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**OVERSIGHT OF INVESTMENT BANKS' RESPONSE
TO THE LESSONS OF ENRON—VOL. I**

HEARING

BEFORE THE
PERMANENT SUBCOMMITTEE OF INVESTIGATIONS
OF THE
COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
ONE HUNDRED SEVENTH CONGRESS
SECOND SESSION

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DECEMBER 11, 2002
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**OVERSIGHT OF INVESTMENT BANKS' RE-
SPONSE TO THE LESSONS OF ENRON—VOL.
I**

WEDNESDAY, DECEMBER 11, 2002

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:37 a.m., in room SD-106, Dirksen Senate Office Building, Hon. Carl Levin, Chairman of the Subcommittee, presiding.

Present: Senators Levin, Collins, and Bennett.

Staff Present: Linda J. Gustitus, Chief of Staff; Elise J. Bean, Staff Director and Chief Counsel; Mary D. Robertson, Chief Clerk; Bob Roach, Counsel; Jamie Duckman, Professional Staff Member; Jessica Swartz, Intern; Beth Merrilat-Bianchi, Detailee/IRS; Jim Elliott, Detailee/Department of State; Kim Corthell, Republican Staff Director; Alec Roger, Counsel to the Minority; Claire Barnard, Investigator to the Minority; David Mount, Detailee/Secret Service; Jim Pittrizzi, Detailee/General Accounting Office; Meghan Foley, Staff Assistant; Marianne Upton (Senator Durbin); Tara Andringa (Senator Levin); Bob Klepp (Governmental Affairs/Senator Thompson); Mike Nelson (Senator Bennett); Holly Schmitt (Senator Bunning); Felicia Knight (Senator Collins); and Brooke Brewer (Senator Cochran).

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Good morning, everybody. One year ago, on December 2, 2001, Enron Corporation, then the seventh-largest company in the United States, declared bankruptcy. The follow-up to this financial disaster revealed a litany of Enron corporate abuses, from accounting fraud to price manipulation, insider dealing, and tax abuses. Yet it is still the case today, as it was a year ago, that most top Enron officials have walked away from the scandal that they created with tens of millions of dollars in their pockets while Enron employees, creditors, and shareholders have suffered substantial losses.

As disturbing as Enron's own misconduct is the growing evidence that leading U.S. financial institutions not only took part in Enron's deceptive practices, but at times designed, advanced, and profited from them. This is the third in a series of hearings held by this Subcommittee focusing on the role of financial institutions in Enron's collapse.

Our first hearing looked at the more than \$8 billion in deceptive transactions referred to as prepays. Citigroup and J.P. Morgan Chase repeatedly used these deceptive prepays to issue Enron huge loans that were disguised as energy trades, which then enabled Enron to misstate the loan proceeds as cash flow from business operations. Investors and analysts were misled, along with the many employees who lost their life savings and jobs.

Our second hearing looked in detail at a sham asset sale from Enron to Merrill Lynch just before the end of the year 2000 so that Enron could book the fake sale revenue and boost both its year-end earnings and cash flow from operations. This transaction didn't qualify as a true sale under accounting rules because Enron had eliminated risk from the deal by secretly promising Merrill Lynch to arrange a resale of the barges within 6 months, while guaranteeing a 15 percent profit.

In both hearings, substantial evidence showed that the financial institutions involved in the deals knew exactly what was going on. They structured the transactions, signed the paperwork, and supplied the funds, knowing that Enron was using the deal to report that the company was in better financial condition than it really was. In the case of Citigroup and Chase, the banks not only assisted Enron, they developed the deceptive prepays as a financial product and sold it to other companies as so-called balance sheet-friendly financing, earning millions of fees for themselves in the process.

Today's hearing will look at another set of deceptive transactions that took place over a 6-month period, from December 2000 to June 2001, involving Enron ventures in the pulp and paper business. These transactions were known as Fishtail, Bacchus, Sundance, and Slapshot. The evidence shows that Citigroup and Chase actively aided Enron in these transactions despite knowing that they employed deceptive accounting or tax strategies and were being used by Enron to manipulate its financial statements or deceptively reduce its tax obligations. Citigroup and Chase received substantial fees for their actions or favorable consideration from Enron in other business dealings.

These four transactions required months of work by the Subcommittee staff to untangle. The complexity of the deals made the deceptions almost impossible for anyone to understand without a detailed road map. They also show how far our financial institutions have sunk in misusing structured finance. Instead of using structured deals to lower financing costs or spread risk, which are legitimate uses, they used structured finance to mislead investors, analysts, and regulators about a company's true activities and financial condition.

I will place in the record at this time the Subcommittee staff report that describes the four transactions in detail, as well as charts and exhibits showing what happened.¹

Here are some of the highlights from that report and from our investigation. Enron constructed the first three transactions, Fishtail, Bacchus, and Sundance, as a sham asset sale of its new pulp and paper business venture in order to inflate its cash flow and

¹The staff report appears in the Appendix on page 150.

earnings by hundreds of millions of dollars and to keep the substantial debts associated with this business venture off its balance sheet and out of the view of investors and analysts.

The first two transactions took place in December 2000. Enron first pretended to move its pulp and paper trading business off its balance sheet to a new joint venture that it had set up called Fishtail. About 1 week later, in the Bacchus deal, Enron purportedly sold its Fishtail interest to another entity for \$200 million. Enron then booked the \$200 million as sale revenue and declared a profit and earnings of \$112 million on its year-end financial statement, enabling the company to meet Wall Street expectations for its year 2000 earnings.

In the Bacchus transaction, Enron allegedly sold its Fishtail ownership interest to a shell company that it had established earlier called the Caymus Trust, and Exhibit 301(a)¹ shows how the transaction appeared on the surface, and that exhibit is on the screen.

The Caymus Trust came up with the \$200 million purchase price by obtaining a \$194 million loan from Citigroup and an apparent \$6 million cash investment from Fleet Boston Financial that was also guaranteed by Citigroup. However, as Exhibit 301(b)² demonstrates, the transaction was, in reality, a loan. The evidence shows that in addition to openly guaranteeing repayment of the \$194 million Citigroup loan, which is permissible under accounting rules, Enron's Chief Financial Officer, Andrew Fastow, also made an undisclosed, oral agreement with Citigroup to ensure that Citigroup would not incur any loss connected with the so-called \$6 million investment.

These two guarantees meant that Enron, in effect, had ensured repayment of the entire \$200 million purchase price, and those two guarantees also meant that under accounting rules, Citigroup was, in reality, providing Enron a loan and using the Caymus Trust as a pass-through rather than financing a real sale to a real company.

Six months later, Enron and Citigroup set up another joint venture called Sundance to take possession of all of Enron's pulp and paper assets, including the asset presumably just sold to the Caymus Trust, and to keep the debt associated with these assets off Enron's balance sheet. But this joint venture was also a sham. Enron's auditor, Andersen, had told Enron that it would approve off-balance sheet treatment of the Sundance joint venture only if at least 20 percent of Sundance's capital came from an independent investor and at least 3 percent of the total capital was placed at risk when the venture was formed and stayed at risk during the joint venture's operation.

Exhibit 302(a)³ shows that Sundance appeared to meet these accounting requirements. Enron contributed approximately \$750 million in assets and cash. Citigroup appeared to have contributed \$188.5 million, or 20 percent of the joint venture's capital. Citigroup's contribution included \$28.5 million in stock and cash, which supposedly met the requirement for 3 percent up-front cap-

¹ Exhibit No. 301(a) appears in the Appendix on page 185.

² Exhibit No. 301(b) appears in the Appendix on page 186.

³ Exhibit No. 302(a) appears in the Appendix on page 187.

ital at risk and \$160 million in unfunded capital that supposedly would be provided on demand.

But as Exhibit 302(b)¹ shows, the reality was that Citigroup's alleged investment was a sham because it was never intended to be at risk. As Exhibit 302(c)² shows, the terms of the partnership included the following provisions. Citigroup could dissolve the partnership at any time. Enron needed to lose its entire \$750 million before any of Citigroup's so-called investment could be touched, which meant Citigroup would have plenty of time to dissolve the partnership, if necessary, before it had to produce any funds. And Sundance had to keep the \$28.5 million liquid, segregated, and earmarked for Citigroup so that Citigroup could recapture that part of its so-called investment at will.

In summary and in reality, neither Citigroup's \$28.5 million nor its unfunded \$160 million were ever intended to be at risk.

The Sundance joint venture was a sham and all of its assets should have been included in Enron's balance sheet. Indeed, just 2 days before the transaction closed, three senior Citigroup officials strongly urged the investment bank not to do the Sundance deal, with one warning the following: "The GAAP accounting is aggressive and a franchise risk to us if there is publicity." Let me repeat that. Just before this deal was approved, this was the warning. It came from Citigroup people. "The GAAP accounting is aggressive and a franchise risk to us if there is publicity."

But Citigroup did the deal, earning \$1.8 million in fees and preferred dividends and presumably got some good will from Enron. Citigroup also obtained full payment of the \$200 million loan that it had provided earlier in the Bacchus deal, since one of Enron's contributions to Sundance was the \$200 million needed to buy the Fishtail assets from the Caymus Trust and pay off the Citigroup loan.

On paper, Fishtail, Bacchus, and Sundance seemed to bring new investment into Enron's pulp and paper business venture. In reality, these complex financial deals enabled Enron to use a \$200 million Citigroup loan and a sham asset sale to boost its year-end cash flow and earnings and then quietly return the funds via Sundance. Without Citigroup's participation in supplying the lion's share of the funds, Enron would not have been able to pull off these deceptive transactions.

Finally, the Slapshot transaction, another highly disturbing example of a major U.S. financial institution helping Enron engage in a deceptive transaction. It is particularly disturbing because Chase, the financial institution involved here, itself designed the deceptive transaction. That was even more than aiding and abetting. Chase designed the Slapshot deal and sold it to Enron for \$5 million, enabling Enron to claim an estimated \$60 million in Canadian tax savings and \$65 million in financial statement benefits.

The Slapshot sleight of hand took place on June 22, 2001. It was designed as a tax avoidance scheme, and as we can see from the next exhibit,³ it was a spaghetti bowl of structured finance arrangements using loans, funding transfers, and transactions involv-

¹ Exhibit No. 302(b) appears in the Appendix on page 188.

² Exhibit No. 302(c) appears in the Appendix on page 189.

³ Exhibit No. 337 appears in the Appendix on page 347.

ing Chase and Enron affiliates in two countries, many of which were established specifically to facilitate the deal.

In essence, Slapshot took a valid \$375 million loan issued by a consortium of banks to an Enron affiliate and combined it with a \$1 billion sham loan issued by a Chase-controlled shell company called Flagstaff. The sham \$1 billion loan created the appearance, but not the reality, of a loan by using a shell game involving two different transfers of \$1 billion through a maze of bank accounts belonging to Chase and Enron affiliates.

Chase provided the alleged loan by issuing a \$1 billion momentary overdraft to its shell company, Flagstaff. But Chase was unwilling to allow Flagstaff to release the funds to an Enron shell company called Hansen until Chase was sure that the \$1 billion was fully protected and going to be returned the same day, indeed, almost at the same moment. So Chase required Enron to deposit a separate \$1 billion in an escrow account controlled by Chase before Chase would release its \$1 billion to Enron. Enron obtained its own \$1 billion momentary overdraft on an account that it held at Citibank and transferred those funds into an escrow account at Chase.

And then through a series of near-instantaneous transactions among Chase and Enron entities, the \$1 billion sham loan was briefly commingled with the real \$375 million loan to create the appearance of a combined \$1.4 billion loan to an Enron affiliate. The sham \$1 billion was then separated back out through a series of additional transfers and moved within hours back to the Enron account at Citibank. In the meantime, the \$1 billion in Enron escrow funds was released to Chase.

Now, the \$1 billion loan that was supposedly supplied by Chase was a sham. It was issued and paid back within minutes without any of the credit risk that is the point of a loan, even during the few minutes that it moved from Chase's left pocket to its right pocket. It had no economic rationale or business purpose other than to circulate through multiple bank accounts to create the appearance of the larger \$1.4 billion loan. Chase got more than \$5 million for doing it. Enron got tax deductions and better financial statements.

Enron's tax counsel warned that this transaction clearly involves a degree of risk and cautioned that, "in our opinion, it is very likely that Revenue Canada will become aware of the Slapshot transactions and upon becoming aware of them will challenge them."

Chase also knew that the Slapshot transaction was dubious. It worked with Enron to minimize the possibility that Canadian tax authorities would discover it, and they even developed contingency plans in the event that Canada disallowed the sham loan. When analyzing how to structure an interest rate swap that was a part of the transaction, for instance, Enron and Chase jointly considered three alternatives, two of which were described as disadvantageous, in part because they would produce a potential road map, in their words, of the transaction for Revenue Canada. So instead of following those two roads, Enron and Chase jointly chose the third alternative, which was explicitly described as providing no road map.

In addition, Enron and Chase included in the transaction documents what was called a recharacterization rider, in which they agreed if they were caught by Revenue Canada to reclassify retroactively loan payments made by Enron to Chase to look like loans from Enron to Chase. How is that for a move? If Canada disallowed the Slapshot scheme and exposed Enron to additional taxes, Enron would try to make it look as though Enron was lending money to one of the world's largest banks.

Slapshot was designed and intended to be a deceptive transaction. Chase set it up to pretend that a \$375 million loan was really a \$1.4 billion loan by, just for a moment, inserting an extra \$1 billion in the transaction. The combined so-called loan then provided the cover for Enron's Canadian affiliate to claim for tax purposes that it had an outstanding loan obligation of \$1.4 billion and claim its entire \$22 million quarterly loan repayment as tax deductible interest payments on the fake \$1.4 billion loan, instead of deducting only that portion of the payments that was the true interest payment on the \$375 million loan.

Enron could not have completed Slapshot without a major bank like Chase which had the resources to use \$1 billion for a few brief moments and quickly move that \$1 billion through multiple bank accounts across international lines. Chase charged Enron \$5 million for its so-called tax technology. Chase has also shopped that same tax technology to other companies.

The four transactions at issue today, together with the sham transactions examined at earlier hearings, all have deception at their core. All misuse structured finance, which has a legitimate purpose when used for real economic objectives, such as lowering financing costs or spreading risk. But here, there was no such legitimate economic objective. The goal was deception, and none of the transactions could have been executed without the complicity and financial resources of a major financial institution.

Now, the purpose of today's hearing is not just to expose another set of deceptive transactions, but also to take the next step and to determine, 1 year after the Enron scandal broke, what is being done to prevent future deception. Citigroup and Chase have each announced new programs designed to prevent their employees from participating in deals that produce deceptive accounting. We need to learn more about those programs and whether they will prevent the type of deals that we are going to examine today.

But we also are going to find out what our financial regulators are doing, what concrete steps they have taken to prevent U.S. financial institutions from designing, executing, and profiting from illegitimate structured financial transactions intended to help U.S. companies engage in misleading accounting or tax strategies. We want to learn what concrete steps the bank regulators and the SEC are taking, not only to punish wrongdoing on a case-by-case basis, which is important, but also to create a deterrence program to be part of regular bank examinations to stop future wrongdoing.

There is a regulatory gap now. The Securities and Exchange Commission does not generally regulate banks, and bank regulators don't regulate accounting practices or ensure accurate financial statements. Two steps need to be taken, which together could close this gap.

First, the SEC should issue a policy which states clearly that the SEC will take enforcement action against financial institutions which aid or abet a client's dishonest accounting by selling deceptive structured finance or tax products or by knowingly or recklessly participating in deceptive structured transactions.

Second, the bank regulators, including the Federal Reserve that oversees our financial holding companies, need to state that violation of that SEC policy that I just described would constitute an unsafe and unsound banking practice, thereby enabling bank examiners to take regulatory action during bank examinations.

We also need the SEC and the bank regulators to conduct a comprehensive joint review of the structured finance products being sold by or participated in by our financial institutions so that we can root out the ones that corrupt financial statements.

One year after Enron's collapse, we need our regulators to tell our banks and our security firms that the deceptions and the era of self-regulation are over. Enron was an eye opener about the extent and the nature of corporate misconduct going on in the United States today and the role being played by our financial institutions. The question now is whether we have learned the Enron lessons and whether, in addition to punishing wrongdoers on a case-by-case basis, we have taken on the tougher task of building a new deterrence program to prevent future Enrons.

Let me call on Senator Collins, my Ranking Member for a few more weeks and someone who has been such a great, not only supporter of efforts to protect consumers and to protect our economy, but whose staff has been so extraordinarily helpful in the production of this report and these documents. I want to thank her. I want to congratulate her on her new assignment as the Chair of our full Committee, the Governmental Affairs Committee, starting in January. But again, it has been a real pleasure serving with her, both as her Ranking Member here and then having her as my Ranking Member in the last few months.

OPENING STATEMENT OF SENATOR COLLINS

Senator COLLINS. Thank you, Senator Levin. I want to thank you for your kind comments and your extraordinary leadership in this very important investigation. Our staffs have worked very closely together during the past year in what I believe has been an unprecedented level of cooperation to unravel these very complex transactions. It would not have happened without your leadership.

I particularly want to take the opportunity to salute Linda Gustitus, who has been the leader of your staff since, I think, 1979, and will be retiring at the end of this year. Linda and I worked together on the Subcommittee many, many years ago and I know that her leadership will be sorely missed, as well.

Senator LEVIN. Thank you. Thank you for mentioning Linda, who indeed has been absolutely at the forefront of over two decades of investigations by this Subcommittee and by a predecessor Subcommittee that we were also both associated with. Thank you very much for mentioning her. It is totally appropriate and, indeed, well founded.

Senator COLLINS. Today's hearing represents a continuation of the Subcommittee's extensive investigation into the collapse of the

Enron Corporation. It is our third hearing looking specifically at the role played by some of America's leading financial institutions in transactions that enabled Enron to paint a false picture of its financial health and that ultimately contributed to the bankruptcy of the company.

Our earlier hearings documented that certain financial institutions, among them Merrill Lynch, J.P. Morgan Chase, and Citigroup, knowingly participated in and indeed facilitated transactions that Enron officials used to make the company's financial position appear to be more robust than it actually was. These complex transactions allowed Enron to deceive its investors, its customers, and its employees.

Today's hearing will provide additional evidence of the complicity of certain financial institutions in Enron's deceptions. As Senator Levin indicated, we will closely examine four multi-million-dollar structured finance deals that enabled Enron to produce misleading financial statements, and in one case claim a highly questionable \$125 million tax break. Citigroup funded two of the four transactions and J.P. Morgan Chase funded the other two.

The first three transactions, known as Fishtail, Bacchus, and Sundance, involved Enron's so-called sale of certain assets at inflated values to special purpose entities that had been established by Enron, Citigroup, or Chase. In each case, the entities purchasing the assets were funded with equity commitments by Citigroup or Chase that did not truly place funds at risk or were supported by secret oral guarantees by Enron that invalidated the special purpose entity's independent status.

Each of these transactions fabricated to look like an arm's length transaction and sale of a financial asset was, in fact, an artifice designed to enable Enron to obtain a Citicorp or a Chase loan or to sell an asset to itself. The evidence strongly suggests that Citigroup and Chase were not innocent pawns in these transactions. Warning flags were abundant. As Senator Levin noted, an internal memorandum from a senior Citicorp official strongly objected to the transactions, warning that the "accounting is aggressive and a franchise risk to us if there is publicity." Citigroup's involvement in helping to disguise what were essentially phony loans as phony asset sales enabled Enron to inflate its sales revenues and produce misleading financial statements.

The final transaction, known as Slapshot, involved a \$1.4 billion loan and related transactions that were designed to produce Canadian tax benefits for Enron. This complex web of transactions was designed by J.P. Morgan Chase and used Enron affiliates or special purpose entities in the United States, Canada, and the Netherlands. In simplest terms, Slapshot involved a legitimate \$375 million loan issued by a consortium of banks and a phony \$1 billion loan issued by a J.P. Morgan Chase controlled SPE. The \$1 billion loan was issued and repaid on the same day through a complex series of structured finance transactions. The \$375 million loan was to be repaid over 5 years.

Chase provided the \$1 billion for the phony loan by approving a \$1 billion daylight overdraft on an Enron account at Chase. The overdraft presented no risk, however, to Chase because the bank required Enron to deposit a separate \$1 billion in an escrow ac-

count for the duration of the so-called loan. Chase then circulated the \$1 billion through more than a dozen bank accounts held by Enron and Chase affiliates and SPEs, returning the \$1 billion overdraft to the original Chase account by the end of the day.

The end result of these transactions was that Enron was able to treat its quarterly \$22 million loan repayments, each of which were, in fact, a payment of principal and interest on the \$375 million loan, as purely interest payments on the \$1 billion loan. By characterizing each \$22 million loan payment as an interest payment on the larger loan, Enron claimed that it was entitled to deduct the entire \$22 million from its Canadian taxes, for a total tax benefit of \$125 million. In return for designing this phony loan structure and arranging the series of funding transfers, Chase received a fee of \$5.25 million from Enron, and again, outside experts cautioned Chase about this transaction.

The transactions that we are examining today once again demonstrate the extraordinary lengths to which investment banks went to keep Enron, an important client, happy. The checks and balances that were supposed to ensure the integrity of financial transactions apparently were compromised by conflicts of interest and the lure of big fees.

It undermines the integrity of our capital markets when some of the most prestigious financial institutions in our country are involved in designing, marketing, executing, and profiting from financial transactions intended to enable public companies to engage in deceptive accounting and tax strategies.

In earlier testimony, the financial institutions have generally denied any responsibility, claiming that it is simply not their fault if their clients choose to account for these transactions improperly. But the troubling fact remains that Enron could not have gotten away with what it did for so long without the active participation of its financial institutions.

Numerous documents examined by the Subcommittee clearly demonstrate that the financial institutions that partnered with Enron knew of the company's intentions. In fact, in some cases, the financial institutions helped to design the transactions specifically so that Enron could cook its books.

For example, Chase's own documents highlight a particular advantage of the deal as, "[not providing] a 'road map' for Revenue Canada." That has been explained to our staff as a selling point so that the deal would not be easily identified by Canadian tax authorities and audited.

Today, we will also hear from the watchdogs, representatives of the Securities and Exchange Commission, the Federal Reserve, and the Office of the Comptroller of the Currency. There are a number of questions about the role of the regulators. To what extent do these regulatory agencies examine the type of transactions engaged in by J.P. Morgan Chase and Citigroup that enabled Enron to misrepresent its financial condition? What is their view of the legitimacy of the transactions we are examining today? Do the regulators have sufficient authority and expertise to oversee these complicated transactions? Has the current regulatory structure kept pace with changes in the financial markets and innovations in structured finance? The answers to these questions are critical to

strengthening our free enterprise system and to restoring public confidence in our capital markets.

It is important that we remember that the Enron debacle is more than just a tale of one company's greed. As a result of Enron's downward spiral and ultimate bankruptcy, shareholders large and small, individual and institutional, lost an estimated \$60 billion. Moreover, the collapse of Enron caused thousands of Americans to lose jobs, to lose their savings, and to lose confidence in corporate America and U.S. financial institutions.

When the individual investor does not have access to critical information to make wise investment decisions, information that is known only to corporate management and their financial partners, the playing field is far from level. We must ensure that our financial institutions act with integrity, and I want to acknowledge that the institutions before us today have taken several steps since our last hearings to put new safeguards in place. But we must ensure that investors, large and small, have access to complete and accurate information to guide their investment decisions.

I look forward to hearing the testimony of our witnesses today. Thank you, Mr. Chairman.

Senator LEVIN. Thank you, Senator Collins. Senator Bennett.

OPENING STATEMENT OF SENATOR BENNETT

Senator BENNETT. Thank you very much, Mr. Chairman. I have not been as involved in this issue as you and Senator Collins have, and so I will be very brief in what opening statement I have and I will look forward to listening to the witnesses.

I do sit on the Banking Committee, which has the legislative responsibility of coming up with changes in regulation and was involved in both the writing and in the conference report of the Sarbanes-Oxley bill that came almost exclusively as a result of the entire Enron experience. I think this hearing will be very useful, along with the other one which you previously held, in helping us in the Banking Committee's responsibility to provide oversight to both the SEC and to the bank regulators. The Banking Committee is the place where, if legislative changes have to be made, we are going to have to make them. This Permanent Subcommittee on Investigations has made a significant contribution to the institutional knowledge already available to the Banking Committee and I congratulate you for focusing on this in a way that, quite frankly, we on the Banking Committee could not.

I do have one area of concern that I simply will raise for the record. As the previous hearing has gone forward and conducted investigations in a way that is very clearly within the purview and charge of the Permanent Subcommittee on Investigations, some lawyers have attempted to take statements made in that hearing, turn them into evidence with some kind of legal alchemy, and then make them part of a lawsuit that, unfortunate timing, is going on right now. Fortunately, the judge ruled them out of order and refused to allow statements made at the hearing to become part of evidence in a trial.

I would hope that will not be attempted with anything that is said here today. This is an investigative Subcommittee. We are probing for information. We have not come up with a final report,

and even when we do, I don't think our report constitutes evidence that can be used in a court of law to determine a fact. I think what it says is, here are facts. Now you lawyers for one side or another determine your own basis for these facts rather than simply quoting us.

I wouldn't accuse any Member of this Committee of being given over to hyperbole in opening statements, but I do think there have been some members of the Senate who occasionally do that, and to take that hyperbole and try to turn it into evidence in a court of law, I think is a little bit like what we are finding out went on here, that is, a transaction that was intended for one purpose gets twisted into another purpose. There are some members of the trial bar who seem to be anxious to try to do that. They say I was glad the judge slapped them down and said they could not do that from previous statements that were made in these hearings and I would hope that no one in the audience would try to do that from anything that is said here today.

With that, Mr. Chairman, again, I congratulate you for your persistence and your diligence in digging into these matters and I will sit back and learn as much as I can from today's witnesses.

Senator LEVIN. Thank you so much, Senator Bennett, and thank you for your contributions in so many ways in the banking field and many other fields, including your contribution to that Sarbanes-Oxley bill and to this Subcommittee.

Let me now turn to our witnesses. Our first panel of witnesses is from Citigroup. I thank you all for making it here today despite the challenging weather. We welcome Charles Prince, the Chairman and Chief Executive Officer of Citigroup Global Corporate and Investment Bank. We welcome also David Bushnell, Managing Director and Head of Global Risk Management at Citigroup/Salomon Smith Barney; Richard Caplan, the Managing Director and Co-Head of the Credit Derivatives Group at Salomon Smith Barney North America; and William Fox, who is the Managing Director of the Global Power and Energy Group at Citibank.

Pursuant to Subcommittee Rule 6, all witnesses who testify before this Subcommittee are required to be sworn in, and so I would ask you at this time to please stand and to raise your right hand.

Do you swear that the testimony that you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. PRINCE. I do.

Mr. BUSHNELL. I do.

Mr. CAPLAN. I do.

Mr. FOX. I do.

Senator LEVIN. Thank you very much. We will be using our traditional timing system today. At about 1 minute before the 10-minute period for each of your testimony is up, the light will change from green to yellow, which will give you the opportunity to conclude your remarks. Your written testimony will be printed in the record in its entirety. Again, we thank you for your appearance here today and for your cooperation with this investigation.

Mr. Prince.

**TESTIMONY OF CHARLES O. PRINCE III,¹ CHAIRMAN AND
CHIEF EXECUTIVE OFFICER, CITIGROUP GLOBAL COR-
PORATE AND INVESTMENT BANK, NEW YORK, NEW YORK**

Mr. PRINCE. Thank you, Mr. Chairman, Senator Collins, and Senator Bennett. Good morning. My name is Chuck Prince. Since September of this year, I have been Chief Executive Officer of Citigroup's Global Corporate and Investment Bank. I appreciate the opportunity to appear before you to discuss these important issues and I commend you on your determination to understand how and why a Fortune 10 company like Enron could unravel so quickly and to such devastating effect. The collapse of that company has been a disaster for thousands of people—employees, investors, and others—and making sure that similar events do not happen again is a critically important objective that we share.

The last year has been a challenging one on Wall Street. Industry practices that were standard operating procedure for years have come under sharp scrutiny by Congress, regulators, and investors. Many of these practices have been changed and others are in the process of changing. For our part at Citigroup, we want to be at the forefront of change, setting the standard for integrity and professionalism in our industry. This has become a guiding mission for the senior management of our entire organization.

Part of our process has included the recognition that we have engaged in certain activities that do not reflect the way we believe business ought to be done going forward. Let me be clear, I believe that the Citigroup professionals involved with these transactions acted in good faith and understood these transactions to comply with the existing law and prevailing standards of the time. But let me be equally clear, good faith and legal compliance are no longer the issue as far as I am concerned. Even assuming that these transactions were entered into in good faith and were entirely lawful, they do not reflect our standards and they would not happen now at Citigroup.

Recognizing the problems our industry faces, we have worked diligently to develop new practices and policies reflecting the lessons we have learned. When Sandy Weill asked me to take the helm at the Global Corporate and Investment Bank just 3 months ago, he gave me a mandate to accelerate the process of reform and change that was already underway. I have detailed a number of these reforms in my written statement, but in the interest of time, I will turn to the issue of structured transactions that is the focus of today's hearing and was the focus of the hearing you held, Mr. Chairman, on July 23 of this year. As I hope you will agree when I discuss the reform initiative we announced just 2 weeks after your hearing and a month before I became responsible for this business, at Citigroup, we heard you and we took appropriate action.

First, though, let me say a few words about the specific transactions under review. While I believe our people acted in good faith, I think it is fair to say that we never anticipated that a financial intermediary like Citigroup would be criticized for the accuracy of the accounting treatment that a Fortune 10 company gave

¹The prepared statement of Mr. Prince appears in the Appendix on page 91.

to its transactions with the express approval of a then-highly respected Big Five accounting firm. At the time we entered into these transactions, we never imagined that Arthur Andersen wouldn't even exist a year later or that a failure of ethics would have destroyed Enron, a company ranked in the top 20 on the list of most admired companies in the year 2001. But we have learned a hard and valuable lesson, that reliance on public accountants or a company's widely held excellent reputation has significant limits, particularly in the face of corporate malfeasance.

To say that our professionals acted in good faith and in ways they believed to be appropriate is not to say that we consider a "business as usual" approach to be an acceptable prescription going forward. On the contrary, we concluded in the days and weeks following your July 23 hearing, Mr. Chairman, that we needed to act, even in the absence of industry action or regulatory action, and that the best way to protect both investors and our own reputation with regard to the kinds of transactions that appropriately concern this Committee was to insist on transparency.

Accordingly, on August 7, Citigroup announced a new transparency policy, saying, in essence, that from that day forward, Citigroup would execute material financing transactions for companies that were not going to be recorded as debt on their balance sheet if, but only if, that company agreed to clearly disclose the net effect of the transaction on its financial condition.

We announced this net effect rule for two reasons: First, to encourage companies to account for financing in a transparent manner so that investors can adequately assess the net effect of the transaction on the financial condition of the company; and second, because we simply did not wish to be a party to transactions that fail to meet a high standard of transparency.

Under our net effect rule, the transactions at issue in today's hearing would not and could not have happened at Citigroup unless Enron had made clear detailed disclosure to investors. We simply would have refused, and today would refuse, to do those transactions without a commitment to make such disclosures.

Our policy is based on a few key principles. First, it applies to any material structured or complex financing transaction of the sort this Subcommittee has been concerned about. In determining whether the policy applies to a given transaction, the economic reality, not the form of the transaction, is critical.

Second, the required disclosures under our new policy include, among other things, management's analysis of the net effect of the transaction on the financial condition of their company, the nature and amount of the obligations, and a description of any events that may cause an obligation to arise, increase, or become accelerated.

Third, Citigroup will obtain the client's written commitment that disclosure of such transactions in the client's relevant public filings will fairly present the transaction's financial impact. If we do not receive this commitment, we will not do the deal.

Fourth, Citigroup will do these transactions only for clients that agree to provide the complete set of transaction documents to their chief financial officer, their chief legal officer, and their independent auditors. If there are any oral assurances from the client in connection with any transaction that Citigroup believes may give

rise to accounting or disclosure issues, these will also have to be written down and those documents included with such transaction documents.

Fifth, key decisions, such as whether the policy requires additional disclosures in a particular transaction, are made by senior management from our accounting, legal, and risk management control functions acting together. If the senior managers of our control functions do not approve a proposed transaction, then, very simply, that transaction will not go forward. Any concerns about accounting or similar matters must be fully resolved and must be written down, must be documented, if a transaction is to go forward.

I am personally committed to making sure that our new procedures are fully observed. In order to do that, we are enhancing our decisionmaking process so that every step of decisions are documented, and importantly, our internal audit group will review and verify compliance with our procedures.

Promptly after we announced this new transparency policy, we erected what amounted to a roadblock for each structured finance and related transaction to see whether it was the kind of transaction that would not be reflected as debt on a balance sheet and should, therefore, be specially disclosed to the company's investors. None of these transactions was permitted to go forward unless it was submitted to a rigorous examination process by a working group from our control functions. As we move forward, we are continually adjusting and fine tuning this process to allow for more efficient, but equally rigorous, review.

We recognize, of course, that our execution will not be perfect. We are feeling our way, seeing what works, and discovering the challenges of applying a unilateral policy like this to an enormous range of complex transactions. Leaders, by definition, move in uncharted territory, and we will make some mistakes.

But I am quite encouraged by what I have seen so far, by the seriousness and intensity with which Citigroup professionals are grappling with this new policy, from the transactional people on the front lines to the most senior managers of our company. It has already made a measurable difference in the kinds of deals we are doing or declining to do and in the nature of the disclosure that clients are making.

Mr. Chairman, the world has changed a lot in the past year and is continuing to change. The collapse of Enron and the turmoil that followed on Wall Street has done tremendous damage to a great many people and businesses. We recognize that we must take real steps to change our ways of doing business and to get real results. We have done this and we are continuing to do more. This is not a time for half measures or foot dragging or public relations. We at Citigroup understand our role as a leader, our responsibility in that regard, and we embrace the mandate for change and subscribe to the goal of effective, far-reaching reform.

We appreciate the seriousness and the vigor with which you and the Subcommittee approach these issues, and we look forward to working with you and your colleagues on these and other reforms.

I thank you, sir, and I look forward to answering your questions.
Senator LEVIN. Thank you so much, Mr. Prince. Mr. Bushnell.

**TESTIMONY OF DAVID C. BUSHNELL,¹ MANAGING DIRECTOR,
GLOBAL RISK MANAGEMENT, CITIGROUP/SALOMON SMITH
BARNEY, NEW YORK, NEW YORK**

Mr. BUSHNELL. Thank you, Mr. Chairman and Members of the Subcommittee, for the opportunity to speak with you today. My name is David Bushnell. I am a Managing Director at Citicorp's Global and Investment Bank, and I am the head of its Risk Management Division.

The Global Risk Management Division functions as an independent control over our business units. It is the responsibility of my division to ensure that risks, including market risk, credit risk, and risk to the institution's reputation, are identified, measured, and evaluated. No extension of credit is permitted without risk management approval in accordance with our established policies and procedures. Positions that our traders take are subject to limits established by risk management. The firm's Risk Management Committee, including its Capital Markets Approval Committee, report to me. I am also charged with communicating and interpreting the risk views of senior-most management to our business units.

I understand that the Subcommittee is interested in discussing my role in the Sundance transaction. I look forward to answering the Subcommittee's questions about that transaction. But before I do, I would like to take this opportunity to explain some of the very significant changes that Citigroup is making in the way we handle such transactions today.

As you know, on August 7, Citigroup announced a new policy regarding transactions that raise significant accounting or disclosure issues. As its chief risk manager, I have been centrally involved in developing and implementing this policy. You have just heard Mr. Prince's testimony that describes the key elements of the policy and our implementation program.

The message that I want to convey to you is that this new policy is having a real impact on the ground at Citigroup where transactions are done. Every material structured or complex financing of the sort this Subcommittee has been concerned with is being subject to a rigorous review process. The Capital Markets Approval Committee is thoroughly evaluating the transparency of transactions and is working with our business people to ensure that in any transaction we do, the client discloses fairly and appropriately the net effect of that transaction on the company's financial condition. If the client will not commit to these kinds of disclosures, the answer is simple: Citigroup will not execute the transaction.

In the months since August 7, we have reviewed dozens of transactions and we are learning a great deal. This process is helping us to develop a uniform approach to assessing, routing, and where appropriate, approving and documenting transactions consistent with the principles of our new policy, and the policy has already had a real impact on the transactions we are declining or we are agreeing to do.

One of the most significant objectives of the past few months has been to embed in our culture an understanding of the importance of this policy. I can tell you that our people are taking it seriously,

¹The prepared statement of Mr. Bushnell appears in the Appendix on page 101.

from the front lines of our business units to our senior-most management. We are making this policy a living, breathing part of the way we do business.

Thank you, and I look forward to answering your questions.
 Senator LEVIN. Thank you, Mr. Bushnell. Mr. Caplan.

**TESTIMONY OF RICHARD CAPLAN,¹ MANAGING DIRECTOR
 AND CO-HEAD, CREDIT DERIVATIVES GROUP, SALOMON
 SMITH BARNEY NORTH AMERICAN CREDIT/CITIGROUP, NEW
 YORK, NEW YORK**

Mr. CAPLAN. Thank you, Mr. Chairman and Members of the Subcommittee. My name is Rick Caplan. I am a Managing Director of Citigroup's Global Corporate and Investment Bank and Co-Head of the North American Credit Derivatives Group. The Credit Derivatives Group is one of several business units at Citigroup that structures sophisticated financing for clients.

I have worked in the derivatives business at Citigroup since 1997. I appreciate the opportunity to answer questions about Project Bacchus and Project Sundance. While I want to make clear that I understood these transactions to be appropriate under the prevailing laws and standards, I also want to reiterate the point that Mr. Prince made in his opening remarks. Under Citigroup's new structured finance policies, we will not do these transactions today unless the client agrees to provide clear, detailed disclosure to investors.

Thank you, Mr. Chairman and Members of the Subcommittee. I look forward to answering your questions.

Senator LEVIN. Thank you, Mr. Caplan. Mr. Fox.

**TESTIMONY OF WILLIAM T. FOX III,² MANAGING DIRECTOR,
 GLOBAL POWER AND ENERGY GROUP, CITIBANK/CITI-
 GROUP, NEW YORK, NEW YORK**

Mr. FOX. Thank you, Mr. Chairman and Members of the Subcommittee. My name is William Fox. I have worked for Citibank since 1967. I am currently a Managing Director in the Global Relationship Bank and head of its Energy and Mining Department. I have overall responsibility for Citibank's relationship with clients in the energy and mining industries.

I have been invited here today to discuss two transactions that Citigroup executed for Enron, Project Bacchus and Project Sundance. While I am generally familiar with Project Bacchus, my familiarity with Project Sundance is more limited. I understand the Subcommittee has several questions about these transactions and Citibank's role in them. I look forward to helping the Subcommittee in any way that I can to answer questions about these transactions.

While we believe these transactions met applicable legal standards, they are not transactions that Citigroup would undertake today without clear and detailed disclosure from our clients about the net effect of those transactions on a company's financial statements.

¹The prepared statement of Mr. Caplan appears in the Appendix on page 103.

²The prepared statement of Mr. Fox appears in the Appendix on page 104.

Thank you, Mr. Chairman and Members of the Subcommittee. I look forward to answering your questions.

Senator LEVIN. Thank you so much, Mr. Fox.

Let me summarize the joint venture which we are going to start with called Fishtail and then ask my questions.

At the end of the year 2000, Enron wanted to show a sale of the interest that it held in a joint venture called Fishtail. They wanted to show that sale in order to generate cash flow and earnings for its year-end financial statement, and Enron contrived a sale of its interest to an entity called the Caymus Trust for \$200 million. The funding for Caymus was a \$194 million loan from Citibank, which Enron in turn gave Citibank a guarantee on. The other \$6 million was listed as being an equity investment by Fleet Boston which Citibank had guaranteed.

Now, that \$6 million had to be true equity for this to be a real sale by Enron, and Citibank understood this. If the \$6 million was a loan instead of true equity at risk, then this could not be shown as a sale on Enron's books and the whole purpose of the transaction would have been defeated.

But Citibank, on the other hand, wanted to reduce or eliminate its risk on this so-called equity investment, and so Citibank went to get an assurance from Enron's CFO, Andy Fastow, to, in the words of a memo, Exhibit 322 in these exhibits that are in front of you, this is Exhibit 322(c),¹ Citi was looking to obtain the right comfort from Andy Fastow.

Mr. Fox, let me ask you these questions. You are the one who met with Mr. Fastow to obtain this comfort for your bank. At our staff interview, you indicated that Mr. Fastow said that Enron would take whatever steps were necessary to make certain that Citibank's equity interest in Bacchus would be bought out. This was an important transaction for Enron, according to that same Exhibit 322(c). On the second page, this transaction was said to be "mission critical" by them and "a must" for Enron, and the words that I have quoted were on page one of that Exhibit 322(c) when it was said that Enron has offered to have the CFO discuss this "at whatever level of our organization we think necessary to obtain the right comfort." That is comfort now for Citibank.

First of all, looking at that Exhibit 322—I am going to change the 322 now to Exhibit 322(h),² if you would take a look at that. Exhibit 322(h) is a memo or e-mail from Lydia Junek to you, Mr. Fox, and it says that, "the equity component," if you will look at page two at the top, that "the equity component has been approved on the basis of verbal support verified by Enron CFO Andy Fastow." So they were promising you verbal support.

First of all, who is Lydia Junek, the woman who sent you the e-mail?

Mr. FOX. Lydia Junek is a Managing Director in our Houston office and she reports to me and did at that time, as well.

Senator LEVIN. So is it true, Mr. Fox, that Citi would not have provided the equity for this transaction unless it had this verbal support from Enron through Mr. Fastow?

¹ Exhibit No. 322(c) appears in the Appendix on page 229.

² Exhibit No. 322(h) appears in the Appendix on page 239.

Mr. FOX. Senator, this transaction was an interim bridge financing that we were engaged in. Our firm typically does not engage in bridge financings unless we are involved in the take-out or providing the permanent financing. In this case, we were not. So for this reason, I went and visited with Mr. Fastow because he had control of the take-out of this transaction. He was working with another institution. So we wanted comfort from him that they were going to take all steps necessary in order to ensure that the take-out financing was accomplished and our entire transaction would be repaid within its terms.

Senator LEVIN. So he gave you this assurance that your so-called investment would be repaid within that 6-month period?

Mr. FOX. He gave me the assurance that he would take all steps necessary to make certain that the take-out financing was accomplished and, therefore, the entire Bacchus transaction would be repaid.

Senator LEVIN. Now, would you have reassessed your participation in the deal had you not obtained that support?

Mr. FOX. I believe we would have. That assurance was important to us. As I said, we were not involved in the take-out of the financing of Bacchus, and typically our firm would not be involved in a bridge financing that was dependent upon a take-out unless we were involved in the take-out, and we were not in this case.

Senator LEVIN. Now, if you take a look at the top line of Exhibit 318,¹ page three, it says the equity component that we provide—this was supposed to be equity, not a loan, supposed to be equity—will be based on verbal support committed by Andrew Fastow to Bill Fox. It is a commitment now. It says that the verbal support—and by the way, that verbal support was referred to a number of times in the memo—but is it not a fact, Mr. Fox, that the verbal support was an oral guarantee from Mr. Fastow and Enron that your equity interest would be returned to Citi one way or another?

Mr. FOX. Senator, no, I do not believe so. We did not view it as an oral guarantee. It was verbal support and assurance to us that he and Enron would take all steps necessary to ensure the take-out financing, the permanent financing was accomplished so that our entire transaction would, in fact, be repaid within its terms.

Senator LEVIN. You did not consider the support, the oral assurance, the commitment, to be a guarantee?

Mr. FOX. The oral assurance, we did not view that as a guarantee. We viewed ourselves as being at risk for that \$6 million component of the transaction.

Senator LEVIN. The bottom line is, you did not consider that to be an oral guarantee?

Mr. FOX. We did not consider that to be an oral guarantee.

Senator LEVIN. Now take a look at Exhibit 366.² This is a Citibank credit approval document relating to Enron. It is dated December 2000, the month of the Bacchus transaction. At the top of page one, it lists Lydia Junek as the “responsible officer.” On the second-to-the-last page, she has signed the document. Citi’s loan

¹ Exhibit No. 318 appears in the Appendix on page 219.

² Exhibit No. 366 appears in the Appendix on page 655.

and so-called equity interest in the Bacchus transaction is referred to, if you will look at pages six and seven.

Now, the numbers are a little different, because at the time the document was written, it was expected that Bacchus would require a \$242 million loan and \$7.5 million in equity, so that is the numbers that are in there, but these amounts are the amounts that we are referring to here. They were reduced to the \$194 million loan and \$6 million in equity, but this is the same transaction, although the numbers were slightly reduced.

Now, on page seven of this document, under the word "support" in the middle of that page, it says, "verbal guarantees" in capital letters. You said there were no verbal guarantees. You didn't consider them verbal guarantees. The lady who signed this document for the bank under your supervision, in fact, said in this document these were "verbal guarantees" in capital letters. Now, if they weren't guarantees, why did she say they were verbal guarantees?

Mr. FOX. Senator, I would not—as I said, I was the one who had the conversation with Mr. Fastow. I was the one that understood exactly what he said. He did not give me a verbal guarantee. I did not seek a verbal guarantee.

Senator LEVIN. Did you ever see this document that said there were verbal guarantees?

Mr. FOX. I don't recall that I saw it. I may have. I probably did.

Senator LEVIN. And Ms. Junek works under your supervision?

Mr. FOX. Yes, she does, Senator.

Senator LEVIN. But you are trying, then, to make the distinction—you are trying to make a distinction that what you got is a commitment, an assurance, that all steps necessary would be taken to repay that money. How is that different from a guarantee? All steps necessary means all steps necessary.

Mr. FOX. Senator, as I said before, what I obtained from Mr. Fastow was his verbal assurance that they were going to take all steps necessary to make certain the take-out financing was done on a timely basis such that our entire transaction would be repaid.

Senator LEVIN. How is that different from a verbal guarantee? "All steps necessary" sounds to me like a guarantee, and Ms. Junek was very straightforward under your supervision in saying it.

Mr. FOX. Senator, this—

Senator LEVIN. How is "all steps necessary" different from a guarantee?

Mr. FOX. This was not legally enforceable. It was a businessman's understanding with the company. They had control of the take-out, they and the other financial institution they were involved in. We had no knowledge, not detailed knowledge of what that take-out financing was going to be. So I was relying on his verbal assurances that they were going to take the steps and they had the wherewithal to take those steps to make certain that the take-out financing was accomplished.

Senator LEVIN. You don't specifically remember seeing those words, "verbal guarantees," in that document?

Mr. FOX. I do not, Senator.

Senator LEVIN. You knew that Enron was going to book this transaction as a sale, is that not correct?

Mr. FOX. That is correct.

Senator LEVIN. And you also knew that if Citibank did not truly have a 3 percent equity at risk, that it would be improper for Enron to book the transaction as a sale?

Mr. FOX. We understood that we had to be at risk for the 3 percent of the transaction.

Senator LEVIN. Well, it seems clear to me, Mr. Fox, that Citibank was aware that 3 percent had to be at risk. You just said so. You had to be assured that it would not be guaranteed in order for this to be booked as a sale. But to protect Citibank from loss, you went out and got a verbal assurance, a commitment, a statement that all steps necessary would be taken by Enron to pay you back. It was characterized properly by your assistant as a verbal guarantee. You are not a lawyer, are you, in terms of whether it is legally enforceable, or are you a lawyer?

Mr. FOX. I am not a lawyer.

Senator LEVIN. Did you receive an opinion that this was not legally enforceable?

Mr. FOX. We did not receive an opinion with respect to this aspect of the transaction. As I said earlier, my view was I was there. What I got was assurances from Mr. Fastow that the take-out financing would be executed, and we would be paid out of the entire transaction within its terms.

Senator LEVIN. It was clear that in doing this, you were trying to protect yourself from loss, isn't that correct?

Mr. FOX. No, we understood we were at risk, but since we were not involved in the take-out and this was a short-term bridge financing, we wanted to make certain that that bridge financing was going to be executed and we would be out of this transaction within the terms.

Senator LEVIN. Isn't that the same way of saying that you were trying to protect yourself from loss?

Mr. FOX. We clearly understood we were at risk.

Senator LEVIN. But weren't you trying to protect yourself from any loss from the transaction?

Mr. FOX. We wanted to make certain that we were out of the transaction on a timely basis, that is correct.

Senator LEVIN. And you were aware of the fact, I take it, that if this assurance, commitment was a guarantee, that that would queer the deal, is that correct?

Mr. FOX. If we had obtained a guarantee, we understood that they could not achieve their accounting objective.

Senator LEVIN. And that would queer the deal? The transaction would not have occurred, is that correct?

Mr. FOX. I don't know what Enron would have done at the time, but we certainly knew that for them to achieve their objective, accounting objective, we had to be at risk on the \$6 million.

Senator LEVIN. Their financial statement, in showing this totally as a sale, with a sale of equity, not showing any guarantee, not showing any assurance to anybody, but just simply showing it as a sale, was clearly deceptive. You are not going to reach a judgment on the Enron books, I assume, or are you?

Mr. FOX. No, Senator, I am not.

Senator LEVIN. Others will and others have. It was clearly deceptive. By not showing on its books that oral guarantee that it made,

in the words of Ms. Junek, it deceived the people who were reviewing its books, and you can split hairs and say that assurance, using all efforts, taking all the necessary steps, commitments, doesn't constitute a guarantee, but it is, one, hair splitting, and two, inconsistent with your own document which says, in fact, it was an oral guarantee.

My final question to you is, under your current standards that Citibank has adopted, would this transaction occur?

Mr. FOX. Senator, no, it would not occur under our current standards without complete and full disclosure of the net effect of the transaction on Enron's financial statements.

Senator LEVIN. Well, now, would it occur knowing what you know?

Mr. FOX. We would have not done the transaction unless they fully disclosed all aspects of the transaction and the net effect of it on their financial statements.

Senator LEVIN. And had they done that in this case, based on what you know, would this transaction have taken place?

Mr. FOX. Senator, I don't know what they would have done at the time, but—

Senator LEVIN. What would you do, knowing what you know?

Mr. FOX. We would have gone to Enron and asked them, under our new standards, to have the complete, total disclosure of the net effect of the transaction. We would have had to make certain that their chief financial officer, general counsel were aware of the transaction, all aspects of it, not only the written documents, but also any oral understandings.

Senator LEVIN. What is the net effect of this transaction on Enron? Was it in net effect a loan or net effect a sale?

Mr. FOX. They booked—

Senator LEVIN. No, I know what they booked, but you are going to look at the net effect, right?

Mr. FOX. Right.

Senator LEVIN. Under your new standards.

Mr. FOX. Yes. We would look at the net effect.

Senator LEVIN. In your judgment, what was the net effect of this transaction on Enron, a sale or a loan?

Mr. FOX. I think we would have required them to disclose the conversation with me. We would have required them to disclose all aspects of the transaction and the net impact on its financial statements. At that stage, I would assume they and their accountants would review the transaction with their legal people and determine how it would be booked. I am not in a position to determine how they would have booked it. I can only suggest and require them to have full and complete net effect exposure—disclosure.

Senator LEVIN. I am not sure, Mr. Prince, what your new standards really mean if all you are going to say is if Enron discloses this on their books, it is OK with you, when it is so obvious, it seems to me, to anybody that when you give a guarantee, as they gave to you, that they would take all necessary steps to make sure that was repaid and that they gave assurances to that. If you can possibly then say, well, we would proceed the same way we did before providing they said that, I am not sure what your new standards really mean.

Mr. PRINCE. Well, Senator, you have highlighted two key differences between what happened then and what would happen now. The first is that these oral assurances would be written down and would be included in the transaction documents that are forwarded to the chief financial officer, the chief legal officer, and the outside auditors, so everyone would have the same base of information.

And second, the net effect rule would require that the net effect of the transaction, as I mentioned in my opening statement, on the assets, the liabilities, the balance sheet, the income statement, the net effect of all of the complicated moving around of assets would have to be disclosed.

I think those are two very important differences between what happened then and what happened now.

Senator LEVIN. And if they decided the net effect was a sale, that is OK with you?

Mr. PRINCE. Well, Senator, it is not just a word, and it is not just a sentence. They wouldn't disclose the net effect was a sale.

Senator LEVIN. Pardon.

Mr. PRINCE. They would not, sir. They would not simply disclose a conclusory sentence that this was a sale or not a sale. As part of a sale, if it were a sale under the complicated accounting rules, they would have to disclose the net effect of that sale on their balance sheet, on their income statement.

Senator LEVIN. And my question to you is, based on your study of this record and your judgment, would you conclude and agree that the net effect of this transaction was a sale?

Mr. PRINCE. Senator—

Senator LEVIN. If they concluded that, would you accept their conclusion?

Mr. PRINCE. Senator, again, I am trying to answer your question. It is more than the word "sale." The net effect of the transaction, what happens to the balance sheet, what happens to the income statement is what our rule calls for, not the word "sale" or not sale.

Senator LEVIN. The net effect on the Enron financial statement was \$112 million in earnings from that transaction, but you cannot tell us today, based on all of these documents, that if they concluded again that that was a sale, that you would not proceed with that transaction, based on what you know?

Mr. PRINCE. Senator, I—

Senator LEVIN. You know all the underlying facts. You can say it is not just the conclusion. I agree with you. You are going to look at the underlying facts and conclude whether or not it is a fair judgment that this is a sale. Otherwise, you said, it seems to me that you are not going to proceed. My question to you is, based on all these underlying facts which have been laid out in front of you, would you proceed if Enron again in this kind of a situation said, or Enron said in this kind of a situation that this was a sale? Would you proceed?

