995 AND 1994	PREFERRED STOCK SHARES	PREFERRED STOCK AMOUNT	COMMON STOCK SHARES	COMMON STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	CUMULATIVE TRANSLATION ADJUSTMENT	TOTAL
Balance, December 31, 1993	–	$ –	10,388	$10	$ 6,214	$ 7,235	$ (31)	$ 13,428
Dividend ($0.40 per share)	–	–	–	–	–	(800)	–	(800)
Net income	–	–	–	–	–	6,021	–	6,021
Balance, December 31, 1994	–	–	10,388	10	6,214	12,456	(31)	18,649
Dividend ($0.40 per share)	–	–	–	–	–	(800)	–	(800)
Net income	–	–	–	–	–	7,378	–	7,378
Balance, December 31, 1995	–	–	10,388	10	6,214	19,034	(31)	25,227
Issuance of preferred stock	5,000	50	–	–	49,950	–	–	50,000
Conversion of preferred stock to common stock	(5,000)	(50)	2,179	3	47	–	–	–
Issuance of common stock, net	–	–	7,276	7	109,172	–	–	109,179
Tax benefit from stock options exercised	–	–	–	–	29	–	–	29
Net income	–	–	–	–	–	18,692	–	18,692
Balance, December 31, 1996	–	$ –	19,843	$20	$165,412	$37,726	$ (31)	$203,127

The accompanying notes are an integral part of these consolidated financial statements.

CALPINE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

FOR THE YEARS ENDED DECEMBER 31,	1996	1995	1994
Cash flows from operating activities:			
Net income	$ 18,692	$ 7,378	$ 6,021
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization, net	36,600	25,931	20,342
Deferred income taxes, net	2,028	(1,027)	3,180
(Income) loss from unconsolidated investments in power projects	(5,263)	2,854	2,754
Provision for write-off of project development costs and other	–	–	1,038
Change in operating assets and liabilities:			
Accounts receivable	(12,652)	(3,354)	(2,578)
Acquisition project receivables	8,014	(8,805)	–
Other current assets	(6,521)	(737)	79
Accounts payable and accrued expenses	15,636	6,847	6,218
Deferred revenue	3,347	(2,434)	(2,858)
Net cash provided by operating activities	59,881	26,653	34,196
Cash flows from investing activities:			
Acquisition of property, plant and equipment	(24,057)	(17,434)	(7,023)
Acquisition of Greenleaf, net of cash on hand	–	(14,830)	–
Watsonville transaction, net of cash on hand	–	494	–
Acquisition of TPC, net of cash on hand	–	–	(62,770)
Loans to Coperlasa	(12,926)	(6,062)	–
(Increase) decrease in notes receivable	2,750	(286)	(13,556)
Investment in collateral securities	(98,446)	–	–
King City transaction, net of cash on hand	(11,567)	–	–
Maturities of collateral securities	2,900	–	–
Acquisition of Gilroy, net of cash on hand	(138,073)	–	–
Capitalized project costs	(5,887)	(1,258)	(175)
Decrease (increase) in restricted cash	(41,591)	1,186	(900)
Other, net	63	(307)	(20)
Net cash used in investing activities	(326,834)	(38,497)	(84,444)
Cash flows from financing activities:			
Payment of dividends	–	(800)	(800)
Net borrowings from (repayments of) line of credit	(19,851)	19,851	(52,595)
Borrowings from non-recourse project financing	119,760	76,026	60,000
Repayments of non-recourse project financing	(84,708)	(79,388)	(12,735)
Proceeds from short-term borrowings	45,000	2,683	4,500
Repayments of short-term borrowings	(46,177)	(6,006)	–
Proceeds from issuance of Senior Notes	180,000	–	105,000
Proceeds from issuance of preferred stock	50,000	–	–
Proceeds from issuance of common stock	109,208	–	–
Financing costs	(8,079)	(1,239)	(3,921)
Proceeds from note payable	–	–	5,167
Repayment of notes payable – FMRP	–	–	(36,807)
Other, net	–	–	(1,200)
Net cash provided by financing activities	345,153	11,127	66,609
Net increase (decrease) in cash and cash equivalents	78,200	(717)	16,361
Cash and cash equivalents, beginning of period	21,810	22,527	6,166
Cash and cash equivalents, end of period	$100,010	$ 21,810	$ 22,527
Supplementary information – cash paid during the year for:			
Interest	$ 43,805	$ 32,162	$ 19,890
Income taxes	6,947	4,294	683

The accompanying notes are an integral part of these consolidated financial statements.

1. ORGANIZATION AND OPERATIONS OF THE COMPANY

Calpine Corporation ("Calpine"), a Delaware corporation, and subsidiaries (collectively, the "Company") are engaged in the development, acquisition, ownership and operation of power generation facilities in the United States and selected international markets. The Company has ownership interests in and operates geothermal steam fields, geothermal power generation facilities, and natural gas-fired cogeneration facilities in northern California and Washington. Each of the generation facilities produces electricity for sale to utilities. Thermal energy produced by the gas-fired cogeneration facilities is sold to governmental and industrial users, and steam produced by the geothermal steam fields is sold to utility-owned power plants. For the year ended December 31, 1996, primarily all electricity and steam sales revenue from consolidated subsidiaries was derived from sales to two customers in northern California (see Note 27), of which 48% related to geothermal activities. In 1996, the Company began marketing power and energy services to utilities and other end users.

In July 1996, the Company's Board of Directors authorized the reincorporation of the Company into Delaware in connection with the Company's initial public offering. In addition, the Board of Directors approved a stock split of approximately 5.194-for-1. On September 13, 1996, the reincorporation of the Company and the stock split became effective. The accompanying financial statements reflect the reincorporation and the stock split as if such transactions had been effective for all periods (see Note 24).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation. The consolidated financial statements include the accounts of Calpine Corporation and its wholly owned and majority-owned subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation. Prior to 1994, the Company acquired Calpine Geysers Company, L.P. ("CGC"). During 1994, the Company formed Calpine Thermal Power, Inc. ("Calpine Thermal") and Calpine Siskiyou Geothermal Partners, L.P. (see Notes 4 and 7, respectively). Calpine Thermal acquired Thermal Power Company ("TPC") during 1994. During 1995, the Company formed Calpine Greenleaf Corporation ("Calpine Greenleaf"), Calpine Monterey Cogeneration, Inc. ("CMCI") and Calpine Vapor, Inc. ("Calpine Vapor"). Calpine Greenleaf indirectly acquired two operating gas-fired cogeneration plants (see Note 5) and CMCI acquired an operating lease for a gas-fired cogeneration facility (see Note 6). Calpine Vapor made loans to fund construction of new geothermal wells in Mexico (see Note 8). During 1996, the Company formed Calpine King City Cogen L.L.C. ("CKCC"), Calpine Gilroy Cogen, L.P. ("Gilroy"), and Pasadena Cogeneration, L.P. CKCC completed an operating lease transaction for a gas-fired cogeneration plant (see Note 9) and Calpine Gilroy acquired the assets of a gas-fired cogeneration plant in California (see Note 10). In December 1996, Pasadena Cogeneration entered into an energy sales agreement and will construct a 240 megawatt gas-fired power plant (see Note 11).

Accounting for Jointly Owned Geothermal Properties. The Company uses the proportionate consolidation method to account for TPC's 25% interest in jointly owned geothermal properties. TPC has a steam sales agreement with Pacific Gas and Electric Company ("PG&E") pursuant to which the steam derived from its interest in the properties is sold (see Note 4).

Use of Estimates in Preparation of Financial Statements. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates with regard to these financial statements relate to future development costs and total productive resources of the geothermal facilities (see *Property, Plant and Equipment* and Note 7), the estimated "free steam" liability (see Note 3), receivables which the Company believes to be collectible (see Note 15) and the realization of deferred income taxes (see Note 21). Additionally, the Company believes that certain industry restructuring (see Note 28, *Regulation and CPUC Restructuring*) will not have a material effect on existing power service agreements ("PSA") and, accordingly, will not have a material effect on existing business or results of operations.

Revenue Recognition. Revenue from electricity and steam sales is recognized upon transmission to the customer. Revenues from contracts entered into or acquired since May 21, 1992 are recognized at the lesser of amounts billable under the contract or amounts recognizable at an average rate over the term of the contract. The Company's power sales agreements related to CGC were entered into prior to May 1992. Had the Company applied this principle, the revenues of the Company recorded for the years ended December 31, 1996, 1995 and 1994, would have been approximately $16.1 million, $12.6 million, and $11.9 million less, respectively.

The Company performs operations and maintenance services for all projects in which it has an interest, except for TPC and the geothermal investment in Mexico. Revenue from investees is recognized on these contracts when the services are performed. Revenue from consolidated subsidiaries is eliminated in consolidation.

Cash and Cash Equivalents. The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. The carrying amount of these instruments approximates fair value because of their short maturity.

Restricted Cash. The Company is required to maintain cash balances that are restricted by provisions of its debt agreements and by regulatory agencies. The Company's debt agreements specify restrictions based on debt service payments and drilling costs for the following year. Regulatory agencies require cash to be restricted to ensure that funds will be available to restore property to its original condition. Restricted cash is invested in accounts earning market rates; therefore, the carrying value approximates fair value. Such cash is excluded from cash and cash equivalents for the purposes of the statements of cash flows.

Investment in Collateral Securities. The Company's investments in collateral securities are related to the King City transaction (see Note 9) and are classified as held-to-maturity and stated at amortized cost. The investments in debt securities mature at various dates through August 2018 in amounts equal to a portion of the lease payment. The fair value of held-to-maturity securities was determined based on the quoted market prices at the reporting date for the securities.

The components of held-to-maturity securities by major security type as of December 31, 1996 are as follows (in thousands):

	AMORTIZED COST	AGGREGATE FAIR VALUE	UNREALIZED HOLDING GAINS
Debt securities issued by the United States	$54,826	$56,737	$1,911
Corporate debt securities	40,450	40,499	49
	$95,276	$97,236	$1,960

Concentration of Credit Risk. Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of cash and accounts / notes receivable. The Company's cash accounts are held by eight major financial institutions. The Company's accounts / notes receivable are concentrated within entities engaged in the energy industry, mainly within the United States, some of which are related parties. Certain of the Company's notes receivable are with a company in Mexico (see Note 15).

Property, Plant and Equipment. Property, plant and equipment are stated at cost less accumulated depreciation and amortization.

The Company capitalizes costs incurred in connection with the development of geothermal properties, including costs of drilling wells and overhead directly related to development activities, together with the costs of production equipment, the related facilities and the operating power plants. Geothermal properties include the value attributable to the geothermal resources of CGC and all of the property, plant and equipment of Calpine Thermal. Proceeds from the sale of geothermal properties are applied against capitalized costs, with no gain or loss recognized.

Geothermal costs, including an estimate of future development costs to be incurred and the estimated costs to dismantle, are amortized by the units of production method based on the estimated total productive output over the estimated useful lives of the related steam fields. Depreciation of the buildings and roads is computed using the straight-line method over their estimated useful lives. It is reasonably possible that the estimate of useful lives, total units of production or total capital costs to be amortized using the units of production method could differ materially in the near term from the amounts assumed in arriving at current depreciation expense. These estimates are affected by such factors as the ability of the Company to continue selling steam and electricity to customers at estimated prices, changes in prices of alternative sources of energy such as hydro-generation and gas, and changes in the regulatory environment.

