THORATEC CORP
Form 10-K
March 16, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

(Mark one)

þ **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2005

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to .

Commission file number: 1-8145

Thoratec Corporation

(Exact Name of Registrant as Specified in Its Charter)

California	**94-2340464**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*
6035 Stoneridge Drive, Pleasanton, California	**94588**
(Address of Principal Executive Offices)	*(Zip Code)*

Registrant s telephone number, including area code: (925) 847-8600

Securities registered pursuant to Section 12(b) of the Exchange Act: None

Securities registered pursuant to Section 12(g) of the Exchange Act: Common Stock

Indicate by a check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by a check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No þ

Indicate by a check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by a check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by a check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12(b)-2)Yes o No þ

The aggregate market value of the voting stock held by non-affiliates computed by reference to the last sale reported of such stock on July 2, 2005, the last business day of the Registrant s second fiscal quarter, as listed on The Nasdaq National Stock Market was $739,742,359.

As of March 10, 2006, registrant had 52,319,017 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Designated portions of Thoratec s definitive proxy statement for its 2006 annual meeting of shareholders are incorporated by reference into Part III of this Form 10-K.

Thoratec, the Thoratec logo, Thoralon, TLC-II, HeartMate and *Vectra* are registered trademarks of Thoratec Corporation, and Heart Hope, HeartMate II and IVAD are trademarks of Thoratec Corporation.

HEMOCHRON, ProTime, Surgicutt, Tenderlett, Tenderfoot and IRMA are registered trademarks of International Technidyne Corporation, or ITC, our wholly-owned subsidiary.

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PART I

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, including the documents incorporated by reference in this Annual Report, includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended. These statements can be identified by the words expects, projects, hopes, believes, intends, should, estimate, will, would, may, anticipates, plans, coul
Actual results, events or performance could differ materially from these forward-looking statements based on a variety of factors, many of which are beyond our control. Therefore, readers are cautioned not to put undue reliance on these statements. Factors that could cause actual results or conditions to differ from those anticipated by these and other forward-looking statements include those more fully described in the Risk Factors section of this Annual Report and in other documents we file with the Securities and Exchange Commission. These forward-looking statements speak only as of the date hereof. We undertake no obligation to publicly release the results of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof, or to reflect the occurrence of unanticipated events.

Item 1. *Business*

OVERVIEW

Thoratec Corporation (we, our, us, the Company) is a leading manufacturer of circulatory support products for t treatment of heart failure, or HF. We sell Ventricular Assist Devices, or VADs, our primary product, to leading heart transplant centers throughout the world and account for three out of the four VADs approved by the U.S. Food and Drug Administration, or FDA, as a bridge to heart transplant for adults and are commercially marketed. These devices are used for the temporary support of adult patients awaiting a heart transplant and as the only FDA-approved ventricular assist device approved for permanent implant, or Destination Therapy. We also are a leading provider of point-of-care and incision blood diagnostic test systems.

Incorporated in the state of California in 1976, Thoratec Corporation trades on the NASDAQ under the ticker symbol THOR and is headquartered in Pleasanton, California.

Our business is comprised of two operating divisions: Cardiovascular and International Technidyne Corporation, or ITC, a wholly owned subsidiary.

The product line within the Cardiovascular segment is:

Circulatory Support Products. Our circulatory support products include VADs for the short, intermediate, and long-term treatment of advanced HF. In addition, we have developed small diameter grafts using our proprietary materials to address the vascular access market. Our grafts are sold in the U.S. and internationally for use in hemodialysis.

The product lines within the ITC segment are:

Point-of-Care Diagnostics. Our point-of-care products, or POC, include coagulation diagnostic test systems that monitor a patient in a variety of clinical settings during the administration of certain anticoagulants, and blood gas/electrolyte/chemistry products that monitor patients in a variety of clinical settings.

Incision. Our incision products include devices to obtain patients blood samples for diagnostic testing and screening for platelet function.

Heart failure is a disorder in which the heart loses its ability to pump blood efficiently. This condition may affect the right side, the left side or both sides of the heart, depriving many organs, including the kidneys and liver, of adequate oxygen and nutrients. This damages these organs and reduces their ability to function properly. Approximately 23 million people worldwide suffer from HF, with two million new cases of HF diagnosed each year worldwide. In the U.S., according to the American Heart Association, or AHA, nearly five million patients suffer from HF and an additional 550,000 patients are diagnosed with the condition annually. In contrast to other cardiovascular disorders, many of which have actually declined in the past few decades, the incidence of heart failure ranks as the most rapidly growing cardiovascular disorder in the U.S. Our VADs provide hemodynamic restoration therapy, which supports the performance of the heart and restores blood flow to adequately meet the needs of vital organs.

Our VADs have been clinically proven to improve patient survival and quality of life. We currently offer the widest range of products to serve this market, including VADs for short, intermediate and long-term support, as well as devices that are FDA-approved as a bridge-to-transplantation, for Destination Therapy and/or postcardiotomy myocardial recovery. We believe that our long-standing reputation for quality and innovation and our excellent relationships with leading cardiovascular surgeons worldwide position us to capture growth opportunities in the expanding heart failure market.

We currently market VADs that may be implanted or worn outside the body, can be used for left, right or biventricular support and that are suitable for treatments for different durations for patients of varying sizes and ages. We estimate that doctors have implanted more than 10,000 of our devices, primarily for patients awaiting a heart transplant or those who require permanent support. On November 6, 2002, the FDA approved the HeartMate VE as the first heart assist device for Destination Therapy, or permanent support for patients suffering from late-stage heart failure who are not eligible for heart transplantation. On April 7, 2003, the FDA approved the HeartMate XVE, an enhanced version of the HeartMate VE, for Destination Therapy. Thoratec is the only company to offer a VAD approved by the FDA for Destination Therapy and marks the first time a VAD has been approved as a permanent treatment for late-stage heart failure patients who do not qualify for heart transplants because of age or extenuating health circumstances, and who otherwise have a life expectancy of less than two years. The FDA s decision to approve the HeartMate VAD for Destination Therapy was based on data from a clinical trial called REMATCH, or Randomized Evaluation of Mechanical Assistance for the Treatment of Congestive Heart Failure, which showed our HeartMate device nearly doubled and tripled survival over the drug therapy group at one and two years, respectively.

The Centers for Medicare & Medicaid Services, or CMS, issued a National Coverage Decision Memorandum covering reimbursement for the use of a Left Ventricular Assist System for Destination Therapy, effective October 1, 2003. CMS has subsequently adjusted the relative weight and base level of reimbursement it will provide under DRG (diagnosis-related group) 103 Heart Transplant or Implant of Implantable Heart Assist Systems , or DRG 103, to raise the average payment for CMS Destination Therapy-certified Centers to approximately $136,000, the same reimbursement given for heart transplants. In many cases the actual payments to hospitals under DRG 103 could be higher or lower, based on geographical location and other factors.

Several private payors have also issued positive coverage decisions. The majority of local Blue Cross and Blue Shield plans have created positive medical policy for both bridge-to-transplantation and long-term therapy indications. Since December 2002, the majority of national insurance carriers, including Aetna, Cigna, Humana, United Health Group and UNICARE, have issued positive coverage policies to cover the use of ventricular assist devices for FDA-approved indications, including Destination Therapy.

OUR MARKETS

CARDIOVASCULAR SEGMENT

Circulatory Support and Graft Products

The primary markets for our VAD products serve those patients suffering from late stage HF. Late-stage HF is a chronic disease that occurs when degeneration of the heart muscle reduces the pumping power of the heart, causing the heart to become too weak to pump blood at a level sufficient to meet the body s demands. The condition can be caused by artery or valve diseases or a general weakening of the heart muscle itself. Other conditions, such as high blood pressure or diabetes, also can lead to HF.

According to estimates by the AHA, 5 million patients suffer from HF in the U.S. and approximately 550,000 new cases are diagnosed each year. The AHA also estimates that approximately 80% of men and 70% of women HF patients under age 65 will die within eight years of diagnosis. While the number of treatment options for earlier stage HF has increased in recent years, medication remains the most widely used approach for treatment of the disease. These drug therapies include ACE inhibitors, anti-coagulants and beta-blockers, which facilitate blood flow, thin the blood or help the heart work in a more efficient manner. Other procedures include angioplasty, biventricular pacing, valve replacement, bypass and left ventricular reduction surgery.

Despite attempts to manage HF through drug therapy, the only curative treatment for the disease is a heart transplant. Unfortunately, the number of hearts available for transplant each year can meet the needs of only a small number of the patients requiring one. The United Network for Organ Sharing reported that there were only 2,096 hearts available for transplant in the U.S. in 2004. At any given time, approximately 4,000 patients are on the U.S. national transplant waiting list, and we believe a comparable number of patients are waiting in Europe. The median wait for a donor heart is approximately nine months; many patients have to wait as long as two years. In 2002, approximately 15% of these patients died while waiting for a donor heart.

In the U.S., there are currently two FDA-approved indications for the long-term use of VADs in patients with HF: as a bridge to heart transplant and as Destination Therapy. We are currently pursuing an additional indication for our Thoratec VAD products: therapeutic recovery of the heart. Beyond the HF markets, VADs are also approved for use during recovery following cardiac surgery. All four indications are summarized below.

Bridge-to-Transplantation Ventricular assist devices provide additional cardiac support for patients in late-stage heart failure waiting for a donor heart. Of the approximately 4,000 patients on the waiting list for a heart transplant in the U.S., we estimate that approximately 25% receive a VAD. We believe that the percentage of patients bridged to transplant will continue to increase with surgeons level of comfort with the technology, particularly for longer-term support cases. There are currently five devices approved in the U.S. as a bridge to-transplant in adults, four of which are Thoratec devices.

Destination Therapy On November 6, 2002, we received approval to market the HeartMate VAD for Destination Therapy patients with late-stage HF who are not candidates for heart transplantation due to other degenerative illnesses or advanced age. The National Institutes for Health (NIH) estimated that the Destination Therapy application represents a long-term market opportunity of up to 100,000 additional patients annually in the U.S. For these late-stage HF patients, drug therapy is currently the only other treatment available. Even with drug therapy, the 12-month mortality rate for these patients is approximately 80%. We believe that the HeartMate provides a significant survival benefit for this patient population. We believe that the success in transitioning this market from maximum drug therapy to VADs is dependent on the development of products such as our HeartMate that deliver substantial longevity and proof of clinical efficacy.

Therapeutic Recovery We believe that for most patients the recovery of their own heart is a better alternative than either heart transplantation or permanent implantation of a blood pumping device. Based on recently reported cases of recovery in heart failure patients, we believe that our VAD system, in combination with other agents such as cell or drug therapies, has the potential to reverse the complications of late-stage HF in certain patients. While this therapeutic recovery indication is not yet approved for our devices, we are actively investigating the worldwide experience with our VAD systems as a means of therapeutic recovery and the requirements for pursuing regulatory approval for this indication. Although it is not certain how many patients with HF could benefit from this indication, based upon our estimate of the percentage of patients with late-stage HF, we believe that the patient population could be substantial. We are pursuing a bridge to myocardial recovery indication to add to our labeling that is approved by the FDA which would allow the Thoratec VAD to be used to treat patients diagnosed with acute cardiac disorders such as fulminate myocarditis. We will continue working with the FDA toward this goal in 2006. We are also formulating a regulatory and clinical strategy for non-U.S. markets.

Post-cardiotomy Myocardial Recovery Following Cardiac Surgery In addition to chronic HF, our devices are also used for patients who suffer from acute cardiac failure and undergo cardiac surgery. Following cardiac surgery, some patients have difficulty being weaned off heart/lung machines, a complication that arises in open-heart procedures. Many of these patients ultimately die from heart failure when the heart, weakened by disease and the additional trauma of surgery, fails to maintain adequate blood circulation. We believe that only a small portion of this market is currently being treated with VADs and that this patient population could benefit substantially from the use of our FDA approved Thoratec VAD and IVAD products in this market.

Vascular Graft Products In addition to the circulatory support market, we sell a device that addresses the vascular access graft market, which we market as the *Vectra* Vascular Access Graft, or *Vectra,* for patients undergoing renal hemodialysis.

ITC SEGMENT

Point-of-Care Diagnostics Products Our point-of-care blood diagnostic test systems provide fast, accurate blood test results to improve patient management, reduce healthcare costs and improve patient outcomes. These products are sold into the hospital point-of-care market, into the alternate site point-of-care market including physicians offices, long-term care facilities, clinics, visiting nurse associations, home healthcare companies, and directly to patients. We believe that the market growth for point-of-care diagnostic products is fueled by convenience, ease of use, the clinical benefits that more frequent monitoring at alternate site point-of-care allows and availability of time sensitive test results where the patient is being treated.

Incision Products Our incision products are used by professionals to obtain a patient s blood sample for diagnostic testing. Our incision products are sold into both the hospital point-of-care and the alternate site point-of-care markets. All products feature permanently retracting blades for a safe, less painful incision.

OUR STRATEGY

Our strategy to maintain and expand our leadership position is comprised of the following:

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Offer a broad range of products. Our VADs provide hemodynamic restoration therapy for the heart and have been clinically proven to improve patient survival and quality of life. We currently offer the widest range of VADs to cover indications for use ranging from acute to long-term support. We believe that our broad and diverse product offering represents an important competitive advantage because it allows us to address the various preferences of surgeons, the clinical needs of a wide variety of patients, and the economic requirements of third party payors. We intend to further broaden our product line through internal development, acquisition and licensing.

Focus on and partner with leading heart centers. We have developed long-standing relationships with leading cardiovascular surgeons and heart centers worldwide. We believe that no other cardiac assist company enjoys the same depth of relationships and access to these customers. These relationships are an important part of our growth strategy, particularly for the development and introduction of new products and the pursuit of additional indications for our existing products. In 2005, we continued our investment in building these relationships by hiring five heart failure therapy specialists as part of our program to generate referrals to our leading VAD centers, including those in our Heart Hope Program that we began in 2004. These specialists work in partnership with our VAD centers to increase the awareness of hemodynamic restoration therapy and VADs in the cardiology community.

Increase penetration of existing markets. We plan to treat a greater number and variety of patients within our current customer base. To accomplish this, we are building upon our existing relationships with leading cardiac surgeons, cardiac catheterization labs and hospitals, and using our existing sales channels to gain acceptance and adoption of our products.

> *Bridge-to-Transplantation Market.* On July 28, 2003, Thoratec received CE mark certification, providing approval to market the Thoratec Implantable Ventricular Assist Device, or IVAD, within European Union countries. In August 2004, we received FDA approval in the U.S. to market the IVAD for use in bridge-to-transplantation and post-cardiotomy recovery patients who are unable to be weaned from cardiopulmonary bypass. This makes the IVAD the only currently approved implantable cardiac assist device that can provide left, right or biventricular support.
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> *Destination Therapy Market*. In November 2002, we received approval for the HeartMate VAD for Destination Therapy in the treatment of late-stage HF patients who are not candidates for heart transplants. While the initial CMS reimbursement approval was limited to 69 centers in 2004, we estimate the market penetration for this indication could eventually be a meaningful portion of the 100,000 patients annually diagnosed with late-stage HF mentioned above, as we introduce new technologies that increase the useful life of our VAD and improve the outcome of procedures.
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> *Home Discharge for our TLC-II portable driver*. On December 1, 2003, the FDA approved the TLC-II portable driver (the unit providing power, monitoring and operational control of a VAD) for home use. The TLC-II was already approved for in-hospital use in the U.S., and had been approved for home therapy in Europe for several years. This approval enables patients supported by the device to be discharged from the hospital to their home while awaiting heart transplantation or recovery of their existing heart. The TLC-II driver is the first portable driver approved for home discharge to support biventricular patients.
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> *Point-of-Care Market*. In late 2003, we acquired the IRMA product line of blood gas/electrolyte and chemistry tests from Diametrics Medical, Inc. This has significantly increased our test menu offering, and also provides us with the opportunity to develop the next generation system which combines coagulation and blood gas tests into one platform. In the interim, the IDMS data management and connectivity system, acquired as part of the IRMA acquisition, will allow the stand-alone Hemochron and IRMA systems to interface with a hospital s laboratory or hospital information system. We also currently sell the ProTime for monitoring anticoagulation therapy to physician offices, nursing homes and other Clinical Laboratory Improvement Act, or CLIA, waived settings (facilities that perform simple types of tests and have lower level training for performing these tests).

Obtain approval for new products. We completed a U.S. Phase I clinical trial of 25 patients at 10 study sites for our HeartMate II VAD and began our U.S. Phase II pivotal trial in the first quarter of 2005. The Phase II study includes both a BTT and DT arm, the first time the FDA has approved a clinical trial with both indications in one protocol. The BTT arm will involve 133 patients in total, with the primary endpoint being the rate of survival to either transplantation or 180 days of support. The DT arm of the study will involve 200 total patients, randomizing the HeartMate II to the company s HeartMate XVE on a 2-1 basis, respectively. The DT arm provides for a two-year composite endpoint, which includes patient survival, rate of neurological events and device reliability. We had more than 180 patients enrolled in the clinical trial as of the end of 2005. The pivotal trial will evaluate the safety and effectiveness of the HeartMate II for use as a bridge to-transplantation and Destination Therapy. The HeartMate II is an implantable Left Ventricular Assist Device System consisting of a miniature rotary blood pump designed to provide long-term support. Its design is intended to be not only smaller but also simpler, quieter, and longer lasting than current generation assist devices.

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Increase cost effectiveness of the therapies that employ our products. While a recent study indicates that the cost of implanting a VAD for Destination Therapy is comparable with that of a heart, liver or other major organ transplant, cost remains a significant concern for our customers. In October 2003, CMS issued a favorable National Coverage decision for the use of left ventricular assist systems that are approved by the FDA for treating Destination Therapy in late-stage heart failure patients. We work closely with the 69 CMS-approved centers to develop the Destination Therapy market, which we believe will ultimately improve the cost effectiveness of this solution. We also are expanding our market education and training programs, and continue to make improvements that enhance the performance and cost effectiveness of our products.

Increase our presence in Cardiovascular and ITC market segments. In addition to increasing our presence in the heart failure, cardiovascular disease, point-of-care and incision markets through internal growth, we continue to evaluate strategic alliances, joint ventures, acquisitions and related business development opportunities.

OUR PRODUCTS

Cardiovascular Segment

Our Cardiovascular segment offers the following broad product portfolio of implantable and external circulatory support product devices:

The Thoratec Ventricular Assist Device System is an external device for short to mid-term cardiac support. The device, which is sold worldwide, is approved to assist left, right and biventricular support and is worn outside of the body. The Thoratec VAD is approved by the FDA for use as a bridge to transplantation and for post-cardiotomy myocardial recovery.

The Thoratec IVAD is the only implantable blood pump approved for both bridge-to-transplantation and post-cardiotomy myocardial recovery that can be used for left, right, or biventricular support. The IVAD utilizes the same internal working components as the Thoratec VAD System, but has an outer housing made of a titanium alloy that makes it more suitable for implantation.

The HeartMate XVE Left Ventricular Assist System, or LVAS, is an implantable device for mid to longer-term cardiac support and is the only device approved in the U.S., Europe and Canada for permanent support for those patients ineligible for heart transplantation. This device is designed to assist the pumping function of the left ventricle of the natural heart and feature a unique textured blood-contacting surface that eliminates the need for systemic anticoagulation.

The HeartMate II is an implantable LVAS consisting of a miniature rotary blood pump designed to provide long-term support. Its design is intended to be not only smaller, but also simpler, quieter, and longer lasting than the current generation of ventricular assist device. The HeartMate II is CE Marked and approved for distribution in Europe, but is currently only approved in the U.S. for investigational use.

In addition to our cardiac assist products, we sell vascular access graft products used in hemodialysis for patients with late-stage renal disease.

Circulatory Support and Graft Products

Ventricular assist devices perform some or most of the pumping function of the heart in patients with severe heart failure. In most cases, a cannula connects the left ventricle of the heart to a blood pump. Blood flows from the left ventricle to the pump chamber via the cannula, powered by an electric or air driven mechanism that drives the blood through another cannula into the aorta. From the aorta, the blood then circulates throughout the body. Mechanical or tissue valves enable unidirectional flow in some devices. Currently the power source remains outside the body for all FDA-approved VADs.

Certain VADs are implanted internally, while others are placed outside the body. Some external devices are placed immediately adjacent to the body (paracorporeal), while other external VADs are positioned at a distance from the body (extracorporeal).

We estimate that between 20% and 35% of assist patients require biventricular support and therefore require a second pump for the right ventricle.

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The Thoratec VAD

The Thoratec VAD has been FDA approved since 1995 and has treated over 2,900 patients worldwide. The Thoratec VAD is a paracorporeal device that is less invasive than implantable VADs since only the cannula must be implanted. The paracorporeal nature of the Thoratec VAD has several positive consequences including relatively shorter and less invasive implantation times (approximately two hours) and the ability to use the device in smaller patients.

A pneumatic power source drives the Thoratec VAD. It is designed for intermediate duration use of a few weeks to several months, though this device has supported numerous patients for six to 18 months. Offering left, right or biventricular support, the Thoratec VAD is the only biventricular support system approved for use as a bridge-to-transplant. This characteristic is significant since approximately 50% of bridge-to-transplant patients treated with the Thoratec VAD require right as well as left-sided ventricular assist. The Thoratec VAD is also the only device approved for both bridge-to-transplantation and recovery following cardiac surgery. We are working with the FDA to gain approval for a therapeutic recovery indication for the Thoratec VAD. The Thoratec VAD incorporates our proprietary biomaterial, Thoralon, which has excellent tissue and blood compatibility and is resistant against blood clots.

The Thoratec VAD uses our TLC-II driver, which is a small portable driver that increases portability and ambulation options compared to the typical drive console. The TLC-II portable driver was approved in the U.S. in June 2001 for use in off-site excursions and in December 2003 for home discharge use. The TLC-II has been approved for use in Europe since 1998.

The Thoratec IVAD

We received CE Mark certification to market the Thoratec IVAD in Europe in July 2003 and FDA approval for the U.S. market in August 2004. The IVAD was approved in Canada in November 2004. The IVAD is the only currently approved implantable cardiac assist device that can provide left, right or biventricular support. The IVAD maintains the same blood flow path, valves and blood pump as the paracorporeal (Thoratec VAD) device and is better suited for longer-term support compared to the Thoratec VAD. The outer covering of the IVAD is made of a titanium alloy, which facilitates implantation. The device weighs less than one pound and can be implanted in patients ranging in weight from 90 lbs to more than 220 lbs. The IVAD is designed as a bridge-to-transplantation and potentially for therapeutic recovery, but is not currently considered for Destination Therapy.

The HeartMate XVE LVAS

The HeartMate VE initially received FDA approval in September 1998. The enhanced version of the product, called the HeartMate XVE, received FDA approval in December 2001 for bridge-to-transplantation. In April 2003, the HeartMate XVE received FDA approval for Destination Therapy. The HeartMate XVE is designed for use for a duration from several months to up to two or three years. The HeartMate XVE offers only left ventricular support. Patients with a HeartMate XVE do not require anti-coagulation drugs, other then aspirin, because of the product s incorporation of proprietary textured surfaces and tissue valves. As a result, we believe this device has the lowest rate of stroke incidence for patients using ventricular support. The implantable nature of this device enables patient mobility and home discharge.

The HeartMate II

The HeartMate II is a next generation device intended for long-term cardiac support (5-7 years) for patients who are in late-stage heart failure. The HeartMate II is a small, implantable, electrically powered device that weighs about 12 ounces and is approximately 1.7 inches in diameter and 3.2 inches long. In addition to being significantly smaller than the HeartMate XVE, with only one moving part the HeartMate II is simpler and designed to operate more quietly than pulsatile devices. As an axial flow device, the HeartMate II is designed to provide blood flow through the circulatory system on a continual basis and is smaller and easier to implant than pulsatile devices. More than 180 patients have been enrolled in the clinical trials of the HeartMate II device as of the end of 2005. The Investigational Device Exemption (IDE) for the pivotal trial in the U.S. for both bridge-to-transplantation and Destination Therapy indications for use was fully approved by the FDA in May 2005. Approval to apply the CE Mark for commercial distribution in Europe was obtained in November 2005.

VAD Products Under Development

We are also developing the HeartMate III, which is a centrifugal, continuous flow pump that incorporates a magnetically levitated rotor in order to eliminate the potential for bearing-induced wear. The device is designed for implantation of 10 years or more in patients with late-stage HF, including Destination Therapy, bridge-to-transplantation and therapeutic recovery. The product design is being finalized and pre-clinical studies are being performed to ready the device for clinical evaluation.

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Vascular Graft Products

The *Vectra* vascular access graft was approved for sale in the U.S. in December 2000 and in Europe in January 1998. It is designed for use as a shunt between an artery and a vein, primarily to provide access to the bloodstream for renal hemodialysis patients requiring frequent needle punctures during treatment.

ITC Segment

Our ITC segment offers a broad portfolio of point-of-care diagnostic test systems and incision products.

Point-of-Care Diagnostics

Our ITC point-of-care product lines consist of the following:

Hemochron point-of-care coagulation system;

Immediate Response Mobile Analysis, or IRMA, point-of-care blood gas/electrolyte and chemistry system;

ProTime coagulation monitoring system; and

Hemoglobin Pro system.

Hospital point-of-care

The Hemochron and IRMA products are primarily sold into the hospital point-of-care segment of the market.

Hemochron is used to monitor a patient s coagulation while being administered anticoagulants in various settings, including in the cardiovascular operating room to monitor the drug Heparin and in an anticoagulation clinic to monitor the drug Coumadin. Hemochron is considered a moderately complex device and must be used by professionally trained personnel. The system consists of a small, portable analytical instrument and disposable test cuvettes.

IRMA is used to monitor a patient s blood gas/electrolyte and chemistry status. It is considered moderately complex and its use requires supervision by professionally trained personnel. The system consists of a small, portable analytical instrument and disposable test cartridges.

Alternate site point-of-care

The ProTime and Hemoglobin Pro products are sold into the alternate site point-of-care market comprising physicians offices, long-term care facilities, clinics, visiting nurse associations, and home healthcare companies.

ProTime is used to monitor a patient s coagulation while taking oral anticoagulants such as Coumadin, and can be prescribed to be used by the patient at home or in the physician s office or clinic. The system consists of a small, portable analytical instrument and disposable test cuvettes.

Hemoglobin Pro, or Hgb Pro, is used by professionals, mainly in doctor s offices to test for anemia; it provides quick results from a very small blood sample. The system consists of a small, hand-held test meter and disposable test strips.

Growth in this market is being fueled by convenience and ease of use for patients and physicians. In addition, in the case of the ProTime monitoring of oral anticoagulants, clinical studies have shown that more frequent monitoring results in patients that stay in their therapeutic range more often. More frequent monitoring is made possible by patients testing themselves at home, in addition to being tested in a doctor s office, when appropriate.

Incision Products

Our ITC incision product lines consist of the following:

Tenderfoot incision;

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Tenderlett incision; and,

Surgicutt Bleeding Time Devices.

Our incision products are used to obtain a patient s blood sample for diagnostic testing. These products are sold to both the hospital and alternate site point-of-care markets. Our products offer certain advantages and command a premium over the competition, and are sold in the higher end of the market.

Tenderfoot is used by professionals as a heel stick for infant testing, allowing blood to flow more freely to reduce the need to squeeze the foot. The Tenderfoot is our most successful incision product and is available in four incision depths. We market this product based on its high-end features. Long-term, however, we believe that price will increasingly drive purchasing decisions.

Tenderlett is used by professionals as a finger incision device that contains a surgical stainless steel blade that incises to a controlled, standardized depth. The Tenderlett creates a small, shallow incision in the finger and is available in three incision depths.

Surgicutt is used to perform screening tests to determine platelet function. This product is also engineered to perfect the bleeding time test and better control many of the variables that have previously hindered test standardization. The Surgicutt contains a stainless steel blade that incises to a standardized depth and length for more reproducible results. It is sold in three sizes to meet the needs of specific patient populations from infants to adults.

The growth in this segment will require increased patient testing, better patient outcomes reflecting the importance of timely and accurate results for health care professionals and increased decentralization of testing from central laboratories to point-of-care.

Our cardiac assist and vascular graft products represented 62%, 60%, and 63% of our product sales in 2005, 2004, and 2003, respectively. Our point-of-care blood diagnostics test systems and services and incision products amounted to 38%, 40% and 37% of our total product sales in 2005, 2004, and 2003, respectively. For financial information related to our segments for each of the past three years, please see Item 8, Note 11 to our Consolidated Financial Statements.

SALES AND MARKETING

Circulatory Support Products

Hospitals that perform open heart surgery and heart transplants are the potential customers for our circulatory support products. We estimate that 136 of the approximately 1,000 hospitals in the U.S. that perform open-heart surgery also perform heart transplants. We actively market to heart transplant hospitals and large cardiac surgery centers as well as to the approximately 100 heart transplant hospitals in Europe.

We have recruited and trained a direct sales force that, as of December 31, 2005, comprised 19 experienced cardiovascular sales specialists to sell our circulatory support systems in the U.S., Canada, France, Germany, Spain, United Kingdom, Austria, Switzerland, Netherlands, Portugal and South Africa.

Thoratec s sales effort is complemented by 13 direct clinical specialists and five heart failure therapy specialists. The clinical specialists conduct clinical educational seminars, assist with a new open-heart center s first VAD implant and resolve clinical questions or issues. Our heart failure therapy specialists work with lour leading VAD centers to generate referrals and increase awareness in the cardiology community regarding hemodynamic restoration therapy and VADs. We partner with universities, experienced clinicians and opinion leaders to assist with expanding clinical educational needs. The sales team focuses on cardiac surgeons that perform heart transplantation, perfusionists and the transplant nursing staff.

In addition to our direct selling efforts, we have a network of international distributors who cover those markets representing the majority of our remaining VAD sales potential. Our sales and marketing tactics include direct mail, education seminars, symposia, equipment purchase and lease programs and journal advertisements, all common in the cardiovascular device market.

Hospitals or other medical institutions that acquire a VAD system generally purchase VAD pumps, related disposables and training materials, and purchase or rent two of the associated pump drivers (to ensure that a backup driver is available). The time from the initial contact with the cardiac surgeon until purchase is generally between nine and 18 months, due to the expense of the product and common hospital capital equipment acquisition procedures. Upon receipt of a purchase order, we usually ship the products within thirty days.

The introduction of a VAD system in a hospital or other medical facility requires that the surgical and clinical support personnel possess certain product expertise. We provide initial training and best practice instruction for these personnel, along with a variety of training materials that accompany the initial delivery of our VAD products, including instructions for use, patient management manuals and assorted videos. We provide clinical support during implants and provide 24-hour access to clinically trained personnel. In addition, our sales force helps customers understand and manage reimbursement from third-party payors.

Vascular Graft Products

We market the *Vectra* through C.R. Bard Corp. (a competitor of ours) in the U.S., and selected countries in Europe, the Middle East and Northern Africa and through Goodman Co. Ltd. in Japan. On December 5, 2005 we modified our distributor agreement to continue exclusive distribution until December 31, 2006.

Point-of-Care Diagnostics

In 2005, ITC completed the process of establishing a direct sales force in the U.S. to sell our hospital point-of-care coagulation and IRMA products. We currently maintain a direct sales staff of 46 people in the U.S. that sell directly to hospitals and to distributors in the alternate site market. Outside the U.S., ITC has four salespeople selling principally to third party distributors. ITC s product sales prior to 2005, came through our distributor channels, with Quality Assured Services as our largest distributor.

As we have integrated the IRMA product line of blood gas analyzers into our business, an increasing portion of our revenue in the U.S. market has been generated by direct sales rather than through distributors. This shift has required expanding the sales, technical service, customer service and shipping headcount at ITC to provide our customers with the support and service historically provided by our distributors.

Incision Products

Our incision products are sold by distributors worldwide. Our largest incision distributor in the U.S. market is Cardinal Healthcare, which generated 71% of ITC s annual incision product sales in 2005. In October of 2005, we appointed a second distributor, Surgilance, for our Tenderfoot incision product in the U.S. market. Both Cardinal and Surgilance will distribute the Tenderfoot on a co-exclusive basis in the U.S.

COMPETITION

Competition from medical device companies and medical device divisions of health care and pharmaceutical companies is intense and is expected to increase. Our principal competitors for the VAD system include WorldHeart Corporation, MicroMed Technology, Inc., AbioMed, Inc., and SynCardia Systems, Inc. in the U.S. and Berlin Heart AG in Europe. Principal competitors in the vascular graft market include W.L. Gore, Inc., C.R. Bard and Boston Scientific Corporation. Principal competitors in the hospital coagulation and blood gas monitoring equipment market include the Cardiac Surgery Division of Medtronic, Inc., Radiometer A/S, Abbott Diagnostics, and Instrument Laboratories. Our primary competitor in the skin incision device market is Becton, Dickson and Company. Competitors in the alternate site point-of-care diagnostics market include Roche Diagnostics and HemoSense, Inc.

We believe that key competitive factors include the relative speed with which we can develop products, complete clinical testing, receive regulatory approvals, achieve market acceptance and manufacture and sell commercial quantities of our products.

We estimate that we have a majority of the VAD market domestically and more than 50% internationally. We believe that potential competitors are several years away from completion of clinical trials required before those products will become commercially available and compete with our products in the U.S. In addition, unless our competitors products result in significantly better outcomes than our products, we believe that absent any compelling reason, cardiac centers will not generally change suppliers.

Large medical device companies dominate the markets in which our ITC business competes and we estimate that we hold anywhere from a 2% to 20% market share, depending on the product. We expect that our growth in this market will be generated by gaining market share and from a shift of testing from the central laboratory to the point-of-care. However, this market segment is very competitive, and includes the following potential drivers:

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New competitors might enter the market with broader test menus. To address this risk, in late 2003 we acquired the IRMA product line of blood gas/electrolyte and chemistry tests, which has significantly increased our test menu offering, and also offers us the opportunity to develop the next generation system that combines blood gas and electrolyte testing in one machine.