Mr. PRINCE. Senator, if I understand your question correctly, if you are asking me, would I make the judgment that this was a sale or not a sale based on these various facts, I can't make that decision sitting here today. I would want to consult with my control

people. I would want to have a much more rigorous review than the detail we have had here this morning.

Senator LEVIN. Mr. Fox, you told the Subcommittee staff that Citi had a business policy that it would not engage in structural transactions that had a material impact on reported net income. That was the business policy that you had, and that Citi would look further at the project and assure itself that the project would not impact reported net income. That was your policy in place at the time.

Yet, throughout the Bacchus transaction, you were notified that there was a possibility that Enron would use the transaction to report net income in its year 2000 financial statement. Exhibit 322(a)¹ is an e-mail to you and it states the following: "Enron's motivation in the deal now appears to be writing up the asset in question from a basis of about \$100 million to as high as \$250 million, thereby creating earnings."

Exhibit 322(c)² is a November 28 e-mail which states, "According to Enron, it is possible that there will be funds flow and/or earnings impacts. Although not certain at this time, we should assume that there will be funds flow from operations/earnings implications." That is what you said you were going to assume.

Finally, on December 6, there is an e-mail, Exhibit 322(d),³ which states, "It is probable that the monetization will add to funds flow from operations as a portion of the assets will be from merchant pool. It is possible but not certain that there will be earnings impact." That was the last communication on the matter.

Now, did the Citibank policy then require further investigation at that time, since there was the possibility of an earnings impact which your policy would not permit?

Mr. FOX. Senator, the series of e-mails you referred to, starting with the first one, certainly highlighted the potential of an earnings impact. We went back to the company. We went back to the treasurer of the company, who confirmed to us that there would not be significant material earnings impact.

I was shocked when I learned from your staff, which was the first time I knew about it, that the impact of this transaction created \$112 million of earnings. Quite frankly, Senator, in this particular case, we were lied to. We relied on Enron, who was the only one that could determine the impact of a transaction as to what the earnings impact would be.

Senator LEVIN. So that you specifically contacted Enron after your decision that there could be an earnings impact to see whether there would be and they told you there would not be?

Mr. FOX. I did not specifically contact them.

Senator LEVIN. Who did?

Mr. FOX. Jim Reilly, who is a Managing Director of our firm. If you go further into that last e-mail you made reference to, he reports that Enron has suggested, however, that because of their ongoing involvement in the business, it is unlikely there will be any material earnings benefit.

¹ Exhibit No. 322(a) appears in the Appendix on page 226.

² Exhibit No. 322(c) appears in the Appendix on page 229.

³ Exhibit No. 322(d) appears in the Appendix on page 232.

Senator LEVIN. And you accepted that without further investigation?

Mr. FOX. We relied on Enron's word. They were a highly respected company. They were a company we had a good relationship with at the time and that is something we would have relied on, yes, Senator.

Senator LEVIN. And their word was "unlikely"?

Mr. FOX. Their word, it was unlikely that there will be any material—I don't know what their word was. That was Mr. Reilly's word.

Senator LEVIN. But that was not enough, the fact that it was unlikely, still possible, investigation as your policy it seemed to me required you to do to assure yourself that there would not be an earnings impact.

Mr. FOX. I believe that this would have sufficiently satisfied ourselves at the time.

Senator LEVIN. You were not aware yourself of the conclusion?

Mr. FOX. I was not aware. I did not have the conversations directly with the company, no, Senator.

Senator LEVIN. You had earlier, in Exhibit 322(g),¹ in a memo, you were aware of the fact that this highly reliable company, one of the largest in the country, significantly dresses up its balance sheets at year end. You were very much aware of Enron being someone who liked to and was willing to and typically did dress up their balance sheets, because you wrote in that memo that is at Exhibit 322(g) that, "based on 1999 numbers, it would appear that Enron significantly dresses up its balance sheet for the year end. Suspect we can expect the same this year."

So you were expecting a dressing up, disguise, costume by Enron at the end of the year 2000. You had received strong suggestions from other Citi relationship managers that it was possible that Citi would claim earnings from the Bacchus transaction. You were told only apparently—you are supposed to be in a position here of some decisionmaking import—you were told that it was—you just took Enron's word that it was unlikely that there would be an earnings impact. Of course, if there was an earnings impact, that violated your policy. But knowing that this company put on a show at the end of its year, you nonetheless, or your bank nonetheless simply accepted their statement that it was likely that there would not be an earnings impact. How can you explain that?

Mr. FOX. Let me comment and address that, Senator. My reference to dressing up the balance sheet is a slang reference that a number of companies will take certain steps at various points in their financial cycle to address balance sheet targets. They can stretch out payables to generate cash. They can monetize or securitize receivables to generate cash and pay down debt. They can borrow under their bank facilities and pay down short-term commercial paper. Many steps that large financial—I mean, large Fortune 500 companies take to impact their balance sheet.

The context here was that I was looking at their September 1999 financial statements, reviewed them, and if I recall correctly, the debt-to-capital ratio appeared higher than it would at year end and

¹ Exhibit No. 322(g) appears in the Appendix on page 237.

that seemed to indicate to me that they would take certain steps as it impacts their balance sheet. That was a balance sheet comment and statement. It was not related to the income.

Remember, at the time, Enron was an important relationship. Enron was a highly respected company. We had no reason to suspect or believe that we could not trust and accept their word.

Senator LEVIN. Do you recall telling the Subcommittee staff that this unlikely earnings impact conclusion was an insufficient resolution as far as you were concerned of Citi's policy? Do you recall telling the staff that?

Mr. FOX. No, I don't, Senator.

Senator LEVIN. All right. Let me ask you, Mr. Prince, under your current policy, would this be a sufficient resolution?

Mr. PRINCE. Indeed not, Senator.

Senator LEVIN. This is my final question and then we will turn it over to Senator Collins, for this round, at least. Mr. Prince, let me first say that we all are hopeful that Citigroup's apparent willingness to change its practice will lead to the kind of results that you hope for and expressed in your opening statement, and I just want to ask you some questions about your new policy.

Your new net effect rule is described as follows: Citigroup would execute material financing transactions for companies that were not going to be recorded as debt on their balance sheet if and only if, as you stated, the company agreed to disclose the net effect of the transaction on its financial condition.

The first problem that I have with this policy, or question, is that it states that Citigroup will continue to provide financing in cases where it knows the company isn't going to record the debt on its balance sheet. Doesn't that mean that Citigroup still thinks it is OK to sell loans that aren't honestly reported as loans?

Mr. PRINCE. No, Senator, it does not mean that. There are many things that are appropriately not recorded as debt on a balance sheet. The key for us is that even if they are appropriately not recorded as debt on a balance sheet, the effect of the transaction must be disclosed. It doesn't matter anymore whether you do just this much or just that much and you satisfy this little rule or that little rule and suddenly it shifts from one shoebox to another shoebox, or one pigeon hole to another pigeon hole. You are not done at that point. Even if you satisfy a test and it goes to the next category on the balance sheet, the effect of the transaction, separate from the accounting conclusion on the classification, has to be disclosed. That is the difference.

Senator LEVIN. Are you going to make a judgment as to the fairness of the conclusion relative to net effect, or are you just going to accept the conclusion of the other company, of your client?

Mr. PRINCE. Senator, I think one of the things that we have learned is that we have to make our own judgments in that regard.

Senator LEVIN. Because Enron could argue, for instance, in those prepaids that we made reference to and you are aware of from an earlier hearing, they did disclose the net effect of the transactions because it included the energy trades in its year 2000 financial statements. It recorded \$4 billion worth of cash flow from operations, but no debt. Since Enron included the energy trades in its financial statements as cash flow from operations, would that meet

your disclosure requirement, or would you look behind that and make sure that it is a fair and accurate disclosure?

Mr. PRINCE. Senator, I think it is clearly the second. We would require that the effect of the transaction be disclosed. So we would require them to disclose it in a way where anyone could understand.

One of the problems that we all face is that these matters are way too complex and getting to a simple decision shouldn't lead to opaqueness, shouldn't lead to, well, now that we have got the answer from an accounting standpoint, the effect of the transaction that goes one way or the other. Despite the accounting conclusion, the effect of the transaction has to be disclosed.

Senator LEVIN. If I understand what you said a moment ago, not just disclosed, but that you would reach an independent judgment that the disclosure was a fair statement of the facts.

Mr. PRINCE. Yes, sir. We would have to be comfortable ourselves with that disclosure.

Senator LEVIN. And one last point. In Sundance, three senior Citigroup officials recognized the accounting problems with Sundance and said, don't do it. Citigroup did it anyway. What is the solution there? If there is no agreement among your top officials, will there be a requirement that whoever approves that at a higher level is going to have to put a stamp of approval on it?

Mr. PRINCE. Senator, as I said in my opening statement, one of the key differences we have now is that every part of the process has to be documented. We have to be able to pull out a paper to put in this notebook which will say who finally and formally signed off and why they signed off once an issue has been raised.

Senator LEVIN. Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Prince, I do recognize the steps that you have taken since our last hearings to put additional safeguards in place and I don't minimize those actions. I think they do represent progress. But in looking at the documents involved in these transactions, I find it very difficult to understand how these transactions were approved under your old procedures. There were warning flags galore, and I want to read you some of the comments by Citigroup's own employees, who it seems to me kept trying to raise red flags, kept trying to bring concerns to the attention of senior management.

In one e-mail, for example, an Alan McDonald says, "We, Bill Fox and I, share risk's view and if anything feel more strongly that the suitability issues and related risks, when coupled with returns, make it unattractive. It would also be an unfortunate precedent if both GRB management relationship and risk's views were ignored."

Another e-mail describes one of these transaction as "a funky deal accounting-wise," and characterizes another Citigroup employee's view as being "amazed that they can get it off the balance sheet."

Yet another e-mail, which Senator Levin has referred to, "based on 1999 numbers would appear that Enron significantly dresses up its balance sheet for year end; suspect we can expect the same this year."

Yet another from a memo, the "accounting is aggressive and a franchise risk to us if there is publicity."

Yet another e-mail, this one from Rick Caplan, "Sounds like we've made a lot of exceptions to our standard policies. I'm sure we've gone out of our way to let them know that we are bending over backwards for them. Let's remember to collect this IOU when it really counts."

How did this happen? Why would these transactions all be approved when you have Citigroup employees raising so many red flags, describing the accounting as "funky," saying that they don't understand how this achieves Enron's objectives of getting off-the-books treatment for these transactions, saying that a lot of exceptions were made to standard policies? How could this have happened under your old procedures?

Mr. PRINCE. Senator, I will tell you honestly, I have done a lot of soul searching about that. As the new CEO of this business, I am responsible for it now and I am responsible for what happens going ahead and I have to make sure that problems can't arise under my leadership of the business, and so I have thought a lot about how this could have happened when the issues that you have identified were raised.

I think, honestly, that our people did spot some of those issues, did raise them. You have quoted the various documents. And I think that in hindsight, our people were too comfortable with the ability to rely on the outside auditors, on the law firms that structured and closed these transactions, and on the representations from Enron themselves. I think that at that time we did not view ourselves as being responsible for what Enron did with its own books and I think we have learned a very painful lesson in that regard.

Senator COLLINS. But it wasn't as if the representations by Enron or Andersen or the legal team that Enron used didn't raise questions.

Mr. PRINCE. That is correct, Senator.

Senator COLLINS. And that is the part that is troubling. There are some cases where there was outright deception in the information and data that were provided to you. But in other cases, the information provided to Citigroup raised red flags and yet the transactions went through.

Mr. PRINCE. And indeed, Senator, I think some of the language reflects our mental state at that time. The one you quoted that said we are surprised they can get it off their balance sheet, it is obvious that we are observing their decision process. We didn't view ourselves as a participant in that decision process. We were watching it. We were relying on what they told us. We were relying on what Arthur Andersen said was OK or not from an accounting standpoint. We have learned a painful lesson that we can't be a bystander and just watch that process.

Senator COLLINS. Mr. Prince, how much was this driven by the fact that there was the lure of big fees? I come back to this e-mail, and it is Exhibit 322(i),¹ where it says, "Sounds like we made a lot of exceptions to our standard policies. I'm sure we've gone out of our way to let them know that we're bending over backwards for

¹Exhibit No. 322(i) appears in the Appendix on page 242.

them. Let's remember to collect this IOU when it really counts." What does that mean to you?

Mr. PRINCE. Well, Senator, as you know, I was not managing this business and I wasn't intimately involved in these transactions, but in being briefed on these transactions, my understanding is that the exceptions to our policies involved things like choice of law, whether it is Texas law or New York law, things like that.

But the short answer is, I can't put myself in the minds of the people who did these transactions. I don't believe that in a company like ours, an individual transaction would drive people to do bad things. Based on what I know, I believe that our people, acting under the rules as they understood them to be and with the clear mental state that I mentioned a moment ago about relying on others, that they acted in good faith. That is my belief. If I did not believe that, the people would not still be with the company. But I believe they did act in good faith under the rules as they understood them at the time, and I don't think that fees, whether on this transaction or others, corrupted our organization.

Senator COLLINS. Mr. Fox, I want to follow up on your discussion with Senator Levin, which still leaves many questions in my mind. You traveled to Houston and met with Andrew Fastow, Enron's CFO at the time, because you wanted to discuss the verbal support or the support for Citigroup's investment in the Bacchus transaction, is that correct?

Mr. FOX. Yes. I traveled to Houston to meet with Mr. Fastow to discuss the entire transaction and obtain his assurances that they were going to take the necessary steps to make certain that the take-out or permanent financing was put in place and that we would be repaid.

Senator COLLINS. Yet in your testimony today in response to questions from Senator Levin, you indicated that it was never your understanding that Mr. Fastow provided you with any kind of guarantee, is that correct?

Mr. FOX. That is correct. He did not provide me with any guarantee.

Senator COLLINS. And you also testified, and this is obviously the critical point, that you considered Citigroup's investment to be at risk, is that correct?

Mr. FOX. That is correct.

Senator COLLINS. OK. Now, the reason I am having difficulties understanding that is a document that is the loan approval memorandum, which is Exhibit 318,¹ where over and over again, in fact, I think four times in the document, there is reference to the verbal support, the verbal commitment that you received from Mr. Fastow.

For example, there is a sentence on page two of the memorandum in the first paragraph that says, "From our perspective, the equity portion of the facility will be at risk and there is consequently a large element of trust and relationship rationale involved. However, this equity risk is largely mitigated by verbal support received from Enron Corporation as per its CFO." That is

¹Exhibit No. 318 appears in the Appendix on page 219.

obviously referring to the conversation that you had with the CFO, is it not?

Mr. FOX. Yes, it is.

Senator COLLINS. Again in the memorandum, on page three, there is a statement saying, "Enron's CFO has given his verbal commitment to Bill Fox that Enron Corporation will support the 3 percent equity piece of this transaction." At the top of that page, again, "The equity component we provide will be based on verbal support as committed by Andrew Fastow to Bill Fox." It says over and over again in this document, which is the loan approval memorandum, that you had a verbal commitment. So I am trying to understand how you could view the funds as being truly at risk given the verbal support of the investment that you received from Enron.

Mr. FOX. Senator, what we are doing here, I believe, in this document is trying to highlight to all that were involved in the transaction and approving it that a portion of the transaction was at risk as equity based solely on verbal support. It did not have a legal obligation from Enron. It did not have the faith and full faith and credit from Enron. It was simply that Enron through Mr. Fastow was going to make certain that the take-out transaction was going to be accomplished.

Senator COLLINS. What did the verbal support mean and why was it so important that it appears four times in the loan approval memorandum?

Mr. FOX. We, I believe I would say, we were trying to highlight the risk for all the approvers, that this was not a legal obligation by any stretch of Enron to pay us back the \$6 million. It was verbal support. We were at risk, but we were dependent on them to make certain that the take-out financing, the permanent financing, was going to be accomplished.

Senator COLLINS. I have to tell you that I read it exactly the opposite. If it was important enough for you to go and meet with Andrew Fastow to get that commitment, and if it appears four times in the approval memorandum, and when there is actually a statement in this memorandum saying that the equity risk is largely mitigated by the verbal support received from Enron, how can you continue to maintain that this commitment really had no meaning?

Mr. FOX. I think that is just the point, Senator. It was mitigated, not eliminated. We had that risk, and I think that is what we were highlighting to everyone, so that everyone in our firm who was approving the transaction understood that this was an incremental risk we were undertaking.

Senator COLLINS. On Exhibit 366,¹ the phrase is used that it is a verbal guarantee and the percentage is 100 percent. What does that mean.

Mr. FOX. Senator, I am sorry. Where are you exactly in the exhibit?

Senator COLLINS. It is Exhibit 366. It is under "Support" typed to the left. It says, "verbal guarantees," "Enron Corporation," "percentage: 100."

Mr. FOX. Yes, I am sorry.

Senator COLLINS. Doesn't the word "guarantee" mean something?

¹Exhibit No. 366 appears in the Appendix on page 655.

Mr. FOX. Senator, I don't know who completed that form, and it is a form that gets completed, but that was not what I obtained from Mr. Fastow, and I think what I obtained from Mr. Fastow was generally well articulated in some of the other written documentation. I obtained from him his verbal assurance that they would take all necessary steps to make certain that the take-out financing was accomplished and our entire financing, not just the equity piece but also the debt piece, would be repaid.

Senator COLLINS. So are you saying that the word "guarantee" should not have been used on this document?

Mr. FOX. That was not an accurate representation of my conversation with Mr. Fastow.

Mr. CAPLAN. Senator, could I make one clarification, just looking at this for the first time?

Senator COLLINS. Yes.

Mr. CAPLAN. I am not certain that what Mr. Fox is inconsistent with—what he is saying is inconsistent with what this says, because if you note that this section of this memo is about the term loan, the \$194 million term loan that we were providing as a bridge, and I think you could very easily conclude that the verbal guarantee is that Enron is going to work hard and get that take-out done at the termination of this loan. This doesn't actually refer to the equity at all. It seems just to refer to the term loan.

Senator COLLINS. Let me ask one final question.

Senator LEVIN. If you would yield to me on that point—

Senator COLLINS. Absolutely.

Senator LEVIN [continuing]. Because you are inaccurate. Take a look at the prior page at the bottom. That is the term loan.

Mr. CAPLAN. Well, it says in the middle of the page, "Facility description, term loan," and then—

Senator LEVIN. I understand. I know exactly what you are saying. I am saying that the larger loan, the \$242 million, which was then reduced, as I indicated in my opening statement, is on the previous page, and that is page six. This is, without any doubt, referring to the equity, which was listed as \$7.5 million, but, in fact, as I indicated, was reduced to \$6 million. But there is no doubt that this is the equity portion, so-called equity portion, called a term loan, by the way, in this document. I just want to—stated to be verbal guarantees, not just mitigated, 100 percent—but the point here is that you are wrong when you—

Mr. CAPLAN. I would agree.

Senator LEVIN. OK.

Mr. CAPLAN. But I think, though, if I might, I think this is the beauty of our new policy, because whether we called this thing—whether this thing turns out to be a sale or a loan, the effect of whatever the intent behind the transaction would be disclosed in the financials. We would require disclosure of that in the finances of the company. I think that is really the difference we are trying to articulate here today.

Senator COLLINS. One final question, because my time has expired. Mr. Fox, had you not received the oral commitment, whether we are calling it a verbal guarantee or an oral commitment, from Enron, would you have proceeded with this transaction?

Mr. FOX. Senator, today, I am not certain I can tell you one way or the other. If we had not received it, it would have certainly been a different risk, as the memo highlighted. The verbal support mitigated some of that risk. Without that, as I said earlier, it is unusual for us to engage in a bridge financing where we are not in control or involved in the take-out. So I can't say for certain today whether we would or would not have gone forward without it, but it clearly was important to us.

Senator LEVIN. Thank you. Senator Bennett.

Senator BENNETT. Thank you, Mr. Chairman.

Coming to this de novo, without the kind of research that both my Chairman and Ranking Member have done, I have a slightly different reaction. I think the first documents that refer to mitigation on the basis of verbal support pass the smell test. The second document clearly does not, the one that says verbal guarantee, 100 percent, and I think that is a bureaucratic slip-up that the people who had the conversation with Fastow—you, Mr. Fox—clearly understood you were at risk, and your first document makes it clear. We are at risk.

Now, anybody on an approval basis reading that document says, well, what do we have to deal with the risk, and your answer is, I have had a conversation with Fastow and he says he is going to take it out. That is not legally binding, it is not something we can go to the bank with, but we are satisfied that they will make good on it and that mitigates the risk. I think that document passes the smell test.

But as it got handled by the sausage machine down to the final drafting of the final loan document, that reference of a mitigation got turned into something more than a mitigation and it came out as a 100 percent guarantee and I think that is something you ought to look at in terms of the way documents get drafted within large bureaucracies. I am not surprised by it. I am not horrified by it. It happens all the time.

But I think it is a clear message to you that when a deal is made at your level, Mr. Fox, it gets documented to the point that when it finally comes out in the final document that is done by an employee who is used to doing hundreds, if not thousands, of these in a very routine way, that the significant deal you made still retains its flavor when it comes out in the final wash. That is how I read what happened here. Now, if you want to challenge that and say, no, that is not where it is, looking at it strictly, as I say, de novo, that is what I see what happened here.

So just to nail it down one last time, Mr. Fox, you were convinced, regardless of what the documents said, that Citibank really was at risk here?

Mr. FOX. Yes, Senator, I was.

Senator BENNETT. And you were satisfied that it was a risk Citibank could afford to take because Andy Fastow had told you, "We are going to be able to meet our obligation"?

Mr. FOX. That is correct, Senator.

Senator BENNETT. OK. If that is all the farther it went, I think that is a legitimate position for you to have. The difficulty comes from what Enron did with this, and as Senator Collins said, you understood what they were doing with this was really, to use the

catch-all term, very aggressive. “Very aggressive” usually means getting close to the edge of something that is improper.

Now, Mr. Prince outlines the actions that Citibank is going to take, and this is what I really want to focus on, rather than the details of this particular situation. We are talking about a new role for banks. In the old world, banks did not view as their role—I interrupt myself here. Let me lay it out as I see it and then you agree or disagree.

In the old world, banks did not view their role as being watchdogs of investors and borrowers. Banks viewed their role as being watchdogs for the investors in the bank. So as long as the bank was satisfied that it would get its money back, it really didn’t care what the borrowers did with the money.

Now we are saying the bank should have been part of the watchdog team that would blow the whistle and say, these guys are borrowing the money and they are going to do squirrely things with it on their balance sheet, and unless they disclose the real effect on their balance sheet of taking on this loan, we are not going to give them the loan. Is that a fair characterization of the switch in the role of the bank that has occurred as a result of the Enron collapse?

Mr. BUSHNELL. Mr. Bennett, perhaps I could take that one. Yes, I think that is a fair characterization of the new policy and the switch from where we were and the policies and independencies that we used to have versus the procedure going forward.

Senator BENNETT. It does represent a fairly significant change in policy, because up until now, we, the Federal Government, have assumed that the role of gaining transparency in financial statements is primarily, if not exclusively, the SEC, and as long as the SEC does its job, the banks don’t have to worry about it. They can just make the loan as long as they are sure their shareholders will be taken care of and leave it up to the SEC to make sure the borrowers do the right thing with the money. Now we are saying, no, in addition to the SEC, the banks must play a role in disclosure to the shareholders of the borrower.

Mr. BUSHNELL. I think that is right, Senator. I think our feeling is that, as Mr. Prince discussed in his opening remarks, this has been such a painful process for us, even if our depositors weren’t hurt or the bank got its money back in this case, which it did, it has clearly been a damage to the financial system, to the trust in the development and establishment of the smooth flowing of our capital markets, and that in our own self-interest, if you will, we need to make that trust come back and be a party to it.

Senator BENNETT. This raises a number of very interesting possibilities. If the bank does assume a role and, therefore, a responsibility for the accuracy of financial statements on the part of the borrower, can the bank be sued if the borrower misstates the use of the funds it obtains from the bank?

Mr. BUSHNELL. I understand that, Senator. I don’t think we are looking to take on the legal responsibility or the accounting responsibility for this. We do think that there are regulatory agencies and that is others’ jobs. We just think that when there are questions like this, the best policy as a risk manager, transparency, shedding

the light on what the transaction is in plain English so that everybody can understand what happened, is the best policy for us.

Senator BENNETT. I think that is a very important point for you to make because I don't think you want to expose yourselves to lawsuits on the basis that you did not adequately require transparency on the part of the borrower. I think you want to keep the wall there that the lawsuits can go to the accounting firm that didn't adequately provide disclosure or require disclosure. The lawsuits obviously can go to the borrower themselves if they lied, as Enron clearly did. But that the lawsuits can't go to the deep pockets of a bank who, in their requirements for disclosure, fell short of the kinds of requirements.

You want to make it clear, I think, that in the policies you are adopting, you are adopting these policies to protect the safety and soundness of the banks and the investment in the banks of the banks' shareholders. I think the case can be made that the kind of disclosures Mr. Prince has described here do, in fact, reduce the risk to shareholders of the bank, and by making these requirements on the part of the borrower, you are saying that the bank will ultimately have fewer bad debts and fewer write-offs.

Let me ask the question that has not been answered here. Did you lose the \$6 million? It was at risk. Did you lose it?

Mr. FOX. No, Senator. The permanent financing was executed and the entire Bacchus financing was repaid.

Senator BENNETT. OK. Are there any other of the transactions we will be discussing here this morning where the bank had money at risk which you lost?

Mr. FOX. Not in the transactions that we are discussing here today.

Senator BENNETT. OK. So the changes that Mr. Prince has talked about, if they had been in place, would not have changed the losses sustained by the bank. In other words, these changes would not have retrospectively benefitted the shareholders of the bank.

Mr. FOX. I think they may have benefitted the shareholders because we wouldn't have been associated with these transactions, but—

Senator BENNETT. That is fair, yes. They would have affected the shareholders in that they protect the reputation of the bank and the reputation of the bank is obviously something that is of value to the shareholders. So I will accept that, even if there was not a specific monetary loss.

Mr. FOX. That is correct, but we did not lose money on these transactions. They were repaid within—to us.

Senator BENNETT. That is my point, Mr. Chairman, and I will stop there. I think the things we have heard from Mr. Prince are salutary and we should congratulate Citibank on its willingness to move forward.

I think it should be pursued, but I think everybody should be a little careful about crossing the line and putting a liability on the bank, any bank, if they fail to do these kind of things, because traditionally, regulation of disclosure and achieving of transparency is something that should be accomplished by the SEC and by the independent accountants who are paid handsomely to make sure that there is transparency and that it should not be ultimately

spilled over into a lender so that a lender could be liable for making a loan where the disclosure requirements of the lender were deemed to not be sufficient to protect the interests of the shareholders and the investor. That strikes me as very dangerous ground that would open the door for a huge number of lawsuits, to the detriment of everybody, if we are not very careful.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you, Senator Bennett.

What we are looking into is, in addition to the changes which Citibank is indicating it is making in the way its procedures operate, we are also looking at what it didn't do relative to the procedures that it had in place on these transactions. This is not just saying in hindsight that we have reached a conclusion. It is saying that the investigation discloses that at the time these transactions were inappropriate, that they aided and abetted deception, that there were major concerns raised internally that were overridden, set aside in order to please Enron or to make a fee.

This isn't just a question of hindsight or under current rules these transactions wouldn't be approved. There were rules at the time about not aiding and abetting deceptive transactions. That is not a new rule for a bank. That is an old rule.

There is an old accounting requirement that was in existence at the time that says there is no room for accounting representations that subordinate substance to form, and you cannot aid and abet a violation of that rule.

So that is our major concern here, it is the way in which major institutions facilitated deceptive accounting and bent the rules or violated the rules that existed at the time. Senator Collins has made reference to this Exhibit 322(i),¹ which says, "it sounds like we made a lot of exceptions to our standard policy." Those are policies that existed at the time. Those aren't new policies. "I am sure we have gone out of our way to let them know that we are bending over backwards for them," for Enron. "Let's remember to collect this IOU when it really counts. Happy holidays to all."

Let us move to Sundance. A few months after Bacchus, Enron decided to create Sundance as a joint venture that would keep all of Enron's pulp and paper assets off its balance sheet. And, as I discussed in my opening statement, the joint venture was a sham because Citi really didn't have any investment at stake, and here are the facts.

Citibank's \$28.5 million that it was supposed to invest and have at risk, in fact, was set aside, kept segregated, available for Citibank. Seven-hundred-and-forty-seven million dollars of Enron's money would have had to have been lost before any of Citibank's money could be touched. Citibank could unilaterally dissolve this venture at any time, ensuring that it wouldn't lose anything on its investment.

I want to go over this whole situation here with you, Mr. Caplan. Most auditors require that for a joint venture to be unconsolidated, the capital commitment must be split 50-50. Arthur Andersen was a lot weaker, a lot less conservative, and the second partner in the venture only had to put up 20 percent under Arthur Andersen's

¹Exhibit No. 322(i) appears in the Appendix on page 242.

rules in order for the joint venture to be unconsolidated on the books of Enron, and that is, of course, what Enron was interested in. That was their goal.

Now, even with the weaker approach, the 20 percent approach, Citi and Enron still went around it through all the ways that I discussed. Twenty-eight-point-five million dollars was segregated, couldn't be touched. Citibank could end this whole deal any time it wanted. Enron's \$747 million had to all be spent before there was even any Citi money spent at all, whether it was the \$28.5 million or the balance, which I believe was \$160 million.

Citibank also had a guaranteed return interest rate, and I would like you to look at one Citi e-mail, Exhibit 333(i),¹ which appears to me to be an accurate summation of Citibank's so-called investment in Sundance. It is supposed to be an investment at risk. Principal is supposed to be at risk.

Here is what the e-mail from Citibank says. "Still an equity investment of sorts, accounting and tax basis for partnership, but it is structured in such a way that the 670 basis points are guaranteed or we blow the deal. Also, our invest," I assume that means investment, "is so subordinated and controlled," and now these are the key words, "that it is unimaginable how our principal is not returned," Unimaginable how the principal could not be returned.

This is supposed to be an investment at risk. Guaranteed return interest. Unimaginable, in your own words, how your principal would not be returned. Now, how does one realistically say that funds are at risk under those circumstances so that Enron could keep Sundance off its balance sheet?

No one here is suggesting that you have got to go out and investigate the other guy's balance sheets, but my gosh, this is something that you knew. You knew that your investment was so subordinated, so unlikely to be reached, so much in your control—it was controlled by you. You could terminate that joint venture anytime you wanted. It was unimaginable that your principal was not going to be returned. Now, you tell me how that is an investment which is at risk.

Mr. CAPLAN. Well, I would say a few things. First, I think it is important to note that this structure was presented to us by Enron in exactly this form, and our investment was absolutely in a preferred position. It was senior to Enron's investment. They absolutely had to lose \$700 million. But my choice of words would not be "unimaginable." There were many circumstances that we ran through—

Senator LEVIN. Whose choice of words were they?

Mr. CAPLAN. Tim Leroux.

Senator LEVIN. And who is he?

Mr. CAPLAN. He is someone who works for me.

Senator LEVIN. OK. So your employee described this as unimaginable.

Mr. CAPLAN. But we spent a fair amount of time going through scenarios in which we could lose our money in this transaction. Now, I will submit to you that they are remote scenarios, but nevertheless, they are real. For example, one of the assets in this part-

¹ Exhibit No. 333(i) appears in the Appendix on page 296.

nership was a paper mill in Canada sitting on the St. Lawrence River. If that paper mill blew up and caused significant environmental damage, we would have—our return would have been subordinated to the liability caused by that damage, and that was something we were very concerned with in this transaction.

Senator LEVIN. Was there insurance on the paper mill, by the way?

Mr. CAPLAN. I believe that there was insurance on the paper mill.

Senator LEVIN. So the risk here was that the paper mill would blow up. That risk was covered by insurance. Get to some real risk here, will you?

Mr. CAPLAN. In addition, the way that this transaction was structured was presented to us by Enron and it was a combination of things. It was a combination of this preferred equity investment, which had the full blessing of Arthur Andersen, and my understanding was the more important test was not just that we had an equity investment, but that we had voting rights in the structure, and we had 50 percent of the voting rights. We had the ability to control the destiny of the entity, and if we were a creditor of the entity, that would not be true.

So I will absolutely submit to you that this is a preferred investment. It operates much like many other preferred investments out there, and it was not our accounting judgment as to how—as to whether this worked or not. This is an area of—I would call this joint venture accounting, is an area of accounting that there isn't a lot of literature on point and the way that our understanding is, that joint ventures are accounted for, is that the Big Five accounting—or Big Four now—accounting firms that give guidance, and this was Arthur Andersen's guidance on how to account for this transaction.

Senator LEVIN. If you look at Exhibit 333(d),¹ which is an e-mail to you, Perwein, who is a Citi tax attorney, is quoted as saying that "Sundance was a funky deal accounting-wise, and was amazed that Enron can get it off the balance sheet." Do you remember getting this?

Mr. CAPLAN. I do.

Senator LEVIN. Do you have any reason to disagree with that?

Mr. CAPLAN. With—I am sorry.

Senator LEVIN. With the statement that it is amazing that they could get this off the balance sheet.

Mr. CAPLAN. I am not an accountant. Neither is Mr. Perwein—

Senator LEVIN. You were aware of this tax attorney's conclusion that it was a funky deal accounting-wise and amazing that Enron could get it off their balance sheet, is that right? You were aware of that?

Mr. CAPLAN. Again, I think that is an accounting determination made by Arthur Andersen on how the structure should work. They were fully aware of all of the terms of the preferred investment. I think interestingly in this e-mail, you will see later on in it where, "John C. called. He is most concerned about Garden State. I am trying to set up an environmental call." All this is indicative of our

¹Exhibit No. 333(d) appears in the Appendix on page 290.

concerns about risks in this transaction, albeit remote risks, but real risk to our investment in the transaction.

Senator LEVIN. And is this not your words, that in Exhibit 333(t),¹ that this transaction is structured to safeguard against the possibility that we need to contribute our contingent equity and to ensure that there is sufficient liquidity at all times to repay our \$28.5 million investment? That was ensured, wasn't it?

Mr. CAPLAN. Well, if you think about what this was, it was a collection of fairly illiquid assets, a couple paper mills, a trading business. We were trying to mitigate our risk to the extent possible, and to the extent we wanted to get out of the transaction, we didn't have creditor's rights to call in event of default and accelerate our debt, something like that. We only had the position of an equity holder who could force effectively a dissolution of the company, at which time the assets of the company would have needed to have been liquidated. We were concerned that the assets were extremely illiquid, so we put in steps to mitigate the illiquidity of the assets.

Senator LEVIN. Well, it was way more than that, though, Mr. Caplan. You talk about liquidating assets. One of those assets was an account with \$28.5 million in cash which was there to protect your \$28 million, isn't that correct?

Mr. CAPLAN. One of the assets when we closed the transaction was \$28 million of Enron commercial paper, which is a liquid asset. It was absolutely designed to protect our ability to get out of the transaction in what I would call a timely and efficient manner. But again, all this was vetted fully with Enron's accountants, and I think this goes to the—

Senator LEVIN. I am talking about your accounts. I am talking about your advice. Your advice was funky transaction. You don't know how they can do it. And you knew the \$28 million is there in an account. You insisted on it, for you. That is money to come back to you, guaranteed. This isn't something where you have to liquidate an asset. You don't liquidate something that is liquid. It is there, set aside, isolated, segregated for Citibank. That is supposed to be an investment at risk? You call that mitigating risk? That is not mitigating risk, it is eliminating risk on the \$28.5 million. It is in a segregated account. Only you can touch it. You call that mitigation? I call that elimination.

Mr. CAPLAN. With respect, Senator, originally, the money was in Enron commercial paper, and if they had defaulted the day after the transaction, if they had gone into bankruptcy the day after this transaction had closed, our \$28 million would not have been—

Senator LEVIN. Was there any suggestion that Enron was going to go into bankruptcy at that time?

Mr. CAPLAN. No, none at all.

Senator LEVIN. You are talking about the possibility that they would go into bankruptcy the next day, and you had the \$28 million there segregated for you.

Mr. CAPLAN. I am not going to argue—

Senator LEVIN. Take a look at Exhibit 327,² Project Sundance. Investment in the Sundance partnership is an equity investment.

¹ Exhibit No. 333(t) appears in the Appendix on page 310.

² Exhibit No. 327 appears in the Appendix on page 255.

However—this is at the bottom of the page, number nine. “However, based on the way the deal is structured, it is more like debt rather than equity.” Would you agree with that?

Mr. CAPLAN. Well, I think I would agree in the context that Sundance as an entity had no debt, and we had a preferred position in effectively a liquidation scenario. So in that respect, it was debt-like because it was senior in the capital structure to Enron’s interest in the transaction.

Senator LEVIN. Senior doesn’t make it debt.

Mr. CAPLAN. Well, if the company were to liquidate and there were debt in the company, the debt, being senior in the capital structure, would be repaid first. Since there was no debt in the company, our interest was the most senior interest in the company and, therefore, any liquidation proceeds would go to pay off our investment prior to repaying Enron.

Senator LEVIN. Whose document is this, Exhibit 327? Is that your document? I know it is a Citibank document.

Mr. CAPLAN. It is—when we have a transaction that is unusual or the first of its kind, we have an approval committee called the Capital Markets Approval Committee at which we discuss the transaction. This transaction was discussed at the Capital Markets Approval Committee—

Senator LEVIN. Was that an accurate statement, that based on the way the deal was structured, it was more like debt rather than equity? Is that accurate?

Mr. CAPLAN. It is accurate to the extent that Sundance as an entity had no debt. Yes, it is accurate. And understood by Enron and their accountants as to that was the structure. I think the key thing is, we had risk in the transaction and we had voting control, and that was the test laid out by Andersen. It was not that our risk was *pari passu* with Enron’s.

Senator LEVIN. No one is suggesting that. Let me go back to this \$28.5 million. Is it correct that a couple days before bankruptcy, that you insisted that that \$28 million come back to Citibank?

Mr. CAPLAN. We had, under the transaction documents, as a partner in the partnership, a contractual right to call a board and dissolve the structure at any point in time, and as Enron moved towards bankruptcy, we effectively exercised that right.

Senator LEVIN. So your statement a few moments ago that what would happen if Enron would go bankrupt the next day, as a matter of fact, it did go bankrupt the next 2 days after, many months down the road, and you were then able to protect that \$28 million by terminating the deal, is that correct?

Mr. CAPLAN. We were able to exit the transaction prior to the bankruptcy.

Senator LEVIN. Exit the transaction.

Mr. CAPLAN. If the bankruptcy had happened prior to our insistence on blowing this transaction up, we would have been at risk on that \$28 million for—

Senator LEVIN. After you knew that it was on the verge of bankruptcy, you could get your \$28 million just like that, couldn’t you?

Mr. CAPLAN. That was the structure of the transaction.

Senator LEVIN. And that is what you call being at risk?

Mr. CAPLAN. I will not dispute with you that this is a—that the risk here was very contingent and remote. Nevertheless, it is risk and it was sufficient risk—I think the important point is that it was sufficient risk for Andersen to reach its conclusion that this joint venture would not consolidate on the balance sheet of Enron.

And I think the paradigm shift that we have implemented in our business model now is this kind of transaction would not be—we would not execute this kind of transaction today unless we felt that there was clear, sufficient disclosure as to the net effect of it as to what really goes on here to investors, and I think that is the take-away from this. We have learned something from this transaction.

Senator LEVIN. Well, I hope the world has learned something about this transaction, as well, and that is at the time, it was improper, not just now. At the time, it was improper.

Exhibit 333(n),¹ this is what you wrote. This is from Mr. Bushnell, he wrote to Michael Carpenter. This will be my last question of this panel in this round. Mr. Bushnell, you wrote to Michael Carpenter, who was the head of Global Corporate and Investment Bank at the time for Citibank, on May 30, 2001, 2 days before this deal went through, and here is what you told Mr. Carpenter. This is on page two of Exhibit 333(n). “If you recall, this is a complex structured transaction which I have refused to sign off on.”

And then you later said the following. “The risk management has not approved this transaction for the following reasons,” and then one of your reasons, which is the one, two, three, fourth bullet, is that “the GAAP accounting is aggressive and a franchise risk to us if there is publicity, a la Xerox.”

This transaction was a franchise risk to Citibank if there was publicity, that is what you said in this document. Were you telling the truth?

Mr. BUSHNELL. Yes, Senator.

Senator LEVIN. And yet, you went ahead with this. This is what really is so troubling to me from Mr. Prince’s testimony and otherwise and why the explanation that we have heard this morning is so unsatisfying. Well, this is all something in hindsight and we were following the rules at the time. Your own rules were bent. You made exceptions to them. You identified this transaction as one which would actually put the reputation of your bank at risk, and you proceeded anyway with this transaction. This isn’t hindsight, folks. This is a lack of foresight on the part of Citibank as to what you were up to.

How often do you write that a project or a transaction is a franchise risk? Is that a fairly common thing?

Mr. BUSHNELL. Senator, perhaps I can give some context to this memo. First of all, I could have killed this deal and not let it go forward. I don’t need to write a memo to kill a deal. If you read the entirety of the memo, most of this is an alert to Mike Carpenter about some process concerns and some internal differences between divisions about what to do with the transaction, and yes, I do express there are some concerns about what the GAAP accounting standard is.

¹ Exhibit No. 333(n) appears in the Appendix on page 302.

Senator LEVIN. If I could just interrupt your answer, that is not my question, about concerns over GAAP standards. My question to you was, how often do you write that a project or a transaction is a franchise risk to us if there is publicity? Is that a fairly common conclusion that you reach?

Mr. BUSHNELL. I am sorry, Senator. I was trying to get to that point. I don't write it often. I sit about ten yards away from Mike Carpenter and he and I discussed lots of risk transactions, I would say three to five times a day. Some, and I will admit that it is not many, have an instance of reputational issues that could be there. It is not frequent. I normally don't write it down because I didn't—I just walked into Mike's room or I called him on the phone.

In this particular instance, Mike was out of the country and I was trying to give him something to look at. That is the reason why I wrote it down. It is not frequent, but it is a risk issue that we talk about in some transactions.

Senator LEVIN. A risk issue is a little bit different from saying there is a franchise risk to us if there is publicity. Is that something that you said about many transactions that have proceeded?

Mr. BUSHNELL. Again, Senator, in terms of communications, not many, but this isn't the only one that we discussed reputational issues.

Senator LEVIN. I am trying to go a little bit beyond reputational issues. This isn't quite that. This is your conclusion that this accounting is—it is not an issue, it is your conclusion that accounting is so aggressive it is a franchise risk to us. You concluded that—

Mr. BUSHNELL. Yes, Senator.

Senator LEVIN [continuing]. If it is made public, and yet, it proceeded. Do you often proceed with loans, or forget that word, this wasn't a loan, really was a loan, but putting aside the loan-equity question, let me get to my question. Is it common that you have stated or concluded that accounting is so aggressive that it is a franchise risk to us if there is publicity, and yet the transaction nonetheless was concluded? Has that happened frequently?

Mr. BUSHNELL. It has not, no.

Senator LEVIN. Senator Collins.

Senator COLLINS. Mr. Bushnell, what was Mr. Carpenter's response to your memo and your concerns about the Sundance deal?

Mr. BUSHNELL. Senator, I wish I could recall those concerns. As I said, Mike was traveling at the time. He and I had hundreds of conversations about various risk issues. We have looked back at the record. It is clear, I think, that we had a conversation. I can't remember the specifics of those conversations, or indeed, how I might have paraphrased that concern about franchise or reputational risk or what the conversations might be.

Senator COLLINS. Initially, you refused to sign off on the transaction. Did you ultimately approve it?

Mr. BUSHNELL. Yes, I did, Senator.

Senator COLLINS. And what caused you to change your mind?

Mr. BUSHNELL. One of the very things that caused my mind is I wanted to talk to Mike Carpenter. As I said, I could have—I didn't need to write a memo to not do this deal. The reason why I sent the memo to Mike and the reason why I held up on approving the deal or declining the deal is I wanted to talk to him. I

wanted to alert him about several issues that I had about the way this transaction came up, the way it was handled, and what some of the concerns about it were.

Senator COLLINS. Did anyone at the bank direct you to approve the transaction?

Mr. BUSHNELL. No, Senator.

Senator COLLINS. Did Mr. Carpenter provide some sort of approval for the transaction?

Mr. BUSHNELL. I can't recall it, but I am sure he must have. If he didn't want the transaction to go forward, we wouldn't have done it.

Senator COLLINS. Are you aware that the Subcommittee has requested the paperwork authorizing the transaction, but that Citigroup to date has failed to locate and provide that paperwork?

Mr. BUSHNELL. Yes, I am, Senator, and I think that is a breach of our policies and procedures. We do have—for an equity investment like this, at this size, it required a sign-off from both the Chief Financial Officer and Mike Carpenter. I believe we have provided the Subcommittee with the Chief Financial Officer's sign-off, but we don't have Mike Carpenter's sign-off in our files.

Senator COLLINS. Thank you, Mr. Chairman.

Senator LEVIN. You indicated that you remember today that you approved this deal?

Mr. BUSHNELL. Yes, Senator.

Senator LEVIN. Because you told our staff when you were interviewed by them that you did not recall approving the deal. Has something changed between that conversation and today?

Mr. BUSHNELL. Yes, Senator. I have seen subsequently e-mail results that give me a conclusion—I can't recall verbally saying, "I am OK with this deal," but there is an e-mail trail that says that I did talk with one of the transactors, a person in Mr. Caplan's division, and that we had agreed to go forward with the transaction.

Senator LEVIN. According to this memo that I think you may be referring to, which you say refreshed your memory, I believe this is Exhibit 333(r),¹ "If you recall, Mike Carpenter was out of the country the day the transaction closed"—this is dated June 29, 2001. The approval memo was given to Mike's assistant and faxed to him. Mike then had a conversation with Dave Bushnell, who shared with us Mike's feedback. We proceeded to close the transaction that day, given the absence of instructions from Mike or Dave to the contrary."

Apparently, the transaction went through not because you approved it but because you didn't give any instructions to the contrary, is that true, or did you approve it actually?

Mr. BUSHNELL. I can't recall verbally saying I approved it. I take this memo to mean that I had a conversation with the transactors and said that I had talked with Mike and that met the requirements or my criteria for going forward.

Senator LEVIN. If you talked to Mike, what did he say?

Mr. BUSHNELL. Senator, as I say, I wish I could recall that. I really do. It would make things a lot easier for all of us. And in our new policies, this is the type of thing that we want to have

¹ Exhibit No. 333(r) appears in the Appendix on page 308.

written down so that we can recall how we got to conclusions or overcame issues that are brought up about structured finance transactions. But I can't recall the nature of that conversation.

Senator LEVIN. This is an unusual transaction. You just testified it is uncommon that there be a transaction where you would say there is a reputational risk serious to your bank, could actually risk your bank's reputation if made public. And yet, you went ahead and approved it. You can't remember the conversation with Carpenter. The approval document is missing. There are a number of very disturbing and unusual aspects to this transaction. It would seem to me that something which is this unusual should be remembered by you in terms of your conversation with Carpenter.

Mr. BUSHNELL. Senator, I wish I could remember it, but as I said, I had three to five conversations a day on all significant risk transactions. This was 18 months ago, and I just can't recall having the conversation or, obviously, any specifics of the conversation if I had it.

Senator LEVIN. If you look at the first page of Exhibit 333(n),¹ which is an e-mail that Alan MacDonald, Head of the Global Relationship Bank, sent to Michael Carpenter the day after you wrote your memo, that previous memo we talked about. In it, he forwards Mr. Carpenter another copy of the memo and writes the following. "We, Bill Fox and I, share risk's view and, if anything, feel more strongly that suitability issues and related risks, when coupled with the returns, make it unattractive. It would be an unfortunate precedent if both GRB relationship management and risk's views are ignored."

Mr. Fox, Mr. MacDonald writes that you shared the views of Mr. Bushnell. Did you have concerns about this project?

Mr. FOX. I had some questions about the project, mostly surrounding the returns we were attempting to achieve. I was concerned that it was going to potentially disenfranchise another product area of ours called capital structuring. Initially, I had raised some issues concerning the fact that I didn't understand how the accounting was able to achieve Enron's objectives. Those were the areas of my concern.

Senator LEVIN. Were you satisfied?

Mr. FOX. With respect to the accounting question, I received an e-mail back from an individual that confirmed that Arthur Andersen had reviewed and utilized this type of structure elsewhere.

Senator LEVIN. And what about the reference to the franchise risk if there is publicity?

Mr. FOX. I had not seen Mr. Bushnell's memo until after the fact. My communication, though I don't recall it, must have been with Mr. MacDonald directly.

Senator LEVIN. So here, we have got serious concerns raised by Mr. Bushnell and Mr. Fox about the accounting associated with it. You, at least, Mr. Bushnell, about the risk to the bank's reputation. You, Mr. Bushnell, as head of risk management, refused to sign off on the project because, in part, the aggressive accounting did create a franchise risk if it was made public, if it came to light. And yet, the deal went through, helped Enron to make its balance sheet look

¹ Exhibit No. 333(n) appears in the Appendix on page 302.

a lot better than it was entitled to look, and I am afraid that that story is a sad story.

This is not just a story about should we make banks look at the books of clients. This is a story of how a bank with serious concerns, even to its reputation, was willing to proceed with a transaction which its own people thought was incredible in terms of its accounting techniques, and nonetheless, you went ahead and did it. You did it for a couple of reasons, I assume. One was there was money in it, and two, you wanted to keep a good client happy.

But I do think it is important as we look at what our regulators are going to do about it and what your new procedures are to hopefully stop this from happening, that we recognize that these are problems that were raised at the time. This is not retroactive applying new standards. This is looking at how a bank of high reputation that should be a pillar in our economy stooped pretty low. We have got to learn from that lesson. The bank says it has. I am glad to hear you have. I hope you have. For the sake of our economy, I even pray you have, because this has got to stop.

We are going to rely to some extent on self-regulation, but we cannot rely totally or even to a great degree on self-regulation because it hasn't worked in the past. There is too much temptation out there, to please customers and to make money, and I guess those are one and the same thing. And so we are going to need to talk to our regulators, and we will a little later on today, after we talk to Chase, as to how we, as a government, can be sure that these kind of activities are not repeated.

I want to thank our witnesses. Again, I know this was a difficult day for you to get here. We also want to again repeat that Citibank as well as Chase has cooperated in our investigation. You have provided us with documents, obviously, and you have appeared. You have come and been interviewed by us, and those are important pluses on the ledger. We thank you and you are excused.

Mr. BUSHNELL. Thank you, Senator.

Mr. CAPLAN. Thank you, Senator.

Mr. FOX. Thank you, Senator.

Senator LEVIN. We are going to take a 5 minute recess.

[Recess.]

Senator LEVIN. We will come back to order. I would like to call now our second panel of witnesses. I want to thank all of you, as I did our first panel, for making it here in this weather. It was bad enough when you got here. I think it is worse now. I don't know if that is good news or bad news, but it is the fact, apparently.

We want to welcome Michael Patterson, who is the Vice President of J.P. Morgan Chase and Company; Andrew Feldstein, the Managing Director and Co-Head of Structured Products and Derivatives Marketing at J.P. Morgan Chase; Robert Traband, Vice President of J.P. Morgan Chase in Houston; and Eric Peiffer, a Vice President of J.P. Morgan Chase in New York.

Pursuant to Rule 6, witnesses who testify before the Subcommittee are required to be sworn and so I would ask you all to please stand and raise your right hand.

Do you swear that the testimony that you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. PATTERSON. I do.

Mr. FELDSTEIN. I do.

Mr. TRABAND. I do.

Mr. PEIFFER. I do.

Senator LEVIN. As I mentioned before, a minute before the red light comes on signaling that you should end your testimony, you will be given a green to yellow light, which will give you the opportunity to conclude your remarks. We will print testimony in its entirety in the record, so we would ask you to limit your oral testimony to no more than 10 minutes.

Mr. Feldstein.

Mr. PATTERSON. Mr. Chairman, with your permission, may I begin?

Senator LEVIN. Sure. Do you want to start off?

Mr. PATTERSON. Yes, sir.

Senator LEVIN. Sure. Mr. Patterson.

**TESTIMONY OF MICHAEL E. PATTERSON,¹ VICE CHAIRMAN,
J.P. MORGAN CHASE AND COMPANY, NEW YORK, NEW YORK**

Mr. PATTERSON. Mr. Chairman and Members of the Subcommittee, my name is Michael Patterson. I am a Vice Chairman of J.P. Morgan Chase and head of the firm's Policy Review Office since August of this year.

I am joined today by my colleagues Andrew Feldstein, a Managing Director and Co-Head of Structured Products and Derivatives Marketing since March of this year; Robert Traband, a Vice President of J.P. Morgan Chase; and Eric Peiffer, also a Vice President of the bank. After my statement, Mr. Traband will read a joint statement for himself and Mr. Peiffer, and with the permission of the Subcommittee, Mr. Feldstein will then give a brief opening statement.

Senator LEVIN. That is fine.

Mr. PATTERSON. I am pleased to be here to discuss the firm's policies and practices regarding transactions with publicly traded U.S. companies. As requested in your invitation letter, I will address policies and practices relating most particularly to structured finance, accounting, and tax matters.

J.P. Morgan Chase and its predecessor firms have long had in place policies and procedures governing transactions with clients. These policies and procedures address, among many other subjects, compliance with external legal and regulatory requirements, as well as the aspects of the transaction that could raise reputation risk for the firm. These policies and procedures are periodically reviewed and updated to take account of our experience and external developments.