Gas-fired power production facilities include the cogeneration plants and related equipment and are stated at cost. Depreciation is recorded utilizing the straight-line method over the estimated original useful life of up to thirty years. The value of the above-market pricing provided in PSAs acquired is recorded in property, plant and equipment and is amortized over the life of the PSA or operating lease. When assets are disposed of, the cost and related accumulated depreciation are removed from the accounts, and the resulting gains or losses are included in the results of operations.

As of December 31, 1996 and 1995, the components of property, plant and equipment are as follows (in thousands):

	1996	1995
Geothermal properties	$297,002	$296,495
Buildings, machinery and equipment	277,572	198,358
Power sales agreement	145,957	–
Miscellaneous assets	11,287	2,425
	731,818	497,278
Less accumulated depreciation and amortization	100,674	60,511
	631,144	436,767
Land	754	754
Construction in progress	18,155	10,230
Property, plant and equipment, net	$650,053	$447,751

Investments in Power Projects. The Company accounts for its unconsolidated investments in power projects under the equity method. The Company's share of income from these investments is calculated according to the Company's equity ownership or in accordance with the terms of the appropriate partnership agreement (see Note 14).

Capitalized Project Costs. The Company capitalizes project development costs upon the execution of a memorandum of understanding or a letter of intent for a power or steam sales agreement. These costs include professional services, salaries, permits and other costs directly related to the development of a new project. Outside services and other third-party costs are capitalized for acquisition projects. Upon the start-up of plant operations or the completion of an acquisition, these costs are generally transferred to property, plant and equipment and amortized over the estimated useful life of the project. Capitalized project costs are charged to expense when the Company determines that the project will not be consummated or is impaired.

Earnings Per Share and As Adjusted Earnings Per Share. For the calendar year ending after the Company's initial public offering in September 1996, net income per share was computed using the weighted average number of common and common equivalent shares using the treasury stock method for outstanding stock options. Net income per share also gives effect to common equivalent shares from convertible preferred shares from the original date of issuance that automatically converted upon completion of the Company's initial public offering (using the if-converted method).

For the year ended December 31, 1995, as adjusted net income per share was computed using the weighted average number of common equivalent shares, which includes the net additional number of shares which would be issuable upon the exercise of outstanding stock options, assuming the Company used the proceeds received to purchase additional shares at an assumed public offering price. Net income per share also gives effect to common equivalent shares from preferred stock that converted upon the closing of the Company's initial public offering assuming such shares were outstanding from the beginning of the period in accordance with Securities and Exchange Commission staff policy. Earnings per share prior to 1995 have not been presented since such amounts are not deemed meaningful due to the significant change in the Company's capital structure that occurred in connection with its initial public offering.

Power Marketing. The Company, through its wholly owned subsidiary Calpine Power Services Company ("CPSC"), markets power and energy services to utilities, wholesalers, and end users. CPSC provides these services by entering into contracts to purchase or supply electricity at specified delivery points and specified future dates. In some cases, CPSC utilizes option agreements to manage its exposure to market fluctuations. At December 31, 1996, CPSC held forward sales and purchase contracts with notional quantities of approximately 724,000 megawatt hours and 631,600 megawatt hours, respectively.

Net open positions may exist due to the origination of new transactions and the Company's evaluation of changing market conditions. The open position exposes the Company to the risk that fluctuating market prices may adversely impact its financial position or results of operations. However, the net open position is actively managed. The impact of such fluctuations on the Company's financial position is not necessarily indicative of the impact of price fluctuations throughout the year. CPSC values its portfolio using the aggregate lower of cost or market method. An allowance is recorded currently for net aggregate losses of the entire portfolio resulting from the effect of market changes on the net open positions. Net gains are recognized when realized.

With respect to open power contracts, CPSC has established certain reserves and allowances, principally for adverse changes in market conditions prior to termination of the commitments. At December 31, 1996, the Company had recorded allowances of approximately $917,000 which is included in Service contract revenue in the accompanying consolidated statement of operations.

The Company's credit risk associated with power contracts results from the risk of loss as a result of non-performance by counterparties. The Company reviews and assesses counterparty risk to limit any material impact to its financial position and results of operations. The Company does not anticipate non-performance by the counterparties. The Company sets credit limits prior to entering into transactions and has not obtained collateral or other security.

Impact of Recent Accounting Pronouncements. In March 1995, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of.* This pronouncement requires that long-lived assets and certain identifiable intangible assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is to be recognized when the sum of undiscounted cash flows is less than the carrying amount of the asset. Measurement of the loss for assets that the entity expects to hold and use are to be based on the fair market value of the asset. The Company adopted SFAS No. 121 effective January 1, 1996, and determined that adoption of this pronouncement had no material impact on the results of operations or financial condition as of January 1, 1996.

In February 1997, the FASB issued SFAS No. 128, *Earnings Per Share,* which simplifies the standards for computing earnings per share previously found in Accounting Principles Board Opinion ("APBO") No. 15. SFAS No. 128 replaces the presentation of primary earnings per share with a presentation of basic earnings per share, which excludes dilution. SFAS No. 128 also requires dual presentation of basic and diluted earnings per share on the face of the income statement for all entities with complex capital structures and requires a reconciliation. Diluted earnings per share is computed similarly to fully diluted earnings per share pursuant to APBO No. 15. SFAS No. 128 must be adopted for financial statements issued for periods ending after December 15, 1997, including interim periods; earlier application is not permitted. SFAS No. 128 requires restatement of all prior-period earnings per share data presented. The Company has not yet quantified the effect of adopting SFAS No. 128.

Reclassifications. Prior years' amounts in the consolidated financial statements have been reclassified where necessary to conform to the 1996 presentation.

3. CALPINE GEYSERS COMPANY, L.P.

CGC, a wholly owned subsidiary of the Company, is the owner of two operating geothermal power plants and their respective steam fields, Bear Canyon and West Ford Flat, and three geothermal steam fields, which provide steam to PG&E's Unit 13 and Unit 16 power plants and to Sacramento Municipal Utility District's ("SMUD") geothermal power plant. The power plants and steam fields are located in The Geysers area of northern California. Electricity from CGC's two operating geothermal power plants is sold to PG&E under 20-year agreements.

Under the PG&E Unit 16 and the SMUD agreements, if the quantity of steam delivered is less than 50% of the units' capacities, then neither PG&E nor SMUD is required to make payment for steam delivered during such month until the cost of the affected power plant has been completely amortized. Further, both PG&E and SMUD can terminate their agreements with written notice under conditions specified in the agreement if further operation of the plants becomes uneconomical. In the event that CGC terminates the agreements, PG&E or SMUD may require CGC to assign them all rights, title and interest to the wells, lands and related facilities. In consideration for such an assignment to SMUD, SMUD shall reimburse CGC for its original costs net of depreciation for any associated materials or facilities.

CGC revenues from sales of steam were calculated considering a future period when steam would be delivered without receiving corresponding revenue. The estimated "free steam" obligation was recorded at an average rate over future steam production as deferred revenue in 1993. As of December 31, 1993, the Company had deferred revenue of $8.6 million. During 1994, based on estimates and analyses performed, the Company determined that these deliveries would no longer be required for a customer and reversed approximately $5.9 million of its deferred revenue liability. This reversal was recorded as a $1.9 million purchase price reduction to property, plant and equipment, with the remaining $4.0 million as an increase in revenue. Concurrently, $800,000 of the revenue increase was reserved for future construction of gathering systems required for future production of the steam fields, with the offset recorded in property, plant and equipment.

In October 1994, PG&E agreed to the termination of the free steam provision for one of the geothermal steam fields. During 1995, CGC took additional measures regarding future capital commitments and other actions which will increase steam production and, based on additional analyses and estimates performed, the Company recognized the remaining $2.7 million of previously deferred revenue.

On April 19, 1993, the Company acquired Freeport-McMoRan Resource Partners, L.P.'s ("FMRP") interest in CGC for $23.0 million in cash and non-recourse notes payable to FMRP totaling $40.5 million. On February 17, 1994, the Company exercised its option to prepay the notes utilizing a discount rate of 10% by paying $36.9 million including interest in full satisfaction of its obligations under the FMRP notes. The difference between the original carrying amount of the notes and the prepayment was recorded as an adjustment to the purchase price.

4. CALPINE THERMAL POWER, INC.

On September 9, 1994, Calpine Thermal acquired the outstanding capital stock of TPC for a total purchase price of $66.5 million, consisting of a $60.0 million cash payment and the issuance by Calpine of a non-interest bearing promissory note to Natomas in the amount of $6.5 million (discounted to $5.2 million), which is due September 9, 1997. Calpine received payments of $3.0 million from the seller, which represented cash from TPC's operations for the period from July 1, 1994 to September 8, 1994. These payments were treated as purchase price adjustments.

Calpine Thermal owns a 25% undivided interest in certain producing geothermal steam fields located at The Geysers area of northern California. Union Oil Company of California owns the remaining 75% interest in the steam fields, which deliver geothermal steam to twelve operating plants owned by PG&E. The steam fields currently provide the twelve operating plants with sufficient steam to generate approximately 604 megawatts of electricity.

Steam from Calpine Thermal's steam field is sold to PG&E under a steam sales agreement. In addition, Calpine Thermal receives a monthly capacity maintenance fee, which provides for effluent disposal costs and facilities support costs, and a monthly fee for PG&E's right to curtail its power plants. The steam price, capacity maintenance and curtailment fees are adjusted annually. Calpine Thermal is required to compensate PG&E for the unused capacity of its geothermal power plants due to insufficient field capacities of its steam supply (offset payment).

In accordance with the steam sales agreement, PG&E may curtail the power plants which receive steam from the Union Oil/Calpine Thermal Steam Fields in order to produce energy from lower cost sources. However, PG&E is constrained by its contractual obligation to operate all the power plants at a minimum of 40% of the field capacity during any given year. During 1995 and 1996, Calpine Thermal experienced extensive curtailments of steam production due to low gas prices and abundant hydro power.

In March 1996, the Company and Union Oil entered into an alternative pricing agreement with PG&E for any steam produced in excess of 40% of average field capacity as defined in the steam sales contract. The alternative pricing agreement is effective through December 31, 2000. Under the alternative pricing agreement, PG&E has the option to purchase a portion of the steam PG&E would likely curtail under the existing steam sales agreement. The price for this portion of steam will be set by the Company and Union Oil with the intent that it be at competitive prices.

The steam sales agreement between Calpine Thermal and PG&E terminates two years after the closing of the last PG&E operating unit. PG&E may terminate the agreement upon a one-year written notice to Calpine Thermal. In the event the agreement is terminated by PG&E, Calpine Thermal has the right to purchase PG&E's facilities at PG&E's unamortized cost. Calpine Thermal will provide capacity maintenance services for five years after termination by PG&E or closure of the last PG&E operating unit. Alternatively, Calpine Thermal may terminate the agreement upon a two-year written notice to PG&E. PG&E has the right to take assignment of Calpine Thermal's facilities on the date of termination. In such a case, Calpine Thermal would generally continue to pay offset payments for 36 months following the date of termination.

5. CALPINE GREENLEAF CORPORATION

On April 21, 1995, Calpine Greenleaf acquired the outstanding capital stock of Portsmouth Leasing Corporation, LFC No. 38 Corp. and LFC No. 60 Corp. (collectively, the "Acquired Companies") for $80.5 million. The purchase price included a cash payment of $20.3 million and the assumption of project debt totaling $60.2 million. In April 1996, the Company finalized the purchase price.