New drug therapies under development may not require the intense monitoring of a patient s coagulation necessary with the current anti-coagulation drug of choice, Heparin. To try to mitigate this risk, we participate in clinical trials with key pharmaceutical companies to provide the hemostasis monitoring that will ultimately be required for new drug therapies.

PATENTS AND PROPRIETARY RIGHTS

We seek to patent certain aspects of our technology. We hold, or have exclusive rights to, several U.S. and foreign patents. Except for the patents mentioned below and one patent pertaining to the TLC-II, the Thoratec VAD system is not protected by any other patents. We do not believe that this lack of patent protection will have a material adverse effect on our ability to sell our VAD system because of the lengthy regulatory period required to obtain approval of a VAD. Several patents cover aspects of our HeartMate line of products.

Our patents relating to blood coagulation, blood gas, blood electrolytes, and blood chemistry devices include patents transferred to ITC as part of our acquisition of the IRMA blood analysis system business from Diametrics Medical. We own or hold rights in the remainder of the U.S. patents by virtue of the merger between Thoratec and TCA, which resulted in the transfer of the ownership of the TCA patents to Thoratec.

Several patents cover aspects of our proprietary biomaterials technology. Aspects of our blood coagulation, blood gas, blood electrolytes, blood chemistry, and skin incision device products are covered by patents directed to tube-and micro-coagulation whole blood analysis, including test methods, reagents and integral (on-board) controls, thick film electrochemical analysis of blood gases, blood electrolytes, and blood chemistry, and low trauma skin incision devices for capillary blood sampling, and methods of manufacturing such devices. The duration remaining of some of our biomaterials patents ranges from four to nine years, on our grafts from two to 15 years and on our blood coagulation, blood gas, blood electrolytes, blood chemistry, and skin incision device products from two to 16 years. During the term of our patents, we have the right to prevent third parties from manufacturing, marketing or distributing products that infringe upon our patents.

In addition, we hold several patents on the HeartMate II axial blood flow pump and transcutaneous energy transmission technology, the remaining duration of which ranges from nine to 16 years. In August 1998, we obtained a license to incorporate technology developed by Sulzer Electronics Ltd. and Lust Antriebstechnik GmbH into the HeartMate III. HeartMate III is a miniature centrifugal pump featuring a magnetically levitated rotor with a bearingless motor that has been developed by Levitronix GmbH. The license from Sulzer and Lust gives us the exclusive right to use in our HeartMate products technology protected by several U.S. and foreign patents covering implantable bearingless motors for the duration of those patents, subject to our payment of royalties. In December 2000, we were informed by Sulzer Electronics that Sulzer had sold all of its business in the bearingless motor and magnetic bearing fields to Levitronix and had assigned its portion of the agreements between Sulzer and us to Levitronix. We believe that the license remains in full force and effect.

We also hold, or have exclusive rights to, several international patents.

We have developed technical knowledge which, although non-patentable, we consider to be significant in enabling us to compete. It is our policy to enter into confidentiality agreements with each of our employees prohibiting the disclosure of any confidential information or trade secrets. In addition, these agreements provide that any inventions or discoveries by employees relating to our business will be assigned to us and become our sole property.

Despite our patent rights and policies with regard to confidential information, trade secrets and inventions, we may be subject to challenges to the validity of our patents, claims that our products allegedly infringe the patent rights of others and the disclosure of our confidential information or trade secrets. These and other related risks are described more fully under the heading *Our inability to protect our proprietary technologies or an infringement of others patents could harm our competitive positions* in the Risk Factors section of this Annual Report.

At this time, we are not a party to any material legal proceedings that relate to patents or proprietary rights.

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GOVERNMENT REGULATIONS

Regulation by governmental authorities in the United States and foreign countries is a significant factor in the manufacture and marketing of our current and future products and in our ongoing product research and development activities. All of our proposed products will require regulatory approval prior to commercialization. In particular, medical devices are subject to rigorous pre-clinical testing as a condition of approval by the FDA and by similar authorities in foreign countries.

U.S. Regulations

In the U.S., the FDA regulates the design, manufacture, distribution and promotion of medical devices pursuant to the Federal Food, Drug, and Cosmetic Act and its regulations. Our VAD systems, blood coagulation testing devices, skin incision devices, and *Vectra* graft products are regulated as medical devices. To obtain FDA approval to market VADs similar to those under development, the FDA requires proof of safety and efficacy in human clinical trials performed under an Investigational Device Exemption (IDE). An IDE application must contain pre-clinical test data supporting the safety of the product for human investigational use, information on manufacturing processes and procedures, proposed clinical protocols and other information. If the IDE application is accepted, human clinical trials may begin. The trials must be conducted in compliance with FDA regulations and with the approval of one or more institutional review boards. The results obtained from these trials, if satisfactory, are accumulated and submitted to the FDA in support of either a Pre-Market approval, or PMA application, or a 510(k) premarket notification. There are substantial user fees that must be paid at the time of PMA, PMA Supplement or 510(k) submission to the FDA to help offset the cost of scientific data review that is required before the FDA can determine if the device is approvable. Premarket approval from the FDA is required before commercial distribution of devices similar to those under development by us is permitted in the U.S.

A PMA Supplement is required to make modifications to a device or application approved by a PMA. A PMA Supplement must be supported by extensive preclinical data, and sometimes human clinical data, to prove the safety and efficacy of the device with respect to the modifications disclosed in the supplement. By regulation, the FDA has 180 days to review a PMA application, during which time an advisory committee may evaluate the application and provide recommendations to the FDA. While the FDA has approved PMA applications within the allotted time period, reviews can occur over a significantly protracted period, usually 18 to 36 months, and a number of devices have never been cleared for marketing. This is a lengthy and expensive process and there can be no assurance that FDA approval will be obtained.

Under the FDA s requirements, if a manufacturer can establish that a newly developed device is substantially equivalent to a legally marketed predicate device, the manufacturer may seek marketing clearance from the FDA to market the device by filing a 510(k) premarket notification with the FDA. This is the process that is used to gain FDA market clearance for most of ITC s products. The 510(k) premarket notification must be supported by data establishing the claim of substantial equivalence to the satisfaction of the FDA. The process of obtaining a 510(k) clearance typically can take several months to a year or longer. If substantial equivalence cannot be established, or if the FDA determines that the device requires a more rigorous review, the FDA will require that the manufacturer submit a PMA application that must be approved by the FDA prior to marketing the device in the U.S.

Both a 510(k) and a PMA, if approved, may include significant limitations on the indicated uses for which a product may be marketed. FDA enforcement policy prohibits the promotion of approved medical devices for unapproved uses. In addition, product approvals can be withdrawn for failure to comply with regulatory requirements or the occurrence of unforeseen problems following initial marketing.

The approval process for each of our products is expensive and time consuming and we cannot be sure that any regulatory agency will grant its approval. Our inability to obtain, or delays in obtaining, such approval would adversely affect our ability to begin marketing our products. We cannot assure you that we will have sufficient resources to complete the required testing and regulatory review processes. Furthermore, we are unable to predict the extent of adverse governmental regulations, which might arise from future U.S. or foreign legislative or administrative action. On October 26, 2002, the FDA signed into law The Medical Device User Fee and Modernization Act of 2002. This law amends the FDA Act and regulations to provide, among other things, the ability for the FDA to impose user fees for medical device reviews. Our activities require that we make many filings with the FDA that are subject to this fee structure. Although the precise amount of fees that we will incur each year will be dependent upon the specific quantity and nature of our filings, these fees could be a significant amount per year.

In addition, any products distributed pursuant to the above authorizations are subject to continuing regulation by the FDA. Products must be manufactured in registered establishments and must be manufactured in accordance with Quality System Regulations. Adverse events must be reported to the FDA. Labeling and promotional activities are subject to scrutiny by the FDA and, in certain instances, by the Federal Trade Commission. The FDA often requires post market surveillance, or PMS, for significant risk devices, such as VADs, that require ongoing collection of clinical data during commercialization that must be gathered, analyzed and submitted to the FDA periodically for up to several years. These PMS data collection requirements are often burdensome and expensive and have an effect on the PMA approval status. The failure to comply with the FDA s regulations can result in enforcement action, including seizure, injunction, prosecution, civil penalties, recall and/or suspension of FDA approval. The export of devices such as ours is also subject to regulation in certain instances.

We are also subject to regulation by various state authorities, which may inspect our facilities and manufacturing processes and enforce state regulations. Failure to comply with applicable state regulations may result in seizures, injunctions or other types of enforcement actions.

International Regulations

We are also subject to regulation in each of the foreign countries in which we sell products. These regulations relate to product standards, packaging and labeling requirements, import restrictions, tariff regulations, duties and tax requirements. Many of the regulations applicable to our products in these countries are similar to those of the FDA. The national health or social security organizations of certain countries require our products to be qualified before they can be marketed in those countries.

In order to be positioned for access to European and other international markets, we sought and obtained certification under the ISO 13485 Series of Standards. ISO 13485 is a set of integrated requirements, which when implemented form the foundation and framework for an effective quality management system. These standards were developed and published by the ISO, a worldwide federation of national bodies, founded in Geneva, Switzerland in 1947. ISO has more than 90 member countries and ISO certification is widely regarded as essential to enter Western European markets. We obtained EN ISO 13485:2003 Certification in February 2006. Since 1998, all companies are required to obtain CE Marks for medical devices sold or distributed in the European Union. The CE Mark is an international symbol of quality. With it, medical devices can be distributed within the European Union. A prerequisite for obtaining authority to CE Mark products is to achieve full quality system certification in accordance with ISO 13485 and European Directives, such as the Medical Device Directive (MDD), In-Vitro Device Directive (IVDD) and the Active Implantable Medical Device Directive (AIMD). These are quality standards that cover design, production, installation and servicing of medical devices manufactured by us. We have the ISO 13485 and appropriate MDD, IVDD or AIMD certification and authority to CE Mark all our devices in commercial distribution, including our skin incision devices, blood coagulation testing devices, *Vectra* graft and VAD systems such as the Thoratec VAD, IVAD and HeartMate Systems. We are also certified to be in compliance with the requirements of the Canadian Medical Device Regulations (CMDRs) at all Thoratec manufacturing sites, which certification is required to sell medical devices in Canada.

Other Regulations

We are also subject to various federal, state and local laws and regulations relating to such matters as safe working conditions, laboratory and manufacturing practices and the use, handling and disposal of hazardous or potentially hazardous substances used in connection with our research and development work. Specifically, the manufacture of our biomaterials is subject to compliance with federal environmental regulations and by various state and local agencies. Although we believe we are in compliance with these laws and regulations in all material respects, we cannot provide assurance that we will not be required to incur significant costs to comply with environmental laws or regulations in the future.

THIRD PARTY REIMBURSEMENT AND COST CONTAINMENT

Our products are purchased primarily by hospitals and other users, which then bill various third party payors for the services provided to the patients. These payors, which include CMS, private health insurance companies and managed care organizations, reimburse part or all of the reasonable costs and fees associated with these devices and the procedures performed with these devices.

To date, CMS and a majority of private insurers with whom we have dealt approved reimbursement for our VADs and our diagnostic and vascular graft products. Effective October 1, 2003, CMS issued a National Coverage Decision Memorandum for the use of LVAS that are approved by the FDA for treating Destination Therapy in late-stage HF patients. Sixty-nine centers are now recognized by CMS as Medicare LVAD centers.

Effective October 1, 2004, Medicare reimbursement payment increased for heart assist devices with CMS LVAD centers receiving an average payment of approximately $90,000 to approximately $136,000. This change of DRG category for implantable heart assist devices to DRG 103 from 525 has raised the average payment under DRG 103 by more than 30%. Twenty-six new Healthcare Common Procedure Coding System codes also have been created by CMS to provide reimbursement for outpatient equipment and supplies. Since FDA approval of the HeartMate LVAS for Destination Therapy, several private payors also have issued positive coverage decisions. In December 2002, Blue Cross/Blue Shield Technology Evaluation Center issued a positive decision on the use of

LVADs for Destination Therapy. The majority of local Blue Cross Blue Shield plans now have created positive medical policy for both bridge-to-transplantation and Destination Therapy indications. Since December 2002, the majority of national private insurance carriers, such as Aetna, Cigna, Humana, United Health Group and UNICARE, have issued positive coverage policies to cover the use of ventricular assist devices for FDA-approved indications, including Destination Therapy.

The reimbursement policies and practices of third party payors are subject to changes that might be unfavorable to our VAD systems and such unfavorable changes could seriously harm sales of our products.

MANUFACTURING

Our Cardiovascular segment products are manufactured at our facility in Pleasanton, California. This facility has been inspected, approved and licensed by the FDA and the State of California Department of Health Services, Food and Drug Section for the manufacture of medical devices and has received the International Standards Organization (ISO) 9001 certification. Our manufacturing processes consist of the assembly of standard and custom component parts, and the testing of completed products. We rely on single sources of supply for several components of our VADs. We are aware of alternative suppliers for a majority, but not all, of our single-sourced items.

Our ITC segment blood coagulation testing and skin incision devices are manufactured in Edison, New Jersey, with the exception of the ProTime instrument and the hemoglobin monitor, which are manufactured through single source third party contract manufacturers in China and Germany, respectively. Our blood gas analyzer devices are manufactured in Roseville, Minnesota. The New Jersey and Minnesota facilities have been inspected, approved and licensed by the FDA and applicable state regulators. In addition, these facilities maintain ISO9001, ISO 13485 and Canadian (CMDCAS) ISO certifications.

A significant amount of our ITC segment manufacturing at these facilities is vertically integrated, with only limited reliance on third parties, such as for the manufacture of printed circuit boards and the sterilization and testing of products. We rely on single sources of supply for some components manufactured at our New Jersey and Minnesota facilities, and use safety stocks where there might be risk in qualifying a second supplier in a timely manner.

Both segments have typically been able to fill orders from inventory and historically have not had significant order backlogs. At the end of 2004 and during 2005, we experienced backlog due to higher demand. We have expanded capacity during 2005 and plan to continue expansion efforts in 2006 to accommodate the increased demand for both the Cardiovascular and ITC manufacturing locations. Total backlog as of the end of fiscal 2005 and 2004 were approximately $1.2 million and $0.6 million for our Cardiovascular segment and $0.5 million and $0.7 million for our ITC segment, respectively.

RESEARCH AND DEVELOPMENT

Thoratec s research and development expenses in 2005, 2004 and 2003 totaled $32.3 million, $28.7 million, and $26.1 million, respectively. Research and development costs are largely project driven, and the level of spending depends on the level of project activity planned and subsequently approved and conducted. The primary component of our research and development costs is employee salaries and benefits. Projects related to our Cardiovascular segment typically include clinical trials, such as our HeartMate II pivotal trial, efforts to develop new products, such as the HeartMate II and HeartMate III, and efforts to improve the operation and performance of current products, such as efforts to improve the life of various components of the HeartMate and Thoratec VAD products. ITC research and development projects are typically involved with developing instruments and disposable test cuvettes or cartridges that will be used at the point-of-care. One such system is the Hemochron Signature Elite which was introduced in September of 2005. In addition, ITC devotes research and development efforts to maintain and improve current products based on customer feedback. Research and development costs for both segments also include regulatory and clinical costs associated with our compliance with FDA regulations and clinical trials such as the Phase II HeartMate II pivotal trial.

MAJOR CUSTOMERS AND FOREIGN SALES

We primarily sell our products to large hospitals and distributors. No customer accounted for more than 10% of total product sales in fiscal year 2005.

Sales originating outside the U.S. and U.S. export sales accounted for approximately 23%, 23% and 19% for the years ended 2005, 2004 and 2003, respectively, of our total product sales. No individual foreign country accounted for a material portion of our net sales in any of the last three fiscal years.

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EMPLOYEES

As of December 31, 2005, we had a total of 963 employees, consisting of 955 full-time employees and eight part-time employees, 526 of whom worked in manufacturing, 99 in engineering, 127 in quality control and regulatory affairs, 137 in marketing and sales support, 33 in administration and finance and 41 in other support functions, including human resources, management information systems, purchasing and facilities. Of our total employees, 938 are employed in the U.S. and 25 are employed in the United Kingdom and other European countries. None of our employees are covered by a collective bargaining agreement. We consider relations with our employees to be good.

ADDITIONAL INFORMATION

Additional information about Thoratec is available on our website at http://www.thoratec.com (although none of this information is, or should be deemed to be, incorporated by reference into this Annual Report on Form 10-K). We make filings of our periodic reports to the Securities and Exchange Commission (SEC), including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as amendments to those reports, available free of charge on our website as soon as reasonably practicable following electronic filing of those reports with the SEC.

Item 1A. *Risk Factors*

Our business faces many risks. These risks include those related to the development of new products and markets including Destination Therapy, the growth of existing markets for our products, customer and physician acceptance of our products, changes in the mix of our product sales, and the related gross margin for such product sales, the results of clinical trials, including those for the HeartMate II, the ability to improve financial performance, regulatory approval processes, the effect of healthcare reimbursement and coverage policies, our product sales, the effects of price competition from any of our competitors and the effects of any merger and acquisition related activities. The risks described below are what we believe to be the material risks facing our company. However, the risks described below may not be the only risks we face. Additional risks that we do not yet know of or that we currently believe are immaterial may also impair our business operations. If any of the events or circumstances described in the following risk factors actually occur, our business, financial condition or results of operations could suffer, and the trading price of our common stock could decline significantly. Investors should consider the following risks, as well as the other information included in this Annual Report on Form 10-K, and other documents we file from time to time with the SEC, such as our quarterly reports on Form 10-Q, our current reports on Form 8-K and any public announcements we make from time to time.

If we fail to obtain approval from the FDA and from foreign regulatory authorities, we cannot market and sell our products under development in the U.S. and in other countries, and if we fail to adhere to ongoing FDA Quality System Regulations, the FDA may withdraw our market clearance or take other action.

Before we can market new products in the U.S., we must obtain PMA approval or 510(k) clearance from the FDA. This process is lengthy and uncertain. In the U.S., one must obtain clearance from the FDA of a 510(k) pre-market notification or approval of a more extensive submission known as a PMA application. If the FDA concludes that any of our products do not meet the requirements to obtain clearance under Section 510(k) of the Federal Food, Drug, and Cosmetic Act, then we will be required to file a PMA application. The process for a PMA application is lengthy, expensive and typically requires extensive pre-clinical and clinical trial data.

We may not obtain clearance of a 510(k) notification or approval of a PMA application with respect to any of our products on a timely basis, if at all. If we fail to obtain timely clearance or approval for our products, we will not be able to market and sell them, thereby harming our ability to generate sales. The FDA also may limit the claims that we can make about our products. We also may be required to obtain clearance of a 510(k) notification or a PMA Supplement from the FDA before we can market products that have been cleared, that have since been modified or that we subsequently wish to market for new disease indications.

The FDA also requires us to adhere to Quality System Regulations, which include production design controls, testing, quality control, storage and documentation procedures. The FDA may at any time inspect our facilities to determine whether we have adequate compliance. Compliance with Quality System Regulations for medical devices is difficult and costly. In addition, we may not be found to be compliant as a result of future changes in, or interpretations of, regulations by the FDA or other regulatory agencies. If we do not achieve compliance, the FDA may withdraw marketing clearance, require product recall or take other enforcement action, which in each case would harm our business. Any change or modification to a device is required to be made in compliance with Quality System Regulations, which compliance may cause interruptions or delays in the marketing and sale of our products. The FDA also requires device manufacturers to submit reports regarding deaths, serious injuries and certain malfunctions relating to use of their products.

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Sales of our products outside the U.S. are subject to foreign regulatory requirements that vary from country to country. The time required to obtain approvals from foreign countries may be longer or shorter than that required for FDA approval, and requirements for foreign licensing may differ from FDA requirements. In any event, if we fail to obtain the necessary approvals to sell any of our products in a foreign country, or if any obtained approval is revoked or suspended, we will not be able to sell those products there.

The federal, state and foreign laws and regulations regarding the manufacture and sale of our products are subject to future changes, as are administrative interpretations and policies of regulatory agencies. If we fail to comply with applicable federal, state or foreign laws or regulations, we could be subject to enforcement actions. Enforcement actions could include product seizures, recalls, withdrawal of clearances or approvals, and civil and criminal penalties, which in each case would harm our business.

If hospitals do not conduct Destination Therapy procedures using our VADs, market opportunities for our product will be diminished.

The use of our VADs as long-term therapy in patients who are not candidates for heart transplantation (i.e., Destination Therapy patients) was approved by the FDA in 2002, and was approved for reimbursement by CMS in late 2003.

The number of Destination Therapy procedures actually performed depends on many factors, many of which are out of our direct control, including:

- the number of CMS sites approved for Destination Therapy;
- the clinical outcomes of Destination Therapy procedures;
- cardiologists and referring physicians education, and their commitment to Destination Therapy;
- the economics of the Destination Therapy procedure for individual hospitals, which include the costs of the VAD and related pre- and post-operative procedures and their reimbursement;
- the impact of changes in reimbursement rates on the timing of purchases of VADs for Destination Therapy; and
- the economics for individual hospitals of not conducting a Destination Therapy procedure, including the costs and related reimbursements of long-term hospitalization.

The different outcomes of these and other factors, and their timing, will have a significant impact on our future Cardiovascular product sales.

Physicians may not accept or continue to accept our current products and products under development.

The success of our current and future products will require acceptance or continued acceptance by cardiovascular and vascular surgeons, and other medical professionals. Such acceptance will depend on clinical results and the conclusion by these professionals that our products are safe, cost-effective and acceptable methods of treatment. Even if the safety and efficacy of our future products are established, physicians may elect not to use them for a number of reasons. These reasons could include the high cost of our VAD systems, restrictions on insurance coverage, unfavorable reimbursement from health care payors, or use of alternative therapies. Also, economic, psychological, ethical and other concerns may limit general acceptance of our ventricular assist, graft and other products.

We rely on specialized suppliers for certain components and materials in our products and alternative suppliers may not be available.

We depend on a number of custom-designed components and materials supplied by other companies including, in some cases, single source suppliers for components, instruments and materials used in our VAD products and blood testing products. For example, single sources currently manufacture and supply our ProTime and Hemoglobin instruments and the heart valves used in our HeartMate products. The suppliers of our ProTime and Hemoglobin products are located in China and Germany, respectively. We do not have long-term written agreements with most of our vendors and receive components from these vendors on a purchase order basis only. If we need alternative sources for key raw materials or component parts for any reason, such alternative sources may not be available and our inventory may not be sufficient to fill orders before we find alternative suppliers or begin manufacturing these components or materials ourselves. Cessation or interruption of sales of circulatory support products or our point-of-care products would seriously harm our business, financial condition and results of operations.

Alternative suppliers, if available, may not agree to supply us. In addition, we may require FDA approval before using new

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suppliers or manufacturing our own components or materials. Existing suppliers could also become subject to an FDA enforcement action, which could also disrupt our supplies. If alternative suppliers are not available, we may not have the expertise or resources necessary to produce these materials or component parts internally.

Because of the long product development cycle in our business, suppliers may discontinue components upon which we rely before the end of life of our products. In addition, the timing of the discontinuation may not allow us time to develop and obtain FDA approval for a replacement component before we exhaust our inventory of the legacy component.

If suppliers discontinue components on which we rely, we may have to:

- pay premium prices to our suppliers to keep their production lines open or to obtain alternative suppliers;
- buy substantial inventory to last through the scheduled end of life of our product, or through such time that we will have a replacement product developed and approved by the FDA; or
- stop shipping the product in which the legacy component is used once our inventory of the discontinued component is exhausted.

Any of these interruptions in the supply of our materials could result in substantial reductions in product sales and increases in our production costs.

We may encounter problems manufacturing our products.

We may encounter difficulties manufacturing products in quantaties sufficient to meet demand in the quantities required. We do not have experience in manufacturing some of our products in the commercial quantities that might be required if we receive FDA approval of those products and indications currently under development, including the HeartMate II VAD. If we have difficulty manufacturing any of our products, our sales may prove lower than would otherwise be the case and our reputation could be harmed.

Identified quality problems can result in substantial costs and write-downs.

FDA regulations require us to track materials used in the manufacture of our products, so that any problems identified in a finished product can easily be traced back to other finished products containing the defective materials. In some instances, identified quality issues require scrapping or expensive rework of the affected lot(s), not just the tested defective product, and could also require us to stop shipments.

In addition, since some of our products are used in situations where a malfunction can be life threatening, identified quality issues can result in the recall and replacement, generally free of charge, of substantial amounts of product already implanted or otherwise in the marketplace.

Any identified quality issue can therefore both harm our business reputation and result in substantial costs and write-offs, which in either case could materially harm our business and financial results.

If we fail to successfully introduce new products, our future growth may suffer.

As part of our growth strategy, we intend to develop and introduce a number of new products and product improvements. We also intend to develop new indications for our existing products. For example, we are currently developing updated versions of our HeartMate and Point-of-Care blood diagnostics products. If we fail to commercialize these new products, product improvements and new indications on a timely basis, or if they are not well accepted by the market, our future growth may suffer.

Our inability to protect our proprietary technologies or an infringement of others patents could harm our competitive position.

We rely on patents, trade secrets, copyrights, know-how, trademarks, license agreements and contractual provisions to establish our intellectual property rights and protect our products. These legal means, however, afford only limited protection and may not adequately protect our rights. In addition, we cannot assure you that any of our pending patent applications will issue. The U.S. Patent and Trademark Office may deny or significantly narrow claims made under patent applications and the issued patents, if any, may not provide us with commercial protection. We could incur substantial costs in proceedings before the U.S. Patent and Trademark Office or in any future litigation to enforce our patents in court. These proceedings could result in adverse decisions as to the validity and/or enforceability of our patents. In addition, the laws of some of the countries in which our products are or may be sold may not protect our products and intellectual property to the same extent as U.S. laws, if at all. We may be unable to protect our rights in trade secrets and unpatented proprietary technology in these countries.

Our commercially available VAD products, which account for a majority of our sales, generally are not protected by any patents. We rely principally on trade secret protection and, to a lesser extent, patents to protect our rights to our HeartMate product line. We rely principally on patents to protect our coagulation testing equipment, skin incision devices, Hemochron disposable cuvettes, IRMA analyzer, IRMA disposable cartridges, and Hgb Pro disposable test strips.

We seek to protect our trade secrets and unpatented proprietary technology, in part, with confidentiality agreements with our employees and consultants. Although it is our policy to require that all employees and consultants sign such agreements, we cannot assure you that every person who gains or has gained access to such information has done or will do so. Moreover, these agreements may be breached and we may not have an adequate remedy.

Our products may be found to infringe prior or future patents owned by others. We may need to acquire licenses under patents belonging to others for technology potentially useful or necessary, and such licenses may not be available to us. We could incur substantial costs in defending suits brought against us on such patents or in bringing suits to protect our patents or patents licensed by us against infringement.

For example, in 2003, a patent infringement claim was filed against us by Bodycote Materials Testing Canada, Inc. and David C. MacGregor, M.D. related to materials used in the HeartMate LVAS. On February 3, 2004, we settled the claim and recorded a charge of $2.3 million in the fourth quar0pt 0pt
.0001pt;page-break-after:avoid;text-align:right;">6

22

19

Interest income

10

3

22

8

Other, net

1

3

(5

)

35

Total other (expense) income, net

(1,179

)

(20

)

(1,222

)

(36

)

(Loss) Income From Continuing Operations

Before Reorganization Items, Income Taxes and Minority Interest

(1,346

)

127

(1,210

)

417

Reorganization items, net

109

62

203

192

Provision for Income Taxes

56

17

88

49

Minority Interest

7

5

20

17

(Loss) Income From Continuing Operations

(1,518

)

43

(1,521

)

159

Income (Loss) from Discontinued Operations, net of tax

3

(11

)

7

(65

)

Net (Loss) Income

$

(1,515

)

$

32

$

(1,514

)

$

94

(Loss) Earnings Per Share:

Basic and Diluted:

From continuing operations

$

(3.75

)

$

0.11

$

(3.75

)

$

0.39

From discontinued operations

0.01

(0.03

)

0.02

(0.16

)

Net (loss) income

$

(3.74

)

$

0.08

$

(3.73

)

$

0.23

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

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MIRANT CORPORATION AND SUBSIDIARIES
(Debtor-in-Possession)
CONDENSED CONSOLIDATED BALANCE SHEETS

		At September 30, 2005 (Unaudited) (in millions)	At December 31, 2004
ASSETS			
Current Assets:			
Cash and cash equivalents		**$ 1,229**	$ 1,485
Funds on deposit		**1,210**	493
Receivables, net		**818**	771
Price risk management assets		**1,489**	209
Inventories		**341**	353
Prepaid expenses		**235**	253
Assets held for sale		**26**	230
Other		**80**	133
Total current assets		**5,428**	3,927
Property, Plant and Equipment, net		**6,055**	6,162
Noncurrent Assets:			
Intangible assets, net		**269**	276
Investments		**260**	248
Price risk management assets		**180**	112
Funds on deposit		**188**	210
Deferred income taxes		**186**	185
Other		**316**	304
Total noncurrent assets		**1,399**	1,335
Total assets		**$ 12,882**	$ 11,424
LIABILITIES AND STOCKHOLDERS DEFICIT			
Current Liabilities:			
Short-term debt		**$ 12**	$ 15
Current portion of long-term liabilities		**395**	206
Accounts payable and accrued liabilities		**680**	725
Price risk management liabilities		**2,072**	286
Accrued taxes and other		**222**	174
Total current liabilities		**3,381**	1,406
Noncurrent Liabilities:			
Long-term debt		**813**	1,169
Price risk management liabilities		**125**	62
Deferred income taxes		**305**	346
Other		**434**	378
Total noncurrent liabilities		**1,677**	1,955
Liabilities Subject to Compromise		**10,468**	9,217
Minority Interest in Subsidiary Companies		**174**	164
Commitments and Contingencies			
Stockholders Equity (Deficit):			
Common stock, $.01 par value, per share		**4**	4
Authorized 2,000,000,000 shares			
Issued	September 30, 2005: 405,568,084 shares		
	December 31, 2004: 405,568,084 shares		
Treasury	September 30, 2005: 100,000 shares		
	December 31, 2004: 100,000 shares		
Additional paid-in capital		**4,918**	4,918
Accumulated deficit		**(7,669)**	(6,155)
Accumulated other comprehensive loss		**(69)**	(83)
Treasury stock, at cost		**(2)**	(2)
Total stockholders deficit		**(2,818)**	(1,318)
Total liabilities and stockholders deficit		**$ 12,882**	$ 11,424

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

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MIRANT CORPORATION AND SUBSIDIARIES
(Debtor-in-Possession)
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)
(UNAUDITED)

	Common Stock (in millions)	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock
Balance, December 31, 2004	$ 4	$ 4,918	$ (6,155)	$ (83)	$ (2)
Net loss			**(1,514)**		
Other comprehensive income				**14**	
Balance, September 30, 2005	**$ 4**	**$ 4,918**	**$ (7,669)**	**$ (69)**	**$ (2)**

MIRANT CORPORATION AND SUBSIDIARIES
(Debtor-in-Possession)
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	Nine Months Ended September 30, 2005 (in millions)	2004
Net (Loss) Income	$ (1,514)	$ 94
Other comprehensive income, net of tax		
Reclassification of TIERS investment unrealized gains to earnings		(7)
Cumulative translation adjustment	14	5
Unrealized gain on TIERS investments		5
Other comprehensive income, net of tax	14	3
Total Comprehensive (Loss) Income	**$ (1,500)**	**$ 97**

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

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MIRANT CORPORATION AND SUBSIDIARIES
(Debtor-in-Possession)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended September 30, 2005 (in millions)	2004
Cash Flows from Operating Activities:		
Net (loss) income	**$ (1,514)**	$ 94
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Amortization of transition power agreements and other obligations (non-cash revenue)	**(13)**	(288)
Depreciation and amortization	**236**	240
Impairment losses and restructuring charges	**9**	55
Non-cash postpetition interest expense	**1,168**	
Loss on sales of assets and investments	**24**	50
Equity in income of affiliates, net of dividends	**(10)**	(4)
Non-cash charges for reorganization items	**105**	137
Minority interest	**20**	17
Price risk management activities, net	**400**	(93)
Deferred income taxes	**15**	12
Other, net	**33**	6
Changes in operating assets and liabilities:		
Receivables, net	**(136)**	187
Other current assets	**(702)**	(100)
Other assets	**1**	7
Accounts payable and accrued liabilities	**(7)**	(273)
Taxes accrued	**87**	41
Other liabilities	**8**	(20)
Total adjustments	**1,238**	(26)
Net cash (used in) provided by operating activities	**(276)**	68
Cash Flows from Investing Activities:		
Capital expenditures	**(137)**	(94)
Cash paid for acquisitions		(21)
Proceeds from the sale of assets and minority owned investments	**183**	3
Cash paid related to disposition		(12)
Other	**(5)**	1
Net cash provided by (used in) investing activities	**41**	(123)
Cash Flows from Financing Activities:		
Payments on short-term debt, net	**(1)**	(11)
Proceeds from issuance of long-term debt	**125**	266
Repayment of long-term debt	**(192)**	(192)
Payment of dividends to minority interests	**(11)**	(8)
Change in debt service reserve fund	**57**	(46)
Other	**1**	
Net cash (used in) provided by financing activities	**(21)**	9
Net Decrease in Cash and Cash Equivalents	**(256)**	(46)
Cash and Cash Equivalents, beginning of period	**1,485**	1,587
Cash and Cash Equivalents, end of period	**$ 1,229**	$ 1,541
Supplemental Cash Flow Disclosures:		
Cash paid for interest, net of amounts capitalized	**$ 102**	$ 101
Cash paid for income taxes	**$ 43**	$ 31
Cash paid for reorganization items	**$ 115**	$ 77
Business Acquisitions:		
Fair value of assets acquired	**$**	$ 21
Less cash paid		21
Liabilities assumed	**$**	$

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

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MIRANT CORPORATION AND SUBSIDIARIES
(Debtor-in-Possession)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

A. Description of Business

Overview

Mirant Corporation (formerly Southern Energy, Inc.) and its subsidiaries (collectively, Mirant or the Company) is an international energy company incorporated in Delaware on April 20, 1993. Prior to April 2, 2001, Mirant was a subsidiary of Southern Company (Southern). The Company s revenues are primarily generated through the production of electricity in the United States, the Philippines and the Caribbean. As of September 30, 2005, Mirant owned or leased approximately 18,000 megawatts (MW) of electric generating capacity.