Structured finance encompasses a wide variety of transactions and instruments designed to help clients achieve their risk management, financing liquidity, and other financial objectives within the framework of applicable and often complex legal, regulatory, tax, and accounting rules and principles. Securitization, special purpose vehicles, and derivatives are among the well-recognized

¹The prepared statement of Mr. Patterson appears in the Appendix on page 105.

techniques used to allocate risks, capital, and cash flows to meet client objectives.

To make sure that our structured finance transactions comply in all respects with that framework, the business transaction approval process requires adherence to applicable policies, as well as review and sign-off from internal legal, conflicts, tax, and accounting policy groups, among others, such as credit and market risk management. Transactions involving a special purpose vehicle receive special scrutiny and must comply with a special purpose vehicle policy administered by a committee to ensure that every such entity is properly approved, documented, and monitored.

The primary responsibility for adherence with all policies and procedures, including those designed to address reputation risk, lies with the business units conducting the transactions in question. But in addition to this framework, J.P. Morgan Chase in August of this year put in place a new set of procedures designed to reinforce our focus on reputation risk and provide a senior level of review of transactions with clients.

Business units are required to submit to regional policy review committees proposed transactions that may raise reputation risks for any reason, but specifically including transactions where a material objective is to achieve a particular accounting treatment, those designed to achieve a particular tax treatment, those where there may be material uncertainty about legal or regulatory treatment, those with highly complex structures or cash flow profiles, and those which have as a significant purpose or effect the providing of financing, but which take the form of derivatives.

The members of the regional policy review committees, including the Americas Committee, are senior representatives of the business and the support units, including tax and accounting policies, in the region. Transactions are reviewed from every angle that could affect reputation risk, but including specifically, where applicable, the intended financial disclosure of the transaction by the client, and the committee approves, rejects, or requires further clarification or changes in the transaction. These committees and their deliberations are overseen by a Policy Review Office, which I lead, and transactions can be formally escalated by the committees to me.

We at J.P. Morgan Chase believe that one of the tests of our leadership in the financial marketplace is to learn from our experiences and to adjust our practices in light of these experiences and the changing environment. The core lessons we have learned are, one, that we cannot rely solely on our clients and their experts to determine that our transactions with them will be properly accounted for and disclosed; two, that we need to make sure that our transactions with clients are not misused to deceive investors or others; and three, that even where these tests are met, we need to consider carefully whether transactions could be viewed adversely in a way that would be harmful to our reputation for integrity, fair dealing, and doing first-class business in a first-class way.

I believe that the policy review process we have put in place and which I have just outlined, together with our business transaction approval policies and procedures, are well designed and are already serving to enable us to meet these standards.

As a final note, I would add that as the biggest corporate lender in America and as one of the largest investment managers, we have as much interest as anyone in increased transparency and disclosure and integrity in financial markets. We have our money and our investment management clients' money at risk in our belief that those financial statements are accurate.

I would, of course, be happy to respond to any questions the Chairman or other Members of the Subcommittee may wish to put to me regarding the policy review process. Thank you, Senator.

Senator LEVIN. Thank you very much, Mr. Patterson.

Mr. Traband, I believe you were going to proceed next.

TESTIMONY OF ROBERT W. TRABAND,¹ VICE PRESIDENT, J.P. MORGAN CHASE AND COMPANY, HOUSTON, TEXAS; ACCOMPANIED BY ERIC N. PEIFFER, VICE PRESIDENT, J.P. MORGAN CHASE AND COMPANY, NEW YORK, NEW YORK

Mr. TRABAND. Thank you, Mr. Chairman. My name is Robert Traband and I am currently a Vice President of J.P. Morgan Chase Bank. I am making a joint statement on behalf of myself and Eric Peiffer.

Let me say at the outset, Mr. Chairman, that while we believe that our participation in the Fishtail and Flagstaff transactions was perfectly legal and followed established rules, had we known then what we know now about Enron's practices, we would not have engaged in these transactions with Enron. We would not have accepted at face value, as we did in 2000 and 2001, Enron's statements that its requests to structure Fishtail or Flagstaff in particular ways were designed to properly achieve Enron's desired financial statement treatment of the transactions in accordance with Generally Accepted Accounting Principles.

In addition, we would have wanted to know more about the aspects of the transactions in which the firm was not involved. But at that time, we, like many other parties, dealt with Enron in the belief that it was one of the most respected companies in America and that it was not our role to second guess our counterparties' accounting or other structuring determinations.

In the case of Enron, the firm suffered substantial injury, not only by the loss of hundreds of millions of dollars from its own transactions with Enron, but also from the injury to its reputation from the erroneous suggestions of some that the firm was involved in Enron's wrongdoing. For these and many other reasons, we regret that we ever dealt with Enron.

Let me now turn to the specific transactions with respect to which the Subcommittee has requested information from the firm. The first of these transactions has been referred to by the Subcommittee and others as Fishtail. This transaction was a \$41.5 million loan commitment extended by the firm in December 2000 to a special purpose entity named Annapurna LLC, established by Enron. This commitment expired by its terms in June 2001 and was never funded.

¹The joint prepared statement of Mr. Traband, Mr. Peiffer, and Mr. Feldstein, appears in the Appendix on page 107.

Enron informed the firm that in anticipation of its ultimate contribution of the existing pulp and paper business to a joint venture, Enron wanted to deconsolidate its pulp and paper business from the rest of its businesses. Enron also told us that in consultation with its accounting advisors, it had devised a structure to achieve this objective. Enron would contribute its economic interests in the present and future contracts of the pulp and paper business to a newly formed entity, Fishtail, which would be jointly owned by Enron and Annapurna.

As I have said, the firm's participation in this transaction was limited to a 6-month commitment to make a bank loan to Annapurna. The firm had no other involvement in the transaction. The decision to make a commitment to Annapurna was a reasonable credit decision and it is not at all unusual, as banks often make loan commitments with the expectations that they will not be funded.

The firm acted as a leader—a lender in this transaction and, consistent with industry practice, it did not make any determination whether completion of the transaction would achieve Enron's accounting objective, a deconsolidation of Enron's pulp and paper business. Such determinations were properly for Enron to make with the advice and assistance of its internal accountants and external auditors. In this connection, I note that the Subcommittee staff report states that Arthur Andersen actually did approve this transaction.

In December 2000, when the Fishtail transaction was agreed to, the firm had no reason to believe that any such determinations were not being made by Enron and/or Arthur Andersen, which was then one of the Nation's premier accounting firms, in accordance with Generally Accepted Accounting Principles.

There is one final point I would like to make about the Fishtail transaction. It appears that Fishtail included a broader set of transactions by Enron to effectuate not just the deconsolidation of Enron's pulp and paper trading business, but to recognize income in connection with the sale of those assets. The firm was not involved in these other transactions, and indeed was told very little about them by Enron or anyone else, for that matter.

The Subcommittee has also asked for information concerning the firm's understanding of and participation in the Slapshot project, particularly with regard to the Flagstaff transaction. As I will explain in greater detail, Slapshot was the name given by the firm to a generic form of transaction intended to permit a loan by a U.S. lender to a Canadian borrower, to be structured in a manner that would provide advantageous tax treatment to the Canadian borrower under Canadian law.

Flagstaff was the name under which a specific transaction with Enron was undertaken in June 2001 to provide long-term refinancing for the acquisition of a Canadian pulp and paper mill, Stadacona, acquired by a joint venture in which Enron was an equity participant. In short, Flagstaff was an actual transaction; Slapshot was not.

As the Subcommittee is aware, there are substantial differences in tax codes of other countries that taxpayers, including both individuals and businesses, may lawfully and properly take advantage

of. Such a situation existed under Canadian tax law, but before proposing the transaction to any client, the firm's structured finance group solicited and received a written opinion of an independent and highly regarded Canadian law firm setting forth the likely tax consequences of that structure under Canadian law. Ultimately, the firm obtained written opinions from two leading Canadian law firms that the structure and the Canadian tax benefits it provided were legal and valid.

As I have indicated, the Flagstaff transaction had its genesis in the planned purchase of the Stadacona Canadian paper mill by CPS, a Canadian corporation owned by a joint venture, Sundance, between Enron and another party. The firm did not participate in the formation of the Sundance joint venture. Documents shown to employees by the firm by the Subcommittee staff during interviews in preparation for this hearing reveal that there were many aspects of the structure and funding of the joint venture that were completely unknown to us. Indeed, at the time of the Flagstaff transaction, the firm did not know the identity of Enron's partner in the joint venture.

In January 2001, representatives of the firm met with Enron to present a proposal under which a group of banks would make a loan to finance the acquisition of the mill. During the meeting, the firm advised Enron that it had concluded, based on the opinion of counsel, that the loan transaction could be structured in a manner that would provide advantageous tax treatment to a Canadian borrower under Canadian law. Enron informed the firm's representatives that Enron was aware of and had itself already devoted substantial attention to analyzing a substantially similar Canadian tax structure.

Enron ultimately selected the firm to lead the bank group, but opted to complete the acquisition of the Stadacona mill in March 2001 with a bridge loan of approximately \$375 million provided by Enron. The Flagstaff transaction was thereafter completed in June 2001 in order to repay the bridge loan and provide the long-term debt financing. The Flagstaff loan transaction was structured in a manner intended to permit the realization of the Canadian tax benefits by the Canadian borrowers. To the best of the firm's knowledge, this structure did not provide otherwise unavailable U.S. tax benefits to any party. We understand that Enron obtained and relied upon its own written opinion from Canadian tax counsel and that the anticipated Canadian tax benefits could and should be realized under the structure.

As the Subcommittee is aware, the Flagstaff structure is highly complex, and among the several transactions that comprise the structure was an intraday loan of approximately \$1 billion provided by the firm to Flagstaff. It also involved two special purpose entities created by Enron or its affiliates. The complexity of the Flagstaff financing and the legal documentation required to implement it was necessitated by Canadian tax considerations and were undertaken in reliance of the opinions of Canadian tax counsel to facilitate realization of the Canadian tax benefits.

As the Subcommittee also is aware, the credit support for the loan was provided by Enron, principally through a total return swap and certain supporting transactions, rather than as originally

contemplated, a guarantee by Enron. This change was specifically requested by Enron. One or more members of our team understood at the time that a principal reason for Enron's position on this respect was that Enron had concluded that a guarantee might require consolidation of the entire Sundance joint venture, the assets of which included CPS and the Stadacona mill.

The firm understood that the use of a total return swap to facilitate the continued deconsolidation of the joint venture had been vetted by Enron with its external auditors, Arthur Andersen, and had been approved by them. The firm did not attempt to second guess this accounting judgment. As I have noted earlier, under applicable law and practice, each party is properly responsible to ensure that it correctly accounts for the transactions to which it is a party. At the time, the firm had no reason to believe that any such determinations were not being made by Enron and its external auditors in accordance with Generally Accepted Accounting Principles.

Consequently, from the firm's standpoint, the issue presented by Enron's decision not to provide a guarantee was whether the total return swap provided sufficient credit support for Flagstaff loans, that the new arrangement could prudently be accepted by the banks in lieu of a direct Enron guarantee. Ultimately, we and the other members of the bank group each concluded that the total return swap provided adequate credit support.

This concludes my statement, Mr. Chairman. I am happy to answer any questions.

Senator LEVIN. Mr. Peiffer, you are not going to give a statement at this point?

Mr. PEIFFER. It was a joint statement on behalf of both of us.

Senator LEVIN. Mr. Feldstein.

TESTIMONY OF ANDREW T. FELDSTEIN,¹ MANAGING DIRECTOR, CO-HEAD STRUCTURED PRODUCTS AND DERIVATIVES MARKETING, J.P. MORGAN CHASE AND COMPANY, NEW YORK, NEW YORK

Mr. FELDSTEIN. Thank you, Mr. Chairman. My name is Andrew Feldstein. As Mr. Patterson said, I am a Managing Director at J.P. Morgan Chase, and since March of this year, I have been the Co-Head of our Structured Products and Derivatives Group in North America. In addition, I work closely with Mr. Patterson on the firm's Policy Review Office, designing and implementing the policies to guard against participation in transactions that don't comport with our standards for integrity and our commitment to transparent financial markets.

I would like to say four things. First, based on my review of the facts from this Subcommittee's report as well as from my internal inquiries, I am convinced that neither Mr. Traband nor Mr. Peiffer nor anyone else at J.P. Morgan Chase knowingly aided and abetted Enron's apparently deceptive activities.

Second, Mr. Chairman, you mentioned earlier today the need to root out corruption in financial statement presentations. We agree

¹The joint prepared statement of Mr. Traband, Mr. Peiffer, and Mr. Feldstein, appears in the Appendix on page 107.

with you 110 percent. We think it is incumbent upon all participants in our capital markets to combat that type of conduct at every turn. We are with you.

Third, what has changed? The processes that our firm has implemented and the culture that we are endeavoring to create at all levels of the firm are meant to avoid our firm's participation in transactions contrary to the principles of integrity and transparency.

One thing in particular bears noting here. We now insist not only everyone that works for me in structured finance, but everyone in the firm, to ask questions, more questions, and more specific questions than were commonly asked 1 year ago. We no longer rely on the assurances of clients or their outside advisors when the facts and circumstances of proposed transactions should give us pause.

I like to think that senior management chose people like Mr. Paterson and me to play a big part in this cultural evolution because we have the ability to be real thought leaders and we can work with all professionals in the firm to identify the indicia of transactions that must be thoroughly questioned.

Finally, let me end with this. The fact that things are changing, whether internally at firms like ours or with the accounting rules, that is evidence of what is good in the U.S. capital markets. Participants join together with the encouragement of committees like yours to help make the markets work even better.

I appreciate being given the opportunity to appear before you today and I look forward to answering any questions. Thank you.

Senator LEVIN. Thank you all.

Mr. Peiffer, let me start with some questions to you. You worked, as I understand it, on the implementation of the Slapshot deal and the negotiations with Enron, is that correct?

Mr. PEIFFER. That is correct.

Senator LEVIN. As I indicated in my opening statement, I believe the details of that structure show it to be a sham and I would like to go through the \$1 billion so-called loan that Chase, through an SPE or special purpose entity that it created called Flagstaff, made to the Enron special purpose entity called Hansen.

The \$1 billion that Chase sent to Flagstaff, which again was under its control, was returned to it on the same day, as a matter of fact, within a period of a few hours or even a few minutes, and I want to look at some slides that show the general schematic of the transaction.

First, step one. Chase provided a \$1 billion so-called daylight overdraft loan to Flagstaff, its own special purpose entity. That is a loan which existed for just a few hours, if that long.

This is, I believe, Exhibit 303(a),¹ if you want to take a look in your book. It may be hard for you to see that far. So step one, at the bottom right, a \$1 billion loan from Chase to Chase's special purpose entity, Flagstaff. That is the daylight overdraft loan for the few hours.

Step two, Enron gets the \$1 billion daylight overdraft from Citibank, runs the money through a few of Enron's subsidiaries, and puts it in an escrow account at Chase, and that escrow account

¹Exhibit No. 303(a) appears in the Appendix on page 190.

you will see there is called Newman and that is another Enron special purpose entity.

Step three, Flagstaff at that time, and only then, releases the Chase \$1 billion and it goes through a number of Enron entities to Citibank. So Citibank now has got its \$1 billion back a few moments later. And then as soon as Flagstaff releases the Chase \$1 billion, Newman releases the \$1 billion from the escrow account to Flagstaff and then back to Chase. Now, all of these transactions occur within a matter of hours, some within a matter of minutes. One billion dollars this way, a billion dollars, that way.

Exhibit 352¹ is the funds flow schedule that was attached to the opinion of Enron's tax counsel, who is also your tax counsel. Notations next to the funding steps show that certain steps will be completed by certain times, and it shows that the \$1 billion would be returned to Chase between 10 a.m. and 12 noon the same day that it left Chase.

Chase released over \$1 billion from its left hand, took the money back with its right hand, and you designed the structure so that even though \$1 billion was returned almost instantaneously, at least on the same day, there would be an appearance to Canadian tax authorities that there was an outstanding loan of \$1.4 billion.

Now, Mr. Peiffer, isn't it the case that the amount of the \$1 billion, \$1.039 billion to be precise, was mathematically derived to ensure that interest payments made on the \$1.4 billion apparent loan would equal the principal and interest payments on the \$375 million loan?

Mr. PEIFFER. That is correct.

Senator LEVIN. So the \$1.03 billion amount wasn't derived from some independent business need, it was simply the number required to make the tax transaction work, is that correct?

Mr. PEIFFER. It was the number required to make the tax transaction work as it was intended.

Senator LEVIN. Now, the company receiving the loan, the so-called loan, was Hansen, a Nova Scotia unlimited liability corporation which had been established by Enron. Do you know when Hansen was incorporated?

Mr. PEIFFER. Where it was incorporated? I am sorry.

Senator LEVIN. When Hansen was incorporated.

Mr. PEIFFER. Nova Scotia, I believe.

Senator LEVIN. No, when, not where.

Mr. PEIFFER. I don't know when it was incorporated.

Senator LEVIN. Well, I will tell you when it was formed, less than 2 weeks before this transaction took place. That was also the same day that Newman, the company that formed the escrow account, was created.

Given how new Hansen was, do you believe that it was a company with an identified business purpose that warranted a \$1 billion loan?

Mr. PEIFFER. I think here, it depends on what context you are defining business purpose.

Senator LEVIN. The normal.

Mr. PEIFFER. In my understanding——

¹ Exhibit No. 352 appears in the Appendix on page 525.

Senator LEVIN. Just normal understanding.

Mr. PEIFFER. My understanding is that Enron set up both Hansen and Newman to help effect this transaction and that for Canadian tax purposes, based on advice we and they received from our Canadian tax counsel, that the contracts they entered into constituted a business purpose.

Senator LEVIN. So these were set up for this transaction, these companies?

Mr. PEIFFER. That is my recollection, yes.

Senator LEVIN. What was the commercial business purpose that was associated with this \$1 billion loan to Hansen?

Mr. PEIFFER. The loan to Hansen was actually \$1.4 billion, and as you—

Senator LEVIN. I want to talk about the \$1 billion portion of it. What was the commercial business purpose associated with that \$1 billion, which was the majority of the \$1.4 billion?

Mr. PEIFFER. I think it is hard to talk about, with all due respect, just the \$1 billion portion, since it was one \$1.4 billion loan. I will acknowledge that, of course, as you did, that \$1 billion came from J.P. Morgan into Flagstaff and that J.P. Morgan was repaid that same day, and so at the end of the day, there was \$375 million remaining in this joint venture.

Senator LEVIN. Which was the real loan, correct?

Mr. PEIFFER. Yes, the real loan, the economic loan is what I would prefer to call it. However, if you look at the actual contracts, there actually was a \$1.4 billion loan. Those were actual contracts that continue to be respected from a legal perspective to this day, and in addition to that, from a Canadian tax perspective, which follows much more form over substance type of regime, my understanding, not being a Canadian tax lawyer, but given the advice that we are given, that the Canadian tax advisers would respect that as a \$1.4 billion loan.

To answer specifically your question as to what the business purpose is, the business purpose of this transaction as a whole was to provide financing to Enron in a tax advantageous way, and the \$1 billion—

Senator LEVIN. Tax advantageous way—

Mr. PEIFFER [continuing]. And the \$1 billion helped with that.

Senator LEVIN. That was the tax advantageous part of the \$1.4 billion?

Mr. PEIFFER. I think the right way to say it is that it did help with the making, of course, of the \$1.4 billion loan, and that, taken together with the other contracts, given the advice that we were given from Canadian tax counsel, helped to generate the Canadian tax benefits that were intended.

Senator LEVIN. But the \$1 billion was the tax advantage portion, was it not, of the \$1.4 billion? That is what created the tax advantage.

Mr. PEIFFER. The \$1 billion helped to create the tax advantage.

Senator LEVIN. Was there any other tax advantage, other than what was created by the \$1 billion?

Mr. PEIFFER. There were only Canadian tax advantages generated with respect to the full \$1.4 billion loan interacting with the other contracts.

Senator LEVIN. But I am saying, if it had just been the economic loan, as you put it, the business loan of \$375 million, there would not have been any tax advantage from that, would there?

Mr. PEIFFER. Right. I think it is fair to say that if it were only a \$375 million loan, that Enron would have received tax deductions on that \$375 million loan and that is it.

Senator LEVIN. The interest on it?

Mr. PEIFFER. Yes.

Mr. FELDSTEIN. May I add something, Mr. Chairman?

Senator LEVIN. I would rather not. I want to just keep going with Mr. Peiffer and then you can come in a little later, if you like.

Mr. Peiffer, would Chase have approved the \$1 billion loan, that portion of the \$1.4 billion loan to Hansen, if it had not been assured that it would receive the money back immediately from an escrow account held by Enron?

Mr. PEIFFER. I think it is fair to say it would not. From a credit perspective, Chase obviously would be concerned about getting paid back that amount of money, and so felt more comfortable if Enron was either paying to us \$1 billion first via a separate transaction, and preferably through an escrow account, which I recall is what—where Newman had the money prior to paying to Chase under the subscription assumption agreement.

Senator LEVIN. So is it fair to say, then, that the \$1 billion portion of that loan to Hansen would not have been made by Chase unless you knew that there was money in escrow to immediately pay that money back to you, is that fair?

Mr. PEIFFER. That is fair.

Senator LEVIN. Now, Mr. Peiffer, you are listed on the incorporation papers of Chase's special purpose entity Flagstaff as Flagstaff's Vice President, and Mr. Traband, you are listed as the Treasurer of Flagstaff. So as corporate officers of Flagstaff, both of you, with fiduciary duty to the company, I take it that you would not have felt comfortable loaning \$1 billion to Hansen if you didn't know that the same amount of money was already in an established escrow physically located at Chase and that Chase would immediately receive the money back from Enron, is that a fair statement? You wouldn't possibly be handing \$1 billion out to this new company without being darn sure that that \$1 billion was coming right back to you, is that fair to say?

Mr. PEIFFER. I think it is fair to say we would go to measures to make sure that \$1 billion was repaid.

Senator LEVIN. Mr. Traband, do you agree with that?

Mr. TRABAND. Yes. We understood the full scope of the transaction.

Senator LEVIN. Now, even though the \$1 billion, then, of the so-called \$1.4 billion was already returned, you have asserted that the—Mr. Feldstein, did you want to interrupt at this point?

Mr. FELDSTEIN. No, I think I will wait.

Senator LEVIN. OK. Even though the \$1 billion was already returned, you nonetheless have asserted in your testimony that the tax deduction for interest on the entire \$1.4 billion was allowed in Canada, and Chase has put a great deal of emphasis on that assertion in its statements. I am aware that a Canadian law firm informed Chase that Slapshot would be acceptable. However, that

same law firm had provided services to Enron and told their client that Slapshot was likely to attract scrutiny by Revenue Canada.

Were you aware of the fact that advice was given, by the same lawyer who advised you, to Enron that this transaction would attract scrutiny by Revenue Canada, Mr. Peiffer?

Mr. PEIFFER. At the time of this transaction, I was not aware. I have since become aware. But to comment on that, I don't think it necessarily would be surprising to say that this transaction or any necessarily complex transaction with tax advantages would—might invite some scrutiny.

Senator LEVIN. But you designed the structure to be hidden from authorities, Canadian authorities. For example, Flagstaff, which is your special purpose entity, was concerned because the \$375 million that it received from the bank consortium had a different interest rate than the so-called \$1.4 billion loan, so Chase could lose money.

And so Enron and Chase considered alternatives to avoid that risk, and Exhibit 344,¹ if you will turn to that, contains a chart depicting various alternative strategies to alleviate Chase's interest rate risk. The chart on page 12 of that Exhibit 344 addresses alternative one under this section, entitled "Advantages." Advantages—there were three alternatives you were looking at to address your interest rate risk, three alternatives.

Alternative one had the advantage of not having a road map for Revenue Canada, and to read the exact words there, "No road map for Revenue Canada. No swap by Enron on economic interest."

Now, a few pages later in Exhibit 344 is a chart that summarizes all three alternatives. One of the advantages of alternative two—excuse me, one of the disadvantages of alternative two is that it leaves a potential road map. Do you see that on page 15, under alternative two, disadvantages?

Mr. PEIFFER. Yes, I do.

Senator LEVIN. Potential road map. Who does it leave a potential road map for? That same Revenue Canada.

And then looking at the disadvantages listed for alternative three, it lists under disadvantages, possible road map for Revenue Canada with respect to these alternatives. So it clearly was your design and your joint decision with Enron, is it not correct, that you wanted to avoid providing a road map to Revenue Canada, is that a fair statement?

Mr. PEIFFER. Well, what I think is unfair is to say that the transaction was designed to avoid scrutiny. I think with any tax advantaged transaction that any company would do, there is an inherent desire to avoid highlighting the transaction. This, in particular, the interest rate swap, I don't think had on the margin very significant ability to highlight or not highlight the transaction.

As you can see, there are a number of boxes and arrows, so to speak, with the transaction. I think that if the transaction was to be audited or not audited based on that, and to isolate it to the interest rate swap, I don't believe was the case.

I mean, it was one of many advantages or disadvantages under each alternative that we considered and Enron ultimately ended up

¹ Exhibit No. 344 appears in the Appendix on page 396.

choosing the alternative based on whether it felt it could get comfortable with taking on additional fixed-rate interest rate exposure. There was very little discussion as to the road map, and when Enron actually chose that alternative, my recollection of the conversation was that it was based entirely on its ability to absorb additional fixed interest rate exposure and that there was no concern or discussion about this potential road map issue that we are looking at here.

Senator LEVIN. Whether there was discussion of it or not, this is a document that you used to pitch this particular approach, did you not? Didn't you design this? Wasn't this a Chase design?

Mr. PEIFFER. I was not heavily involved at all in designing the structure, as I am not a tax expert.

Senator LEVIN. Was it Chase's design, though?

Mr. PEIFFER. It was Chase's design, using a good deal of existing technology, tax technology, let us call it, that existed and other tax regimes where form took a great deal of place over substance.

Senator LEVIN. So in the Chase design, or its tax technology, as you call it, you listed the advantages and disadvantages of each of three approaches, and Chase listed an advantage of there not being a road map to a potential customer, and listing alternatives two and three having disadvantages of having potential road map or possible road map. That is what you were pitching to a client here, is that not correct?

Mr. PEIFFER. Well, at this point—

Senator LEVIN. Whether there was discussion of it or not, this is your document, isn't it?

Mr. PEIFFER. Right. This was an organizational meeting. It was discussing the transaction, assuming that the transaction would go forward. It is our document, but, again, it naturally would have been this company's preference to not highlight a transaction.

Senator LEVIN. Which company, yours or Enron's, when you say—

Mr. PEIFFER. Enron's.

Senator LEVIN. Why would you want to not have a transaction be apparent, or be transparent? Why would you want to try to sell an advantage of an option as not being transparent to the tax folks and to avoid giving them a road map? Why did you want to avoid that? Why did you think Enron wanted to avoid that?

Mr. PEIFFER. I think it is customary that any company would rather not highlight a transaction with tax advantages, given that I think that the transaction itself would more or less highlight itself were it to be looked at by Revenue Canada, and they certainly would.

Senator LEVIN. Well, if they were going to look at it anyway, then you wouldn't have to pitch the absence of a road map as being an advantage, would you?

Mr. PEIFFER. In the end, there ended up being very little, if any, discussion around this particular aspect of choosing the interest rate swap precisely because of that.

Senator LEVIN. I am not so interested in whether there was a discussion. I am much more interested in why Chase would design a structure and make a pitch for one of the options as having the advantage of being less transparent to the tax authorities. If you

have nothing to hide, it would seem to me that Enron would be perfectly willing to share all the information with the tax authorities. They would not care if they gave it a road map or not.

Something was being hidden here by Enron. They didn't want this to come to the attention of the tax authorities. They had an opinion, as a matter of fact, which you say you didn't know about, but they had an opinion from the tax lawyer who also gave you tax advice on this transaction. The opinion from their tax lawyer and yours, but you say only to Enron, was that this would be challenged, or might be challenged by tax authorities in Canada, and then you went and pitched this deal to them on something that you obviously thought would be attractive to them, which is that it would not give a road map to the people that would challenge this or might challenge this.

Mr. PEIFFER. With all due respect, the opinion that Blake Casels wrote to Enron took place a good number of months after this was put together, and so based on the opinion that we had, we believed, given the strength of the opinion, that even if it were challenged, that it was a strong transaction and that the tax benefits inherent in it would stand.

Again, the interest rate swap was a very small aspect of this transaction, and so to say whether it was not highlighted or not, I think it is very difficult to extrapolate and say we are trying to hide or even not highlight the entire transaction.

Senator LEVIN. That is not extrapolation. I am reading your document.¹

Mr. PEIFFER. But with all due respect, this is a very small part of the entire transaction, and to say—

Senator LEVIN. I am not extrapolating.

Mr. PEIFFER [continuing]. And to say on the margin that this is what is hiding the transaction—

Senator LEVIN. Advantage No. 1, no road map. Advantage No. 2, no swap fees. Advantage No. 3, most preferable alternative, Canadian tax perspective.

Mr. PEIFFER. That is—I am sorry.

Senator LEVIN. That is listed by you as advantage No. 1 for alternative No. 1. I am not reading something into this. I am reading your words. That is advantage No. 1.

Mr. FELDSTEIN. May I say something that—

Senator LEVIN. Sure.

Mr. FELDSTEIN [continuing]. Maybe helps to make sense of this, and if you will give me permission, I wanted to say something more broadly. I will get to your questions about the swap transaction, at least my impressions of what went on. But, as well, I wanted to talk about the \$1 billion which you mentioned previously.

So I want to start maybe with just some general comments on—very brief, I promise—on transactions with big tax consequences like this. I want to give you my impressions of the Slapshot deal based, of course, on 20/20 hindsight, and I want to really briefly, I promise, talk about what is different at our institution relative to when this transaction was done.

¹ Exhibit No. 344 appears in the Appendix on page 396.

So first, unlike in the United States, tax principles in some jurisdictions elevate the importance of the form of a transaction. Sometimes that helps taxpayers and sometimes it works to their detriment. It is usually accepted in these jurisdictions that taxpayers are entitled to structure a business transaction in the most advantageous form for tax purposes. In fact, their shareholders might say that companies are obligated to do that. So that is just general observation.

My second point, which is on this specific transaction, I, too, am not a Canadian tax expert, but from what I have gleaned, from what I have read, including the report and internal inquiries, I believe that the Canadian tax laws relevant to this transaction are very formalistic. The business transaction, you described correctly, was a \$375 million borrowing. The form of the transaction, including the economic reality, what was an economic reality, the \$1 billion flow of funds, if respected, including all the separate entities and the separate instruments that were created under some very formalistic Canadian tax laws, showed a \$1.4 billion borrowing and it was tax advantageous to do that and it was very formalistic.

My impressions of the swap, to get back to the questions you were asking, is that it was also important, being a very formalistic regime, to make the swap look like it was swapping the transactions that were trying to be respected as the form of the transaction, i.e., swapping the \$1.4 billion transaction, not swapping what the underlying business transaction was, which was the \$375 million loan.

From the review I have done and from your report, I glean also that the structures on this transaction received advice from Canadian tax counsel that the form should be respected. Tax counsel didn't say it was 100 percent certain, and generally, that is not a condition for structuring deals with material tax consequences.

We know now, after the fact, that Enron received an opinion from tax counsel, and you were right, it was the same tax counsel that had previously represented Morgan, but my understanding in talking with people is that it was at Enron's request that we stop using that counsel so they could because it was their regular tax counsel. They received an opinion from that counsel on the specific facts of this transaction that heavily caveated the advice. My understanding is that no one from J.P. Morgan Chase saw that caveated opinion.

So that brings me to item No. three, which is what would we do differently now, because I think we would do things differently. First of all, we now insist on advice from our own internal corporate tax department, which is separate from the business unit, an independent third party tax counsel of their choosing to give us advice on the specific facts of any transaction. I presume that on the specific facts of this transaction, given what we learned after the fact about the opinion that Enron received, that we might have had new and different information that may have—I was not there, so I don't know for sure, but that may have caused us to act differently in this case.

Senator LEVIN. Why would you have acted differently, only if you had access to the legal opinion?

Mr. FELDSTEIN. Again, let me try to maybe—

Senator LEVIN. You said you might have acted differently. I am trying to figure out why.

Mr. FELDSTEIN. Maybe I wasn't—

Senator LEVIN. What would you have now that you didn't have then?

Mr. FELDSTEIN. I guess I didn't explain it well enough. What we didn't do then, but we do now, is with respect to any transaction with material tax consequences or transactions which appear to us to have material tax consequences, we take that transaction and all the specific actual facts of that transaction to our corporate tax group, a completely separate group within the firm, not part of the business unit. Based on the facts that we provide to the corporate tax group, their review of them, but also the review of outside counsel selected by the corporate tax group reviewing the specific facts of the deal, we get advice on the strength of the tax consequences or the tax analysis of that specific transaction.

That step was not part of our policy when this transaction was undertaken, so that as you pointed out, the opinion delivered to Enron, not seen by us, caveated the original advice that J.P. Morgan Chase had received about the certainty of the tax consequences. It caveated it heavily.

I presume, I don't know for certain, but I presume that if we had engaged our corporate tax group, if the people working on the transaction had engaged the corporate tax group and the corporate tax group had engaged the outside counsel, independent outside counsel that they would today, that J.P. Morgan Chase, as well as Enron, based on the specific facts of the deal as it was structured, would have received very heavily caveated advice about it. And if that were the case, the fact that we received very heavily caveated advice may have caused us to walk away from this transaction.

The big policy change, again, because maybe I didn't express myself clearly the first time, is that all transactions of this nature, and not just ones where we know explicitly there is a material tax consequence, but ones that have certain indicia that lead us to presume that there are material tax consequences, there is a rule that now everybody follows willingly to take that transaction, the specific facts of the transaction to the corporate tax group for independent advice.

Senator LEVIN. You very much hedged your statement. I think the bottom line is, would Chase be pitching this deal today? This is your design. This is your structure.

Mr. FELDSTEIN. Let me first—

Senator LEVIN. This isn't something Enron cooked up. This is something Chase cooked up. Would you be pitching this deal today?

Mr. FELDSTEIN. I think that is an excellent question.

Senator LEVIN. I appreciate your saying that, but let me just have a clear answer. Would you be pitching this today?

Mr. FELDSTEIN. Let me answer it in two ways, first, specifically. We don't pitch this transaction today. Second, more generally—

Senator LEVIN. How would you pitch it today, given what you know about it?

Mr. FELDSTEIN. We would not pitch it today, given what we learned are the—we would not enter into this transaction the way it was—

Senator LEVIN. Let us get to it. You designed this structure. It is not entered into it.

Mr. FELDSTEIN. Let me—

Senator LEVIN. You designed the structure. Would you design a structure like this today?

Mr. FELDSTEIN. I do not believe we would. I was not there at the time, so I don't know what went into designing this structure.

Senator LEVIN. That is why I am saying today. Would you design this structure today?

Mr. FELDSTEIN. Let me talk more generally, then, about what we do today that is different from what we did then in the design of transactions and the marketing of transactions.

I would characterize the way the firm approached the business last year as a product-out approach. That is, the firm would design products like this and they would go and market those products to clients. We have reoriented our approach. I would describe the approach today as a client-in approach.

As opposed to designing generic transactions that we market to any number of clients who may or may not have the appropriate situation for those transactions, we start from a specific client situation, understand what makes the most sense for that client, and sometimes there are tax consequences to transactions where we advise clients to do things in a certain way to take—to create a transaction that most effectively—with the most effective tax consequences. But that is different from what I think the old orientation was, which was to design a transaction generically and market it.

So on your specific question, I don't think we would have done this transaction today given the policies we have in place to understand more about it, and more generally, I don't think we do business the way we did business then. As a business matter, we are much more client-in as opposed to product-out.

Senator LEVIN. But putting that aside, generic change, client-in, client-out, this is a structure, whether you design it or whether it is designed by somebody else. Would you be using this structure today?

Mr. FELDSTEIN. We don't use this structure today, so it wouldn't—

Senator LEVIN. Based on what you know about this structure, I know you don't, but would you use it, given its \$1 billion fake appearance of a loan? Would you participate in this thing—

Mr. FELDSTEIN. Given the tax—

Mr. PATTERSON. Can I take a crack at that, Senator Levin?

Senator LEVIN. You folks helped to create the appearance of a \$1.4 billion loan. It wasn't. It was an economic loan of less than \$400 million. The billion you handed with this hand got it back with this hand. You helped them create an appearance which then, as you knew it, allowed that—because you sold it—allowed that company to claim an interest payment for the full amount of what was really a payment of interest and principal. You knew you were participating in that.

Now, you also knew that it might be recharacterized by the tax authorities in Canada and you even took steps to what would happen if the jig was up, if they caught on, if they didn't allow the in-

terest payment on the \$1.4 billion and they took that payment as being payment of interest and principal. You even then went to the lengths of deciding what would you do if Revenue Canada said, hey, wait a minute. That is not a \$1.4 billion loan. That is a \$400 million loan and the repayments of it are payments of principal and interest, not all interest. We are not going to give you a tax deduction, Enron. You folks even worked with Enron on what you would do then.

My question is, would you participate in this kind of a transaction now? I don't care whether you design it or someone else designs it. You know what this transaction was. You know the details of it. Would you participate in this transaction today? That is my question.

Mr. PATTERSON. I think not. The result that you describe seems quirky, but as Mr. Feldstein explained, there are some tax jurisdictions where form seems to triumph over substance. That is why we rely on the advice of tax counsel in those jurisdictions before we go ahead.

In this case, as Mr. Feldstein said, we didn't consult the tax counsel in the same way that we would today, and I won't repeat everything he described, but we would have our corporate tax department, which is charged with looking after the firm's reputation in these matters, get its own outside counsel and get an opinion based on all the facts.

I do not know, because I am not a tax counsel, whether we would get as clean an opinion today as would be necessary for us to go forward. But even if we did, sir, as I mentioned in my opening statement, beyond assuring compliance with all external requirements, including tax laws, even if we thought this one might work, I personally, as head of the policy review function, would have to take into account how this would look to the world if, as we always have to assume, it would be publicly disclosed, and whether even if it met all the legal requirements and passed muster under Canadian tax law, it would be difficult to explain and might adversely affect our reputation. And on that basis, knowing what I know, I would not market this structure today.

Senator LEVIN. Is this just a matter of how it looks to the world? Is this just a matter of that? Isn't there something rotten about something which looks like a \$1.4 billion loan which is a \$400 million loan? Doesn't that trouble you as a banker?

Mr. PATTERSON. Well, the public perception of it troubles me. If you put the—what if we went to the Canadian tax authorities and got an opinion from the Canadian tax authorities that it worked? It would still look kind of quirky, but it would not be viewed in Canada as rotten.

Senator LEVIN. Would you be willing to do what you did with Enron back then in terms of figuring out, what are we going to do if the Canadian tax authorities find out about this, despite your lack of a road map, that they track it anyway, that they spend as much time as this Subcommittee staff had to spend to figure out what was really going on here, Canadian tax authorities, if they did that, if they reached the same conclusion that this was more than quirky, this is just simply misleading because you are pretending that there was \$1.4 billion which was lent, when in fact

it was only \$375 million, and if they reached that conclusion, you folks worked, and if you will take a look here at Exhibit 351,¹ you folks even had a recharacterization rider. You had a fallback. You had a safety net here if they caught on and if they recharacterized this.

This is your document. The rider attempts to recast any principal paid in excess of 25 percent of the recharacterized loan as instead being a loan to Chase, instead of from Chase. Here you have got Enron. You are cooking up a deal. This is something you are pitching, you pitched.

Mr. PATTERSON. I actually think that was added by Enron to the deal we pitched.

Senator LEVIN. All right. You accepted it.

Mr. PATTERSON. We accepted it, yes.

Senator LEVIN. You agreed to this rider, which says if they decide, if the Canadian authorities find out about it despite your lack of a road map, if they find out about it, you agreed with Enron that you would then retroactively recast this as a loan to Chase instead of from Chase. One of the biggest banks in the world is being lent money by a client. That is what you agreed to. Does that trouble you, not just the appearance if it is made public, does that bother you as a person, as a banker?

Mr. PATTERSON. Well, the fact that we borrow money from a client doesn't bother me. It seems to me not surprising that one would try to anticipate what we would do if the initially intended tax results were rejected by the Canadian tax authorities. I assume in that context, I don't know, but I assume that the whole transaction would be transparent to the Canadian tax authorities at that time, including the recharacterization, and they might accept it or not accept it.

Senator LEVIN. Is there any way in just common sense understanding that that could accurately be characterized as a loan to you?

Mr. PATTERSON. To be honest, I am not familiar enough with the transaction to be able to answer that question.

Senator LEVIN. Well, think about it, would you, and give us an answer for the record.²

Mr. PATTERSON. Whether—

Senator LEVIN. Would you do that? Would you give it a little thought and give us an answer for the record?

Mr. PATTERSON. Whether it would be possible to characterize—

Senator LEVIN. Whether you think—

Mr. PATTERSON [continuing]. Recharacterize a transaction as a loan to us?

Senator LEVIN. Whether you think that in any way could be fairly described as a loan from Enron to Chase.

Mr. PATTERSON. Happy to.

Senator LEVIN. My understanding, by the way, is that opinion that came to Enron from the lawyers came within a couple days of, what, the completion of the transaction. It wasn't, as you indi-

¹ Exhibit No. 351 appears in the Appendix on page 514.

² Exhibit No. 391 appears in the Appendix on page 1006.

cated, Mr. Peiffer, months later. It was just right around the transaction.

Mr. PEIFFER. My understanding—

Senator LEVIN. It is obvious Chase knew that there was a question about this. We might as well cut to the chase. It is obvious that you knew that there could be a problem. Whether that same tax lawyer gave you that advice that they gave Enron or not, you knew it because you had worked out what would happen if the Canadian authorities decided that this wasn't right. You worked that out. So you knew that there could be a problem with this.

To that extent that you had a retroactive recharacterization to turn something which was a loan from you into a loan to you, and it is that recharacterization document which seems to me to speak volumes.¹ It may only be a page, but it speaks volumes. It speaks about what Chase really believed. Whether you saw that opinion that the Enron folks got from that same lawyer or not, you knew there could be a problem.

Mr. PEIFFER. Could I make a comment on this?

Senator LEVIN. Please.

Mr. PEIFFER. Again, Enron came to us with this. We are not sure why—actually, I can say I do know why Enron came to us with this. In the event that the Canadian tax authorities would recharacterize this, or choose—

Senator LEVIN. Disallow it.

Mr. PEIFFER. Disallow, yes, choose to disallow it by choosing to recharacterize it as a \$375 million loan, Enron was concerned specifically in that situation, if that was, say, a 20, 25 percent chance of that happening, which would be consistent with a "should" level opinion, then they wanted to limit the specific downside with respect to withholding tax. They and their counsel thought that this provision would have a chance of success with that. It is not something we came up with, nor was it something we even thought made sense for Enron to put in that, and we voiced that opinion to them.

Senator LEVIN. You agreed to it.

Mr. PEIFFER. We didn't think it was needed.

Senator LEVIN. Did you agree to it?

Mr. PEIFFER. Because of our strong opinions and what we knew their opinion to be, or that we thought it was going to be, but yes, we agreed to it and it was something that Enron even amongst themselves was deliberating. And so I think it would be incorrect to mischaracterize this as saying this is a reflection of what everybody thought of the deal. I think this was a specific clause to recharacterize something specifically, withholding tax benefits, withholding tax that would need to be paid—

Senator LEVIN. Sure.

Mr. PEIFFER [continuing]. If the intended tax benefits were not achieved, and my understanding—

Senator LEVIN. You agree—

Mr. PEIFFER [continuing]. With a lot of tax transactions, whether in the United States, Canada, anywhere, is that there are provi-

¹ Exhibit No. 351 appears in the Appendix on page 514.

sions to address certain things like that if the intended tax benefits aren't achieved.

Senator LEVIN. But Chase agreed to recharacterize something as a loan to it instead of a loan from it in order to help Enron avoid taxes.

Mr. PEIFFER. I think in order to, under the Canadian tax rules, potentially avoid withholding taxes if the transaction were—if the tax benefits with respect to the transaction were disallowed. That doesn't take away the strength of the opinions or what we or Enron believed to be the high probability of the tax benefits.

Senator LEVIN. There is nothing to take away from those opinions, because you knew—Chase knew that this loan was not \$1.4 billion. That much, we know you knew. You have acknowledged that. You knew it was an economic loan of \$400 million.

Mr. PEIFFER. It was an economic loan of \$375 million—

Senator LEVIN. Three-hundred-and-seventy-five million.

Mr. PEIFFER [continuing]. For legal and Canadian tax purposes, the advice we received is that it was, indeed, a \$1.4 billion loan.

Senator LEVIN. And you also knew that it was going to be challenged or could be challenged, and you also then agreed with Enron that if it were challenged, you would retroactively change its nature. You would recharacterize it so that Enron wouldn't be hit with taxes by Canada. You helped to perpetrate a fiction. You helped them perpetrate a fiction, because there was no \$1 billion loan.

Mr. PEIFFER. I am sorry, I take exception with that.

Senator LEVIN. You might take exception—

Mr. PEIFFER. I don't look at this as perpetrating a fiction.

Senator LEVIN. That is a fiction. There was no \$1 billion lent to them.

Mr. PEIFFER. We have opinions from Canadian tax counsel—

Senator LEVIN. Was \$1 billion lent to them or not?

Mr. PEIFFER [continuing]. With that—

Senator LEVIN. Was \$1 billion lent to them? I know there was \$375 million. I am not talking about that. Was there \$1 billion lent?

Mr. PEIFFER. There was a \$1.4 billion loan made to the subsidiary of—

Senator LEVIN. Of which \$1 billion was repaid within minutes, is that—

Mr. PEIFFER. Under a separate contract, with money coming from elsewhere in Enron.

Senator LEVIN. Separate contract, it was repaid within minutes, wasn't it?

Mr. PEIFFER. I think the distinction here again to make is that Canada follows a very form over substance—

Senator LEVIN. I am not talking Canada. I am talking Chase, your reputation, transparency. We hear lectures about transparency, that you are going to be transparent. I am not talking about Canada. Canada will take care of itself. I am talking about Chase. You knew that the \$1 billion of the \$1.4 billion came right back to you, did you not? You knew that much.

Mr. PEIFFER. I knew \$1 billion was coming back to us, that is correct.

Senator LEVIN. Of that \$1.4 billion.

Mr. PEIFFER. Money is fungible and it was two separate transactions and we were advised that the transaction as a whole should be split up into two separate transactions, and yes, we did receive \$1 billion back.

Senator LEVIN. Did you get a legal opinion about this re-characterization?

Mr. PEIFFER. We did not—

Senator LEVIN. When you agreed to this—

Mr. PEIFFER. There was no need for Chase to.

Senator LEVIN. When you agreed to this, was there a legal opinion on this that Chase got?

Mr. PEIFFER. With respect to this, in the context of this, Chase did not need to receive a legal opinion, but my understanding is that Enron received advice from their Canadian tax counsel that it might be advantageous to put this in there in the event that this were audited and all the facts had become known and that there is the potential that this might do something for them.

Senator LEVIN. You understood that Enron got an opinion from its lawyers about this?

Mr. PEIFFER. Yes, I do.

Senator LEVIN. But you didn't?

Mr. PEIFFER. We had an opinion based on the generic transaction, the generic structure—

Senator LEVIN. No, I know that—

Mr. PEIFFER [continuing]. But with respect to—

Senator LEVIN. The recharacterization.

Mr. FELDSTEIN. My understanding is J.P. Morgan Chase did not get an opinion on the specific details of the transaction.

Mr. PEIFFER. Right.

Mr. FELDSTEIN. Today, we certainly would.

Senator LEVIN. Mr. Peiffer, you helped dream up Slapshot and helped develop it. Were you rewarded in any way by your supervisors for this, any special way?

Mr. PEIFFER. I think it is fair to say?

Senator LEVIN. Was there a bonus, special bonus of any kind? Did you get—

Mr. PEIFFER. There was no special bonus with respect to this. I think it is fair to say that it was one of many elements that, you know, played into the paying of a year-end bonus. We would all have been much better off, I think, also, if we had never made any of these loans to Enron and Enron had not gone bankrupt and the bank had more money to pay the bonuses. We all would have been better off if that were the case.

Senator LEVIN. Let me conclude by just saying this. You have got some language on your website which says that banks were victims in fraud cases, not accomplices. All I can tell you is this, that this is a structure which you folks designed. You are not the victim here. You designed a structure. You sold a structure. Part of the sale was that it would not be providing a road map. You then agreed if, in fact, the Canadian tax authority would find that was not allowable, even agreed retroactively to recharacterize a loan from you into a loan to you. You folks aren't victims here.

Mr. FELDSTEIN. May I add something?

Senator LEVIN. You folks helped a deceptive practice by Enron to be perpetrated, and it is—I am glad you are changing your approach. I can't tell you how glad I am. I will look forward, Mr. Patterson, to your answering the question for the record that you said you would think about.¹

But it is important that we all worry about how things look, and that is important. But what is more important is how things really are.

Mr. FELDSTEIN. Could I just address your comments about the victim? My interpretation of that was that financial institutions were the victims of deceptive accounting practices and disclosure practices, or apparently deceptive practices at Enron. This transaction, and we have gone through the certainty or lack thereof in terms of the tax consequences, but this had nothing to do with the accounting presentation that Enron provided, but rather was a transaction which rested upon whether Canadian tax law would respect the form in which it was structured, and the victim comment, I think, is about the apparent accounting deception practiced by Enron, which is a different subject, I believe.

Senator LEVIN. Your prepay pitch book back in 1998, if you look at Exhibit 128, says the following. This is what you were pitching. Prepayment received for a forward sale of inventory, fixed quantity, specific delivery locations. Your third dot says, balance sheet-friendly. Is that still the kind of pitch you would make, balance sheet-friendly, or balance sheet accurate? Which is more important?

Mr. FELDSTEIN. Balance sheet accurate.

Senator LEVIN. Is it fair to say, Mr. Patterson, you wouldn't be making a pitch quite like that anymore?

Mr. PATTERSON. I don't have it and can't see it, but—

Senator LEVIN. It is Exhibit 128.

Mr. PATTERSON. I don't think we have No. 128 here.

Senator LEVIN. I am sorry, I have got the wrong number. It is Exhibit 169.

Mr. PATTERSON. I don't think we have that, either.

Senator LEVIN. Let me try again, Exhibit 369.²

Mr. PATTERSON. Three-sixty-nine. No, I think that we probably would not use that terminology today. That doesn't mean that accounting considerations are not relevant to our clients and to the transactions they enter into. They are structured in a way to comply with accounting rules. So accounting considerations continue to be an important part of structured finance. The key is that the accounting treatment be correct and not misleading.

Senator LEVIN. Thank you. Thank you all for your appearance here today and we wish you good luck in greeting the weather on your return home, and we also wish you good luck in implementing fully and forcefully your new approach. It is important that our institutions, the ones we rely so heavily on, such as Chase and Citibank and others that have been such an important part of this economy, have the confidence and credibility of the public. I hope

¹ Exhibit No. 391 appears in the Appendix on page 1006.

² Exhibit No. 369 appears in the Appendix on page 687.

your new guidance has an impact in that regard, both internally and externally. Thank you all for coming.

Mr. PATTERSON. Thank you, Senator.

Mr. PEIFFER. Thank you.

Senator LEVIN. Ms. Siebert, we now welcome you, President and Chair of Muriel Siebert and Company of New York. Ms. Siebert gained fame as the first woman member of the New York Stock Exchange and Superintendent of Banks for the State of New York, now an owner of a discount stock brokerage firm, one of our wise elders—I hope you won't mind that description—when it comes to finance and the securities business. I want to thank you for your travels here today from New York, also fighting the elements.

Pursuant to Rule 6, as I have mentioned to all of our witnesses, our witnesses need to be sworn because of that rule of the Subcommittee, and so I would ask you to please stand and raise your right hand.

Do you swear that the testimony that you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Ms. SIEBERT. Yes, I do.

Senator LEVIN. Ms. Siebert, I think you have a statement, which we would ask you now to proceed with.

**TESTIMONY OF MURIEL SIEBERT,¹ PRESIDENT AND CHAIR,
MURIEL SIEBERT AND COMPANY, INC., NEW YORK, NEW YORK**

Ms. SIEBERT. Yes. I submitted a written statement, but I have an abbreviated oral statement. I would like to thank you for inviting me. I am sorry I was late, but I came by way of LaGuardia Airport and then the train because they canceled our flights, so I apologize for being late.

Senator LEVIN. Actually, you are right on time, except you missed some testimony.

Ms. SIEBERT. Terrific. I commend your Subcommittee for tackling this very tough, nasty job. You know, it will be 35 years ago that I became the first woman member of the New York Stock Exchange, and at the time, while many people did not want me, I joined a group where your word was your bond and you would go broke before you broke your word. Things have changed when I look at the Enron transactions. The money became too vast and it was made too fast. I am sorry to say that greed became the creed.

Enron, in my opinion, represents a total moral bankruptcy. It took more than the officers and the directors of the company. It required help from the accountants, the lawyers, and the investment and commercial banks. Many people profited from these transactions, except the investing public, many of whom will never be able to make their losses back. It has affected their future retirement and we have to make sure this does not happen again.

My interest in Enron really began in February. I received a call from the man that runs our retail discount operations and he told me that he was seeing things that he never saw before. We had clients selling out their entire portfolios and requesting a check. We would not see that transaction if they sold their entire portfolios

¹The prepared statement of Ms. Siebert appears in the Appendix on page 113.

and went into a money market fund. That would be an automatic sweep. But when they requested a check, it took an action on their part and our part.

I asked Peter, because we call every customer that leaves our firm, and if it is because their nephew has gone to work for Merrill Lynch, so be it. God bless them and good luck. If it is because of something we have done wrong, I want to know about it.