The acquisition was accounted for as a purchase, and the purchase price has been allocated to the acquired assets and liabilities based on their estimated fair values. The adjusted allocation of the purchase price is as follows (in thousands):

Current assets	$ 6,572
Property, plant and equipment	122,545
Total assets	129,117
Current liabilities	(1,079)
Deferred income taxes, net	(46,580)
Total liabilities	(47,659)
Net purchase price	$ 81,458

The Acquired Companies own 100% of the assets of two 49.5 megawatt natural gas-fired cogeneration facilities Greenleaf 1 and Greenleaf 2 (collectively, the "Greenleaf Power Plants"), located in Yuba City in northern California. Electrical energy generated by the Greenleaf Power Plants is sold to PG&E pursuant to two long-term PSAs (expiring in 2019) at prices equal to PG&E's full short-run avoided operating costs, adjusted annually. The PSA also includes payment provisions for firm capacity payments through 2019 for up to 49.2 megawatts on each unit and as-delivered capacity on excess deliveries. PG&E, at its discretion, may curtail purchases of electricity from the Greenleaf Power Plants due to hydro-spill or uneconomic cost conditions. The thermal energy generated is used by thermal hosts adjacent to the Greenleaf Power Plants.

Gas for the Greenleaf Power Plants is supplied by Montis Niger, Inc. ("MNI"). On January 31, 1997, the Company purchased MNI for $7.5 million.

6. CALPINE MONTEREY COGENERATION, INC.

On June 29, 1995, CMCI acquired a 14.5-year operating lease (through December 2009) for a 28.5 megawatt natural gas-fired cogeneration power plant located in Watsonville, California. The Company acquired the operating lease from Ford Motor Credit Company for $900,000. The Watsonville Power Plant sells electricity to PG&E under a 20-year PSA, generally at prices equal to PG&E's full short-run avoided operating costs. Basic and contingent lease rental payments are described in Note 26. The power plant also provides steam to two local food processing plants. The Company also provides project and fuels management services.

7. CALPINE SISKIYOU GEOTHERMAL PARTNERS, L.P.

In 1994, the Company formed a partnership with Trans-Pacific Geothermal Corporation ("TGC") to build a geothermal power generation facility located at Glass Mountain in northern California. TGC had previously signed a memorandum of understanding ("MOU") with Bonneville Power Administration ("BPA") and the Springfield, Oregon Utility Board ("SUB") to develop the project at Vale, Oregon. BPA and SUB consented in August 1994 to the assignment of the MOU to the partnership and the relocation of the project to Glass Mountain. The MOU contemplated execution of a 45-year power purchase agreement subject to satisfaction of certain conditions precedent and included an option for an additional 100 megawatts. The partnership is consolidated as the Company owns a controlling interest.

In December 1996, the partnership and BPA entered into a settlement agreement which restructured the rights and obligations of the parties. In return for the payment of $12.0 million by BPA to the partnership and the grant by the partnership to BPA of future options to purchase power at Glass Mountain, the partnership and BPA terminated the MOU and certain ancillary agreements. In addition, BPA will pay the partnership additional consideration should certain future events occur related to the ongoing environmental review of the Glass Mountain project. Following the settlement with BPA, TGC withdrew from the partnership.

Of the $12.0 million received by the partnership in December 1996, $4.7 million was allocated to TGC, of which $3.0 million was received by the Company in payment of a loan (see Note 15). Previously capitalized project costs were charged to expense, and no significant gain or loss was included in net income for the year 1996.

At December 31, 1996, the Company had $4.0 million of geothermal leases at Glass Mountain recorded as Property, plant and equipment, net in the accompanying consolidated balance sheet. The Company is continuing to pursue the development of Glass Mountain, and expects to recover the cost of such leases from the future development of the resource.

8. CALPINE VAPOR, INC.

In November 1995, Calpine Vapor entered into agreements with Constructora y Perforadora Latina, S.A. de C.V. ("Coperlasa") and certain Mexican bank lenders to loan funds to Coperlasa in connection with a geothermal steam production contract at the Cerro Prieto geothermal resource in Baja California, Mexico. The resource currently produces electricity from geothermal power plants owned and operated by Comision Federal de Electricidad ("CFE"), Mexico's national utility. The steam field contract is between Coperlasa and CFE. Calpine Vapor loaned $18.5 million to Coperlasa, and received fees for technical services provided to the project. At December 31, 1996, notes receivable (see Note 15) totaled $18.0 million. The Company is deferring the recognition of income on this loan until the Cerro Prieto project generates sufficient cash flows available for distribution to support the collectibility of interest earned.

In December 1995, Calpine Vapor also paid $1.5 million for an option to purchase an equity interest in Coperlasa. The option is being amortized over the estimated repayment period of the Coperlasa loan and is included in Other assets.

9. KING CITY TRANSACTION

In April 1996, the Company entered into a long-term operating lease with BAF Energy, A California Limited Partnership ("BAF"), for a 120 megawatt natural gas-fired cogeneration power plant located in King City, California. The power plant generates electricity for sale to PG&E pursuant to a long-term PSA through 2019 and provides steam to a vegetable processing plant.

The Company makes semi-annual lease payments to BAF on each February 15 and August 15, a portion of which is supported by a $95.0 million collateral fund owned by the Company. The collateral fund consists of investment grade and U.S. Treasury Securities that mature serially in amounts equal to a portion of the lease payment. The collateral fund securities are classified as held-to-maturity investments (see Note 2). As of December 31, 1996, future rent payments are $24.4 million for 1997, $23.8 million for 1998, $19.4 million for 1999, $20.1 million for 2000, $20.8 million for 2001, and $183.2 million thereafter. Included in the accompanying December 31, 1996 balance sheet is approximately $12.7 million of unamortized prepaid lease costs.

The Company recorded the value of the above-market pricing provided in the PSA as an asset which is included in property, plant and equipment. The Company has also recorded a deferred lease incentive of $78.5 million at December 31, 1996 equal to the value of the above-market payments to be received. The asset and liability are being amortized over the life of the power sales agreement and lease, respectively.

10. GILROY TRANSACTION

On August 29, 1996, the Company acquired a 120 megawatt natural gas-fired cogeneration power plant located in Gilroy, California. The cost of the Gilroy Power Plant was $125.0 million plus certain contingent consideration, which is expected to be $24.1 million. The Company recorded the value of the above-market pricing provided in the PSA of $82.1 million as an asset which is included in Property, plant and equipment.

Electricity generated by the Gilroy Power Plant is sold to PG&E pursuant to a long-term PSA terminating in 2018. The PSA contains payment provisions for capacity and energy. The Gilroy Power Plant also produces and sells thermal energy to ConAgra, Inc.

Pro Forma Consolidated Results

The following unaudited pro forma consolidated results for the Company give effect to (i) the King City Transaction and (ii) the Gilroy Transaction as if such transactions had occurred on January 1, 1996; unaudited pro forma consolidated results are also provided for the effects of the above transactions and (iii) the Watsonville operating lease acquired on June 28, 1995, and (iv) the Greenleaf Transaction, as if such transactions had occurred on January 1, 1995 (in thousands, except per share amounts):

	1996	1995
Revenue	$237,924	$221,447
Net income	$ 18,954	$ 11,288
Earnings per share	$ 1.29	$ 0.80

11. PASADENA COGENERATION PROJECT

The Company has entered into a development agreement with Phillips Petroleum Company ("Phillips") to construct and operate a 240 megawatt gas-fired cogeneration project at the Phillips Houston Chemical Complex ("HCC") located in Pasadena, Texas. In December 1996, the Company entered into an Energy Sales Agreement with Phillips pursuant to which Phillips will purchase all of HCC's steam and electricity requirements of approximately 90 megawatts. It is anticipated that the remainder of available electricity output will be sold into the competitive market. The Company provided a $3.0 million letter of credit to Phillips to secure the performance under the project development agreement. The Company also entered into a credit agreement with ING U.S. Capital Corporation to provide $98.6 million of non-recourse project financing. In accordance with the credit agreement, the Company contributed $53.1 million in cash to the project, of which the remaining $41.0 million is included in Restricted cash in the accompanying consolidated balance sheet. The Company commenced construction in February 1997, with commercial operation scheduled to begin in October 1998. There can be no assurances that the Company will be successful in completing any additional PSAs or that the anticipated schedule for construction will be met.

12. ACCOUNTS RECEIVABLE

At December 31, 1996, accounts receivable of $42.8 million included $1.9 million to be received from the Los Angeles Department of Water and Power for reimbursement of costs related to the Coso development project incurred by the Company in prior years. Such amount was received in 1997.

Accounts receivable from related parties at December 31, 1996 and 1995 include the following (in thousands):

	1996	1995
O.L.S. Energy-Agnews, Inc.	$ 687	$ 806
Geothermal Energy Partners, Ltd.	350	462
Sumas Cogeneration Company, L.P.	590	908
Electrowatt Ltd. and subsidiaries	1,199	1
	$ 2,826	$ 2,177

At December 31, 1996, the $1.2 million receivable from Electrowatt Ltd. was for reimbursement of costs for the sale of Electrowatt's ownership of Calpine common stock during the Company's initial public offering.

13. ACQUISITION PROJECT RECEIVABLES

In connection with an unsuccessful bid to acquire O'Brien Environmental Energy, Inc. ("OEE") in 1995 through the U.S. Bankruptcy Court, the Company incurred and capitalized project acquisition costs. On November 8, 1996, the court denied Calpine's application for approval of such costs and fees and the Company recorded a $3.7 million loss for unrecoverable amounts (included in Other income, net in the accompanying consolidated statement of operations). The Company is appealing the court's decision.

The Company also purchased $1.9 million of accounts receivable from two subsidiaries of OEE. Payments were made to the Company based on cash availability for each subsidiary. In February 1996, the Company received approximately $1.1 million against these receivables.

The Company purchased for $900,000 from Stewart & Stevenson, Inc. ("S&S") a participation interest in a $1.0 million note issued by OEE. The Company received principal plus accrued interest in 1996.

The Company purchased all of S&S's rights and obligations in a Subordinated Loan Agreement and Note between S&S and O'Brien (Newark) Cogeneration, Inc. The purchase price was $2.8 million and the notes bore interest at prime plus 2.0%. The Company received principal plus accrued interest in 1996.