Mirant manages its business through two principal operating segments: North America and International. The Company s North America segment consists of the ownership and operation of power generation facilities and energy trading and marketing operations. The International segment includes power generation businesses in the Philippines, Curacao and Trinidad and Tobago, and integrated utilities in the Bahamas and Jamaica.

Basis of Presentation

The accompanying condensed consolidated financial statements (unaudited) of Mirant and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Form 10-K for the year ended December 31, 2004.

The accompanying financial statements include the accounts of Mirant and its wholly-owned, and controlled majority-owned, subsidiaries, as well as variable interest entities (VIEs) in which Mirant has an interest and is the primary beneficiary, and have been prepared from records maintained by Mirant and its subsidiaries in their respective countries of operation. All significant intercompany accounts and transactions have been eliminated in consolidation. Investments in minority-owned companies in which Mirant exercises significant influence over operating and financial policies are accounted for using the equity method of accounting. Jointly owned affiliates which Mirant does not control, as well as interests in VIEs in which Mirant is not the primary beneficiary, are also accounted for using the equity method of accounting.

The Company has held a minority equity interest in a non-consolidated variable interest entity (VIE) since July 2000. The non-consolidated VIE primarily holds an interest in a generation facility and had total assets of approximately $114 million at September 30, 2005. The Company believes that its maximum exposure to loss associated with its interest in the non-consolidated VIE is the Company s carrying value of its investment in the VIE at September 30, 2005 of approximately $59 million.

Certain prior period amounts have been reclassified to conform to the current period financial statement presentation.

Recently Adopted Accounting Standards

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 153 (SFAS 153), *Exchanges of Productive Assets: an Amendment of APB Opinion No. 29.* SFAS 153 addresses the measurement of exchanges of certain nonmonetary assets. It amends APB Opinion No. 29, *Accounting for Nonmonetary Exchanges*, and requires that nonmonetary exchanges (except for certain exchanges of products or property held for sale in the ordinary course of business) be accounted for at the fair value of the assets exchanged, with gains or losses being recognized, if the fair value is determinable within reasonable limits and the transaction has commercial substance. The provisions of SFAS 153 are effective for transactions involving nonmonetary exchanges that occur in fiscal periods beginning after June 15, 2005. The Company has determined that certain exchanges of emissions credits that the Company may periodically transact would qualify as nonmonetary exchanges under SFAS 153. For the quarter ended September 30, 2005, the Company identified certain transactions involving exchanges of emissions credits of one vintage year for a different year. Because the fair value of the assets exchanged approximated the fair value of the assets received in each trade no material gain or loss was recorded. As a result, the adoption of SFAS 153 had no impact on the Company s consolidated results of operations, cash flows or financial position as of September 30, 2005.

New Accounting Standards Not Yet Adopted

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment: an amendment of FASB Statements No. 123 and 95* (SFAS 123R), which requires companies to recognize in their income statement the grant-date fair value of stock options and other equity-based compensation issued to employees. The provisions of SFAS 123R are effective for financial statements issued for fiscal years beginning after June 15, 2005. The Company will use the modified prospective transition method. Under the modified prospective transition method, awards that are granted, modified or settled after the date of adoption will be measured and accounted for in accordance with SFAS 123R. Compensation cost for awards granted prior to, but not vested as of, the date SFAS 123R is adopted will be based on the grant date fair value and attributes originally used to value those awards. The Company will adopt the provisions of SFAS 123R on the earlier of its emergence from bankruptcy or the effective date of SFAS 123R. The Company has a number of options granted prior to the Petition Date that are not fully vested. Under the Company s proposed Plan (as defined below), these options will be cancelled. New options may be granted to employees after the Company emerges from bankruptcy. Due to the Company s debtor-in-possession status and uncertainty related to the Plan and timing of the Company s emergence from bankruptcy, the Company cannot currently predict the effect SFAS 123R will have on its financial statements.

In March 2005, the FASB issued FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47). The interpretation requires companies to recognize a liability for the fair value of a legal obligation to perform asset retirement activities that are conditional on a future event if the amount can be reasonably estimated. FIN 47 is effective for fiscal years ending after December 15, 2005. The Company will adopt the provisions of FIN 47 on the earlier of its emergence from bankruptcy or the effective date of FIN 47. The Company has identified potential liabilities for additional evaluation, but has not yet quantified the impact of FIN 47 on its financial statements.

B. Bankruptcy Related Disclosures

On January 19, 2005, the Mirant Debtors filed a proposed Plan and Disclosure Statement (as amended, the Disclosure Statement) with the Bankruptcy Court. A First Amended Plan and a First Amended Disclosure Statement were filed on March 25, 2005.

On September 7, 2005, the Mirant Debtors reached an agreement with the Statutory Committees representing the key constituencies in their Chapter 11 case, including the committees representing the unsecured creditors of Mirant, the unsecured creditors of Mirant Americas Generation, LLC (Mirant Americas Generation) and the equity security holders of Mirant (collectively, the Statutory Committees), regarding the terms upon which the Mirant Debtors will emerge from bankruptcy protection. A Second Amended Plan and a Second Amended Disclosure Statement were filed on September 22, 2005 and subsequently updated on September 30, 2005. On September 30, 2005, the Bankruptcy Court approved the Disclosure Statement and authorized its use in connection with the solicitation of votes on the proposed Plan from those creditors, security holders and interest holders who are entitled to vote on the proposed Plan.

The proposed Plan sets forth the proposed structure of the Mirant Debtors at emergence and outlines how the claims of creditors and stockholders are proposed to be treated. The proposed Plan is built around the following key elements:

- the business of the Mirant Debtors will continue to be operated in substantially its current form, subject to (1) certain internal structural changes that the Mirant Debtors believe will improve operational efficiency, facilitate and optimize their ability to meet financing requirements and accommodate the enterprise s debt structure as contemplated at emergence and (2) organizing a new parent entity for the Mirant Debtors ongoing business operations (New Mirant);

- the consolidated business will have approximately $4.258 billion of debt, comprised of (1) $1.063 billion of debt obligations associated with non-debtor international subsidiaries of Mirant; (2) $145 million of miscellaneous domestic indebtedness; (3) $1.7 billion of reinstated debt at Mirant Americas Generation; and (4) $1.35 billion of new debt issued by Mirant North America, LLC (Mirant North America), a newly organized holding company subsidiary of Mirant Americas Generation, in partial satisfaction of certain existing Mirant Americas Generation debt. The foregoing amounts exclude (a) the obligations of Mirant Mid-Atlantic, LLC (Mirant Mid-Atlantic) under the lease-financing transactions covering the Morgantown Power Station and the Dickerson Power Station and (b) any amounts drawn on a new $1 billion senior secured revolving credit facility that is part of the exit financing to be provided to Mirant North America under the Plan;

- in settlement of the intercompany claims and potential causes of action arising from the complex historical relationships between and among the Mirant Debtors, (1) the estates of the Mirant Debtors (excluding Mirant Americas Generation and its debtor subsidiaries) (collectively, the Consolidated Mirant Debtors) will be treated as comprising a single estate, (a) eliminating any distributions under the Plan in respect of intercompany claims between and among the Consolidated Mirant Debtors and (b) limiting a creditor holding a base claim against a Consolidated Mirant Debtor and a guarantee of such base claim from another Consolidated Mirant Debtor to a single recovery thereon; (2) the estates of Mirant Americas Generation and its debtor subsidiaries (collectively, the Consolidated Mirant Americas Generation Debtors) will be treated as a single estate, eliminating intercompany claim distributions and multiple recoveries on guarantee claims, as described in (a) and (b) above with respect to the Consolidated Mirant Debtors; and (3) all claims and actions between the Consolidated Mirant Debtors and the Consolidated Mirant Americas Generation Debtors will be released;

- the holders of unsecured claims against the Consolidated Mirant Debtors (excluding certain de minimis claims that will be paid in cash) will receive (1) a pro rata share of 96.25% of the shares of New Mirant common stock to be issued under the Plan, excluding: (a) certain shares to be issued to the holders of certain claims against the Consolidated Mirant Americas Generation Debtors, as described below, and (b) the shares reserved for issuance pursuant to the New Mirant employee stock programs; and (2) the right to receive cash payments equal to 50% of the cash recoveries realized by New Mirant, if any, in connection with certain designated avoidance actions, subject to certain adjustments for offsets, expenses and certain tax consequences to New Mirant;

- a settlement of the contractual subordination provisions among the holders of certain senior unsecured obligations of Mirant and the beneficial holders of certain subordinated notes of Mirant pursuant to which, in lieu of the shares of New Mirant common stock they would otherwise receive absent subordination, (1) the holders of such subordinated notes will receive (a) 3.5% of the New Mirant common stock issued under the Plan (which shares are included in the 96.25% referred to in the immediately preceding paragraph and subject to the exclusions noted above for Mirant s general unsecured creditors, as applicable) and (b) warrants to purchase an additional 5% of New Mirant common stock, and (2) the holders of such subordinated notes will share pari passu with Mirant s general unsecured creditors in the recoveries under the designated avoidance actions, if any;

- the outstanding equity interests in Mirant will be cancelled and the holders thereof will receive (1) 3.75% of the shares of New Mirant common stock (subject to the exclusions noted above for Mirant s general unsecured creditors as applicable), (2) warrants to purchase up to an additional 10% of the New Mirant common stock and (3) the right to receive cash payments equal to 50% of the cash recoveries realized by New Mirant, if any, in connection with certain designated avoidance actions, subject to certain adjustments for offsets, expenses and certain tax consequences to New Mirant;

- the holders of unsecured claims against the Consolidated Mirant Americas Generation Debtors will be paid in full (including post-petition interest) through (1) the issuance to general unsecured creditors and holders of the Mirant Americas Generation revolving credit facilities and senior notes maturing in 2006 and 2008 of (a) $1.35 billion cash proceeds from third-party financing transactions or, at the option of the Mirant Debtors, new debt securities of Mirant North America and (b) receipt of a pro rata share of 2.3% of the shares of New Mirant common stock issued under the Plan, excluding shares reserved for issuance pursuant to the New Mirant employee stock programs, and (2) the reinstatement of the Mirant Americas Generation senior notes maturing in 2011, 2021 and 2031;

- in consideration of the agreement of the committee representing the unsecured creditors of Mirant Americas Generation to support the Plan and to help ensure the feasibility of the Plan, the establishment of certain additional covenant protections with respect to the Mirant Americas Generation senior notes maturing in 2011, 2021 and 2031;

- to further support the feasibility of the Plan with respect to the Consolidated Mirant Americas Generation Debtors, Mirant will contribute (or cause to be contributed) value to Mirant Americas Generation, including (1) the transfer of Mirant s trading and marketing business to Mirant North America (subject to the transfer to New Mirant or Mirant Americas, Inc. (Mirant Americas) of $250 million of cash and certain receivables), (2) the transfer of Mirant Peaker, LLC (Mirant Peaker) and Mirant Potomac River, LLC (Mirant

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Potomac River) to Mirant Mid-Atlantic, (3) the transfer of Mirant Zeeland, LLC to Mirant North America and (4) commitments to make prospective capital contributions of $150 million for refinancing of certain Mirant Americas Generation debt that matures in 2011 and, under certain circumstances, up to $265 million to Mirant North America for environmental capital expenditures;

- the Mirant Debtors that own our New York assets, including Mirant Lovett, LLC (Mirant Lovett), Mirant Bowline, LLC (Mirant Bowline) and Mirant NY-Gen, LLC (Mirant NY-Gen) will remain in Chapter 11 until the resolution of issues arising out of the sinkhole at Swinging Bridge owned by Mirant NY-Gen and the related flood study and the disputes regarding the ad valorem real property taxes for the Bowline and Lovett facilities are settled and resolved on terms that permit the feasible operation of these assets;

- substantially all of the assets of Mirant will be transferred to New Mirant, which will serve as the corporate parent of the Mirant Debtors business enterprise on and after the effective date of the proposed Plan; similarly, the Mirant trading and marketing business of Mirant Americas Energy Marketing, L.P. (Mirant Americas Energy Marketing) will be substantially transferred to Mirant Energy Trading, LLC (a subsidiary of Mirant North America); and

- the Mirant Debtors obligations under all agreements with Potomac Electric Power Company (PEPCO) will be performed on an interim basis pending a final determination of the Mirant Debtors right to reject, recharacterize, avoid or recover payments under a contractual arrangement (the Back-to-Back Agreement), the Asset Purchase and Sale Agreement (APSA) and certain Assignment and Assumption Agreements (collectively the Assumption/Assignment Agreement) entered into by various Mirant Debtors in December 2000 related to the asset purchases that were the subject of the APSA. If the Mirant Debtors do not reject, recharacterize, avoid or recover payments under the Back-to-Back Agreement, APSA and the Assumption/Assignment Agreement, and such agreements constitute executory contracts under the Bankruptcy Code, the Mirant Debtors will assume such agreements (and the Back-to-Back Agreement, APSA and the Assumption/Assignment Agreement will be assigned to Mirant Power Purchase, LLC (Mirant Power Purchase) and guaranteed by New Mirant) and any cure obligations will be performed pursuant to the Plan.

Between April 18, 2005 and June 27, 2005, the Mirant Debtors, the Statutory Committees and representatives of certain other interests were party to proceedings before the Bankruptcy Court with respect to the valuation of the Mirant Debtors. Pursuant to a letter dated June 30, 2005, as subsequently amended, the Bankruptcy Court instructed the Mirant Debtors and their financial advisors, The Blackstone Group, to make certain modifications to the business plan of the Mirant Debtors and the valuation report prepared by The Blackstone Group. The Bankruptcy Court indicated that it intended to use the modified business plan and valuation report to generate an enterprise value for the Mirant Debtors which could be used for purposes of confirmation of a plan of reorganization for the Mirant Debtors. Due to the agreement reached on September 7, 2005, the Bankruptcy Court ordered that the previously ordered modifications to the business plan and valuation report not be completed and stated that it would not issue a formal opinion regarding valuation unless required to do so in connection with confirmation of the Plan.

Pursuant to the Bankruptcy Court s order of September 30, 2005, approving the Disclosure Statement, the Mirant Debtors mailed solicitation materials to all known holders of impaired claims and equity interests against the Mirant Debtors entitled to vote on the Plan. In addition, the Bankruptcy Court fixed December 1, 2005 as the date for the hearing to consider confirmation of the Plan and related matters. Properly executed ballots and any objections to the Plan are due by

November 10, 2005. Until such time as the Plan is confirmed by the Bankruptcy Court, it is not possible to accurately predict if or when some or all of the Mirant Debtors may emerge from bankruptcy protection under Chapter 11.

Accounting for Reorganization

The accompanying unaudited condensed consolidated financial statements of Mirant have been prepared in accordance with Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code*, and on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. However, as a result of the bankruptcy proceedings, such realization of assets and satisfaction of liabilities are subject to a significant number of uncertainties. Mirant s unaudited condensed consolidated financial statements do not reflect adjustments that might be required if Mirant (or each of the Mirant Debtors) is unable to continue as a going concern.

Unaudited condensed combined financial statements of the Mirant Debtors and Non-Debtors are set forth below. Mirant Debtors include all entities that filed for protection from creditors in 2003. Non-Debtors include the Company s businesses in the Caribbean and Philippines that are not in bankruptcy proceedings, as well as certain non wholly-owned subsidiaries and Mirant s Canadian subsidiaries which emerged in May 2004 from creditor protection under the Companies Creditors Arrangement Act in Canada.

Unaudited Condensed Combined Statement of Operations Data
For the Three Months Ended September 30, 2005
(in millions)

	Debtors	Non-Debtors	Consolidation/ Elimination Entries	Consolidated
Operating revenues	$ 557	$ 323	$	$ 880
Cost of fuel, electricity and other products	594	123		717
Operating expenses	223	107		330
Operating (loss) income	(260)	93		(167)
Other (expense) income, net	(1,187)	(10)	18	(1,179)
Reorganization items, net	107		2	109
(Benefit) provision for income taxes	(36)	92		56
Minority interest		7		7
(Loss) income from continuing operations	(1,518)	(16)	16	(1,518)
Income from discontinued operations, net of tax	3			3
Net (loss) income	$ (1,515)	$ (16)	$ 16	$ (1,515)

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Unaudited Condensed Combined Statement of Operations Data
For the Nine Months Ended September 30, 2005
(in millions)

	Debtors	Non-Debtors	Consolidation/ Elimination Entries	Consolidated
Operating revenues	$ 1,789	$ 913	$ (7)	$ 2,695
Cost of fuel, electricity and other products	1,365	321	(6)	1,680
Operating expenses	699	305	(1)	1,003
Operating (loss) income	(275)	287		12
Other expense, net	(1,126)	(45)	(51)	(1,222)
Reorganization items, net	200	(1)	4	203
(Benefit) provision for income taxes	(80)	168		88
Minority interest		20		20
(Loss) income from continuing operations	(1,521)	55	(55)	(1,521)
Income from discontinued operations, net of tax	7			7
Net (loss) income	$ (1,514)	$ 55	$ (55)	$ (1,514)

Unaudited Condensed Combined Balance Sheet Data
September 30, 2005
(in millions)

	Debtors	Non-Debtors	Consolidation/ Elimination Entries	Consolidated
Current assets	$ 4,336	$ 1,325	$ (233)	$ 5,428
Intercompany receivables	715	585	(1,300)	
Property, plant and equipment, net	3,918	2,137		6,055
Intangible assets, net	256	13		269
Investments	2,171	244	(2,155)	260
Other	373	497		870
Total assets	$ 11,769	$ 4,801	$ (3,688)	$ 12,882
Liabilities not subject to compromise:				
Current liabilities	$ 2,758	$ 623	$	$ 3,381
Intercompany payables	494	716	(1,210)	
Other noncurrent liabilities	359	505		864
Long-term debt	185	628		813
Liabilities subject to compromise	10,791		(323)	10,468
Minority interest		174		174
Stockholders (deficit) equity	(2,818)	2,155	(2,155)	(2,818)
Total liabilities and stockholders deficit	$ 11,769	$ 4,801	$ (3,688)	$ 12,882

Unaudited Condensed Combined Statement of Cash Flows Data
For the Nine Months Ended September 30, 2005
(in millions)

	Debtors	Non-Debtors	Consolidation/ Elimination Entries	Consolidated
Net cash (used in) provided by:				
Operating activities	$ (522)	$ 246	$	$ (276)
Investing activities	21	20		41
Financing activities	99	(120)		(21)
Net (decrease) increase in cash and cash equivalents	(402)	146		(256)
Cash and cash equivalents, beginning of period	953	532		1,485
Cash and cash equivalents, end of period	$ 551	$ 678	$	$ 1,229
Cash paid for reorganization items	$ 112	$ 3	$	$ 115

Liabilities Subject to Compromise

The amounts subject to compromise at September 30, 2005 and December 31, 2004, consisted of the following items (in millions):

	September 30, 2005	December 31, 2004
Items, absent the bankruptcy proceedings, that would have been considered current:		
Accounts payable and accrued liabilities	$ 2,214	$ 1,028
Current portion of long-term debt	3,715	3,112
Price risk management (assets) liabilities	(4)	80
Items, absent the bankruptcy proceedings, that would have been considered noncurrent:		
Long-term debt	3,537	3,974
Price risk management liabilities	443	460
Note payable to Mirant Trust I	356	356
Other noncurrent liabilities	207	207
Total	$ 10,468	$ 9,217

The price risk management liabilities reflect the fair values of power purchase agreements (PPAs) with PEPCO. The current portion of the fair value of the PPAs is a net asset of $4 million at September 30, 2005 due to high power prices as of that date. See PEPCO Litigation later in this section for further discussion.

On June 28, 2005, the Bankruptcy Court approved a settlement agreement among Mirant, Mirant Americas Energy Marketing, Perryville Energy Partners, LLC (Perryville) and Perryville Energy Holdings, LLC that resolves the Perryville parties claims against the Mirant Debtors and Mirant Americas claim against Perryville. The settlement agreement had previously been approved by the bankruptcy court overseeing the bankruptcy proceedings of the Perryville parties. Under the settlement, Perryville received an allowed unsecured claim of $207 million against Mirant Americas Energy Marketing, an allowed unsecured guaranty claim against Mirant of $177 million, and an allowed claim against Mirant Americas of $99 million, with the maximum amount of its recovery on these claims being limited to the amount of the claim against Mirant Americas Energy Marketing. Mirant Americas received an allowed claim against Perryville of $99 million. On June 30, 2005,

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Perryville sold its generating facility to a subsidiary of Entergy Corp. Pursuant to the terms of the settlement, this sale resulted in the offset of Mirant Americas claim in Perryville s bankruptcy proceeding against the claims held by Perryville in the Mirant bankruptcy proceedings as of July 20, 2005, and, thus, Perryville s claim against Mirant Americas was eliminated and its claims against Mirant Americas Energy Marketing and Mirant were reduced to $108 million. Accordingly, as of September 30, 2005, $108 million is included in liabilities subject to compromise in the unaudited condensed consolidated balance sheets.

Interest Expense

The Mirant Debtors discontinued recording interest on liabilities subject to compromise on the Petition Date and since filing for bankruptcy have disclosed the contractual interest on liabilities subject to compromise in excess of reported interest for each period. In the third quarter of 2005, the Company determined that it was probable that contractual interest on liabilities subject to compromise from the Petition Date would be incurred for certain claims expected to be allowed under the Plan. As a result, the Mirant Debtors recorded interest expense of approximately $1.2 billion on liabilities subject to compromise. This amount represents interest from the Petition Date through September 30, 2005, and is included in accounts payable and accrued liabilities in the table above. The interest amount was calculated based on the provisions of the proposed Plan. The $1.2 billion expense amount includes approximately $373 million related to Mirant Americas Generation senior notes maturing in 2011, 2021 and 2031, which would be reinstated under the proposed Plan.

Reorganization Items

Reorganization items, net represents expense or income amounts that were recorded in the consolidated financial statements as a result of the bankruptcy proceedings primarily related to estimated claims and losses on rejected and amended contracts, and professional fees for accounting and legal services. For the three and nine months ended September 30, 2005 and 2004, the following represents the significant items within this category (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Estimated claims	$ 84	$ 44	$ 109	$ 134
Professional fees and administrative expense	32	22	116	74
Interest income and other (gains) losses, net	(7)	(4)	(22)	(16)
Total	$ 109	$ 62	$ 203	$ 192

For the nine months ended September 30, 2005, estimated claims include a $32 million gain related to the California settlement.

PEPCO Litigation

In 2000, Mirant purchased certain power generating assets and certain other assets from PEPCO, including certain PPAs. Under the terms of the APSA, Mirant and PEPCO entered into the Back-to-Back Agreement with respect to certain PPAs, including PEPCO s long-term PPAs with Ohio Edison Company (Ohio Edison) and Panda-Brandywine L.P. (Panda), under which (1) PEPCO agreed to resell to Mirant all capacity, energy, ancillary services and other benefits to which it is entitled under those agreements; and (2) Mirant agreed to pay PEPCO each month all amounts due from PEPCO to the sellers under those agreements for the immediately preceding month associated with such capacity, energy, ancillary services and other benefits. The Panda and Ohio Edison PPAs run until 2021 and December 2005, respectively. Under the Back-to-Back Agreement, Mirant is obligated to purchase power from PEPCO at prices that are typically higher than the market prices for power.

Back-to-Back Agreement Litigation: On August 28, 2003, the Mirant Debtors filed a motion in the bankruptcy proceedings to reject the Back-to-Back Agreement (the First Rejection Motion), along with an adversary proceeding to enjoin PEPCO and the FERC from taking certain actions against the Mirant Debtors (the Injunction Litigation). On October 9, 2003, the United States District Court for the Northern District of Texas entered an order that had the effect of transferring to that court from the Bankruptcy Court the First Rejection Motion and the Injunction Litigation. In December 2003, the district court denied the First Rejection Motion and, thereafter, dismissed the Injunction Litigation. The district court ruled that the Federal Power Act preempts the Bankruptcy Code and that a bankruptcy court cannot affect a matter within the FERC s jurisdiction under the Federal Power Act, including the rejection of a wholesale power purchase agreement regulated by the FERC.

The Mirant Debtors appealed the district court s orders to the United States Court of Appeals for the Fifth Circuit (the Fifth Circuit). The Fifth Circuit reversed the district court s decision, holding that the Bankruptcy Code authorizes a district court (or bankruptcy court) to reject a contract for the sale of electricity that is subject to the FERC s regulation under the Federal Power Act as part of a bankruptcy proceeding and that the Federal Power Act does not preempt that authority. The Fifth Circuit remanded the proceeding to the district court for further action on that motion. The Fifth Circuit indicated that on remand the district court could consider applying a more rigorous standard than the business judgment standard typically applicable to contract rejection decisions by debtors in bankruptcy, which more rigorous standard would take into account the public interest in the transmission and sale of electricity.

On December 9, 2004, the district court held that the Back-to-Back Agreement was a part of and not severable from, and therefore could not be rejected apart from, the APSA. The district court also noted that if the Fifth Circuit overturned the district court s ruling with respect to severability, the Back-to-Back Agreement should be rejected only if Mirant can prove that the Back-to-Back Agreement burdens the bankrupt estates; that, after scrutiny and giving significant weight to the comments of the FERC relative to the effect of rejection on the public interest, the equities balance in favor of rejecting the Back-to-Back Agreement; and that rejection of the Back-to-Back Agreement would further the Chapter 11 goal of permitting the successful rehabilitation of the Mirant Debtors. The Mirant Debtors have appealed the district court s December 9, 2004 decision to the Fifth Circuit and requested that the Fifth Circuit hear this appeal on an expedited basis. On March 8, 2005, the Fifth Circuit denied Mirant s request to have the appeal expedited.

On January 21, 2005, the Mirant Debtors filed a motion in the bankruptcy proceedings to reject the APSA, including the Back-to-Back Agreement but not including other agreements entered into between Mirant and its subsidiaries and PEPCO under the terms of the APSA (the Second Rejection Motion). On February 10, 2005, PEPCO filed a motion requesting the district court to assert jurisdiction over and rule upon the Second Rejection Motion rather than having the Bankruptcy Court rule on that motion. On March 1, 2005, the district court ruled that it would withdraw the reference to the Bankruptcy Court of the Second Rejection Motion and would itself hear that motion. On August 16, 2005, the district court informally stayed the Second Rejection Motion pending rulings by the Fifth Circuit on the Mirant Debtors appeals from the district court s December 9, 2004 decision denying the First Rejection Motion and from the district court s March 1, 2005 order as subsequently modified as described below.

Suspension of PEPCO Back-to-Back Payments: On December 9, 2004, in an effort to halt further out-of-market payments under the Back-to-Back Agreement while awaiting resolution of issues related to the potential rejection of the Back-to-Back Agreement (but prior to notice of entry of the district court s order of December 9, 2004), the Mirant Debtors filed a notice in the Bankruptcy Court stating that the Mirant Debtors were suspending further payments to PEPCO under the Back-to-Back Agreement absent further order of the court (the Suspension Notice). On December 10, 2004, in response to the Suspension Notice, PEPCO filed a motion in the district court seeking a temporary restraining order and injunctive relief to require the Mirant Debtors to perform under the Back-to-Back Agreement (the Injunctive Relief Motion). On December 13, 2004, the district court issued an order referring the Injunctive Relief Motion to the Bankruptcy Court. On December 21, 2004, the Bankruptcy Court issued an order denying the temporary restraining order sought by PEPCO.

On December 14, 2004, PEPCO filed the following additional litigation: (1) a motion seeking relief from the automatic stay provision of Bankruptcy Code section 362(a) to permit PEPCO to terminate performance under the APSA (the Lift Stay Motion); (2) a motion to compel the Mirant Debtors to pay, as administrative expenses, payments that had been suspended under the Back-to-Back Agreement (the Administrative Expense Motion); and (3) an adversary proceeding seeking to compel the Mirant Debtors to make payments under the Back-to-Back Agreement (the PEPCO Lawsuit). On December 16, 2004, PEPCO filed a motion requesting the district court to withdraw the reference to the Bankruptcy Court with respect to the litigation filed by PEPCO on December 14, 2004, as well as the Injunctive Relief Motion (the Second Withdrawal Motion). On January 4, 2005, the district court denied the Second Withdrawal Motion in its entirety.

On January 19, 2005, the Bankruptcy Court entered an order embodying a ruling made orally by the court on January 14, 2005, in which it denied the Lift Stay Motion and the Administrative Expense Motion, but required the Mirant Debtors to pay amounts due under the Back-to-Back Agreement in January 2005 and thereafter until either (1) the Mirant Debtors filed a motion to reject the APSA, (2) the Fifth Circuit issued an order reversing the district court s order of December 9, 2004 denying the motion to reject the Back-to-Back Agreement, or (3) the Mirant Debtors were successful in having the obligations under the Back-to-Back Agreement recharacterized as debt obligations. PEPCO filed an appeal of the Bankruptcy Court s January 19, 2005 order. On January 21, 2005, the Mirant Debtors filed the Second Rejection Motion.

On March 1, 2005, the district court withdrew the reference to the Bankruptcy Court of the Second Rejection Motion and the Administrative Expense Motion, ordered the Mirant Debtors to pay PEPCO all past-due, unpaid obligations under the Back-to-Back Agreement by March 10, 2005 and dismissed as moot PEPCO s appeal of the January 19, 2005 order denying the Administrative Expense Motion. The Mirant Debtors on March 4, 2005 filed a motion requesting that the district court reconsider its order of March 1, 2005 or alternatively to stay that order while the Mirant Debtors appeal it to the Fifth Circuit. On March 7, 2005, the district court modified the March 1, 2005 order to require PEPCO to file a response to the Mirant Debtors motion for reconsideration by March 14, 2005 and to delay until March 18, 2005, the date by which the Mirant Debtors were to pay past-due, unpaid obligations under the Back-to-Back Agreement.

On March 16, 2005 the Mirant Debtors filed a petition for writ of mandamus with the Fifth Circuit asking it to order the district court to vacate the March 1, 2005 order, as modified, and to reinstate PEPCO s appeal of the Bankruptcy Court s order of January 19, 2005 denying the Administrative Expense Motion. The petition asked the Fifth Circuit alternatively to stay the March 1, 2005 order until the Mirant Debtors appeal of that order was resolved. Also on March 16, 2005 the district court further modified its order of March 1, 2005 to clarify that the amounts to be paid by the Mirant Debtors by March 18, 2005 did not include any amounts that became due prior to the filing of the Chapter 11 cases on July 14, 2003. On March 16, 2005, the Mirant Debtors also appealed the district court s March 1, 2005 order, as modified, to the Fifth Circuit. On March 17, 2005, the Fifth Circuit issued a temporary stay of the March 1, 2005 order, as modified. On April 11, 2005, the Fifth Circuit vacated the temporary stay entered on March 17, 2005, denied the petition for writ of mandamus and denied the Mirant Debtors request for a stay pending appeal. In its order, the Fifth Circuit concluded that the Mirant Debtors challenges to the district court s order of March 1, 2005, as modified, could be remedied in their pending appeals and that the Mirant Debtors had not shown they would suffer irreparable harm if the order was not stayed pending appeal. On April 20, 2005, the district court entered an order directing the Mirant Debtors to pay PEPCO by April 25, 2005 all unpaid amounts due under the Back-to-Back Agreement accruing since the Petition Date to the extent they had not already done so, and to continue performance of all obligations under the agreement until further order of the district court. The Mirant Debtors have paid all amounts due under the Back-to-Back Agreement accruing since the Petition Date.

Potential Adjustment Related to Panda Power Purchase Agreement: At the time of the acquisition of the Mirant Mid-Atlantic assets from PEPCO, Mirant also entered into an agreement with PEPCO that, as subsequently modified, provided that the price paid by Mirant for its December 2000 acquisition of PEPCO assets would be adjusted if by April 8, 2005 a binding court order had been entered finding that the Back-to-Back Agreement violated PEPCO s power purchase agreement with Panda (the Panda PPA) as a prohibited assignment, transfer or delegation of the Panda PPA or because it effected a prohibited delegation or transfer of rights, duties or obligations under the Panda PPA that was not severable from the rest of the Back-to-Back Agreement. Panda initiated legal proceedings in 2000 asserting that the Back-to-Back Agreement violated provisions in the Panda PPA prohibiting PEPCO from assigning the Panda PPA or delegating its duties under the Panda PPA to a third party without Panda s prior written consent. On June 10, 2003, the Maryland Court of Appeals, Maryland s highest court, ruled that the assignment of certain rights and delegation of certain duties by PEPCO to Mirant did violate the non-assignment provision of the Panda PPA and was unenforceable. The court, however, left open the issues whether the provisions found to violate the Panda PPA could be severed and the rest of the Back-to-Back Agreement enforced and whether Panda s refusal to consent to the assignment of the Panda PPA by PEPCO to Mirant was unreasonable and violated the Panda PPA. The Company believes that the June 10, 2003 decision by the Maryland Court of Appeals does not suffice to trigger a purchase price adjustment under the agreement between Mirant and PEPCO. If that court order were found to have triggered the purchase price adjustment, the agreement between Mirant and PEPCO provides that the amount of the adjustment would be negotiated in good faith by the parties or determined by binding arbitration so as to compensate PEPCO for the termination of the benefit of the Back-to-Back Agreement while also holding Mirant economically indifferent from such court order.

PEPCO Avoidance Action: On July 13, 2005, Mirant and several of its subsidiaries, including Mirant Mid-Atlantic and Mirant Americas Generation, filed a lawsuit against PEPCO before the Bankruptcy Court to avoid and recover fraudulent transfers under 11 U.S.C. §§ 544 and 550 and applicable state law in connection with the acquisition of PEPCO s assets by Mirant in December 2000 and disallow PEPCO s proofs of claim. The suit asserts that Mirant did not receive fair value in return for the purchase price paid for the PEPCO assets and that the acquisition occurred at a time when Mirant was either insolvent or was rendered insolvent as a result of the transaction. On November 3, 2005, the district court granted a motion filed by PEPCO seeking to have the suit heard by the district court rather than the Bankruptcy Court. The likely outcome of this proceeding cannot now be determined, and the Company cannot estimate what recovery, if any, it may obtain in this action.