So I started to get the reports every week, and the answer was, don't trust the integrity of the system. The system is against us. We can't let this happen. The reports have continued to come in that way, although very few people compared to what we had before.

Our capital raising system is a national treasure. In the 1990's, the United States created tens of millions of new jobs. Every new technological development was made in the United States, and for most of the decade, at least the early part and middle part of the 1990's, the market was orderly and the public, the small investors, started to invest. First, they bought mutual funds. They wanted to own a piece of America.

After I received the same answers for a few weeks, I realized the seriousness of the abrupt change in our investors' attitudes. Many of them, when we called them, specifically mentioned Enron. Sure, that was probably because there was a lot of publicity going on at that time, but they had been hurt in bond funds and other products.

I will give you an example. When I gave a speech for the *Miami Herald* at their yearly investors' conference, a man in his 80's during the question and answer period told me, "I lost a third of my money. Will they go to jail?" This is serious.

Enron could not have happened without two new financial products, derivatives and structured finance. These products in themselves are not bad. It was the purpose that was employed that was terribly wrong. They were used to deceive. The financial engineering permitted operations by legal loophole.

Derivatives are not new. I testified in 1988, I have it here, after the 1987 market break. That was portfolio insurance. The regulators passed some laws and portfolio insurance is finished.

I testified in 1998, 10 years later, after long-term capital market. Our country, frankly, lucked out in Long-Term Capital Management. Bob Rubin was our Secretary of Treasury and he was the only Secretary of Treasury that has ever come from the trading desks. He had helped invent derivatives. He knew what to do. Long-Term Capital Management had an equity, it is reported, of \$4 to \$5 billion and they were carrying, using derivatives, the notional value was over \$1 trillion. When they made the wrong bet, major margin calls were threatened. The Federal Reserve called in the firms downtown. They called in the banks and they put together money and they took over the operations of Long-Term Capital Management and we liquidated it in a way that the public was not hurt.

When I continued to see the attitude of our individual investors, in late spring, I said, well, I had better go down to Washington and tell some people what I am seeing, because I had never seen this before. So I had lunch with Larry Lindsey. I had a telephone ap-

pointment with Secretary O'Neill and I spent time with Mr. Pitt and his deputies. I recommended three things.

Under Sarbanes-Oxley, officers of corporations must certify the authenticity of the earnings reports. I recommend that we add a statement to those reports that these figures represent economic reality. That would eliminate the sham transactions. That would have eliminated the phony energy trades. No officer would sign a statement that the transactions that your Subcommittee is examining represented economic reality.

Enron was the leader in energy trading when it became deregulated. They used legal loopholes to create an illusion of activity. The trading practices of buying and selling on the same day, the same amount, at the same price, are illegal. They are considered to be wash sales in the listed markets. In the over-the-counter markets, they were legal. Other formerly solid conservative utilities participated in these trades, which are still being unraveled. As a result, some of these utilities have had to reduce or suspend their dividends. Most of these stocks are owned by individuals who count on the dividends for their livelihood.

In some cases, the price of some of these utility stocks have been cut in half very fast, literally overnight.

Now, when companies issue debt, they have an indenture which spell out the terms that these bonds are being issued under. It is their covenants, for example, the ratio of interest coverage, the ratio of asset coverage, the rating of bonds by rating agencies. If these covenants are violated, they have debt triggers in there whereby certain things are triggered. They can force a company to repay the bonds immediately. It is very difficult for individuals or institutional investors to get the terms of these bonds. They would not have owned a lot of these securities had these terms been readily available.

I recommend that the debt triggers and terms of indentures on bonds, as well as covenants or terms in the preferred stocks, be made available easily and be listed on the corporation's website so that anyone who takes the effort, who wants to invest money, I do not care if it is 100 share of a Duke preferred stock or a Dominion preferred stock, can see the terms and see under what circumstances their income might be stopped or they will lose their protection.

Finance is now global. It is almost impossible for regulators to keep up with the fast-moving technology. The SEC and Federal and State regulators, bank regulators, together could identify these transactions if the information was furnished. Otherwise, it is very hard for them to get into this. The SEC could have identified it. The Federal bank and the State bank regulators could have identified some of these transactions. It is difficult for U.S. regulators to act unilaterally. It will have the effect of driving the business offshore, but will not stop the business.

We know we are going to have global bank regulations. We have some now. We will have global accounting standards. I suggest that our country be the leader to establish global securities regulations, that we include derivatives and margin requirements and other things that are used to get around the purpose of the laws.

Certain laws and regulations have been passed which will stop the same practices from occurring again, but we must make sure that our focus is on the individual investor also, and that it is geared towards reinstating their faith in the system.

Thank you for inviting me and allowing me to participate.

Senator LEVIN. Thank you very much, Ms. Siebert, for your very thoughtful testimony.

I don't know how much of the testimony this morning you were here to hear. I know you had to take a train when you expected to fly, but I think you have had an opportunity to look at the transactions which we were discussing here this morning in the report of our staff. What is your reaction to those transactions that you read about in our report?

Ms. SIEBERT. They were designed to deceive. They were designed to create the illusion of certain economic events. I do not see the economic reality for it.

Senator LEVIN. I think your testimony probably answered this question, but I will ask it, in effect, again. Are these the types of transactions that we want our major banks not only participating in, but designing and selling to public companies and to other clients?

Ms. SIEBERT. No, they are not the kind of transactions, and I would also say that if they do participate in those kind of transactions, they should not have the benefit of FDIC insurance.

Senator LEVIN. We are going to be hearing from our regulators in our next panel and we want to find out what is being done to stop this kind of deceptive practice, and I am wondering whether you would agree that our regulators need to not only take enforcement actions on a case-by-case basis to punish wrongdoers, but also to construct a regulatory deterrence program to deter future wrongdoing.

Ms. SIEBERT. I believe they can do it. Our regulators are really a top quality group. The Federal Reserve and Federal bank regulators, the State bank regulators, the SEC, they have dedicated staff there. I mean, it is wonderful to see them. But I also believe that the information must be furnished them so they don't have to go hunting for it.

Senator LEVIN. And if that information is furnished for them, or to them, excuse me, would it be useful if they can design, as you put it in your testimony, acting together with the SEC and the bank regulators acting together to regulate the kind of transactions which we have heard about and talked about here at this Subcommittee.

Ms. SIEBERT. I believe it is. For a long time, I have said that we need regulation by function, because investment banks are doing the job previously done by banks and banks are doing the job previously done by investment firms. So they will have to work together. Normally, I don't like to see Uncle Sam and the regulators get too big, but it is probably the only way where we can effectively put our arms around this problem.

Senator LEVIN. And in terms of the information that you say is so important for them to have so that they can act, would you feel it would be helpful if the SEC and the bank regulators conducted a comprehensive joint review of these structured finance products

which are being sold by or used by our financial institutions so that they could identify the ones that are designed to deceive?

Ms. SIEBERT. Yes, I believe that would be very welcome and necessary.

Senator LEVIN. Our thanks again. You are a frequent visitor to committees of the Congress, to be providing the kind of testimony which comes from your experience and we are very grateful for that testimony and for your experience, for what you bring to the world in which you spend a great deal of your time.

Ms. SIEBERT. I believe in the system. It has been very good to a lot of us.

Senator LEVIN. It has, and we are going to do everything we can to make sure that system is strengthened and that credibility in it is restored, and it is going to take, I believe, at least, a combination of the entities, the institutions, the financial folks acting on their own to clean house, but it also is going to take a stronger regulatory arm, and we are going to talk to our regulators right now and see whether they are in agreement with that. Thank you again.

Ms. SIEBERT. That is great. Thank you.

Senator LEVIN. Let me now introduce our final panel of witnesses who represent one of the most important pieces to this puzzle and that is our regulators. We not only thank you for making it—I don't think you came quite as far as our other witnesses, but you have waited longer. I hope that it was worthwhile to you in terms of the testimony that you heard here. It is a very complicated subject that you live with and we are dealing with and we have spent a lot of time attempting to understand it and our staff has spent a huge amount of their time putting together a staff report, which I think has been made available to you.

We have at our witness table today Richard Spillenkothen, Director of the Division of Banking Supervision and Regulation at the Federal Reserve. I think Ms. Annette Nazareth is on her way. She is the Director of the Division of Market Regulation at the Securities and Exchange Commission. And Douglas Roeder, Senior Deputy Comptroller for Large Bank Supervision at the Office of the Comptroller of the Currency.

This is a very distinguished panel. We know that they are involved in a lot of things and had to sort out their schedule to make it possible to be here today. We look forward to hearing your views.

As I have indicated, pursuant to Rule 6 of this Subcommittee, all witnesses who testify before us are required to be sworn, and at this time, then, I would ask you to stand and raise your right hand.

Do you swear that the testimony that you will give before this Subcommittee today will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. SPILLENKOTHEN. I do.

Mr. ROEDER. I do.

Senator LEVIN. I think, Mr. Spillenkothen, we are going to call on you first.

TESTIMONY OF RICHARD SPILLENKOTHEN,¹ DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION, THE FEDERAL RESERVE, WASHINGTON, DC

Mr. SPILLENKOTHEN. Thank you, Mr. Chairman, for the opportunity to testify on the continuing efforts of the Federal Reserve Supervisors to address issues emanating from the excesses of the recent credit cycle, including large corporate defaults and accounting irregularities.

The focus of today's hearing, on how complex structured financial products provided by banks and other financial institutions were used by their customers to obscure financial statements or to engage in questionable tax strategies, is timely. Events of the past year, such as the bankruptcy of Enron, have focused attention on the need for strong risk management, sound accounting, improved disclosures, and more active corporate governance oversight to avoid the kinds of losses that have been costly both in very real human and economic terms.

The Federal Reserve has been reviewing bank participation in the types of structured financial activities that have raised significant legal and accounting questions and I will discuss the status of our efforts in a moment. I will also briefly discuss both our supervisory expectations for banks involved in transactions such as those that have been the focus of this Subcommittee, as well as how we are considering amending our procedures and refocusing our supervisory reviews.

But first, I would like to say a word about the role of bank supervisors. The primary focus of the Federal Reserve's supervision is ensuring an institution's overall safety and soundness, as well as compliance with banking and consumer laws and regulations in a way that protects the Deposit Insurance Fund and the consumer while promoting stability of the financial system. As part of this risk-based approach to supervision, examiners focus primarily on areas posing the greatest risk to the institution, primarily credit risk, market liquidity, legal, and reputation.

In carrying out our responsibilities, the Federal Reserve coordinates its supervisory activities with other Federal and State banking and securities agencies, such as my colleagues here from the OCC and the SEC, other functional regulators, and the bank regulatory agencies of other nations. If in the course of their review examiners have reason to believe that a bank is engaging in questionable activities that might relate to a possible violation of securities laws, then supervisors would refer those matters to the SEC as the primary interpreter and enforcer of those laws.

I would say for an example, recently, Federal Reserve supervisors identified transactions by a banking organization, not one the subject of these discussions, but by a banking organization that raised concerns regarding the bank's accounting and public disclosure. In this case, we referred those potential securities law violations to the SEC, and in coordination with the SEC and the bank's primary regulator, took enforcement action and remedial action in a coordinated fashion.

¹The prepared statement of Mr. Spillenkothén appears in the Appendix on page 117.

Now, some basic principles and expectations for banking organizations guide our work in examining complex financial transactions. First and most obviously, banks must obey the law. In particular, they must have policies and procedures in place to ensure that they are in compliance with all applicable laws and regulations with regard to a particular activity or product.

Second, banks should perform thorough due diligence on the transactions they are engaged in or involved in and check with appropriate legal, accounting, and tax authorities within their own organizations, as well as their outside experts when appropriate, and also provide appropriate and relevant information to their customers. However, banks ordinarily should not be held legally responsible for the judgments and actions or malfeasance of their customers. Such an expectation would require, inappropriately, in my judgment, banking organizations to assume management responsibility for their customers and also could place undue significant costs on banking organizations to audit the activities of their customers. However, banks must not participate in activities of their customers that the banks know to be illegal or improper, nor should banks engage in borderline transactions that are likely to result in significant reputational or operational risks to the banks.

Third, the role of banks is to assume and manage all the attendant risks related to their activities as financial intermediaries. In light of recent events, banking organizations should be, and indeed are, reevaluating the risks related to both their traditional as well as their new products, recognizing that as financial markets and practices change, legal and reputational risks may manifest themselves in new ways or in new magnitudes not previously recognized.

As part of our supervisory review of complex structured transactions, we are assembling and evaluating the various findings and observations of our examiners, as well as the conclusions of other primary and functional regulators we work with, and identifying any necessary follow-up. While I am unable to discuss ongoing Federal Reserve supervisory reviews, as you know, there are several transactions that are currently under investigation by the SEC and other enforcement agencies with whom we have strong working relationships and with whom we have conferred on these matters. We are continuing to collaborate with them and receive their views and conclusions on various matters on an ongoing basis. As our fact finding is completed and our conclusions are drawn, we will provide institutions with feedback on any identified weaknesses, and if warranted, take appropriate supervisory corrective actions, including referrals to other authorities.

More generally, in light of recent events, we have already modified our examination plans for larger banking organizations to focus more fully on evaluating the largest customer relationships, that is, the large relationship with the customers that they have and also looking at the overall customer relationship, not just a transaction-by-transaction basis. These plans or examinations cover the specific areas of concern in the structured finance business and an evaluation of the steps banks are taking to manage the credit, legal, and reputational risks in response to events of the past year. We will also be looking at the new product review process and how

they manage the real and reputational risks in the new product review process.

We have already begun the process of modifying our examination guidance and are considering additional supervisory guidance or regulatory changes, especially in the area of structured finance, and if we do this, we will obviously work with our colleagues from the other banking agencies and, as appropriate, the SEC.

In this connection, we will also evaluate the range of reforms banking organizations are adopting, and once we are able to observe their performance and practice, consider whether there are some sound practices that should be adopted more widely within the industry.

In closing, the fallout from the recent round of excesses and large corporate defaults appears to be resulting in some positive steps by corporations, banks, and capital markets. Supervisors should play a positive leadership role and work to ensure that these corrective actions, that their ongoing supervisory activities reinforce these corrective steps and help them to endure over the longer term. If banking organizations, corporations, and supervisors are attentive to the lessons learned over the past year and adopt appropriate policies and controls, the risk of repeating similar excesses in the coming years should be substantially reduced. Thank you.

Senator LEVIN. Thank you very much, Mr. Spillenkothen. Mr. Roeder.

**TESTIMONY OF DOUGLAS W. ROEDER,¹ SENIOR DEPUTY
COMPTROLLER FOR LARGE BANK SUPERVISION, OFFICE OF
THE COMPTROLLER OF THE CURRENCY, WASHINGTON, DC.**

Mr. ROEDER. Thank you. Chairman Levin, thank you for inviting the OCC to participate in these important hearings. I am Douglas Roeder, Senior Deputy Comptroller for Large Bank Supervision.

Let me begin by commending the Subcommittee for holding these hearings. Enron's failure has been nothing short of a national tragedy, especially for the thousands of Enron employees who lost their jobs and retirement savings. At its height, Enron was a multi-billion-dollar corporation whose influence was wide ranging and far reaching. Inevitably, some of its business involved national banks which operate under OCC supervision. In my statement, I would like to focus on the steps that national banks and the OCC as their supervisor are taking to help prevent Enrons from occurring, future Enrons.

The OCC is responsible for supervising over 2,000 banks, some of which are the largest in the world. Resident examiners working in these large banks use a risk-based approach to supervision, an approach that takes into account the various sources of risk to a bank. Because credit risk has traditionally posed the greatest threat to safety and soundness of banks, much of our supervisory attention has traditionally focused on credit issues. However, the Enron situation demonstrates just how significant other types of risk can be. As a result, we have asked ourselves how our current approach could be enhanced.

¹The prepared statement of Mr. Roeder appears in the Appendix on page 123.

First, we intend to focus more intently on banks' procedures for authorizing new products. Our examiners will evaluate the bank's system to ensure that a comprehensive process exists for senior managers to review and approve new product offerings. Also, we believe it is important that the new product approval process is sufficiently robust to capture even seemingly small changes that could transform an existing product into one that poses an entirely different degree or type of risk. When in doubt as to whether a product requires vetting through the new product approval process, we encourage bank management to take a conservative approach and to apply the process to the proposed product or activity.

Going forward, we will sample more extensively transactions going through the banks' new product approval process. In particular, we will check to see whether banks are complying with their own processes and whether proper review and authorization are received prior to engaging in complex structured transactions.

In addition, we are in the midst of discussions with the other banking agencies to determine whether interagency guidelines should be revised to more specifically address board and senior management responsibilities for the approval and oversight of new products, such as complex structured products.

Second, while banks' board and senior management may place their stamp of approval on a new product, the bank must also carefully consider the appropriateness of complex structured transactions from the standpoint of the bank's client. This represents a shift in our approach into supervising such transactions. In the past, our focus has been on how well the bank assesses the sophistication of the customer and that customer's ability to perform under the terms of the contract. We will now ask our examiners, in addition, to determine whether bank management understands the customer's disclosure and accounting intent.

While it is not realistic for banks to be held responsible for how customers account for transactions on their own financial statements, it is incumbent on bank management to carefully consider the potential impact of their actions on the bank and to decline to participate in transactions that do not meet the standards of integrity that the bank has established.

Third, we plan to review large relationships, even if credit risk is low, and flag structured products during our credit work for potential further review. We think it is important that bank management establishes controls that encompass the bank's total relationship with its large customers. Competitive pressures are a natural part of any business environment, but care must be taken to ensure that line managers eager to retain or expand business with important customers don't cross the line and jeopardize the trust and credibility that forms the foundation of a bank.

It is encouraging to report that banks are studying and learning from the Enron experience, whether or not that experience was firsthand. Banks that offer complex structured transactions have come to realize that they stand to suffer great harm if they are implicated in questionable activities conducted by their customers. As a result, banks have taken steps to improve their internal controls of complex structured transactions and special purpose entities.

Some banks have made changes to management, establishing new oversight committees, developing new policies and procedures, tightening controls, upgrading internal reporting to management and the board, and improving the quality and quantity of disclosures. Banks have also strengthened their review and approval processes for complex structured transactions. This includes expanding the definition of products to be approved and enhancing the approval process to provide for a broader range of senior-level management review. Also, banks are putting a greater focus on assessing customer motivation and appropriateness, including securing representations from customers regarding disclosures and accounting treatment.

We believe that these are all positive steps toward strengthening internal processes. We are currently evaluating the responses of national banks and will assess these reforms as they are implemented.

I also want to highlight another important facet of the supervisory process. That is the interaction among the Federal regulatory agencies. The ability to make and receive referrals ensures that the agency with the appropriate authority and expertise is involved. We are coordinating our reviews of national banks' previous involvement with Enron with the Federal Reserve and the SEC. Because this is an open matter, I am unable to comment institution specific details that pertain to the current reviews underway.

Thank you once again for inviting OCC to testify at this important hearing.

Senator LEVIN. Thank you very much, Mr. Roeder.

Let me welcome Ms. Nazareth. We know that you were late, tied up somewhere, but we are going to need now to swear you in as we do all of our witnesses, so I would ask you to stand and raise your right hand.

Do you solemnly swear that the testimony that you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Ms. NAZARETH. I do.

Senator LEVIN. Thank you. Ms. Nazareth, thank you.

TESTIMONY OF ANNETTE NAZARETH,¹ DIRECTOR, DIVISION OF MARKET REGULATION, U.S. SECURITIES AND EXCHANGE COMMISSION, WASHINGTON, DC

Ms. NAZARETH. Thank you, and I apologize for being late, Mr. Chairman. My name is Annette Nazareth and I am the Director of the Division of Market Regulation at the Securities and Exchange Commission. I would like to submit my written testimony for the record and briefly summarize, if I may.

Senator LEVIN. Thank you, and it will be made part of the record.

Ms. NAZARETH. Thank you. I will take just a few minutes to highlight a couple of key points. First, the SEC has significant powers to investigate possible violations of the Federal securities laws and to enforce those laws through civil and administrative actions. The Commission to date has charged two former Enron officers

¹The prepared statement of Ms. Nazareth appears in the Appendix on page 134.

with fraud based on their participation in transactions designed to mislead investors about Enron's financial results. The Commission's investigation is ongoing and the Commission's Division of Enforcement continues to work diligently and vigorously with the Justice Department's Enron Task Force to ensure that all those responsible answer for their misdeeds.

While I cannot speak publicly regarding the specifics of any ongoing investigation, several aspects of the Commission's general enforcement authority are particularly relevant to the issues of disclosure and transparency that are at the root of the problems you are examining today.

The Commission has clear authority to proceed against public companies that file false information as part of their financial statements. Such conduct is potentially subject to various provisions of the Federal securities laws, including the requirement that companies' filings with the SEC be materially complete and accurate and the SEC's general anti-fraud authority.

The Commission brings numerous actions, 163 this past fiscal year, based on false and fraudulent financial reporting and disclosures. Among these was an action the Commission recently brought against a public company for, among other things, using an undisclosed off-balance-sheet special purpose entity to dramatically overstate the company's cash flow from operations. Cases like this make clear that public companies using off-balance-sheet special purpose entities must ensure not only that their accounting treatment complies with Generally Accepted Accounting Principles, known as GAAP, but also that they have accurately portrayed the economic realities of the transaction.

The Commission also has explicit statutory authority not only to proceed against primary violators of the Federal securities laws, but also against aiders and abettors of those violations. The Commission aggressively employs this authority. In addition, the Commission may order any person who is or was a cause of a violation of any provision of the Exchange Act due to an act or omission the person knew or should have known would contribute to the violation, to cease and desist from causing such violations.

Aggressive enforcement not only punishes wrongdoers, but also helps deter future illegal behavior, and in fulfilling this mission, the Commission cooperates with the Federal bank regulators, among others. The SEC obtains evidence of possible violations of the securities laws from many sources, including from other regulatory authorities, such as the Federal bank regulators. In addition, when appropriate, the Commission coordinates its investigations with Federal banking regulators, which can result in coordinated regulatory settlements.

For example, in a recent case, the SEC took action with respect to accounting improprieties of the PNC Financial Services Group, Inc., a bank holding company. The Commission's order found, among other things, that PNC materially overstated its earnings by failing to consolidate into its financial statements three special purpose entities to which it transferred approximately \$762 million of volatile, troubled, or under-performing loans and venture capital assets. Based in part on this conduct, the Commission found that

PNC had violated the anti-fraud record keeping and reporting provisions of the securities laws.

At the same time the Commission's order was issued, the Federal Reserve announced that PNC had entered into a written agreement to address bank supervisory matters. The Commission acknowledged the substantial cooperation provided by the board in this matter.

The Commission has long recognized the need to consult and coordinate with the Federal banking agencies on matters involving financial institutions that are public companies. For example, the chief accountants of the Commission and the Federal Deposit Insurance Corporation, the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision meet periodically to discuss matters of mutual interest. Similarly, key decision makers meet regularly to implement supervisory programs, work on international agreements, and guard against money laundering.

While our enforcement activities are ongoing, there are numerous other efforts underway at the Commission to improve the quality of reported financial information, the reliability of that information, and the timeliness of that information. The fall of Enron, along with other corporate scandals, has crystallized the importance of efforts to strengthen the accountability of public company officers as well as other so-called gatekeepers of our financial markets, the lawyers, the accountants, the auditors who work with public companies as part of the financial reporting process. Enactment of the Sarbanes-Oxley law also will help ensure that regulation with regard to these parties is stronger.

Some of these regulations are already final. For example, as of August of this year, the CEOs and CFOs are now required to certify the financial and other information in issuers' quarterly and annual reports. Other rules to implement the Act are proposed and are on track to be finalized in January. For example, in November, the Commission proposed rules regarding standards of professional conduct for attorneys, and in October, the Commission proposed rules that would significantly tighten the requirements for companies to disclose non-GAAP financial measures and for corporate management to disclose material off-balance-sheet arrangements. Individually and in their totality, these rules should have a significant effect on the quality and reliability of financial reporting and, thus, should serve to enhance investor confidence.

At the same time that we are working to strengthen our own rules and regulations, we are also diligently exercising our oversight role through our Office of Chief Accountant to make sure that the private sector's standard-setting bodies, including the FASB and the AICPA, are making improvements in their auditing and accounting standards. You will find the details of these improvements outlined in my written testimony.

To conclude, Mr. Chairman, there is no question that as we continue to unravel the improprieties of the Enron scandal and others, we will take away many more important lessons, and in response to these lessons, we will continue to refine our internal procedures, cooperate with other regulatory bodies, and hone our rules and reg-

ulations so that Enron-type disasters are less likely to occur in the future. Thank you.

Senator LEVIN. Thank you, Ms. Nazareth.

We have seen in a number of transactions financial institutions participating, aiding and abetting, contributing to deceptive pre-pays which were constructed to look like energy trades instead of debt, deceptive asset sales that are backed by secret guarantees, ensuring that the buyer will get its money back when the asset is sold a second time, deceptive joint ventures that are formed to move assets off balance sheets but ensure that the second investor never has any funds at risk, and deceptive tax products that include fake business transactions.

I know that each of you, because you are leaders in your field, are troubled by those kinds of deceptive transactions and, indeed, spend your professional life in trying to see if we can't remove deceptive transactions or deceptive accounting from our financial world.

It seems to me what we are facing is the following, that we have both our banking regulators and our SEC doing case-by-case enforcement, that when it comes to banks, we have a gap. We have a gap because, on the one hand, the SEC does not generally regulate banks, and we, on the other hand, don't have our banking regulators that do the work relative to banks that the SEC would do if it did regulate banks.

I know you all work together, and that is really essential, that you do work together if we are going to overcome and to end some of the deceptive practices that we have both heard about and we have written about, our investigation has uncovered, and so forth, and I am not going to ask you to comment on any specific practice of any specific institution for obvious reasons.

Is it possible that you could, working together, end that, or fill that gap in our regulatory regime, in the oversight that you carry out, because the SEC doesn't generally regulate banks and the bank regulators don't generally regulate accounting practices or ensure accounting financial statements, we have got that gap. Unless we have our regulators working together, we are not going to be able to deter. We may be able to, on a case-by-case basis, get to a problem in terms of punishment after the fact, but in terms of examining the books of financial institutions, we are not going to be able to do the deterrent work which is usually available in most regulatory bodies. We need a deterrence program.

I would like you to react to the following approach. First, that the SEC issue a clear policy statement, that the SEC would take enforcement action against financial institutions which aid or abet a client's dishonest accounting, or, of course, if they participate in a deceptive structured transaction. We know the SEC has the authority to go after aiders and abettors, but what I am suggesting here is not just a case-by-case going after an aider or abetter, but issuing a clear policy statement that the SEC would take enforcement action against financial institutions if they aid or abet a client's dishonest accounting or participate in a deceptive structured transaction. Now, that would be the SEC side of the two-step action which I am suggesting.

The second step would be by the bank regulators, here, informing the banks that violation of that SEC policy which I have just described would constitute an unsafe and unsound practice. That would enable bank examiners to take appropriate action during regular bank examinations.

If the SEC issues a clear policy statement relative to aiding and abetting by the financial institutions and if then the banking regulators as part of their regular bank examination let the financial institutions understand that a violation of that SEC policy, in turn, would constitute an unsound and unsafe practice, we then will have addressed this gap which exists, which I think most people would agree should somehow or other be filled.

So I am wondering whether or not I could get a reaction from our three witnesses today to that, and if that is something which needs to be looked at, fine. If there is a different approach where you can join together to fill this regulatory gap, then we would welcome your comments on it. Let me take you in the same order that I called on you before. Mr. Spillenkothén.

Mr. SPILLENKOTHEN. Mr. Chairman, I think if the SEC had a requirement that said a certain activity was a violation of securities laws or a violation of the law or securities regulation, then I think it would be the responsibility of bank regulators, if they found a situation that was a violation of an SEC rule, to take action, to deal with that, take enforcement action or refer to the SEC.

So I would, again, without having had a chance to work this through entirely—I am not a lawyer—but if an activity is clearly stated, if an activity is a violation of a securities law or regulation that the SEC has established or that is established, then I would think banking regulators would have no difficulty in taking steps when they found a violation. Obviously, you still have to make a judgment as to whether the organization is violating the law. But if the clear established rule is that a certain activity is a violation of the law, then the bank regulators would take an action it would be unsafe and unsound to violate securities law.

Senator LEVIN. This would be part of their bank examination, or it could be part of their routine, regular bank examination?

Mr. SPILLENKOTHEN. If we found a violation of a securities law, we should take action or refer to the SEC in the course of our ongoing supervisory process, yes.

Senator LEVIN. You say law. My reference and my question was to either a law, regulation, or a policy clearly stated by the SEC as to what action they would take if they found certain activities. So I tried to identify the word "policy." Now, it can't just be general and it can't just be oral. It would have to be a clearly stated enforcement policy of the SEC, obviously, but would that do it or does it have to be a regulation?

Mr. SPILLENKOTHEN. I am not a lawyer, sir.

Senator LEVIN. OK. If you could just take that back to your lawyers, I know they are waiting for work and will welcome the question. [Laughter.]

Senator LEVIN. Mr. Roeder.

Mr. ROEDER. If the SEC issued a policy statement as you indicated, I think from our standpoint, a bank that would violate that statement, we would consider that an unsafe and unsound practice,

because as Mr. Spillenkothen indicated, we expect banks to obey and comply with law.

If we, in our examination process, detected noncompliance with that statement, in addition to referring that matter to our colleagues at the SEC, our own current enforcement authorities allow us to initiate action against an institution ourselves for unsafe and unsound practices. So I think what you propose is workable.

Senator LEVIN. Thank you. Ms. Nazareth.

Ms. NAZARETH. I think to a large extent, what the Commission does is consistent with the spirit of, I think, what you are looking to achieve. Our enforcement actions are all settled pursuant to SEC orders that are very highly negotiated and contain, I think, very clear articulations of what is the Commission's position with respect to the activity, and as you know, we have a—one reason why people find it particularly painful to have had an enforcement action with the SEC is that we really name and shame. We are quite public in these actions in terms of making public what the activity was and what the Commission's articulation of the issue was.

In the cases that you are discussing, those cases would be brought under our general anti-fraud authority. I think that, in general, our position is that we want it very clear—in other words, we would want to make it very clear to people, as we have in some of our recent aider and abetter cases, that there is aiding and abetting liability for this type of activity. You can see the specific examples in those cases as to what resulted in aider and abetter liability.

But we, frankly, by not putting out a specific policy statement, we don't limit the context or the fact patterns in which we could find that activity to be violative, which I think is important. We are careful not to find ourselves in a position, I think, where ultimately someone could say, well, what I did was technically around the edges of your policy statement. Rather, I think we leave ourselves sufficient room so that regardless of how imaginative some of these schemes can become, that we will be on all fours in being able to bring a case against the parties.

But again, that having been said, I think the language is quite clear in these enforcement orders and would provide sufficient guidance to other regulators to ascertain what we had found to be a legal activity, and I suspect as a result of all of this, all of us at this table and other regulators, as well, will be thinking through our own, as we have testified, our own examination procedures in terms of the kinds of activities that we will be looking for, the kinds of internal procedures that we will expect these entities to have in order to ensure that they are not engaging in these types of activities.

Senator LEVIN. Would you take up with the SEC the suggestion that you adopt a policy statement relative to types of special purpose entities or structured transactions which you would consider to be improper? The advantage of that, obviously, is the one that I set out, that then the banking regulators would have not just the case-by-case results from your shop, but would have a policy statement which could appear prospectively. They wouldn't have to just interpret from a case or a finding in a specific case from a different agency, but they would have a policy statement of that agency.

I think if you would be willing to take that back, that idea back, it also could contain within it a statement that your enforcement actions are not limited to those particular examples of practices which you would feel to be deceptive or not reflective of good accounting practices. You could make that clear that those are simply examples and don't represent the total universe of what your enforcement actions might be.

But if you could at least consider taking that kind of action, it would, I believe, be an important step to filling what is a real gap, and that is the gap which I have identified, which is that SEC generally doesn't regulate banks and that banking examiners generally don't do—generally don't look for the kind of things that you look at in public corporations in terms of their financial statements. So would you be willing to do that?

Ms. NAZARETH. Yes, of course, I will take that back.

Senator LEVIN. Let me turn now to Senator Bennett for a time.

Senator BENNETT. Thank you, Mr. Chairman. I apologize to the members of the other panels that I missed. I had a longstanding lunch engagement that I felt I had to keep, but you are still going forward, so I appreciate the opportunity to be back here.

One of the things that has come out of all this is a recognition that contrary to general impressions, accounting is not an exact science. Indeed, accounting can be quite philosophical.

My brother, who taught philosophy at the University of Utah, described getting acquainted with the new head of the accounting department at the University of Utah and the two of them would go to lunch together and discuss the philosophy of accounting, and interestingly enough, this fellow, whose name I do not know, was ultimately asked to leave the University of Utah because his philosophy of accounting was sufficiently upsetting to other members of the faculty, that even though his recruiting had been considered a great coup by the university at one time because he had something of an international reputation, it didn't mesh culturally with the other members of the faculty and he was ultimately asked to teach someplace else.

I think the average person on the street thinks of accounting in the same terms as he does balancing his own checkbook or filling out his tax return and doesn't realize that there are all kinds of different ways that you can account for economic activity and all kinds of justifications that can be raised and defended for these different approaches.

So the challenge that you face as regulators is not just one to make sure that the checkbook balances and all the numbers add up, but that the philosophy, if I can use that term, that is being applied will, in fact, be the clearest statement of what things really are.

In the Banking Committee, we have had long and sometimes acrimonious debates about accounting in mergers and acquisitions, of whether you do it on a pooling basis or a purchase basis, and those that favor pooling insist that philosophy of accounting is responsible for the boom of the 1990's, and those that favor the purchase basis insist that pooling is a shell game that is hiding real value.

The question that the Chairman of the Banking Committee, Senator Graham, raised, was is there really a depreciation of the value

of some of the intangible assets? For example, does the reputation of Coca-Cola really go down to nothing over a 40-year period? Does the value of the Coca-Cola formula depreciate over time that can show up as a number on the income statement or in the balance sheet? And we debated that with all of the fervor of medieval theologians discussing how many angels can dance on the head of a pin.

I would like your reaction to the following that has come to me as I have listened through all of this and contemplated the true disaster that Enron represents. It was a disaster for its employees and a disaster for its shareholders, but as I have reviewed the testimony of Muriel Siebert, it was also a disaster for the system as a whole and shook investor confidence in the entire American system in a way that we are still living with.

You can manage earnings. That is a phrase that has come out of the whole Enron experience, that executives are managing earnings so that they will meet the numbers that the analysts have projected. I have been the CEO of a company and I know how, very rudimentarily, how to do some things to produce that result, how to put a particular loss in this quarter as opposed to next quarter, how to set up reserves that are perfectly legitimate, but you set them up in such a way as to manage how much money shows up on the bottom line. You can't manage cash flow. The cash is either in the bank or it is not. You can't fudge that one.

As we are debating what to do about the economy in the next year, one of the proposals that is on the table has to do with the deductibility or tax treatment of dividends, and it has occurred to me that if we were to make dividends tax deductible or tax free to the individual investor who receives them, the investor would, therefore, have an incentive—economics is all about incentives—have an incentive to purchase a stock whose return could rival that of municipal bonds.

Management would have a very difficult time managing the dividend flow, managing the cash flow that would make it possible to pay dividends. It would be much more difficult to try to manipulate market perceptions of your company if you had to come up with the cash every quarter to maintain your dividend payment in order to maintain your stock price, and that would change the incentive on the part of the CEO very dramatically.

Instead of going into his CFO and saying, "Find me an offshore special purpose entity that I can play with and pretend I have created earnings," the CEO would go to his operational leaders and say, "Find me a place where I can get a little more cash so I can meet my dividend so that my stock price won't be hurt if the dividend is cut."

In today's market, it is considered a sign of weakness if a company pays dividends. I remember speaking to a CEO of a company that was awash in cash and saying to him, why don't you pay some dividends, and he said, "If we paid dividends, it would be an admission that we were not in a position to earn more money for our investors' dollars within the company than they could earn with after-tax dollars investing it themselves, and we don't want to admit that we are not good enough managers to do better with their dollars keeping them here as pre-tax dollars than we would

be if we gave them the money and then they had to pay taxes on it and then they could get a still better rate of return.”

Now, I know this is economic policy. I know this is part of the tax debate. But thinking of it in terms of a corporate governance issue as opposed to a tax issue, do you see any change in corporate behavior if dividends were tax-free to the recipients and, therefore, corporations had a strong incentive in terms of the impact on their stock price to accumulate enough cash, not phony accounting activities, cash, to be able to pay out dividends?

I would appreciate any reaction you might have. This is a little bit afield from what we have been talking about, but it is very current in what we will be talking about in January and it has come to my mind as I have tried to think my way through Enron and what could have been done to prevent it. If the Enron executives had had an incentive to meet genuine cash responsibilities, they would probably not have engaged in some of the very high-risk activities that they did engage in. I would like your reaction.

I have caused all three of you to look at each other and smile. I won't interpret that as being, this Senator is completely out of his mind, but a more benign interpretation, but whoever might want to take it.

Mr. SPILLENKOTHEN. Well, Senator, you are right, this question is beyond my bailiwick as a mere bank supervisor, so I don't have a good insight there. I think your point about accounting being not science certainly is a true one and I think that—but we would argue as a bank supervisor that banking organizations and private sector firms still have an obligation to get the accounting right.

Senator BENNETT. There is no question about that.

Mr. SPILLENKOTHEN [continuing]. An obligation to get it right, and speaking as a bank supervisor, I am very strongly supportive of efforts by the Financial Accounting Standards Board, by the Congress in establishing reforms. We think the progress on getting the Auditor Oversight Board set up and getting that process working to provide more discipline to the accounting profession are all very good things and they are very critical for bank supervision.

So I don't have an opinion on your original point, but getting the accounting right, bringing discipline to the accounting profession, bringing to bear some of the reforms that this Congress has established, the oversight board for accountants, the Auditor Oversight Board, the reforms that the FASB is trying to do, the steps that the SEC has been taking to improve disclosure and accounting are very critical to our role as bank supervisors.

Ms. NAZARETH. I feel like it is a trick law school question.

Senator BENNETT. Not at all. I am unburdened with a legal education—

Ms. NAZARETH. Excellent.

Senator BENNETT [continuing]. So you can go in any direction you want.

Ms. NAZARETH. Well, I can assure you, a legal education doesn't necessarily bring you to the right answer.

It is not clear to me as a lawyer and as a securities regulator what the consequences of that would be from a corporate governance perspective. I really haven't had time to think it through.

I think what it is fair to say, though, is that I think we do need to continue to think creatively about ways that we can appropriately incent companies, incent boards of directors, to act in the best interests of shareholders, in the best interests of their corporations and their businesses, and to account for their activities in appropriate ways. And so, certainly, that is a creative idea that we could consider, as well as others, to get to that desired goal.

Senator BENNETT. As I say, economics is about incentives, and as I have gone through the Enron disaster, I realize there was a strong incentive in terms of the stock price to, again the phrase I mentioned this morning, be aggressive in reporting earnings, a strong incentive in terms of the stock price to find every possible way within the law, if you were determined to abide by the law, or outside the law if you were of that mind, to account for earnings in a way that would inflate them and hope that somehow the real business would catch up with that later on and you wouldn't get trapped.

But I am old enough to have come from the school that says you manage the business properly and the earnings take care of themselves, and ultimately, they take care of themselves in the terms of money in the till. If you could share that money with your investors without their having to pay the double taxation on it, that becomes an incentive to move in the other direction. I won't berate that hobby horse any further. We will have debate about that.

Mr. Chairman, I appreciate your indulgence. I noticed going through Mr. Spillenkothen's statement, his statement more clearly than I made it this morning on an issue that came out of this morning's comment, where he says banks should not be held legally responsible for the judgments, actions, or malfeasance of their customers, nor should they be required to second guess their customers' accountants, tax, or legal experts, or police their customers' activities. Such an expectation would require, inappropriately, banking organizations to assume management responsibility for their customers and place potential legal liability on banking organizations that would compromise their ability to perform their role as financial intermediaries or threaten their safety and soundness, and that is the point I was trying to make this morning, sir, and you have made it more eloquently.

But you say in the next paragraph, as we all agree, that banks must not participate in activities of their customers that the banks know to be illegal or improper, and that is the area that the Chairman is looking into, very appropriately.

Thank you very much for your testimony.

Senator LEVIN. Thank you very much, Senator Bennett.

We have all encountered some of the deceptive accounting practices since Enron in various forms and guises. In one instance that we discussed today, three senior officials of the investment bank told the head of the investment bank not to go forward with a transaction. They used words like it would put the reputation of the franchise at risk, but nonetheless, they proceeded because Enron had pressured the bank to go forward.

So you have got client pressure, you have got competition pressure, and in the last few years, banks have begun competing for business on the basis of who can sell the product that makes the

client's financial statement look the best, and that is the race to the bottom. So our banks and our security firms need accurate financial statements, but too often, instead of promoting honest accounting, they have been sold and are selling products that produce dishonest accounting.

I just really need a good, clear statement from our regulators, because you are at the top of your professions, that this is unacceptable, that our financial institutions have got to stop facilitating accounting deceptions, they have got to stop helping clients manipulate their financial statements. I would ask you for a clear statement of that without commenting on any specific case.

Mr. SPILLENKOTHEN. Mr. Chairman, I think in my statement I indicated that we do not think banks should engage in borderline transactions because they can pose operational and legal risks to the bank and they can also expose the bank to risks and ultimately risk to the depositors and the insurance funds. So we do not believe banks should engage in borderline transactions.

Ms. NAZARETH. I concur with that statement, as well.

Mr. ROEDER. And I take no disagreement with that.

Senator LEVIN. Now, when it comes to the area of structured finance operations at banks and security firms, the question is how do you separate the legitimate from the illegitimate. There are obviously some legitimate purposes, as we have all indicated, for structured finance operations, but there are some clearly illegitimate uses to which they have been put, where there is no business purpose, where all they have been used for is to try to turn a loan into income or to try to pretend that there was an asset sale when there wasn't, there was a loan, where you have this kind of deceptive structure which is created.

We have got to, if we are going to restore confidence in these financial statements, we have got to be able to identify, describe what separates the wheat from the chaff when it comes to these structured finance operations. Would you be willing to conduct, or take back to your agencies the suggestion that there be a joint review of structured finance operations at banks and security firms in order to identify the ones which are promoting deceptive accounting and to distinguish them from the legitimate uses of these structured finance operations? Would you be willing to take that suggestion back about such a joint review? Let me start with you, Mr. Roeder.

Mr. ROEDER. I think we have to absolutely work together, and, of course, do so around the ongoing matters under review or investigation within our agencies.

One of the difficult things, as you mention, is separating good from bad, especially considering the large number of transactions that these banks conduct. Fortunately, the transactions that we have talked about today are, we believe, limited in banks.

In addition, the life of some of these transactions is very short, so the scope and how you might go about conducting that review would clearly be something we would have to spend time talking about. We are all faced with limited resources, so I think you have to bear down on those things that are very complex and assess the reforms that the banks have adopted and try to determine how you could extract best practices in hopes that would lead us to maybe

a better differentiation between what is appropriate and not appropriate. But I think a coordinated review, as long as it doesn't interfere with our current reviews, is sensible.

Senator LEVIN. Ms. Nazareth.

Ms. NAZARETH. I think that there are a number of lessons that we are going to—that will ultimately emerge from this period and I think it would be incumbent on all the regulators to look back on this after we have completed all these enforcement investigations and see what the lessons learned are.

Certainly, I think we will be much more knowledgeable about the types of transactions that were problematic. I think we could share information on that, and perhaps with assistance from the various auditing and accounting groups who assist us in these efforts, perhaps we could try to give some guidance for terms of what we saw that was problematic.

Senator LEVIN. Thank you. Mr. Spillenkothén.

Mr. SPILLENKOTHEN. Thank you, Mr. Chairman. As I said, the Federal Reserve is actually reviewing a handful of organizations that are engaging in these transactions, so we are involved now in a review of these transactions. We are consulting with our colleagues at the OCC and the SEC in this process, so we will continue that.

As I indicated, we will, after this process is finished and we have had a chance to assess our results, consider the need for additional supervisory guidance to our examiners or to the industry. We will consider the need for additional sound practice guidance in some of these procedures that the banks are putting in place. I think the banking organizations themselves have recognized, as they have indicated to you, that they need to revise their internal controls and vetting processes.

So we are engaged in a review and we will consider, after that review is done, whether we need to provide additional supervisory guidance or sound practice guidance in this area.

Senator LEVIN. What is the time table for that review?

Mr. SPILLENKOTHEN. Hopefully in the next weeks and months. I don't know exactly. We have got a lot of people doing a lot of things, but we are attempting to get this done.

Senator LEVIN. Do you expect perhaps in a few months, it would be done?

Mr. SPILLENKOTHEN. I would hope so.

Senator LEVIN. Do you think it is likely that you will be issuing some guidance which we could, or you could label as being guidance that was contributed to by the other regulatory agencies?

Mr. SPILLENKOTHEN. Well, we would certainly coordinate with the other agencies. We also need time to make our own assessments, and I think I should also point out that whatever we do, we would have to go to our oversight board and make an evaluation of all this. But we certainly would do this in coordination with the other regulators.

Senator LEVIN. One of the recommendations we will be making in our report is that there be that kind of a joint review so that we can have that kind of guidance come from not just the Fed, but from all of our regulatory agencies working together. It would be, I think, a very important step in what we are trying to accomplish.

Some time ago, if you could take a look, Mr. Spillenkothen, at the exhibits—let me see if I can find the number here—Exhibit 370.¹ I think we shared this with the folks at the Fed some time ago. This was an e-mail back in 1999 that is dated March 5, 1999, and it is entitled, “Disguised Loans.” It says that we are making disguised loans, usually buried in commodities or equities derivatives, and I am sure in other areas. With few exceptions, they are understood to be disguised loans and approved as such, but I am queasy about the process.

And then the employee of Chase listed a number of concerns, and one of which he said was he worried about loans that escape routine transparencies. The loan is buried in the trading books, and when we say we have X loans to Country Y, it is not included. And then he says further down, as a policy matter, I think we need a small task force to not eliminate disguised loans, but to make sure they are done right.

I am wondering if your staff at the Fed has talked to you about it, are you aware of it, and whether anyone has talked to Chase about that.

Mr. SPILLENKOTHEN. Mr. Chairman, I—

Senator LEVIN. It does address a safety and soundness problem. When a bank evaluates risk, how much of its money is tied up in a particular country or company or currency, how does it take into account all the loans disguised as energy trades or derivatives or asset sales and so forth? How do you do a risk analysis when you are missing important transactions? Are you familiar with this particular—

Mr. SPILLENKOTHEN. Not in detail. I think because we are reviewing these transactions, I really can’t discuss specific questions.

Senator LEVIN. All right, fair enough.

Mr. Roeder, your office at the OCC oversees about 2,000 national banks, and you stated in your prepared testimony that complex structured transactions such as those entered into by Enron are generally offered at only a small number of large banking companies. About how many banks are we talking about?

Mr. ROEDER. Our review would indicate fewer than ten.

Senator LEVIN. So that the banks that would require extra scrutiny on structured finance would be a small population?

Mr. ROEDER. There are a number of institutions that offer very standard structured finance products and services. The most complex products tend to be concentrated in fewer than ten institutions. So, yes, it is not something that we have found to date to be widespread.

Senator LEVIN. Therefore, I presume that makes the regulatory burden a little narrower in terms of the targets?

Mr. ROEDER. It helps, yes.

Senator LEVIN. One last document.² This was a Chase document, too, in which it was back in 1998 selling or pitching prepays and used the term “balance sheet-friendly.” I take it you would all agree that our balance sheets should be accurate, neither friendly

¹ Exhibit No. 370 appears in the Appendix on page 701.

² Exhibit No. 369 appears in the Appendix on page 687.

nor unfriendly, but accurate. Would that be a fair statement, Mr. Spillenkothen?

Mr. SPILLENKOTHEN. That is a fair statement.

Senator LEVIN. Ms. Nazareth.

Ms. NAZARETH. Yes.

Senator LEVIN. And Mr. Roeder.

Mr. ROEDER. Absolutely.

Senator LEVIN. OK. Let me close by thanking you all. It has been a long day, but we have learned a lot. A lot of practices which we believe are deceptive have been analyzed. Some of our leading financial institutions, in our judgment, helped Enron cook the books, and the safety and the soundness and the vitality of our financial system depends on honest accounting and accurate financial reporting. So we need these banks that are the guardians and promoters of honest accounting to be that and not willing accomplices in accounting deceptions.

We have heard testimony today which is extremely troubling about the extent of financial deceptions that Enron and its banks engaged in. The banks say that they recognize the problems now. They are changing the way in which they do business, and they say what was acceptable a year ago is not acceptable today. Hopefully, they will take the actions that are promised.

But we simply cannot rely upon self-regulation and promises. We need our regulators to step in, ratchet up efforts to ensure honest accounting, and put an end to banks assisting their clients to produce deceptive financial statements.

The gap now in the regulatory oversight area needs to be closed, the gap that exists because the SEC does not generally regulate banks and the bank regulators don't generally look at accounting practices or ensure accurate financial statements. We need to continue the effort to get regulators working together, of course, punishing wrongdoers on a case-by-case basis, but that is not enough. We need to design a new deterrence program.

It needs a lot of work. Steps need to be taken together by our regulators, our watchdogs. I have outlined a couple steps that I thought would be useful, and we welcomed our witnesses' willingness to take those suggestions back to their agencies. We will make those suggestions, as I indicated, part of a Subcommittee report based on our staff investigation and our staff report.

It would be very helpful if the SEC would issue a clear policy statement, that the SEC will take enforcement action against financial institutions that aid or abet dishonest accounting by a client. At the same time, we need bank regulators to tell banks that violation of such an SEC policy would constitute an unsafe and unsound practice, which would then enable bank examiners to take appropriate action during regular bank examinations.

A comprehensive joint review, such as apparently is being undertaken by the Fed, would be very helpful if it is a joint review of the structured finance products that are being sold or participated in by our financial institutions so that we can clearly separate the products and the structured finance arrangements which are deceptive from the ones that serve a legitimate financial and economic purpose.

The short story is that we need to send our financial firms, some of which are the most renowned firms in the world, much less in the country, we have got to send them an unmistakable message, that while we welcome their self-regulation and their growing awareness of what they participated in, willingly or unwillingly, wittingly or unwittingly, the message has got to be that touting balance sheet-friendly deals that allow clients to hide debt or to report deceptive amounts of cash flow or earnings are simply not going to be tolerated. Our financial institutions must be part of the restoration of credibility by helping us to return to that good old fashioned honest accounting.

We all look forward to working with the banking industry and the regulators to get that message out and to establish that deterrence program that is needed to prevent future calamities, such as Enron.

We again thank all of our witnesses here today. We thank our last panel for your patience, for your contributions, and most importantly, for the day-to-day work that you are engaged in and committed to, in which we place so much faith, that you will take aggressive actions against wrongdoers where you find them and that you will help us design a deterrence regime and a procedure so that we can deter wrongdoing in the future.

With that, we stand in recess.

[Whereupon, at 3:17 p.m., the Subcommittee was adjourned.]

APPENDIX

Opening Statement of Charles Prince
Before the Senate Permanent Subcommittee on Investigations
December 11, 2002

Introduction

Thank you Mr. Chairman and members of the Committee.

My name is Chuck Prince. Since September of this year, I have been Chief Executive Officer of Citigroup's Global Corporate and Investment Bank. Before that, I was Chief Operating Officer of Citigroup, and have been with the company or its predecessors for the past 23 years. I appreciate the opportunity to appear before you to discuss these important issues and commend you on your determination to understand how and why a Fortune 10 company like Enron could unravel so quickly and to such devastating effect. The collapse of that company has been a disaster for thousands of people -- employees, investors and others -- and making sure that similar events do not happen again is a critically important objective that we share.

The last year has been a challenging one on Wall Street. Industry practices that were standard operating procedure for years have come under sharp scrutiny by Congress, regulators and investors. Many of these practices have been changed and others are in the process of changing. Although it has not always been pleasant, we believe it has been a useful and largely constructive process. For our part, we want to be at the forefront of change, setting a standard for integrity and professionalism in our industry. This has become a guiding mission for the senior management of our entire organization.

Enron and its aftermath has, indeed, been a catalyst for change in our industry more generally, and we recognize that while we have sought a leadership role, many other financial institutions are examining their own ways of doing business and making changes. And, of course, legislators and regulators have been and continue to be critical drivers of the reform process.

Part of our process of self-examination has included the recognition that we have engaged in certain activities that do not reflect the way we believe business ought to be done going forward.

Let me be clear: I believe that the Citigroup professionals involved with these transactions acted in good faith and understood these transactions to comply with the existing law and prevailing standards of the time. But let me be equally clear: good faith and legal compliance are no longer the issue as far as I'm concerned. Even assuming that these transactions were entered into in good faith and were entirely lawful, they do not reflect our standards and they would not happen now, at Citigroup. The facts that have been uncovered about Enron and other companies show us that opaque transactions like those Enron sought to take advantage of do not serve the interests of the capital markets and clearly do not serve the interests of institutions like ours, because they undermine our credibility with investors. Our credibility is our most important asset.

Recognizing the problems our industry faces, we have worked diligently to develop new practices and policies reflecting the lessons we've learned. When Sandy Weill asked me to take the helm at the GCIB three months ago, he gave me a mandate to accelerate the process of reform and change that was already underway in that

business. Before turning to the specific arena of structured finance that is the focus of this hearing, I think it would be useful for me to briefly outline the broader reforms that Citigroup has taken a leadership role to institute.