14. INVESTMENTS IN POWER PROJECTS

The Company has unconsolidated investments in power projects which are accounted for under the equity method. Financial information related to these investments is as follows (in thousands):

1996	SUMAS COGENERATION COMPANY, L.P.	O.L.S. ENERGY-AGNEWS, INC.	GEOTHERMAL ENERGY PARTNERS, LTD.
Operating revenue	$ 44,092	$ 11,023	$22,302
Net income (loss)	8,494	(840)	6,367
Assets	129,273	37,160	69,249
Liabilities	125,652	36,711	38,304
Company's percentage ownership	(a)	20%	5%
Equity investments in power projects	11,382	124	1,556
Project development costs	875	–	–
Total investments in power projects	12,257	124	1,556
Company's share of net income (loss)	$ 6,396	$ (190)	$ 331

1995	SUMAS COGENERATION COMPANY, L.P.	O.L.S. ENERGY-AGNEWS, INC.	GEOTHERMAL ENERGY PARTNERS, LTD.
Operating revenue	$ 31,526	$ 10,779	$ 21,676
Net income (loss)	(6,098)	(483)	5,538
Assets	122,802	40,330	76,017
Liabilities	123,377	39,034	51,439
Company's percentage ownership	(a)	20%	5%
Equity investments in power projects	5,763	314	1,229
Project development costs	912	–	–
Total investments in power projects	6,675	314	1,229
Company's share of net income (loss)	$ (3,049)	$ (82)	$ 227

1994	SUMAS COGENERATION COMPANY, L.P.	O.L.S. ENERGY-AGNEWS, INC.	GEOTHERMAL ENERGY PARTNERS, LTD.
Operating revenue	$ 32,060	$ 11,985	$ 21,721
Net income (loss)	(5,777)	(415)	5,548
Assets	130,148	42,596	77,081
Liabilities	124,625	40,864	58,041
Company's percentage ownership	(a)	20%	5%
Equity investments in power projects	8,812	396	952
Project development costs	946	8	–
Total investments in power projects	9,758	404	952
Company's share of net income (loss)	$ (2,888)	$ (143)	$ 277

(a) Distributions will be made out of operating income after certain required deposits are made and certain minimum balances are met. After receiving certain preferential distributions, the Company will have a 50% interest in the profits and losses of Sumas until earning a 24.5% pre-tax cumulative return on its investment, at which time the Company's interest in Sumas will be reduced to 11.33%.

Sumas Cogeneration Company, L.P. Sumas Cogeneration Company, L.P. ("Sumas") is a Delaware limited partnership formed between Sumas Energy, Inc. ("SEI"), a Washington State Subchapter S corporation, and Whatcom Cogeneration Partners, L.P. ("Whatcom"), a wholly owned partnership of the Company. SEI is the general partner and Whatcom is the limited partner. Sumas has a wholly owned Canadian subsidiary, ENCO Gas, Ltd. ("ENCO"), which is incorporated in New Brunswick, Canada.

Sumas owns and operates a 125 megawatt natural gas-fired cogeneration power plant. In connection with the Sumas power plant is a lumber dry kiln facility and a 3.5 mile private natural gas pipeline. ENCO acquired, developed and is operating a portfolio of proven natural gas reserves in British Columbia and Alberta, Canada to provide a dedicated fuel supply for the Sumas Power Plant.

Sumas produces and sells electrical energy to Puget Sound Power & Light Company ("Puget") under a 20-year agreement for an average 123 megawatts. Sumas leases the dry kiln facility and sells steam to Socco, Inc. ("Socco"), a custom lumber drying operation owned by an affiliated individual.

Construction financing was provided through a $95.2 million construction and term loan agreement with The Prudential Insurance Company of America ("Prudential") and Credit Suisse, an affiliate of the Company. In addition, ENCO has a $24.8 million loan agreement with Prudential and Credit Suisse. On May 25, 1993, the entire $120.0 million was converted to a term loan.

In addition, the Company provides operations and maintenance services to Sumas and receives a fixed fee of $1.1 million per year adjusted annually for inflation, an annual base fee of $150,000 per year also adjusted annually for inflation and certain other reimbursable expenses. The Company is entitled to an annual performance bonus of up to $400,000 based upon the achievement of certain performance levels. This arrangement will expire upon the date Whatcom receives its 24.5% pre-tax return or 10 years, subject to renewal terms, whichever is later. The Company recorded revenue of approximately $2.0 million, $2.0 million, and $1.9 million associated with this arrangement during the years ended December 31, 1996, 1995 and 1994, respectively.

O.L.S. Energy-Agnews, Inc. The Company has a 20% interest in O.L.S. Energy-Agnews, Inc., a joint venture with GATX Capital Corporation, which owns and operates a 29 megawatt gas-fired combined-cycle cogeneration facility at the State-owned Agnews Developmental Center ("Center") in San Jose, California. The cogeneration plant provides the Center with all of its thermal and electric requirements. Excess electricity is sold to PG&E under a Standard Offer No. 4 contract. The Company's original investment was $1.8 million.

In addition to its interest as stated above, the Company has been contracted by the joint venture to provide operations and maintenance services at cost plus overhead and fees, as specified. The Company recorded revenue of $2.0 million, $1.5 million, and $1.4 million associated with this service agreement and for other services provided to the joint venture for the years ended December 31, 1996, 1995 and 1994, respectively.

In January 1990, O.L.S Energy-Agnews, Inc. entered into a credit agreement with Credit Suisse providing for a $28.0 million loan. The loan is secured by all of the assets of the Agnews Power Plant and bears interest on the unpaid principal balance based on the London Interbank Offered Rate ("LIBOR") plus a margin rate varying between 0.05% and 1.5%.

Geothermal Energy Partners, Ltd. During 1989, the Company acquired a 5% interest in Geothermal Energy Partners Ltd. ("GEP"). GEP was established in 1988 to develop, finance and construct a 20 megawatt geothermal power production facility located in The Geysers area of northern California. The facility began operations on June 6, 1989.

In addition to its interest as stated above, the Company has been contracted by GEP to provide operations and maintenance services at cost plus overhead and fees, as specified. The Company recorded revenue of $4.0 million, $3.5 million and $3.7 million associated with this service agreement to GEP for the years ended December 31, 1996, 1995 and 1994, respectively.

The Company accounts for its investment in GEP under the equity method because control of the project is deemed to be shared under the terms of the partnership agreement, and the Company has significant influence over the operation of the venture.

15. NOTES RECEIVABLE

In May 1993, in accordance with the Sumas partnership agreement, the Company was entitled to receive a distribution of $1.5 million and SEI, the Company's partner in Sumas, was required to make a capital contribution of $1.5 million. In order to meet SEI's $1.5 million capital contribution requirement, the Company loaned $1.5 million to the sole shareholder of SEI, who in turn loaned the funds to SEI, who in turn contributed the capital to Sumas. The loan bears interest at 20% and is secured by a security interest in the loan between SEI and its sole shareholder. The Company will receive payments of 50% of SEI's cash distributions from Sumas. The payments will first reduce any accrued and unpaid interest and then reduce the principal balance. On May 25, 2003, all unpaid principal and interest is due.

In March 1994, the Company loaned $10.0 million to the sole shareholder of SEI. The loan matures in 10 years and bears interest at 16.25%. The loan is secured by a pledge to Calpine of SEI's interest in Sumas. In order to provide for the payment of principal and interest on the loan, an additional 12½% of the cash flow generated by Sumas was assigned to Calpine. The Company deferred the recognition of interest income from these notes until Sumas generated net income. In 1996, the Company recognized a total of $2.1 million of interest income related to the above two loans, which represents the portion of Sumas' earnings not recognized by Calpine related to its equity investment in Sumas.

In August 1994, the Company entered into a loan agreement providing for loans up to $4.8 million to Trans-Pacific Geothermal Glass Mountain Ltd. ("TGGM"), a subsidiary of TGC (see Note 7). The loan bore interest at 10% and had a maturity date which was based on certain future events. The loan was secured by a pledge to Calpine of the partner's interest in the Glass Mountain project. The Company was deferring the recognition of income from this note until the Glass Mountain project generated sufficient income to support the collectibility of interest earned. At December 1, 1996, $4.1 million was outstanding. In December 1996, the Company received $3.0 million from TGGM in payment of the loan and recorded a $1.1 million loss for uncollectible amounts, which was included in Other income, net (see Note 7).

As of December 31, 1996, Calpine Vapor had notes receivable of $18.0 million from Coperlasa and associated unamortized loan acquisition fees of $1.1 million (see Note 8). Interest accrues on the outstanding notes receivable at approximately 18.9%. The Company is deferring the recognition of income from this note until the Cerro Prieto project generates sufficient cash flows available for distribution to support the collectibility of interest earned.

16. REVOLVING CREDIT FACILITY AND LINES OF CREDIT

At December 31, 1996, the Company had a $50.0 million three-year credit facility available with a consortium of commercial lending institutions which include The Bank of Nova Scotia, International Nederlanden U.S. Capital Corporation, Sumitomo Bank of California and Canadian Imperial Bank of Commerce. As of December 31, 1996, the Company had no borrowings and $5.9 million of letters of credit outstanding, which reflect $3.0 million to secure performance with the Pasadena Power Plant and $2.9 million related to operating expenses at CMCI. Borrowings bear interest at The Bank of Nova Scotia's base rate or at LIBOR plus an applicable margin. Interest is paid on the last day of each interest period for such loans, but not less often than quarterly, based on the principal amount outstanding during the period for base rate loans, and on the last day of each applicable interest period, but not less often than 90 days, for LIBOR loans. The credit agreement expires in September 1999. The credit agreement specified that the Company maintain certain covenants with which the Company was in compliance. Commitment fees related to this line of credit are charged based on 0.50% of committed unused credit.

At December 31, 1995, the Company had a $50.0 million credit facility with Credit Suisse (whose parent company owns approximately 44.9% of Electrowatt Ltd. ("Electrowatt"), the former indirect sole owner of the Company prior to the initial public offering on September 25, 1996). At December 31, 1995, the Company had $19.9 million of borrowings outstanding, bearing interest at LIBOR plus 0.5% (6.4% at December 31, 1995). Interest could be paid at either LIBOR or the Credit Suisse base rate, plus applicable margins in both cases. The credit agreement specified that the Company maintain certain covenants with which the Company was in compliance. The Company terminated its Credit Suisse credit facility on September 25, 1996.

At December 31, 1996, the Company had a loan facility with available borrowings totaling $1.2 million. There were no borrowings and $900,000 of letters of credit outstanding as of December 31, 1996. At December 31, 1995, the Company had three loan facilities with available borrowings totaling $10.2 million. Borrowings and letters of credit outstanding were $1.2 million and $3.8 million as of December 31, 1995, respectively. Interest is payable at variable interest rates based on bank base rates, LIBOR or prime plus applicable margins in all cases (approximately 7.6% at December 31, 1995 on borrowings). The credit agreements specified that the Company maintain certain covenants with which the Company was in compliance.

17. WORKING CAPITAL LOAN

The Company has a $5.0 million working capital loan agreement with a bank providing for advances and letters of credit. The aggregate unpaid principal of the working capital loan is payable in full at least once a year, with the final payment of principal, interest and fees due June 30, 1998. Interest on borrowings accrues at the option of the Company at either a base rate, LIBOR, or a certificate of deposit rate (plus applicable margins in all cases) over the term of the loan. No borrowings were outstanding at December 31, 1996 and 1995. The Company had letters of credit outstanding of $459,000 at December 31, 1996 and 1995. Outstanding letters of credit bear interest at 0.625% payable quarterly.

18. NON-RECOURSE PROJECT FINANCING

The components of non-recourse project financing as of December 31, 1996 and 1995 are (in thousands):

	1996	1995
Senior-term loans:		
Fixed rate portion	$ 73,000	$ 99,400
Variable rate portion	20,000	20,000
Premium on debt	1,824	2,959
Total senior-term loans	94,824	122,359
Junior-term loans	19,965	19,965
Notes payable to banks	194,478	133,026
Total long-term debt	309,267	275,350
Less current portion	30,627	84,708
Long-term debt, less current portion	$278,640	$190,642

The Company entered into the Senior-Term Loans and Junior-Term Loans in connection with the Company's acquisition of CGC in 1993.