C. Assets Held for Sale

The Company has reclassified amounts for prior periods in the financial statements to report separately, as discontinued operations, the revenues and expenses of components of the Company that have been disposed of or are expected to be disposed of in the next year. The components in assets held for sale are discussed below.

Coyote Springs 2: Loss from discontinued operations for the nine months ended September 30, 2004 reflects the Company s 50% undivided interest in the 241 MW combined cycle natural gas fired Coyote Springs 2 generating facility in Oregon (Coyote Springs 2). In October 2004, Mirant Oregon, a wholly-owned subsidiary of Mirant, entered into an agreement to sell its interest in Coyote Springs 2 to Avista Energy, subject to Bankruptcy Court and regulatory approvals. The Bankruptcy Court and regulatory approvals occurred in the fourth quarter of 2004. The Company completed the sale of Coyote Springs 2 for $63 million in January 2005 after conducting an auction in which Mirant Oregon solicited higher bids.

Wrightsville: Income from discontinued operations for the nine months ended September 30, 2005 and 2004 includes the 548 MW Wrightsville generating facility in Arkansas (Wrightsville). In February 2005, certain indirect subsidiaries of the Company entered into an agreement to sell the Wrightsville generating facility to Arkansas Electric Cooperative Corporation, subject to Bankruptcy Court and regulatory approvals. After receipt of Bankruptcy Court and regulatory approvals, the Company completed the sale of Wrightsville for $85 million in September 2005. Due to the completion of the sale, the Company recognized a gain on sale of assets, net of $2 million which is included in income from discontinued operations, net of tax, for the three and nine months ended September 30, 2005 in the unaudited condensed consolidated statements of operations.

Mirant Service Center: On September 13, 2005, Mirant Mid-Atlantic executed an agreement to sell its Mirant service center building and accompanying 68 acres located in Upper Marlboro, Maryland for $13 million. The execution of the agreement initiated a 30-day due diligence period, which concluded with no substantive issues identified. The Company is pursuing Bankruptcy Court approval of the sale and anticipates a closing by year-end.

A summary of the operating results for these discontinued operations for the three and nine months ended September 30, 2005 and 2004 follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Operating revenues	$	$	$ 2	$
Operating expenses, including other income (expense), net	3	(2)	2	(56)*
Income (loss) before reorganization items	3	(2)	4	(56)
Reorganization items (benefit), net		9	(3)	9
Net income (loss)	$ 3	$ (11)	$ 7	$ (65)

* For the nine months ended September 30, 2004, an impairment charge of approximately $48 million was recorded related to Coyote Springs 2.

Current assets held for sale include discontinued operations and the following assets that the Company has disposed of or expects to dispose of in the next year:

Wyandotte: In May 2005, the Company entered into an agreement to sell most of the equipment for Wyandotte, LLC (Wyandotte), a 560 MW suspended construction project in Michigan. In the second quarter of 2005, the Company recognized a loss on sale of assets, net of $21

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million. Also in the second quarter of 2005, the Company recognized an impairment loss of $7 million for the remaining assets associated with the project. Both the loss on sale of assets and the impairment loss are included in operating expenses for the nine months ended September 30, 2005 in the unaudited condensed consolidated statements of operations. After receiving Bankruptcy Court approval in June 2005, the Company completed the sale and received net proceeds of $23 million in July 2005.

Mint Farm: The Company entered into an agreement to sell its interest in Mint Farm Generation LLC (Mint Farm), a 298 MW suspended construction project in Longview, Washington, subject to Bankruptcy Court approval. In the second quarter of 2005, the Company recognized a loss on sale of assets, net of $7 million, which is included in operating expenses for the nine months ended September 30, 2005 in the unaudited condensed consolidated statements of operations. After receiving Bankruptcy Court approval in October 2005, the Company completed an auction process that resulted in a highest bid that was higher than the Company s previous agreement to sell its interest in Mint Farm. The Company expects to complete the sale in the fourth quarter of 2005 or first quarter of 2006 and receive proceeds of approximately $26 million.

The table below presents the components of the balance sheet accounts classified as current assets held for sale as of September 30, 2005 and December 31, 2004 (in millions):

	September 30, 2005	December 31, 2004
Current Assets:		
Current assets	$	$ 2
Property, plant and equipment, net	26	228
Total current assets held for sale	$ 26	$ 230

The following table presents the effects of the reclassifications in the previously presented balance sheet as of December 31, 2004 (in millions).

	As of December 31, 2004		
	As Previously Presented	Reclassifications	As Presented
Assets:			
Assets held for sale	$ 222	$ 8	$ 230
Property, plant and equipment, net	6,170	(8)	6,162

D. Price Risk Management Assets and Liabilities

The fair values of Mirant s price risk management assets and liabilities, net of credit reserves, as of September 30, 2005 are included in the following table (in millions):

	Net Price Risk Management Assets/(Liabilities)				
	Assets		Liabilities		Net Value at
	Current	Noncurrent	Current	Noncurrent	September 30, 2005
Electricity	$ 1,033	$ 121	$ (1,687)	$ (101)	$ (634)
Natural Gas	384	27	(361)	(22)	28
Oil	64	11	(23)		52
Coal	23	21	(1)	(2)	41
Other, including credit reserve	(15)				(15)
Total	$ 1,489	$ 180	$ (2,072)	$ (125)	$ (528)

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Of the $528 million net value liability at September 30, 2005, a net price risk management liability of $246 million relates to the remainder of 2005, a net price risk management liability of $348 million relates to 2006 and a net price risk management asset of $66 million relates to periods thereafter.

The volumetric weighted average maturity, or weighted average tenor, of the price risk management portfolio at September 30, 2005, was approximately eight months. The net notional amount of the price risk management assets and liabilities at September 30, 2005, was a net short position of approximately 11 million equivalent megawatt-hours (MWh).

Through our asset management activities, the Company enters into a variety of exchange-traded and OTC energy and energy-related derivative contracts, such as forward contracts, futures contracts, option contracts and financial swap agreements to manage its exposure to commodity price risk and changes in spark spreads. These derivatives have varying terms and durations, or tenors, which range from a few days to a number of years, depending on the instrument. The Company s optimization trading activities also utilize similar contracts in markets where it has a physical presence to attempt to generate incremental gross margin. In addition, the Company s legacy portfolio consists of a variety of energy and energy-related derivative and non-derivative contracts that have been determined to be no longer consistent with its asset management or optimization trading strategies.

For the third quarter of 2005, the Company recognized unrealized losses on asset management, optimization and legacy portfolios of $533 million in the unaudited condensed consolidated statements of operations as a component of gross margin. These unrealized losses primarily relate to forward power sales contracts used to economically hedge the Company s North America generation portfolio and are the result of significant power price increases in the third quarter of 2005. A significant portion of these positions relate to the fourth quarter of 2005 and to 2006 and the losses are expected to reverse as the Company generates power and settles these positions in future periods.

For forward contracts physically settled, the unrealized loss will be reversed and the Company will also recognize and receive revenue based on the fixed price of the forward contract in the period that it delivers the power. For contracts financially settled, the Company will settle the contracts and separately recognize and receive the spot market price for power generated and delivered. The financial impact is the same in that the Company realizes the fixed price for which it previously contracted (through the use of a financial instrument to provide an economic hedge of its expected generation output).

The following table represents the net fair value of Mirant s price risk management assets and liabilities by portfolio, net of credit reserves, as of September 30, 2005 (in millions):

Optimization	$ 12
Asset management	(579)
Legacy	39
Total	$ (528)

E. Mirant Mid-Atlantic Operating Leases

In conjunction with the acquisition of certain assets from PEPCO, Mirant Mid-Atlantic has leased the Morgantown and the Dickerson baseload units and associated property for terms of 33.75 and 28.5 years, respectively. In addition, Mirant Mid-Atlantic has an option to extend the leases. Any extensions of the respective leases would be limited to 75% of the economic useful life of the facility, as measured from the beginning of the original lease term through the end of the proposed remaining lease term. The Company is accounting for these leases as operating leases. Rent expenses associated with the Morgantown and Dickerson operating leases totaled approximately $24 million and $75 million for the three and nine months ended September 30, 2005, respectively, as compared to $30 million and $78 million for the same periods in 2004. Because of the variability in the scheduled payment amounts over the lease term, the Company recognizes rental expense for these leases on a straight-line basis. As of September 30, 2005 and December 31, 2004, Mirant Mid-Atlantic had paid approximately $271 million and $285 million, respectively, of actual operating lease payments in accordance with the lease agreements in excess of rent expense recognized. A further $12 million of scheduled rent due on June 30, 2005 was funded through a draw made by the lease trustee on letters of credit arranged by the Company and recorded as prepaid rent in the condensed consolidated balance sheets. In addition to the regularly-scheduled rent payments, Mirant Mid-Atlantic paid an additional $5 million and $11 million as of September 30, 2005 and December 31, 2004, respectively, as required by the lease agreements. In September 2005, the lease trustees made an additional draw of $49 million prior to the letters of credit expiration in September 2005. This amount is recorded in funds on deposit in the condensed consolidated balance sheets.

As of September 30, 2005, the total notional minimum lease payments for the remaining term of the leases aggregated approximately $2.4 billion and the aggregate termination value for the leases was approximately $1.4 billion. Mirant Mid-Atlantic leases the Morgantown and the Dickerson baseload units from third party owner lessors that purchased the baseload units from PEPCO. These owner lessors each own the undivided interests in these baseload generating facilities. The subsidiaries of the institutional investors who hold the membership interests in the owner lessors are called owner participants. Equity funding by the owner participants plus transaction expenses paid by the owner participants totaled $299 million. The issuance and sale of pass through certificates raised the remaining $1.2 billion needed for the owner lessors to acquire the undivided interests.

The pass through certificates are not direct obligations of Mirant Mid-Atlantic. Each pass through certificate represents a fractional undivided interest in one of three pass through trusts formed pursuant to three separate pass through trust agreements between Mirant Mid-Atlantic and State Street Bank and Trust Company of Connecticut, National Association, as pass through trustee. The property of the pass through trusts consists of lessor notes. The lessor notes issued by an owner lessor are secured by that owner lessor s undivided interest in the lease facilities and its rights under the related lease and other financing documents.

The operative documents relating to the leveraged leases contain certain covenants that restrict Mirant Mid-Atlantic and its designated subsidiaries which term includes Mirant Chalk Point, LLC (Mirant Chalk Point), Mirant Peaker and Mirant Potomac River including the following:

Restricted payments. Mirant Mid-Atlantic cannot make any of the following restricted payments:

- distributions in respect of equity interests in Mirant Mid-Atlantic (in cash, property, securities or obligations other than additional equity interests of the same type);

- payments or distributions on account of payments of interest, set apart money for a sinking or analogous fund for, or purchase or redeem any portion of, any equity interest in Mirant Mid-Atlantic or of any warrants, options or other rights to acquire any such equity interest (or make payments to any person such as phantom stock payments, where the amount of the payment is calculated with reference to its fair market or equity value); or

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- payments on or with respect to the purchase, redemption, defeasance or other acquisition or retirement for value of any subordinated indebtedness;

unless, at the time of the restricted payment, each of the following conditions is satisfied:

- Mirant Mid-Atlantic s fixed charge coverage ratio for the most recently ended period of four full fiscal quarters equals at least:

(1) 1.7 to 1.0; or

(2) 1.6 to 1.0, 1.45 to 1.0, 1.3 to 1.0 or 1.2 to 1.0 if, as of the last day of the most recently completed fiscal quarter, Mirant Mid-Atlantic and its designated subsidiaries have entered into power sales agreements (meeting certain criteria, including investment grade ratings criteria) covering, in the aggregate, at least 25%, 50%, 75% or 100%, respectively, of the projected total consolidated operating revenue for the consecutive period of eight full fiscal quarters following that date; and

- The projected fixed charge coverage ratio for Mirant Mid-Atlantic (determined on a pro forma basis after giving effect to any such dividend) for each of the two following periods of four fiscal quarters commencing with the fiscal quarter in which the restricted payment is proposed to be made equals at least:

(1) 1.7 to 1.0; or

(2) 1.6 to 1.0, 1.45 to 1.0, 1.3 to 1.0 or 1.2 to 1.0, if, as of the last day of the most recently completed fiscal quarter, Mirant Mid-Atlantic and its designated subsidiaries have entered into power sales agreements (meeting certain criteria, including investment grade ratings criteria) covering, in the aggregate, at least 25%, 50%, 75% or 100%, respectively, of the projected total consolidated operating revenue for the consecutive period of eight full fiscal quarters following that date; and

- Before and immediately after the making of the distribution, no significant lease default or event of default has occurred and is continuing.

In accordance with the terms of the leases, Mirant Mid-Atlantic calculates the projected fixed charge coverage ratio based on projections prepared in good faith based upon assumptions consistent in all material respects with the relevant contracts and agreements, historical operations and Mirant Mid-Atlantic s good faith projections of future revenue and projections of operating and maintenance expenses in light of then existing or reasonably expected regulatory and market environments in the markets in which the leased facilities or other assets owned by it will be operated.

Mirant s ability to pay its obligations, and the ability of Mirant Americas Generation and, upon formation, Mirant North America to pay their obligations, may be adversely affected in the event that Mirant Mid-Atlantic is unable to make distributions to Mirant North America. See Management Discussion and Analysis Liquidity and Capital Resources for a discussion of the impact of the restricted payments test in the Mirant Mid-Atlantic leveraged leases.

Additional indebtedness. Neither Mirant Mid-Atlantic nor any of its subsidiaries (including any designated subsidiary) can incur or assume any indebtedness, except (1) Mirant Mid-Atlantic and any subsidiary (including any designated subsidiary) can incur:

- any indebtedness, if, after incurring such indebtedness, no lease default or lease event of default has occurred and both S&P and Moody s confirm the ratings of the pass through certificates prior to incurring the indebtedness. However, if either rating is below investment grade, the indebtedness cannot be incurred unless the fixed charge coverage ratio for the

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previous four quarters and the projected fixed charge coverage ratios for the following eight fiscal quarters are each at least 2.5 to 1.0;

- any letters of credit, surety bonds or guarantees issued in the ordinary course of business;
- any indebtedness secured by a pre-existing lien on any assets acquired by Mirant Mid-Atlantic or a designated subsidiary, so long as the indebtedness has recourse only to those assets;
- any intercompany loans;
- any indebtedness incurred to finance capital expenditures made to comply with law or to finance required improvements to either of the leased facilities covered by the leveraged lease; or
- any indebtedness incurred by Mirant Mid-Atlantic and its subsidiaries (including any designated subsidiary) in an aggregate principal amount not to exceed $100 million (and with respect to any individual designated subsidiary, in an aggregate principal amount not to exceed $50 million);

and (2) Mirant Mid-Atlantic and any subsidiary other than a designated subsidiary can incur:

- any indebtedness incurred to refinance indebtedness secured by a pre-existing lien on acquired assets;
- any indebtedness guaranteed by a parent of Mirant Mid-Atlantic that has a credit rating of BBB/Baa2 or higher;
- any working capital indebtedness;
- any interest rate hedging transactions entered into in the ordinary course of business; or
- any subordinated indebtedness.

Merger and consolidation. Neither Mirant Mid-Atlantic nor any of its designated subsidiaries can consolidate or merge with or into any other entity or sell or otherwise transfer all or substantially all of its properties or assets to any person or entity except, among other conditions, that the resulting entity or transferee of assets is organized under the laws of the United States or any state, assumes the obligations of Mirant Mid-Atlantic or the designated subsidiary obligations and has a credit rating of BBB-/Baa3 after the merger or transfer.

Sale of assets. Mirant Mid-Atlantic cannot sell any of its assets other than certain limited permitted asset sales including sales of assets that do not exceed, in the aggregate, fifteen percent (15%) of the consolidated book value of Mirant Mid-Atlantic and its designated subsidiaries.

Liens. Mirant Mid-Atlantic cannot, and cannot permit any designated subsidiary to, create, incur, assume or otherwise suffer to exist any liens on its interest under a facility lease, other than certain limited permitted encumbrances.

Assignment and sublease. Without the consent of other parties to the operative documents, Mirant Mid-Atlantic cannot assign or sublease its interest under a facility lease unless certain requirements are met including the requirement that the assignee or its guarantor has a credit rating of at least BBB/Baa2.

The lease payment obligations of Mirant Mid-Atlantic are senior unsecured obligations and rank equally in right of payment with all of its other existing and future senior unsecured obligations. Under the terms of the lease, Mirant Mid-Atlantic is responsible for the payment of rent to the indenture trustee, which in turn makes payments of principal and interest to the pass

through trust and any remaining balance to the owner lessors for the benefit of the owner participants. The lease obligations of Mirant Mid-Atlantic are not obligations of its parent, Mirant Americas Generation, or, its indirect parent, Mirant, or any of its other affiliates. However, Mirant had arranged a letter of credit to provide for the rent payment reserve required in connection with this lease transaction in the event that Mirant Mid-Atlantic was unable to pay its lease payment obligations. The lease trustee drew $12 million from these letters of credit in the second quarter of 2005 and drew the remaining balance of $49 million in the third quarter of 2005.

Significant disputes have arisen between the Mirant Debtors, on the one hand, and the owner lessors and the indenture trustee for the Mirant Mid-Atlantic leveraged leases, on the other hand, regarding, among other things, whether or not the leveraged lease transactions constitute a lease (or leases) within the meaning of section 365 of the Bankruptcy Code, or instead evidence a financing or other arrangement. In April 2005, the Bankruptcy Court dismissed the recharacterization claim filed by the Mirant Debtors, ruling that, based upon the current posture of the Chapter 11 cases, a determination on the merits was not presently warranted. In its ruling, the Bankruptcy Court reserved the right to reconsider the merits of recharacterization in the event that facts and circumstances changed in a manner such that further consideration would be warranted.

As a result of Mirant Mid-Atlantic s bankruptcy filing, a lease event of default has occurred under the leases. The leases provide that, upon a lease event of default, the owner lessors remedies include (1) terminating the leases and repossessing the leased assets, (2) selling their interests in the leased assets, (3) demanding payment by Mirant Mid-Atlantic of the excess, if any, of the termination value over the fair market sales value of the leased assets or the discounted fair market rental value of the leased assets and (4) demanding payment of the termination value mitigated by a sale of the leased assets for the account of Mirant Mid-Atlantic. The ability of the owner lessors to exercise their remedies under the leases is currently stayed as a result of Mirant Mid-Atlantic s Chapter 11 filing.

The proposed Plan provides that, solely for purposes of the Plan, the Mirant Mid-Atlantic leases shall be treated as unexpired true leases under section 365 of the Bankruptcy Code. The proposed Plan further provides that on or before the effective date of the proposed Plan, the Mirant Mid-Atlantic leases will be assumed and all cure obligations and all obligations to provide adequate assurance of future performance will be satisfied as required by the Bankruptcy Code. Under the proposed Plan Mirant Mid-Atlantic will (i) assign the Mirant Mid-Atlantic leases to a legal entity that will be formed as a direct wholly-owned subsidiary of Mirant Mid-Atlantic (MD Leaseco) pursuant to section 365(f) of the Bankruptcy Code, and (ii) be relieved of any obligations under the Mirant Mid-Atlantic leases pursuant to section 365(k) of the Bankruptcy Code.

The Mirant Debtors believe that, with the possible limited exception of reimbursement of fees and expenses incurred by the owner lessors and the indenture trustee for the Mirant Mid-Atlantic leases, as of September 30, 2005, Mirant Mid-Atlantic was current with respect to all monetary obligations owing under the Mirant Mid-Atlantic leases. The owner lessors and the indenture trustee for the Mirant Mid-Atlantic leases have informed the Mirant Debtors that they incurred approximately $20 million in the aggregate of fees and expenses in connection with the Chapter 11 cases and that each will seek to have its respective share reimbursed as part of cure obligations of Mirant Mid-Atlantic owing upon assumption of the leases. Mirant Mid-Atlantic disputes that the full amount of such fees and expenses is compensable appropriately under the terms of the leases and pursuant to applicable law. To the extent that the Bankruptcy Court determines that all or part of such fees and expenses is due and owing under the leases and applicable law, Mirant Mid-Atlantic will pay such amounts before or upon assumption of the leases. The Mirant Debtors believe that no other obligations are required to be cured as a condition to assumption of the leases. The owner lessors and the indenture trustee for the Mirant Mid-Atlantic leases may assert that additional obligations remain owing or otherwise require cure. In such event, cure obligations of Mirant Mid-Atlantic will be subject to a determination of the Bankruptcy Court. Mirant Mid-Atlantic has reserved the right to seek alternative relief from the Bankruptcy Court, including a reconsideration of the recharacterization of the leases in the event Mirant Mid-Atlantic determines that such cure obligations are unduly burdensome. The impact of any of these events will be reflected in the Company s financial statements if and when they occur.

Mirant Mid-Atlantic has taken the position that certain provisions relating to the creditworthiness of the lessee contained in the lease documentation are unenforceable under applicable bankruptcy law on and after the effective date of the proposed Plan, as to Mirant Mid-Atlantic and MD Leaseco as Mirant Mid-Atlantic s assignee as de facto anti assignment clauses, provisions relating to the financial condition of the debtor and otherwise statutorily superseded by the debtor s (and its assignee s) obligation to provide adequate assurance of future performance upon assumption and assignment of the unexpired lease. These provisions (the unenforceable covenants), include the sections of the respective participation agreements relating to qualifying credit support, limitations on the incurrence of liens, limitations on the incurrence of indebtedness and limitations on the ability to make certain restricted payments, including dividends. Mirant Mid-Atlantic and MD Leaseco have reserved the right under the proposed Plan at any time, including after the effective date of the proposed Plan, to seek a determination that other provisions of the lease documentation are unenforceable under the Bankruptcy Code.

The Mirant Debtors anticipate that the owner lessors and the indenture trustee for the Mirant Mid-Atlantic leases will contest the assertions of the Mirant Debtors as to the unenforceability of the unenforceable covenants. In the event that the Bankruptcy Court were to determine that some or all of the unenforceable covenants are in fact enforceable against MD Leaseco upon assignment of the leases thereto, the Mirant Debtors have taken the position that as a result of such assignment, none of the unenforceable covenants will apply directly or indirectly to any entity that is not a wholly owned subsidiary of MD Leaseco, including Mirant Chalk Point, Mirant Potomac and Mirant Peaker. The Mirant Debtors anticipate that the owner lessors and the indenture trustee for the Mirant Mid-Atlantic leases will dispute such conclusions.

In connection with entry of the confirmation order with respect to the proposed Plan, the Mirant Debtors intend to seek from the Bankruptcy Court certain findings of fact and conclusions of law, as appropriate, providing that (i) the Dickerson leases constitute a single integrated transaction, (ii) the Morgantown leases constitute a single integrated transaction, (iii) the above referenced sections of the relevant participation agreement in respect of the leases are unenforceable against Mirant Mid-Atlantic or MD Leaseco, as assignee, pursuant to sections 365 (b) (2), (e) (1) and/or (f) (1) of the Bankruptcy Code, (iv) upon assignment of the leases, Mirant Chalk Point, LLC, Mirant Peaker and Mirant Potomac or any other entity other than a wholly owned subsidiary of MD Leaseco shall not be considered designated subsidiaries or subsidiaries as such terms are used in the relevant participation agreement in respect of the leases, and (v) any failure of Mirant Mid-Atlantic and/or MD Leaseco to comply with the unenforceable covenants shall not constitute a default or event of default under any of the leases. Further, the Mirant Debtors would seek an order from the Bankruptcy Court providing that all parties to the Mirant Mid-Atlantic leases are permanently enjoined from taking any action or exercising any remedies against any other party to the leases on account of the Mirant Debtors and/or MD Leaseco s failure to comply with the unenforceable covenants.

During the pendency of the chapter 11 cases, Mirant Mid-Atlantic has not made any distributions or other restricted payments and, thus, has not been required to determine and report the fixed charge coverage ratio (FCCR) under the Mirant Mid-Atlantic leases. The restricted payments test under the Mirant Mid-Atlantic lease documentation, described above under

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Restricted Payments , includes a historical look-back of actual business performance as well as a look forward component of projected performance. Pursuant to the terms of the lease documentation, Mirant Mid-Atlantic is, subject to certain conditions, permitted to reserve cash in a current period and treat such cash as available for the payment of capital expenditures in a future period. In the event that the Bankruptcy Court determines that the restricted payments provisions are enforceable against Mirant Mid-Atlantic or MD Leaseco on and after the effective date of the proposed Plan, for the purposes of determining the historical FCCR under the restricted payments test, Mirant Mid-Atlantic intends to treat EBITDA generated and not distributed during the chapter 11 cases as being reserved in such period for the payment of capital expenditures in future periods. Furthermore, ambiguity exists as to whether certain sources of income (or loss), such as unrealized mark-to-market gains and losses, should be considered in determining consolidated EBITDA, which is a component of the FCCR under the participation agreements. The Mirant Debtors believe that the phrase similar non-cash charges and reserves as used in the definition of consolidated EBITDA is intended to deduct all non cash income (or loss) when calculating consolidated EBITDA under the participation agreement. The inclusion or exclusion of these non-cash charges materially impacts the calculated EBITDA. As of September 30, 2005, Mirant Mid-Atlantic would be unable to make distributions and other restricted payments if certain non-cash charges were included in the calculation. It is a condition of the commitment of the lenders for the proposed revolving credit facility for Mirant North America that such lenders shall have received certification that Mirant Mid-Atlantic is not prohibited and not projected to be prohibited from making distributions or dividends. The Mirant Debtors are seeking a determination of the Bankruptcy Court in connection with the entry of the confirmation order that the interpretations set forth in this paragraph are fair and appropriate. In the event that the restricted payments test is not revised and continues to apply to Mirant Mid-Atlantic, the Bankruptcy Court does not make the requested determinations and the unrealized losses are included in the calculation of the restricted payments tests, the Mirant Debtors may not be able to emerge from bankruptcy under the proposed Plan.

The Mirant Debtors and the owner lessors have engaged in active discussions regarding the settlement of all disputes between the parties, including all issues relating to the assumption and assignment of the Mirant Mid-Atlantic leases by Mirant Mid-Atlantic to MD Leaseco, the enforceability of the unenforceable covenants and Mirant Mid-Atlantic s cure obligations and obligations to provide adequate assurance of future performance. To the extent the parties are unable to reach an affirmative agreement, to avoid the expense and risk associated with litigation of these complicated issues, the proposed Plan constitutes an offer of settlement by the Mirant Debtors, which, in light of the non-voting status of the owner lessors, will be deemed to have been accepted and consented to by the owner lessors unless confirmation of the proposed Plan is affirmatively objected to by any of the owner lessors. The terms of the proposed settlement include adequate assurance of future performance with respect to the Mirant Mid-Atlantic leases, (A) in lieu of assigning the leases to MD Leaseco, Mirant Mid-Atlantic will assume, affirm and agree to be bound from and after the effective date by the leases, including each section identified as an unenforceable covenant, except for (I) the restricted payments provisions shall be deemed to be unenforceable under sections 365(b)(2), (e)(1) and/or (f)(1) of the Bankruptcy Code, provided that in lieu thereof Mirant Mid-Atlantic will agree to be bound by the provisions thereof subject to (aa) the threshold of the fixed charge coverage ratio being lowered, (bb) consolidated EBITDA as used therein shall have the same meaning as set forth in the relevant documentation, except that the word similar shall be deleted, (cc) Mirant Mid-Atlantic may treat consolidated EBITDA generated and not distributed during the chapter 11 cases as being specifically reserved in such period for the payment of capital expenditures in future periods, and (dd) Mirant Mid-Atlantic may make restricted payments based upon the fixed charge coverage ratios for the most recently ended four full fiscal quarters for which financial statements are available, and (II) the provisions

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with respect to qualifying credit support in the lease documentation, shall be deemed to be unenforceable under sections 365(b)(2), (e)(1) and/or (f)(1) of the Bankruptcy Code, provided that in lieu thereof Mirant Mid-Atlantic will agree to be bound by the provisions thereof except that an irrevocable, unconditional, collateralized stand by letter of credit shall also constitute qualifying credit support as such term is used therein; and (B) as set forth in the proposed Plan, the Mirant Americas Series A Preferred Shares will be contributed to Mirant Mid-Atlantic.

If an affirmative agreement is reached, which agreement may differ materially from the proposed settlement set forth herein, Mirant Mid-Atlantic will seek appropriate approval of such agreement at or before the confirmation hearing and such agreement shall be deemed to be incorporated into the proposed Plan. Mirant Mid-Atlantic reserved the right to alter the structure of the proposed settlement, provided that such alteration does not have a material negative economic impact on the owner lessors as compared with the current proposed settlement structure, including providing for Mirant Mid-Atlantic to assume and assign the leases to MD Leaseco and to contribute all of its assets to MD Leaseco, including all of Mirant Mid-Atlantic s equity interests in Mirant Chalk Point, Mirant Potomac River and Mirant Peaker and providing for each to be considered a designated subsidiary or subsidiary under the leases.

The owner lessors and indenture trustee for the leases have not consented to, and oppose the proposals for assuming and assigning the leases under the proposed Plan. Such parties contend that, pursuant to section 365 of the Bankruptcy Code, the leases cannot be assumed and assigned in accordance with the Mirant Debtors proposal. The owner lessors and indenture trustee for the leases believe that the subject power plants are a critical component of the proposed Plan in that the proposed Plan assumes that the power plants will continue to be operated by Mirant Mid-Atlantic or its assignee post-confirmation. Further, the owner lessors and indenture trustee for the leases contend that Mirant Mid-Atlantic can perform all of its obligations under the leases pursuant to their present terms, including the terms and provisions which Mirant Mid-Atlantic seeks pursuant to the proposed Plan to eliminate or otherwise preclude the owner lessors and indenture trustee for the leases from enforcing pursuant to the proposed Plan. If the Bankruptcy Court does not permit Mirant Mid-Atlantic to assume and assign the leases pursuant to the terms and conditions proposed in the proposed Plan, or the Mirant Debtors and the owner lessors and indenture trustee for the leases do not reach an agreement on the terms and conditions of assumption, or assumption and assignment of the leases, confirmation of the proposed Plan may not be possible.

F. Debt

Jamaica Public Service Company Limited Debt

Jamaica Public Service Company Limited is in the process of renegotiating its purchased power agreement with Jamaica Energy Partners. The current agreement is treated as an operating lease with Jamaica Public Service Company Limited as the lessee. The current agreement is being renegotiated to extend the term another 20 years and to include a new unit that is expected to be completed in January 2006. The Company expects that the renegotiated agreement will be accounted for as a capital lease and that its total obligations over the term of the agreement will be approximately $347 million. The Company expects the agreement to be signed in late 2005.

Mirant Grand Bahama Limited Debt

Mirant Grand Bahama Limited is negotiating a new six year credit facility with the lender under its existing maturing credit facility. The lender has granted an extension of the maturity date of the existing facility from August 15, 2005 until November 15, 2005.

G. Litigation and Other Contingencies

The Company is involved in a number of significant legal proceedings. Some matters may be unresolved for several years. The Company cannot currently determine the outcome of the proceedings described below or the ultimate amount of potential losses and, therefore, has not made any material provision for such matters unless specifically noted below. Pursuant to SFAS No. 5, *Accounting for Contingencies*, management provides for estimated losses to the extent information becomes available indicating that losses are probable and that the amounts are reasonably estimable. Additional losses could have a material adverse effect on the Company s consolidated financial position, results of operations or cash flows.

Effect of Chapter 11 Proceedings

On July 14, 2003 and July 15, 2003 (the Petition Date), August 18, 2003, October 3, 2003 and November 18, 2003, the Mirant Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. As of the Petition Date, most pending litigation (including some of the actions described below) is stayed, and absent further order of the Bankruptcy Court, no party, subject to certain exceptions, may take any action, again subject to certain exceptions, to recover on pre-petition claims against the Mirant Debtors. One exception to this stay of litigation is for an action or proceeding by a governmental agency to enforce its police or regulatory power. The claims asserted in litigation and proceedings to which the stay applies may be fully and finally resolved in connection with the administration of the bankruptcy proceedings and, to the extent not resolved, will need to be addressed in the Plan. On November 19, 2003, the Bankruptcy Court entered an order staying most litigation pending against current or former officers, directors and managers of the Mirant Debtors arising out of the performance of their duties and against certain potential indemnitees of the Mirant Debtors. The Bankruptcy Court took that action to avoid the risk that the continuation of such litigation would impede the Mirant Debtors ability to reorganize or would have a negative impact upon the assets of the Mirant Debtors. At this time, it is not possible to predict the outcome of the Chapter 11 proceedings or their effect on the business of the Mirant Debtors or outstanding legal proceedings. The Mirant Debtors intend to resolve as many of these claims as possible through the claims resolution process in the bankruptcy proceeding or the Plan.

California and Western Power Markets

FERC Refund Proceedings: On July 25, 2001, the FERC issued an order requiring proceedings (the FERC Refund Proceedings) to determine the amount of any refunds and amounts owed for sales made by market participants, including Mirant Americas Energy Marketing, to the California Independent System Operator (the CAISO) or the California Power Exchange (the Cal PX) from October 2, 2000 through June 20, 2001 (the Refund Period). Various parties have appealed these FERC orders to the United States Court of Appeals for the Ninth Circuit (the Ninth Circuit) seeking review of a number of issues, including changing the Refund Period to include periods prior to October 2, 2000 and expanding the sales of electricity subject to potential refund to include bilateral sales made to the California Department of Water Resources (the DWR) and other parties. Any such expansion of the Refund Period or the types of sales of electricity potentially subject to refund could significantly increase the refund exposure of Mirant Americas Energy Marketing in this proceeding. Although Mirant Americas Energy Marketing is the Mirant entity that engaged in transactions with the CAISO and the Cal PX, the orders issued by the FERC in the refund proceedings, and the filings made by other parties in those proceedings, generally refer to the Mirant entity involved as Mirant without being more specific. Mirant believes that the Mirant entity that would actually be liable to third parties for any refunds determined by the FERC to be owed, or that would be due any receivables found to be owed to Mirant, is Mirant Americas Energy Marketing. Agreements that were in effect at the time of the transactions at issue between Mirant Americas Energy Marketing and the Mirant Americas Generation subsidiaries that own Mirant s generating facilities in California would shift some of the economic burden of such refunds or the benefit of such receivables from Mirant Americas Energy Marketing to those Mirant Americas Generation subsidiaries.