Citigroup's Recent Reforms

In facing a variety of industry-related challenges, Citigroup has instituted a number of leading reforms:

- **Strong Code of Conduct** -- Citigroup's Board of Directors recently approved an updated and strengthened Code of Conduct for all employees. In addition, much earlier this year, we initiated a complete review of our compliance and governance that has already resulted in significant changes.
- **Expensing stock options** -- Citigroup was among the first of the major financial institutions to adopt the proposal to expense stock options.
- **Pension reform** -- Citigroup has taken steps so that, by year end, Citigroup's pension will be fully funded.
- **Independent research**
 - We were the first major firm to voluntarily adopt the Spitzer Principles to insulate equity research from investment banking.
 - We were the first major firm to adopt the SEC's proposal that analysts certify their research, putting the requirement into place immediately after it was proposed.
 - We were the first, and so far the only, major firm to structurally separate research from investment banking by moving it into a new independent business unit, headed by Sallie Krawcheck, former CEO of the research

firm Sanford A. Bernstein and a leading voice on analyst independence. This structure ensures the independence of research from investment banking.

- o While we continue to work with the industry and regulators on reforms designed to protect the independence of research, last month we unilaterally adopted interim policies governing the ways that research analysts may interact with investment bankers. These policies prohibit analysts from attending investment banking pitches or road shows, and include other significant limitations on the circumstances in which analysts and bankers may interact, as well as gate keeping procedures to monitor those interactions.
- Ongoing review of business practices -- We have established a new corporate-level Business Practices Committee to ensure that all business practices are consistent with industry leading standards.
- Corporate governance -- Our Board formed a new Nomination and Governance Committee chaired by Frank Thomas -- our longest serving independent board member and the former President of the Ford Foundation -- to ensure continued focus on the highest standards of corporate governance.
- Auditor consulting -- To avoid even the appearance of conflicts, Citigroup does not use its outside auditor for consulting. Our auditor only provides audit, audit-related and tax services.
- Control processes -- We have strengthened an already robust control environment by, among other things: establishing a Business Practices

Committee specifically for the GCIB and requiring that our Capital Markets Approval Committee (CMAC) periodically report to that Committee on transactions it reviews; expanding the jurisdiction of the CMAC to cover all complex transactions that raise accounting issues; requiring formalized approval of the creation of new legal vehicles, including Special Purpose Vehicles, as well as enhanced review of transactions involving the use of SPVs; and establishing a rigorous policy governing tax sensitive transactions.

Structured Finance -- The Transactions at Issue

Let me turn now to the issue of structured transactions that is the focus of today's hearing and was the focus of the hearing you held, Mr. Chairman, on July 23 of this year. As I hope you will agree when I discuss the reform initiative we announced just two weeks after that hearing, at Citigroup we heard you and we took appropriate action.

First, though, let me say a few words about the specific transactions under review. While I believe our people acted in good faith, I think it is fair to say that we never anticipated -- no one ever anticipated -- that a financial intermediary would be criticized for the accuracy of the accounting treatment that a Fortune 10 company gave to its transactions with the express approval of a then-highly respected Big Five accounting firm. At the time we entered into these transactions, we never imagined -- no one ever imagined -- that Arthur Andersen wouldn't exist a year later or that a failure of ethics would have destroyed Enron, a company ranked 18th on the list of *Fortune Magazine's* Most Admired Companies for the year 2001. But we all learned something -- that reliance on public accountants or a company's widely held excellent reputation has important limits, particularly in the face of corporate malfeasance.

Structured Finance – Citigroup's Reform

To say that our professionals acted in good faith and in ways they believed to be appropriate is not to say that we consider a business-as-usual approach to be an acceptable prescription going forward. On the contrary, we concluded in the days and weeks following your July 23 hearing that we needed to act, even in the absence of industry or regulatory action, and that the best way to protect both investors and our own reputation with regard to the kinds of transactions that appropriately concern this Committee was to insist on transparency. The regulators have recognized the same principle, and indeed last January recommended guidance for the disclosure of off balance sheet and related transactions. But, in the absence of any mandatory rules, we recognized that we needed to play a leadership role by requiring companies with whom we did business to make clear, straightforward disclosure of the impact of structured financings and related transactions.

Accordingly, on August 7, Citigroup announced a new transparency policy, saying, in essence, that from that day forward, Citigroup would execute material financing transactions for companies that were not going to be recorded as debt on their balance sheet if -- and only if -- the company agreed to disclose the net effect of the transaction on its financial condition. We announced this "net effect" rule for two reasons -- first, to encourage companies to account for financings in a transparent manner so that investors can adequately assess the net effect of the transaction on the financial condition of the company, and second because we simply did not wish to be a party to transactions that fail to meet a high standard of transparency. Under our net

effect rule, the transactions at issue in today's hearing would not and could not have happened at Citigroup unless Enron had made clear, detailed disclosure to investors. We simply would have refused to do these transactions without a commitment to make such disclosures.

The Policy. Our policy is based on a few key principles. First, it applies to any material structured or complex financing transaction of the sort this Committee has been concerned about. In determining whether the policy applies to a given transaction, the economic reality -- not just the form of the transaction -- is critical.

Second, the required disclosures include, among other things, (1) management's analysis of the net effect of the transaction on the financial condition of the company; (2) the nature and amount of the obligations; and (3) a description of events that may cause an obligation to arise, increase, or become accelerated. Examples of appropriate disclosures might include: the transaction amount, the term (including the economic features that could shorten the maturity, such as step-ups, ratings triggers, or events of default), any recourse, and the effect on assets, liabilities, net income, earnings per share, cash flow or other significant balance sheet items. The precise elements of the required disclosure will vary depending on the transaction.

Third, Citigroup will obtain the client's written commitment that disclosure of such transactions in the client's relevant public filings will fairly present the transaction's financial impact. If we do not receive this commitment, we will not do the deal.

Fourth, Citigroup will do these transactions only for clients that agree to provide the complete set of transaction documents to their chief financial officer, chief legal officer and independent auditors. If there are any oral assurances from the client in

connection with any transaction that Citigroup believes may give rise to accounting or disclosure issues, these have to be documented and then included with such transaction documents.

Fifth, key decisions, such as whether the policy requires additional disclosure in a particular transaction, are made by senior management from our Accounting Advisory, Legal and Risk Management control functions, acting together. If the senior managers of our control functions do not approve a proposed transaction then, very simply, that transaction will not go forward. Concerns about accounting or similar matters must be fully resolved and documented if a transaction is to go forward. I am committed to making sure that our new procedures are fully observed. In order to do that, we are enhancing our decision-making process so that, at every step, decisions are documented and our internal audit group can review and verify compliance with our procedures.

Implementation. Promptly after Citigroup announced this transparency policy, we erected what amounted to a roadblock for each structured finance and related transaction to see whether it was the kind of transaction that would not be reflected as debt on the balance sheet, and should therefore be specially disclosed to the company's investors. None of these transactions was permitted to go forward unless it was submitted to a rigorous examination process by a working group composed of top management from Financial, Legal and Risk Management control functions. This process, while initially cumbersome, served both to ensure that the policy was implemented immediately upon its enactment and to educate the business units about the details of the policy. As we move forward, we are continually adjusting and fine

tuning the process to allow for more efficient, but equally rigorous, review. We are now preparing to launch a training program that will be based on our experience so far and informed by the SEC's new proposed disclosure rules.

We recognize, of course, that our execution will not be perfect. We are feeling our way, seeing what works, discovering the challenges of applying a policy like this to an enormous range of complex transactions. Leaders, by definition, move in uncharted territory and will make some mistakes.

But I am quite encouraged by what I have seen so far -- by the seriousness and intensity with which Citigroup professionals are grappling with this new policy, from the transactional people on the front lines to the most senior managers of our company. It has already made a measurable difference in the kinds of deals we are doing or declining to do and in the nature of the disclosure clients are making.

SEC's Proposed Disclosure Rules

Of course, our unilateral initiatives do not satisfy the need for a strong, independent accounting profession and for clear regulatory guidance. In this regard, we were pleased that the Sarbanes-Oxley law takes a number of important steps, such as requiring auditors to give up certain consulting duties in light of their potential to create at least the appearance of a conflict of interest, and mandating new SEC rules on the periodic reporting of off balance sheet transactions, which were just released in proposed form by the SEC last month.

We embrace the SEC's proposed rules. They are properly directed at public companies and issuers, since the legal disclosure obligation belongs to them, not to financial intermediaries. The SEC's proposed rules follow earlier guidance from the

SEC on this subject, issued last January, which Citigroup followed in disclosing off balance sheet transactions in our most recent 10-K filing. Having done so, our own disclosures are now in substantial conformance with the SEC's most recent proposals. We will, of course, fully comply with the new SEC requirements when the proposals are finalized. Greater transparency is also important to us as a lender and underwriter, since in those roles we necessarily place much reliance on financial statements.

The SEC's new proposed rules, when finalized, will supersede one objective of our net effect rule -- the one aimed at prodding companies to make better disclosure -- because that role appropriately will be played by the SEC, with the more comprehensive scope and forceful tools that a regulator commands. At the same time, the other objective of our net effect rule -- assuring that we don't walk into transactions that we would be better off avoiding -- remains fully in force. We recognize that as a financial intermediary -- even though the legal disclosure obligation is not ours -- we have an active interest in sustaining the credibility of the financial markets, the confidence of investors, and our own reputation.

Conclusion

Mr. Chairman, the world has changed markedly in the past year and is continuing to change. The collapse of Enron and the turmoil that followed on Wall Street has done tremendous damage to a great many people and businesses. We recognize that we must take real steps to change our ways of doing business and get real results. We have done this and are continuing to do more. This is not a time for half measures or foot-dragging or public relations gimmicks. We at Citigroup understand our role as a leader, embrace the mandate for change, and subscribe to the goal of effective, far-reaching reform.

We appreciate the seriousness and vigor with which you approach these issues, and look forward to working with you and your colleagues on these and other reforms.

I thank you and look forward to answering your questions.

Opening Statement of David Bushnell

Before the Senate Permanent Subcommittee on Investigations

December 11, 2002

Mr. Chairman and Members of the Committee, thank you for the opportunity to speak to you today.

My name is David Bushnell. I am a Managing Director at Citigroup's Corporate & Investment Bank and the head of Global Risk Management for the Global Corporate & Investment Bank (GCIB). Global Risk Management functions as an independent control over our business units. It is the responsibility of my department to ensure that risks — including market risk, credit risk, and risks to the institution's reputation — are identified, measured and evaluated for the GCIB. No extension of credit is permitted without Risk Management's approval in accordance with our established policies and procedures. The firm's risk management committees, including the Capital Markets Approval Committee, report to me. I am also charged with communicating to and interpreting for our business units the views of senior-most management as they pertain to issues of risk.

I understand that the Committee is interested in discussing my role in the Sundance transaction. I look forward to answering the Committee's questions about that transaction. But before I do, I would like to take this opportunity to explain some of the very significant changes that Citigroup is making in the way we handle such transactions today.

As you know, on August 7, Citigroup announced a new policy regarding transactions that raise significant accounting or disclosure issues. As chief risk manager, I have been centrally involved in developing and implementing this policy. In his testimony, Mr. Prince describes the key elements of the policy and our implementation program. The message that I want to convey is that this new policy is having a real impact on the ground at Citigroup where transactions are done.

Every material structured or complex financing transaction of the sort this Committee has been concerned about is being subject to a rigorous review process. The Capital Markets Approval Committee is thoroughly evaluating the transparency of transactions and is working with our business people to ensure that in any transaction we do, the client discloses fairly and appropriately the net effect of the transaction on the company's financial condition. If the client will not commit to these kind of disclosures, the answer is simple: Citigroup will not execute the transaction.

In the months since August 7, we have reviewed dozens of transactions and we are learning a great deal. This process is helping us to develop a uniform approach to assessing, routing, and, where appropriate, approving and documenting transactions, consistent with the principles of our policy. And, the policy has already had a real impact on the transactions we are doing or declining to do.

One of the most significant objectives of the past few months has been to embed in our culture an understanding of the importance of this policy. I can tell you that our people are taking it seriously -- from the front lines of our business units to our senior-most management. We are making this policy a living, breathing part of the way we do business.

Thank you and I look forward to answering your questions.

Opening Statement of Rick Caplan
Before the Senate Permanent Subcommittee on Investigations
December 11, 2002

Thank you Mr. Chairman and members of the Committee.

My name is Rick Caplan. I am a Managing Director of Citigroup's Corporate and Investment Bank and co-head of the Credit Derivatives Group. The Credit Derivatives Group is one of several business units at Citigroup that structures financings for sophisticated clients. I have worked in the derivatives business at Citibank since 1997.

I understand that the Committee is interested in discussing two transactions that Citigroup executed for Enron: Project Bacchus and Project Sundance. I appreciate the opportunity to answer questions about these transactions. While I want to make clear that I understood these transactions to be appropriate under the prevailing laws and standards, I also want to reiterate the point that Mr. Prince made in his opening remarks: under Citigroup's new structured finance policies, we will not do these transactions today unless the client agrees to provide clear, detailed disclosure to investors.

Thank you Mr. Chairman and members of the Committee, and I look forward to answering whatever questions you may have.

Opening Statement of William Fox
Before the Senate Permanent Subcommittee on Investigations
December 11, 2002

Thank you Mr. Chairman and members of the Committee.

My name is William Fox. I have worked for Citibank since 1967. I am currently a Managing Director in the Global Relationship Bank and the head of its Energy and Mining department. I have overall responsibility for Citibank's relationships with clients in the energy and mining industries.

I have been invited here today to discuss two transactions that Citigroup executed for Enron — Project Bacchus and Project Sundance. While I am generally familiar with Project Bacchus, my familiarity with Project Sundance is more limited.

I understand that the Subcommittee has several questions about these transactions and Citibank's role in them. I look forward to helping the Subcommittee in any way that I can to answer questions about these transactions. While we believed that these transactions met applicable legal standards, they are not transactions that Citigroup would undertake today without clear and detailed disclosure from our clients about the net effect of those transactions on a company's financial condition.

Thank you Mr. Chairman, members of the Committee. I look forward to answering your questions.

STATEMENT OF MICHAEL PATTERSON
ON BEHALF OF
J.P. MORGAN CHASE & CO.
SUBMITTED TO
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENT AFFAIRS
UNITED STATES SENATE
DECEMBER 11, 2002

Mr. Chairman and Members of the Subcommittee. I am Michael Patterson, a vice chairman of J.P. Morgan Chase (“JPMC”) and head of its Policy Review Office. I am pleased to be here to discuss JPMC’s policies and practices regarding transactions with publicly-traded U.S. companies. As requested in your invitation letter, I will address policies and practices relating most particularly to structured finance, accounting and tax matters.

JPMC and its predecessor firms have long had in place policies and procedures governing transactions with clients. These policies and business transaction approval procedures address, among many other subjects, compliance with external legal and regulatory requirements as well as the aspects of a transaction that could raise reputation risk for the firm. JPMC’s policies and procedures are periodically reviewed and updated to take account of our experience and external developments.

“Structured finance” encompasses a wide variety of transactions and instruments designed to help clients achieve their risk management, financing, liquidity and other financial objectives within the framework of applicable, and often complex, legal, regulatory, tax and accounting rules and principles. Securitization, special purpose vehicles and derivatives are among the well-recognized techniques used to allocate risks, capital and cash flows to meet client objectives.

To make sure that our structured finance transactions comply in all respects with that framework, the business transactions approval process requires adherence to applicable policies as well as review and sign-off from internal legal/compliance, conflicts, tax and accounting policy groups (among others). Transactions involving a special purpose vehicle receive special scrutiny and must comply with a special purpose vehicle policy (administered by a SPV committee), to ensure that every such entity is properly approved, documented and monitored.

Primary responsibility for adherence with the policies and procedures designed to address reputation risk lies with the business units conducting the transactions in question. In addition to this framework, JPMC this year put in place a new set of procedures designed to reinforce our focus on reputation risk and provide a senior level of review of transactions with clients. Business units are required to submit to regional Policy Review Committees proposed transactions that may raise reputation risk for any reason but specifically including transactions

- where a material objective is to achieve a particular accounting treatment,
- designed to achieve a particular tax treatment,
- where there is material uncertainty about legal or regulatory treatment,
- with unusual or highly complex structures or cash flow profiles, or
- which have as a significant purpose or effect the providing of financing but which take the form of derivatives.

The members of the regional policy review committees, including the Americas committee, are senior representatives of the business and support units (including tax and accounting policies) in the region. Transactions are reviewed from every angle that could affect reputation risk -- including, where applicable, the intended financial disclosure of the transaction by the client -- and the committee approves, rejects or requires further clarification or changes. The committees and their deliberations are overseen by a Policy Review Office, which I lead. Transaction review can be formally escalated by the committees to the Policy Review Office.

We at J. P. Morgan Chase believe that one of the tests of our leadership in the financial marketplace is to learn from our experiences and to adjust our practices in light of those experiences and the changing environment. I believe that the Policy Review process we have put in place and which I have just outlined, together with our business transaction approval policies and procedures, are well designed to enable us to meet this challenge.

I would be happy to respond to any questions the Chairman or other members of the Subcommittee may wish to put to me regarding the Policy Review Office or process.

**JOINT STATEMENT OF
ROBERT TRABAND, ERIC PEIFFER AND ANDREW FELDSTEIN
ON BEHALF OF
J. P. MORGAN CHASE & CO.
SUBMITTED TO
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
DECEMBER 11, 2002**

Mr. Chairman and Members of the Subcommittee, my name is Robert Traband. I am currently a Vice President of J.P. Morgan Chase & Co. ("JPMC"). Through its subsidiaries and affiliated companies, JPMC offers global financial services, has operations in more than 50 countries and employs nearly 100,000 people throughout the United States and worldwide. We serve more than 30 million consumers as well as the world's most prominent corporate, institutional and governmental clients, including over 90 percent of the *Fortune 1000* companies.

I am based in Houston, Texas and have served in our corporate banking group since 1999. I participated, as a member of a larger JPMC team, in the two JPMC transactions with Enron that we have been advised the Subcommittee is examining today. My principal responsibilities involved evaluating the credit exposure to Enron on each of these transactions.

In accordance with the Subcommittee's request, I am accompanied today by my colleague Eric Peiffer. Mr. Peiffer is also a Vice President and is based in New York. He joined our interest rate derivatives group in July 2002, after having served in our structured finance group since February 2000. During his tenure with the structured finance group, Mr. Peiffer participated, also as a member of a larger JPMC team, in one of the transactions that the Subcommittee is examining today; specifically, the so-called "Flagstaff" transaction.

I am also accompanied by my colleague Andrew Feldstein. Mr. Feldstein is a Managing Director of JPMC and is co-head of our Structured Products and Derivatives Marketing Group.

Preliminary Statement

Let me make two important points at the outset, Mr. Chairman. First, while we believe that our participation in the "Fishtail" and "Flagstaff" transactions was perfectly legal and followed established rules, had we known then what we know now about Enron's allegedly fraudulent practices, we would not have engaged in these transactions with Enron. We would not have accepted at face value, as we did in 2000 and 2001, Enron's statements that its requests to structure Fishtail or Flagstaff in particular ways were designed to properly achieve Enron's desired financial statement treatment of the transactions in accordance with generally accepted accounting principles. In addition, we would have wanted to know more about the aspects of the transactions in which JPMC was not involved. But at the time, JPMC—like many other parties—dealt with Enron in the belief that it was a respected and creditworthy company and that it was not JPMC's role to second guess our counterparty's accounting or other structuring determinations. In the case of Enron, JPMC suffered substantial injury, not only by the loss of

hundreds of millions of dollars from its own transactions with Enron, but also to the injury to its reputation from the erroneous suggestions of some that JPMC was “involved” in Enron’s wrongdoing. For these and many other reasons, we regret that we ever dealt with Enron.

As one of the world’s leading financial institutions, we recognize that it is incumbent upon us to do more than simply express our regret. One of the hallmarks of our leadership is that we learn from prior experiences and thoughtfully adjust our practices in light of those experiences. In this regard, you will shortly hear from my colleague, Michael Patterson, who will outline the procedures we now have in place to meet the challenges before JPMC now and in the future.

Second, we have cooperated fully and voluntarily with this Subcommittee, as well as the full Committee on Government Affairs, in the year-long investigation of the collapse of Enron. We have presented testimony at two prior public hearings, responded affirmatively to staff requests to conduct numerous interviews of our employees, and provided a broad array of documents.

This cooperation reflects our recognition that Congress has an important responsibility in its duties under Article I of the U.S. Constitution to determine whether, in the public interest, changes in laws or regulations are necessary or appropriate in light of the failure of Enron. Under our system, the judicial branch is properly the exclusive forum within which to determine whether liabilities should be imposed with respect to matters involving Enron, and to adjudicate the rights and responsibilities of private parties that have financial claims with respect to transactions involving Enron; but we recognize that this Subcommittee’s responsibilities in the public policy arena, although different from those of the judiciary, are important as well.

The Enron Transactions

Let me now turn to the specific transactions with respect to which the Subcommittee has requested information from JPMC. Because we have provided the Subcommittee staff with detailed descriptions of each of these transactions, together with supporting documentation, I will not unduly lengthen this statement by repeating those descriptions in their entirety. Nevertheless, we are, in accordance with the Subcommittee’s request, prepared to respond to questions concerning JPMC’s understanding of and participation in these transactions.

The “Fishtail” Transaction

The first of these transactions has been referred to by the Subcommittee and others as “Fishtail”. This transaction was a \$41.5 million loan commitment extended by JPMC in December 2000 to a special purpose entity named Annapurna LLC (“Annapurna”) established by Enron. This commitment expired by its terms in June 2001 and was never funded.

More specifically, with the assistance of JPMC, Enron was engaged in an effort to find an equity investor to participate in a joint venture (commonly known as "Enron Networks") to conduct Enron's pulp and paper trading business. By December 2000, Enron had engaged in discussions with a number of potential investors, but had not reached agreement with any. Enron informed JPMC that, in anticipation of its ultimate contribution of the existing pulp and paper business to such a joint venture, Enron wanted to deconsolidate its pulp and paper business from the rest of its businesses and that, in consultation with its accounting advisors, had devised a structure to achieve this objective. Enron would contribute its economic interests in the present and future contracts of the pulp and paper business to a newly formed entity ("Fishtail"), which would be jointly owned by Enron and Annapurna.

As I have said, JPMC's participation in this transaction was limited to a six-month commitment to make a bank loan to Annapurna. JPMC had no other involvement in the transaction. The loan to Annapurna could be drawn only to fund Annapurna's capital contribution to Fishtail. And Annapurna could be called upon to make its capital contribution only if Fishtail sustained losses in excess of \$208 million during the six-month commitment period. JPMC was willing to make this commitment because it concluded, as a matter of its credit judgment, that it was remote that Fishtail would sustain losses during the six-month commitment period in an amount large enough to trigger the capital call to Annapurna and hence a drawing of the JPMC loan. This was a reasonable credit decision and it is not at all unusual as banks often make loan commitments with the expectation that they will not be funded. For example, banks frequently issue standby letters of credit supporting debt issuances by clients. In such cases, it is anticipated that the bank only will be called upon to fund the letter of credit if the client has defaulted on the underlying obligation because of adverse changes in its financial condition (or other factors).

JPMC did not initiate the Fishtail transaction and it did not develop the basic structure. It was merely asked to extend a loan commitment, which it did. It never extended any funds and its commitment terminated after six months. JPMC acted as a lender in this transaction and, consistent with industry practice, it did not make any determination whether completion of the transaction would achieve Enron's accounting objective, a deconsolidation of Enron's pulp and paper business. Such determinations were properly for Enron to make, with the advice and assistance of its internal accountants and its external auditors. In December 2000, when the Fishtail transaction was agreed to, JPMC had no reason to believe that any such determinations were not being made by Enron and Arthur Andersen in accordance with generally accepted accounting principles.

There are two final points I would like to make about the Fishtail transaction. First, it appears that Fishtail included a broader set of transactions by Enron to effectuate, not just the deconsolidation of Enron's pulp and paper trading business, but to recognize income in connection with the sale of those assets. JPMC was not involved in these other transactions and,

indeed, was told very little about them by Enron, or anyone else for that matter. Second, while JPMC provided a loan commitment to Annapurna, the equity in that entity was provided by the LJM2 limited partnership. As JPMC has previously disclosed, certain of its affiliated companies – along with many others – had invested at the end of 1999 as limited partners in LJM2, so that JPMC had a small stake in LJM2. JPMC, however, was a passive investor in the LJM2 partnership and played no role in LJM2's decision to invest in Annapurna.

In view of your decision, Mr. Chairman, to examine transactions used by Enron to achieve accounting objectives for the purpose of enabling the Subcommittee to evaluate the need for changes in laws and regulations, we believe it is appropriate to call to your attention that it is widely acknowledged that our current financial accounting standards consists of a large body of specific "rules" and that, as a result, the accounting treatment of a particular transaction frequently is a consequence of the form of transaction selected by the parties themselves. Earlier this year, this Subcommittee received testimony from others suggesting that, as a matter of broad public policy, it may be desirable to move to a "principles" based system of accounting standards. Significantly, in section 108(d) of the Sarbanes-Oxley Act, as enacted in July 2002, Congress directed the Securities and Exchange Commission to conduct a study of such an approach and to provide a report on the results of that study within one year. As the Subcommittee may be aware, a companion private sector initiative was announced by the Financial Accounting Standards Board on October 21, 2002. JPMC believes that these studies represent a constructive public policy response to the Enron collapse.

The "Flagstaff" Transaction

The Subcommittee has also asked for information concerning JPMC's understanding of and participation in the "Slapshot" project, particularly with regard to the "Flagstaff" transaction. As I will explain in greater detail, "Slapshot" was the name given by JPMC to a generic form of transaction intended to permit a loan by a U.S. lender to a Canadian borrower to be structured in a manner that would provide advantageous tax treatment to the Canadian borrower under Canadian law. "Flagstaff" was the name under which a specific transaction with Enron was undertaken in June 2001 to provide long-term refinancing for the acquisition of a Canadian pulp and paper mill ("Stadacona") acquired by a joint venture in which Enron was an equity participant. In short, "Flagstaff" was an actual transaction, but "Slapshot" was not.

Representatives of JPMC's Global Structured Finance Group participated, as members of a larger JPMC team, in connection with the Flagstaff transaction, and much of JPMC's prior internal analysis of the generic Slapshot transaction was performed within that group. As the Subcommittee is aware, the term "structured finance" encompasses a wide variety of transactions and instruments designed to help clients achieve their risk management, financing, liquidity and other financial objectives within the framework of applicable legal, regulatory, tax

and accounting rules and principles. These transactions and instruments are widely used by governments, corporations, consumers and investors, and virtually every major financial institution has a structured finance group.

Let me emphasize, Mr. Chairman, that JPMC takes very seriously the principle that structured finance transactions must be developed *within* the framework of applicable legal, regulatory, tax and accounting rules and principles. This was true in the case of Slapshot. As the Subcommittee is aware, there are substantial differences in the tax codes of other countries that taxpayers, including both individuals and businesses, may lawfully and properly take advantage of. Such a situation existed under Canadian tax law, but before proposing the transaction to any client, the JPMC structured finance group solicited and received a written opinion of an independent and highly regarded Canadian law firm setting forth the likely tax consequences of that structure under Canadian law. Ultimately, JPMC obtained written opinions from two leading Canadian law firms that the structure, and the Canadian tax benefits it provided, were legal and valid.

As I have indicated, the "Flagstaff" transaction had its genesis in the planned purchase of the Stadacona Canadian paper mill by CPS, a Canadian corporation owned by a joint venture ("Sundance") between Enron and another party. JPMC did not participate in the formation of the Sundance joint venture. Documents shown to JPMC by the Subcommittee staff during interviews in preparation for this hearing reveal that there were many aspects of the structure and funding of the joint venture that were completely unknown to JPMC. Indeed, at the time of the Flagstaff transaction, JPMC did not even know the identity of Enron's partner in the joint venture.

JPMC learned of the Stadacona mill acquisition before it was consummated. In January 2001, representatives of JPMC met with Enron to present a proposal under which a group of banks led by JPMC would make loans to finance the acquisition of the mill. During that meeting, JPMC advised Enron that it had concluded, based on the opinion of counsel, that the loan transaction could be structured in a manner that would provide advantageous tax treatment to a Canadian borrower under Canadian law. Enron informed JPMC that it was aware of and had itself already devoted substantial attention to analyzing the same (or a substantially similar) Canadian tax structure.

Enron ultimately selected JPMC to lead the bank group, but opted to have CPS complete the acquisition of the Stadacona mill in March 2001, with a bridge loan of approximately \$375 million provided by Enron. At that time, the Stadacona mill, which is located in Quebec City, Canada, was the 11th largest newsprint producer in North America. The Flagstaff transaction was thereafter completed in June 2001 in order to repay the bridge loan and provide the long term debt financing.

At closing, the \$375 million loan was funded by JPMC and three other banks in the form of loans to Flagstaff, a wholly-owned subsidiary of JPMC, which then reloaned the funds to the CPS group.

The Flagstaff loan transaction was structured in a manner intended to permit the realization of the Canadian tax benefits by the Canadian borrowers. To the best of JPMC's knowledge, this structure did not provide otherwise unavailable U.S. tax benefits to any party. We understand that Enron obtained, and relied upon, its own written opinion from Canadian tax counsel that the anticipated Canadian tax benefits could, and should, be realized under the structure.

As the Subcommittee is aware, the Flagstaff structure is highly complex, and among the several transactions that comprised the structure was an intraday loan of approximately \$1 billion provided by JPMC to Flagstaff. It also involved two special purpose entities created by Enron or its affiliates. The complexity of the Flagstaff financing and the legal documentation required to implement it were necessitated by Canadian tax considerations and were undertaken in reliance on the opinions of Canadian tax counsel to facilitate realization of the Canadian tax benefits.

As the Subcommittee also is aware, the credit support for the loan was provided by Enron principally through a total return swap (and certain supporting transactions) rather than, as originally contemplated, a guarantee by Enron. This change was specifically requested by Enron. One or more members of the JPMC team understood at the time that a principal reason for Enron's position in this respect was that Enron had concluded that a guarantee might require consolidation of the entire joint venture, the assets of which included CPS and the Stadacona mill.

JPMC understood that the use of a total return swap to facilitate the continued deconsolidation of the joint venture had been vetted by Enron with its external auditors, Arthur Andersen, and had been approved by them. JPMC did not attempt to "second guess" this accounting judgment. As I have noted earlier, under applicable law and practice, each party is properly responsible to ensure that it correctly accounts for the transactions to which it is a party. At that time, JPMC had no reason to believe that any such determinations were not being made by Enron and its external auditors in accordance with generally accepted accounting principles. Consequently, from JPMC's standpoint, the issue presented by Enron's decision not to provide a guarantee was whether the total return swap provided sufficient credit support for the Flagstaff loans that the new arrangement could prudently be accepted by the banks in lieu of a direct Enron guarantee. Ultimately, JPMC and the other members of the bank group each concluded that the total return swap provided adequate credit support.

Conclusion

JPMC was just one of many firms that provided financial services to Enron. JPMC also has been one of the parties most harmed by Enron's failure. We are prepared to respond to your questions today and will continue to cooperate with the Subcommittee in its consideration of the public policy aspect of Enron's collapse.

Testimony of

Muriel Siebert
Chairman and CEO,
Siebert Financial Corp.

Testimony
December 11, 2002
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Thank you for inviting me to share my thoughts with you today. The Committee is to be commended for its commitment to looking into these transactions. Only by understanding what happened with Enron can we hope to learn the lessons necessary to prevent such events from occurring in the future.

And we must do what we can to see that such *abuses* don't happen again. Because there is no doubt that the integrity of our markets – and the faith that the ordinary investor has in their fairness – have been severely damaged.

I began to realize this last February. I got a call from my senior executive in charge of our retail operations. He told me that he was seeing something he had never seen before. Investors were calling to sell out their entire accounts and request a check for the entire proceeds. Normally, if an investor thinks the market is overvalued they will sell out their account but will put the funds into money market accounts until they wish to reinvest. But these people were opting entirely out of the market.

We made a special point of talking to these customers to see why they were taking this action and the answer was alarming. They said they no longer had faith in the integrity and fairness of the system and that the markets were against them. They cited Enron as the key reason.

When we lose the individual investor we have a serious problem. The U.S. capital markets are the envy of the world.

During the 1990s, we created tens of millions of new jobs – the only country in the world to do so. We funded an explosion of new technology and business activity. We are the economic engine that pulls the global economy. This is all made possible because of our unique capital-raising system. We cannot put that system at risk. Individual investors, through their investments in mutual funds and retirement accounts, fueled this expansion. Recently when I gave a speech for the Miami Herald, I was asked by an elderly gentleman; "Miss Siebert, I lost a third of my money. Will they go to jail?"

So the problems we are discussing today are very important. Corporate executives and financiers must not be allowed to circumvent the intent of our laws in order to manipulate the financial results they report, using sham transactions that technically may be legal but certainly aren't ethical or reflective of true economic activity. We cannot legislate or regulate integrity, but neither can we allow our financial institutions to operate without regard to even the most basic principles of business.

The transactions we are discussing today demonstrate the way that structured finance and complex investment products can be misused. Through financial engineering, companies like Enron were able to operate by legal loophole. And as we see today, some of our most respected and largest financial institutions were there to help them, participating in these questionable transactions and providing the funding that made them possible.

The distressing thing is that this type of behavior is not really new. Indeed, financial engineering has been with us for decades.

I have with me today copies of Congressional testimony I gave on two other occasions – in 1988 and in 1998. I'd like to read two short excerpts from these statements that I think underscore an important point that we should all recognize as we explore the issues we have before us today. Specifically, it relates to the use of derivatives in our capital markets and the role they have played in triggering the last three market downturns.

In 1988, I testified before the subcommittee on Telecommunications and Finance on program trading and portfolio insurance. This was in the wake of the stock market crash of October 1987. The major problem

with the stock market, I said, was not the presence of large institutional players, but rather the way these investors were trading.

To quote from the testimony:

"Our problem stems from the institutions' trading stocks not for traditional reasons, but rather because of momentary imbalances in the futures and options markets, the so-called derivative markets. Program trades and index arbitrage end up bringing the volatility and rampant speculation of the futures pits to the floor of the Big Board. Futures have become the tail wagging the dog."

And, as we all remember, it was program trading based on derivatives -- otherwise known as portfolio insurance -- that fueled the unprecedented sell-offs that occurred on October 19, 1987.

In that case, there was a strong regulatory response that put collars on these automated trading programs to bring rationality back to the markets. Today, portfolio insurance no longer exists.

Ten years later, I was back before Congress again, this time before the House Committee on Banking and Financial Services. I was commenting on the near demise of Long Term Capital Management and its effect on global capital markets.

You'll recall that it took an unprecedented rescue package of this massively over-leveraged hedge fund to head off a meltdown in the global financial system. It would have caused catastrophic damage to both financial institutions and the investment community if the institutions had to liquidate Long Term's portfolio to meet margin calls.

To quote from my testimony:

"Simply stated, regulation has not kept up with advancements in technology and new financial products. Unregulated hedge funds using legal loopholes have borrowed vast amounts of money which they use to speculate in highly leveraged transactions."

I then went on to describe the family of products that made the Long Term Capital implosion possible -- derivatives. Long Term Capital had relied upon foreign exchange derivatives trading to hedge its bets. And it bet wrong. Again we saw the stock market head south, driven downward by a derivative-induced crisis.

Of course, it could have been much worse. Using derivatives, Long Term Capital employed vast amounts of leverage to create a portfolio with the notional value of its positions worth over a trillion dollars. Had the Federal Reserve not stepped in to create a consortium of some of our leading financial institutions to provide an infusion of capital and systematically liquidate it, the effect of the margin calls could have been devastating to every corner of the global financial markets.

And so we meet again here on Capitol Hill in 2002. The current market crisis, like others before it, has parts of its genesis in the derivatives arena, that murky corner of the securities industry where futures, options, swaps, warrants and convertibles are the vehicles of choice.

And it's bigger than ever. The notional amount of derivatives in insured commercial bank portfolios was recently estimated at \$40-50 trillion dollars.

Yet despite its size, the derivative market is largely opaque and unregulated, a fertile field for those looking to create the latest legal loophole.

Let's explore what happened with Enron for a minute, and how derivatives fueled the fire.

Using derivatives and off-balance sheet special purpose entities, Enron in some cases allegedly used "pre-paid" transactions that were really debt and made them look like revenues. Also using derivatives, Enron bought and sold energy contracts of the same amount, at the same price, on the same day. Their purpose? - To create the illusion of volume. These transactions were legal in the unregulated OTC energy trading markets, but would have been illegal in the listed commodities market where they would have been considered "wash sales."

In short, the deregulation of the energy markets coupled with the use of derivatives enabled the phony energy trading. All to create the illusion of activity and revenues; when, in reality, no real economic activity was being conducted by these "trades."

This not only affected Enron, but many other well established, old-line energy companies, which joined the fray as counter parties. There are at least a dozen formerly solid utilities that traded in this market. Many of them have had to eliminate or reduce dividends and have seen their stock prices drop precipitously. Many of their shareholders were not aware of the risk these companies incurred. They counted on the dividends.

One of the reasons so many other entities were hurt is the speed with which Enron went under. Significantly, it was the terms of Enron's bonds that caused this quick collapse, in particular the debt triggers that were in place. Under the bonds' indentures, changes in certain conditions -- like asset coverage, earnings results, credit rating downgrades -- put the bonds in violation of the terms in the indenture. In some cases the bonds became due and payable once these debt triggers were activated.

Yet with so much of Enron's activity taking place in off-balance sheet special purpose entities, no one had any way of knowing the risks that Enron -- and all the companies that did business with it -- were undertaking. In many cases, the terms of these bonds were simply not publicly available.

And Enron was not alone. Many telecom companies entered into swaps. Their companies and bonds have also collapsed, causing losses of hundreds of millions of dollars to public pension plans.

What should we make of all this from a regulatory perspective?

We know that the last three market downturns can all be traced to movement in the derivatives field. In 1987, it was portfolio insurance and program trading. In 1998, it was Long Term Capital Management and the foreign exchange markets. And in 2001 it started with Enron energy trades and off-balance-sheet special purpose entities.

And we should note that regulatory responses to the first two did nothing to stop the third. And I'm afraid nothing we do today can prevent the next debacle, unless we address the core problems, which are the lack of management accountability and the lack of transparency of these new financial tools. This financial engineering permitted the illusion of economic activity. Is there any wonder why investors do not trust the system?

Attempts to restore the system to health or prevent further crisis with regulations alone will fail. The professionals who create these schemes must be accountable. Sure, the SEC and accounting oversight board can shut down specific transaction types, but whatever they do will undoubtedly become obsolete over time.

I spent the better part of five years as the Superintendent of Banking of New York State and learned something very important:

Regulations pertaining to financial products have never been able to stay ahead of fast-moving, new technology. The advent of ever more complex financial products and investment vehicles are created

and promoted by accountants, banks, lawyers and corporate financiers. Time and again, such new products have allowed companies to operate and influence reported earnings using legal loopholes made possible by financial engineering.

And it must be said that these tools have their legitimate uses. We should not be in the business of stifling new types of trading and finance. So rather than crafting new regulations covering off-balance-sheet special purpose entities and other specific transaction types, our focus should be on assigning accountability within our public corporations, providing investors with more information, and demanding principled behavior from our financial institutions. The penalties must be commensurate with the abuses.

For instance, the SEC has implemented new regulations that require that officers and directors report trades within two or three days, including those facilitated with derivatives, which up to now have not had to be reported on a timely basis. And, of course, CEOs and CFOs of public companies must also now certify in a signed declaration that the company's financial reporting is correct.

However, we must go further to bring greater accountability and transparency, because I really believe many of the dubious transactions of the sort we are considering today cannot stand public scrutiny.

First, I would recommend that the certification statement be strengthened so that officers must certify that their financial disclosures "reflect economic reality." And that certification must cover any transaction that was created for the purpose of having an effect on reported earnings, whether it's on or off the balance sheet.

Second, I would propose greater transparency or regulation of the derivatives industry and loan transactions involving derivatives, especially those involving banks and investment banks as counter parties. Towards that end, I would suggest that we try to bring more people with a trading background in derivatives into our regulatory agencies. The SEC should work closely with the federal and state bank regulators.

Third, we must address the leverage issue in the derivatives market. We have international bank regulations and will have international accounting standards in the future. Global margin requirements could help rein in some of the leverage abuses now taking place in the derivatives area. The U.S. should take the lead in establishing global margin and reporting regulations for securities and derivatives.

Fourth, I would suggest that complete terms of bond indentures, especially debt triggers, be listed in schedules available on request or preferably on companies' web sites, even if they pertain to off balance entities.

And finally, we must demand that the corporate finance industry adopt and abide by some basic principles. Certainly, transactions for their clients should have an easily understood and genuine business purpose. Structured finance – even at its most aggressive – should not be employed to circumvent the intent of our securities and tax laws. Commercial and investment banks should have review panels in place to ensure that every deal adheres to such basic principles.

Certainly, there is much in the transactions you have brought to light today that must be considered by our regulators – the SEC, as well as those overseeing banking at the state and federal level. I hope as they do so they can be guided in part by some of the ideas outlined above.

Thank you very much for your attention.

Statement by

Rich Spillenkothen

Director, Division of Banking Supervision and Regulation

Board of Governors of the Federal Reserve System

Introduction

Thank you for the opportunity to testify on the continuing efforts of Federal Reserve supervisors to address issues emanating from the excesses of the recent credit cycle, including large corporate defaults and accounting irregularities. I would like to note that my testimony today reflects the views of Federal Reserve supervisory staff, and not necessarily those of the Board of Governors.

The focus of today's hearing on how complex structured financial products provided by banks and other financial institutions may have been used by their customers to obscure financial statements and hamper sound analysis by creditors and investors, or to engage in questionable or improper tax strategies, is timely. Events of the past year, such as the bankruptcy of Enron, have focused attention on the need for strong risk management, sound accounting, improved disclosures, and more active corporate governance to avoid the kinds of losses that have been costly both in human and economic terms. Efforts to improve accounting standards and enforce greater accountability from corporate officers have led to important reforms that should improve the meaningfulness and integrity of financial statements.

For its part, the Federal Reserve has been reviewing bank participation in the types of structured finance activities that have raised significant legal and accounting questions. As we complete the necessary fact-finding and collaborate with other functional and primary regulators, we will follow up with individual institutions with regard to any appropriate remedial actions. In response to these incidents, we have already revised our examination plans for larger institutions to focus on these particular areas of concern. We are also considering additional supervisory guidance and refinements to our examination and regulatory policies and procedures.

With many new products and innovations, excesses in how products are used emerge over time, particularly during periods of lengthy expansion as we have experienced in the past decade. Downturns uncover weaknesses and provide the opportunity to implement reforms and incorporate them into ongoing practice. In this sense, the U.S. financial system is going through an evolutionary process that if managed properly by its participants could result in milder fluctuations of performance in the future, though new manifestations of risks will undoubtedly emerge that will test institutions once again. It is usually the risks that were not clearly apparent at the time they were undertaken that are the most costly. Otherwise they would have been avoided or minimized beforehand.

In that regard, banking organizations are actively responding to recent events. From past credit cycles, they have learned the importance of diversification of credit risk and strong capital and reserves, which has paid off recently in much milder levels of credit problems than in the previous recession. However, in this credit cycle banking organizations are now recognizing, like many institutions, that some customer relationships can carry much greater credit, legal and reputational risks than originally anticipated. Management is recognizing the need to evaluate the soundness not only of individual transactions, but the effect of the sum total of the customer relationship on the organization's overall risk. They now have a greater appreciation for the importance of maintaining strong due diligence and of enhancing the legal vetting of transactions by qualified experts. Banking organizations must actively evaluate and incorporate lessons

learned from the recent credit cycle to ensure their risk management systems remain relevant to the challenges before them now and throughout the next decade.

In addition, bank supervisors are reviewing and enhancing their procedures for addressing the new ways risks are presenting themselves to banking organizations. I will discuss both our supervisory expectations for banks involved in transactions such as those that have recently received much attention, as well as how we are considering amending our procedures and focusing our supervisory reviews.

Role of Supervisors

At the outset, it is important to provide some background on the Federal Reserve's role as supervisor of financial institutions and our relationship with other supervisory authorities in carrying out our responsibilities. The primary focus of the Federal Reserve's supervision is ensuring an institution's safety and soundness, as well as compliance with banking and consumer laws and regulations, in a way that protects the deposit insurance fund and the consumer, while promoting stability of the financial system. To accomplish these goals, the Federal Reserve's examination program focuses on evaluating the overall adequacy of an institution's internal controls and risk management systems as benchmarked against not only regulatory standards and expectations, but also against the evolving practices of well managed firms. To ensure those systems are functioning properly in practice, examiners review selected transactions across business lines to identify whether policies and procedures are being followed.

As part of this risk-based approach to supervision, examiners focus primarily on areas posing the greatest risk to the institution, particularly credit risk. In their review, examiners assess the adequacy of a bank's credit risk analysis and identify whether appropriate due diligence has been followed in evaluating other market or legal risks associated with the transaction. In addition to traditional financial analysis, a bank's evaluation of credit risk also includes an assessment of the trustworthiness of the borrower and the reliability of the financial statements. In the case of more complex transactions, examiners seek to determine whether the banking organization has a process in place for obtaining its own appropriate legal, tax and accounting approvals. As part of the approval process, the bank is expected to gain reasonable assurance that the customer understands the transaction and has the type of legal, tax, accounting and control infrastructure within its corporate governance that is suitable for complex transactions. During the review, examiners do not perform an independent legal, tax or accounting analysis of the transaction from the customer's perspective. Examiners are not qualified to perform such a review and, moreover, it would be inappropriate for them to do so in their role as bank supervisors, by straying into matters that are the responsibility of corporate management outside of regulated financial institutions.

In carrying out its responsibilities, the Federal Reserve coordinates its supervisory activities with other federal and state banking and securities agencies, such as the Office of the Comptroller of the Currency (OCC) and the Securities and Exchange Commission (SEC), other functional regulators, and the bank regulatory agencies of other nations. As mandated by statute, the Federal Reserve relies as much as possible on the supervisory efforts of an institution's primary bank supervisor and nonbank functional regulators to ensure that risks are maintained at

acceptable levels. For example, if in the course of their review examiners have reason to believe that a bank is engaging in questionable activities that might relate to a possible violation of securities laws, then supervisors would refer those matters to the SEC, as the primary interpreter and enforcer of those laws.

Supervisory Expectations for Banking Organizations

Some basic principles and expectations for banking organizations guide our work in examining complex financial transactions. First, and most obviously, banks must obey the law. In particular they must have policies and procedures in place that are followed by their employees to ensure that they are in compliance with all applicable laws and regulations with regard to a particular activity or product. The laws most commonly applicable include banking, consumer, securities and tax laws, whether federal, state or foreign.

Second, banks should perform thorough due diligence on the transactions they are involved in and check with appropriate legal, accounting and tax authorities within their own organizations, as well as their outside experts in this area, and also provide appropriate and relevant information to their customers. However, banks ordinarily should not be held legally responsible for the judgments, actions or malfeasance of their customers. Nor should they be required to second guess their customer's accountants, tax or legal experts or police their customer's activities. Such an expectation would require, inappropriately, banking organizations to assume management responsibility for their customers, place potential legal liability on banking organizations that would compromise their ability to perform their role as financial intermediaries or threaten their safety and soundness, and place significant costs on banking organizations to audit the activities of their customers.

Banks, however, must not participate in activities of their customers that the banks know to be illegal or improper. Nor should banks engage in borderline transactions that are likely to result in significant reputational or operational risks to the banks.

Third, the role of banks is to assume and manage all the attendant risks related to their activities as financial intermediaries. As banks offer new products and engage in new activities, they should evaluate all the dimensions of risks, including credit, market, legal, operational and reputational risks, before using such products or undertaking such activities. In addition, in light of recent events, banking organizations should be re-evaluating the risks related to both their traditional and new products, recognizing that as financial markets and practices change, legal and reputational risks may manifest themselves in new ways or in magnitudes not previously recognized. Moreover, as practices and products change, banks must build appropriate mitigating controls to manage the evolving risk exposures and ensure that a process is in place to assess the effectiveness of those controls over time.

Trends in Structured Finance Markets

What then are the issues that have been presented to banks and supervisors over the past year and what are some of the actions that have been undertaken by supervisors and banks in response? First, it may be instructive to discuss the trends that have led to the latest round of

reforms and reassessments. Over the past decade, financial markets have grown rapidly and innovations in financial instruments have facilitated the structuring of cash flows and allocation of risks among borrowers and a range of investors in more efficient ways. Financial derivatives for market and credit risk, asset backed securities with customized cash flow features, specialized financial conduits that manage pools of purchased assets, among others, have in the vast majority of cases served the legitimate business purposes of customers. Significantly, banks have played an important role in structuring, arranging or participating in these transactions, which have become an essential part of U.S. capital markets -- the most vibrant and innovative in the world. To the economy's benefit, the structured finance business has led to a lower cost of capital to businesses and consumers, which has helped fuel greater access to credit and longer term growth. A good example is the mortgage-backed-securities business, which over the past two decades has developed a range of complex and sophisticated structured cash flow products that have helped lower the cost of housing finance and improved the range of choices to investors.

At the same time, the more complex variations of these instruments within the world of structured finance have placed pressures on the interpretation of accounting rules that were established when times were simpler. While new accounting statements, interpretations and advisories have been issued in recent years to keep up with these innovations, the staggeringly wide variation in features and complexity have severely challenged the ability of traditional accounting measures to reflect the underlying economic substance of the transactions. The new initiatives by the Financial Accounting Standards Board to address these shortcomings are steps in the right direction.

In addition to diversifying risks and cash flows and reducing the cost of capital, another consideration of firms that use banks for structured finance transactions may be the extent to which the transactions would affect the appearance of balance sheets to investors or reduce tax liabilities, consistent with applicable laws and accounting rules. In a similar way, a chief financial officer might choose to lease rather than buy equipment to take advantage of both the off-balance-sheet financing characteristics as well as the tax advantages. How such considerations might influence a CFO's selection of traditional or more structured transactions will depend both on the economics of the transaction as well as the firm's particular culture. However, choosing an off-balance sheet or leasing alternative in and of itself should not be viewed in hindsight as being illegal, improper or deceptive, so long as the transactions comport with existing accounting and legal precedents and appropriate disclosures are made in the firm's financial statements.

In more extreme and less prevalent cases, a transaction with only a nominal commercial purpose might be driven by accounting, with some firms aggressively exploiting ambiguities in the rules in ways that move the accounting farther and farther away from the underlying economic substance of the transaction. These efforts may be designed not just to improve balance sheet presentations, but also to obscure the firm's underlying performance and condition, while operating within the letter, albeit not the spirit, of the accounting rules. I should note that drawing the line between what is a traditional accounting interpretation and what is "aggressive" is a sometimes difficult and largely subjective judgment. It is also much easier to detect and

criticize these practices in hindsight. The new FASB proposals should provide more guidance in drawing this line.

Finally, in the most extreme cases, inappropriate accounting might be used in conjunction with fraud to misrepresent the nature of the transaction. For example, despite the requirement that special purpose entities be capitalized with a modest level of outside shareholder's equity for de-consolidation treatment, a firm might use its own employees as nominee shareholders that inject the firm's own money into the subsidiary to receive off-balance-sheet treatment.

At this point, investor reaction to alleged accounting fraud at Enron and other firms has fueled a backlash that is now resulting in both reforms and more conservative practices that are contributing to better transparency of corporate financial statements. For example, even in cases where firms could structure transactions to meet existing accounting guidelines, some firms are choosing to put transactions on the balance sheet to provide the greater transparency and clarity demanded by investors. Firms that are suspected of being less than forthcoming with their financial disclosures appear to be subject to stiff penalties by the marketplace in the form of depressed stock prices and higher borrowing expenses. The call by the SEC and recent Congressional legislation for CEOs to certify their financial statements has also helped to ensure that transactions in gray areas of accounting are further scrutinized and verified for appropriateness.

Supervisory Responses

In response to these events, federal and state supervisors are ascertaining the relevant facts and circumstances, coordinating with other regulatory bodies, and identifying appropriate responses. For its part, the Federal Reserve's ongoing supervisory activities are focused on evaluating how the credit, market, legal and reputational risks related to overall customer relationships were managed in practice, and during the transaction testing phase of our examinations, understanding the nature and risks of individual transactions. There are several transactions that are currently under investigation by the SEC and other enforcement authorities, with whom we have strong working relationships and with whom we have conferred on these matters. We are continuing to collaborate with them and receive their views and conclusions on various matters on an ongoing basis.

With regard to risk management issues, some early lessons learned have become clear and will guide our work going forward. Not surprisingly, the lessons hark back to risk management fundamentals. In particular, banks should recognize that a fundamental time-tested element of analyzing credit risk, evaluating a borrower's character, can heavily influence the magnitude of losses, even when significant credit risk is not evident from other factors. In addition, banks should recognize that although they are not directly accountable for the actions of their customers, to the extent their name or product is implicitly associated with their customer's misconduct, additional legal and reputational risks may arise. Such risks may ultimately lead to significant costs. If these risks are not recognized and addressed, they could affect an institution's financial health. In short, banks must decide whether to continue a relationship with a customer that has not shown good faith or integrity in its dealings with the bank or others, given the potential credit, legal and reputational risks.

Even more fundamentally, it is also clear that many banks need to strengthen their credit risk analysis of investment grade customers by performing more due diligence and independent analysis while placing less reliance on third parties. There are undoubtedly many other lessons that will come forth as the facts and findings are further digested over time.