Senior-Term Loans. Principal and interest are payable in quarterly installments at variable amounts with the final payment of principal, interest and fees due June 30, 2002. A portion of the senior-term loans bears interest fixed at 9.93% (see discussion on swap agreement below) with the remainder accruing interest at LIBOR plus an applicable margin (6.75% and 6.69% at December 31, 1996 and 1995, respectively) over the term of the loan, collateralized by all of CGC's assets and the Company's interest in CGC. The premium is amortized over the life of the fixed rate portion of the loan using the interest method.

Junior-Term Loans. Principal and interest are payable in quarterly installments at variable amounts beginning September 30, 2002 with the final payment of principal, interest and fees due June 30, 2005; interest accrues at LIBOR plus an applicable margin (7.75% and 7.69% at December 31, 1996 and 1995, respectively) over the term of the loan, collateralized by all of CGC's assets and the Company's interest in CGC.

The Company entered into two interest rate swap agreements to minimize the impact of changes in interest rates on a portion of its senior-term loans. These agreements fix the interest on this portion at 9.93%. At December 31, 1996, the swap agreements applied to debt with a principal balance total of $73.0 million. The interest rate swap agreements mature through December 31, 2000. The premium on debt was recorded in conjunction with the acquisition as discussed above. The amortization of the premium adjusts the effective interest rate on the fixed-rate debt to 7.05% per annum. The floating interest rate associated with this portion of the senior-term loans was LIBOR plus an applicable margin (6.63% at December 31, 1996 and 6.99% at December 31, 1995). The Company is exposed to credit risk in the event of non-performance by the other parties to the swap agreements.

Notes Payable to Banks. In September 1994, the Company entered into a two-year agreement with The Bank of Nova Scotia to finance the acquisition of TPC. In May 1996, a portion of the net proceeds from the Company's issuance of the 10½% Senior Notes Due 2006 was utilized to repay the total $57.0 million of borrowings under this agreement.

In June 1995, the Company entered into an agreement with Sumitomo Bank to finance the acquisition of the Greenleaf Power Plants. Of the $74.7 million debt outstanding at December 31, 1996, $59.0 million bears interest fixed at 7.4%, with the remaining floating rate portion accruing interest at LIBOR plus an applicable margin (6.24% as of December 31, 1996). At December 31, 1995, $76.0 million of debt was outstanding, of which $60.0 million was at the fixed interest rate of 7.4%, with the remaining floating rate portion accruing interest at approximately 6.5%. This debt is secured by all of the assets of Greenleaf 1 and 2. Interest on the floating rate portion may be at Sumitomo's base rate plus an applicable margin or at LIBOR plus an applicable margin. Interest on base rate loans is paid at the end of each calendar quarter, and interest on LIBOR based loans is paid on each maturity date, but not less often than quarterly, based on the principal amount outstanding during the period. At the Company's discretion, the LIBOR based loans may be held for various maturity periods of at least 1 month up to 12 months. The $74.7 million debt will be repaid quarterly, with a final maturity date of December 31, 2010.

On August 29, 1996, the Company entered into an agreement with Banque Nationale de Paris ("BNP") to finance the acquisition of the Gilroy Power Plant. As of December 31, 1996, BNP had provided a $119.8 million loan consisting of a 15-year tranche in the amount of $84.8 million and an 18-year tranche in the amount of $35.0 million. In addition, BNP provided two additional tranches for the payment of certain contingent consideration, which at December 31, 1996 totaled $19.6 million. The debt is secured by all of the assets of the Gilroy Power Plant. A portion of the BNP notes bears interest fixed at a weighted average of 6.6% (see discussion below), with the remainder accruing interest at LIBOR plus an applicable margin (6.6% at December 31, 1996). Interest on the floating rate portion may be at BNP's base rate plus an applicable margin or at LIBOR plus an applicable margin. Interest on base rate loans is payable not less often than quarterly. Interest on LIBOR based loans is paid on each maturity date, but not less often than quarterly. At the Company's discretion, LIBOR based loans may be held for various maturity periods of at least 1 month and up to 12 months. The $119.8 million debt will be repaid semi-annually beginning August 31, 1997, with a final maturity date of August 28, 2011. Commitment fees are charged based on 1% to 1.125% of committed unused credit.

The Company entered into four interest rate swap agreements to minimize the impact of changes in interest rates. These agreements fix the interest on $87.5 million of principal at a weighted average interest rate of 6.6%. The interest rate swap agreements mature through August 2011. The Company is exposed to credit risk in the event of non-performance by the other parties to the swap agreements.

The annual principal maturities of the non-recourse debt outstanding at December 31, 1996 are as follows (in thousands):

1997	$ 30,627
1998	32,658
1999	24,183
2000	24,851
2001	24,631
Thereafter	170,493
	307,443
Unamortized premium on fixed portion of senior loans	1,824
Total	$309,267

The carrying value of $73.0 million and $99.4 million of the senior-term loan as of December 31, 1996 and 1995, respectively, has an effective rate of 9.93% under the Company's interest rate swap agreements (7.05% after consideration of the debt premium). Based on the borrowing rates currently available to the Company for bank loans with similar terms and maturities, the fair value of the debt as of December 31, 1996 and 1995 is approximately $83.2 million and $107.3 million, respectively. The carrying value of the remaining $20.0 million of the senior-term and the $20.0 million junior-term loans and the notes payable to banks approximate the debts' fair market value as the rates are variable and based on the current LIBOR rate.

The non-recourse debt is held by subsidiaries of Calpine. The debt agreements of the Company's subsidiaries and other affiliates governing the non-recourse project financing generally restrict their ability to pay dividends, make distributions or otherwise transfer funds to the Company. The dividend restrictions in such agreements generally require that, prior to the payment of dividends, distributions or other transfers, the subsidiary or other affiliate must provide for the payment of other obligations, including operating expenses, debt service and reserves.

On December 20, 1996, the Company entered into a credit agreement with ING U.S. Capital Corporation to provide $98.6 million of non-recourse project financing for the Pasadena Cogeneration Project (see Note 11). No borrowings were outstanding at December 31, 1996. Interest is payable at ING's base rate or the Federal Funds Rate plus an applicable margin on the last day of each calendar quarter, or at LIBOR plus an applicable margin upon maturity of the loan, but no less than quarterly. All interest is due and payable upon conversion of the construction loan to a term loan. Subject to the terms of the credit agreement, all or part of the construction loan will be converted to a term loan upon completion of construction. Commitment fees are charged based on 0.375% of committed unused credit.

19. NOTES PAYABLE

At December 31, 1996, the Company had a non-interest bearing promissory note for $6.5 million payable to Natomas Energy Company, a wholly owned subsidiary of Maxus Energy Company. This note has been discounted to yield 8.0% per annum, due September 9, 1997. The carrying amount of $6.2 million at December 31, 1996 approximates fair market value.

In January 1995, the Company purchased the working interest covering certain properties in its geothermal properties at CGC from Santa Fe Geothermal, Inc. The purchase price included $6.0 million cash, and a $750,000 non-interest bearing note discounted to yield 9% per annum and due on December 26, 1997. The Company may repay all or any part of the note at any time without penalty. The carrying value of $686,000 of the discounted non-interest bearing note at December 31, 1996 approximates fair market value.

20. SENIOR NOTES

On May 16, 1996, the Company issued $180.0 million aggregate principal amount of 10 1/2% Senior Notes Due 2006. The net proceeds of $174.9 million were used to repay $53.7 million of borrowings under the Credit Suisse Credit Facility, $57.0 million of non-recourse project financing and $45.0 million of borrowings from The Bank of Nova Scotia. The remaining $19.2 million was available for general corporate purposes. Transaction costs of $5.1 million incurred in connection with the public debt offering were recorded as a deferred charge and are amortized over the ten-year life of the 10 1/2% Senior Notes Due 2006.

The 10½% Senior Notes Due 2006 will mature on May 15, 2006. The Company has no sinking fund or mandatory redemption obligations with respect to the 10½% Senior Notes Due 2006. Interest is payable semi-annually on May 15 and November 15. Based on the traded yield to maturity, the approximate fair market value of the 10½% Senior Notes Due 2006 was $191.7 million as of December 31, 1996.

On February 17, 1994, the Company completed a $105.0 million public debt offering of 9¼% Senior Notes Due 2004. Transaction costs of $4.1 million incurred in connection with the public debt offering were recorded as a deferred charge and are amortized over the ten-year life of the 9¼% Senior Notes Due 2004.

The 9¼% Senior Notes Due 2004 will mature on February 1, 2004. The Company has no sinking fund or mandatory redemption obligations with respect to the 9¼% Senior Notes Due 2004. Interest is payable semi-annually on February 1 and August 1. Based on the traded yield to maturity, the approximate fair market value of the 9¼% Senior Notes Due 2004 was $105.7 million as of December 31, 1996.

The Senior Note indentures specify that the Company maintain certain covenants with which the Company was in compliance. The Company may, under certain circumstances, be limited in its ability to make restricted payments, as defined, which include dividends and certain purchases and investments, incur additional indebtedness and engage in certain transactions.

21. PROVISION FOR INCOME TAXES

The Company follows the liability method of accounting for income taxes whereby deferred income taxes are recognized for the tax consequences of "temporary differences" to the extent they are not reduced by net operating loss and tax credit carryforwards by applying enacted statutory rates.

The components of the deferred tax liability as of December 31, 1996 and 1995 are (in thousands):

	1996	1995
Expenses deductible in a future period	$ 3,329	$ 1,674
Net operating loss and credit carryforwards	19,856	19,480
Other differences	1,186	2,034
Deferred tax asset, before valuation allowance	24,371	23,188
Valuation allowance	(692)	(749)
Deferred tax asset	23,679	22,439
Property differences	(119,842)	(116,314)
Difference in taxable income and income from investments recorded on the equity method	(2,753)	(2,311)
Other differences	(1,469)	(1,435)
Deferred tax liabilities	(124,064)	(120,060)
Net deferred tax liability	$(100,385)	$ (97,621)

The net operating loss and credit carryforwards consist of Federal and State net operating loss carryforwards which expire 2005 through 2010 and 2000, respectively, and Federal and State alternative minimum tax credit carryforwards which can be carried forward indefinitely. At December 31, 1996, the Federal and State net operating loss carryforwards were approximately $23.8 million and $12.0 million, respectively. At December 31, 1996, the State net operating losses have been fully reserved for in the valuation allowance due to the limited carryforward period allowed by the State of California. At December 31, 1996, Federal and State alternative minimum tax credit carryforwards were approximately $6.7 million and $1.7 million, respectively.

Realization of the deferred tax assets and federal net operating loss carryforwards is dependent, in part, on generating sufficient taxable income prior to expiration of the loss carryforwards. In September 1996, the Company underwent an ownership change as a result of the initial public offering of the Company's common stock. This ownership change limits the amount of net operating loss and credit carryforwards available to offset current tax liabilities. Although realization is not assured, management believes it is more likely than not that all of the deferred tax asset will be realized based on estimates of future taxable income. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

In 1996, the Company decreased its deferred income tax liability by $769,000 to reflect the change in California's state income tax rate from 9.3% to 8.84% effective January 1, 1997.

The provision for income taxes for the years ended December 31, 1996, 1995 and 1994 consists of the following (in thousands):

	1996	1995	1994
Current:			
Federal	$5,671	$3,085	$ 96
State	1,805	1,163	365
Deferred:			
Federal	3,890	816	2,546
State	(801)	(15)	547
Adjustment in state tax rate	(769)	–	–
Revision in prior years' tax estimates	(732)	–	–
Increase in valuation allowance	–	–	299
Total provision	$9,064	$5,049	$3,853

The Company's effective rate for income taxes for the years ended December 31, 1996, 1995 and 1994 differs from the U.S. statutory rate, as reflected in the following reconciliation.