In the July 25, 2001 order, the FERC also ordered that a preliminary evidentiary proceeding be held to develop a factual record on whether there had been unjust and unreasonable charges for spot market bilateral sales in the Pacific Northwest from December 25, 2000 through June 20, 2001. In that proceeding, the California Attorney General, the California Public Utility Commission (the CPUC) and the California Electricity Oversight Board (the EOB) filed to recover certain refunds from parties, including Mirant Americas Energy Marketing, for bilateral sales of electricity to the DWR at the California/Oregon border, claiming that such sales took place in the Pacific Northwest. In an order issued June 25, 2003, the FERC ruled that no refunds were owed and terminated the proceeding. On November 10, 2003, the FERC denied requests for rehearing filed by various parties. Various parties have appealed the FERC s decision to the Ninth Circuit.

On September 9, 2004 the Ninth Circuit reversed the FERC s dismissal of a complaint filed in 2002 by the California Attorney General that sought refunds for transactions conducted in markets administered by the CAISO and the Cal PX outside the Refund Period set by the FERC and for transactions between the DWR and various owners of generation and power marketers, including Mirant Americas Energy Marketing and subsidiaries of Mirant Americas Generation. The Ninth Circuit remanded the proceeding to the FERC for it to determine what remedies, including potential refunds, are appropriate where entities, including Mirant Americas Energy Marketing, purportedly did not comply with certain filing requirements for transactions conducted under market-based rate tariffs. Mirant Americas Energy Marketing and other parties have filed a petition for rehearing with the Ninth Circuit.

On January 14, 2005, Mirant and certain of its subsidiaries entered into a Settlement and Release of Claims Agreement (the California Settlement) with Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas and Electric Company, the CPUC, the DWR, the EOB and the Attorney General of the State of California (collectively, the California Parties) and with the Office of Market Oversight and Investigations of the FERC. The California Settlement was approved by the FERC on April 13, 2005 and became effective April 15, 2005 upon its approval by the Bankruptcy Court. The California Settlement results in the release of most of Mirant Americas Energy Marketing s potential liability (1) in the FERC Refund Proceedings for sales made in the CAISO or the Cal PX markets, (2) in the proceeding also initiated by the FERC in July 2001 to determine whether there had been unjust and unreasonable charges for spot market bilateral sales in the Pacific Northwest from December 25, 2000 through June 20, 2001 and (3) in any proceedings at the FERC resulting from the Ninth Circuit s reversal of the FERC s dismissal of the complaint filed in 2002 by the California Attorney General. Under the California Settlement, the California Parties and those other market participants who have opted into the settlement have released Mirant and its subsidiaries from any liability for refunds related to sales of electricity and natural gas in the western markets from January 1, 1998 through July 14, 2003. Also, the California Parties will assume the obligation of Mirant Americas Energy Marketing to pay any refunds determined by the FERC to be owed by Mirant Americas Energy Marketing to other parties that do not opt into the settlement for transactions in the CAISO and Cal PX markets during the Refund Period, with the liability of the California Parties for such refund obligation limited to the amount of certain receivables assigned by Mirant Americas Energy Marketing to the California Parties under the California Settlement. Subject to applicable bankruptcy law, however, Mirant Americas Energy Marketing will continue to be liable for any refunds that FERC determines it to owe (1) to participants in the Cal PX and CAISO markets that are not California Parties (or that did not elect to opt into the settlement) for periods outside of the Refund Period and

(2) to participants in bilateral transactions with Mirant Americas Energy Marketing that are not California Parties (or that did not elect to opt into the settlement).

FERC Show Cause Proceeding Relating to Trading Practices: On June 25, 2003, the FERC issued a show cause order (the Trading Practices Order) to more than 50 parties, including Mirant Americas Energy Marketing and subsidiaries of Mirant Americas Generation, that a FERC staff report issued on March 26, 2003 identified as having potentially engaged in one or more trading strategies of the type employed by Enron Corporation and its affiliates (Enron), as described in Enron memos released by the FERC in May 2002. The Trading Practices Order identified certain specific trading practices that the FERC indicated could constitute gaming or anomalous market behavior in violation of the CAISO and Cal PX tariffs. The Trading Practices Order requires the CAISO to identify transactions between January 1, 2000 and June 20, 2001 that may involve the identified trading strategies, and then requires the applicable sellers involved in those transactions to demonstrate why such transactions were not violations of the CAISO and Cal PX tariffs. On September 30, 2003, the Mirant entities filed with the FERC for approval of a settlement agreement (the Trading Settlement Agreement) entered into between certain Mirant entities and the FERC Trial Staff, under which Mirant Americas Energy Marketing would pay $332,411 to settle the show cause proceeding, except for an issue related to selling of ancillary services, which is discussed below. In a November 14, 2003 order in a different proceeding, the FERC ruled that certain allegations of improper trading conduct with respect to the selling of ancillary services during 2000 should be resolved in the show cause proceeding. On December 19, 2003, the Mirant entities filed with the FERC for approval of an amendment to the Trading Settlement Agreement reached with the FERC Trial Staff with respect to the sale of ancillary services. Under that amendment the FERC would have an allowed unsecured claim in Mirant Americas Energy Marketing s bankruptcy proceeding for $3.67 million in settlement of the allegations with respect to the sale of ancillary services (the Ancillary Amount). The Trading Settlement Agreement, as amended, must be approved by the FERC and the Bankruptcy Court to become effective. On April 15, 2005 the California Settlement became effective, and, as a result, the California Parties withdrew their opposition to the Trading Settlement Agreement as amended and supported approval of the Trading Settlement Agreement as proposed by the Mirant entities that are parties to that agreement and the FERC Trial Staff without change or modification. The FERC approved the Trading Settlement Agreement, as amended, on June 27, 2005, and the Bankruptcy Court approved it on August 24, 2005. Certain parties have filed motions for rehearing with the FERC, which motions remain pending.

Shareholder-Bondholder Litigation

Mirant Securities Consolidated Action: Twenty lawsuits have been filed since May 2002 against Mirant and four of its officers alleging, among other things, that the defendants violated federal securities laws by making material misrepresentations and omissions to the investing public regarding Mirant s business operations and future prospects during the period from January 19, 2001 through May 6, 2002 due to potential liabilities arising out of its activities in California during 2000 and 2001. The complaints seek unspecified damages, including compensatory damages, and the recovery of reasonable attorneys fees and costs. These suits have been consolidated into a single action.

In November 2002, the plaintiffs filed an amended complaint that added as defendants Southern, the directors of Mirant immediately prior to its initial public offering of stock, and various firms that were underwriters for the initial public offering by the Company. In addition to the claims set out in the original complaint, the amended complaint asserts claims under the Securities Act of 1933, alleging that the registration statement and prospectus for the initial public offering of Mirant s stock misrepresented and omitted material facts. On July 14, 2003, the district court dismissed the claims asserted by the plaintiffs based on the Company s California business activities but allowed the case to proceed on the plaintiffs other claims. This action is stayed as to Mirant by the filing of its Chapter 11 proceeding. On November 19, 2003, the Bankruptcy Court entered an order staying this action also with respect to the other defendants to avoid the suit s impeding Mirant s ability to reorganize or having a negative effect upon Mirant s assets. The Bankruptcy Court has modified the stay to allow the plaintiffs to proceed with discovery of documentary materials from Mirant and the other defendants. On December 11, 2003, the plaintiffs filed a proof of claim against the estate of Mirant, which was subsequently withdrawn on or about October 10, 2004. On August 29, 2005, the district court, at the request of the plaintiffs, dismissed Mirant as a defendant in this action.

Under a master separation agreement between Mirant and Southern, Mirant is to indemnify Southern for any losses arising out of any acts or omissions by Mirant and its subsidiaries in the conduct of the business of Mirant and its subsidiaries. The underwriting agreements between Mirant and the various firms added as defendants that were underwriters for the initial public offering by the Company also provide for Mirant to indemnify such firms against any losses arising out of any acts or omissions by Mirant and its subsidiaries.

Shareholder Derivative Litigation: Four purported shareholders derivative suits have been filed against Mirant, its directors and certain officers of the Company. Two of those suits have been consolidated. These lawsuits allege that the directors breached their fiduciary duty by allowing the Company to engage in alleged unlawful or improper practices in the California energy markets in 2000 and 2001. The Company practices alleged in these lawsuits largely mirror those alleged with respect to the Company s activities in California in the shareholder litigation discussed above. One suit also alleges that the defendant officers engaged in insider trading. The complaints seek unspecified damages on behalf of the Company, including attorneys fees, costs and expenses and punitive damages. These actions are stayed as to Mirant by the filing of its Chapter 11 proceeding. The plaintiffs have not filed a claim in the Bankruptcy Court against the Company. On November 19, 2003, the Bankruptcy Court entered an order staying these actions also with respect to the individual defendants to avoid the suits impeding Mirant s ability to reorganize or having a negative effect upon Mirant s assets. On December 8, 2003, the court in one of the derivative suits, the Cichocki suit, took notice of the Bankruptcy Court s Order dated November 19, 2003 staying the litigation and administratively closed the action.

Mirant Americas Generation Bondholder Suit: On June 10, 2003, certain holders of senior notes of Mirant Americas Generation maturing after 2006 filed a complaint in the Court of Chancery of the State of Delaware*, California Public Employees Retirement System, et al. v. Mirant Corporation, et al.,* that named as defendants Mirant, Mirant Americas, Mirant Americas Generation, certain past and present Mirant directors, and certain past and present Mirant Americas Generation managers. Among other claims, the plaintiffs assert that a restructuring plan pursued by the Company prior to its filing a petition for reorganization under Chapter 11 of the Bankruptcy Code was in breach of fiduciary duties allegedly owed to them by Mirant, Mirant Americas and Mirant Americas Generation s managers. In addition, the plaintiffs challenge certain dividends and distributions made by Mirant Americas Generation prior to the Petition Date. The plaintiffs seek damages in excess of $1 billion. Mirant has removed this suit to the United States District Court for the District of Delaware. This action is stayed with respect to the Mirant entities that are defendants by the filing of the Chapter 11 proceedings of these entities. On November 19, 2003, the Bankruptcy Court entered an order staying this action also with respect to the individual defendants to avoid the suit impeding the ability of the Mirant Debtors to reorganize or having a negative effect upon the assets of the Mirant Debtors. The Mirant Americas Generation Creditor Committee in 2003 filed a motion in Mirant s bankruptcy proceedings seeking to pursue claims against Mirant, Mirant Americas, certain past and present Mirant directors, and certain past and present Mirant Americas Generation managers similar to those asserted in this suit. The Bankruptcy Court ruled that while the committee has standing to assert claims on behalf of the estate of Mirant Americas Generation, no such claims could be filed without the Bankruptcy Court s approval and no motions seeking such approval could be filed at least through April 2004. On June 15, 2005, the Mirant Americas Generation Creditor Committee again filed a motion in Mirant s bankruptcy proceedings seeking to pursue claims against Mirant, Mirant Americas, certain past and present Mirant directors, and certain past and present managers of the Company similar to those asserted in this suit. On June 30, 2005, the Bankruptcy Court issued an oral ruling that if the Mirant Debtors had not by July 8, 2005 entered into agreements with the individual defendants in this action tolling the running of any statute of limitations, then the Mirant Americas Generation Creditor Committee would be authorized to file claims against those defendants on behalf of the estate of Mirant Americas Generation. The Mirant Debtors did obtain tolling agreements from each of the individual defendants.

In December 2003, Lehman Commercial Paper Inc. (Lehman), as agent for various lenders under certain pre-petition credit agreements, filed a claim against Mirant Americas Generation in the bankruptcy proceedings. In December 2003, Wells Fargo Bank, N.A. (Wells Fargo) also filed claims in the bankruptcy proceedings as successor indenture trustee for bond indebtedness under a certain indenture against Mirant Americas Generation. In addition to their original claims, Lehman and Wells Fargo filed contingent, unliquidated supplemental claims against Mirant Americas Generation, Mirant and a number of other subsidiaries of Mirant (the Supplemental Claims) seeking recovery of principal, interest, fees, and costs under the Mirant Americas Generation loan documents and bond documents, respectively. In their Supplemental Claims, Lehman and Wells Fargo essentially seek to preserve whatever rights and remedies they may have, if any, based upon the claims previously sought to be asserted by the Mirant Americas Generation Creditor Committee or other claims identified through discovery.

On November 3, 2004, the Mirant Debtors objected to the Supplemental Claims against Mirant Americas Generation and the other Mirant entities on the grounds that: (1) Lehman and Wells Fargo lack standing to pursue the Supplemental Claims, which are derivative claims belonging to each respective Mirant Debtor s estate; (2) there is no factual basis for any of the potential causes of action against Mirant Americas Generation and no basis whatsoever for the claims against any other Mirant entities; and (3) the Supplemental Claims are duplicative and contingent. In addition to the objection, the Mirant Debtors also filed a motion to dismiss the Supplemental Claims on the basis that the Supplemental Claims do not allege any independent harm to Lehman and Wells Fargo and assert nothing more than derivative claims belonging to the Mirant Debtors estates that cannot be asserted by Lehman and Wells Fargo. The Bankruptcy Court issued an order on April 12, 2005, ruling that (A) the Supplemental Claims will be withdrawn without prejudice, (B) the date set by the Bankruptcy Court by which claims against the Mirant Debtors must be filed not to be barred is extended for the Supplemental Claims, to the extent that they are not property of the estates of or derivative of a Mirant Debtor (the Withdrawn Claims), through the date of confirmation of a plan in the Mirant Debtors Chapter 11 proceedings, (C) to the extent the Supplemental Claims are derivative, the rights of Lehman, Wells Fargo or any other party in interest to assert the Supplemental Claims or any issue relating thereto in connection with the confirmation of a plan of reorganization would be preserved and (D) the rights of Lehman, Wells Fargo and the Mirant Americas Generation Committee to seek leave to assert the Supplemental Claims would be preserved.

Mirant Americas Generation Securities Class Action: On June 11, 2003, a purported class action lawsuit alleging violations of Sections 11 and 15 of the Securities Act of 1933 was filed in the Superior Court of Fulton County, Georgia entitled *Wisniak v. Mirant Americas Generation, LLC, et al*. The lawsuit names as defendants Mirant Americas Generation and certain current and former

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officers and managers of Mirant Americas Generation. The plaintiff seeks to represent a putative class of all persons who purchased debt securities of Mirant Americas Generation pursuant to or traceable to an exchange offer completed by Mirant Americas Generation in May 2002 in which $750 million of bonds registered under the Securities Act of 1933 were exchanged for $750 million of previously issued senior notes of Mirant Americas Generation. The plaintiff alleges, among other things, that Mirant Americas Generation s restatement in April 2003 of prior financial statements rendered the registration statement filed for the May 2002 exchange offer materially false. The complaint seeks damages, interest and attorneys fees. The defendants have removed the suit to the United States District Court for the Northern District of Georgia. This action is stayed as to Mirant Americas Generation by the filing of its Chapter 11 proceeding. On November 19, 2003, the Bankruptcy Court entered an order staying this action also with respect to the individual defendants to avoid the suit impeding the ability of Mirant Americas Generation to reorganize or having a negative effect upon its assets. On December 8, 2003, the district court took notice of the Bankruptcy Court s order dated November 19, 2003 staying the litigation and administratively closed the action. On December 16, 2003, the plaintiff dismissed Mirant Americas Generation as a defendant, without prejudice, and filed a proof of claim against Mirant Americas Generation in the bankruptcy proceedings asserting the same claims set forth in the lawsuit.

Mirant Americas Generation and the plaintiff have entered into a stipulation of settlement of the Wisniak suit and the claim filed against Mirant Americas Generation that was approved by the Bankruptcy Court on January 19, 2005. Under the terms of the stipulation of settlement, the plaintiff will seek certification of a class by the district court that will receive $2.25 million to be paid by insurers for Mirant Americas Generation and an allowed, unsecured claim for $2 million against Mirant subordinated to the claims of its other unsecured creditors. On September 6, 2005 the district court entered an order approving the settlement and dismissing the action.

U.S. Government Inquiries

Department of Justice Inquiries: In November 2002, Mirant received a subpoena from the Department of Justice (DOJ), acting through the United States Attorney s office for the Northern District of California, requesting information about its activities and those of its subsidiaries for the period since January 1, 1998. The subpoena requested information related to the California energy markets and other topics, including the reporting of inaccurate information to the trade press that publish natural gas or electricity spot price data. The subpoena was issued as part of a grand jury investigation. The DOJ s investigation of the reporting of inaccurate natural gas price information is continuing, and we have held preliminary discussions with the DOJ regarding the disposition of this matter. The DOJ s investigation is based upon the same circumstances that were the subject of an investigation by the Commodities Futures Trading Commission (CFTC) that was settled in December 2004. As described in the Company s Annual Report on Form 10-K for the year ended December 31, 2004 in *Legal Proceedings Other Governmental Proceedings CFTC Inquiry*, Mirant and Mirant Americas Energy Marketing pursuant to the settlement consented to the entry of an order by the CFTC in which it makes findings, which are neither admitted or denied by Mirant and Mirant Americas Energy Marketing, that (1) from January 2000 through December 2001, certain Mirant Americas Energy Marketing natural gas traders (a) knowingly reported inaccurate price, volume, and/or counterparty information regarding natural gas cash transactions to publishers of natural gas indices and (b) inaccurately reported to index publishers transactions observed in the market as Mirant Americas Energy Marketing transactions and (2) from January to October 2000, certain Mirant Americas Energy Marketing west region traders knowingly delivered the false reports in an attempt to manipulate the price of natural gas. Under the settlement, the CFTC received a subordinated allowed, unsecured claim against Mirant Americas Energy Marketing of $12.5 million in the Chapter 11 proceedings. The DOJ could decide that further action against the

Company is not appropriate or could seek indictments against one or more Mirant entities, or the DOJ and the Company could agree to a disposition that might involve undertakings or fines, the amount of which cannot be reasonably estimated at this time but which could be material. The Company has fully cooperated with the DOJ and intends to continue to do so.

Department of Labor Inquiries: On August 21, 2003, the Company received a notice from the Department of Labor (the DOL) that it was commencing an investigation pursuant to which it was undertaking to review various documents and records relating to the Mirant Services Employee Savings Plan and the Mirant Services Bargaining Unit Employee Savings Plan. The DOL has interviewed Mirant personnel regarding those plans. The Company intends to continue to cooperate fully with the DOL.

Environmental Matters

EPA Information Request. In January 2001, the EPA issued a request for information to Mirant concerning the air permitting and air emissions control implications under the EPA s new source review regulations promulgated under the Clean Air Act (NSR) of past repair and maintenance activities at Mirant Potomac River s plant in Virginia and Mirant Mid-Atlantic s Chalk Point, Dickerson and Morgantown plants in Maryland. The requested information concerns the period of operations that predates the Company subsidiaries ownership and lease of the plants. Mirant has responded fully to this request. Under the sales agreement with PEPCO for those plants, PEPCO is responsible for fines and penalties arising from any violation associated with historical operations prior to the Company subsidiaries acquisition or lease of the plants. If a violation is determined to have occurred at any of the plants, the Company subsidiary owning or leasing the plant may be responsible for the cost of purchasing and installing emissions control equipment, the cost of which may be material. If such violation is determined to have occurred after the Company s subsidiaries acquired or leased the plants or, if occurring prior to the acquisition or lease, is determined to constitute a continuing violation, the Company subsidiary owning or leasing the plant at issue would also be subject to fines and penalties by the state or federal government for the period subsequent to its acquisition or lease of the plant, the cost of which may be material.

Mirant Potomac River Notice of Violation. On September 10, 2003, the Virginia Department of Environmental Quality (Virginia DEQ) issued a Notice of Violation (NOV) to Mirant Potomac River alleging that it violated its Virginia Stationary Source Permit to Operate by emitting nitrogen oxide (NOx) in excess of the cap established by the permit for the 2003 summer ozone season. Mirant Potomac River responded to the NOV, asserting that the cap is unenforceable, noting that it can comply through the purchase of emissions allowances and raising other equitable defenses. Virginia s civil enforcement statute provides for injunctive relief and penalties. On January 22, 2004, the EPA issued an NOV to Mirant Potomac River alleging the same violation of its Virginia Stationary Source Permit to Operate as set out in the NOV issued by the Virginia DEQ.

On September 27, 2004, Mirant Potomac River, Mirant Mid-Atlantic, the Virginia DEQ, the Maryland Department of the Environment, the DOJ and the EPA entered into, and filed for approval with the United States District Court for the Eastern District of Virginia, a consent decree that, if approved, will resolve Mirant Potomac River s potential liability for matters addressed in the NOVs previously issued by the Virginia DEQ and the EPA. The consent decree requires Mirant Potomac River and Mirant Mid-Atlantic to (1) install pollution control equipment at the Potomac River plant and at the Morgantown plant leased by Mirant Mid-Atlantic in Maryland, (2) comply with declining system-wide ozone season NOx emissions caps from 2004 through 2010, (3) comply with system-wide annual NOx emissions caps starting in 2004, (4) meet seasonal system average emissions rate targets in 2008 and (5) pay civil penalties and perform supplemental environmental projects in and around the Potomac River plant expected to achieve additional environmental benefits. Except for the installation of the controls planned for the Potomac River units and the installation of selective catalytic reduction (SCR) or equivalent technology at Mirant Mid-Atlantic s Morgantown Units 1 and 2 in 2007 and 2008, the consent decree does not obligate the Company s subsidiaries to install specifically designated technology, but rather to reduce emissions sufficiently to meet the various NOx caps. Moreover, as to the required installations of SCRs at Morgantown, Mirant Mid-Atlantic may choose not to install the technology by the applicable deadlines and leave the units off either permanently or until such time as the SCRs are installed. The aggregate amount of the civil penalties to be paid and costs to be incurred by Mirant Potomac River for the supplemental environmental projects is $1.5 million. The consent decree is subject to the approval of the district court and the Bankruptcy Court.

The owners/lessors under the lease-financing transactions covering the Morgantown and Dickerson plants (the Owners/Lessors) have objected to the proposed consent decree in the Bankruptcy Court and filed a motion to intervene in the district court action. The Owners/Lessors argue that the consent decree unjustly imposes financial hardships on them and significantly affects the economic value of the Morgantown and Dickerson plants by requiring capital investments to install pollution control equipment and imposing significant operating limitations.

On July 22, 2005, the district court granted a motion filed by the City of Alexandria seeking to intervene in the district court action, although the district court imposed certain limitations on the City of Alexandria s participation in the proceedings. On September 23, 2005, the City of Alexandria filed a motion seeking authority to file an amended complaint in the action seeking injunctive relief and civil penalties under the Clean Air Act for alleged violations by Mirant Potomac River of its Virginia Stationary Source Permit To Operate and the State of Virginia s State Implementation Plan. Based upon a computer modeling, the City of Alexandria asserts that emissions from the Potomac River plant exceed national ambient air quality standards (NAAQS) for sulfur dioxide (SO2), nitrogen dioxide (NO2), and particulate matter. The City of Alexandria also contends based on its modeling analysis that the plant s emissions of hydrogen chloride and hydrogen fluoride exceed Virginia state emission standards. Mirant Potomac River disputes the City of Alexandria s allegations that it has violated the Clean Air Act and Virginia law.

Mirant Potomac River Downwash Study. On September 23, 2004, the Virginia DEQ and Mirant Potomac River entered into an order by consent with respect to the Potomac River plant under which Mirant Potomac River agreed to perform a modeling analysis to assess the potential effect of downwash from the plant (1) on ambient concentrations of SO2, NO2, carbon monoxide (CO) and particulate matter less than or equal to 10 micrometers (PM10) for comparison to the applicable NAAQS and (2) on ambient concentrations of mercury for comparison to Virginia Standards of Performance for Toxic Pollutants. Downwash is the effect that occurs when aerodynamic turbulence induced by nearby structures causes pollutants from an elevated source, such as a smokestack, to be mixed rapidly toward the ground resulting in higher ground level concentrations of pollutants. If the modeling analysis indicates that emissions from the facility may cause exceedances of the NAAQS for SO2, NO2, CO or PM10, or exceedances of mercury compared to Virginia Standards of Performance for Toxic Pollutants, the consent order requires Mirant Potomac River to submit to the Virginia DEQ a plan and schedule to eliminate and prevent such exceedances on a timely basis. Upon approval by the Virginia DEQ of the plan and schedule, the approved plan and schedule is to be incorporated by reference into the consent order. The results of the computer modeling analysis showed that emissions from the Potomac River plant have the potential to contribute to localized, modeled instances of exceedances of the NAAQS for SO2, NO2 and PM10 under certain conditions. In response to a directive from the Virginia DEQ, Mirant Potomac River temporarily shut down the Potomac River plant on August 24, 2005 pending identification and implementation of modifications to the plant or its operations, which modifications could be material. On September 21, 2005, Mirant Potomac River commenced partial operation of one unit of the plant. The financial and operational implications of the discontinued or limited operation of the Potomac River plant or any such modifications are not known at this time, but could be material depending on the length of time that operations are discontinued or limited.

City of Alexandria Nuisance Suit. On October 7, 2005, the City of Alexandria filed a suit against Mirant Potomac River and Mirant Mid-Atlantic in the Circuit Court for the City of Alexandria. The suit asserts nuisance claims, alleging that the Potomac River plant s emissions of coal dust, fly ash, NOx, SO2, particulate matter, hydrogen chloride, hydrogen fluoride, mercury and oil pose a health risk to the surrounding community and harm property owned by the City. The City seeks injunctive relief, damages and attorneys fees.

Mirant NY-Gen Pipeline Leak. In the fall of 2003, Mirant NY-Gen discovered a leaking underground pipeline at the Hillburn generating facility in Ramapo, New York. The underground line was used for supplying kerosene fuel to the gas turbines located on site. After confirmatory testing revealed a potential leak, the line was removed from service and plans were undertaken to excavate and sample portions of the line to determine the extent of the line damage and the possible soil contamination. Upon initial discovery, the leak was reported to the New York State Department of Environmental Conservation (NYSDEC) and the Rockland County Health Department. In the summer of 2004 soil contamination was discovered and a subsequent testing of portions of the line revealed a small hole.

On May 19, 2005, the NYSDEC issued a Notice of Hearing and Complaint to Mirant NY-Gen seeking an order requiring Mirant NY-Gen to implement its approved remediation plan, to pay all costs relating to the cleanup (including all costs incurred by the NYSDEC), and to pay a civil penalty in the amount of $100,000. On August 1, 2005, Mirant NY-Gen and the NYSDEC entered into a consent order regarding the remediation of the pipeline leak. That consent order requires Mirant NY-Gen to (1) determine to what extent, if any, the leak impacted the groundwater in the area of the Hillburn facility and (2) design and install equipment to remediate impacted soil and groundwater. Mirant NY-Gen and the NYSDEC entered into a second consent order on September 15, 2005 to address penalties and cost reimbursement to the NYSDEC relating to the remediation of the pipeline leak. Under the September 15, 2005 consent order, Mirant NY-Gen will (1) pay a penalty of $50,000, (2) reimburse the NYSDEC for costs to date and future costs in an amount not to exceed $20,000 and (3) pay costs associated with an independent, third-party environmental audit of the Hillburn facility, which is expected to cost approximately $35,000. The consent orders were approved on September 22, 2005.

Currently, investigations are continuing to determine the extent of contamination and possible remedial activities to clean up the area. Additionally, Mirant NY-Gen is working under the direction of the NYSDEC to remove all free product contamination from the groundwater and undertake remediation actions for additional on-site and off-site contamination. The current estimate of the cost of cleanup and subsequent monitoring is at least $3 million; however, due to the ongoing evaluation to determine the extent of the off-site contamination, the exact cost of remediation is unknown at this time.

Riverkeeper Suit Against Mirant Lovett. On March 11, 2005, Riverkeeper, Inc. filed suit against Mirant Lovett in the United States District Court for the Southern District of New York under the Federal Water Pollution Control Act (the Clean Water Act). The suit alleges that Mirant Lovett s failure to implement a marine life exclusion system at its Lovett generating plant and to perform monitoring for the exclusion of certain aquatic organisms from the plant s cooling water intake structures violates Mirant Lovett s water discharge permit issued by the State of New York. The plaintiff requests the court to enjoin Mirant Lovett from continuing to operate the Lovett generating plant in a manner that allegedly violates the Clean Water Act, to impose civil penalties of $32,500 per day of violation, and to award the plaintiff attorney s fees. On April 20, 2005, the district court approved a stipulation agreed to by the plaintiff and Mirant Lovett that stays the suit until 60 days after entry of an order by the Bankruptcy Court confirming a plan of reorganization for Mirant Lovett becomes final and non-appealable.

PEPCO Assertion of Breach of Local Area Support Agreement

Following the shut down of the Potomac River plant on August 24, 2005, Mirant Potomac River notified PEPCO on August 30, 2005 that it considered the circumstances resulting in the shut down of the plant to constitute a force majeure event under the Local Area Support Agreement dated December 19, 2000 between PEPCO and Mirant Potomac River. That agreement imposes obligations upon Mirant Potomac River to dispatch the Potomac River plant under certain conditions, to give PEPCO several years advance notice of any indefinite or permanent shutdown of the plant, and to pay all or a portion of certain costs incurred by PEPCO for transmission additions or upgrades when an indefinite or permanent shutdown of the plant occurs prior to December 19, 2010. On September 13, 2005, PEPCO notified Mirant Potomac River that it considers Mirant Potomac River s shutdown of the plant to be a material breach of the Local Area Support Agreement that is not excused under the force majeure provisions of the agreement. Mirant Potomac River disputes PEPCO s interpretation of the agreement. The outcome of this matter cannot be determined at this time.

City of Alexandria Zoning Action

On December 18, 2004, the City Council for the City of Alexandria, Virginia (the City Council) adopted certain zoning ordinance amendments recommended by the City Planning Commission that result in the zoning status of Mirant Potomac River s generating plant being changed from noncomplying use to nonconforming use subject to abatement. Under the nonconforming use status, unless Mirant Potomac River applies for and is granted a special use permit for the plant during the seven-year abatement period, the operation of the plant must be terminated within a seven-year period, and no alterations that directly prolong the life of the plant will be permitted during the seven-year period. If Mirant Potomac River were to apply for and receive a special use permit for the plant, the City Council would likely impose various conditions and stipulations as to the permitted use of the plant and seek to limit the period for which it could continue to operate.

At its December 18, 2004 meeting, the City Council also approved revocation of two special use permits issued in 1989 (the 1989 SUPs), one applicable to the administrative office space at Mirant Potomac River s plant and the other for the plant s transportation management plan. Under the terms of the approved action, the revocation of the 1989 SUPs was to take effect 120 days after the City Council revocation, provided, however, that if Mirant Potomac River within such 120-day period filed an application for the necessary special use permits to bring the plant into compliance with the zoning ordinance provisions then in effect, the effective date of the revocation of the 1989 SUPs would be stayed until the final decision by the City Council on such application. The approved action further provides that if such special use permit application is approved by the City Council, revocation of the 1989 SUPs will be dismissed as moot, and if the City Council does not approve the application, the revocation of the 1989 SUPs will become effective and the plant will be considered a nonconforming use subject to abatement. On July 7, 2005, the Circuit Court for the City of Alexandria entered a consent order agreed to by the City of Alexandria and Mirant Potomac River in the suit described in the next paragraph that extends through October 17, 2005 the period within which Mirant Potomac River may file an application for the necessary special use permits. The City of Alexandria and Mirant Potomac River have submitted to the court for its approval another consent order that would further extend that time period to January 31, 2006.

On January 18, 2005, Mirant Potomac River and Mirant Mid-Atlantic filed a complaint against the City of Alexandria and the City Council in the Circuit Court for the City of Alexandria. The complaint seeks to overturn the actions taken by the City Council on December 18, 2004 changing the zoning status of Mirant Potomac River s generating plant and approving revocation of the 1989 SUPs, on the grounds that those actions violated federal, state and city laws. The complaint asserts, among other things, that the actions taken by the City Council constituted unlawful spot zoning, were arbitrary and capricious, constituted an unlawful attempt by the City Council to regulate emissions from the plant, and violated Mirant Potomac River s due process rights. Mirant Potomac River and Mirant Mid-Atlantic request the court to enjoin the City of Alexandria and the City Council from taking any enforcement action against Mirant Potomac River or from requiring it to obtain a special use permit for the continued operation of its generating plant.

New York Tax Proceedings

The Company s subsidiaries that own generating plants in New York are or were (in the settled proceedings discussed below) the petitioners in 41 proceedings (Tax Certiorari Proceedings) initially brought in various New York state courts challenging the assessed value of those generating plants determined by their respective local taxing authorities. Mirant Bowline has challenged the assessed value of the Bowline generating facility and the resulting local tax assessments paid for tax years 1995 through 2003. Mirant Bowline succeeded to rights held by Orange & Rockland Utilities, Inc. (Orange & Rockland) for the tax years prior to its acquisition of the Bowline Plant in 1999 under its agreement with Orange & Rockland for the purchase of that plant. Mirant Lovett has initiated proceedings challenging the assessed value of the Lovett facility for each of the years 2000 through 2003. Mirant NY-Gen (collectively with Mirant Bowline and Mirant Lovett, the New York Debtors) has settled its tax certiorari proceedings with respect to the combustion turbine and hydroelectric facilities it owns for each of the years 2000 through 2003. If the remaining Tax Certiorari Proceedings result in a reduction of the assessed value of the generating facility at issue in each proceeding, the New York Debtor owning the facility would be entitled to a refund with interest of any excess taxes paid for those tax years.