As part of our supervisory review of complex structured transactions, we are assembling and evaluating the various findings and observations of our examiners, as well as the conclusions of other primary and functional regulators we work with, and identifying any necessary follow up. We will provide institutions with feedback through their reports of examination or inspection on any identified weaknesses and, if warranted, take appropriate supervisory corrective actions, including referrals to other authorities. We will also evaluate the steps banks are taking to address deficiencies they themselves have identified as being in need of remedial action. The initiation of self-corrective steps is encouraging, but at this stage it is probably too early to tell how well reforms laid out on paper will actually perform in practice.

More broadly, we are considering additional supervisory guidance or regulatory changes, especially in the area of structured finance. In this connection, we will also evaluate the range of reforms banking organizations are adopting and consider whether there are some sound practices that should be adopted more widely within the industry.

The past year has influenced the thinking of supervisors as well as banks on effectively targeting resources toward more vulnerable points within an institution's risk management structure. In particular, it has become clear that in developing the scope of a supervisory review, factors used to prioritize reviews should go beyond standard balance sheet measures of risk to include a customer's overall contribution to a business line's revenue or that of the overall firm. These relationships are the ones for which the adequacy of internal checks and balances needs most to be tested and perhaps reinforced. In cases where a banking organization becomes too dependent on the credit and fee related revenue of individual clients, it may become easier to rationalize away information that is suggestive of growing risk or problems.

Consequently, we have already modified our examination plans for larger banking organizations to focus more fully on evaluating the largest customer relationships. These plans also cover areas of concern in the structured finance business and an evaluation of the steps banks are taking to manage credit, legal, and reputational risks in response to events of the past year.

Conclusion

In closing, the fallout from the recent round of excesses and large corporate defaults appears to be resulting in positive corrective steps by corporations, banks and the capital markets. Supervisors must work to ensure that their ongoing supervisory activities reinforce these corrective actions and help them to endure over the longer term. At the same time, supervisors will be working to maintain their focus on fundamental safety and soundness issues at financial institutions. These efforts include encouraging banking organizations to strengthen their credit risk management practices, to enhance their new product review and approval procedures, and to strengthen their overall approach to identifying, managing and controlling legal, reputational and other operational risks. If banking organizations, corporations, and supervisors are attentive to the lessons learned over the past year and adopt appropriate policies and controls, the risk of repeating similar excesses in the coming years should be substantially reduced.

**TESTIMONY OF
DOUGLAS W. ROEDER
SENIOR DEPUTY COMPTROLLER
OFFICE OF THE COMPTROLLER OF THE CURRENCY**

Introduction

Chairman Levin, Ranking Member Collins and members of the Subcommittee, I am Douglas Roeder, Senior Deputy Comptroller responsible for large bank supervision. Thank you for inviting the Office of the Comptroller of the Currency (OCC) to participate in this important hearing.

We share your concerns over the Enron debacle and commend you for holding this hearing. What happened to Enron employees, who lost their jobs and their retirement savings, is tragic. We also have a concern about the role national banks played in some transactions entered into by Enron. As I will discuss, both the banks themselves and the OCC are taking steps to try to guard against future occurrences of this type. It is important to keep in perspective, however, that the role of bank regulators is only one component of the challenge of preventing the repeat of an Enron-like disaster.

My testimony will address how the OCC supervises large national banks in general and complex structured transactions such as those entered into by Enron in particular. For clarity, when I refer to complex structured transactions, I mean highly customized financial transactions that often involve a derivative or off-balance sheet component, such as a Special Purpose Entity (SPE). I will discuss where we think we should broaden our supervisory focus and strengthen our processes and the steps we have taken to do so. I will also describe the OCC's coordination with the Securities and Exchange Commission (SEC), the Internal Revenue Service (IRS) and other agencies in cases where we believe there may have been violations of laws administered by

Statement required by 12 U.S.C. 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

those agencies. My testimony will close with comments on some of the steps the banks are taking to improve their own processes.

Large Bank Supervision

The OCC is responsible for supervising over 2,000 banks. Some of these banks are among the largest banks in the country, indeed the world; they offer a wide array of financial services and are engaged in millions of transactions every day. For maximum effect, the OCC has dedicated teams of examiners actually residing in our largest national banks. Nonetheless, given the volume and complexity of bank transactions, it simply is not feasible to review every transaction in each bank, or for that matter every single product line or bank activity. Accordingly, we focus on those products and services posing the greatest risk to the bank.

The first step in risk-based supervision is to identify the most significant risks and then to determine whether a bank has systems and controls to measure, monitor, manage and control those risks affecting the institution. Next, we assess the integrity and effectiveness of risk management systems, with appropriate validation through transaction testing. If we have concerns, then we “drill down” to test additional transactions. If this reveals problems, we have a variety of tools with which to respond, ranging from informal supervisory actions directing corrective measures, to formal enforcement actions, to referrals to other regulators or law enforcement.

Resident examiners apply risk-based supervision to a broad array of risks, including reputation risk and transaction risk. Because historically, it is credit risk that has posed the greatest threat to safety and soundness of banks and indeed, the banking system, bank supervisors have devoted significant attention to the supervision of credit risk. The case of Enron demonstrates just how significant other types of risk can be to the operations of a large financial institution.

As a result of this experience, the OCC will refine its approach to supervising aspects of bank operations that may cause reputation, litigation and other operational risks in the area of complex structured transactions. Banks have also learned from this experience. As a result, they have tightened their procedures and controls. I will discuss both of these developments in greater detail below.

OCC Policies and Procedures for Complex Structured Transactions

Complex structured transactions, such as those entered into by Enron, are generally offered at only a small number of large banking companies, although other companies may conduct isolated transactions. Our supervision of complex products focuses on a bank's ability to manage the relevant credit, market and transactions risks. Within the context of our risk-based supervisory approach, we believe we can enhance our supervision of complex structured transactions to better assess the broader risks inherent in those activities. To understand these planned supervisory changes, it is useful to start with the OCC's policies for dealing with complex structured transactions and then describe how we intend to enhance them.

As I mentioned previously, the types of transactions engaged in by Enron generally involved some type of derivative or off-balance sheet product, often an SPE. While derivatives (and SPEs) serve many legitimate purposes and have resulted in more efficient markets and enhanced the safety and soundness of our financial system, they, like any other tool, can also be misused. The OCC's *Risk Management of Financial Derivatives* explicitly addresses derivatives products and provides guidance for examiners to follow when evaluating a bank's risk management system for complex structured transactions. In the wake of Enron, we have asked ourselves how our current approach could be enhanced. We have identified several areas where we believe enhancements are warranted.

New product approval. OCC's evaluation of new product approval begins with an assessment of the bank's process. Our examiners evaluate the bank's system for ensuring that responsible senior managers approve new product offerings and that risk management reports adequately capture such products. We direct bankers to ensure that adequate technical knowledge and financial resources are in place before offering new products or services, and we emphasize the importance of a robust control environment that includes sign-off by all members of relevant areas such as: risk control, operations, accounting, legal, audit, and senior line management.

Having a sound approval process for new products is essential, but equally important is the definition of new products. The reputation risk, including potential legal or regulatory action, to which a bank exposes itself if it engages in questionable new products can be

significant. Our current policies provide that when bank management is deciding whether or not a product must be routed through the new product process, it should consider various factors: structure variations, pricing considerations, legal and regulatory compliance, and market characteristics. When in doubt as to whether a product requires vetting through the new product approval process, we advise bank management to err on the side of conservatism and apply the process to the proposed product or activity.

Going forward, we will sample more extensively transactions going through the new products approval process. In particular, we will check on whether banks are following their own processes and whether proper review and authorization are received prior to engaging in complex structured transactions.

In addition, we are considering whether an amendment to our safety and soundness guidelines, which are part of our part 30 regulations, is in order. These interagency guidelines set out minimum safety and soundness standards for banking activities including: internal audit, credit underwriting, loan documentation, and internal controls. Violation of a guideline can result in a bank having to prepare and submit a compliance plan, or it can result in a regulator taking an enforcement action. We are discussing with our sister banking agencies whether to revise these interagency guidelines to address more specifically board and senior management responsibilities for the approval and oversight of corporate strategies, business plans and approval of new products that involve transactions such as complex structured products.

Customer appropriateness. While a given product may be approved through the new product approval process as an activity acceptable to the bank's board and senior management, the bank must also carefully consider the appropriateness of complex structured transactions for any particular client. In testing such controls, our focus has been on how well the bank assesses the sophistication of the customer. To that end, our examiners look at the bank's assessment of the nature of the customer's business and the purpose of the customer's derivatives activities. They review the bank's evaluation of the possibility that a customer does not understand a transaction or that the transaction is inconsistent with the customer's policies, thereby inhibiting the customer's ability to perform under the terms of the contract. To make this assessment, examiners review a sample of credit and marketing files to determine whether the files contain sufficient information to understand the risks the customer is attempting to manage, the types of derivatives expected to be used, and the overall impact on the customer's financial condition.

In testing a bank's controls on customer appropriateness, we will enhance our process and consider not only whether the bank has assessed the customer's ability to understand the transaction and to perform under the terms of the contract, but also if bank management understands the purpose and the customer's disclosure/accounting intent, so the bank does not become embroiled in questionable practices engaged in by its customers. We will test compliance with new policies and procedures, including policies regarding customer disclosures of material financings, and review audit's plans and performance.

Bank management involved in structured finance bears crucial responsibilities. Independent risk management personnel should be involved in the review of any transactions

that appear to “push the envelope” and may expose the bank to undue risk. When in doubt, bank management should apply additional scrutiny, for example, obtaining opinions from bank counsel or accountants. While it is not realistic for banks to be responsible for how customers account for transactions on their own financial statements, where uncertainty continues to exist regarding business needs or whether a transaction meets required standards, it is incumbent on bank management to carefully consider their actions and the potential impact on the bank and to decline to participate in transactions that do not meet the standards of integrity that the bank has established.

Large Relationships. We think it is important that bank management has established controls that encompass the total relationship the bank has with its large customers. We plan to sample large relationships (even if credit risk is low) and “flag” structured products during our credit work for potential further review. We expect that this will involve using a cross-functional team of examiners to assess credit, price, compliance and reputation risk associated with approved complex structured transactions. Competitive pressures are a natural part of any business environment, but care must be taken to assure that line managers eager to retain or expand business with important customers don’t cross the line and jeopardize the trust and credibility that form the foundation of a bank. The lost business, diminished market capitalization and increased funding costs that a bank may suffer if financial market participants lose confidence in a bank’s control structure can significantly outweigh actual financial losses arising from direct exposures to the customer in question.

Cooperation with Other Agencies

Enron and other corporate governance scandals have revealed some weaknesses in our nation's accounting rules and in the oversight of the accounting profession. The Sarbanes - Oxley Act is a crucial response to those shortcomings. The Securities and Exchange Commission is in the process of adopting and amending regulations to carry out the Sarbanes - Oxley Act and the new Public Company Accounting Oversight Board has vital new responsibilities to oversee accounting standards and the accounting industry. These changes should go a long way toward addressing the weaknesses in our accounting regime and corporate governance that allowed Enron to happen.

For our part, in addition to our direct supervisory responsibilities under the federal banking laws, we work cooperatively with many other federal agencies and law enforcement. These include the other federal banking agencies, the SEC and the IRS, and also National Association of Securities Dealers, Federal Trade Commission, Federal Trade Commission, the Department of Labor, Department of Justice, the Federal Bureau of Investigation, and the Secret Service. When we become aware of information that indicates a national bank may have violated a law or regulation under the jurisdiction of another agency, we make referrals to that agency. We cooperate, as needed, if the agency determines to pursue the matter. The cooperation may entail providing documents, information and expertise, and making OCC examiners available to serve as witnesses in criminal trials and enforcement proceedings. When other agencies refer to the OCC potential violations of banking law, the OCC will investigate and take enforcement action, as appropriate. In addition, pursuant to OCC regulations, national

banks file tens of thousands of suspicious activity reports with federal law enforcement agencies each year.

Focusing on the SEC, for example, the OCC has referred violations of federal securities law to the SEC and cooperated in SEC investigations. Similarly, we have received referrals and information from the SEC concerning infractions of banking laws. Our agencies have shared information concerning potential violations of law from examinations or inspections and from investigations, and OCC examiners have served as witnesses in SEC enforcement actions. In appropriate situations, we have coordinated our enforcement efforts and brought simultaneous or joint enforcement actions. The OCC and SEC also participate together in working groups, such as the National Interagency Bank Fraud Working Group and the Interagency Working Group on Financial Markets, which provide opportunities to share concerns and discuss matters of mutual interest.

Actions Taken by the Banks

The recent series of corporate scandals at Enron and other large corporations has served as a wake-up call for the corporate world, including banks. Whether or not they were involved with Enron, the banks that offer complex structured transactions realize that they can suffer great harm if they become embroiled in questionable activities engaged in by their customers. As a result, all have taken steps to improve their internal controls of complex structured transactions and SPEs.

Some banks have made changes to management, established new oversight committees, developed new policies and/or procedures, tightened controls, improved internal reporting to management and the Board and improved disclosures. Other banks have centralized the process for establishment, use and management of SPEs and conducted separate audits to review SPE activities.

Banks also have strengthened their review and approval processes for complex structured transactions in several ways. First, they too have realized how critical the definition of new products is to the new product approval process, and as a result they have expanded the definition of nonstandard products that require approval. Second, they have enhanced the approval process to provide for a broader range of senior level management review from various areas of the bank, including, audit, compliance and legal. Third, banks are putting a greater focus on assessing customer motivation and appropriateness. Fourth, banks are implementing broader review procedures, which include securing representations from customers regarding disclosures and accounting treatment, and defining strict reporting standards with which customers must comply in order to obtain a structured product.

We believe these are all positive steps toward strengthening internal processes. We will evaluate the changes banks have made and will continue to monitor and assess these reforms as they are implemented. In our assessments, we are reviewing committee structures, charters, minutes and, most importantly, actions taken by management under the new control structures. We continue to sample complex structured transactions to ensure they receive appropriate approval, and to review regulatory capital treatment of these products to ensure capital

requirements are being applied appropriately. We have also reviewed special audit reports and Board presentations on SPEs to assess uses, risk, control systems and audit recommendations.

Progress has been made, but we believe that it is too early in the process to identify the full package of appropriate practices with respect to complex structured transactions. It takes some period of time to evaluate how well new policies and procedures will actually work in practice. To the extent that additional formal guidance from bank regulators is appropriate, we would expect to develop such guidance with our colleagues at the Federal Reserve Board and the FDIC.

Conclusion

The Enron debacle has indeed been tragic. No one wants to see its circumstances repeated. While it is important to keep in perspective the role of bank regulators, we think there are steps we can take to improve our oversight of complex structured transactions. Similarly, the banking industry has recognized it can do a better job. We will continue to refine our processes for assuring that banks have, and follow, proper policies and procedures for dealing with all the risks involved in complex structured transactions.

Thank you once again for inviting the OCC to testify at this important hearing. I will be glad to answer any questions.

TESTIMONY OF
ANNETTE NAZARETH
DIRECTOR, DIVISION OF MARKET REGULATION
U.S. SECURITIES AND EXCHANGE COMMISSION

CONCERNING TRANSPARENT FINANCIAL REPORTING FOR
STRUCTURED FINANCE TRANSACTIONS

Before the Permanent Subcommittee on Investigations

Committee on Governmental Affairs

U.S. Senate

December 11, 2002

The Securities and Exchange Commission (“SEC” or “Commission”) is pleased to submit this written statement about our efforts to monitor the use of and promote transparent financial reporting for structured finance transactions.¹

Structured finance plays an important role in the modern business environment. When used properly, it can provide needed liquidity and funding sources, investment opportunities, and can facilitate risk dispersion. There are numerous participants in any structured finance transaction. The principal actors in the transaction are, of course, a company and its counterparties, which can include various combinations of financial institutions and intermediaries. Investors also act as principals, but most transactions are brought to investors and not designed by them. Each principal player also brings to the deal table advisors representing many disciplines, including accounting, tax, legal, and valuation services. A regulatory framework and infrastructure, again with many components, surrounds each transaction and can affect the various players. These components involve regulators such as the various banking regulators, the Internal

¹ For purposes of this testimony, the use of the term “structured finance transactions” is not limited to asset backed securities.

Revenue Service, and the SEC, the accounting standard setters, and various professional bodies that maintain codes of conduct and other professional standards for their disciplines.

Each of the various components in the regulatory framework plays a crucial role in maintaining confidence in our financial markets. This is especially evident in the use of structured finance transactions, which, notwithstanding the benefits noted above, have at times been used inappropriately to achieve a specific accounting or tax result or provide “window-dressing” for financial statements. Sometimes this inappropriate use has been achieved only by violating existing regulations or accounting standards.

It is important to note that the Commission’s statement will relate to the Commission’s recent and ongoing efforts related to structured finance transactions, as well as to completed investigations and enforcement cases in this area. The Commission does not comment on specific ongoing investigations or enforcement actions.

This statement will describe the role of the SEC in the regulatory framework that surrounds structured finance transactions. It will begin by describing the primary mission of the SEC, and providing some context as to how that mission fits within the overall regulatory framework. The statement will then discuss the relevant activities of the Commission’s Divisions and Offices to regulate structured finance transactions.²

The Commission’s Role in the Markets and Financial Reporting

The primary mission of the SEC is to protect investors and maintain the integrity of the securities markets. In this effort, the Commission is responsible for administering the federal securities laws. The Commission does not have authority to approve or disapprove various securities transactions on their merits. Rather, the Commission’s primary job is to ensure that companies properly account for and fully disclose material transactions and fully inform investors of their impact on the company’s financial condition so that investors can make informed investment decisions. This system is designed to maintain market transparency. It allows market forces rather than regulatory controls to determine what securities transactions occur and at what prices a company’s securities will trade. Without full and fair disclosure, markets cannot assign an appropriate value for the securities of public companies, whether they are large or small companies, or financially-stable or financially-troubled.

² The Committee’s letter of invitation also asks for an evaluation of the “post-Enron reforms put in place by Citicorp, JP Morgan Chase, and other financial institutions and to develop guidance on best practices in the U.S. financial industry to prevent involvement in misleading or improper structured finance, accounting or tax transactions.” While the Commission, in general, supports private parties’ efforts to improve their internal compliance practices, it would be inappropriate for the Commission to comment on these companies’ particular policies while the Commission’s Enron investigation is continuing.

The SEC also oversees key participants in the securities market, including stock exchanges, broker-dealers, investment advisors, mutual funds, and public utility holding companies. Here again, the SEC is concerned primarily with protecting investors who interact with these various organizations and individuals.

Crucial to the SEC's effectiveness is its enforcement authority. Each year the SEC brings between 400-500 civil enforcement actions against individuals and companies that violate the securities laws. Typical infractions include insider trading, accounting fraud, and providing false or misleading information about securities and the companies that issue them.

Many of the Commission's efforts are focused on protecting investors by requiring full and fair disclosure of material information about publicly-traded securities. Full disclosure ultimately benefits both investors and the capital markets. By enhancing investors' confidence in the completeness and accuracy of information about public companies, these full disclosure requirements encourage investor participation in the capital markets. This full and fair disclosure necessitates transparent financial reporting, a concept elaborated on in the discussion of the activities of the Office of the Chief Accountant.

The SEC's Enforcement Authority and Relevant Activities

The SEC has significant powers to investigate possible violations of the federal securities laws and to enforce those laws through civil actions in federal court or before an administrative law judge. In its federal court actions, the Commission seeks injunctions; a person who violates an injunction is subject to fines or imprisonment for contempt. In addition, the Commission often seeks civil money penalties and the disgorgement of ill-gotten gains. Both the courts and, pursuant to the Sarbanes-Oxley Act, an administrative law judge may also bar or suspend individuals from acting as corporate officers or directors. Also, the Commission can bring both civil and administrative actions against broker dealers in a variety of contexts. Further enhancing its enforcement authority in this area, the Commission can charge such regulated entities for failing to supervise their employees, including salespersons and broker-dealers. While the SEC has civil enforcement authority only, it works closely with various criminal law enforcement agencies throughout the country to develop and bring criminal cases when the misconduct warrants more severe action.

In the aftermath of Enron's collapse, the SEC initiated and is continuing to conduct an enforcement investigation to identify violations of the federal securities laws that may have occurred, and those who perpetrated them. The Commission to date has charged two former Enron officers with fraud based on their participation in transactions designed to mislead investors about Enron's financial results. The Commission's investigation is continuing and the Commission's Division of Enforcement continues to work diligently and vigorously with the Justice Department's Enron Task Force to make sure that all those responsible answer for their misdeeds. Any further information relating to that investigation is nonpublic at this point. The public can have full

confidence, however, that our Division of Enforcement is conducting a thorough investigation and that the Commission will redress any and all wrongdoing and wrongdoers.

As a general matter, however, the Committee may find several aspects of the Commission's authority particularly relevant to its interest in the regulation of financial institutions that structure transactions that may be used by public companies engaging in improper financial reporting practices.

First, the Commission has clear authority to proceed against public companies that file false information as part of their financial statements. Such conduct is potentially subject to various provisions of the federal securities laws, including the requirement that companies' filings with the SEC be materially complete and accurate and the SEC's general antifraud authority. The Commission brings numerous actions — 163 this past fiscal year — based on false and fraudulent financial reporting and disclosures. Among these was an action the Commission recently brought against a public company for, among other things, using an undisclosed off-balance sheet special-purpose entity to dramatically overstate the company's cash flow from operations.³ Cases like this make clear that public companies using off-balance sheet special-purpose entities must ensure not only that their accounting treatment complies with generally accepted accounting principles ("GAAP"), but also, that they have accurately portrayed the economic substance of the transactions.

Second, the Commission has explicit statutory authority not only to proceed against primary violators of the federal securities laws, but also against aiders and abettors of those violations.⁴ The Commission aggressively employs this authority. In addition, the Commission also may order any person who is or was a *cause* of a violation of any provision of the Exchange Act, due to an act or omission the person knew or should have known would contribute to the violation, to cease and desist from causing such violations. A person may be a cause of a non-scienter based violation, such as a

³ See In the Matter of Dynegy, Inc., A.P. File No: 3-10897 (September 24, 2002). Dynegy settled this case, without admitting or denying the Commission's findings, by agreeing to, among other things, a cease-and-desist order and a \$3 million fine.

⁴ Most notably, as added by the Private Securities Litigation Reform Act of 1995, Section 20(e) of the Exchange Act provides that "any person that knowingly provides substantial assistance to another person in violation of a provision of this title, or any rule or regulation issued under this title, shall be deemed to be in violation of such provision *to the same extent as the person to whom such assistance is provided.*" 15 U.S.C. §78t(e) (emphasis added).

reporting violation, through negligent conduct that contributes to the violation. Intentional or reckless conduct is not required.⁵

In this regard, in a recent case, the Commission found that a public company called Ashford.com had improperly deferred \$1.5 million in expenses under a contract with Amazon.com, causing Ashford.com to materially understate its marketing expenses and allowing the company to report a pro forma net loss that was less than analyst's expectations. The improper deferral resulted from the settlement of a dispute with Amazon.com using two separate documents that were prepared by Amazon.com at Ashford.com's request. Ashford.com subsequently failed to disclose one of the two documents to its auditors. The Commission found, based on this and other conduct, that Ashford.com had violated the reporting and antifraud provisions of the securities laws. The Commission also found that Amazon.com was a cause of Ashford.com's reporting violations.⁶

Another weapon against secondary actors—available to both the Commission and private litigants—is the fact that there can be and often is more than one primary violator in any securities fraud. The parameters of this doctrine are still uncertain as the federal courts are working through the issue of who is a primary violator. The Commission is taking an active role in shaping the law in this area by, in appropriate cases, filing briefs *amicus curiae* addressing the liability of such “secondary actors.”⁷

Liability of secondary actors is an issue in the class action litigation pending against Enron and numerous secondary actors, including financial institutions, in the Southern District of Texas.⁸ The Commission filed a motion in that case, as *amicus curiae*, asking for permission to submit its Klein Amicus Brief as guidance to the court on the legal question of whether a person who creates a misrepresentation can be liable as a primary violator (the Commission's position) or whether the person must be publicly identified as the author of the misrepresentation. The Court granted this motion and the matter is under consideration.

⁵ See *KPMG, LLP v. SEC*, 2002 U.S. App. LEXIS 9119, *25-27 (D.C. Cir. May 14, 2002).

⁶ Both Ashford.com and Amazon.com consented, without admitting or denying the findings in the Commission's Order, to cease-and-desist orders.

⁷ See, e.g., Brief of the Securities and Exchange Commission as *Amicus Curiae* in Klein v. Boyd, 1998 U.S. App. LEXIS 2004 (February 12, 1998), vacated and reh'g granted, 1998 U.S. App. LEXIS (March 9, 1998). The Klein Amicus Brief was filed by the Commission to inform the full court of the Commission's views on the issues before the court on en banc review. Because the case was settled, there was no en banc decision.

⁸ Newby v. Enron Corp., Civ. Action No. 13624.

Third, and finally, the Commission has a long history of cooperation with the federal bank regulators on enforcement matters. The SEC obtains evidence of possible violations of the securities laws from many sources, including its own surveillance activities, other Divisions and Offices of the SEC, the securities self-regulatory organizations, securities industry sources, press reports, and investor complaints. The Commission also not infrequently receives evidence of possible violations from other regulatory authorities, including the federal bank regulators. In addition, when appropriate, the Commission coordinates its investigations with federal banking regulators, often resulting in coordinated and global regulatory settlements.

For example, in a recent case, the SEC took action with respect to accounting improprieties by The PNC Financial Services Group, Inc., a bank holding company. The Commission's Order found, among other things, that, in violation of GAAP, PNC transferred from its financial statements approximately \$762 million of volatile, troubled or under-performing loans and venture capital assets sold to three special-purpose entities created by a third party financial institution, which resulted in material overstatements of earnings, among other things. Based in part on this conduct, the Commission found that PNC had violated the antifraud and reporting provisions of the securities laws.⁹

At the same time the Commission's order was issued, the Board of Governors of the Federal Reserve System announced that PNC had entered into a written agreement with the Federal Reserve Bank of Cleveland to address bank supervisory matters. The Commission acknowledged the substantial cooperation provided by the Board in this matter.¹⁰

⁹ Without admitting or denying the Commission's findings, PNC agreed to a cease-and-desist order.

¹⁰ The Committee's letter of invitation also asks about the SEC's role in working with the Internal Revenue Service "to detect, deter and stop U.S. financial institutions or U.S. branches or agencies of foreign financial institutions from selling products, offering services, or structuring transactions which result in U.S. publicly traded companies issuing misleading or improper tax returns." The Commission, of course, is not authorized to enforce the Internal Revenue Code and does not directly play a role in the IRS or the Department of Justice's enforcement of these laws. The Commission does, however, at times come across evidence of possible violations of the tax laws in the course of its investigations or other regulatory activity. The Commission's practice is to refer these matters to the IRS. In addition, the Commission has often cooperated and worked closely with the IRS in investigations of conduct that implicates both the securities laws and the U.S. tax laws. For example, the Commission and the IRS closely coordinated their investigations of the practice of "yield burning" in the municipal securities industry.

Recent Rulemaking Initiatives Enhancing Financial Disclosure

The Chief Accountant is the principal adviser to the Commission on accounting and auditing matters. The Office of the Chief Accountant also works closely with domestic and international private-sector accounting and auditing standards-setting bodies (such as the Financial Accounting Standards Board ("FASB"), the American Institute of Certified Public Accountants ("AICPA"), and the recently established Public Company Accounting Oversight Board). The Office of the Chief Accountant consults with registrants, auditors, and other Commission staff regarding the application of accounting standards and financial disclosure requirements, and assists in addressing problems that may warrant enforcement actions.

The Division of Corporation Finance's mission is to see that investors are provided with material information in order to make informed investment decisions - both when a company initially offers its stock to the public and on a regular basis as it continues to give information to the marketplace. The Division also provides guidance to companies on SEC rules and forms and proposes new and revised rules to the Commission.

One of the highest priorities in the Office of the Chief Accountant and the Division of Corporation Finance is to support the Commission's various initiatives to deliver to investors the information required to make informed investment decisions. This includes transparent financial reporting in financial statements and footnotes thereto, as well as full and fair disclosures throughout the remainder of a filing with the Commission.

The Need for Transparent Financial Information

Tremendous emphasis is placed on the price of a company's stock. Investors' requirements provide the motivation for much of the emphasis. In addition, management may have an additional incentive to see that its stock price increases as price increase may influence management's compensation either directly or indirectly. A significant factor considered by the market in determining a company's stock price is its earnings. This includes not only the most recent earnings, but also the trend in the past and, more importantly, the expected trend in the future.

In response to the market's emphasis on earnings, management may have an incentive to adopt strategies that produce short-term results at the expense of longer-term shareholder interests. Financial engineering can be one of those strategies. Financial engineering occurs when the terms of a transaction or series of transactions are structured to achieve a particular result. This often is accomplished through the combination of simple instruments and basic structures in a much more complex, interconnected transaction. While a transaction may be engineered to achieve a valid business purpose, such as reducing the cost of capital or managing risk exposures, it also may be engineered simply to achieve a specific accounting result by arbitraging the accounting standards. The latter strategy, while creating a desired accounting effect, often will come at a true

economic cost in terms of fees and other charges to structure a transaction that complies with the accounting rules.

Financial engineering is sometimes inappropriately used as a synonym for structured finance. As noted earlier, structured transactions are not inherently improper. They can be used to provide important liquidity resources and disperse risk among parties willing to accept it. However, given the overall increased use of structured transactions and the potential for their use in arbitrage strategies as window-dressing, investors and creditors have begun to focus not only on the amounts and trends of earnings, but also on the "quality" of these reported measures. At a conference addressing the quality of earnings, one analyst described the highest-quality earnings as "the earnings that can be taken right to the bank and deposited," and which are "replicated every quarter with 100 percent certainty."¹¹ If a company relies on a structured transaction for a one-time boost in earnings or liquidity, or a series of structured transactions to continue a trend, the investing public absolutely must understand that when evaluating the company. Transparent financial reporting facilitates this evaluation process.

Transparent financial reporting enables investors, creditors, and the market to evaluate the financial condition of a company. In addition to helping investors make better decisions, transparency increases confidence in the fairness of the markets. Further, transparency is important to corporate governance because it enables boards of directors to evaluate management's effectiveness, and to take early corrective actions, when necessary, to address deterioration in the financial condition of companies. Therefore, it is critical that public companies provide an understandable, comprehensive, and reliable portrayal of their financial condition and performance. If the information in a financial report is transparent, then investors and other users are less likely to be surprised by unknown transactions or events.

Current Initiatives in the Office of the Chief Accountant

Recently, companies such as Enron, Xerox, and WorldCom disclosed that their financial statements were not in compliance with GAAP. It is important to note in these cases that the financial reporting model did not necessarily fail. The Commission has alleged that these companies, as further acknowledged by their restatements, failed to properly apply the financial reporting model. Nonetheless, the existing financial reporting model can be improved. This includes both improvements in the underlying GAAP accounting, as well as improvements to other elements of the model.

¹¹ Comments by Bear Stearns analyst Pat McConnell at the "Benchmarking the Quality of Earnings Conference" in April 2001. The conference was jointly sponsored by the Financial Executives Institute and the American Institute of Certified Public Accountants.

There are currently numerous efforts underway within the Commission to improve the overall financial reporting model. Since July 30, 2002, our efforts have also focused significantly on meeting our responsibilities under the mandates within the Sarbanes-Oxley Act of 2002.

The Commission has several rulemaking initiatives recently completed or underway which focus specifically on the nature and quality of financial information that is reported to the public. This includes the financial impact of structured finance transactions. At the same time, the Commission has been fulfilling its oversight role with other private-sector standard setters, including the FASB and the AICPA, and several initiatives in those areas will be addressed.

Commission Rulemaking

The Commission has adopted, or has proposed, rules related to the quality of reported financial information, the reliability of that information, and the timeliness of that information. In addition, the Commission has proposed rules to strengthen the regulation of the “gatekeepers” of our capital markets, such as accountants and lawyers who work with public companies as part of the financial reporting process. Individually and in totality, these rules should have a significant effect on the quality and reliability of financial reporting and, accordingly, should serve to enhance investor confidence. In this statement, we will focus solely on those regulatory actions that directly related to the use of structured transactions and the disclosure of these transactions.

Even before the passage of the Sarbanes-Oxley Act, the Commission was communicating with registrants its expectation for more transparent financial reporting. These communications included three Financial Reporting Releases issued in December 2001 and January 2002 addressing pro-forma measures, critical accounting policies, and MD&A disclosures. Of particular note in this testimony is Financial Reporting Release No. 61 (“FR 61”) issued in January 2002 addressing MD&A disclosures.¹² Among other items, this release provided additional insight into the Commission’s expectations for disclosures related to liquidity and capital resources, including off-balance sheet arrangements, and the effects of transactions with related and certain other parties.

FR 61 served as the basis for our recent rule proposal addressing MD&A disclosures for off-balance sheet arrangements and other contractual and contingent obligations and commitments, as required under the Sarbanes-Oxley Act.¹³ The rule is expected to address off-balance sheet transactions, arrangements, obligations (including

¹² “Commission Statement about Management’s Discussion and Analysis of Financial Condition and Results of Operations” Release Nos.: 34-45321; FR-61 (January 22, 2002).

¹³ “Disclosure in Management’s Discussion and Analysis About Off-Balance Sheet Arrangements, Contractual Obligations and Contingent Liabilities and Commitments” Release No. 33-8144 (November 4, 2002).

contingent obligations), and other relationships of an issuer with unconsolidated entities or other persons that have, or may have, a material effect on financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources. It is important to note that FR 61 remains in effect and the proposed rules simply add additional precision to the existing MD&A requirements, as the disclosures under the proposed rules would be located in MD&A. The proposals would require a registrant to provide, in a separately captioned subsection of MD&A, a comprehensive explanation of its off-balance sheet arrangements. The proposals also would require registrants to provide an overview of its aggregate contractual obligations in a tabular format and contingent liabilities and commitments in either a textual or tabular format. FR 61 also addresses MD&A disclosure of relationships and transactions with persons or entities that derive benefits from their non-independent relationships with the registrant or the registrant's related parties.

Oversight of Private-Sector Standard Setters

The Commission, through the Office of the Chief Accountant, has been exercising its oversight role in regards to the private-standard setting bodies. This has resulted in significant improvements in several areas of the auditing and accounting standards.

Until the formation of the Public Company Accounting Oversight Board, the AICPA, through its Auditing Standards Board, promulgated the auditing literature used by accountants and auditors.¹⁴ In part as a result of the increased use of structured finance transactions and at the urging of the Commission, the AICPA recently addressed two aspects of its auditing literature: the issuance of reports by accountants on the accounting to be applied to given transactions and the consideration of fraud in financial statement audits. In addition, it is working on improvements to the guidance that addresses an auditor's identification and assessment of general risk factors in an audit.

First, at the request of the Chief Accountant, the AICPA amended Statement on Auditing Standard No. 50, *Reports on the Application of Accounting Principles*, ("SAS 50") effective June 30, 2002. A SAS 50 engagement requires the reporting accountant (the one issuing the SAS 50 report) to obtain an understanding of the form and substance of the transaction, review the applicable accounting standards, consider consulting with other professionals or experts, and perform research or other procedures to ascertain and consider the existence of creditable precedents or analogies. A "SAS 50 letter" was originally intended to serve as a mechanism for obtaining accounting advice or perhaps resolving differences between an auditor and client while avoiding "opinion shopping" from among different accounting firms.

¹⁴ After it begins operations, the Public Company Accounting Oversight Board will have the authority to set auditing standards for public companies. See Sections 101 and 103 of the Sarbanes-Oxley Act of 2002.

However, over time, SAS 50 letters were used almost as part of the marketing literature by financial institutions pitching structured finance products. The SAS 50 letter would address the accounting for a “hypothetical transaction” with a given set of facts, including the terms of financial instruments involved in the transaction. It would represent the reporting accounting firm’s view of the application of the accounting literature in that limited set of facts. The SAS 50 letter was then shared with the financial institution’s potential customers as a way of saying, “You can get this accounting treatment.” The Office of the Chief Accountant was concerned that it was not possible for the reporting accountant to know if the final, actual transaction would conform to the facts set forth in the SAS 50 report, or whether the potential customer’s continuing accountants had reached different conclusions on the same or similar transactions in the past. As a result, SAS 50 was amended to preclude the issuance of a report on “hypothetical transactions.”

The AICPA has also amended its guidance on the consideration of fraud in a financial statement audit by issuing Statement on Auditing Standard No. 99, *Consideration of Fraud in a Financial Statement Audit* (“SAS 99”). This standard supersedes the previous guidance on the consideration of fraud. It requires a more expansive consideration of fraud throughout the performance of an audit. Required procedures include discussions among the audit team personnel during the planning phase of the audit, obtaining information to assess the risk of material misstatement from fraud, assessing the impact of an entity’s programs and controls on the risk of fraud, and responding to the identified risks in terms of the nature, timing, and extent of procedures performed during the audit. It also requires certain documentation of the procedures performed and reporting to management and the audit committee.

Many of the fraud risk factors identified in SAS 99 correspond to business factors that could motivate management to inappropriately use structured finance transactions. For example, some of the factors identified include: the perceived or real adverse effects of reporting poor financial results, the profitability or trend level expectations of analysts and institutional investors, and significant portions of management compensation tied to operating results. In an audit, the consideration of these factors, coupled with an observation that a company has used a structured transaction or unusual series of transactions, should cause the auditor to more closely examine the reporting for and disclosure of the transaction.

The AICPA is proposing seven Statements on Auditing Standards to provide improved guidance concerning the auditor’s assessment of the risks of material misstatement in a financial statement audit, and the design and performance of audit procedures whose nature, timing, and extent are responsive to the assessed risks.¹⁵

¹⁵ Exposure drafts released by the AICPA December 2, 2002 – “Amendment to Statement on Auditing Standards No. 95, *Generally Accepted Auditing Standards*,” “Audit Evidence;” “Audit Risk and Materiality in Conducting an Audit; Planning and Supervision;” “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement;” “Performing Audit

Additionally, these proposed SASs establish standards and provide guidance on planning and supervision, the nature of audit evidence, and evaluating whether the audit evidence obtained affords a reasonable basis for an opinion regarding the financial statements under audit. In companies where structured transactions are material, these proposed changes in the auditing literature should serve to emphasize the auditor's need to more closely examine the transactions in the course of the audit.

The FASB is a private-sector body that promulgates GAAP. The Commission currently looks to the FASB, under the Commission's oversight, to provide leadership in establishing and improving accounting principles used to prepare financial statements filed with the Commission.

The FASB also has underway projects to clarify and strengthen the GAAP reporting requirements for key elements related to structured finance transactions. These include projects to address the consolidation of and disclosures for special-purpose entities and the accounting and disclosures for guarantees. The SEC encouraged the FASB to complete these projects on an expedited basis, and as a result, these projects were placed on a "fast track," which is resulting in timely guidance.

The FASB has spent a considerable amount of its time and effort this year developing an interpretation of GAAP as it relates to consolidation by companies of special-purpose entities (SPEs). As this subcommittee is aware, transactions involving SPEs have become increasingly common. This FASB project is intended to establish a model for the consolidation of a SPE where the normal condition for consolidation, which is the existence of voting control, is not present. In addition, the FASB's proposed accounting guidance is expected to require certain disclosures about SPEs and the company's activities with SPEs in instances where SPEs are consolidated by a company, and even in instances where a company does not consolidate, but is significantly involved with SPEs.

The FASB has completed its re-deliberations of this issue and expects to issue final accounting guidance early in 2003. In all, we believe the accounting guidance will improve financial reporting by companies involved with SPEs. It is also important to note, however, that under the Commission's proposed rules regarding disclosure of off-balance sheet transactions, there would be enhanced disclosures of this aspect of structured finance transactions whether or not SPEs are consolidated as required under the proposed accounting guidance.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. Guarantees often play a significant role in structured finance

Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained;" and "Amendment to Statement on Auditing Standards No. 39, *Audit Sampling*."

transactions. This Interpretation, effective for certain guarantees issued or modified after December 31, 2002, requires that guarantees within its scope be recognized at inception within the financial statements at fair value. It also requires disclosure of information such as the nature and term of the guarantee, events that trigger performance, and the maximum potential amount of future payments.

The FASB is also in the process of amending its guidance regarding the accounting for derivatives in Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. A key aspect of this amendment process is the definition of a derivative, which would impact instruments often associated with structured transactions. Recent structured transactions have attempted to classify certain contracts as derivatives, such that they were reported as risk management contracts in the balance sheet and the related cash flows are reported as cash flows from operations, as opposed to treating the contracts as a debt instrument with financing cash flows. The FASB's amendment process will examine how to better distinguish between a derivative contract with an acceptable element of financing and a derivative contract with so much financing that it should be considered a debt instrument. Prepaid commodity contracts, a recent focus of interest, will be among the instruments likely addressed by this project.

Finally, the FASB's Emerging Issues Task Force ("EITF") is addressing several practice issues that are relevant to transparent reporting for structured transactions. The EITF was established by the FASB to, when possible, quickly address emerging issues before they become widespread and before divergent practices become entrenched. Recent EITF activities have included the effective rescission of EITF Issue 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities," which had allowed any contract qualifying as an energy trading contract to receive fair value, or "mark-to-market," accounting.¹⁶ Now essentially only energy contracts that qualify as derivatives under Statement 133 are accounted for at fair value using mark-to-market accounting. Also, the EITF is addressing the issue of when two separate financial instruments should be combined and accounted for as if they were a single contract.¹⁷ This will also help avoid the misuse of structured transactions where an entity may enter into multiple contracts that produce a desirable accounting result when entered into and accounted for separately, but where a single contract with the exact same economics would produce a less desirable accounting result.

¹⁶ EITF Issue 02-3, "Issues Related to Accounting for Contracts Involved in Energy Trading and Risk Management Activities." EITF Issues No. 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities," and No. 00-17, "Measuring the Fair Value of Energy-Related Contracts in Applying Issue No. 98-10," and *EITF Abstracts*, Topic No. D-105, "Accounting in Consolidation for Energy Trading Contracts between Affiliated Entities When the Activities of One but Not Both Affiliates Are within the Scope of Issue No. 98-10."

¹⁷ Issue No. 02-2, "When Separate Contracts That Meet the Definition of Financial Instruments Should Be Combined for Accounting Purposes."

It is important to note that while the Commission has looked to the FASB to promulgate accounting standards, it retains the authority and responsibility for setting accounting standards for registrants. While the final conclusions in the current FASB projects are uncertain, the staff of the Office of the Chief Accountant is diligently monitoring the progress of the projects and communicating with the FASB staff when appropriate to ensure the interests of investors are met.

Working with Banking Regulators

The Commission has long recognized the need to consult and coordinate with the federal banking agencies on matters involving financial institutions that are public companies. The Chief Accountants of the Commission and the Federal Deposit Insurance Corporation, the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision meet periodically to discuss matters of mutual interest. These matters include accounting, disclosure, and corporate governance issues. The staffs of the agencies communicate on a regular basis both about banking industry issues, such as accounting and disclosure issues that affect a number of institutions in the industry, and individual institution issues, when it is appropriate to do so. The Commission and the federal banking agencies have brought joint enforcement actions against particular financial institutions, including those that inappropriately apply off-balance sheet accounting.¹⁸ In addition, as required by the Gramm-Leach-Bliley Act, the Commission staff consults with the federal banking agencies on comments to be issued to public companies related to their reporting of loan loss allowances in the financial statements.

In recent years in particular, the Commission and the federal banking agencies have worked cooperatively together to improve financial reporting by financial institutions. In 1999, the agencies set up a Joint Working Group to study issues related to loan loss allowances. These efforts result in the 2001 issuance by the agencies of parallel guidance to improve institutions' documentation of loan loss allowances.¹⁹ Additionally, the Commission staff has been supportive of federal banking agency efforts to assist institutions in following GAAP by providing clarifying guidance in the areas of loans held for sale and accounting issues affecting credit card operations.²⁰ Further, the

¹⁸ See SEC Accounting and Auditing Enforcement Release No. 1597 (July 18, 2002) (Administrative Proceeding File No. 3-10838) regarding PNC Financial Services Group, Inc.

¹⁹ See SEC Staff Accounting Bulletin No. 102 and Federal Financial Institutions Examination Council (FFIEC) "Policy Statement on Allowance for Loan and Lease Losses (ALLL) Methodologies and Documentation for Banks and Savings Institutions" (July 2001).

²⁰ See the "Interagency Guidance on Certain Loans Held for Sale" (March 2001) and "Interagency Advisory on the Accounting Treatment of Accrued Interest Receivable Related to Credit Card Securitizations" (December 2002).

Commission, the Federal Reserve Board, and the Office of the Comptroller of the Currency have supported private sector and regulatory efforts to improve disclosures by financial institutions about risk exposures.²¹ The Commission fully expects to continue to work with the federal banking agencies in these and other areas of mutual interest.

Inspections and Examinations of Financial Institutions

The Office of Compliance Inspections and Examinations administers the Commission's nationwide examination and inspection program for registered self-regulatory organizations ("SROs"), broker-dealers, transfer agents, clearing agencies, investment companies, and investment advisers. The SEC's regulatory examination authority does not extend to parent companies or affiliates of SEC-registered entities, including banks. However, if compliance, risk management or other information relating to the SEC-registered entity is located at a parent company or an affiliate, the SEC requests and reviews this information during examinations of the broker-dealer. The SEC routinely shares information with banking regulators.

The Office conducts inspections to foster compliance with the securities laws, to detect violations of the law, and to keep the Commission informed of developments in the regulated community. Among the more important goals of the examination program is the correction of compliance problems. When the Office finds deficiencies, it issues a "deficiency letter" identifying the problems that need to be rectified, requires firms to correct the problems, and follows up to ensure corrective action has been taken. Serious violations are referred to the Division of Enforcement for formal action.

Currently, there are approximately 8,100 broker-dealers, 7,700 investment advisers, 1,000 fund groups, and 950 transfer agents registered with the SEC. The SEC's examination staff consists of 688 staff located in headquarters and in the SEC's regional and district offices, 390 staff in the investment adviser/investment company examination program and 298 staff in the broker-dealer and SRO examination program. In the fiscal year ending September 30, 2002, the SEC examined 659 broker-dealers, 32 SRO programs, 1,569 investment advisers, 278 investment company complexes, 2 clearing agencies, and 152 transfer agents.

²¹ For example, the agencies supported the efforts of the Working Group on Public Disclosure (also known as the Shipley Group) and the Multidisciplinary Working Group on Enhanced Disclosure (MWGED) (also known as the Fisher II Group). Both of these groups issued reports in early 2001 recommending improvements to institutions' disclosures about their exposures to market, credit, liquidity and other risks. Staff representatives of the SEC, Federal Reserve Board, and the Office of the Comptroller of the Currency are currently participating in a working group of the Joint Forum that is following up on the work of the MWGED to recommend further enhancements to disclosures by financial institutions (including firms in the banking, securities, and insurance industries).

All broker-dealers must be members of at least one SRO such as the NASD or the NYSE, and many, typically larger broker-dealers, are members of several SROs. Pursuant to the Exchange Act, SROs have examination authority over their member broker-dealers and conduct routine cyclical examinations. The Office of Compliance Inspections and Examinations regularly inspects SRO programs and operations, including the SRO's examination program. In addition, the Office conducts several types of examinations of broker-dealers: oversight examinations of the SRO's review; special purpose examinations that focus on a particular regulatory concern such as anti-money laundering or best execution; and cause examinations to respond to concerns that come to staff's attention, for example through a customer complaint.

Most examinations focus on reviewing broker-dealers' compliance with rules governing the sales of securities to retail investors, and with reviewing broker-dealers' compliance with net capital and financial responsibility rules. The SEC also conducts special purpose examinations to review broker-dealers' internal controls and risk management systems. This type of review is designed to evaluate the processes and procedures that broker-dealers have in place to identify, assess, monitor, and control risks to the broker-dealer. These examinations are focused on measures that the broker-dealer takes to monitor the overall risks from its operations to the broker-dealer, and do not involve a review of specific transactions. Some of the areas reviewed include broker-dealers' systems and procedures for monitoring or controlling risk exposure associated with proprietary trading, lending to counterparties, and contingency planning in the event of a significant business disruption.

Conclusion

Thank you for this opportunity to submit this statement for the record of the Committee's hearing on the role of financial institutions in structured transactions. The Commission takes the need for clear and transparent disclosures very seriously. We intend to continue our vigorous efforts in this area and appreciate your emphasis on the need for the transparent financial reporting that is crucial to our capital markets.

U. S. SENATE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
STAFF REPORT
ON
FISHTAIL, BACCHUS, SUNDANCE, AND SLAPSHOT:
FOUR ENRON TRANSACTIONS
FUNDED AND FACILITATED BY U.S. FINANCIAL INSTITUTIONS

December 11, 2002

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Beginning in December 2000 and ending in June 2001, Enron engaged in a series of four multi-million dollar structured finance transactions known as Fishtail, Bacchus, Sundance, and Slapshot. All four transactions related to Enron's new business venture in pulp and paper trading. All four were financed primarily by the Salomon Smith Barney unit of Citigroup (hereinafter "Citigroup") or JPMorgan Chase & Co. (hereinafter "Chase"). The evidence demonstrates that Citigroup and Chase actively aided Enron in these transactions, despite knowing the transactions utilized deceptive accounting or tax strategies, in return for substantial fees and favorable consideration in other business dealings. The evidence also indicates that Enron would not have been able to complete any of these transactions without the direct support and participation of a major financial institution.

The information and analysis provided in this report are based upon a bipartisan investigation by the U.S. Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs. The Subcommittee's investigation included reviewing hundreds of thousands of documents from Enron, Citigroup, Chase, Arthur Andersen, and other parties; interviewing key personnel involved in the transactions; consulting key federal agencies including the Securities and Exchange Commission, Federal Reserve System, Office of the Comptroller of the Currency, and the Internal Revenue Service; and consulting a number of finance, accounting and tax experts.

The Subcommittee's investigation of these transactions continues its examination of the role of major U.S. financial institutions in the collapse of Enron Corporation.¹ Just over one year ago, on December 2, 2001, Enron declared bankruptcy, ending its status as a leading energy company and the seventh largest corporation in the United States. Since then, Enron's chief financial officer, Andrew Fastow, has been indicted for fraud, money laundering, and other misconduct. Mr. Fastow's key assistant, Michael Kopper, has pleaded guilty to fraud and money laundering. Enron's top Western energy trader, Timothy Belden, has pleaded guilty to fraudulent

¹ See Subcommittee hearings, "The Role of the Financial Institutions in Enron's Collapse" (July 23 and 30, 2002)(hereinafter "July 23 hearing" and "July 30 hearing").

conduct to manipulate prices in the California energy market. Congressional hearings, including by this Subcommittee and the full Governmental Affairs Committee, have presented evidence of Enron's participation in accounting deceptions, price manipulation, insider conflicts of interest, excessive executive compensation, and unfair dealing with employees, investors, and creditors. Additional criminal and civil investigations by the Justice Department, Securities and Exchange Commission, Federal Energy Regulatory Commission, and other law enforcement agencies are continuing.

The purpose of this staff report is to examine four Enron transactions that, like those featured in the Subcommittee's July hearings, demonstrate that U.S. financial institutions are designing, participating in, and profiting from complex financial transactions explicitly intended to help U.S. public companies engage in deceptive accounting or tax strategies. The evidence also shows that U.S. financial institutions and public companies are misusing structured finance vehicles, originally designed to lower financing costs and spread investment risk, to carry out sham transactions that have no legitimate business purpose and mislead investors, analysts, and regulators about companies' activities, tax obligations, and true financial condition.

SUMMARY OF TRANSACTIONS

All four of the transactions at issue in this report involve Enron's fledgling electronic trading business in the pulp and paper industry, a new business venture which Enron was developing with the support of Citigroup, Chase, and others. The assets involved in the transactions include Enron's trading book of derivatives and forward contracts to deliver pulp and paper products, electronic trading software, online trading operations dedicated to pulp and paper trading activity, and certain paper mills and timberlands in the United States and Canada. All four transactions reflect efforts by Enron to keep debt off its balance sheet or to manufacture immediate returns on its pulp and paper trading business and use these returns to report better financial results than the company actually produced in 2000 and 2001.

The four transactions can be summarized as follows.

Sham Asset Sale. The first three transactions, Fishtail, Bacchus, and Sundance, took place within an approximate six month period from December 2000 to June 2001. All three involved the transfer of assets at inflated values from Enron to special purpose entities (SPEs) or joint ventures that Enron orchestrated and, among other problems, established with sham outside investments that did not have the required independence or did not truly place funds at risk. Moreover, when considered as a whole, the three transactions resulted in a disguised, six-month loan advanced by Citigroup to facilitate Enron's deceptive accounting. In effect, Enron transferred its assets to a sham joint venture, Fishtail; arranged for a shell company in Bacchus to borrow \$200 million from Citigroup to "purchase" Enron's Fishtail interest, without disclosing that Enron was guaranteeing the full purchase price; used the sham sale revenue to inflate its year-end 2000 earnings by \$112 million; and then quietly returned the \$200 million to Citigroup six months later via another sham joint venture, Sundance. The result was that the three

transactions enabled Enron to produce misleading financial statements that made Enron's financial condition appear better than it was. Senior Citigroup officials strongly objected to Citigroup's participation in one of the transactions, warning: "The GAAP accounting is aggressive and a franchise risk to us if there is publicity (a la Xerox)." Citigroup nevertheless proceeded and played a key role in advancing this transaction, which could not have been completed without the funding and active support of a large financial institution.