	1996	1995	1994
U.S. statutory tax rate	35.0%	35.0%	35.0%
State income tax, net of Federal benefit	6.0	6.0	6.0
Depletion allowance	(2.3)	(0.3)	(8.6)
Effect of change in tax rates	(3.0)	–	–
Revision in prior years' tax estimates	(2.6)	–	–
Increase in valuation allowance	–	–	7.8
Other, net	(0.4)	(0.1)	(1.2)
Effective income tax rate	32.7%	40.6%	39.0%

22. RETIREMENT SAVINGS PLAN

The Company has a defined contribution savings plan under Section 401(a) and 501(a) of the Internal Revenue Code. The plan provides for tax deferred salary deductions and after-tax employee contributions. Employees automatically become participants on the first quarterly entry date after completion of three months of service. Contributions include employee salary deferral contributions and a 3% employer profit-sharing contribution. Employer profit-sharing contributions in 1996, 1995, and 1994 totaled $485,000, $350,000 and $311,000, respectively.

23. PREFERRED STOCK

The Company had 5,000,000 authorized shares of Series A Preferred Stock, all of which were issued on March 21, 1996 to Electrowatt. The shares of Series A Preferred Stock were not publicly traded. No dividends were payable on the Series A Preferred Stock. The Series A Preferred Stock contained provisions regarding liquidation and conversion rights. Upon the consummation of the Company's initial public offering, all of the Series A Preferred Stock was converted into approximately 2.2 million shares of common stock and sold to the public in the offering by Electrowatt (see Note 24).

24. COMMON STOCK

In September 1996, Calpine completed the initial public offering of 18,045,000 shares of its common stock with $0.001 par value per share (the "Common Stock Offering"). In the Common Stock Offering, the Company issued and sold 5,477,820 shares of common stock and Electrowatt sold 12,567,180 shares of common stock, representing its entire ownership interest in Calpine. As a result of the Common Stock Offering, Electrowatt no longer owns any interest in Calpine. The Company received approximately $82.1 million of net proceeds from the Common Stock Offering. In October 1996, the Company issued an additional 1,793,400 shares of common stock to cover over-allotments of shares in connection with the Common Stock Offering and received approximately $27.1 million of net proceeds. Approximately $13.0 million of total net proceeds was used to repay short-term bank borrowings. The remaining net proceeds are for working capital and general corporate purposes, and for the development and acquisition of power generation facilities. In connection with the Common Stock Offering, the Company completed a 5.194-for-1 stock split of the Company's common stock and converted the Company's outstanding preferred stock into shares of common stock.

25. STOCK-BASED COMPENSATION PROGRAMS

1996 Employee Stock Purchase Plan

The Company adopted 1996 Employee Stock Purchase Plan ("ESPP") in July 1996. Eligible employees may purchase up to 275,000 shares of common stock at semi-annual intervals through periodic payroll deductions. Shares are purchased on February 28 and August 31 of each year. On the first purchase date of February 28, 1997, employees purchased 25,819 shares of common stock at a weighted average fair value of $13.60 per share. The purchase price is 85% of the lower of (i) the fair market value of the common stock on the participant's entry date into the offering period, or (ii) the fair market value on the semi-annual purchase date.

1996 Stock Incentive Plan

The Company adopted the 1996 Stock Incentive Plan ("SIP") in September 1996; such plan succeeded the Company's previously adopted stock option program. The Company accounts for this plan under APB Opinion No. 25, under which no compensation cost has been recognized in 1996. Had compensation cost for this plan been determined consistent with SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company's net income and earning per share would have been reduced to the following pro forma amounts (in thousands, except per share amounts):

	1996	1995
Net income		
As reported	$18,692	$7,378
Pro forma	$18,145	$7,232
Primary earnings per share		
As reported	$ 1.27	–
Pro forma	$ 1.24	–
As adjusted primary earnings per share assuming conversion of preferred stock:		
As reported	–	$ 0.52
Pro forma	–	$ 0.51

Because the SFAS No. 123 method of accounting has not been applied to options granted prior to January 1, 1995, the resulting pro forma compensation cost may not be representative of that to be expected in future years.

The Company may grant options for up to 4,041,858 shares under the SIP. As of December 31, 1996, the Company had granted options to purchase 2,340,294 shares of common stock. Under the SIP, the option exercise price equals the stock's fair market value on date of grant. The SIP options generally vest after four years and expire after 10 years.

A summary of the status of the Company's SIP at December 31, 1996 and changes during the year then ended is presented in the table and narrative below:

	SHARES OF COMMON STOCK		WEIGHTED
	AVAILABLE FOR OPTION OR AWARD	SIP OPTION SHARES	AVERAGE EXERCISE PRICE
Balance, January 1, 1995	1,160,782	1,436,141	$ 1.53
Granted	(444,333)	444,333	$ 4.91
Forfeited	25,963	(25,963)	$ 2.13
Balance, December 31, 1995	742,412	1,854,511	$ 2.34
Additional shares reserved	1,444,935	–	–
Granted	(547,579)	547,579	$ 8.71
Exercised	–	(5,000)	$ 1.85
Forfeited	56,796	(56,796)	$ 7.90
Balance, December 31, 1996	1,696,564	2,340,294	$ 3.69

The following table summarizes information concerning outstanding and exercisable options at December 31, 1996:

	OPTIONS OUTSTANDING		OPTIONS EXERCISABLE	
EXERCISE PRICES	NUMBER OUTSTANDING	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	NUMBER EXERCISABLE	WEIGHTED AVERAGE EXERCISE PRICE
$ 0.50	934,920	6.00	934,920	$ 0.50
$ 1.85	174,193	6.25	174,193	$ 1.85
$ 4.57	296,058	7.75	222,043	$ 4.57
$ 4.91	434,290	8.97	104,590	$ 4.91
$ 8.57	490,833	10.00	–	$ 8.57
$16.00	10,000	9.99	10,000	$16.00
	2,340,294		1,445,746	$ 1.71

The estimated average fair value of options granted in 1995 and 1996 is $1.23 and $3.29 on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: risk-free interest rates of 5.4% to 6.2%; expected dividend yields of zero percent; expected lives of 3 years; expected volatility of 0% to 27%.

26. RELATED PARTY TRANSACTIONS

In January 1995, the Company and Electrowatt entered into a management services agreement whereby Electrowatt agreed to provide the Company with advisory services in connection with the construction, financing, acquisition and development of power projects, as well as any other advisory services as may be required by the Company in connection with the operation of the Company. Pursuant to this agreement, the Company paid $166,000 and $200,000 of such management services in 1996 and 1995, respectively. The management services agreement terminated September 25, 1996, with completion of the initial public offering.

During 1996, 1995, and 1994, the Company paid $123,000, $106,000, and $69,000, respectively, to Electrowatt pursuant to a guarantee fee agreement whereby Electrowatt agreed to guarantee the payment, when due, of any and all indebtedness of the Company to Credit Suisse in accordance with the terms and conditions of the line of credit. Under the guarantee fee agreement, the Company had agreed to pay to Electrowatt an annual fee equal to 1% of the average outstanding balance of the Company's indebtedness to Credit Suisse during each quarter as compensation for all services rendered under the guarantee fee agreement. The guarantee fee agreement terminated in September 1996.

At December 31, 1996, the Company had approximately $1.2 million in accounts receivable from Electrowatt (see Note 12) related to reimbursement of costs for the sale of Electrowatt's common stock in Calpine. As a result of Electrowatt's sale of Calpine common shares, Electrowatt no longer owns any interest in Calpine.

27. SIGNIFICANT CUSTOMERS

The Company's electricity and steam sales revenue is primarily from two sources – PG&E and SMUD. Revenues earned from these sources for the years ended December 31, 1996, 1995 and 1994 were as follows (in thousands):

	1996	1995	1994
PG&E	$183,531	$112,522	$77,010
SMUD	14,609	12,345	9,296
Other	1,324	173	804
	199,464	125,040	87,110
Deferred revenues recognized (see Note 3)	–	2,759	3,185
Total electricity and steam sales	$199,464	$127,799	$90,295

PG&E, the Company's primary customer, is also affected by industry restructuring and deregulation (see Note 28 regarding *Regulation and CPUC Restructuring*).

28. COMMITMENTS AND CONTINGENCIES

Capital Projects. The Company has 1997 commitments for capital expenditures totaling $4.0 million related to various projects at its geothermal facilities. In March 1996, the Company entered into an energy development agreement with Phillips Petroleum Company to develop, construct, own and operate a 240 megawatt gas-fired cogeneration facility at Phillips Houston Chemical Complex in Pasadena, Texas. The Company commenced construction in February 1997, with commercial operation scheduled to begin in October 1998. The Company has 1997 commitments of $97.2 million related to this project.

Royalties and Leases. The Company is committed under several geothermal leases and right-of-way, easement and surface agreements. The geothermal leases generally provide for royalties based on production revenue with reductions for property taxes paid. The right-of-way, easement and surface agreements are based on flat rates and are not material. Under the terms of certain geothermal leases, royalties accrue at rates ranging from 7% to 12.5% of steam and effluent revenue. Certain properties also have net profits and overriding royalty interests ranging from approximately 1.45% to 28%, which are in addition to the land royalties. Most lease agreements contain clauses providing for minimum lease payments to lessors if production temporarily ceases or if production falls below a specified level.

The Company also has working interest agreements with third parties providing for the sharing of approximately 25% to 30% of drilling and other well costs, various percentages of other operating costs and 25% to 30% of revenues on specified wells.

Expenses under these agreements for the years ended December 31, 1996, 1995 and 1994 are (in thousands):

	1996	1995	1994
Production royalties	$10,793	$10,574	$11,153
Lease payments	$ 246	$ 225	$ 252

Natural Gas Purchases. The Company enters into long-term gas purchase contracts with third parties to supply gas to its gas-fired cogeneration projects. Such contracts generally have terms of 1 to 24 months, and existing contracts expire though July 31, 1997, continuing month to month thereafter unless either party terminates the agreement upon sixty days written notice. On January 31, 1997, the Company purchased MNI which supplies gas to the Greenleaf Power Plants (see Note 5).

Watsonville Operating Lease. The Company is committed under an operating lease (through December 2009) for a 28.5 megawatt natural gas-fired cogeneration power plant located in Watsonville, California (see Note 6). Under the terms of the lease, basic and contingent rents are payable each month during the period from July through December. As of December 31, 1996, future basic rent payments are $2.9 million for each year from 1997 to 2001, and $24.4 million thereafter through December 2009. Contingent rent payments are based on the net of revenues less all operating expenses, fees, reserve requirements, basic rent and supplemental rent payments. Of the remaining balance, 60% is payable to the lessor and 40% is payable to the Company.

Office and Equipment Leases. The Company leases its corporate office, Houston office, Portland office, Santa Rosa office facilities and certain office equipment under noncancellable operating leases expiring through 2001. Future minimum lease payments under these leases are (in thousands):

1997	$1,138
1998	1,125
1999	977
2000	936
2001	367
Thereafter	—
Total future minimum lease commitments	$4,543

Lease payments are subject to adjustment for the Company's pro rata portion of annual increases or decreases in building operating costs. In 1996, 1995 and 1994, rent expense for noncancellable operating leases amounted to $1,036,000, $733,000 and $663,000, respectively.