On September 30, 2003, the Mirant Debtors filed a motion (the Tax Determination Motion) with the Bankruptcy Court requesting that it determine what the property tax liability should have been for the Bowline generating facility in each of the years 1995 through 2003, for the Lovett generating facility in each of the years 2000 through 2003, and for the generating facilities owned by Mirant NY-Gen in each of the years 2000 through 2003. The bases for the relief requested in the Tax Determination Motion on behalf of each of the New York Debtors were that the assessed values of generating facilities located in New York made by the relevant taxing authorities had no justifiable basis and were far in excess of their actual value. The local taxing authorities have opposed the Tax Determination Motion, arguing that the Bankruptcy Court either lacks jurisdiction over the matters addressed by the Tax Determination Motion or should abstain from addressing those issues so that they can be addressed by the state courts in which the Tax Certiorari Proceedings described in the preceding paragraph were originally filed.

Collectively, the New York Debtors have not paid approximately $62 million assessed by local taxing authorities on the Bowline and Lovett generating facilities for 2003, which fell due on September 30, 2003 and January 30, 2004, and approximately $53 million assessed by local taxing authorities on the generating facilities for 2004 that fell due on September 30, 2004 and January 30, 2005, and approximately $45 million assessed by local taxing authorities on the generating facilities for 2005 that fell due on September 30, 2005, in order to preserve their respective rights to offset the overpayments of taxes made in earlier years against the sums payable on account of current taxes. The failure to pay the taxes due on September 30, 2003, January 30, 2004, September 30, 2004, January 30, 2005 and September 30, 2005 could subject Mirant Bowline and Mirant Lovett to additional penalties and interest.

All of the Tax Certiorari Proceedings related to the generating facilities owned by Mirant NY-Gen have been resolved on terms favorable to the New York Debtors, but the Tax Certiorari Proceedings related to the Bowline and Lovett generating facilities remain unresolved.

Other Legal Matters

The Company is involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company s financial position, results of operations or cash flows.

Other Contingencies

On May 5, 2005, Mirant NY-Gen discovered a sinkhole at its Swinging Bridge dam, located in Sullivan County, New York. In response to finding the sinkhole, Mirant NY-Gen filled this sinkhole, inspected the dam s penstock and slopes for damage, drew down the lake level by 40 feet, and cleaned the diversion tunnel. Mirant NY-Gen s analysis indicates that the most probable cause of the sinkhole was erosion of soil comprising the dam through a hole in the penstock. The dam is currently stabilized, but is in need of additional repairs before lake levels can be restored to normal. Mirant NY-Gen currently expects to spend approximately $11 million in order to properly repair the dam, but the cost of the repairs could be in excess of this amount. It expects these repairs to be complete by the second quarter of 2006. Mirant NY-Gen currently expects to recover insurance proceeds equal to a significant portion of these repair costs. As a result of the sinkhole, Mirant NY-Gen was required to perform and provide to the FERC a flood study relating to the Swinging Bridge, Rio and Mongaup reservoirs to determine the maximum capacity of the reservoirs and the down stream consequences of a rain event resulting in a greater than the maximum capacity event. The flood study found that under the very extreme weather conditions assumed for the study (which included rainfall over a short period in amounts well in excess of the highest rainfall amounts recorded for such a period historically), the water flowing into the reservoirs could cause the level of the reservoirs to exceed the height of the dams at Mirant NY-Gen s hydro facilities, leading to downstream flooding. Mirant NY-Gen is evaluating the results of the flood study and determining what modifications may be warranted to its hydro facilities based on those results. The costs of such modifications, if any are necessary, are unknown at this time, but could be significant. Mirant NY-Gen may remain in Chapter 11 until these matters are resolved.

Enron Bankruptcy Proceedings

Since December 2, 2001, Enron and a number of its subsidiaries have filed for bankruptcy. Mirant has filed formal claims in the Enron bankruptcy proceedings. The Company currently estimates it will recover approximately $22 million as part of Enron s approved plan of reorganization. Upon ultimate receipt of these amounts, the Company expects to record a gain of

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approximately $17 million. In October 2005, the Company received approximately $3 million in distributions on certain of its claims.

H. Earnings (Loss) Per Share

Mirant calculates basic earnings (loss) per share by dividing the income (loss) available to common shareholders by the weighted average number of common shares outstanding. Diluted earnings (loss) per share gives effect to dilutive potential common shares, including stock options, convertible notes and debentures and convertible trust preferred securities. The following table shows the computation of basic and diluted earnings (loss) per share for the three and nine months ended September 30, 2005 and 2004 (in millions, except per share data):

	Three Months Ended September 30, 2005	2004	Nine Months Ended September 30, 2005	2004
(Loss) income from continuing operations	$ (1,518)	$ 43	$ (1,521)	$ 159
Income (loss) from discontinued operations	3	(11)	7	(65)
Net (loss) income	$ (1,515)	$ 32	$ (1,514)	$ 94
Basic and Diluted:				
Weighted average shares outstanding	405.5	405.5	405.5	405.5
(Loss) earnings per share from:				
Continuing operations	$ (3.75)	$ 0.11	$ (3.75)	$ 0.39
Discontinued operations	0.01	(0.03)	0.02	(0.16)
Net (loss) income per share	$ (3.74)	$ 0.08	$ (3.73)	$ 0.23

The following potential common shares were excluded from the earnings per share calculations (in millions):

	Three Months Ended September 30, 2005	2004	Nine Months Ended September 30, 2005	2004
Out-of-the-money options	14.9	16.6	15.2	18.2
Shares issuable upon conversion of convertible debt	58.6	58.6	58.6	58.6
Shares issuable upon conversion of convertible trust preferred securities	12.5	12.5	12.5	12.5
Total	86.0	87.7	86.3	89.3

As discussed in Note B, the Company plans to cancel the existing common stock as part of its proposed Plan.

Stock-Based Compensation

Mirant accounts for its stock-based employee compensation plans under the intrinsic-value method of accounting for recognition, but discloses pro forma fair value information. Under this method, compensation expense for employee stock options is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. The following table illustrates the effect on net income or loss if the fair value-based method had been applied to all outstanding and unvested awards in each period (in millions, except per share data):

	Three Months Ended September 30, 2005	2004	Nine Months Ended September 30, 2005	2004
Net (loss) income, as reported	$ (1,515)	$ 32	$ (1,514)	$ 94
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effects	(1)	(3)	(3)	(9)
Pro forma net (loss) income	$ (1,516)	$ 29	$ (1,517)	$ 85
(Loss) income per share:				
Basic as reported	$ (3.74)	$ 0.08	$ (3.73)	$ 0.23
Basic pro forma	$ (3.74)	$ 0.07	$ (3.74)	$ 0.21
Diluted as reported	$ (3.74)	$ 0.08	$ (3.73)	$ 0.23
Diluted as pro forma	$ (3.74)	$ 0.07	$ (3.74)	$ 0.21

As discussed in Note A, the Company will change its accounting for stock-based employee compensation upon its adoption of SFAS 123R.

I. Segment Reporting

The Company has two reportable segments: North America and International. The North America segment consists of the Company s power generation and energy trading and marketing operations in the United States. The International segment includes power generation in the Philippines, Curacao and Trinidad and Tobago, and integrated utility operations in the Bahamas and Jamaica. The Company s reportable segments are strategic businesses that are geographically separated and managed independently.

Financial Data by Segment
(in millions)

Three Months Ended September 30, 2005:

	North America	International	Corporate and Eliminations	Consolidated
Operating Revenues by Product and Service:				
Generation	$ 558	$ 120	$	$ 678
Integrated utilities and distribution		202		202
Total operating revenues	558	322		880
Cost of fuel, electricity and other products	594	123		717
Gross Margin	(36)	199		163
Operating Expenses:				
Operations and maintenance	176	76	(3)	249
Depreciation and amortization	42	30	4	76
Impairment losses and restructuring charges	2		1	3
Loss on sales of assets, net	2			2
Total operating expenses	222	106	2	330
Operating (Loss) Income	$ (258)	$ 93	$ (2)	(167)
Other expense, net				(1,179)
Loss from Continuing Operations Before Reorganization Items and Income Taxes and Minority Interest				(1,346)
Reorganization items, net				109
Provision for income taxes				56
Minority interest				7
Loss from Continuing Operations				$ (1,518)
Total assets at September 30, 2005	$ 9,820	$ 4,721	$ (1,659)	$ 12,882

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Nine Months Ended September 30, 2005:

	North America	International	Corporate and Eliminations	Consolidated
Operating Revenues by Product and Service:				
Generation	$ 1,788	$ 364	$	$ 2,152
Integrated utilities and distribution		543		543
Total operating revenues	1,788	907		2,695
Cost of fuel, electricity and other products	1,361	319		1,680
Gross Margin	427	588		1,015
Operating Expenses:				
Operations and maintenance	536	212	(15)	733
Depreciation and amortization	125	92	13	230
Impairment losses and restructuring charges	12		1	13
Loss (gain) on sales of assets, net	29	(2)		27
Total operating expenses	702	302	(1)	1,003
Operating (Loss) Income	$ (275)	$ 286	$ 1	12
Other expense, net				(1,222)
Loss from Continuing Operations Before Reorganization Items and Income Taxes and Minority Interest				(1,210)
Reorganization items, net				203
Provision for income taxes				88
Minority interest				20
Loss from Continuing Operations				$ (1,521)
Total assets at September 30, 2005	$ 9,820	$ 4,721	$ (1,659)	$ 12,882

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Three Months Ended September 30, 2004:

	North America	International	Corporate and Eliminations	Consolidated
Operating Revenues by Product and Service:				
Generation	$ 857	$ 117	$	$ 974
Integrated utilities and distribution		147		147
Total operating revenues	857	264		1,121
Cost of fuel, electricity and other products	510	74		584
Gross Margin	347	190		537
Operating Expenses:				
Operations and maintenance	148	74	17	239
Depreciation and amortization	42	30	5	77
Impairment losses and restructuring charges	3	(1)	7	9
Loss on sales of assets, net	65			65
Total operating expenses	258	103	29	390
Operating Income	$ 89	$ 87	$ (29)	147
Other expense, net				(20)
Income from Continuing Operations Before Reorganization Items and Income Taxes and Minority Interest				127
Reorganization items, net				62
Provision for income taxes				17
Minority interest				5
Income from Continuing Operations				$ 43
Total assets at December 31, 2004	$ 9,354	$ 4,730	$ (2,660)	$ 11,424

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Nine Months Ended September 30, 2004:

	North America	International	Corporate and Eliminations	Consolidated
Operating Revenues by Product and Service:				
Generation	$ 2,796	$ 356	$	$ 3,152
Integrated utilities and distribution		417		417
Total operating revenues	2,796	773		3,569
Cost of fuel, electricity and other products	1,874	211		2,085
Gross Margin	922	562		1,484
Operating Expenses:				
Operations and maintenance	531	215	(12)	734
Depreciation and amortization	125	91	15	231
Impairment losses and restructuring charges	6		10	16
Loss on sales of assets, net	50			50
Total operating expenses	712	306	13	1,031
Operating Income	$ 210	$ 256	$ (13)	453
Other expense, net				(36)
Income from Continuing Operations Before Reorganization Items and Income Taxes and Minority Interest				417
Reorganization items, net				192
Provision for income taxes				49
Minority interest				17
Income from Continuing Operations				$ 159
Total assets at December 31, 2004	$ 9,354	$ 4,730	$ (2,660)	$ 11,424

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Item 2. *Management s Discussion and Analysis of Results of Operations and Financial Condition*

The following discussion should be read in conjunction with Mirant s unaudited condensed consolidated financial statements and the notes thereto, which are included elsewhere in this report.

Overview

We operate as a debtor-in-possession under the jurisdiction of the Bankruptcy Court in accordance with Chapter 11 of the Bankruptcy Code. As a result, our financial statements include the results of Bankruptcy Court actions, probable claims against our estate and professional and administrative costs related to the bankruptcy process.

On January 19, 2005, we filed our initial proposed plan of reorganization with the Bankruptcy Court, which we amended on March 25, 2005. On September 7, 2005 the Mirant Debtors reached an agreement with a number of the key constituencies in their Chapter 11 case, including all three Statutory Committees, regarding the terms upon which the Mirant Debtors will emerge from bankruptcy protection. A Second Amended Plan and a Second Amended Disclosure Statement were filed on September 22, 2005, which was subsequently updated on September 30, 2005. The proposed Plan sets forth the proposed structure of the Mirant Debtors at emergence and outlines how the claims of creditors and stockholders are proposed to be treated. On September 30, 2005, the Bankruptcy Court approved the Disclosure Statement and authorized its use in connection with the solicitation of votes on the proposed Plan from those creditors, security holders and interest holders who are entitled to vote on the proposed Plan. At this time, we are unable to predict the timing of our emergence from bankruptcy protection.

Our financial results for the three and nine months ended September 30, 2005 reflect the impact of sharply higher energy prices, particularly during the third quarter when hurricane activity and above normal temperatures in the Eastern United States caused fuel prices and power prices to rise drastically. Specifically, for the quarter our results include:

- $470 million of unrealized losses, primarily attributable to forward economic hedge positions of our U.S. generating assets. As power prices increased in the third quarter, we recognized losses on short power positions used to hedge the expected output of our power plants. A significant portion of these positions relate to the fourth quarter of 2005 and to 2006 and the losses are expected to reverse as we generate power and settle these positions in future periods;

- $697 million of cash used to collaterize our economic hedge positions noted above, which reduced operating cash flow in 2005. Similar to the income statement effect of these hedge positions, the collateral flow is expected to reverse in later periods as these positions settle in future periods, resulting in increased operating cash flow in such periods. As of September 30, 2005, we had approximately $969 million of cash and drawn letters of credit, as well as $7 million in pre-petition letters of credit and $60 million in debtor-in-possession letters of credit, being utilized to secure energy trading and marketing activities and had approximately $1.1 billion of additional cash and lines of credit available for ongoing liquidity needs.

Excluding the above described financial effect of unrealized economic hedges, our North America segment performed better in the third quarter of 2005 compared to the same period in 2004. We achieved a $114 million increase in realized gross margin that stems from higher energy prices, increased generation volumes, and above normal temperatures in the Eastern United States in the summer of 2005.

Our International segment operating income was $6 million higher for the third quarter of 2005 compared to the same period in 2004. The improved 2005 financial performance stems from the impact of higher sales volumes in the Caribbean and a rate increase in our Philippine energy supply business. Despite improved financial performance in 2005, high oil prices have slowed sales growth and contributed to increased line losses in Jamaica.

In the third quarter of 2005, we recognized $1.2 billion of interest on liabilities subject to compromise for the period from the Petition Date through September 30, 2005. We determined that it was probable that contractual interest on liabilities subject to compromise from the Petition Date would be incurred for certain claims expected to be allowed under the Plan. The interest amount was calculated based on the provisions of the proposed Plan. See Note B for additional discussion of the proposed Plan.

Financial Performance

We reported an operating loss of $167 million and operating income of $12 million for the three and nine months ended September 30, 2005, respectively, compared to operating income of $147 million and $453 million for the same periods in 2004. The $314 million and $441 million decreases in operating income, respectively, are detailed as follows (in millions):

	Favorable/(Unfavorable) **Three Months Ended September 30,**	**Nine Months Ended September 30,**
Gross margin(1)	$ (374)	$ (469)
Operations and maintenance	(10)	1
Depreciation and amortization	1	1
Other impairment losses and restructuring charges	6	3
Loss on sales of assets, net(2)	63	23
Change in operating income	$ (314)	$ (441)

(1) For the three and nine months ended September 30, 2005 and 2004, our gross margin included the following (in millions):

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
	2005	**2004**	**Increase/ (Decrease)**	**2005**	**2004**	**Increase/ (Decrease)**
Realized gross margin	$ 633	$ 459	$ 174	$ 1,406	$ 1,107	$ 299
TPA amortization		51	(51)	9	284	(275)
Unrealized gross margin:						
Unrealized (losses) gains on PPAs	63	4	59	101	152	(51)
Net unrealized gains (losses) on asset management, optimization and legacy portfolios	(533)	23	(556)	(501)	(59)	(442)
Net unrealized gross margin	(470)	27	(497)	(400)	93	(493)
Total gross margin	$ 163	$ 537	$ (374)	$ 1,015	$ 1,484	$ (469)

(2) For the three months ended September 30, 2004, we had a loss on sales of assets, net of $65 million related to the sale of three natural gas combustion turbines. For the nine months ended

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September 30, 2005, we had a $27 million loss on sales of assets, net primarily related to the suspended construction projects that we sold or expect to sell. For the nine months ended September 30, 2004, we had a loss on sales of assets, net of $50 million, primarily related to the sale of three natural gas combustion turbines offset by a gain on the sale of our remaining Canadian natural gas transportation contracts and certain natural gas marketing contracts.

Results of Operations

The following discussion of our performance is organized by reportable operating segment, which is consistent with the way we manage our business.

North America

Our North America segment consists primarily of power generation (approximately 14,000 MW of generating capacity) and energy trading and marketing activities managed as a combined business.

The following table summarizes the operations of our North America segment for the three and nine months ended September 30, 2005 and 2004 (in millions):

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
	2005	**2004**	**Increase/ (Decrease)**	**2005**	**2004**	**Increase/ (Decrease)**
Gross margin	$ (36)	$ 347	$ (383)	$ 427	$ 922	$ (495)
Operating expenses:						
Operations and maintenance	176	148	28	536	531	5
Depreciation and amortization	42	42		125	125	
Impairment losses and restructuring charges	2	3	(1)	12	6	6
Loss on sales of assets, net	2	65	(63)	29	50	(21)
Total operating expenses	222	258	(36)	702	712	(10)
Operating (loss) income	$ (258)	$ 89	$ (347)	$ (275)	$ 210	$ (485)

The following table summarizes gross margin by region for our North America segment for the three and nine months ended September 30, 2005 and 2004 (in millions):

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
	2005	**2004**	**Increase/ (Decrease)**	**2005**	**2004**	**Increase/ (Decrease)**
Mirant Americas Generation:						
Mid-Atlantic	$ (99)	$ 107	$ (206)	$ 120	$ 298	$ (178)
Northeast	(113)	101	(214)	8	202	(194)
West and other	38	51	(13)	100	135	(35)
Total Mirant Americas Generation	(174)	259	(433)	228	635	(407)
Other North America generation	99	69	30	173	145	28
TPA amortization		51	(51)	9	284	(275)
Other, including TPAs and PPAs	39	(32)	71	17	(142)	159
Total	$ (36)	$ 347	$ (383)	$ 427	$ 922	$ (495)

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The following table summarizes capacity factor (average percentage of full capacity used over a specific period) by region for our North America segment for the three and nine months ended September 30, 2005 and 2004:

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ (Decrease)	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ (Decrease)
Mirant Americas Generation:						
Mid-Atlantic	57 %	48 %	9 %	44 %	46 %	(2)%
Northeast	40 %	30 %	10 %	34 %	35 %	(1)%
West	21 %	22 %	(1)%	14 %	20 %	(6)%
Other North America generation	25 %	18 %	7 %	16 %	15 %	1 %
Total North America	37 %	27 %	10 %	28 %	30 %	(2)%

The following table summarizes power generation volumes by region for our North America segment for the three and nine months ended September 30, 2005 and 2004 (in gigawatt hours):

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ (Decrease)	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ (Decrease)
Mirant Americas Generation:						
Mid-Atlantic	5,331	4,530	801	12,420	12,976	(556)
Northeast	2,712	2,062	650	6,843	7,089	(246)
West	1,322	1,394	(72)	2,583	3,782	(1,199)
Other North America generation	2,257	1,598	659	4,404	3,983	421
Total North America	11,622	9,584	2,038	26,250	27,830	(1,580)

Three Months ended September 30, 2005 versus 2004

Gross Margin. Our gross margin decreased by $383 million for the three months ended September 30, 2005 compared to the same period for 2004. The following table details gross margin by realized and unrealized margin for the three months ended September 30, 2005 and 2004 (in millions):

	Three Months Ended September 30, 2005			Three Months Ended September 30, 2004		
	Realized	Unrealized	Total	Realized	Unrealized	Total
Mirant Americas Generation:						
Mid-Atlantic	$ 174	$ (273)	$ (99)	$ 135	$ (28)	$ 107
Northeast	81	(194)	(113)	55	46	101
West and other	41	(3)	38	50	1	51
Total Mirant Americas Generation	296	(470)	(174)	240	19	259
Other North America generation	98	1	99	75	(6)	69
TPA amortization				51		51
Other, including TPAs and PPAs	40	(1)	39	(46)	14	(32)
Total	$ 434	$ (470)	$ (36)	$ 320	$ 27	$ 347

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The following table summarizes the change in realized and unrealized gross margin for the three months ended September 30, 2005 compared to same period in 2004 (in millions):

	Increase/(Decrease) for Three Months Ended September 30, 2005 versus 2004		
	Realized	Unrealized	Total
Mirant Americas Generation:			
Mid-Atlantic	$ 39	$ (245)	$ (206)
Northeast	26	(240)	(214)
West and other	(9)	(4)	(13)
Total Mirant Americas Generation	56	(489)	(433)
Other North America generation	23	7	30
TPA amortization	(51)		(51)
Other, including TPAs and PPAs	86	(15)	71
Total	$ 114	$ (497)	$ (383)

- During the three months ended September 30, 2005, most of our generating facilities had increased realized gross margin primarily due to higher energy prices which contributed to wider conversion spreads. In addition, our volumes increased due to warmer weather in the third quarter of 2005 that increased demand. This increase in energy demand allowed certain cycling and peaking generating units to run more in 2005.

- We also recorded significant unrealized losses on power sales contracts for future periods used to economically hedge our future generation due to large price increases on short power positions during the period. A significant portion of these positions relate to the fourth quarter of 2005 and to 2006 and the losses are expected to reverse as we generate power and settle these positions in future periods. For forward contracts physically settled, the unrealized loss will be reversed and we will also recognize and receive revenue based on the fixed price of the forward contract in the period that we deliver the power. For contracts financially settled, we will settle the contracts and separately recognize and receive the spot market price for power generated and delivered. The financial impact is the same in that we realize the fixed price for which we previously contracted (through the use of a financial instrument to provide an economic hedge of our expected generation output).

- Mid-Atlantic operations gross margin decreased $206 million primarily due to the following:

- An increase of $39 million in realized gross margin primarily due to higher commodity prices and 18% higher generation volumes. Conversion spreads were wider in 2005 due to warmer weather in this region and the impact of hurricane activity on natural gas prices used to fuel power plants. Significant components of the $39 million increase are as follows:

- An increase of $267 million related to higher spot market prices for electricity. Average peak prices in the Pennsylvania-New Jersey-Maryland Interconnection, LLC (PJM) market increased by 116% and off-peak prices increased by 82%.

- An increase of $17 million due to higher prices for ancillary services.

- An increase of $7 million due to higher generation volumes.

- A decrease of $182 million related to the settlement of electricity contracts used to economically hedge our generation output during this period. This reflects the increase in spot market prices mentioned above coupled with our strategy of hedging a large portion of our expected generation.

- A decrease of $61 million related to higher unit prices for fuel. This includes the impact of a change in the mix of generation, with the wider conversion spreads resulting in gas and oil fired generation increasing in greater proportion than coal fired generation.

- A decrease of $6 million due to realized economic hedging of gas and oil.

- A decrease of $3 million due to lower prices for capacity.

- A decrease of $245 million related to unrealized losses from derivative instruments utilized to economically hedge expected generation in future periods.

- Our Northeast operations gross margin decreased by $214 million primarily due to the following:

- An increase of $26 million in realized gross margin primarily due to higher power prices, net of losses on power hedges, exceeding the impact of higher fuel prices, net of gains on fuel hedges. Significant components of the $26 million increase were as follows:

- An increase of $135 million related to higher spot market prices for electricity. Peak prices in the spot markets for power increased an average of 92% and off-peak power prices increased by an average of 75%.

- An increase of $29 million due to settlements on contracts to economically hedge our fuel costs during the period.

- An increase of $5 million related to adjustments received from the ISO in the current period related to 2000-2003.

- An increase of $5 million due to the receipt of insurance proceeds related to an outage at the Bowline facility in 2004.

- An increase of $4 million related to capacity income earned under a new reliability-must-run (RMR) contract for our Kendall facility.

- A decrease of $80 million related to the settlement of electricity contracts used to economically hedge our generation output during the period. This reflects the increase in spot market prices mentioned above coupled with our strategy of hedging a large portion of our generation.

- A decrease of $69 million related to higher unit prices for fuel. This includes the impact of a change in the mix of generation, with the wider conversion spreads resulting in gas and oil fired generation increasing in greater proportion than coal fired generation.

- A decrease of $5 million due to lower capacity prices.

- A decrease of $240 million related to net unrealized losses on derivative instruments utilized to economically hedge expected generation in future periods.

- Our West and other operations gross margin decreased by $13 million primarily due to the following:

- A decrease of $9 million in realized gross margin which includes the following significant components:

- An increase of $4 million in tolling revenue in Texas due to the full quarter impact in 2005 of a tolling agreement entered into in August 2004.

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- A decrease of $11 million due to the expiration of an RMR contract for one of our California generation facilities and a reduction in the amounts received for the remaining facilities, partially offset by capacity income received under a new tolling agreement.

- A decrease of $3 million as a result of lower gains on settlements of power hedges and merchant generation activity.

- A decrease of $4 million related to net unrealized losses on derivative instruments.

- Our other North America generation gross margin increased by $30 million primarily due to the following:

- An increase of $23 million in realized gross margin which includes the following significant components:

- An increase of $48 million related to higher spot market prices for electricity and increases in generation volumes.

- An increase of $11 million due to higher tolling and capacity payments.

- An increase of $4 million related to reduced emissions expenses.

- An increase of $3 million due to gas sales.

- An increase of $2 million due to higher prices for ancillary services.

- A decrease of $31 million due to higher fuel prices and increased generation.

- A decrease of $9 million related to realized losses on power hedges.

- A decrease of $7 million due to realized losses on fuel hedges.

- An increase of $7 million related to lower unrealized losses on derivative instruments in the three months ended September 30, 2004.

- Non-cash revenue related to the amortization of the transition power agreements (TPAs) decreased by $51 million due to the expiration of one TPA in June 2004 and the remaining TPA in January 2005.

- Other gross margin increased by $71 million primarily due to the following:

- An increase of $15 million in realized margin due to the expiration of the remaining TPA.

- A decrease of $15 million in net unrealized losses primarily relating to the PPAs with PEPCO, contracts used to economically hedge the PPAs and oil contracts.

- An increase of $71 million primarily related to lower realized losses on the PPAs with PEPCO and to gross margin from trading and marketing activities.

Operating Expenses. Our operating expenses decreased by $36 million for the three months ended September 30, 2005 compared to the same period in 2004. The following factors were responsible for the changes in operating expenses:

- An increase of $28 million in operations and maintenance expense primarily due to:

- An increase of $3 million in corporate costs allocated to the North America segment in 2005. Corporate expenses allocated were $33 million in 2005 compared to $30 million in 2004.

• An increase of $11 million related to maintenance and repair costs in part due to higher generation volumes and other operating expenses.

• An increase of $18 million due to a $10 million reduction in the reserve related to receivables from Enron and $8 million of property tax settlements related to certain California and New York generation assets in 2004.

• A decrease of $5 million due to additional rent expense in 2004 for our Morgantown and Dickerson baseload units.

• A decrease in loss on sales of assets, net of $63 million. A loss on sales of assets, net of $65 million in 2004 relates to the sale of three natural gas combustion turbines.

Nine Months ended September 30, 2005 versus 2004

Gross Margin. Our gross margin decreased by $495 million for the nine months ended September 30, 2005 compared to the same period for 2004. The following table details gross margin by realized and unrealized margin for the nine months ended September 30, 2005 and 2004 (in millions):

	Nine Months Ended September 30, 2005			**Nine Months Ended September 30, 2004**		
	Realized	**Unrealized**	**Total**	**Realized**	**Unrealized**	**Total**
Mirant Americas Generation:						
Mid-Atlantic	$ 383	$ (263)	$ 120	$ 393	$ (95)	$ 298
Northeast	189	(181)	8	154	48	202
West and other	102	(2)	100	133	2	135
Total Mirant Americas Generation	674	(446)	228	680	(45)	635
Other North America generation	171	2	173	165	(20)	145
TPA amortization	9		9	284		284
Other, including TPAs and PPAs	(27)	44	17	(300)	158	(142)
Total	$ 827	$ (400)	$ 427	$ 829	$ 93	$ 922

The following table summarizes the change in realized and unrealized gross margin for the nine months ended September 30, 2005 compared to same period in 2004 (in millions):

	Increase/(Decrease) for Nine Months Ended September 30, 2005 versus 2004		
	Realized	**Unrealized**	**Total**
Mirant Americas Generation:			
Mid-Atlantic	$ (10)	$ (168)	$ (178)
Northeast	35	(229)	(194)
West and other	(31)	(4)	(35)
Total Mirant Americas Generation	(6)	(401)	(407)
Other North America generation	6	22	28
TPA amortization	(275)		(275)
Other, including TPAs and PPAs	273	(114)	159
Total	$ (2)	$ (493)	$ (495)

- During the nine months ended September 30, 2005 we recognized significant unrealized losses on power sales contracts for future periods used to economically hedge our expected future generation primarily due to large price increases on short power positions during the period, partially offset by the recognition of the fair value of certain coal contracts in the second quarter of 2005. A significant portion of these positions relate to the fourth quarter of 2005 and to 2006 and the losses are expected to reverse as we generate power and settle these positions in future periods. For forward contracts physically settled, the unrealized loss will be reversed and we will also recognize and receive revenue based on the fixed price of the forward contract in the period that we deliver the power. For contracts financially settled, we will settle the contracts and separately recognize and receive the spot market price for power generated and delivered. The financial impact is the same in that we realize the fixed price for which we previously contracted (through the use of a financial instrument to provide an economic hedge of our expected generation output).

- Our realized gross margin was relatively unchanged for the nine months ended September 30, 2005 due to generally lower gross margin in the first six months of 2005 but higher gross margin in the third quarter.

- Mid-Atlantic operations gross margin decreased $178 million primarily due to the following:

- A decrease of $10 million in realized gross margin primarily due to narrower conversion spreads in the first two quarters and the consequent reduction in generation volumes, partially offset by the widening of the conversion spread and the increased generation volumes in the third quarter. Overall for the nine months ended September 30, 2005, generation volumes were 4% less than for the same period in 2004. Significant components of the $10 million decrease are as follows:

- An increase of $329 million related to higher spot market prices for electricity. Average peak prices in the PJM market increased by an average of 44% and off-peak prices increased by an average of 36%.

- An increase of $26 million due to higher prices for ancillary services.

- An increase of $13 million due to a net settlement with a coal supplier related to rail car transportation schedule issues that resulted in lower fuel expense.

- An increase of $6 million due to the 2005 sale of a power option for 2006.

- A decrease of $250 million related to settlement of electricity contracts used to economically hedge our generation output during the period. This reflects the increase in spot market prices mentioned above coupled with our strategy of hedging a large portion of our expected generation.

- A decrease of $84 million related to higher unit prices for fuel.

- A decrease of $27 million due to lower generation volumes.

- A decrease of $10 million related to the settlement of fuel contracts used to economically hedge some of our fuel purchase requirements.

- A decrease of $7 million resulting from reduced emissions prices for SO2 and NOx emissions allowances.

- A decrease of $5 million due to lower capacity prices.

- A decrease of $168 million related to higher unrealized losses from derivative instruments of $263 million in 2005 compared to unrealized losses of $95 million in 2004.

The $263 million loss in 2005 was net of a $6 million loss due to the sale of a power option for 2006.

- Our Northeast operations gross margin decreased by $194 million primarily due to the following:

- An increase of $35 million in realized gross margin primarily due to higher power prices, net of losses on power hedges, exceeding the impact of higher fuel prices, net of gains on fuel hedges and the effects of a 3% reduction in generation volumes. Significant components are as follows:

- An increase of $178 million related to higher spot market prices for electricity. Peak prices in the spot markets for power increased an average of 38% and off-peak power prices increased by an average of 36%.

- An increase of $45 million due to settlements on contracts to economically hedge our fuel costs.

- An increase of $8 million related to capacity income earned under a new RMR contract for our Kendall facility.

- An increase of $5 million related to ISO adjustments from 2000-2003.

- An increase of $5 million due to the receipt of insurance proceeds related to an outage at the Bowline facility in 2004.

- An increase of $3 million due to a reduction in gas transport costs.

- A decrease of $114 million related to higher unit prices for fuel.

- A decrease of $66 million related to settlement of electricity contracts used to economically hedge our generation output during the period. This reflects the increase in spot market prices mentioned above coupled with our strategy of hedging a large portion of our expected generation.

- A decrease of $13 million due to lower generation volumes.

- A decrease of $10 million due to lower net gains on gas sales in 2005 compared to 2004.

- A decrease of $8 million due to lower capacity prices.

- A decrease of $229 million related to net unrealized losses on derivative instruments.

- Our West and other operations gross margin decreased by $35 million primarily due to the following:

- A decrease of $31 million in realized gross margin which includes the following significant components:

- An increase of $8 million due to the elimination of intercompany emissions allowance purchases.

- A decrease of $21 million due to the expiration of an RMR contract for one of our California generation facilities partially offset by capacity income received under a new tolling agreement for that unit and one other California generating unit.

- A decrease of $17 million due to the effect on RMR income of an extended planned outage of one of our California units, as well as lower contractual prices being received under the 2005 RMR agreement.

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- A decrease of $1 million as a result of lower gains on settlements of power hedges and merchant generation activity.

- A decrease of $4 million related to net unrealized losses on derivative instruments utilized to economically hedge expected generation in future periods.

- Our other North America generation gross margin increased by $28 million primarily due to the following:

- An increase of $6 million in realized gross margin which includes the following significant components:

- An increase of $60 million related to higher spot market prices for electricity.