Sham Loan. The final transaction, Slapshot, took place on June 22, 2001. It involves a sham \$1 billion loan and related funding transfers and transactions that Chase designed and presented to Enron to produce up to \$60 million in Canadian tax benefits and up to \$65 million in financial statement benefits for Enron.

In essence, the Slapshot transaction cloaked a legitimate \$375 million loan to Enron issued by a consortium of banks inside a \$1.4 billion sham loan to Enron issued by a Chase-controlled SPE. Chase provided the extra money for the sham loan by approving a \$1 billion "daylight overdraft" on a Chase bank account. To eliminate any risk associated with providing the overdraft funds to Enron, Chase required Enron to deposit a separate \$1 billion in an escrow account at Chase prior to Chase's issuing the sham loan to Enron. Enron obtained the required escrow funds by drawing on its main corporate bank account at Citigroup which issued Enron a separate \$1 billion daylight overdraft. Chase and Enron then circulated Chase's \$1.4 billion in "loan" proceeds and Enron's \$1 billion in escrow funds through a maze of U.S. and Canadian bank accounts held by Enron and Chase affiliates, ending the transaction when both Chase and Enron recovered their respective \$1 billion overdrafts by the end of the day.

The end result of the Slapshot transaction was that Enron kept the \$375 million provided by the bank consortium, and Enron directed its Canadian affiliate to repay the \$375 million loan. But with Chase's assistance, Enron also used the Slapshot transaction records to pretend that its affiliate had actually received the larger \$1.4 billion "loan" and to treat its \$22 million loan repayments – each of which was actually a payment of principal and interest on the \$375 million loan – as pure interest payments on the \$1.4 billion "loan." Canadian tax law, like U.S. tax law, allows companies to deduct from their taxable income all interest payments on a loan, but no payments of loan principal. By characterizing each \$22 million loan payment as an interest payment on the \$1.4 billion loan, Enron claimed to be entitled to deduct the entire \$22 million from its Canadian taxes, as well as obtain related financial statement benefits. Five months later, however, Enron declared bankruptcy before all the projected benefits from Slapshot were realized.²

Chase was paid fees and other remuneration totaling \$5.6 million for allowing Enron to use its "proprietary" Slapshot structure and for designing, coordinating, and completing the complex transactions involved. A written tax opinion provided to Enron by a Canadian law firm

² The current status of Enron's utilization of the Slapshot structure is unclear; the Subcommittee is awaiting Enron's response to correspondence on this matter.

stated that the transaction “clearly involves a degree of risk,” and advocated proceeding only after providing this warning: “We would further caution that in our opinion, it is very likely that Revenue Canada will become aware of the proposed transactions ... [and] will challenge them.” Chase sold similar tax structures to other U.S. companies as well.

Each of the four transactions examined in this report involved deceptive financial structures utilizing multiple SPEs or joint ventures, asset or stock transfers, and exotic forms of financing. All relied on a major financial institution to provide funding, complex funds transfers, and intricate structured finance deals. In the end, all four transactions appear to have had no business purpose other than to enable Enron to engage in deceptive accounting and tax strategies to inflate its financial results or deceptively reduce its tax obligations.

FISHTAIL

The Facts. The first transaction in the four-part series, Fishtail,³ took place in December 2000. This transaction was the first step in a larger plan by Enron to move its pulp and paper trading business off its balance sheet into a separate joint venture, sell its ownership interests in that venture, and then declare the income from the sale on its 2000 financial statements. The first step, Fishtail, called for Enron to contribute its existing pulp and paper trading business – that is, its electronic trading software, pulp and paper online trading operation and personnel, and existing pulp and paper trading book – to a joint venture with another investor in order to convert the business into an equity investment and establish its value.

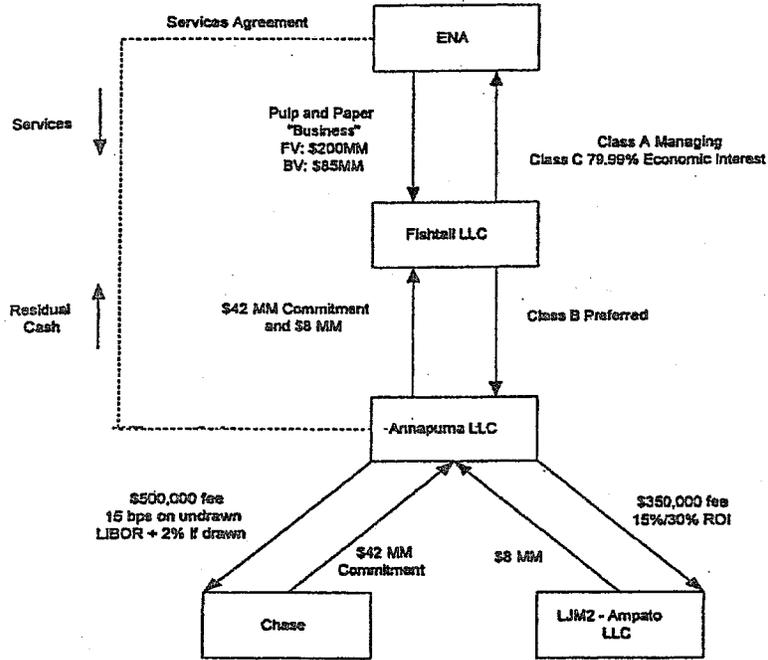
Enron, LJM2 Co-Investment, LP (“LJM2”),⁴ and Chase participated in the Fishtail joint venture which was established on December 19, 2000. To participate in Fishtail, LJM2 (acting through an affiliate LJM2-Ampato LLC) formed a new SPE called Annapurna LLC. Enron (acting through Enron North America) and Annapurna each held 50 percent of Fishtail’s voting shares.⁵ Figure 1 illustrates the final structure of the Fishtail joint venture.

³ The Subcommittee will refer to transactions by the project names that Enron chose. In some instances, the participating financial institutions used different nomenclature. Fishtail, for example, was known internally at Chase as project “Grinch.”

⁴ LJM2 is a Delaware limited partnership which was formed and managed by Enron’s chief financial officer, Andrew Fastow, and which functioned as a private equity fund that dealt almost exclusively with Enron. For more information on LJM2, its dealings with Enron, and the conflicts of interest inherent in its relationship with Enron, see the Subcommittee’s report, “The Role of the Board of Directors in Enron’s Collapse,” S. Prt. 107-170 (7/8/02), at 23-35.

⁵ See “Fishtail LLC Formation/Securitization,” Andersen memorandum by Thomas Bauer and Kate Agnew (12/29/00), Bates AASCGA 008673.1-4. Under generally accepted accounting principles (GAAP), companies typically do not consolidate entities in which they own 50 percent or less of the total outstanding voting shares. Accounting Principles Board Opinion No. 18, “The Equity Method of Accounting for Investments in Common Stock” (1971). Because the two parties in Fishtail each owned 50 percent of the voting shares, the joint venture did

Figure 1: Fishtail



Source: Diagram of Fishtail transaction, Bates DT 000381

Arthur Andersen was Enron's auditor and evaluated the Fishtail transaction to determine whether it complied with GAAP accounting rules. The key Andersen guidelines for capitalizing joint ventures state that, in a 50-50 joint venture involving two parties, the ratio of investment by

not appear on either Enron or Annapurna's financial statements.

the two parties may not exceed a ratio of four to one.⁶ In other words, under the Andersen guidelines, if a 50-50 joint venture is to remain unconsolidated, each party to the joint venture must contribute a minimum of 20 percent of the total capitalization. In addition, the Andersen guidelines require that the contribution provided by the second investor must include capital-at-risk equal to at least 3 percent of the total capitalization. This 3 percent “equity investment” must be funded at the time the joint venture is formed and remain at risk throughout the venture.⁷

Enron’s capital contribution to Fishtail was its pulp and paper trading business. In order to place a dollar value on this contribution, Chase and Enron relied on a November 2000 valuation analysis provided by Chase Securities, Inc. in connection with an earlier effort by Enron and a third party to form a joint venture that was not completed. The Chase Securities analysis had concluded that the pulp and paper trading business was worth \$200 million.⁸ Chase Securities issued this valuation, even though the key asset at the time, Enron’s pulp and paper trading book, was being carried on Enron’s books at less than half that amount, approximately \$85 million.⁹ According to Enron and Chase officials interviewed by the Subcommittee, the remaining \$115 million in value came from intangible or “soft” assets associated with the pulp and paper trading business.¹⁰ Enron’s own internal accounting guidance, however, suggests that

⁶ See Andersen email, plus attachments, from Kate Agnew to Andersen employees John Stewart and others (8/21/00), Bates AASCGA 007193.1-007195.11. Since authoritative accounting literature on establishing, capitalizing and consolidating joint ventures and distinguishing them from special purpose entities is limited, Andersen developed internal policies and guidelines on how to structure joint ventures to ensure their GAAP compliance and prevent abuses such as deconsolidating a joint venture that was really funded and controlled by a single party. The 4:1 rule was one of Andersen’s key requirements for capitalizing joint ventures.

⁷ See “Fishtail LLC Formation/Securitization,” Andersen memorandum by Thomas Bauer and Kate Agnew (12/29/00), Bates AASCGA 008673.1-4. When analyzing the minimum substantive investment required for an unconsolidated joint venture like Fishtail, Andersen analogized to the minimum 3 percent equity at risk requirement already in place for SPEs. (“Specific authoritative guidance surrounding the necessary amount of capital-at-risk to be considered a substantive investment is available only in literature surrounding SPE’s. Although [Fishtail] appears to be a business/strategic joint venture, and is not by definition an SPE, we believe the SPE guidance (EITF 90-15) establishes a good reference point as a minimum standard for our consideration.”)

⁸ See “Enron Network Partners: Valuation Analysis of Contributed Assets,” by Chase Securities, Inc. (11/20/00), Bates CITI-SPSI 0015996-0016017.

⁹ See “Fishtail LLC,” an Enron document summarizing the Fishtail transaction (undated), Bates ECa000015282.

¹⁰ See Subcommittee interview with Michael K. Patrick of Enron (11/14/02) (hereinafter “Patrick interview”) and Robert Traband of Chase (11/19/02) (hereinafter “Traband interview”). See also “Enron Network Partners: Valuation Analysis of Contributed Assets,” by Chase Securities, Inc., CITI-SPSI 0016012. In the section entitled, “Soft Assets,” the Chase Securities analysis states: “In addition to ‘hard dollar’ assets, Enron will contribute credit support, management talent, a technology platform, internet experience (EOL), risk management, and other assets to the partnership Enron believes these assets add significant value to the partnership.” The Chase Securities analysis apparently agreed with Enron’s valuation of these soft assets as worth another \$115 million.

the most appropriate valuation for such intangible or soft assets may be “zero.”¹¹ To justify the significant value assigned to Enron’s soft assets in Fishtail, Enron and Chase contend that the \$115 million figure is the product of an unbiased third-party analysis, but this valuation is, in fact, the product of a Chase affiliate supporting an Enron assessment of its own soft assets.¹²

In light of Enron’s alleged \$200 million contribution, Annapurna was required to contribute at least \$50 million to Fishtail to meet the Andersen 4:1 guideline for capitalizing joint ventures. In addition, Annapurna had to contribute at least 3 percent of the total capitalization at the time the joint venture was formed and ensure it remained at risk.¹³ To provide the required contribution to Fishtail, Annapurna turned to LJM2 and Chase. For its part, LJM2 transferred \$8 million in cash to Annapurna which, in turn, passed the funds to Fishtail. Chase provided Annapurna with a \$42 million “commitment,” set out in a letter of credit, to fund Annapurna if called upon to do so. Annapurna then passed on this funding commitment to Fishtail. The parties referred to Chase’s commitment as an “unfunded capital” investment.¹⁴ One Enron

¹¹ See “Accounting for Investments in Limited Partnerships and other Joint Ownership Entities,” Enron accounting policy and guidance (6/26/01), Bates AAHEC(2) 03172.6 (“[I]n all cases the fair value of the contributions must be objectively determined and verifiable. Certain contributed intangibles may be difficult to objectively measure and therefore maybe [sic] deemed to be valued at zero for the purposes of the economic assessment. The intent is that the third party should not necessarily get ‘equity credit’ for ‘soft’ contributions.” (Emphasis in original.)) Evidence indicates that Enron had vetted the policy statements in this memorandum with Andersen, and they were consistent with Enron valuation principles in place at the time of the Fishtail transaction.

¹² When Enron “sold” its Fishtail ownership interests one week later in the Bacchus transaction, Enron claimed a profit of \$112 million on the “sale.” This outsized profit margin raises obvious questions about whether Enron engineered an inflated asset valuation and sales price to enable it to report a large sales gain on its 2000 financial statements. In addition, one year later, an internal, preliminary asset inventory compiled by Enron in anticipation of declaring bankruptcy estimated the total market value of its pulp and paper trading business as of September 30, 2001, at \$50 million. “Enron Corporate Development Asset Inventory” (11/25/01), Bates EC 001521856-57. This \$50 million internal valuation is dramatically less than the \$200 million valuation Enron claimed in the Fishtail transaction nine months earlier, and the \$228.5 million valuation claimed in the Sundance transaction just four months earlier. See “Sundance Structure,” Citigroup document (undated), Bates CITI-SPSI 0044992.

¹³ See “Fishtail LLC Formation/Securitization,” Andersen memorandum by Thomas Bauer and Kate Agnew (12/29/00), Bates AASCGA 008673.1-4. In addition to the joint venture capitalization rules, under applicable accounting rules for SPEs, Annapurna qualified as an independent entity, unconsolidated with any party, only if, among other requirements, at least 3 percent of its capital came from an independent equity investor and remained genuinely at risk. See *In Re The PNC Financial Services Group, Inc.*, SEC Administrative Proceedings File No. 3-10838 (Order Making Findings and Imposing Cease and Desist Order, 7/18/02); EITF Abstracts, Topic D-14, “Transactions Involving Special Purpose Entities”; EITF Issue No. 90-15, “Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions,” Response to Question No. 3.

¹⁴ Email by Enron employee Michael Patrick to Wes Colwell, (1/4/01), Enron disk produced to the Subcommittee.

employee referred to this novel approach of capitalizing a joint venture with an “unfunded capital” commitment as a “new accounting technology” developed by Enron.¹⁵

According to the same Enron employee, the Fishtail transaction was “primarily accounting driven and the structure was heavily negotiated with Arthur Andersen.”¹⁶ Andersen apparently approved “the unfunded nature of the commitment” made by Chase only after a clause was added to the joint venture agreement giving Fishtail unilateral power to draw down the Annapurna-Chase commitment in certain circumstances.¹⁷ Another aspect of the agreement, however, specified that the first \$200 million dollars of any loss experienced by Fishtail would be allocated to Enron, thereby making it highly unlikely that the Chase commitment would ever actually be drawn.¹⁸ Andersen nevertheless approved the transaction.

Chase was paid \$500,000 in fees for participating in the Fishtail transaction.¹⁹ Its \$42 million unfunded commitment to the joint venture was never used, and Chase never actually contributed any funds to Fishtail. LJM2 was paid an up-front fee of \$350,000 for participating in Fishtail. Approximately six months later, LJM2 was paid \$8.5 million to “sell” its Annapurna ownership interest to Sundance. This payment meant that LJM2 not only recouped its initial capital investment of \$8 million, but also, when combined with its earlier \$350,000 fee, earned an overall 15 percent return on its Fishtail investment.²⁰

¹⁵ *Id.* Several finance and accounting experts told the Subcommittee staff they had never heard of an “unfunded capital” commitment being used to capitalize a joint venture and expressed skepticism over whether it qualified under current accounting rules as a valid joint venture contribution. One expert also said that the arrangement cast doubt on the arms-length nature of the transaction, since it permitted one of the two parties to the joint venture to defer any actual investment in the venture until a later time.

¹⁶ *Id.* Mr. Patrick reaffirmed this information in his Subcommittee interview. The key Andersen employee involved in the Fishtail and Sundance transactions, Thomas Bauer, refused to be interviewed by the Subcommittee prior to the hearing to explain either his role or Andersen’s understanding of the two transactions.

¹⁷ “Amended and Restated Limited Liability Company Agreement of Fishtail LLC” (12/19/00), Clause 4.02, Bates SENATE ANNA 00081. See also “Fishtail LLC Formation/Securitization,” Andersen memorandum by Tom Bauer and Kate Agnew (12/29/00), Bates AASCGA 008673.1 (“Our preference would be to have the amount computed pursuant to the 4 to 1 test to be fully funded upon formation but would not insist since the 4 to 1 test is not mandatory in the literature.”). Mr. Patrick substantiated this account in his Subcommittee interview.

¹⁸ “Amended and Restated Limited Liability Company Agreement of Fishtail LLC” (12/19/00), Clause 4.02, Bates SENATE ANNA 00081. See also “Project Grinch,” summary memorandum by Chase (12/16/00), Bates SENATE ANNA 00397-99 (“It is expected that the commitment will be unfunded.” is stated in bold type in the first paragraph of this memorandum.).

¹⁹ See Chase Securities letter to Enron (12/20/00), SENATE ANNA 00360-61. See also Traband interview and Subcommittee interview with Eric Peiffer (12/4/02)(hereinafter “Peiffer interview”).

²⁰ LJM2 documents show that LJM2 had expected to receive a 15 percent return on its Annapurna investment and to be taken out of the Fishtail transaction within 6 months. See, for example, “LJM2 Investment Summary” (12/20/00), Bates LJM 029881-4. While one Enron employee maintained in a Subcommittee interview

Analysis. The Fishtail transaction was, at its core, a sham joint venture which pretended to have more than one investor, but, in fact, relied solely on Enron. The primary goal of the transaction was to create an appearance of Enron's moving its pulp and paper trading business from an in-house operation to a separate joint venture so that Enron could eliminate the assets from its balance sheet. A secondary goal was to fix a market value to the transferred assets in preparation for their "sale" a week later.

The evidence shows that Fishtail did not qualify for off-balance sheet treatment and should have been consolidated with Enron. Enron's counter party in the joint venture, Annapurna, functioned as a shell operation designed to create the appearance but not the reality of a second investor. Annapurna had no employees, no bank account, and no purpose or activities apart from its passive investment in Fishtail.

Annapurna was allegedly capitalized by LJM2 and Chase. But LJM2's related party status, due to its close Enron ties and the ownership and control exercised by Enron's chief financial officer, Andrew Fastow,²¹ disqualified LJM2 from providing the "independent" equity investment necessary to an unconsolidated SPE or joint venture.²² In addition, Mr. Fastow's pending criminal indictment alleges that Enron, on more than one occasion, used LJM2 "to manufacture earnings through sham transactions" and that Enron had an "undisclosed agreement" with Mr. Fastow to ensure that LJM2 did "not lose money in its dealings with Enron."²³ This undisclosed agreement, if it existed, meant that LJM2's investment in Annapurna was never truly at risk since, in essence, Enron had guaranteed it would not suffer any loss from an Enron venture. Chase's \$42 million commitment also failed to place any funds at risk, since it was never funded or drawn upon and functioned under arrangements which made its use highly unlikely. As one finance expert put it, "Chase never really had any skin in the game."

If Chase's unfunded commitment were disregarded, then Annapurna's capitalization and contribution to Fishtail totals \$8 million in cash, well short of the Andersen 4:1 capitalization guidelines for unconsolidated joint ventures. In addition, if the \$8 million was neither independent nor at risk due to LJM2's related party status and undisclosed agreement with Enron, Annapurna collapses as an SPE, and Fishtail fails to meet its requirement for a minimum 3

that the 15 percent return was the maximum that LJM2 was entitled to receive on the joint venture, and not a guaranteed minimum return, the LJM2 documentation and similar minimum fee arrangements between Enron and LJM2 in other investments, suggest the final amount paid to LJM2 was more than coincidence. See, for example, 15 percent fee arrangement in the Nigerian barge transaction examined at the Subcommittee's July 30 hearing; Patrick interview.

²¹ See Subcommittee report, "The Role of the Board of Directors in Enron's Collapse," S. Prt. 107-170 (7/8/02), at 23-35.

²² See EITF Abstracts, Topic D-14, "Transactions Involving Special Purpose Entities."

²³ United States v. Fastow, (USDC SDTX, Cr. No. H-02-0665), Indictment (10/31/02) at paragraphs 19 and 22.

percent at-risk investment. In either situation, Fishtail should have been consolidated with Enron.

Additional issues are raised by the \$200 million valuation placed on Enron's pulp and paper trading business when it was contributed to Fishtail. This \$200 million figure was more than double the market value of the one "hard asset" carried on Enron's own books, the remaining assets were "soft assets" that Enron itself was cautious about using to establish the value of a joint venture contribution, and the only "independent" asset valuation was performed by a Chase affiliate.

By participating in Fishtail, Chase helped Enron move its pulp and paper trading business off balance sheet and establish a generous market value for the transferred assets. Chase never actually invested any funds in Fishtail or took any active role in the business, yet was paid half a million dollars for pretending to provide the bulk of financing for this so-called joint venture.

BACCHUS

The Facts. The second transaction, Bacchus, took place one week after Fishtail, on or about December 26, 2000. Enron used the Bacchus transaction to declare that a \$200 million asset "sale" had taken place and record a \$112 million "gain" on its 2000 financial statements.

Enron's primary goal in Bacchus was to "monetize" its interest in its pulp and paper trading business so that it could record additional income and cash flow from the "sale" of this business venture on its financial statements.²⁴ The Fishtail transaction took the first step by purporting to move Enron's pulp and paper trading business to a separate joint venture off Enron's books. Once Fishtail was complete, Enron took the next step, in Bacchus, to "sell" its Fishtail investment to an allegedly independent third party so that it could record the cash flow and income on its books.

Enron reasoned that its ownership interests in Fishtail²⁵ qualified as a "financial asset" that could be sold and accounted for under Statement of Financial Accounting Standards (SFAS)

²⁴ See "Transaction Descriptions," Enron document (undated), Bates EC2 000009786-87; Patrick interview; "Fishtail LLC Formation/Securitization," Andersen memorandum by Thomas Bauer and Kate Agnew (12/29/00), Bates AASCGA 008673.1-4.

²⁵ Enron and LJM2 had agreed on three classes of ownership interests in the Fishtail joint venture. Class A interests, owned by Enron, conveyed the right to exercise management control over the joint venture and the right to 0.1 percent of the "economic interests" in Fishtail. Class B interests, owned by Ammapurna, conveyed the right to 20 percent of the "economic interests" in Fishtail. Class C interests, owned by Enron, conveyed the right to 79.9 percent of the "economic interests" in Fishtail. See "Fishtail," a summary of the Fishtail transaction by Deloitte & Touche, LLP, executed in conjunction with the Powers Report, Bates DT 000376-000403. Presumably, by "economic interests" the parties meant the profits or losses sustained by the joint venture.

140.²⁶ SFAS 140 has typically been applied to the sale of financial assets such as pools of mortgages or receivables that have been securitized and transferred to an SPE.²⁷ To avoid consolidation, the SPE purchasing the financial assets must have a minimum outside equity investment which represents at least 3 percent of the SPE's total capital and which must remain genuinely at risk.²⁸

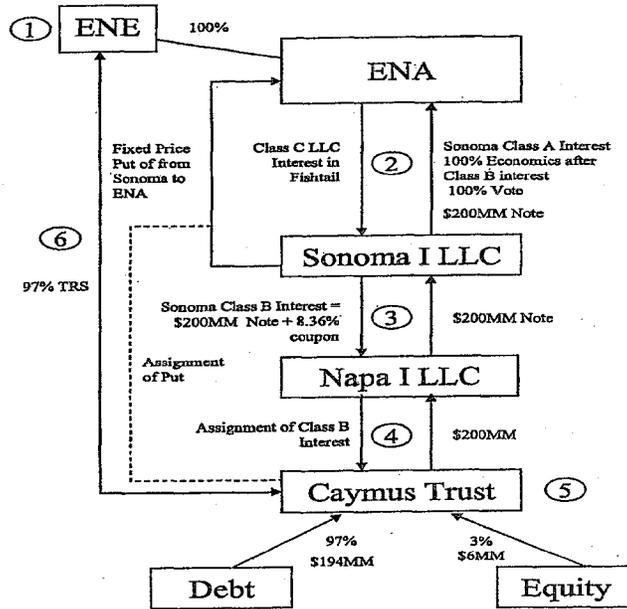
Within one week of forming Fishtail, Enron "sold" its Class C ownership interest in Fishtail for \$200 million to an SPE it had formed called the Caymus Trust. This transaction, which Enron called Bacchus, is illustrated in the following Figure 2.

²⁶ SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities," is a statement of accounting standards issued by the Financial Accounting Standards Board (FASB), an organization designated by the Securities and Exchange Commission (SEC) to develop, promulgate, and interpret generally accepted accounting principles for U.S. business. SFAS 140 superceded and replaced SFAS 125. Enron's reliance on SFAS 140 in this transaction is documented, for example, in a Citigroup draft analysis of the transaction, "Capital Markets Approval Committee: Enron Corp. Project Bacchus FAS 125 Transaction" (12/1/00), Bates CITI-SPSI 012895. Enron engaged in numerous transactions under SFAS 140 and its predecessor SFAS 125, collectively involving more than \$1 billion. See "Finance Related Asset Sales: Prepays and 125 Sales" (presentation to the Finance Committee of the Enron Board of Directors, 8/01), Exhibit 42 in the Subcommittee hearing, "The Role of the Board of Directors in Enron's Collapse" (5/7/02). See also "First Interim Report of Neal Batson, Court-Appointed Examiner," *In Re Enron Corp.*, Case No. 01-16034(AJG) (Bankr. SDNY, 9/21/02).

²⁷ Unlike other asset sales, SFAS 140 has been interpreted to allow the seller of the financial asset to retain a significant degree of control over the asset, even after its securitization and transfer to the SPE. For example, a financing company that routinely issues and acquires car loans may continue to manage and collect payments on these car loans even after pooling them and selling the rights to the cash flow to an SPE in an SFAS 140 transaction. Enron analogized that, in an SFAS 140 transaction, it could sell its Fishtail interests to an SPE, while continuing to exercise control over its pulp and paper trading business even after the sale.

²⁸ See footnote 13. FASB is currently in the process of revising certain SPE accounting standards and, among other changes, may increase the required minimum outside equity for an unconsolidated SPE from 3 to 10 percent. See FASB Exposure Draft, "Consolidation of Certain Special-Purpose Entities" (June 28, 2002).

Figure 2: Bacchus



Source: Diagram of the Bacchus transaction, Bates ECa000196027

The Caymus Trust was established by Enron as a Delaware business trust.²⁹ The Caymus Trust was capitalized with a \$194 million loan from Citigroup and a \$6 million equity “investment” from FleetBoston Financial provided through an off-balance sheet entity it had

²⁹ See “Data Sheet Reprint ... Caymus Trust (c/o Wilmington Trust)” (2/22/02), Bates ECa 000009793.

established called Long Lane Master Trust IV.³⁰ The \$194 million represented 97 percent of the Trust's total capitalization, while the \$6 million represented the required minimum 3 percent outside equity investment. Although FleetBoston appeared to carry the risk associated with the \$6 million equity investment, in fact, the risk had been conveyed to Citigroup through a total return swap.³¹ This arrangement meant that Citigroup was responsible not only for the \$194 million loan it had issued to the Caymus Trust, but also for the \$6 million cash investment ostensibly made by FleetBoston.³²

Enron, in turn, reduced Citigroup's risk in the Bacchus transaction by entering into a total return swap with Citigroup to provide credit support for the \$194 million loan.³³ Under this total return swap, Enron effectively pledged to make Citigroup whole for any decline in value of the Fishtail assets should those assets be needed to repay the loan.³⁴ In effect, Enron had guaranteed the \$194 million loan.³⁵ In an interview, Enron personnel explained to the Subcommittee that Andersen had approved its interpreting SFAS 140 as allowing Enron to guarantee the debt financing associated with the Caymus Trust.³⁶ Andersen instructed that similar credit support could not be provided by Enron for the \$6 million outside equity investment,³⁷ essentially because that support would mean that Enron would, in effect, be guaranteeing the entire purchase price, the purchaser of the assets would assume no risk from participating in the transaction, and the asset transfer would, therefore, no longer qualify as a "sale" under SFAS 140.

³⁰ Citigroup and FleetBoston worked together on at least one other set of Enron transactions, the Yosemite prepaids, which also made use of Long Lane Master Trust IV. For more information, see the July 23 hearing, "Testimony of Robert Roach, Chief Investigator, Permanent Subcommittee on Investigations," Appendix D, at pages D-10 and D-11.

³¹ Email by Citigroup employee James Reilly (11/28/00), Bates CITI-SPSI 0118432; Subcommittee interview with Citigroup employees Richard Caplan (11/21/02) and William Fox (11/22/02). A total return swap is a derivative transaction in which one party conveys to the other party all of the risks and rewards of owning an asset without transferring actual legal ownership of that asset.

³² According to explanations provided by Citigroup employees during their Subcommittee interviews, Citigroup used FleetBoston in the Bacchus transaction because its initial analysis led it to believe that owning both the debt and equity in Caymus Trust would raise regulatory issues. By the time Citigroup realized that these issues would not arise, the transaction was nearly completed and Citigroup decided not to change the structure.

³³ See "Project Bacchus," diagram of Bacchus transaction (undated), Bates ECA 000196027; "Global Loans Approval Memorandum," (12/11/00), Bates CITI-SPSI 0015991-95.

³⁴ Conversely, the total return swap also entitled Enron, in effect, to retain any increase in value of the Fishtail assets, should that occur.

³⁵ By using a total return swap instead of a loan guarantee, Enron avoided having to disclose the guarantee in its financial statement footnotes.

³⁶ Patrick interview.

³⁷ See series of Andersen emails, (11/30/99), Bates AASCGA 001133.1-3.

Although Enron was barred by accounting standards from doing so, the Subcommittee uncovered documentary evidence indicating that Enron had also guaranteed the \$6 million equity “investment” in the Caymus Trust. Enron provided this guarantee by making an undisclosed oral agreement with Citigroup to ensure repayment of the \$6 million. The key internal Citigroup memorandum seeking final approval of the Bacchus transaction from the Citigroup Credit Committee makes multiple references to the existence of this oral agreement.³⁸ The memorandum describes the Bacchus credit “facility” being requested as consisting of two parts: a “loan” and an “equity” contribution. The memorandum states: “The equity component we provide will be based on verbal support as committed by Andrew S. Fastow ... to Bill Fox [of Citigroup].” It also states that the “equity portion of the facility” involves “a large element of trust and relationship rationale” but “this equity risk is largely mitigated by verbal support received from Enron Corp. as per its CFO, Andrew S. Fastow.” At another point, the memorandum states: “Enron Corp. will essentially support the entire facility, whether through a guaranty or verbal support.”³⁹

During an interview with Subcommittee staff, one senior Citigroup official who played a key role in securing final approval of the deal denied that Enron had verbally guaranteed the equity “investment.”⁴⁰ Yet he confirmed that, prior to the closing of the deal, he traveled to Enron in Houston and met with Mr. Fastow to obtain Enron’s “verbal support” for the equity investment. He also told the Subcommittee that Mr. Fastow assured him that Enron would take “whatever steps necessary” to ensure Citigroup would not suffer any loss related to the \$6 million.⁴¹ Later, the same senior official sent an email to Citigroup’s risk management team stating that Citigroup had obtained a “total return swap from Enron” for the debt financing and “verbal support for the balance,” meaning the \$6 million.⁴²

The evidence shows that Enron had, in effect, guaranteed 100 percent of the debt and equity “investment” in the Caymus Trust, and both Enron and Citigroup knew it. Enron’s 100 percent guarantee of the Caymus Trust investments meant that the Caymus Trust had incurred no

³⁸ “Global Loans Approval Memorandum,” (12/11/00), Bates CITI-SPSI 0015991-95.

³⁹ See also “Executive Summary” of certain Citigroup transactions with Enron (undated), Bates CITI-SPSI 0128927 (“Bacchus/Caymus Trust Facility—Citibank has been asked to approve and hold this \$250MM facility consisting of Notes and Certificates. ... The Notes (\$242.5MM) will be supported by a total return swap with Enron Corp as the credit risk. The Certificates are supported by verbal support obtained by Bill Fox from Andy Fastow, Enron Corp’s Chief Financial Officer.”)

⁴⁰ Fox interview.

⁴¹ *Id.*

⁴² Email from Mr. Fox to Citigroup employee Thomas Stott (4/18/01), Bates CITI-SPSI 0085843. Still another Citigroup email, written two days after the Bacchus deal closed, stated: “The equity component has been approved on the basis of verbal support verified by Enron CFO, Andy Fastow.” Email from Citigroup employee Lydia Junek to Mr. Fox (12/21/00), Bates CITI-SPSI 0128944-45.

risk in transferring the \$200 million to Enron to “purchase” the Fishtail assets, because Enron itself had guaranteed repayment of the full amount. The absence of risk meant the asset transfer did not qualify as a “sale” under SFAS 140, and Enron should not have booked either cash flow from operations or a reportable gain from this transaction. Instead, Enron should have treated the \$200 million as a loan from Citigroup and booked the funds as debt and cash flow from financing.

Nevertheless, immediately upon completing the December “sale” of its Class C Fishtail interests to the Caymus Trust, Enron declared an additional \$200 million in cash flow from operations as well as a \$112 million gain in income on its year-end 2000 financial statements.⁴³

Citigroup internal documentation shows that Citigroup participated in the Bacchus transaction in part as an accommodation to Enron. One email from November 2000 describes the Bacchus transaction as follows: “For Enron, this transaction is ‘mission critical’ (their label not mine) for [year-end] and a ‘must’ for us.”⁴⁴ Another email dated a week after the deal closed states with respect to Bacchus: “Sounds like we made a lot of exceptions to our standard policies, I am sure we have gone out of our way to let them know that we are bending over backwards for them. . . let’s remember to collect this iou when it really counts.”⁴⁵ Another document advocating participating in several Enron transactions states: “Given the breadth of our relationship with the company we have been told by Enron that it is important that we participate in these strategic initiatives,” including Bacchus.⁴⁶ Another email a few months later discussing Bacchus and other pending deals observes: “Enron generates substantial GCIB revenue (\$50mm in 2000); any decision to limit/reduce credit availability will significantly reduce revenues going forward both at Cit and SSB and permanently impair the relationship.”⁴⁷

The evidence also indicates that, early on, Citigroup became aware that Enron might use the Bacchus transaction to improve its financial statements. Emails over time show Citigroup personnel were aware, for example, that Enron might use Bacchus to reduce debt and generate cash flow from operations on its financial statements, but Citigroup asserts its personnel were unaware that Bacchus would generate material earnings for Enron. One Citigroup email in

⁴³ See Enron’s 10-K SEC filing for 2000. Enron apparently calculated the \$112 million gain by subtracting \$88 million from the \$200 million “sale” price. This \$88 million was apparently the “basis” Enron claimed for its Class C ownership interest in Fishtail. See “3% Test and Gain Calculation,” Andersen document (11/17/01), Bates AASCGA 002454.6. See also footnote 10.

⁴⁴ Email from Citigroup employee James Reilly to other Citigroup employees (11/28/00), Bates CITI-SPSI 0129017.

⁴⁵ Email from Citigroup employee Steve Wagner to Citigroup employee Amanda Angelini, with copies to Mr. Caplan and others (12/27/00), Bates CITI-SPSI 0119009.

⁴⁶ “Executive Summary,” Citigroup document (undated), Bates CITI-SPSI 0128937.

⁴⁷ Email from Mr. Fox to Citigroup employee Thomas Stott (4/18/01), Bates CITI-SPSI 0085843.

November 2000, states that “Enron’s motivation” in Bacchus “now appears to be writing up the asset in question from a [cost] basis of about \$100 [million] to as high as \$250 [million], thereby creating earnings.”⁴⁸ This email also states a “concern” about “appropriateness since there is now an earnings dimension to this deal, which was not there before.”

Another Citigroup email a month later states that the Bacchus transaction was “designed” in part to “ensure that Enron will meet its [year-end] debt/cap[italization] targets”; it was “probable” the transaction would “add to [funds flow from operations]” on Enron’s financial statements; and “possible, but not certain, that there will be an earnings impact.”⁴⁹ An email two days later calculates that the \$200 million would represent more than ten percent of the cash flow and net income Enron had reported in 1999 and was likely to report in 2000.⁵⁰ An email in response states: “Based on 1999 numbers would appear that Enron significantly dresses up its balance sheet for year end; suspect we can expect the same this year.”⁵¹ While two of the December emails predict any earnings from the Bacchus transaction were likely to be immaterial, Citigroup personnel agreed in Subcommittee interviews that the \$112 million in extra earnings finally reported was material even to a company as large as Enron.⁵² Citigroup denied knowing at the time, however, that Enron had actually recorded these additional earnings on its 2000 financial statements.

In interviews with the Subcommittee staff, Citigroup executives involved in the Bacchus transaction stated that when a structured finance transaction has features suggesting that a client might be using the transaction to manufacture earnings on its financial statements, it creates an “appropriateness issue” which generally requires a greater degree of review and due diligence within the investment bank.⁵³ When asked whether the necessary appropriateness review took place in Bacchus, one Citigroup official stated that “further investigation” was warranted since the emails indicated that Citigroup had not clarified whether Enron was, in fact, going to claim earnings from the transaction and, if so, how much. He also indicated that he was unaware of any additional action taken to examine the earnings or other financial statement implications of

⁴⁸ Email from Citigroup employee Steve Baillie to Mr. Fox (11/24/00), Bates CITI-SPSI 0119040.

⁴⁹ Email from Citigroup employee James Reilly to Mr. Caplan, Mr. Fox, and others (12/6/00), Bates CITI-SPSI 0119046.

⁵⁰ Email from Citigroup employee Shirley Elliott to Mr. Fox (12/13/00), Bates CITI-SPSI 011906 (“In terms of total balance sheet size, it appears that Bacchus is immaterial; however, the \$200 million represents 16.3% and 22.4% of operating cash flow and net income, respectively [for 1999, and] ... 11.6% of cash EBITDA ... [for 2000].”) This analysis assumes a zero basis.

⁵¹ Email from Mr. Fox to Shirley Elliott (12/13/00), Bates CITI-SPSI 0128912.

⁵² Caplan interview; Fox interview.

⁵³ Caplan interview; Fox interview. These Citigroup executives also indicated that Citigroup typically does not get involved in structured transactions that have an earnings impact, with the exception of transactions generating tax benefits.

the transaction. The Subcommittee has not found, and Citigroup has not provided, any evidence establishing that Citigroup undertook any additional appropriateness review to gauge Enron's potential use of Bacchus to generate earnings.

In fact, the Bacchus figures significantly improved Enron's 2000 financial statements. The \$112 million gain represented more than 11 percent of Enron's total net income for the fiscal year, while the \$200 million in cash flow represented about 6 percent of Enron's total cash flow from operations for the year.⁵⁴ These figures suggest that, had the Fishtail and Bacchus transactions failed to close, Enron would likely have failed to meet Wall Street's earnings projections for the year, and the company's share price would have suffered.

Citigroup was paid a \$500,000 fee for its participation in Bacchus, earned \$5 million in interest payments related to the \$200 million debt, and obtained another \$450,000 yield related to the \$6 million "equity investment."⁵⁵

Analysis. Even more than Fishtail, the Bacchus transaction was steeped in deceptive accounting, if not outright accounting fraud. The evidence shows that Enron guaranteed both the debt and equity "investment" in the Caymus Trust, thereby eliminating all risk associated with the "sale" of the Fishtail assets to the Trust. Without risk, the transaction fails to qualify as a sale under SFAS 140. The fact that Enron's guarantee of the \$6 million equity "investment" was never placed in writing, but was kept as an oral side agreement with Citigroup, demonstrates that both parties understood its significance and potential for invalidating the entire transaction. Citigroup nevertheless proceeded with the deal, knowing that a key component, Enron's guarantee of the \$6 million, rested on an unwritten and undisclosed oral agreement.

Citigroup was also aware that Enron was likely to use the Bacchus transaction to improve its financial statements through added cash flow and perhaps added earnings, but did not sufficiently confront this issue either internally or by asking Enron for more information. In the end, Citigroup not only participated in the Bacchus deal, it supplied the funds needed for Enron to book the \$200 million in extra cash flow from operations and \$112 million in extra net income on its 2000 financial statements. Without Citigroup's complicity and financial resources, Enron would not have been able to complete the deal and manipulate its financial statements to meet Wall Street expectations for its 2000 earnings.

⁵⁴ According to its 10-K filing with the SEC, Enron's total net income for 2000 was \$979 million. Using this filing and other information, the Subcommittee estimated Enron's total funds flow from operations in 2000 at about \$3.248 billion. See July 23 hearing, "Testimony of Robert Roach, Chief Investigator, Permanent Subcommittee on Investigations," Appendix A, at page A-4.

⁵⁵ "Global Loans Approval Memorandum," (12/11/00), Bates CITI-SPSI 0015991-95; information supplied by Citigroup to the Subcommittee.

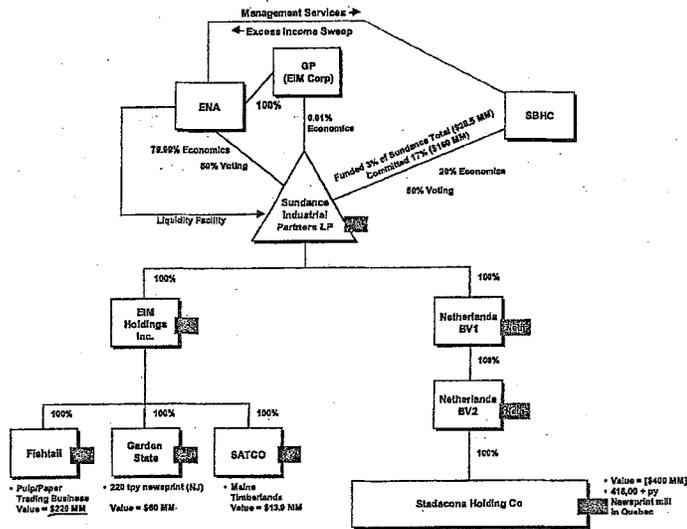
SUNDANCE

The Facts. The third transaction, Sundance, took place six months after Bacchus. Fishtail and Bacchus had been constructed as short term arrangements⁵⁶ intended to enable Enron to move its pulp and paper trading business off-balance sheet and recognize income and cash flow from this business venture prior to the end of the fiscal year. Sundance Industrial Partners ("Sundance") was allegedly established to create a more long-term off-balance sheet entity which Enron could use to hold and manage all of its pulp and paper business assets. Like Fishtail, however, Sundance provided the appearance but not the reality of having more than one investor, and should have been consolidated on Enron's balance sheet.

Sundance was constructed as a 50-50 joint venture between Enron and Citigroup, to be capitalized at a 4:1 ratio in accordance with Anderson's joint venture guidelines. Figure 3 is a diagram of the Sundance structure.

⁵⁶ The \$194 million loan in Bacchus, for example, had a one-year maturity date. See "Global Loans Approval Memorandum," (12/11/00), Bates CITI-SPSI 0015991-95. LJM2's investment in Fishtail was intended to end after six months or trigger higher costs. "LJM2 Investment Summary" (12/20/00), Bates LJM 029881-4.

Sundance Structure



Source: Diagram of Sundance transaction, Bates ECa000169834

Enron contributed the following assets to the Sundance joint venture: a Canadian paper mill known as Stadacona; a New Jersey paper mill known as Garden State Paper; timberland located in Maine and known as SATCO; a \$25 million liquidity reserve for ongoing administrative expenses; a \$65 million commitment to service debt and capital expenditures; and \$208 million in cash.⁵⁷ The total value of Enron's contribution was approximately \$750 million.

⁵⁷ See "Sundance Steps" (6/1/01), Bates CITI-SPSI 0128886.

Citigroup, in turn, appeared to contribute \$8.5 million in cash,⁵⁸ certain shares valued at \$20 million,⁵⁹ and \$160 million in an “unfunded capital commitment.” Citigroup, thus, appeared to contribute assets totaling approximately \$188.5 million to meet the Andersen joint venture capitalization guidelines.⁶⁰

Upon receiving the contributions from Enron and Citigroup, Sundance immediately used the \$208 million cash provided by Enron to buy Enron’s prior Fishtail interests from the Caymus Trust.⁶¹ The Caymus Trust then used these funds to pay off its \$194 million loan from Citigroup

⁵⁸ The \$8.5 million was immediately used by Sundance to purchase Annapurna’s Class B 20-percent economic interest in Fishtail. All of these monies were apparently paid to LJM2, enabling LJM2 to recoup its \$8 million capital contribution to Annapurna and, when combined with an earlier \$350,000 fee, earn an overall return of 15 percent on its Fishtail investment. See “Sundance Steps,” Enron document (5/16/01), Bates ECa 000022315; “Structuring Summary: Project Grinch,” Chase document (12/16/00), Bates JPM-1-00437.

⁵⁹ The shares conveyed ownership of an SPE called Sonoma, LLC whose sole asset consisted of Enron’s Class A interest in Fishtail, which Enron had retained during the Bacchus transaction. The Class A interest essentially conveyed management control over Enron’s pulp and paper trading business. Just prior to contributing the shares to Sundance, Citigroup purchased them from Enron for \$20 million. Enron immediately reported the \$20 million in “sales” revenue on its second quarter 2001 financial statements. The evidence suggests that the \$20 million transaction was executed solely to allow Enron to book the additional \$20 million. Initially, Enron’s outside counsel, Vinson and Elkins, had declined to issue a legal opinion characterizing the Sonoma stock transfer to Citigroup as a “true sale,” since Citigroup had avoided all risk associated with the shares by immediately contributing them to Sundance. To satisfy Vinson and Elkins, Citigroup entered into a derivative transaction with Sundance which, in part, allowed Sundance to sell the shares back to Citigroup within a certain period of time. After this derivative was put in place, Vinson and Elkins issued a “last minute true sale opinion” allowing Enron to book the sale. See “Enron Industrial Markets Finance Presentation of Sundance Industrial Partners,” Enron document, (6/1/01), Bates ECa000169835. An internal Citigroup email indicates that Citigroup itself did not intend to take on any real risk by participating in the derivative transaction: “Spoke with the client. They intend and expect to close tomorrow whether the put issue is resolved or not. They fully understand that we will blow the deal up if we are at risk for the put” Email from Citigroup employee Doug Warren to Mr. Caplan (5/29/01), Bates CITY-SPSI 0123901.

Although Vinson and Elkins viewed the derivative transaction as sufficient to put Citigroup at risk for the Sonoma shares, other terms in the Sundance partnership agreement – which Vinson and Elkins helped draft – explicitly authorized Citigroup to unilaterally dissolve the partnership at any time, prior to incurring any loss. See email by Mr. Caplan to Mr. Fox, with attachments (10/29/01), Bates CITY-SPSI 0127648. Vinson and Elkins knew or should have known that this partnership language insulated Citigroup from any true risk of loss in its Sundance investments. Vinson and Elkins nevertheless issued the true sale opinion allowing Enron to record the \$20 million gain from the Sonoma share transfer.

⁶⁰ The \$188.5 million was intended to provide the minimum 20 percent capital contribution required by the Andersen 4:1 capitalization guidelines for 50-50 unconsolidated joint ventures. The \$28.5 million in cash and stock was intended to provide the minimum 3 percent capital-at-risk required by the Andersen guidelines.

⁶¹ This \$208 million “purchase” of the Class C Fishtail interests, when considered in conjunction with Sundance’s “purchase” of the Class B Fishtail interests for \$8.5 million and Class A Fishtail interests for \$20 million, appears to mean that, as of June 2001, Enron and Citigroup paid a total of \$236.5 million for Enron’s pulp and paper trading business. But see “Sundance Structure,” Citigroup document (undated), Bates CITY-SPSI 0044992 (valuing Fishtail at \$228.5 million). Both figures represent a significant increase over the \$200 million

and return the outstanding \$6 million equity “investment,” thereby eliminating all remaining risk for Citigroup associated with the Bacchus transaction.⁶² The \$208 million payment also included a \$1.5 million payment to the Caymus Trust that was apparently passed along to Citigroup for alleged “breakage costs,” presumably due to early repayment of the \$194 million loan.⁶³ In essence, then, six months after receiving \$200 million from the Caymus Trust – all of which had been financed by Citigroup – and using the money to book cash flow and earnings on its 2000 financial statements, Enron returned \$200 million to Citigroup via the Sundance joint venture.

The evidence suggests that Citigroup agreed to participate in Sundance only after, contrary to accounting principles, the joint venture was structured to ensure that none of Citigroup’s funds were actually at risk and none of its expected returns depended upon the risks and rewards of the joint venture. Citigroup protected its “investments” from loss in several ways. First, under the partnership agreement, Citigroup obtained unilateral authority to dissolve the Sundance partnership at any time and force its liquidation before Enron could draw upon any Citigroup funds.⁶⁴ This unilateral authority meant, in effect, that as long as Citigroup monitored the Sundance transaction and acted promptly to dissolve the partnership, it could protect itself against any loss.

In addition, the partnership agreement required Sundance to maintain at all times \$28.5 million in Enron notes or other high quality, liquid financial instruments to which Citigroup was given preferred access.⁶⁵ These liquid financial instruments were explicitly segregated and set aside to ensure repayment, with a specified return, of Citigroup’s \$8.5 million cash contribution and \$20 million share contribution to the partnership. In addition, the partnership agreement provided that Enron had to exhaust its Sundance investments before any of Citigroup’s \$28.5 million in cash and stock could be used.

Citigroup’s \$160 million “unfunded” capital commitment also operated under multiple protections making it unlikely ever to be used. Under the partnership agreement, Citigroup’s funding commitment could be called on only after the partnership incurred GAAP losses in

value assigned to this business just six months earlier. This increased value was assigned to Enron’s trading business during a period in which many internet-based businesses were falling in value.

⁶² “Sundance Steps,” Enron document (5/16/01), Bates ECa000022315.

⁶³ *Id.*

⁶⁴ The Sundance partnership agreement authorized Citigroup, at its discretion, to invoke the creation of a board of directors and appoint two of the four members. “Sundance Partnership Agreement” (06/01/01), at 52-53, Bates CITI-SPSI 0016044. If this board were to “Deadlock,” it would be considered a “dissolution event” and the partnership would automatically dissolve. *Id.* at 6, 61; see also “Description of the Sundance Transaction,” Citigroup document, (10/29/01), Bates CITI-SPSI 0127648.

⁶⁵ See “Description of the Sundance Transaction,” Citigroup document (10/29/01), Bates CITI-SPSI 0127648.

excess of \$657 million, Enron exhausted its \$65 million debt and capital reserve and \$25 million liquidity reserve, and the \$28.5 million in liquid financial instruments were cashed in. Again, these arrangements meant that Sundance would have to lose almost \$750 million – Enron’s entire investment – before any loss could be repaid from Citigroup’s “contributions.” Enron highlighted these features of the Sundance agreement in a September 2001 presentation to Citigroup, describing it as “SBHC’s Cushion.”⁶⁶ Citigroup was told that it could wait until the entire “cushion” was absorbed before dissolving Sundance to avert any losses.

Citigroup internal documents repeatedly described its Sundance investment as protected from risk. One of Citigroup’s primary negotiators on Sundance put it this way:

“The transaction is structured to safeguard against the possibility that we need to contribute our contingency fund and to ensure that there is sufficient liquidity at all times to repay our \$28.5 million investment.”⁶⁷

Another Citigroup email stated, “our invest[ment] is so subordinated and controlled that it is ‘unimaginable’ how our principal is not returned.”⁶⁸ In addition, Citigroup arranged to receive fees and a specified return on its Sundance “contributions,” rather than share in any profits or increased value in the partnership, which means that its expected return was structured more like a return on debt than on an equity investment. In fact, although Citigroup internally classified its Sundance contribution as an “equity investment,” minutes of a meeting of the Citigroup Capital Markets Approval Committee (CMAC) considering the Sundance structure noted that, “based on the way the deal is structured, it is more like debt rather than equity.”⁶⁹ The final CMAC

⁶⁶ “Enron Industrial Markets Finance Presentation of Sundance Industrial Partners to Salomon Smith Barney,” (September 2001), Bates CITI-SPSI 0044993. SBHC refers to Salomon Brothers Holding Company. The presentation lists the risk mitigation mechanisms point by point, including: “Enron takes the first \$747m in US GAAP losses SBHC has the power to dissolve the partnership at will SBHC has adequate information to assess ongoing risk Daily trading loss cannot exceed \$5.5mm (6.7 months to erode cushion through trading losses) Sundance has enough liquidity to repay SBHC anytime.”

⁶⁷ Email from Mr. Caplan to Mr. Fox with attached Citigroup memorandum, “Description of the Sundance Transaction” (10/29/01), CITI-SPSI 0127647-49.

⁶⁸ Email between Citigroup employees Timothy Leroux and Andrew Lee (5/25/01), Bates CITI-SPSI 0044874. According to a Subcommittee interview with Mr. Richard Caplan (11/21/02), Citigroup was so convinced of the security of its investment and the lack of any real risk, that Citigroup decided not to purchase any default protection related to the Sundance transaction.