Regulation and CPUC Restructuring. Electricity and steam sales agreements with PG&E are regulated by the CPUC. In December 1995, the CPUC proposed the transition of the electric generation market to a competitive market beginning January 1, 1998, with all consumers participating by 2003. Since the proposed restructure results in widespread impact on the market structure and requires participation and oversight of the Federal Energy Regulatory Commission ("FERC"), the CPUC has sought to build a California consensus involving the legislature, the Governor, public and municipal utilities and customers. The consensus has resulted in filings with FERC which should permit both the CPUC and FERC to collectively proceed with implementation of the new competitive market structure. On September 23, 1996, state legislation was passed, AB 1890 (the "Bill"), which codified much of the CPUC decision and directed the CPUC to proceed with implementation of restructure no later than January 1, 1998. The Bill accelerated the transition period to a fully competitive market from five years to four years with all consumers participating by the year 2002. The Bill provided for an electricity rate freeze for the period of transition and mandated through issuance of rate reduction bonds a 10% rate reduction for small commercial and residential customers effective January 1, 1998. The proposed restructuring provides for phased-in customer choice (direct access), development of a non-discriminatory market structure, full recovery of utility stranded costs, sanctity of existing contracts, and continuation of existing public policy programs including funds for enhancement of in-state renewable energy technologies during the transition period. The Company cannot predict the final form or timing of the proposed restructuring and the impact, if any, that such restructuring would have on the Company's exitsting business or results of operations. The Company believes that any such restructuring would not have a material effect on its power sales agreements and, accordingly, believes that its existing business and results of operations would not be materially adversely affected, although there can be no assurance in this regard.

A domestic electricity generating project must be a QF under FERC regulations in order to take advantage of certain rate and regulatory incentives provided by the Public Utility Regulatory Policies Act of 1978, as amended ("PURPA"). PURPA exempts owners of QFs from the Public Utility Holding Company Act of 1935, as amended ("PUHCA"), and exempts QFs from most provisions of the Federal Power Act (the "FPA") and state laws concerning rate or financial regulation. PURPA also requires that electric utilities purchase electricity generated by QFs at a price based on the utility's "avoided cost", and that the utility sell back-up power to the QF on a non-discriminatory basis. If one of the projects in which the Company has an interest should lose its status as a QF, the project would no longer be entitled to the exemptions from PUHCA and the FPA. This could trigger certain rights of termination under the PSA, could subject the project to rate regulation as a public utility under the FPA and state laws and could result in the Company inadvertently becoming a public utility holding company. The Company believes that each of the electricity generating projects in which the Company owns an interest currently meets the requirements under PURPA necessary for QF status.

Litigation. The Company, together with over 100 other parties, was named as a defendant in an action brought in August 1993 by the bankruptcy trustee for Bonneville Pacific Corporation ("Bonneville"), captioned *Roger G. Segal, as the Chapter 11 Trustee for Bonneville Pacific Corporation v. Portland General Corporation*, et al., in the United States District Court for the District of Utah (the "Court"). In December 1996, the trustee and the Company entered into a settlement agreement relating to this matter. The trustee has agreed to waive all claims against the Company and to dismiss the trustee's litigation against the Company in exchange for a payment of $767,500 by the Company.

The Company is involved in various other claims and legal actions arising out of the normal course of business. Management does not expect that the outcome of these cases will have a material adverse effect on the Company's financial position or results of operations.

29. QUARTERLY CONSOLIDATED FINANCIAL DATA (UNAUDITED)

The Company's quarterly operating results have fluctuated in the past and may continue to do so in the future as a result of a number of factors, including, but not limited to, the timing and size of acquisitions, the completion of development projects, the timing and amount of curtailment, and variations in levels of production. Furthermore, the majority of capacity payments under certain of the Company's power sales agreements are received during the months of May through October.

In the first quarter of 1996, the Company issued $50.0 million of preferred stock to Electrowatt (see Note 23).

In the second quarter of 1996, the Company entered into an operating lease for the King City Power Plant (see Note 9) and issued $180.0 million of 10½% Senior Notes Due 2006 (see Note 20).

In the third quarter of 1996, the Company acquired the Gilroy Power Plant (see Note 10) and charged to earnings a $3.7 million uncollectible amount associated with the attempt to acquire the O'Brien companies (see Note 13). The Company also incurred an employee bonus expense of $1.4 million related to the initial public offering of common stock in September 1996, and recorded a $1.8 million loss related to its electricity trading operations. In addition, the Company decreased its deferred income taxes by $769,000 to reflect the change in California's state income tax rate from 9.3% to 8.84% effective January 1, 1997.

In the fourth quarter of 1996, the Company recorded a $1.4 million net gain related to the settlement of the Coso project, offset by a $767,500 expense related to the settlement of certain litigation (see Note 28). In addition, the Company revised its prior years' tax estimates by $700,000.

The Company's common stock has been traded on the New York Stock Exchange beginning September 19, 1996. There were approximately 39 common stockholders of record at December 31, 1996. No dividends have been paid to-date.

	QUARTER ENDED			
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	DECEMBER 31	SEPTEMBER 30	JUNE 30	MARCH 31
1996				
Total revenue	$61,663	$70,897	$50,321	$31,673
Income from operations	$14,303	$29,097	$16,203	$ 7,188
Net income	$ 3,537	$10,732	$ 4,717	$ (294)
Earnings per common share	$ 0.17	$ 0.76	$ 0.35	$ (0.03)
Common stock price per share				
High	$ 20.00	$ 16.38	–	–
Low	$ 16.00	$ 16.00	–	–
1995				
Total revenue	$39,570	$42,176	$28,342	$22,010
Income from operations	$11,473	$16,446	$ 8,195	$ 6,572
Net income	$ 2,115	$ 4,965	$ 239	$ 59
As adjusted earnings per share assuming conversion of preferred stock (see Note 2)	$ 0.15	$ 0.35	$ 0.02	–

CALPINE OFFICES AND PROJECTS

CALPINE CORPORATION
50 West San Fernando Street
San Jose, California 95113
408.995.5115
408.995.0505/fax

CALPINE - GEOTHERMAL OFFICE
1160 North Dutton Avenue
Suite 200
Santa Rosa, California 95401
707.527.6700
707.544.2422/fax

CALPINE - HOUSTON OFFICE
3200 SW Freeway
Suite 3300
Houston, Texas 77027
713.840.6060
713.840.6051/fax

CALPINE - NORTHWEST OFFICE
400 S.W. Sixth Avenue
Suite 600
Portland, Oregon 97204
503.224.3363
503.224.7659/fax

POWER PLANTS AND STEAM FIELDS

AGNEWS *is a gas-fired, combined-cycle cogeneration power plant located in San Jose, California. The facility provides 29 mw of electricity to Pacific Gas and Electric Company (PG&E) and steam to the California State Agnews Developmental Center.*

Agnews Power Plant
3530 Zanker Road
San Jose, California 95134
408.456.2690
408.456.0421/fax

AIDLIN, *located in The Geysers Geothermal Resource area of northern California, is a 20 mw geothermal facility that provides electricity to PG&E.*

Aidlin Power Plant
9500 Geysers Road
Cloverdale, California 95425
707.894.3901
707.894.3906/fax

BEAR CANYON *is a 20 mw geothermal facility located in The Geysers. Electricity is sold to PG&E.*

Bear Canyon Power Plant
10350 Socrates Mine Road
Middletown, California 95461
707.987.0651
707.987.2620/fax

CALPINE FUELS - SACRAMENTO VALLEY *is a natural gas production company that owns an estimated 10 billion cubic feet of proven natural gas reserves and an 80-mile pipeline system that ties into Calpine's Greenleaf Power Plants.*

Calpine Fuels - Sacramento Valley
50 West San Fernando Street
San Jose, California 95113
408.995.5115
408.995.0505/fax

CALPINE SUTTER DRYERS *is the host facility for Calpine's Greenleaf 1 Power Plant. The facility uses thermal heat from Greenleaf 1 to dry a variety of agricultural and timber products.*

Calpine Sutter Dryers
5089 S. Township Road
Yuba City, California 95993
916.671.6526
916.671.7435/fax

CERRO PRIETO *is a 600 mw geothermal steam field located in Baja California, Mexico. The field fuels three geothermal plants owned by Comision Federal de Electricidad, the national utility. Calpine participates in 80 mw of steam supply.*

Calpine - Mexico Geothermal Office
Constructora y Perforadora Latina, S.A. de C.V.
Carretera Pascualitos Pescaderos KM27.5
Campo Geotermico de Cerro Prieto
Mexicali, B.C.
Mexico
011.526.523.1230
011.526.523.1236/fax

THE GEYSERS STEAM FIELDS *provide steam to fuel PG&E's Units 13 and 16, and Sacramento Municipal Utility District's SMUDGEO #1 power plant. The fields provide steam for 227 mw of geothermal power plants.*

The Geysers Steam Field Operations
10350 Socrates Mine Road
Middletown, California 95461
707.987.2156
707.987.0153/fax

GILROY, *Calpine's most recent acquisition, is a 120 mw gas-fired cogeneration power plant located in Gilroy, California. The plant produces electricity that is sold to PG&E and steam that is sold to an adjacent food processing plant owned by Gilroy Foods, Inc., a subsidiary of ConAgra, Inc.*

Gilroy Power Plant
1400 Pacheco Pass Highway, Gate 1
Gilroy, California 95020
408.847.5328
408.847.1088/fax

GREENLEAF 1 *is a 49.5 mw gas-fired cogeneration power plant that sells electricity to PG&E. Located near Sacramento, California, the plant also generates heat that Calpine Sutter Dryers uses to dry a variety of agricultural and timber products.*

Greenleaf 1 Power Plant
5089 S. Township Road
Yuba City, California 95993
916.671.6982
916.671.7435/fax

GREENLEAF 2, *also located near Sacramento, California, is a 49.5 mw cogeneration power plant that sells electricity to PG&E and steam to Sunsweet Growers, the largest dried prune processor in the U.S. This gas-fired facility utilizes steam injection.*

Greenleaf 2 Power Plant
875 N. Walton Avenue
Yuba City, California 95993
916.755.3900
916.755.3903/fax

KING CITY *is a 120 mw gas-fired facility. Located in northern California, this cogeneration power plant produces thermal energy for a subsidiary of Basic American, Inc., a food processing plant, and electricity, which is sold to PG&E.*

King City Power Plant
750 Metz Road
King City, California 93930
408.385.4090
408.385.6683/fax

PASADENA *is a 240 mw gas-fired merchant power plant being built by Calpine in Pasadena, Texas. Steam and electricity will be sold to Phillips Petroleum Company's Houston Chemical Complex. A large portion of the electric output will be sold into the Texas market.*

Pasadena Power Plant
955 Phillips Road
Pasadena, Texas 77501
713.477.7821
713.477.8037/fax

SUMAS, *a gas-fired, combined-cycle cogenerator, sells 125 mw of electricity to Puget Sound Power & Light Company and steam to a nearby lumber-drying facility. The project is located near the Canadian border in Sumas, Washington.*

Sumas Power Plant
601 West Front Street
Sumas, Washington 98295
360.988.7017
360.988.7424/fax

SUTTER *is a 480 mw gas-fired merchant power plant currently under development. The proposed plant will be built, owned and operated by Calpine, and will sell electricity to the deregulated California market.*