- An increase of $6 million due to higher prices for ancillary services.

- An increase of $5 million related to greater payments received for tolling and capacity.

- An increase of $5 million related to lower ISO and other costs at our Las Vegas facility.

- An increase of $4 million related to reduced emissions expenses.

- A decrease of $30 million related to higher unit prices for fuel.

- A decrease of $25 million due to lower generation volumes.

- A decrease of $22 million related to losses on realized power hedges.

- An increase of $22 million related to lower unrealized losses on derivative instruments in the nine months ended September 30, 2004.

- Non-cash revenue related to the amortization of the TPAs decreased by $275 million due to the expiration of one TPA in June 2004 and the remaining TPA in January 2005.

- Other gross margin increased by $159 million primarily due to the following:

- An increase of $215 million primarily related to lower realized losses due to the expiration of the TPAs. Realized losses related to the TPAs in 2005 were $8 million compared to $223 million in 2004.

- A decrease of $114 million in net unrealized gains primarily relating to the PPAs with PEPCO, contracts used to economically hedge the PPAs and oil contracts.

- An increase of $58 million primarily related to lower realized losses on the PPAs with PEPCO and to gross margin from trading and marketing activities.

Operating Expenses. Our operating expenses decreased by $10 million for the nine months ended September 30, 2005 compared to the same period in 2004 primarily due to:

- An increase of $5 million in operations and maintenance expense primarily due to:

- A decrease of $24 million in corporate costs allocated to the North America segment in 2005. As a result of efforts to reduce corporate overhead expenses, corporate expenses allocated were $102 million in 2005 compared to $126 million in 2004.

- An increase of $15 million in other operating expenses in 2005 related to maintenance and environmental remediation costs and other operating expenses.

• An increase of $18 million due to a $10 million reduction in the reserve related to receivables from Enron and $8 million of property tax settlements related to certain California and New York generation assets in 2004.

• A decrease of $5 million due to additional rent expense in 2004 for our Morgantown and Dickerson baseload units.

• An increase of $6 million in impairment losses and restructuring charges due to an impairment charge of $12 million in 2005 relating to suspended construction project costs for Wyandotte that are not included in the expected sale of those assets and other suspended construction projects. In 2004, we recognized a $6 million impairment charge primarily related to software that we no longer utilized.

• A decrease of $21 million in loss on sales of assets, net primarily due to 2005 losses of $21 million on the sale of Wyandotte, $7 million loss on the sale of Mint Farm, a suspended construction project that we sold in October 2005 and $1 million related to leasehold improvements. See Note C to our unaudited condensed consolidated financial statements contained elsewhere in this report for further discussion. The loss on sales of assets, net of $50 million in 2004 primarily related to a loss of $65 million related to the sale of three natural gas combustion turbines offset by a gain of $16 million related to the sale of our remaining Canadian natural gas transportation contracts and certain natural gas marketing contracts.

International

Our International segment consists of power generating operations in the Philippines, Curacao and Trinidad and Tobago and our integrated utilities in Jamaica and the Bahamas. The following table summarizes the operations of our International businesses for the three and nine months ended September 30, 2005 and 2004 (in millions):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2005	**2004**	**Increase/ (Decrease)**	**2005**	**2004**	**Increase/ (Decrease)**
Operating revenues:						
Generation	$ 120	$ 117	$ 3	$ 364	$ 356	$ 8
Integrated utilities and distribution	202	147	55	543	417	126
Total operating revenues	322	264	58	907	773	134
Cost of fuel, electricity and other products	123	74	49	319	211	108
Gross margin	199	190	9	588	562	26
Operating expenses:						
Operations and maintenance	76	74	2	212	215	(3)
Depreciation and amortization	30	30		92	91	1
Impairment losses and restructuring charges		(1)	1			
Gain on sales of assets, net				(2)		(2)
Total operating expenses	106	103	3	302	306	(4)
Operating income	$ 93	$ 87	$ 6	$ 286	$ 256	$ 30

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The following table summarizes gross margin by operations for our International segment for the three and nine months ended September 30, 2005 and 2004 (in millions):

	Three Months Ended September 30, 2005	2004	Increase/ (Decrease)	Nine Months Ended September 30, 2005	2004	Increase/ (Decrease)
Philippines	$ 117	$ 113	$ 4	$ 353	$ 346	$ 7
Caribbean	82	77	5	235	216	19
Total International	$ 199	$ 190	$ 9	$ 588	$ 562	$ 26

The following table summarizes capacity factor (average percentage of full capacity used over a specific period) by operations for our International segment for the three and nine months ended September 30, 2005 and 2004:

	Three Months Ended September 30, 2005	2004	Increase/ (Decrease)	Nine Months Ended September 30, 2005	2004	Increase/ (Decrease)
Philippines	37 %	38 %	(1)%	40 %	38 %	2 %
Caribbean	52 %	49 %	3 %	50 %	50 %	%

The following table summarizes power generation volumes by operations for our International segment for the three and nine months ended September 30, 2005 and 2004 (in gigawatt hours):

	Three Months Ended September 30, 2005	2004	Increase/ (Decrease)	Nine Months Ended September 30, 2005	2004	Increase/ (Decrease)
Philippines	1,590	1,623	(33)	5,088	4,943	145
Caribbean	2,163	2,050	113	6,277	6,169	108

Three Months ended September 30, 2005 versus 2004

Gross Margin. Our gross margin increased by $9 million primarily due to the following:

- An increase of $4 million in the Philippine operations gross margin primarily due to rate increases for our energy supply business and an actualization adjustment on Sual revenue levelization in August 2004 resulting from updated effective capacity rates.

- An increase of $5 million in the Caribbean operations gross margin primarily due to higher residential and commercial sales at our Grand Bahamas Power and Jamaica integrated utilities, partially offset by fuel costs that are not passed on to customers.

Operating Expenses. Our operating expenses increased by $3 million primarily due to an increase of $2 million in corporate costs allocated to the International segment in the 2005 period. Corporate expenses allocated were $7 million in 2005 compared to $5 million in 2004. Other increases include a valuation allowance of $4 million on the payment in the third quarter of 2005 to the Philippine local government unit relating to the Sual power plant. In 2005, we had a $1 million decrease in hurricane related maintenance at our Caribbean operations. Other decreases in our Caribbean operations include $2 million due to a reclassification of pension surplus from other expense, net in our unaudited condensed consolidated statements of operations.

Nine Months ended September 30, 2005 versus 2004

Gross Margin. Our gross margin increased by $26 million primarily due to the following:

- An increase of $7 million in the Philippine operations gross margin primarily due to rate increases for our energy supply business, a higher capacity factor for the Pagbilao power plant and an actualization adjustment on Sual revenue levelization in August 2004 resulting from updated effective capacity rates.

- An increase of $19 million in the Caribbean operations gross margin primarily due to rate increases in non-fuel tariffs at our Jamaica integrated utility in June 2004, and higher energy consumption. These increases were partially offset by higher system losses and higher fuel costs, a portion of which are not being passed on to customers.

Operating Expenses. Our operating expenses decreased by $4 million for the nine months ended September 30, 2005 compared to the same period in 2004 primarily due to the following:

- A decrease of $3 million in operation and maintenance expenses, which reflects a decrease of $6 million in corporate costs allocated to the International segment in the 2005 period. Corporate expenses allocated were $21 million in 2005 compared to $27 million in 2004. This decrease is partially offset by a valuation allowance of $11 million on the conditional payments in 2005 to the Philippine local government units relating to the Pagbilao and Sual power plants and a decrease in our Caribbean operations of $5 million due to a reclassification of pension surplus from other expense, net in our unaudited condensed consolidated statements of operations. In 2005, we had a $1 million decrease in hurricane related maintenance at our Caribbean operations.

- Gain on sale of assets of $2 million in 2005 primarily relates to assets sold to a subsidiary of Mirant Global Corporation (MGC), a joint venture in the Philippines with First Metro Investment Corporation Group.

Corporate

The following table summarizes our corporate expenses for the three and nine months ended September 30, 2005 and 2004 (in millions):

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Increase/ (Decrease)	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Increase/ (Decrease)
Operating (credits) expenses:						
Operations and maintenance	$ (3)	$ 17	$ (20)	$ (15)	$ (12)	$ (3)
Depreciation and amortization	4	5	(1)	13	15	(2)
Other impairment losses and restructuring charges	1	7	(6)	1	10	(9)
Total operating expenses (credits)	$ 2	$ 29	$ (27)	$ (1)	$ 13	$ (14)

The corporate operating expenses for the three months ended September 30, 2005 and three and nine months ended September 30, 2004 represent the amount of costs incurred in excess of billings to operating segments during this period. The corporate operating credits for the nine months ended September 30, 2005 represent the amount of billings to operating segments in excess of costs incurred during this period. Before allocations to operating segments, our corporate expenses in total are $14 million and $37 million lower through the three and nine months ended

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September 30, 2005, respectively, compared to the same period in 2004. These decreases are primarily due to cost cutting efforts and reflect lower insurance expense and consulting fees.

Other Significant Consolidated Statements of Operations Changes

The following table summarizes our consolidated other income and expenses for the three and nine months ended September 30, 2005 and 2004 (in millions):

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
	2005	**2004**	**Increase/ (Decrease)**	**2005**	**2004**	**Increase/ (Decrease)**
Other (expense) income, net:						
Interest expense	$ (1,198)	$ (32)	$ (1,166)	$ (1,261)	$ (98)	$ (1,163)
Equity in income of affiliates	8	6	2	22	19	3
Interest income	10	3	7	22	8	14
Other, net	1	3	(2)	(5)	35	(40)
Total other (expense) income, net	$ (1,179)	$ (20)	$ (1,159)	$ (1,222)	$ (36)	$ (1,186)
Reorganization items, net	$ 109	$ 62	$ 47	$ 203	$ 192	$ 11
Provision for income taxes	56	17	39	88	49	39
Minority interest	7	5	2	20	17	3
Income (loss) from discontinued operations, net	3	(11)	14	7	(65)	72

Three Months ended September 30, 2005 versus 2004

Interest Expense. Interest expense increased by $1.2 billion primarily due to the recognition in 2005 of $1.2 billion of interest on liabilities subject to compromise for the period from the Petition Date through September 30, 2005. See Note B to our unaudited condensed consolidated financial statements contained elsewhere in this report for further discussion.

Reorganization items, net. Reorganization items, net represents expense or income amounts that were recorded in the financial statements as a result of the bankruptcy proceedings.

- For the three months ended September 30, 2005, this amount includes:

- $84 million loss related to changes in estimated claims including a $26 million increase in the estimated claim related to a rejected natural gas transportation agreement and $62 million due to the write-off of unamortized issuance costs related to debt included in liabilities subject to compromise;

- $32 million in professional and administrative fees; and

- $7 million of interest income and other gains, net.

- For the three months ended September 30, 2004, this amount includes:

- $44 million loss related to estimated damage claims on rejected and amended contracts;

- $22 million in professional and administrative fees; and

- ($4) million in other (gains) losses partially offset by interest income.

Provision for Income Taxes. Provision for income taxes increased by $39 million for the three months ended September 30, 2005, compared to the same period in 2004 mainly due to an increase in our tax contingencies related to its Philippine operations. We currently record a tax provision for

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foreign income taxes as appropriate but record no tax benefit for losses for federal and state income tax purposes in the United States.

Discontinued Operations. The $11 million loss from discontinued operations for the three months ended September 30, 2004 includes the generating facilities we expected to dispose of in 2004 and/or 2005.

Nine Months ended September 30, 2005 versus 2004

Interest Expense. Interest expense increased by $1.2 billion primarily due to the recognition in 2005 of $1.2 billion of interest on liabilities subject to compromise for the period from the Petition Date through September 30, 2005. See Note B to our unaudited condensed consolidated financial statements contained elsewhere in this report for further discussion.

Other, net. Other, net decreased by $40 million due to a gain of $38 million in 2004 related to the extinguishment of $83 million of our 2.5% convertible debentures due 2021 that were included in liabilities subject to compromise. The remaining decrease is primarily due to higher foreign currency losses in 2005 compared to same period in 2004.

Reorganization items, net. Reorganization items, net represents expense or income amounts that were recorded in the financial statements as a result of the bankruptcy proceedings.

- For the nine months ended September 30, 2005, this amount includes:
- $141 million loss related to changes in estimated claims;
- $32 million gain related to the California Settlement;
- $116 million in professional and administrative fees; and
- $22 million of interest income and other gains, net.
- For the nine months ended September 30, 2004, this amount includes:
- $134 million loss related to estimated damage claims on rejected and amended contracts;
- $74 million in professional and administrative fees; and
- $16 million of interest income and other gains, net.

Provision for Income Taxes. Provision for income taxes increased by $39 million for the nine months ended September 30, 2005, compared to the same period in 2004 primarily due to a $17 million benefit in 2005 related to a tax settlement with the Dutch Tax Authorities for our Netherlands subsidiaries and an $11 million benefit related to amendments to our U.S. Federal income tax returns for the years 1999 through 2001. As part of the Dutch settlement, Mirant has agreed to forgo the net operating loss carryforwards in the Netherlands in the amount of $510 million which had previously been valued at $0 in our financial statements. These benefits are primarily offset by a change in the Philippine income tax rate resulting in a provision of $12 million and an increase in income at our Philippine and Caribbean operations resulting in an additional provision of $14 million in 2005 as compared with 2004. Other increases include $39 million of tax contingencies primarily related to our Philippine s operations and $2 million of benefits recorded in 2004 related to a prior period. We currently record a tax provision for foreign income taxes as appropriate but record no tax benefit for losses for federal and state income tax purposes in the United States.

Discontinued Operations. The $7 million income and $65 million loss from discontinued operations for the nine months ended September 30, 2005 and 2004, respectively, include the disposal of the Coyote Springs 2 and Wrightsville facilities and certain suspended construction projects. The loss in 2004 is primarily related to an impairment charge of $48 million at the Coyote Springs 2 facility. See Note C to our unaudited condensed consolidated financial statements contained elsewhere in this report for further discussion.

Financial Condition

Liquidity and Capital Resources

The matters described in this section relate to future events or expectations and may be significantly affected by the Chapter 11 proceedings. The Chapter 11 proceedings have resulted in various restrictions on our activities, including limitations on financing, the need to obtain Bankruptcy Court approval for various matters and uncertainty as to relationships with vendors, suppliers, customers and others with whom we may conduct or seek to conduct business. Upon exiting from bankruptcy, we will no longer be subject to these restrictions.

The Company and its subsidiaries continue to participate in the intercompany cash management program for the Mirant Debtors approved by the Bankruptcy Court and to be parties to the debtor-in-possession credit facility, dated November 5, 2003 (the DIP Facility). The parties to the DIP Facility, including the Company, were in compliance with the DIP Facility covenants, or had received affirmative waivers of compliance where compliance was not attained, as of September 30, 2005. The borrowing base as of December 31, 2004 was $724 million. The borrowing base decreased $48 million in January 2005 and decreased another $37 million in September 2005, following the consummation of sales of certain assets of Mirant. In addition, the Company estimates that the reserve for property taxes that decreases the borrowing base has increased by $14 million. The effect of the changes since December 31, 2004 resulted in a borrowing base of $625 million at September 30, 2005. The orders entered by the Bankruptcy Court approving the DIP Facility permit up to $300 million of borrowings, which amount may be increased to $500 million upon written approval of each of the Statutory Committees or further order of the Bankruptcy Court. The DIP Facility also contains an option, exercisable by Mirant or Mirant Americas Generation, to remove Mirant Americas Generation and its subsidiaries as borrowers and obligors under the DIP Facility and reduce the DIP Facility commitment to a maximum of $200 million of borrowings. Borrowings under the DIP Facility are secured by substantially all of the assets of the DIP Borrowers. In October 2005, the Bankruptcy Court approved an extension of the DIP facility through January 31, 2006.

We and certain of our subsidiaries, including Mirant Americas Generation and, upon formation, Mirant North America, are holding companies and as a result, we are dependent upon dividends, distributions and other payments from our subsidiaries to generate the funds necessary to meet our obligations. The ability of certain of our subsidiaries to pay dividends and distributions is restricted under the terms of their debt or other agreements. In particular, a substantial portion of the cash provided by operating activities for our North America segment is generated by Mirant Mid-Atlantic. The Mirant Mid-Atlantic leveraged leases as currently constituted contain a number of covenants, including limitations on dividends, distributions and other restricted payments. Under its leveraged leases, Mirant Mid-Atlantic is not permitted to pay any dividends or make any distributions and other restricted payments unless (1) it satisfies the fixed charge coverage ratio on a historical basis for the last period of four fiscal quarters, (2) it is projected to satisfy the fixed charge coverage ratio for the next two periods of four fiscal quarters, and (3) no significant lease default or event of default has occurred and is continuing. See Note E for a further description of the restricted payments test under the Mirant Mid-Atlantic leveraged leases. The projected fixed charge coverage ratios are based on projections that are not prepared to conform to the guidelines established by the American Institute of Certified Public Accountants regarding forecasts, and are not audited, reviewed or compiled by Mirant s independent registered public accounting firm. It should be noted that the forecasts, market assumptions and many other factors are inherently inaccurate and should not be relied on. In the event of a default under the leveraged leases or if the restricted payments test is not satisfied, the cash of Mirant Mid-Atlantic would not be able to be distributed. The calculation of the fixed charge coverage ratio requires the determination of the Consolidated EBITDA, as defined in the lease agreements, of Mirant Mid-Atlantic exclusive of depreciation, amortization and similar non-cash charges. Management has calculated the fixed charge coverage ratio excluding certain non-cash charges that management believes to be reasonable and appropriate. Based on our calculation of the fixed charge coverage ratios under the leveraged leases as of September 30, 2005 and December 31, 2005, Mirant Mid-Atlantic would fail to meet the required 1.7 to 1.0 ratio for restricted payments if certain non-cash charges are included in the calculation. It is a condition to the commitments of the lenders for the proposed revolving credit facility for Mirant North America that such lenders shall have received certification that Mirant Mid-Atlantic is not prohibited, and is not projected to be prohibited, from making distributions or dividends. The Mirant Debtors are seeking a determination of the Bankruptcy Court in connection with the entry of the confirmation order that the interpretations set forth in Note E with respect to the calculation of the FCCR in connection with the restricted payments test are fair and appropriate. In the event that the restricted payments test is not revised and continues to apply to Mirant Mid-Atlantic, the Bankruptcy Court does not make the requested determinations and the unrealized losses are included in the calculation of the restricted payments test, the Mirant Debtors may not be able to emerge from bankruptcy under the proposed Plan.

The proposed Plan provides for the organization of Mirant North America as an intermediate holding company that would be a subsidiary of Mirant Americas Generation and the parent of its indirect subsidiaries, including Mirant Mid-Atlantic. The proposed Plan provides for Mirant North America to incur certain indebtedness to be issued in connection with the Plan and to enter into a revolving credit facility for working capital and other purposes and secured by the assets of Mirant North America and its subsidiaries, other than Mirant Mid-Atlantic and its subsidiaries. We expect that any such revolving credit facility will include certain covenants typical in such credit facilities, including restrictions on dividends, distributions and other restricted payments. Further, we expect that any such revolving credit facility will include financial covenants that will exclude from the calculation of compliance with such covenants the financial results of any subsidiary that is unable to make distributions or dividends at the time of such calculation. Thus, the ability of Mirant Mid-Atlantic to make distributions to Mirant North America under the leveraged lease transaction is expected to have a material impact on the calculation of the financial covenants under the revolving credit facility and other debt of Mirant North America and on its ability to make distributions to Mirant Americas Generation. The availability of the Mirant North America revolving credit facility, an important source of liquidity for our subsidiaries post-bankruptcy, and our ability to pay our obligations, and the ability of Mirant Americas Generation and Mirant North America, to pay their obligations, may be adversely affected in the event that Mirant Mid-Atlantic is unable to make distributions to Mirant North America.

After we emerge from bankruptcy, we expect to satisfy our liquidity and capital requirements in North America with cash generated by operations and letters of credit and borrowings under the new revolving credit facility as contemplated by the Plan. Further, we expect to satisfy the liquidity and capital requirements of our international subsidiaries with cash generated by those operations and additional financing arrangements.

Jamaica Public Service Company Limited (JPS)

Jamaica Public Service Company Limited has approximately $131 million of indebtedness maturing in the third quarter of 2006. It is management s intention to refinance these loans, on a

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long-term basis, on or before the repayment dates and management is currently in an advanced stage of negotiation with several prospective lenders to effect this refinancing. In addition, JPS has working capital needs arising primarily as a result of higher than anticipated system losses and the non-recovery of hurricane repair costs. In October 2005, an indirect subsidiary of Mirant agreed to provide JPS with a subordinated loan of up to $12 million. JPS is in discussions with a number of financial institutions with respect to securing facilities for working capital and to repay the outstanding shareholder loan. In the event that third-party financing proves unavailable to JPS on acceptable terms, we, together with JPS, would need to evaluate the alternatives available to JPS, including additional shareholder loans.

Mirant Sual Corporation (Mirant Sual)

In the fourth quarter of 2005, we expect that our Philippines business will be required to purchase a 5.1 percent minority interest in Mirant Sual for approximately $35 million, bringing our ownership in Mirant Sual to 100 percent.

Under the financing agreements for the Sual project, Mirant Sual Corporation is restricted from paying dividends and making other subordinated loan payments, if any, if it does not comply with the required debt service coverage ratio. Primarily because of the expiration of its income tax holiday in October 2005, Mirant Sual Corporation is expected not to comply with the required debt service coverage ratio in 2006. It expects to be able to meet the debt service coverage ratio in 2007.

Mirant Grand Bahama Limited

Mirant Grand Bahama Limited is negotiating a new six year credit facility with the lender under its existing maturing credit facility. The lender has granted an extension of the maturity date of the existing facility from August 15, 2005 until November 15, 2005.

Cash Flows

Operating Activities

Cash provided by operating activities decreased $344 million for the nine months ended September 30, 2005 compared to the same period in 2004. Our cash provided by operating activities is volatile as a result of seasonality, changes in energy prices and fluctuations in our working capital requirements. Most notably, when we enter into transactions to economically hedge our expected generation output or fuel requirements and those positions move out-of-the money, we are required to post cash collateral due to our low credit rating.

Net cash provided by operating activities excluding the changes in operating assets and liabilities increased by $247 million primarily due to:

- An increase of $299 million in realized gross margin primarily due to a strong performance from our operations in the third quarter of 2005 and the expirations of the TPAs, partially offset by lower generation volumes and narrower conversion spreads in our North American operations in the first six months of 2005.
- An increase of $38 million in payments related to the bankruptcy proceedings.

See Results of Operations section of Item 2. Management s Discussion and Analysis for further discussion.

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In 2005, changes in operating assets and liabilities required $749 million in cash. Additional net collateral used to support commercial operations was $697 million. The large collateral and margin requirements are due to significant increases in energy prices in the third quarter of 2005 that resulted in large unrealized losses on our forward power sales contracts.

In 2004, changes in operating assets and liabilities required $158 million in cash and included net collateral used to support commercial operations of $115 million. These amounts were posted when energy prices moved against hedges that we entered into in order to economically hedge our expected generation output and fuel requirements.

Investing Activities

In 2005, we had capital expenditures of $137 million primarily related to our Caribbean and Mid-Atlantic facilities. We received $63 million in proceeds from the sale of Coyote Springs 2 and $4 million in remaining proceeds from the 2004 sale of Bowline gas turbines. We also received $85 million and $23 million in proceeds from the sales of our Wrightsville generating facility and equipment from the Wyandotte suspended construction project, respectively.

In 2004, we had capital expenditures of $94 million primarily related to our Caribbean, New York and Mid-Atlantic facilities. Our Philippine business paid $21 million to acquire an additional interest in the Sual project after a minority shareholder exercised its put option. We also paid $12 million to a third party to exit our Canadian natural gas transportation agreements and certain natural gas marketing contracts.

Financing Activities

In 2005, we had proceeds from the issuance of debt of $125 million. Of the $125 million, $100 million represented pre-petition letters of credit being drawn upon by counterparties and banks. The drawing of Mirant Debtor letters of credit creates a liability subject to compromise. The remaining debt proceeds of $25 million in 2005 were related to our Caribbean operations. We repaid long-term debt of $192 million consisting primarily of $159 million of debt related to our Philippine operations and $31 million of debt related to our Caribbean operations. Our Caribbean operations repaid a net $1 million of short-term debt. Cash deposited in the debt service reserves related to our Philippine operations decreased by $57 million.

In 2004, we had proceeds from the issuance of debt of $266 million, which included $236 million of pre-petition letters of credit being drawn upon by counterparties and banks. The drawing of Mirant Debtor letters of credit creates a liability subject to compromise. The remaining debt proceeds of $30 million were related to our Caribbean operations. We repaid long-term debt of $192 million consisting primarily of $159 million of debt related to our Philippine operations and $25 million of debt related to our Caribbean operations. Our Caribbean operations repaid a net $11 million of short-term debt. Cash deposited in the debt service reserves related to our Philippine operations increased by $46 million.

Total Cash, Cash Equivalents and Credit Facility Availability

The table below sets forth total cash, cash equivalents and availability under the debtor-in-possession credit facility (DIP Facility) and other credit facilities of Mirant Corporation and its subsidiaries as of September 30, 2005 and December 31, 2004 (in millions):

	September 30, 2005	December 31, 2004
Cash and Cash Equivalents:		
Debtors(1):		
Mirant Corporation	$ 254	$ 276
Mirant Americas Generation	67	167
Mirant Mid-Atlantic	93	247
Mirant Americas Energy Marketing	15	207
Other subsidiaries	122	56
Total debtors cash and cash equivalents	551	953
Non-debtors	678	532
Total cash and cash equivalents	1,229	1,485
Less: Cash required for operating, working capital or other purposes or restricted by the subsidiaries debt agreements(2)	342	274
Total available cash and cash equivalents	887	1,211
Available under DIP Facility	233	263
Total cash, cash equivalents and credit facilities availability	$ 1,120	$ 1,474

(1) Since filing for protection under Chapter 11, none of the Mirant Debtors has paid dividends or made capital contributions. As discussed above, Mirant and certain of its subsidiaries, including Mirant Americas Generation and Mirant Mid-Atlantic, are participating in an intercompany cash management program approved by the Bankruptcy Court.

(2) Amounts designated as Cash required for operating, working capital or other purposes or restricted by subsidiaries debt agreements are estimated amounts.

Cash Collateral and Letters of Credit

In order to sell power and purchase fuel in the forward markets and perform other energy trading and marketing activities, we often are required to provide trade credit support to our counterparties or make deposits with brokers. In addition, we often are required to provide trade credit support for access to the transmission grid, to participate in power pools, to fund debt service reserves and for other operating activities. Trade credit support includes cash collateral, letters of credit and financial guarantees. In the event of default by us, a counterparty can draw on a letter of credit or apply cash collateral held to satisfy the existing amounts outstanding under an open contract. Our outstanding issued letters of credit totaled $74 million as of September 30, 2005, of which $7 million were issued under pre-petition credit facilities and the remaining $67 million were issued under the DIP Facility. Upon their expiration in 2005 and 2006, these letters of credit may be renewed or replaced with another form of credit support to the counterparties, if required, or under certain circumstances, the letters of credit could be partially or fully drawn upon by the counterparties.

Following is a summary of cash collateral posted with counterparties and brokers and letters of credit issued as of September 30, 2005 and December 31, 2004 (in millions):

	September 30, 2005	December 31, 2004
Cash collateral posted energy trading and marketing(1)	$ 969	$ 392
Cash collateral posted debt service reserves	237	210
Cash collateral posted other operating activities	65	63
Letters of credit energy trading and marketing(2)	67	160
Letters of credit debt service reserves(2)		74
Letters of credit other operating activities(2)	7	8
Total	$ 1,345	$ 907

(1) The amount above includes over $655 million deposited with JP Morgan as clearing broker as of September 30, 2005.

(2) The amounts above represent letters of credit issued under Mirant Corporation credit facilities. There are additional letters of credit issued under local credit facilities at some of our international subsidiaries that are not included in the amounts above.

Other Developments

Plan of Reorganization

On January 19, 2005, Mirant Corporation and substantially all of its wholly-owned and certain non wholly-owned U.S. subsidiaries (Mirant Debtors) filed a proposed Plan of Reorganization (as amended, the Plan) and Disclosure Statement (as amended, the Disclosure Statement) with the Bankruptcy Court. A First Amended Plan and a First Amended Disclosure Statement were filed on March 25, 2005. On September 7, 2005 the Mirant Debtors reached an agreement with a number of the key constituencies in their Chapter 11 case, including all three Statutory Committees, regarding the terms upon which the Mirant Debtors will emerge from bankruptcy protection. A Second Amended Plan and a Second Amended Disclosure Statement were filed on September 22, 2005. The proposed Plan sets forth the proposed structure of the Mirant Debtors at emergence and outlines how the claims of creditors and stockholders are proposed to be treated. On September 30, 2005, the Bankruptcy Court approved the Disclosure Statement and authorized its use in connection with the solicitation of votes on the proposed Plan from those creditors, security holders and interest holders who are entitled to vote on the proposed Plan. Subsequently, the Mirant Debtors mailed solicitation materials to all known holders of impaired claims and equity interests against the Mirant Debtors entitled to vote on the Plan. In addition, the Bankruptcy Court fixed December 1, 2005 as the date for the hearing to consider confirmation of the Plan and related matters. Properly executed ballots and any objections to the confirmation of the Plan are due by November 10, 2005. Until such time as the Plan is confirmed by the Bankruptcy Court, we are unable to predict the timing of our emergence from bankruptcy protection.

The ultimate outcome of matters with respect to which we make forward-looking statements and the terms of any reorganization plan ultimately confirmed can affect the value of our various pre-petition liabilities, common stock and other securities. No assurance can be given as to what values, if any, will be ascribed in the bankruptcy proceedings to each of these constituencies.

Accordingly, we urge that caution be exercised with respect to existing and future investments in our common stock or any claims relating to pre-petition liabilities or other Mirant securities. See Note B to our unaudited condensed consolidated financial statements contained elsewhere in this report for further discussion.

Approval of New Chairman and Chief Executive Officer

On September 30, 2005, the Bankruptcy Court approved the appointment of Edward R. Muller as Chairman of the Board, President and Chief Executive Officer. He was previously elected to these positions by our current Board of Directors. He replaced A. W. Dahlberg as Chairman of the Board and S. Marce Fuller as President and Chief Executive Officer.

Philippines Law Changes

As part of its revenue enhancement program, the Philippine government has enacted certain changes to its existing tax law. The Republic Act No. 9337 (RA 9337) lifts tax exemptions on the sale of electricity and oil products, coal, and natural gas, among others, but allows the tax to be passed on to the consumers. It also gives the President of the Philippines the power to raise the value added tax (VAT) rate to 12 percent from 10 percent starting January 1, 2006 subject to certain conditions.

On September 1, 2005, the Supreme Court of the Philippines issued a decision upholding the constitutionality of the RA 9337. The Court, however, said that the government could not implement the law until the Temporary Restraining Order (TRO) that was issued on July 1, 2005 is lifted.

On October 18, 2005, the Supreme Court TRO imposed on the RA 9337, was lifted, paving the way for implementation. The Court s decision is final and takes effect immediately. The Department of Finance clarified that the implementation of the new tax law will begin November 1, 2005 after complying with the requirements of publication.

There is pending legislation in the Senate and the House of Representatives that seeks to exempt oil and power products from the coverage of the RA 9337 to prevent further escalation of oil and electricity prices in the country. It cannot be determined at this point what the prospects are for this legislation being passed.

Mirant Philippines does not expect that the RA 9337 will have a negative impact on the company. This assessment is contingent on the new tax law s final implementing rules and regulations to be prescribed by the Bureau of Internal Revenue. The new tax law is expected to allow Mirant and other independent power producers (IPPs), including the National Power Corporation (NPC), to pass the VAT on to the consumers.

Additionally, there will be an increase in the corporate income tax rate from November 1, 2005 through the end of 2008 because the corporate income tax rate is increased from 32 to 35 percent as provided for in the RA 9337. It is expected that Mirant will benefit in the long term, when the corporate income tax rate will drop to 30 percent starting in 2009.

The Senate Committee on Energy has resumed public hearings concerning various issues of the electric power industry. There is new proposed legislation that seeks to introduce changes and amendments to the Electric Power Industry Reform Act (EPIRA). Mirant Philippines energy conversion agreements with the NPC provide change in law protection and the Republic of the Philippines has issued performance undertakings to guarantee performance of the NPC s obligations under its energy conversion agreements.

While Mirant believes that it maintains adequate contractual rights and governmental assurances to prevent any adverse financial impact to operations resulting from the new tax law and any amendments to EPIRA, their ultimate effect cannot be determined at this time.

U.S. Energy Legislation

The Energy Policy Act of 2005 (Energy Policy Act) was passed by the U.S. Congress in July 2005 and was signed into law in August 2005. This comprehensive legislation, in pertinent part, repeals the Public Utilities Holding Company Act (PUHCA) effective six months after enactment of the Energy Policy Act, establishes transmission reliability standards, offers incentives for transmission grid improvements and renewables, and prohibits market manipulation. The law does not contain provisions that would prevent or otherwise significantly impair the continuation of competitive markets. Mirant does not believe the legislation will have a demonstrable impact on Mirant s business, but would eliminate limitations imposed by PUHCA, such as limitations currently imposed on Mirant s exempt wholesale generator subsidiaries and foreign utility companies. In addition, the repeal of PUHCA would remove limitations on the ability of a public utility or any other entity to acquire public utility assets.