Sutter Power Plant
990B Klamath Avenue
Suite 3
Yuba City, California 95993
916.821.0180
916.821.0182/fax

THERMAL POWER STEAM FIELDS, *located in The Geysers Geothermal Resource, supply enough steam to generate approximately 150 mw of electricity from twelve PG&E power plants.*

Thermal Power Steam Fields
1160 North Dutton Avenue
Suite 200
Santa Rosa, California 95401
707.527.6700
707.544.2422/fax

WATSONVILLE *is a 28.5 mw gas-fired, combined-cycle cogeneration power plant located in Watsonville, California, 40 miles south of Calpine's headquarters. Electricity is sold to PG&E, and steam is supplied to a Calpine-owned water distillation plant.*

Watsonville Power Plant
831 Walker Street
Watsonville, California 95076
408.761.5355
408.761.5357/fax

WEST FORD FLAT *is a 27 mw geothermal facility located in The Geysers. Electricity is sold to PG&E.*

West Ford Flat Power Plant
10350 Socrates Mine Road
Middletown, California 95461
707.987.9238
707.987.9364/fax

CORPORATE DATA

STOCK TRANSFER AGENT AND REGISTRAR

First Chicago Trust Company of New York
P.O. Box 2500
Jersey City, New Jersey 07303
Shareholder Inquiries: 201.324.1644
Hearing Impaired: 201.222.4955

STOCK LISTING

New York Stock Exchange Symbol: CPN

INVESTOR RELATIONS CONTACT

Rick Barraza, Vice President -- Investor Relations
Calpine Corporation
50 West San Fernando Street
San Jose, California 95113
408.995.5115
408.995.0505/fax
E-mail: rickb@Calpine.com

SEC REPORT

If you would like a copy of the Company's Annual Report on Form 10-K to the Securities and Exchange Commission, please contact Rick Barraza, Investor Relations, at 408.995.5115; fax 408.995.0505.

CORPORATE AUDITORS

Arthur Andersen LLP
1500 Riverpark Tower
333 West San Carlos Street
San Jose, California 95110

ANNUAL MEETING

The Annual Meeting of Stockholders of Calpine Corporation will be held on June 5, 1997, at 9:00 A.M., at the Fairmont Hotel, adjacent to Calpine's headquarters, at 170 South Market Street, San Jose, California 95113.

Design and Production:
Hausman Design, Inc., Palo Alto, CA

Principal Photography:
Michael Grecco, Santa Monica, CA

GLOSSARY OF INDUSTRY TERMS

AVAILABILITY - *Percent of the total hours in a year a power plant is available to deliver electrical energy to the grid. For instance, 99% availability means that all planned and unplanned outages kept the plant out of service 1% of the year, or 88 hours. Availability is the most commonly used measure of a plant's performance.*

CALPINE CONSTRUCT - *An integrated approach for managing the engineering, procuring the major equipment and managing the construction of power projects using non-recourse project financing. Compared with the traditional turnkey approach, Calpine Construct reduces project costs, while providing flexibility for design improvements throughout the engineering and construction phases.*

CAPACITY - *The maximum amount of electricity that a power plant can produce under specified conditions. Capacity is measured in megawatts.*

COGENERATION - *A process used in a power plant using energy from burning fuel to generate electricity and to provide heat for industrial processes. Traditional methods require two separate facilities—an industrial steam boiler and a utility power plant. Cogeneration plants use fuel more efficiently than other fossil fuel technologies.*

COMBINED-CYCLE - *A power plant uses mechanical energy from a gas turbine to drive a generator and heat from the exhaust of the gas turbine to produce steam, which drives a steam turbine connected to a second generator. This combined use increases the efficiency of producing electricity.*

DEREGULATION - *Historically, producers of electric power were regulated utilities generating and distributing power in exclusive service territories. As a result of federal and state legislation, a process of deregulation has been under way in the U.S. since the late 1970s. This has created opportunities for independent power producers to generate electricity and sell it to wholesale customers. As deregulation proceeds, retail customers will be able to select the power company of their choice. In California, retail deregulation will begin in January 1998.*

EBITDA - *Earnings Before Interest, Taxes, Depreciation and Amortization. EBITDA is a measure of cash flow.*

GAS-FIRED POWER PLANTS - *Natural gas has become the fuel of choice for new power generating facilities in the U.S. and elsewhere where large supplies exist. Typically, power from modern gas-fired plants costs less than power from nuclear, oil or new coal plants. Gas-fired plants have shorter construction periods, higher availability and lower capital costs.*

GEOTHERMAL ENERGY - *Geothermal energy is a clean, alternative source of power produced from hot water or steam that has been heated naturally by the earth. Geothermal energy is found in areas of the world where heat sources are close to the surface. Commercially productive geothermal fields exist in over ten countries, including many Pacific Rim nations.*

THE GEYSERS GEOTHERMAL RESOURCE - *Located in north central California near the Napa Valley, The Geysers is the world's largest producing geothermal resource. The region produces roughly 1,200 mw—enough electricity to supply the needs of more than one million households.*

INDEPENDENT POWER PRODUCER (IPP) - *A non-regulated electricity generating company.*

INDUSTRIAL STEAM HOST - *The industrial facility which purchases steam and sometimes electricity from a cogeneration facility.*

KILOWATT (KW), KILOWATT HOUR (KWH) - *A kilowatt (kw) is a unit of electric power equal to 1,000 watts. A kilowatt hour (kwh) is the work done by one kilowatt acting for one hour. A 100 watt light bulb burning for 1,000 hours consumes 100 kwh. The retail price for electricity in the U.S. is about seven to thirteen cents per kwh.*

MEGAWATT (MW) - *A megawatt (mw) is equal to 1,000 kilowatts. Power plants are rated in megawatts. Calpine's plants range in size from 20 mw to 240 mw. A 100 mw power plant can generate approximately 875 million kwh per year.*

MERCHANT POWER PLANT - *A power generation facility that sells electricity directly to the newly competitive power market without the majority of its output being committed to long-term power sales agreements. Calpine's 240 mw Pasadena Power Plant is largely a merchant power plant.*

NON-RECOURSE FINANCING - *An arrangement used to finance the debt portion of a project in which the lender has recourse only to the assets and cash flows of the specific project.*

PG&E - *Pacific Gas and Electric Company, one of the largest investor-owned utilities in the United States.*

POWER AND STEAM SALES AGREEMENTS - *Calpine's gas-fired and geothermal facilities produce electricity and steam that is sold to utilities, industrial companies and government institutions under the terms of long-term power and steam sales agreements.*

POWER TRADING - *The process of buying and selling power as a commodity in the open market. Calpine trades power as part of its overall power marketing program.*

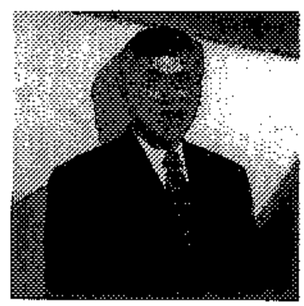
SENIOR STAFF

PETER CARTWRIGHT, *Chairman, President and Chief Executive Officer, founded Calpine in 1984. Pete has over 35 years of experience in the power industry. He was responsible for General Electric Company's nuclear power projects in Japan, Taiwan, Mexico and India, and for Business Development in Europe and Asia. He was Vice President of Gibbs & Hill, Inc., a power engineering firm. He worked on Princeton University's thermonuclear program and served in the U.S. Navy Civil Engineer Corp.*

ANN B. CURTIS *has been with Calpine since its beginning in 1984. She serves as Senior Vice President and Director, responsible for finance and administration, including the functions of general counsel, corporate and project finance, accounting, human resources, and public and investor relations. She is Corporate Secretary and an officer of the Company's subsidiaries. Ann has served the power industry for 18 years in various management positions. During her distinguished career with Calpine, she has played a prominent role in providing the financial and administrative resources required to build a successful power company.*

LYNN A. KERBY *joined Calpine in January 1991. As Senior Vice President, he is responsible for the management of Calpine's operating facilities and the engineering, construction and start-up of power projects. Lynn has extensive domestic and international power plant construction and operations experience. Before joining Calpine, he served the power industry for nearly 30 years with the Guy F. Atkinson Company as Senior Vice President-Operations, President of Guy F. Atkinson Construction Company and Atkinson's representative on Calpine's Board of Directors. He has been responsible for power projects in the U.S., Canada, Latin America and Asia.*

RODNEY M. BOUCHER, *Senior Vice President, joined Calpine in 1995. He is responsible for directing the Company's power marketing operations. Rod has more than 30 years of engineering and management experience with electric utilities and power marketers, most recently serving as Chief Operating Officer of Citizens Lehman Power LP. During his 16-year tenure with PacifiCorp, he served in various management positions, including Vice President Power Resources and Chief Information Officer.*



RICHARD D. BARRAZA *is Vice President, Investor Relations. Prior to assuming responsibility for managing stockholder relations with Calpine's investors and analysts, Rick had served as Director of Financial Planning and Analysis. He is responsible for evaluating project development and acquisition opportunities in addition to managing corporate and project operating budgets. He joined Calpine in 1986 with an extensive background in accounting and finance in the energy industry.*

PETER W. CAMP, *Vice President, Project Development, is responsible for identifying and developing international power generation opportunities. Peter joined Calpine in 1992, and has been associated with the power industry for more than 20 years. His background includes general management positions with General Electric, leadership of a technology start-up and management consulting with McKinsey & Company.*

ROBERT D. KELLY *joined Calpine in 1991. He serves as Vice President, Finance. He led the Calpine financial team in the successful IPO in 1996. Bob is responsible for arranging all debt and equity financing for Calpine and its power generation projects. Prior to joining the Company, he was Marketing Manager of Westinghouse Credit Corporation, where he headed up the Energy Finance Division's West Region, and held various management positions with The Bank of Nova Scotia.*

LARRY R. KRUMLAND *serves as Vice President, Asset Management. Larry joined Calpine in 1984, and is responsible for managing the Company's $1 billion investment portfolio of power generation projects. During his 30-year career in the power industry, Larry served in various positions at Pacific Gas and Electric Company and Gibbs & Hill, Inc.'s Western Regional Office, where he was Director of Sales and Manager of Geothermal Projects.*

JOHN P. ROCCHIO *joined Calpine in 1984 as Vice President, Project Development. John is responsible for developing power generation projects in the U.S. market, most recently launching the development of Calpine's first merchant facility, the 240 mw Pasadena Power Plant, and completing the acquisition of two 120 mw gas-fired power plants. During his three decades in the power industry, he worked in leadership positions at General Electric and Gibbs & Hill, Inc.*

ANGELO E. URBANI *is Vice President, Construction. He joined Calpine in 1992 as Project Manager for construction of the 125 mw power plant in Sumas, Washington. Since bringing the plant on line in 1993, Angelo has been responsible for technical due diligence for Calpine's acquisition and development program. Prior to joining Calpine, he served in various engineering and construction management positions with Century Contractors West, Inc. and Fluor Corporation. Angelo brings nearly three decades of engineering and construction management experience to Calpine.*

RON A. WALTER *joined Calpine in 1984. He currently serves as Vice President, Project Development. He is responsible for power projects in the U.S., including corporate and project acquisitions, and for managing the Company's merchant power plant program. Ron's 24-year tenure in the energy industry includes various management, technical and technology development positions, including Director of Sales-Geothermal for an architect-engineering firm, and in various management positions with Batelle Northwest Laboratories.*

CALPINE

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