Integrated Utility Holding N.V. (Aqualectra)

We own a $40 million convertible preferred equity interest, with a 16.75% dividend, in Aqualectra, an integrated water and electric company in Curacao, Netherland Antilles, owned and operated by the government. Aqualectra is in default under its $115 million credit facility and has a substantial payable balance owed to Curoil for fuel purchases. However, Aqualectra is current in its debt service payments under its credit facility and is engaged in discussions with its lenders with respect to its financial situation and pending defaults. In addition, Curoil continues to provide fuel for Aqualectra s operations. To date, Aqualectra is current with its preferred dividend payments to us, although there can be no assurances that it will continue to have funds sufficient to make such payments or that its lenders will continue to permit it to do so. Further, the lenders may claim that certain previous preferred dividends paid to us were prohibited by the credit facility. Under the terms of the Aqualectra stockholders agreement, we have the right to elect a majority of the members of the supervisory board of Aqualectra and to control the appointment of management and stockholder votes during the pendency of certain triggering events, including (i) a default under indebtedness in excess of $1 million, (ii) a failure to honor our option to require it to purchase our preferred equity interest, (iii) a failure to make two consecutive dividend payments and (iv) a failure to maintain the specified debt service ratio. Although our right to exercise additional control has been triggered, we are continuing to evaluate the situation and, to date, we have not elected to exercise such right.

Wind-down of European Subsidiaries

We are in the process of liquidating several European subsidiaries for which significant operations ceased prior to 2003. As part of the liquidation, we expect to recognize previously deferred foreign exchange gains and losses. Our current estimate is that we will complete this process in 2006 and expect to recognize approximately $64 million in expense related to reducing the cumulative translation adjustment accounts of these entities to zero. This amount will be classified as other expense, net.

Philippine Tax Reporting

The Philippine taxing authority has a pending regulation that will allow companies to use their functional currency, rather than the Philippine Peso, in financial statements and books of accounts for internal revenue tax purposes. Since this regulation is still in draft form, the ultimate impact on Philippine operations cannot yet be determined. However, the potential impact may be a requirement to write-off approximately $84 million of deferred tax assets relating to unrealized foreign exchange losses. These unrealized foreign exchange losses may no longer be allowed as a tax deduction if the final regulations prescribe that income tax liabilities are calculated based on functional currency financial statements.

Mirant Philippines Initial Public Offering

In October 2005, Mirant Philippines Sual and Pagbilao subsidiaries received copies of Resolution No. 18 of the Energy Regulatory Commission (ERC) entitled Implementing Section 43(t) of Republic Act No. 9136 and Rule 3, Section 4(m) of the Implementing Rules and Regulations of the said Act dated August 17, 2005. The Resolution requires all generation companies and distribution utilities not publicly listed on the Philippine Stock Exchange to offer and sell to the public not less than fifteen percent of their common shares of stock by June 26, 2006. We are currently evaluating Resolution No. 18 and cannot predict its impact at this time.

Tolling Arrangement for California Plants

We are currently seeking proposals for a one-, two- or three-year tolling arrangement and/or resource adequacy capacity sale on two of our California natural gas fired generating facilities, Pittsburg 7 and Contra Costa 6. Pittsburg 7 s capacity is 682 MW; Contra Costa 6 s capacity is 337 MW.

Consent Decree with State of New York

On June 11, 2003, Mirant New York, Mirant Lovett and the State of New York entered into a consent decree to resolve alleged violations of New Source Review requirements under the Clean Air Act by the prior owner of the Lovett facility. Under the consent decree, Mirant Lovett committed to install on Lovett s two coal fired units by 2007 through 2008: (1) emission control technology consisting of selective catalytic reduction technology to reduce NOx emissions; (2) alkaline in-duct injection technology to reduce SO2 emissions, and (3) a baghouse. The consent decree allows Mirant Lovett to shut down or convert one of the units to burning natural gas only rather than install the prescribed emission controls on the unit. For one of the units, Mirant Lovett also has the option to convert the unit to operate exclusively as a gas fired boiler and limit the hours of operation rather than install the prescribed emission controls. The consent decree required Mirant Lovett to notify the state of its selected option by August 1, 2004, which date was extended by the State of New York to August 1, 2005. On November 2, 2005, the State of New York extended the deadline to December 23, 2005. Based on Mirant Lovett s expected compliance technology, if Mirant Lovett elects to install the prescribed environmental controls, the cost is expected to exceed $200 million.

Environmental

Regional Greenhouse Gas Initiative. Nine Northeast and Mid-Atlantic states created a cooperative known as the Regional Greenhouse Gas Initiative (RGGI) to develop a template for a regional cap and trade program for carbon dioxide emissions from power plants of 25 MW or greater. Similar to the northeast NOx Budget Rule, this initiative envisions participating states executing a memorandum of understanding and then promulgating implementing regulations substantially the same as the RGGI template. The RGGI, released in August 2005, proposes that the memorandum of understanding requires that aggregate carbon dioxide emissions in the region be capped at current levels from 2009 through 2015, followed by a second phase reduction of 10%

that would be implemented between 2015 and 2020. The recommended allocation scheme calls for allocation of 20% of allowances to a public benefit purpose and 5% to a regional strategic carbon fund, thereby further reducing allowances available to affected facilities. In the future, the RGGI may include other sources of greenhouse gas emissions and greenhouse gases other than carbon dioxide. If the RGGI results in mandatory regulations in states where Mirant has affected generating units, the costs of implementation could be material.

Clean Air Interstate Rule. On March 10, 2005, the EPA promulgated the Clean Air Interstate Rule (CAIR), which establishes a year-round cap and allowance trading program primarily applicable to electric power plants in 28 eastern states and Washington, D.C. The EPA has established a federal framework for the CAIR program that will be administered by the states through their state implementation plans, due in 2006. These cap and trade programs will be implemented in two phases, with the first NOx phase going into effect in 2009, SO2 in 2010 and more stringent caps going into effect in 2015 for both NOx and SO2. On August 1, 2005, to ensure emissions reductions required under the CAIR are achieved, the EPA proposed a federal implementation plan to utilize in the event subject states do not submit appropriate State Implementation Plans. Mirant will monitor the implementation of this rulemaking and develop compliance plans as necessary.

Clean Air Mercury Rule. On March 15, 2005, the EPA promulgated the Clean Air Mercury Rule (CAMR) to reduce mercury emissions from coal fired plants. The EPA withdrew its earlier finding that it was necessary and appropriate to regulate coal fired power plants under the Clean Air Act (CAA) Section 112 hazardous air pollutant rules and opted instead to utilize its authority under CAA Sections 110 and 111 to establish a federal framework for what will ultimately be a mercury cap and trade program administered by states through their state implementation plans. The CAMR establishes a first phase of mercury reductions required by 2010. These reductions are anticipated to occur as co-benefits of the reductions in NOx and SO2 that will result from pollution controls added to meet the requirements of the CAIR rule, discussed above. The second phase of the CAMR cap and trade program for mercury emissions will require substantial further reductions from power plants by 2018. When fully implemented, the CAMR will require a 70% reduction in mercury emissions from power plants. In addition to the cap and trade program, the CAMR establishes standards of performance limiting mercury emissions from new, reconstructed and modified power plants. The EPA announced on October 21, 2005 that it has granted several petitions to reconsider seven issues in the CAMR rulemaking. The EPA is also proposing to reconsider certain aspects of its decision not to regulate electric utility steam generating units under the CAA Section 112 hazardous air pollution rules.

New Source Review. The Clean Air Act provides for a major source permitting program, known as New Source Review (NSR). For the past several years, the EPA has pursued an enforcement policy that resulted in approximately 50 civil suits challenging physical changes made at power plants across the country on the theory that a major source permit was required but not obtained. Among other defenses, the power plant owners asserted that these changes were exempt from the permit requirements because they constituted routine maintenance, repair and replacement of old equipment. If the EPA were to prevail in these cases, the NSR permit would require the addition of state-of-the-art pollution controls at affected power plants as well as penalties. Since the inception of these cases, the EPA has promulgated rules that help clarify what constitutes routine maintenance, repair and replacement and has recently proposed a clarifying standard for assessing whether the NSR permit requirement would apply to physical changes at a power plant. In light of these actions and the CAIR rulemaking, the EPA recently announced that in the future it will focus on cases that violate the proposed, clarified rule and not pursue its earlier theories except that it will conclude the already pending cases.

Regulations under the Federal Water Pollution Control Act. The EPA has issued new regulations under section 316(b) of the Federal Water Pollution Control Act, establishing performance standards reflecting the best technology available for cooling water intake structures to minimize adverse environmental impacts. These regulations apply to all existing steam electric power plants that withdraw more than 50 million gallons per day of cooling water from surface waters of the United States. The EPA s new section 316(b) rules for existing facilities are intended to reduce the losses of aquatic organisms inadvertently impinged (i.e., trapped against) or entrained (i.e., pulled into) by cooling water intake structures at existing facilities, as compared to a baseline condition. The performance standard the EPA has adopted requires exiting facilities to reduce impingement mortality by 80 to 95 percent, and entrainment by 60 to 90 percent.

The section 316(b) regulations for existing facilities give power plants flexibility to choose among different compliance alternatives for meeting the performance standards. Potential compliance alternatives can include using existing technologies, selecting additional fish protection technologies, using restoration measures or demonstrating that alternative standards are warranted. Over the next few years, our power plants subjected to this cooling water intake regulation (Lovett, Bowline, Canal, Kendall, Pittsburg, Contra Costa, Potrero, Chalk Point, Morgantown, Potomac and Dickerson) will be in the process of evaluating and implementing the requirements of the section 316 (b) existing facility regulations by completing impingement and entrainment studies, evaluating technologies, operational measures, restoration measures and collecting other required information. At this time, and until the aquatic studies and evaluation of compliance options are completed, the costs to comply with the 316(b) existing facility regulations are not known. The regulatory deadline for completing those studies and presenting a proposal for compliance (known as a Compliance Demonstration Study or CDS) varies depending on the duration of the current National Pollutant Discharge Elimination System permit. Facilities whose permits expire before January 9, 2008 are entitled to request an extension until January 7, 2008 to submit the CDS, while those with four or more years remaining must submit the CDS as part of the normal permit renewal process.

Critical Accounting Policies and Estimates

The accounting policies described below are considered critical to obtaining an understanding of our consolidated financial statements because their application requires significant estimates and judgments by management in preparing our consolidated financial statements. Management s estimates and judgments are inherently uncertain and may differ significantly from actual results achieved. Management believes that the following critical accounting policies and the underlying estimates and judgments involve a higher degree of complexity than others do. Management discussed the selection of and application of these accounting policies with the Audit Committee of the Board of Directors.

Potential Applicability of Fresh Start Accounting

We may be required, as part of our emergence from bankruptcy protection, to adopt fresh start accounting in a future period. If fresh start accounting is applicable, our assets and liabilities will be recorded at fair value as of the fresh start reporting date. The fair value of our assets and liabilities may differ materially from the recorded values of assets and liabilities on our unaudited condensed consolidated balance sheets. In addition, if fresh start accounting is required, our financial results after the application of fresh start accounting will be different than historical trends and those differences may be material.

Accounting for Energy Trading and Marketing Activities

Our North America businesses use derivative financial instruments and other energy contracts to economically hedge our electricity generation assets and to engage in optimization trading activities. We use a variety of derivative contracts, such as futures, swaps and option contracts in the management of our business. Such derivative contracts have varying terms and durations, or tenors, which range from a few days to a number of years, depending on the instrument.

Most of these activities are reflected in our financial statements at fair value, with changes in fair value recognized currently in earnings. The fair value of these contracts is included in price risk management assets and liabilities in our unaudited condensed consolidated balance sheets. Certain transactions do not meet the definition of a derivative or are considered normal purchases or normal sales and, therefore, qualify for the use of accrual accounting.

The fair value amounts contained within our unaudited condensed consolidated financial statements are estimates based largely on the mid-point of quoted market prices. The mid-point may vary significantly from the bid or ask price for some delivery points. If no active market exists, we estimate the fair value of certain derivative contracts using quantitative pricing models. Our modeling techniques include assumptions for market prices, correlation and volatility, such as using the prices of one delivery point to calculate the price of the contract s delivery point. The degree of complexity of our pricing models increases for longer duration contracts, contracts with multiple pricing features and off-hub delivery points.

The fair value of price risk management assets and liabilities in our unaudited condensed consolidated balance sheets are also impacted by our assumptions regarding interest rate and counterparty credit risk. The nominal value of the contracts is discounted using a forward interest rate curve based on the London InterBank Offered Rate (LIBOR). In addition, the fair value of our derivative contracts is reduced to reflect the estimated risk of default of counterparties on their contractual obligations to us.

The amounts recorded as revenue change as estimates are revised to reflect actual results and changes in market conditions or other factors, many of which are beyond our control. Because we use derivatives that do not currently qualify for cash flow or fair value hedge accounting under SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, our financial statements including gross margin, operating income and balance sheet ratios are, at times, volatile and subject to fluctuations in value primarily due to changes in energy and fuel prices. We plan to implement cash flow hedge accounting during 2006 and expect reduced gross margin volatility related to commodity contracts.

Bankruptcy Claims Assessment

Our accompanying unaudited condensed consolidated financial statements include, as liabilities subject to compromise, our estimated pre-petition liabilities and settlements approved by the Bankruptcy Court prior to September 30, 2005. In addition, we also reflect as liabilities subject to compromise the probable claim amounts relating to liabilities for rejected contracts, litigation, accounts payable and accrued liabilities, debt and other liabilities (the Probable Claims Estimates). These Probable Claims Estimates require management to estimate the likely claim amount that will be allowed by the Bankruptcy Court prior to the Bankruptcy Court s ruling on the individual claims. These estimates are based on assumptions of future commodity prices, reviews of claimants supporting material and assessments by management and outside experts. We expect that our estimates, although based on the best available information, will change as the claims are resolved in the Bankruptcy Court.

The following table summarizes the claims filed in our Chapter 11 case as of September 30, 2005:

	Total number of Claims	Total amount of Claims (in millions)
Total Claims Filed	8,683	$ 268,608
Less:		
Redundant claims	26	8
Claims with basis for objection	7,142	259,377
Total Claims	1,515	9,223
Additional scheduled liabilities		7
Remaining Claims		$ 9,230

The amount of the claims, net of redundancies and amounts for which we have identified a basis for objection, totals approximately $9 billion, as summarized above. This amount plus approximately $2 billion of estimated liabilities for which claims either have not been filed or have been filed with an undetermined amount represents the total estimate of current claims exposure against the Mirant Debtors as of September 30, 2005. The $2 billion of estimated liabilities is mainly related to our operating leases.

Long-Lived Assets

We evaluate our long-lived assets (property, plant and equipment) and definite-lived intangibles for impairment whenever indicators of impairment exist or when we commit to sell the asset. The accounting standards require that if the sum of the undiscounted expected future cash flows from a long-lived asset or definite-lived intangible is less than the carrying value of that asset, an asset impairment charge must be recognized. The amount of an impairment charge is calculated as the excess of the asset s carrying value over its fair value, which generally represents the discounted expected future cash flows from that asset or, in the case of assets we expect to sell, at fair value less costs to sell.

Our evaluations for impairment require us to apply judgment in estimating future energy prices, environmental and other maintenance expenditures and other cash flows. Our estimates of the fair value of the assets require estimating useful lives and selecting a discount rate that reflects the risk inherent in future cash flows. If actual results are not consistent with our assumptions used in estimating future cash flows and asset fair values, we may be exposed to additional losses that could be material to our results of operations.

During the current period, market prices of natural gas have increased substantially in most markets. The prices were mainly influenced by fuel supply shortages that resulted from hurricane activity and by abnormally warm weather in the Eastern half of the United States. As a result of the increases in our cost of fuel for our natural gas and oil fired generation facilities, we considered these long-lived assets for potential impairment. While our estimated cost of fuel in future periods has increased, at this time we do not view that the spark spreads in the markets in which we operate have narrowed significantly in the long-term. In addition, our natural gas fired generation facilities have remaining useful lives that are long enough such that the undiscounted expected cash flows on these assets would need to decrease dramatically for the amounts to be less than the carrying value of these assets.

As discussed in Note G to our unaudited condensed consolidated financial statements contained elsewhere in this report, we temporarily shut down our Potomac River generation facility in August 2005 in response to a directive from the Virginia Department of Environmental Quality. We are currently evaluating modifications to the generation facility and its operations but the outcome is not known at this time. If, in the future, we assume that this facility will be shutdown beyond 2006, we will need to evaluate this generation facility for impairment.

Litigation

We are currently involved in certain legal proceedings. These legal proceedings are discussed in Part II Item 1. Legal Proceedings and Note G to the unaudited condensed consolidated financial statements contained elsewhere in this report. We estimate the range of liability through discussions with legal counsel and analysis of applicable case law and legal precedents. We record our best estimate of a loss, if estimable, when the loss is considered probable, or the low end of our range if no estimate is better than another estimate within a range of estimates. As additional information becomes available, we reassess the potential liability related to our pending litigation and revise our estimates. Revisions in our estimates of the potential liability could materially impact our results of operations, and the ultimate resolution may be materially different from the estimates that we make.

Item 3. *Quantitative and Qualitative Disclosures about Market Risk*

We are exposed to market risks associated with changes in commodity prices, foreign currency exchange rates and interest rates. We are also exposed to counterparty credit risk.

In connection with our power generating business in North America, we are exposed to energy commodity price risk associated with the acquisition of fuel needed to generate electricity, as well as the electricity produced and sold. A portion of our fuel requirements is purchased in the spot market and a portion of the electricity we produce also is sold in the spot market. In addition, the open positions in our optimization trading and legacy portfolio activities expose us to risks associated with the changes in energy commodity prices. As a result, our financial performance in North America varies depending on changes in the prices of energy and energy-related commodities. See Critical Accounting Policies and Estimates for a discussion of the accounting treatment for our energy trading and market activities and see Note D to the unaudited condensed consolidated financial statements for detail of our price risk management assets and liabilities as of September 30, 2005.

For a further discussion of market risks, our risk management policy, and our use of Value at Risk to measure some of these risks, see Item 7A. Quantitative and Qualitative Disclosures about Market Risk in our Annual Report on Form 10-K for the year ended December 31, 2004.

Item 4. *Controls and Procedures*

Inherent Limitations in Control Systems

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. As a result, our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures, or our internal control over financial reporting, will prevent all error and all fraud. Our management does, however, have reasonable assurance as to the effectiveness of our disclosure controls and procedures and our internal control over financial reporting (discussed in the next paragraph).

Effectiveness of Disclosure Controls and Procedures

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act), our management, including our Chief Executive Officer and our Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined by Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of September 30, 2005. Based upon this evaluation, our management concluded that, as of September 30, 2005, the design and operation of these disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting identified in connection with our required review of such control that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

Appearing as exhibits to this report are the certifications of the Chief Executive Officer and the Chief Financial Officer required in accordance with Section 302 of the Sarbanes-Oxley Act of 2002.

PART II

Item 1. *Legal Proceedings*

The descriptions below update and should be read in conjunction with the complete descriptions in the section titled Legal Proceedings in the Company s Form 10-K for the year ended December 31, 2004 and the Company s Form 10-Qs for the quarters ended March 31, 2005 and June 30, 2005. Also see Note G Litigation and Other Contingencies to the unaudited condensed consolidated financial statements contained elsewhere in this report for further discussion.

California Litigation by Governmental Units and Certain Other Parties

FERC Show Cause Proceeding Relating to Trading Practices. On June 27, 2005, the FERC approved the settlement agreement entered into between certain Mirant entities and the FERC Trial Staff filed with the FERC for its approval on September 30, 2003 (as amended in the filing made by the Mirant entities and the FERC Trial Staff on December 19, 2003 to include issues related to the selling of ancillary services) (the Trading Settlement Agreement). The Bankruptcy Court approved the Trading Settlement Agreement on August 24, 2005. Certain parties have filed motions for rehearing with the FERC, which motions remain pending.

California Settlement. Under the California Settlement, PG&E and Mirant Delta, LLC were to negotiate by September 30, 2005 (extended by the parties from the original date of April 30, 2005) an agreement (the Option Agreement) under which PG&E would have separate options to purchase each of Mirant Delta s existing Contra Costa generating plant and its existing Pittsburg generating plant, in both cases once no unit at the plant has operated for a certain period of years. The Option Agreement was not finalized, and Mirant Delta and the other Mirant parties to the California Settlement have no further obligations to PG&E with respect to the Option Agreement or the rights it was to provide to PG&E.

Rate Payer Litigation

California Rate Payer Litigation. Various lawsuits were filed in 2000 through 2003 that assert claims under California law based on allegations that certain owners of electric generation facilities in California and energy marketers, including Mirant, Mirant Americas Energy Marketing and several Mirant Americas Generation subsidiaries, engaged in various unlawful and anti-competitive acts that served to manipulate wholesale power markets and inflate wholesale electricity prices in California. With respect to the six such suits that were filed between November 27, 2000 and May 2, 2001 in various California Superior Courts, on October 3, 2005 the California state court dismissed the six consolidated suits on the grounds that the plaintiffs claims were barred by federal preemption as a result of the Federal Power Act. The period within which the plaintiffs may appeal that dismissal has not yet expired.

Shareholder-Bondholder Litigation

Mirant Americas Generation Securities Class Action: On September 6, 2005, the district court entered an order approving the settlement entered into by Mirant Americas Generation and the plaintiff in the *Wisniak* suit, certifying a settlement class, and dismissing the action.

City of Alexandria Zoning Action

On July 7, 2005, the Circuit Court for the City of Alexandria entered a consent order agreed to by the City of Alexandria and Mirant Potomac River in the suit filed on January 18, 2005 by Mirant Potomac River and Mirant Mid-Atlantic against the City of Alexandria and the City Council. The

consent order extends through October 17, 2005, the period within which Mirant Potomac River may file an application for such special use permits as may be necessary as a result of the actions taken by the City Council for the City of Alexandria on December 18, 2004 changing the zoning status of the Potomac River plant and revoking certain special use permits issued to Mirant Potomac River in 1989. The City of Alexandria and Mirant Potomac River have submitted to the court for its approval another consent order that would further extend that time period to January 31, 2006.

Environmental Proceedings

New York Opacity. On June 8, 2005, the New York State Department of Environmental Conservation (NYSDEC) entered an order agreed to by the Mirant defendants that set penalty amounts for future violations of opacity standards by Mirant Bowline and Mirant Lovett, and required the Mirant defendants to pay a penalty of $44,100 for emissions violations occurring prior to January 1, 2005. The Bankruptcy Court approved the agreed to order on August 17, 2005.

Mirant Potomac River Notice of Violation. On September 10, 2003, the Virginia Department of Environmental Quality (Virginia DEQ) issued a Notice of Violation (NOV) to Mirant Potomac River alleging that it violated its Virginia Stationary Source Permit to Operate by emitting NOx in excess of the cap established by the permit for the 2003 summer ozone season. Mirant Potomac River responded to the NOV, asserting that the cap is unenforceable, noting that it can comply through the purchase of emissions allowances and raising other equitable defenses. Virginia s civil enforcement statute provides for injunctive relief and penalties. On January 22, 2004, the EPA issued an NOV to Mirant Potomac River alleging the same violation of its Virginia Stationary Source Permit to Operate as set out in the NOV issued by the Virginia DEQ.

On September 27, 2004, Mirant Potomac River, Mirant Mid-Atlantic, the Virginia DEQ, the Maryland Department of the Environment, the DOJ and the EPA entered into, and filed for approval with the United States District Court for the Eastern District of Virginia, a consent decree that, if approved, will resolve Mirant Potomac River s potential liability for matters addressed in the NOVs previously issued by the Virginia DEQ and the EPA. The consent decree requires Mirant Potomac River and Mirant Mid-Atlantic to (1) install pollution control equipment at the Potomac River plant and at the Morgantown plant leased by Mirant Mid-Atlantic in Maryland, (2) comply with declining system-wide ozone season NOx emissions caps from 2004 through 2010, (3) comply with system-wide annual NOx emissions caps starting in 2004, (4) meet seasonal system average emissions rate targets in 2008 and (5) pay civil penalties and perform supplemental environmental projects in and around the Potomac River plant expected to achieve additional environmental benefits. Except for the installation of the controls planned for the Potomac River units and the installation of selective catalytic reduction (SCR) or equivalent technology at Mirant Mid-Atlantic s Morgantown Units 1 and 2 in 2007 and 2008, the consent decree does not obligate the Company s subsidiaries to install specifically designated technology, but rather to reduce emissions sufficiently to meet the various NOx caps. Moreover, as to the required installations of SCRs at Morgantown, Mirant Mid-Atlantic may choose not to install the technology by the applicable deadlines and leave the units off either permanently or until such time as the SCRs are installed. The aggregate amount of the civil penalties to be paid and costs to be incurred by Mirant Potomac River for the supplemental environmental projects is $1.5 million. The consent decree is subject to the approval of the district court and the Bankruptcy Court.

The owners/lessors under the lease-financing transactions covering the Morgantown and Dickerson plants (the Owners/Lessors) have objected to the proposed consent decree in the Bankruptcy Court and filed a motion to intervene in the district court action. The Owners/Lessors argue that the consent decree unjustly imposes financial hardships on them and significantly affects the economic value of the Morgantown and Dickerson plants by requiring capital investments to install pollution control equipment and imposing significant operating limitations.

On July 22, 2005, the district court granted a motion filed by the City of Alexandria seeking to intervene in the district court action, although the district court imposed certain limitations on the City of Alexandria s participation in the proceedings. On September 23, 2005, the City of Alexandria filed a motion seeking authority to file an amended complaint in the action seeking injunctive relief and civil penalties under the Clean Air Act for alleged violations by Mirant Potomac River of its Virginia Stationary Source Permit To Operate and the State of Virginia s State Implementation Plan. Based upon a computer modeling, the City of Alexandria asserts that emissions from the Potomac River plant exceed national ambient air quality standards (NAAQS) for SO2, nitrogen dioxide (NO2), and particulate matter. The City of Alexandria also contends based on its modeling analysis that the plant s emissions of hydrogen chloride and hydrogen fluoride exceed Virginia state emission standards. Mirant Potomac River disputes the City of Alexandria s allegations that it has violated the Clean Air Act and Virginia law.

Mirant Potomac River Downwash Study. On September 23, 2004, the Virginia DEQ and Mirant Potomac River entered into an order by consent with respect to the Potomac River plant under which Mirant Potomac River agreed to perform a modeling analysis to assess the potential effect of downwash from the plant (1) on ambient concentrations of SO2, NO2, carbon monoxide (CO) and particulate matter less than or equal to 10 micrometers (PM10) for comparison to the applicable NAAQS and (2) on ambient concentrations of mercury for comparison to Virginia Standards of Performance for Toxic Pollutants. Downwash is the effect that occurs when aerodynamic turbulence induced by nearby structures causes pollutants from an elevated source, such as a smokestack, to be mixed rapidly toward the ground resulting in higher ground level concentrations of pollutants. If the modeling analysis indicates that emissions from the facility may cause exceedances of the NAAQS for SO2, NO2, CO or PM10, or exceedances of mercury compared to Virginia Standards of Performance for Toxic Pollutants, the consent order requires Mirant Potomac River to submit to the Virginia DEQ a plan and schedule to eliminate and prevent such exceedances on a timely basis. Upon approval by the Virginia DEQ of the plan and schedule, the approved plan and schedule is to be incorporated by reference into the consent order. The results of the computer modeling analysis showed that emissions from the Potomac River plant have the potential to contribute to localized, modeled instances of exceedances of the NAAQS for SO2, NO2 and PM10 under certain conditions. In response to a directive from the Virginia DEQ, Mirant Potomac River temporarily shut down the Potomac River plant on August 24, 2005 pending identification and implementation of modifications to the plant or its operations, which modifications could be material. On September 21, 2005, Mirant Potomac River commenced partial operation of one unit of the plant. The financial and operational implications of the discontinued or limited operation of the Potomac River plant or any such modifications are not known at this time, but could be material depending on the length of time that operations are discontinued or limited.

City of Alexandria Nuisance Suit. On October 7, 2005, the City of Alexandria filed a suit against Mirant Potomac River and Mirant Mid-Atlantic in the Circuit Court for the City of Alexandria. The suit asserts nuisance claims, alleging that the Potomac River plant s emissions of coal dust, fly ash, NOx, SO2, particulate matter, hydrogen chloride, hydrogen fluoride, mercury, and oil pose a health risk to the surrounding community and harm property owned by the City. The City seeks injunctive relief, damages and attorneys fees.

Mirant NY-Gen Pipeline Leak. In the fall of 2003, Mirant NY-Gen, LLC (Mirant NY-Gen) discovered a leaking underground pipeline at the Hillburn generating facility in Ramapo, New York. The underground line was used for supplying kerosene fuel to the gas turbines located on site. After confirmatory testing revealed a potential leak, the line was removed from service and plans were

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undertaken to excavate and sample portions of the line to determine the extent of the line damage and the possible soil contamination. Upon initial discovery the leak was reported to the NYSDEC and the Rockland County Health Department. In the summer of 2004 soil contamination was discovered and a subsequent testing of portions of the line revealed a small hole.

On May 19, 2005, the NYSDEC issued a Notice of Hearing and Complaint to Mirant NY-Gen seeking an order requiring Mirant NY-Gen to implement its approved remediation plan, to pay all costs relating to the cleanup (including all costs incurred by the NYSDEC), and to pay a civil penalty in the amount of $100,000. On August 1, 2005, Mirant NY-Gen and the NYSDEC entered into a consent order regarding the remediation of the pipeline leak. That consent order requires Mirant NY-Gen to (1) determine to what extent, if any, the leak impacted the groundwater in the area of the Hillburn facility and (2) design and install equipment to remediate impacted soil and groundwater. Mirant NY-Gen and the NYSDEC entered into a second consent order on September 15, 2005 to address penalties and cost reimbursement to the NYSDEC relating to the remediation of the pipeline leak. Under the September 15, 2005 consent order, Mirant NY-Gen will (1) pay a penalty of $50,000, (2) reimburse the NYSDEC for costs to date and future costs in an amount not to exceed $20,000 and (3) pay costs associated with an independent, third-party environmental audit of the Hillburn facility, which is expected to cost approximately $35,000. The consent orders were subject to the approval of the Bankruptcy Court, which was obtained on September 22, 2005.

Currently, investigations are continuing to determine the extent of contamination and possible remedial activities to clean up the area. Additionally, Mirant NY-Gen is working under the direction of the NYSDEC to remove all free product contamination from the groundwater and undertake remediation actions for additional on-site and off-site contamination. The current estimate of the cost of cleanup and subsequent monitoring is at least $3 million; however, due to the ongoing evaluation to determine the extent of the off-site contamination, the exact cost of remediation is unknown at this time. Mirant NY-Gen may remain in Chapter 11 until these matters are resolved.

New York Oil Storage Assessment. Mirant Bowline and Mirant Lovett have undertaken a program to review compliance with federal and state regulations applicable to oil storage at the Bowline and Lovett plants. Results of the Lovett assessment indicate the secondary containment capacity may not be adequate for the design capacity of the tanks, although it is sufficient for the working volume. Additionally, approximately 10% of the liner may need repair. At Bowline, the secondary containment is adequate; however, an evaluation of the liner permeability is currently being undertaken. The cost of any repairs of the facilities is unknown at this time.

Other Governmental Proceedings

Department of Justice Inquiries: In November 2002, Mirant received a subpoena from the Department of Justice (DOJ), acting through the United States Attorney s office for the Northern District of California, requesting information about its activities and those of its subsidiaries for the period since January 1, 1998. The subpoena requested information related to the California energy markets and other topics, including the reporting of inaccurate information to the trade press that publish natural gas or electricity spot price data. The subpoena was issued as part of a grand jury investigation. The DOJ s investigation of the reporting of inaccurate natural gas price information is continuing, and we have held preliminary discussions with the DOJ regarding the disposition of this matter. The DOJ s investigation is based upon the same circumstances that were the subject of an investigation by the Commodities Futures Trading Commission (CFTC) that was settled in December 2004. As described in the Company s Annual Report on Form 10-K for the year ended December 31, 2004 in *Legal Proceedings Other Governmental Proceedings CFTC Inquiry*, Mirant and Mirant Americas Energy Marketing pursuant to the settlement consented to the entry of an

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order by the CFTC in which it makes findings, which are neither admitted or denied by Mirant and Mirant Americas Energy Marketing, that (1) from January 2000 through December 2001, certain Mirant Americas Energy Marketing natural gas traders (a) knowingly reported inaccurate price, volume, and/or counterparty information regarding natural gas cash transactions to publishers of natural gas indices and (b) inaccurately reported to index publishers transactions observed in the market as Mirant Americas Energy Marketing transactions and (2) from January to October 2000, certain Mirant Americas Energy Marketing west region traders knowingly delivered the false reports in an attempt to manipulate the price of natural gas. Under the settlement, the CFTC received a subordinated allowed, unsecured claim against Mirant Americas Energy Marketing of $12.5 million in the Chapter 11 proceedings. The DOJ could decide that further action against the Company is not appropriate or could seek indictments against one or more Mirant entities, or the DOJ and the Company could agree to a disposition that might involve undertakings or fines, the amount of which cannot be reasonably estimated at this time but which could be material. The Company has fully cooperated with the DOJ and intends to continue to do so.

There have been no other material developments in legal proceedings involving the Company or its subsidiaries since those reported in Mirant s Annual Report on Form 10-K for the year ended December 31, 2004 and its Form 10-Qs for the quarters ended March 31, 2005 and June 30, 2005.

Item 6. *Exhibits*

(a) ***Exhibits.***

2.1*	Second Amendment to the Joint Chapter 11 Plan of Reorganization for Mirant Corporation and its Affiliated Debtors (Exhibit A to the Second Amended Disclosure Statement Relating to the Debtors Second Amended Joint Chapter 11 Plan of Reorganization Designated on Form 8-K filed October 7, 2005 as Exhibit 99.1)
10.1*	Employment Agreement, dated September 30, 2005, between Mirant Corporation, Mirant Services, LLC and Edward R. Muller (Designated on Form 8-K filed September 30, 2005 as Exhibit 10.1)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Subsection (a) of Section 7241, Chapter 98 of Title 15, United States Code)
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Subsection (a) of Section 7241, Chapter 98 of Title 15, United States Code)
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)

* Asterisk indicates exhibits incorporated by reference.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on this 7th day of November, 2005.

MIRANT CORPORATION
By: /s/ DAN STREEK
Dan Streek
Vice President and Controller
(Principal Accounting Officer)

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