⁶⁹ “Capital Markets Approval Committee (CMAC) Minutes to Meeting” (5/16/01), Bates CITI-SPSI 0016030-31. See also email between Citigroup employees Amanda Angelini and Timothy Leroux (4/27/01), Bates CITI-SPSI 0044852 (listing reasons why Sundance “is more like debt than equity”).

approval memorandum stated: "The investment has been structured to act like debt in form and substance."⁷⁰

Given the lack of risk associated with Citigroup's Sundance "investment," Citigroup personnel repeatedly questioned Sundance's proposed off-balance sheet accounting. One Citigroup e-mail two weeks before the deal's closing noted: "[A Citigroup tax attorney] wanted to say that this is a funky deal (accounting-wise). He is amazed that they can get it off balance sheet."⁷¹ Another email from Citigroup's Global Energy and Mining group head in the Global Relationship Bank questioning several aspects of the transaction stated: "Also not clear to me how this structure achieves Enron's off balance sheet objectives. Do we have a full understanding of this aspect of the transaction?" A Citigroup official responded by writing: "On the accounting: [Andersen] has agreed that by maintaining an 80/20 split on ownership with equal voting they can achieve off b/s treatment. We have not advised nor opined on the accuracy of that. However, according to Rick Caplan, it is identical to what Dynegy did in the gas deal for abg gas."⁷²

Just prior to the closing for the Sundance transaction, three senior Citigroup officials strongly warned against proceeding with the deal, in part due to its "aggressive" accounting. The head of Citigroup's Risk Management team for the Global Corporate and Investment Bank stated in a memorandum sent to the head of the investment bank:

"This is a follow-up to our lunch conversation on the transaction for Enron. If you recall, this is a complex structured transaction, which I have refused to sign off on. Risk Management has not approved this

⁷⁰ "Capital Markets Approval Committee New Product/Complex Transaction Description Guidelines Enron Corp. Project Sundance Transaction" (5/15/01), Bates CITI-SPSI 0044830. See also email from Citigroup employee Paul Gregg, "Subject: Enron Exposure on NA Credit Derivs," (10/22/01), Bates CITI-SPSI 0123218 ("Note that these equity partnerships, are designed to act as debt exposure due to numerous triggers built in which allow us to terminate.").

⁷¹ Email from Citigroup employee Lynn Feintech to Mr. Caplan, "RE:cmac memo" (5/15/01), Bates CITI-SPSI 0122412.

⁷² Email exchange between Citigroup employees Mr. Fox and Ms. Feintech, "RE: Sundance," (5/16/01), Bates CITI-SPSI 0119011. This email exchange may contain a reference to Dynegy and an SPE it sponsored, ABS Gas Supply LLC. If so, the SEC has recently determined that Dynegy violated certain securities laws and accounting rules by failing to consolidate ABS Gas on its balance sheet. While not admitting any of the SEC findings on this or other unrelated matters, Dynegy agreed to entry of a cease and desist order in the case and paid a \$3 million penalty. See SEC v. Dynegy Inc., Civil Action No. H-02-3623 (USDC SDTX), Complaint (9/23/02), paragraphs 42-53.

transaction for the following reasons: ... The GAAP accounting is aggressive and a franchise risk to us if there is publicity (a la Xerox).⁷³

In an accompanying email, the head of Citigroup's Global Relationship Bank wrote:

"We ([the Global Energy and Mining group head] and I) share Risk's view and if anything, feel stock, and recovered this entire amount plus a return.⁷⁴ Citigroup also terminated its \$160 million funding commitment. Citigroup's actions showed that the partnership features had worked as intended to insulate its entire Sundance "investment" from loss.

For participating in Sundance more strongly than suitability issues and related risks when coupled with the returns, make it unattractive. It would be an unfortunate precedent if both GRB relationship management and Risk's views were ignored."⁷⁵

Despite these strongly worded warnings from senior personnel the transaction went forward on June 1, 2001. The final go-ahead came on the day after a key Citigroup employee working on the deal sent an email at 6:00 p.m. stating: "Any word? Am getting a significant amount of pressure from Enron to execute."⁷⁶ Another Citigroup email dated one month later reported: "[The head of the investment bank] was out of the country the day that transaction closed. The approval memo was ... faxed to him. [He] then had a conversation with [the Risk Management head], who shared with us [his] feedback. We proceeded to close the transaction that day, given the absence of in[s]tructions [from either person] to the contrary."⁷⁷

Citigroup has been unable to tell the Subcommittee who provided the final approval of the Sundance transaction. Although Citigroup internal policy requires signed management transaction approvals for transactions as large as Sundance, Citigroup could not locate any of the

⁷³ Citigroup memorandum by Mr. Bushnell, "Enron--Project Sundance Transaction," (5/30/01), Bates CITI-SPSI 0124615. The concerns expressed in the memorandum were raised internally five days earlier in draft form. See email from Citigroup employee Eleanor Wagner to Mr. Bushnell (5/25/01), Bates CITI-SPSI 0044872.

⁷⁴ *Id.* See also email from Mr. Caplan (11/30/01), Bates CITI-SPSI 0125273. Although the Sonoma shares Citigroup had contributed to Sundance had likely lost value in light of Enron's bankruptcy and Citigroup had allegedly assumed any risk of loss, Citigroup secured the full \$20 million that the shares had supposedly been worth when contributed five months earlier.

⁷⁵ Email from Citigroup employee Alan MacDonald to Citigroup employee Michael Carpenter, "FW:Memo on Enron--Project Sundance" (5/31/01), Bates CITI-SPSI 0124614.

⁷⁶ Email from Mr. Caplan to Shawn Feeny (5/31/01), CITI-SPSI 012894.

⁷⁷ Email from Citigroup employee Shawn Feeny to Citigroup employee Andrew Lee (6/29/01), Bates CITI-SPSI 0122944.

normal signed approvals.⁷⁸ In his interview, Citigroup's Risk Management head for the investment bank, who composed the strongly worded memorandum warning against proceeding with Sundance, stated that he was unable to recall virtually anything about his objections to the transaction, how his concerns were resolved, or who actually gave the final approval for the transaction. For example, he stated that he could not recall the specifics of his accounting concerns; whether he discussed his accounting concerns with the investment bank head, although he assumes he did; the reassurances he received on the accounting issues, although he assumes he received reassurances; whether he ever signed off on the transaction, although he assumes he did; or whether the investment bank head ultimately approved the project.⁷⁹

In any event, the Sundance transaction did close. When negative information about Enron began to emerge a few months later and questions began to arise about Enron's solvency, Citigroup invoked the Sundance agreement provisions protecting it from loss and actually terminated the Sundance partnership on or about November 30, 2001, five months after it was established and two days before Enron filed for bankruptcy.⁸⁰ At that time, Citigroup demanded that Enron buy out its Sundance interest for the \$28.5 million Citigroup had "contributed" in cash and ce, Citigroup was apparently paid upfront fees of \$725,000 as well as another \$1.1 million return on its \$28.5 million "investment."⁸¹ Citigroup also facilitated pre-payment of the \$194 million loan in Bacchus and received \$1.5 million in "breakage costs."

Analysis. Like Fishtail and Bacchus, the Sundance transaction involves deceptive accounting and sham investments. One key objective of the Sundance transaction was to keep Enron's pulp and paper assets off its balance sheet by placing them in a separate joint venture. But the lack of risk associated with Citigroup's so-called "investment" in Sundance indicates that this joint venture did not qualify for off-balance sheet treatment and should have been consolidated with Enron.

To qualify as an unconsolidated 50/50 joint venture, Sundance needed two investors contributing capital in accordance with the Andersen 4:1 joint venture capitalization guidelines. In addition, a minimum 3 percent of the total capitalization had to be an independent equity investment at risk for the duration of the joint venture. The evidence indicates, however, that none of Citigroup's Sundance investment was ever truly at risk in light of Citigroup's right to dissolve the partnership at will prior to any loss, and the additional safeguards provided for each

⁷⁸ See email exchange between Citigroup employees T. Leroux to A. Lee, "RE: Sundance Approvals," (6/6/01), Bates CITI-SPSI 0123806 ("Would you happen to have a copy of the management approvals for the sundance trade (The Firm Investments group needs it for the ir files.))" Response: "No ... was given a verbal go ahead Understand signed is to follow"). See also email from Mr. Fox to Mr. MacDonald (6/04/01), Bates CITI-SPSI 0124617 ("any feed back from Carpenter on Sundance; apparently the deal closed.")

⁷⁹ Bushnell interview (12/03/02).

⁸⁰ Caplan interview.

⁸¹ Information provided to the Subcommittee by Citigroup.

of its "investments." In the case of its \$160 million "unfunded commitment," Citigroup funds could be used only after Enron's entire \$750 million investment was exhausted. In the case of its \$28.5 million contribution of cash and stock, Enron's investment not only had to be exhausted beforehand, but also the \$28.5 million had to be kept in segregated, liquid financial instruments to which Citigroup had preferred access. In the end, none of Citigroup's funding commitment was actually used and all of its cash and stock contributions were returned on short notice, in cash, with interest. Without Citigroup's sham investment in Sundance, Enron would have had to consolidate this partnership on its balance sheet, include in its financial results all of the Sundance pulp and paper assets, and disclose to investors and financial analysts all of the debt associated with this business venture.

Senior Citigroup officials opposed participating in Sundance, calling its accounting "aggressive" and a "franchise risk." Just prior to the transaction's closing, three senior Citigroup officials warned against proceeding with it. The final go-ahead on the transaction was provided verbally by an unidentified Citigroup official. The final approval documents cannot be located.

Sundance's aggressive accounting troubled senior Citigroup officials who were analyzing the transaction on its own terms. But its aggressive nature deepens when Sundance, Bacchus, and Fishtail are analyzed as a whole. When viewed together, the three transactions result in a disguised six-month loan advanced by Citigroup to facilitate Enron's deceptive accounting. In effect, Enron borrowed \$200 million from Citigroup in December 2000; arranged for a shell company, the Caymus Trust, to use the funds to "purchase" the Fishtail assets for \$200 million, without disclosing that Enron was guaranteeing the full purchase price; used this sham sale to inflate its 2000 cash flow from operations by \$200 million and its earnings by \$112 million; and then quietly returned the \$200 million to Citigroup six months later via Sundance.³² This view of the three transactions as a disguised \$200 million loan is further strengthened by evidence indicating that Citigroup never truly placed any money at risk in the Bacchus or Sundance transactions, it profited from the transactions by obtaining fees and interest charges rather than equity rewards, and the \$200 million seems, in the end, to have been cycled through all three transactions for the sole business purpose of facilitating Enron's financial statement manipulation.

SLAPSHOT

The Facts. The fourth and final transaction, Slapshot, took place on June 22, 2001, soon after creation of the Sundance joint venture. Undertaken in connection with a loan to refinance a Canadian paper mill associated with Sundance, Slapshot was designed as a tax avoidance scheme

³² In fact, when setting up the mechanics of the Sundance transaction, Enron personnel cautioned Enron against muddying the timing by reacquiring its old Fishtail assets too soon. One internal Enron email instructed: "Fishtail CANNOT touch Enron's Balance Sheet before Sundance is deconsolidated." "Sundance Steps," Enron document (5/16/01), Bates ECa000022315.

that centered on utilizing a one-day, \$1 billion "loan" from Chase to generate approximately \$60 million (U.S.) in Canadian tax benefits, as well as \$65 million in financial statement benefits for Enron.⁸³

Enron first purchased the Canadian paper mill in March 2001 for about \$350 million.⁸⁴ Three months later, in June, Enron contributed the paper mill to the Sundance joint venture with the explicit understanding that Enron would soon be refinancing the purchase price.⁸⁵

Chase presented Enron with a refinancing proposal that would not only provide Enron with a loan from a consortium of banks to pay for the paper mill but also, at the same time, provide an Enron affiliate with significant Canadian tax benefits.⁸⁶ In exchange for \$5.25 million in fees, Chase provided Enron with access to its "proprietary" structured finance arrangement⁸⁷ utilizing a purported \$1 billion "loan" intended to be issued and repaid within a matter of hours. Although the \$1 billion "loan" was to be issued and repaid on the same day, the Slapshot structure was designed to enable Enron's Canadian affiliate to claim tax deductions and reap other Canadian tax benefits as if a real \$1 billion loan had been issued and remained outstanding. See Figure 4 for a diagram of the Slapshot structure.

⁸³ When Chase first presented the Slapshot structure to Enron, it projected Canadian tax benefits totaling \$125 million in U.S. dollars. "Results and Cash Flows," Chase document (undated), Bates SENATE FL-00939. When Enron performed its own analysis of potential tax savings using more conservative assumptions, it calculated that, over five years, Enron would obtain "a tax savings NPV of US\$60 million" and "net income improvement over the next five years of NPV US\$65 million." "Slapshot Savings," Enron document (undated), Bates ECA000195947. NPV means net present value.

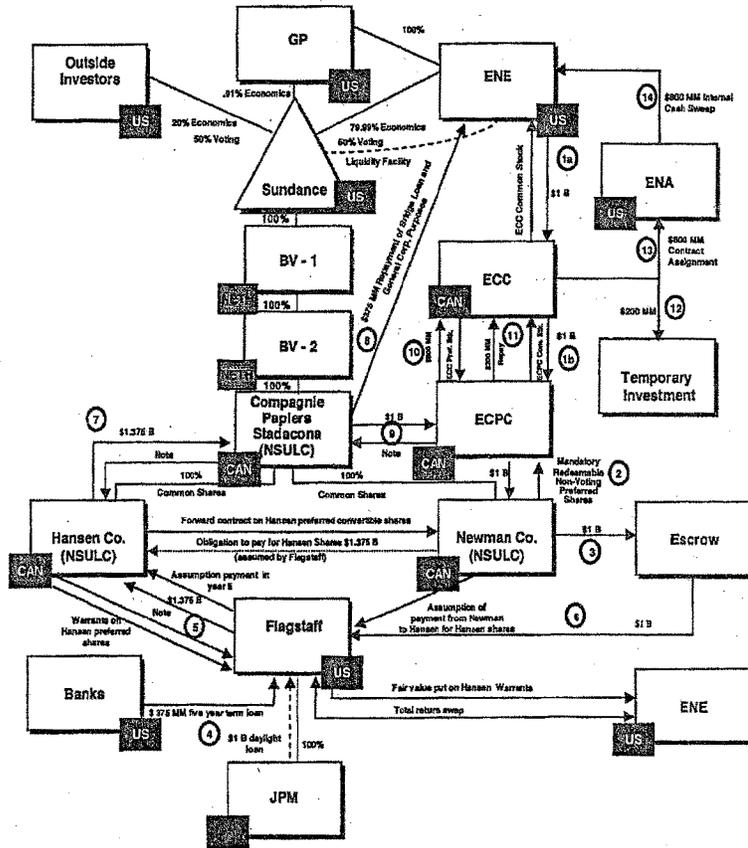
⁸⁴ Enron bought the mill, located in Quebec City, Canada, from Daishowa, Inc. and provided the initial financing. When purchased by Enron, the mill was named the Daishowa Forest Products paper mill; Enron renamed it Stadacona. According to a tax opinion letter, CPS had originally borrowed approximately \$346 million from Enron to purchase the Stadacona paper mill. The larger \$375 million loan amount in the Slapshot transaction was provided not only to refinance the mill's purchase price, but also to pay Enron a \$29 million "structuring fee." See tax opinion letter from Skadden, Arps, Slate, Meagher & Flom LLP And Affiliates ("Skadden Arps") to Enron Wholesale Services, (8/15/01), Bates EC2 000047056.

⁸⁵ Since Stadacona was a key joint venture asset, Citigroup demanded and was given the right to approve any refinancing arrangement to ensure that Enron did not encumber the asset. Enron accordingly informed Citigroup about the Slapshot structure, and Citicorp apparently registered no objection to Enron's participation in it. Enron also paid Citigroup a fee to reimburse it for the costs associated with Citicorp's analyzing the Slapshot structure.

⁸⁶ Since 2000, Enron had been working to design a tax structure that would enable it to use Canadian tax laws to generate tax deductions. Enron halted that effort when it decided to use the Chase structure. See email, with attachments, between Enron employees Stephen Douglas and Davis Maxey (12/11/00)(no Bates number), Enron disk produced to the Subcommittee; and Subcommittee interview with Stephen Douglas (12/3/02).

⁸⁷ A key Chase employee involved in Slapshot, Eric Peiffer, referred to it as a new "tax technology." Peiffer interview.

Figure 4: Slapshot



Source: Diagram of the Slapshot transaction, Bates ECA000195943

Chase provided Enron with a step-by-step description of how the Slapshot transaction was to be executed.⁸⁸ These instructions described a complex series of structured finance arrangements using shell corporations, fake loans, and complex funding transfers across international lines. They also showed how the \$1 billion in supposed loan proceeds would be repaid later the same day. Chase personnel actively assisted in planning and completing the specified steps in the Slapshot deal. The transaction itself actually took place on June 22, 2001.

The transaction involved a number of Chase and Enron affiliates and SPEs, a number of which were established specifically to facilitate the Slapshot deal. Chase established its key entity in the transaction, Flagstaff Capital Corporation ("Flagstaff"), as a wholly-owned SPE in Delaware. Chase also organized a bank consortium made up of itself and three other large banks to issue the \$375 million loan to refinance the paper mill.⁸⁹ Enron established Compagnie Papier Stadacona ("CPS") in Canada as the direct owner and operator of the Stadacona paper mill.⁹⁰

On June 22, Chase advanced the bank consortium's \$375 million loan to Flagstaff to be repaid in five years and one day.⁹¹ On the same day, Enron entered into a complex series of derivatives with Flagstaff, in essence, to guarantee repayment of the \$375 million.⁹² According to one internal Chase document, these derivatives gave Chase and the bank consortium "credit

⁸⁸ See, for example, "Structured Canadian Financing Transaction Organizational Meeting," (2/8/01), Bates SENATE FL-00881 (providing 6-step description of Slapshot transaction); "Transaction Summary," Chase document (undated), Bates SENATE FL-00909-14 (providing 7-step description).

⁸⁹ The bank consortium members were Chase, Royal Bank of Scotland, Industrial Bank of Japan, and Bank of Tokyo-Mitsubishi, each of which was responsible for an equal share of the \$375 million loan.

⁹⁰ Enron contributed CPS to the Sundance joint venture. Enron established CPS as a Nova Scotia Unlimited Liability Company ("NSULC"), which is a particular type of corporation in Canada. Enron did not own CPS directly, but created a longer ownership chain which included two Dutch corporations it had established, BV-1 and BV-2. As indicated in the diagram, Sundance owned BV-1 which owned BV-2 which directly owned CPS. Enron also created two additional NSULCs, Hansen and Newman, that were both wholly-owned by CPS. Enron created this complex maze of companies, CPS, BV-1, BV-2, Hansen, and Newman, as part of the Slapshot tax avoidance structure in order to take advantage of differences between U.S. and Canadian tax laws. For example, since Hansen, Newman and CPS were NSULCs, U.S. tax law would allow Enron to treat them as pass-through entities for U.S. federal income tax purposes. Similarly, under U.S. tax law, BV-1 was a controlled foreign corporation, while BV-2 could be treated as a disregarded entity for tax purposes. A tax opinion letter issued to Enron by Skadden Arps supporting the proposed structure explained, in part, that "since CPS itself [will be] treated as a branch of BV-2, which in turn [will be] treated as branch of BV-1, Newman and Hansen will both be treated as disregarded entities all of the assets and liabilities of which [will be] owned by BV-1 for United States federal income tax purposes." At the same time, Canadian law viewed CPS, Hansen, and Newman as separate companies which would increase the amount of potential Canadian tax benefits.

⁹¹ The loan was structured to be in excess of five years in order to qualify for certain withholding tax benefits under Canadian tax law.

⁹² Rather than a simple loan guarantee, Chase and Enron devised a complex set of derivatives involving a warrant, put option, and total return swap, which functioned together to support repayment of the \$375 million loan. See email by Eric Peiffer (10/16/01), Bates SENATE FL 004540.

support equivalent to a guarantee . . . that does not constitute a guarantee for GAAP accounting for Enron's purposes, thus providing an accounting benefit to Enron.⁹³ In addition, by authorizing a "daylight overdraft" on the Flagstaff account, Chase "loaned" its affiliate, Flagstaff, another \$1.039 billion.⁹⁴

At the conclusion of these initial steps, Flagstaff held two loans totaling approximately \$1.4 billion (\$375 million from the bank consortium and \$1.039 billion from Chase).⁹⁵ Flagstaff immediately loaned the entire amount to an Enron affiliate, Hansen, in exchange for a note.⁹⁶

Upon receiving the \$1.4 billion from Flagstaff, Hansen immediately "loaned" the money to its parent, CPS, another Enron affiliate.⁹⁷ CPS then directed \$375 million of the \$1.4 billion to Enron. CPS "loaned" the remaining \$1.039 billion to an Enron subsidiary in Canada called Enron Canadian Power Company ("ECPC").

At the same time this loan activity was occurring, Hansen entered into an agreement with its fellow subsidiary, Newman.⁹⁸ This agreement obligated Newman to purchase 99.99 percent of Hansen's shares in five years and one day for \$1.4 billion, the same amount Hansen already "owed" to Flagstaff.

Newman and Flagstaff then entered into an agreement whereby Newman immediately paid Flagstaff \$1.039 billion in exchange for Flagstaff's agreeing to assume Newman's obligation to

⁹³ "(Flagstaff) Transaction Summary," Chase document (undated), Bates FL-00910. An Enron employee indicated that this transaction was structured so that Enron could avoid disclosure of the guarantee in its financial statement footnotes. A Chase representative indicated that Enron told Chase it wanted to structure the transaction as a swap because it was concerned that a guarantee would require Enron to carry the mill on its books.

⁹⁴ According to a Skadden Arps opinion letter, despite the amount involved, "no instrument was prepared to evidence the Day-Light Loan" from Chase to Flagstaff. Tax opinion letter from Skadden Arps to Enron Wholesale Services, (8/15/01), Bates EC2 000047056.

⁹⁵ The total loan amount was \$1,414,504,347, but for ease of reference, the figure \$1.4 billion will be used in the following analysis.

⁹⁶ Hansen is a NSULC shell company established by Enron and wholly owned by CPS. The Hansen note set up a so-called "bullet loan" of five years and one day, which required Hansen to pay only interest on the loan for five years and then, on the last day of the loan, repay the principal in its entirety.

⁹⁷ Hansen "loaned" the funds to CPS on essentially the same terms as the "loan" between Hansen and Flagstaff. Apparently in an effort to make the two loans between Flagstaff and Hansen and between Hansen and CPS technically different and to allow Hansen to assert that its "business purpose" in entering into the transactions was to make money off its loan to its parent CPS, the former loan had an interest rate of 6.12 percent, and the latter an interest rate of 6.13 percent.

⁹⁸ Newman is another NSULC shell company established by Enron and, like Hansen, wholly owned by CPS.

pay for Hansen's shares in five years and one day.⁹⁹ The \$1.039 billion Newman paid to Flagstaff had been provided to Newman by Enron for placement in an escrow account.¹⁰⁰ Chase had been unwilling to release its \$1.039 billion daylight overdraft "loan" to Enron until it was sure that there was \$1.039 billion in an escrow account available to ensure Chase would recover its money within the same day. To accommodate Chase, Enron had secured its own \$1.039 billion daylight overdraft authorization on an account it held at Citibank. Once these funds were wired from Citibank to an escrow account at Chase, Chase released the \$1.4 billion in Flagstaff that would go up the chain to Hansen and CPS. Flagstaff also took possession of the Enron escrow funds and forwarded the money to Chase which used it to pay off the daylight overdraft it had issued at the beginning of the day.

The net result of the Slapshot transaction is as follows.

- In two offsetting transfers of funds that moved through multiple bank accounts of Chase, Enron, and their affiliates, Chase issued a sham loan of \$1.039 billion to Enron and, on the same day, had Enron send \$1.039 billion in escrow funds to Chase which used the escrow funds to satisfy the sham loan. Chase's alleged "loan" was never at risk, however, since Chase had required Enron to transfer the funds to an escrow account at a Chase bank, before Chase released any of the "loan" proceeds to Enron.
- Hansen and Flagstaff exchanged obligations to pay each other an identical amount, \$1.4 billion, in five years and one day. The legal documents explicitly authorized them to set off the funds owed to each other.¹⁰¹
- CPS was left with a net outstanding loan of \$375 million, to be repaid with interest, to the bank consortium through Hansen and Flagstaff over five years and one day. The

⁹⁹ The parties calculated that \$1.039 billion was the net present value of the \$1.4 billion owed by Newman to Hansen in five years and one day.

¹⁰⁰ Enron sent the \$1.039 billion to Newman in accordance with a series of transactions involving ECPC and other Enron affiliates. Enron's corporate bank account at Citigroup was, thus, both the origination point and termination point for the two different chains of transfers involving two separate amounts of \$1.039 billion – Enron's \$1.039 billion in escrow funds and Chase's \$1.039 billion in "loan" proceeds.

In the Newman-ECPC transaction, ECPC obtained Newman debenture shares. These debenture shares were designed to provide monetary distributions which exactly mirrored the interest payable to CPS under the CPS-ECPC note. That meant ECPC was to pay interest on the note to CPS in an amount exactly equal to the distributions that ECPC was to receive from Newman, an entity wholly-owned by CPS. According to Enron, Canadian tax lawyers advised it that the expected interest and distributions needed to actually change hands among the parties, notwithstanding the fact that from ECPC's perspective the net result was a wash.

¹⁰¹ See "Credit Agreement," (6/22/01), Bates JPM-14-00475, Section 10.08 ("Right of Setoff") at Bates JPM-14-00512.

loan was guaranteed by Enron through a complex set of derivatives that did not show up as a loan guarantee on Enron's books.¹⁰²

Notwithstanding the reality that only \$375 million was actually loaned to CPS, the transaction was structured in such a way as to allow CPS, for tax purposes, to act as if it were subject to a \$1.4 billion "loan" obligation that remained outstanding. The purpose was to circumvent the general principle in U.S. and Canadian tax law which allows companies to deduct only their loan interest payments, but not their loan principal payments. The Chase structure was intended to enable CPS to claim to be entitled to a Canadian tax deduction for its entire amount of its payments on the \$375 million loan.

The Chase-designed structure worked as follows. The transaction documents required CPS to make quarterly loan payments to Hansen in the amount of approximately \$22 million. Hansen was then to pay Flagstaff an identical amount, and Flagstaff was to pay the same amount to the bank consortium. The \$22 million was equivalent to a payment of principal and interest, using a fixed 6.12 percent interest rate, on the existing \$375 million loan. In five years and one day, these payments would reduce the \$375 million loan to zero.

At the same time, Chase and Enron had manipulated the size of the loans between Flagstaff and Hansen and Hansen and CPS, as well as the interest rates on those loans, in such a way that the \$22 million quarterly payment was also equivalent to an interest-only payment, using a fixed 6.13 percent interest rate, on the \$1.4 billion loan. Under Canadian tax law, if CPS were to characterize the \$22 million as an interest-only payment on an outstanding loan, it could deduct the full \$22 million from its Canadian taxes. Assuming repayment of the loan in full, Enron calculated the total deductions and related Canadian tax benefits from the Slapshot transaction over five years to be in the range of \$60 million.¹⁰³ These Canadian tax benefits were also calculated to convey additional financial statement benefits for Enron totaling about \$65 million.¹⁰⁴

Prior to participating in Slapshot, Chase obtained a legal opinion from a Canadian law firm, Blake, Cassels & Graydon, LLP ("Blake Cassels"), supporting the Slapshot structure. Enron apparently relied on that opinion and ultimately obtained its own opinion from the same law

¹⁰² The transaction was also structured to allow CPS to account for the loan on its books by showing a net debt of \$375 million, not \$1.4 billion. See, for example, "Transaction Summary," (undated), Bates SENATE FL-00912.

¹⁰³ "Slapshot Savings," Enron document (undated), Bates ECa00195947. Enron indicated that this \$60 million represented the net present value of the total tax savings over five years. See also Chase projection of tax and financial statement benefits, "Results and Cash Flows," Chase document (undated), Bates SENATE FL-00939.

¹⁰⁴ *Id.* Enron stated that a "tax depreciation delay" over five years would create a "deferred tax benefit, resulting in net income improvement over the next five years of NPV US\$65 million." (Emphasis omitted.)

firm.¹⁰⁵ The opinion provided to Enron, which included caveats and warnings that did not appear in the law firm's earlier opinion to Chase, noted that the Slapshot structure "clearly involves a degree of risk" and advocated proceeding only after providing this warning:

"We would further caution that in our opinion it is very likely that Revenue Canada will become aware of [the Slapshot transactions] and, upon becoming aware of them, will challenge them under [the Canadian anti-tax avoidance statute]. It is also, in our view, likely that such a Revenue Canada challenge would not be resolved in the Courts at a level below that of the Federal Court of Appeal. It is therefore likely that Enron will be faced with the decision as to whether to pursue the matter through the Courts or to attempt to reach a settlement with Revenue Canada pursuant to which it would receive a reduced Canadian tax benefit."

In short, Enron's own tax counsel warned that Slapshot would likely result in litigation over Enron's tax liability and Enron would have to determine whether to settle the expected dispute with Revenue Canada.

Internal documentation indicates that both Enron and Chase were concerned about the Canadian tax authorities disallowing the Slapshot structure and so took steps to keep information that would provide insights about the transaction to a minimum. For example, in analyzing how to structure an interest rate swap, Chase and Enron jointly considered three alternatives, two of which were described as disadvantageous in part because they would produce a "potential road map" of the transaction for Revenue Canada. Chase and Enron chose the third alternative which was explicitly described as advantageous in part because it provided "no road map" for Revenue Canada.¹⁰⁶

Chase and Enron also included in the Slapshot legal documents a "recharacterization rider" to take effect only if Canadian tax authorities successfully challenged the underlying tax structure and reclassified the payments from Hansen to Flagstaff as payments of principal and interest on the \$375 million loan. Should such an event occur, Chase and Enron agreed to "recast any principal paid in excess of 25% of the recharacterized loan as instead being a loan from [Hansen] to Flagstaff."¹⁰⁷ This rider was designed to avoid payment of certain Canadian withholding taxes that would be triggered if Hansen's loan principal payments were to exceed the

¹⁰⁵ See tax opinion letters from Blake Cassels to Chase Securities Inc. (11/7/00) (no Bates number), and from Blake Cassels to Enron North America Corp. (6/23/01), Bates EC2 000047037. The tax opinion Enron received from Blake Cassels is dated one day after the transaction closed; Enron told the Subcommittee it was informed orally of its substance prior to the closing. Subcommittee interview of Stephen Douglas (12/3/02).

¹⁰⁶ "Structured Canadian Financing Transaction Organizational Meeting," (2/8/01), Bates SENATE FL-0088.

¹⁰⁷ "5/25 Recharacterization Rider," joint Chase-Enron document (undated), Bates SENATE FL-00075.

25 percent limit. The rider's solution was to recharacterize the Hansen loan payments to Flagstaff as the reverse – as the extension of loans by Hansen to Flagstaff – which is the opposite of what was intended under the Slapshot structure. This rider's existence is additional evidence, not only that Chase and Enron had real concerns that Revenue Canada might overturn Slapshot, but also that both were willing to continue to use deceptive strategies to avoid payment of Canadian taxes.

Analysis. Chase constructed and sold Slapshot as a tax avoidance structure whose core transaction was a deception – a sham \$1 billion loan that had no economic rationale or business purpose apart from generating deceptively large tax deductions.¹⁰⁸ The funds never performed any function other than to transverse multiple bank accounts in a single day to create the appearance of a loan that was, in fact, an illusion. The funds were issued without any of the paperwork that normally accompanies a billion-dollar borrowing. Chase's \$1 billion was never even truly at risk since Chase had required Enron to place the same amount in a Chase escrow account before Chase issued the original "loan" to Enron.

The deceptive nature of the Slapshot transaction is clear from its component parts. Serial billion-dollar-plus loans were issued to newly created shell companies such as Flagstaff and Hansen which had virtually no capitalization, assets, or business operations to justify the lending. Another key transaction was a complex stock agreement between Hansen and Newman, two companies that were incapable of negotiating at arms-length because both were Enron-sponsored SPEs, wholly owned by the same Enron affiliate, CPS, with identical company officers. With respect to another key series of transactions, Flagstaff and Hansen clearly intended to set-off their identical \$1.4 billion obligations to each other, but this intent to set-off is never mentioned in the transaction documents due to legal advice that it would undercut the supposed arms-length nature of the transaction.¹⁰⁹ Still another decision on interest rates appears to have been made not to rationalize or maximize the benefits to any one party but to avoid providing Revenue Canada with a useful "road map" to the transaction. Chase and Enron even agreed to recast the very nature of key transactions to salvage limited Canadian tax benefits in the event Canadian tax authorities refused to recognize Hansen as paying off a \$1.4 billion "loan."

¹⁰⁸ In one interview, Enron contended that one of the purported business purposes of the transactions was that the various Chase and Enron affiliates were profiting from the loans they exchanged. Douglas interview. However, the interest rate difference in the loans between Flagstaff and Hansen and between Hansen and CPS differed by only 0.01 percent. In addition, Hansen and CPS were both Enron affiliates, contradicting any business rationale for them to profit from each other. Moreover, the loan activity among these entities had no function apart from the \$1.039 billion loan. All of the loans and related transactions were engineered by Chase and Enron to function together.

¹⁰⁹ A Chase email stated: "As Flagstaff's payment to [Hansen] is conditional on [Hansen's] repaying, Chase can just choose to invoke set-off which is Chase's full intention – to direct [Hansen] to keep its money rather than repay the loan, in return for Flagstaff not having to pay cash for the [Hansen] shares. Clearly there is no benefit to Chase/Flagstaff to have the money move. As discussed, the lawyers (especially the tax lawyers) are hesitant to state explicitly Chase's intent to set-off or to require this set off, as they wish to keep the documents as 'arm's length' as possible rather than tie them together (which additional 'intent to set-off' language would do)." Email between Chase employees Eric Peiffer and Kathryn Ryan (date illegible but possibly 2/28/01), Bates SENATE FL-02335.

Many features of Slapshot – the sham billion-dollar loan that had no business purpose apart from generating tax benefits, the contrived set offs between key parties, and the involvement of multiple shell companies lacking ongoing business operations – raised the real possibility that the entire Slapshot transaction would be invalidated under Canada’s statutory general anti-avoidance rule. Despite the legal risks associated with Slapshot, Chase and Enron proceeded with the transaction.¹¹⁰ If Enron had not gone bankrupt, the large tax deductions generated by Slapshot would likely have been used to shelter the paper mill’s income from the payment of Canadian corporate income tax. Lower tax liabilities would have then translated into stronger Enron financial statements. Enron’s bankruptcy, however, interrupted Slapshot just five months after it began producing the promised benefits.

Chase was paid more than \$5 million for designing and orchestrating Slapshot. Enron could not have completed this transaction without the initiative and enthusiastic backing of a major financial institution with the resources to issue and move a \$1 billion daylight overdraft through multiple bank accounts across international lines in a single day. Without Chase’s willing efforts to design, fund, and execute the incredibly complex transactions involved, whose details had to be carefully planned and coordinated, Enron would not have been able to make use of this deceptive tax strategy.

CONCLUSION

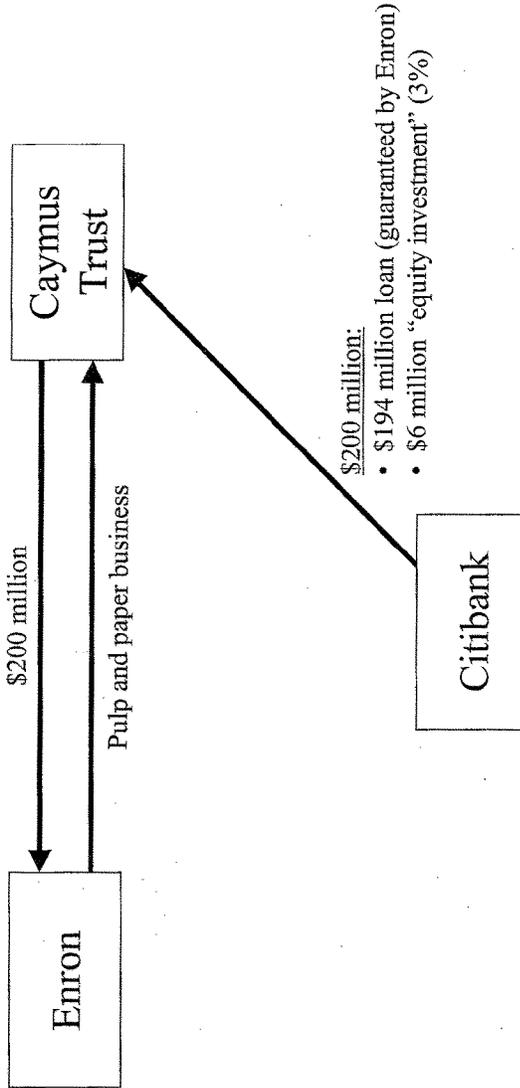
The four transactions discussed in this report, Fishtail, Bacchus, Sundance, and Slapshot, are examples of the complex, deceptive transactions that have become Enron’s signature. None of the four could have been completed without the backing and active participation of a major financial institution willing to facilitate a client’s deceptive accounting or tax transactions. This report shows that Citigroup and Chase each deliberately misused structured finance techniques to help Enron engage in deceptive accounting or tax strategies, and were rewarded with millions of dollars and favorable consideration in other business dealings. Evidence gathered in this and other Congressional and law enforcement proceedings indicates that this type of misconduct was not confined to Enron or these two financial institutions, but was also committed by other public companies and financial institutions in the United States. The resulting loss of investor confidence in the honesty and integrity of U.S. companies and financial institutions is an ongoing problem that has yet to be resolved.



¹¹⁰ In fact, one Chase employee informed the Subcommittee that it has marketed the Slapshot structure to at least 15 to 20 other companies in addition to Enron.

Bacchus

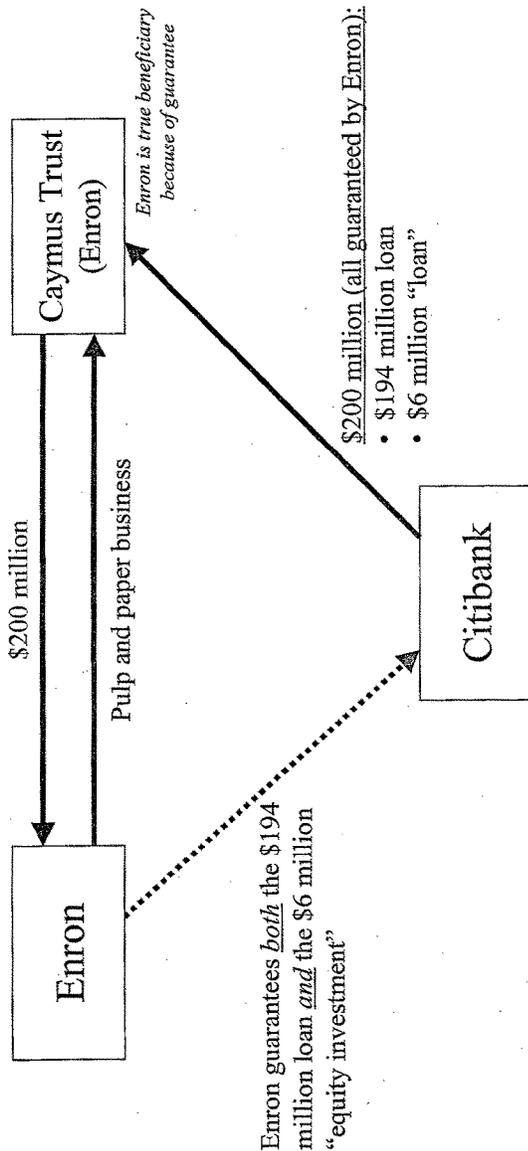
The appearance is a sale.



Permanent Subcommittee on Investigations
EXHIBIT #301a

Bacchus

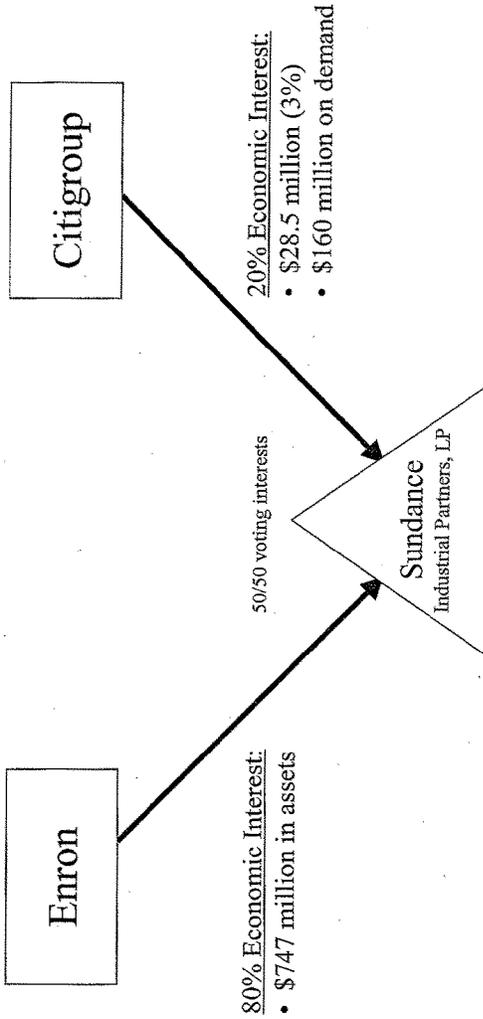
The reality is a loan.



Permanent Subcommittee on Investigations
EXHIBIT #301b

Sundance

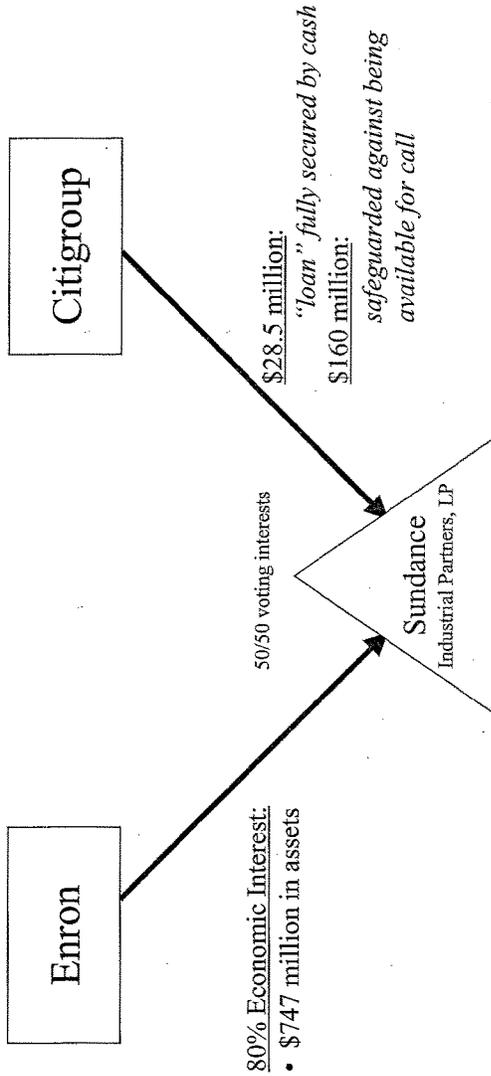
The appearance is a joint investment.



Sundance

~~The appearance is a joint investment.~~

The reality is a sham investment by Citigroup.



Permanent Subcommittee on Investigations
EXHIBIT #302b

Deception allows Enron to keep the contributed assets off its balance sheet.

Sundance

The agreement included these provisions

- The \$28.5 million that Citigroup is supposed to have “invested” is in fact kept in a “reserve” which is liquid, segregated, and available for Citigroup upon dissolution.
- Citigroup can dissolve the partnership before its \$28.5 million is accessed, and also Citigroup’s \$160 million “contribution” cannot be called until Enron’s \$747 million contribution is lost.

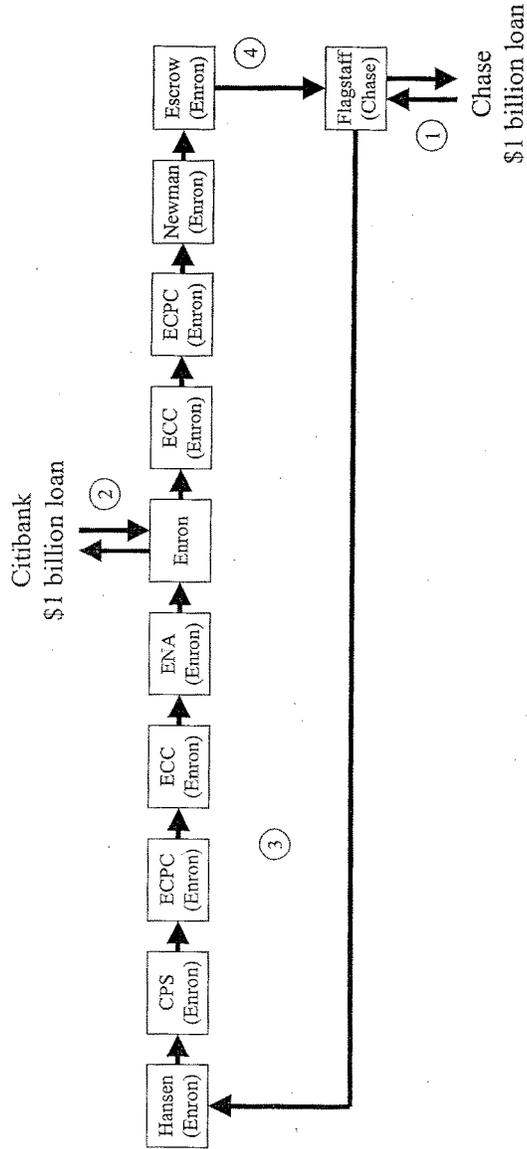
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Conclusion: None of Citigroup’s “investment” was at risk.

Permanent Subcommittee on Investigations
EXHIBIT #302c

\$1 Billion Cash Flow

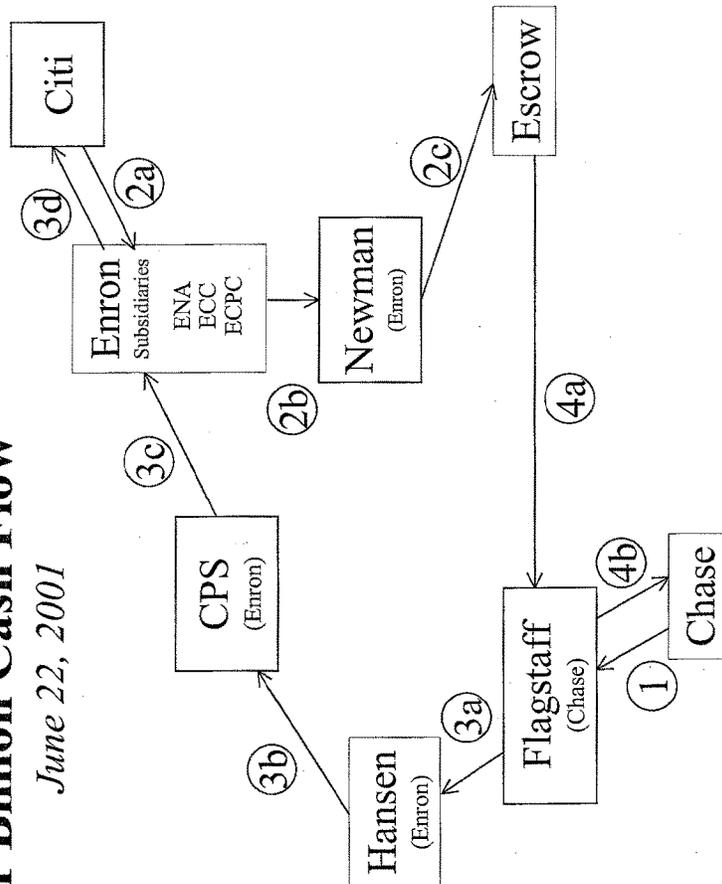
June 22, 2001



Permanent Subcommittee on Investigations
EXHIBIT #303a

\$1 Billion Cash Flow

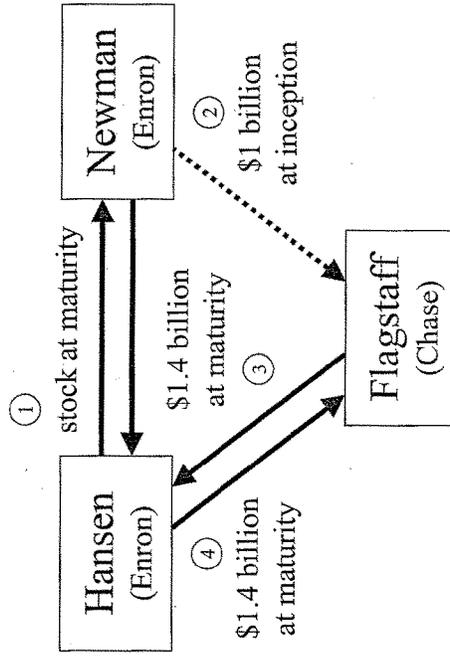
June 22, 2001



Permanent Subcommittee on Investigations
EXHIBIT #303b

Flagstaff-Hansen \$1.4 billion

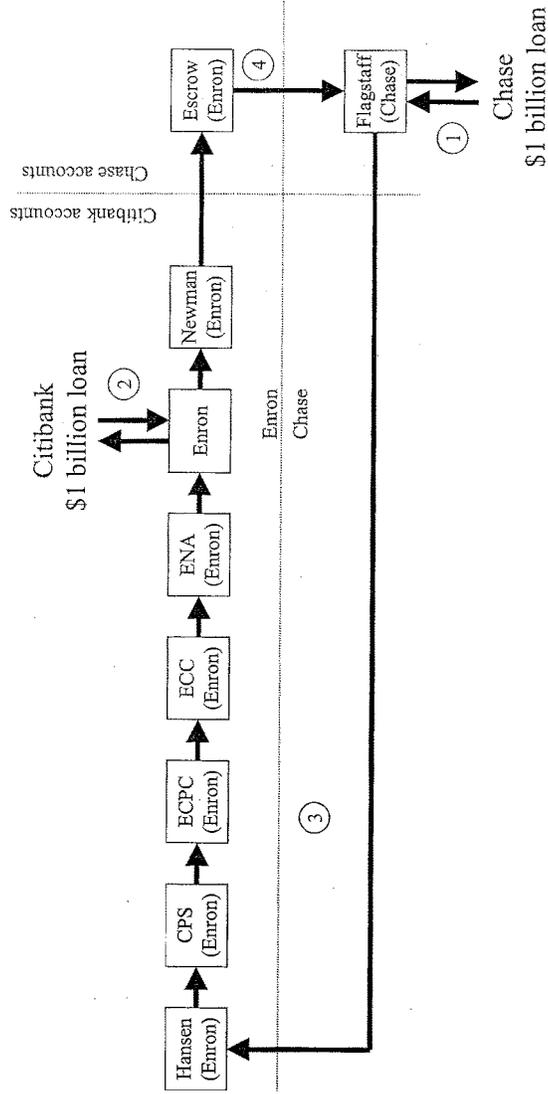
Share Subscription/Assumption/Payment Set off



Permanent Subcommittee on Investigations
EXHIBIT #303c

\$1 Billion Cash Flow

June 22, 2001



Permanent Subcommittee on Investigations
EXHIBIT #303d

**ENRON GUARANTEES CITIGROUP'S "EQUITY"
INVESTMENT IN BACCHUS**

CITIGROUP Email (11/28/00):

- "They have offered to have the CFO discuss this at whatever level of our organization we think necessary to obtain the right comfort."¹

CITIGROUP Memo (12/06/00):

- "ENRON Corp. will essentially support the entire facility, whether through a guaranty or verbal support."
- "ENRON's CFO, Andrew S. Fastow, has given his verbal commitment to Bill Fox, GEM Industry Head, that ENRON Corp. will support the 3% equity piece of this transaction."
- "The equity component we provide will be based on verbal support as committed by Andrew S. Fastow, ENRON Corp's CFO, to Bill Fox, GEM Industry Head."
- "...this equity risk is largely mitigated by verbal support received from ENRON Corp. as per its CFO, Andrew S. Fastow."
- "The remaining 3% equity of \$7.5mm will be at risk, but is mitigated by the verbal support of ENRON Corp., as provided by CFO Andrew S. Fastow."²

CITIGROUP Email (12/21/00):

- "The equity component has been approved on the basis of verbal support verified by ENRON CFO, Andy Fastow."³

CITIGROUP Email (04/18/01):

- "\$200mm – BACCHUS: SPV where we have a total return swap from ENRON for \$180mm and verbal support for the balance"⁴

CITIGROUP Memo Executive Summary (12/00):

- "The certificates are supported by verbal support obtained by Bill Fox from Andy Fastow, ENRON Corp's chief financial officer."⁵

Prepared by U. S. Senate Permanent Subcommittee on Investigations, December 2002

¹ CITI-SPSI 0118432

² CITI-SPSI 0015991-995

³ CITI-SPSI 0128945

⁴ CITI-SPSI 0085843

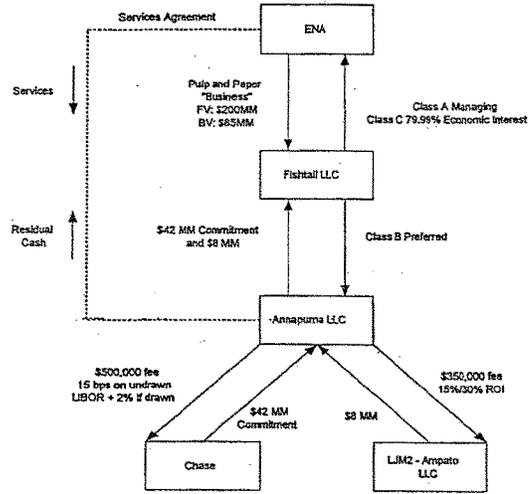
⁵ CITI-SPSI 0128937

Permanent Subcommittee on Investigations

EXHIBIT #304

Initial Transaction Diagram

Below is a diagram of the initial Fishtail deal structure:



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DRAFT-SUBJECT TO REVISION

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DT 000381

CONFIDENTIAL

Permanent Subcommittee on Investigations
EXHIBIT #305

LJM2 INVESTMENT SUMMARY

| | |
|---------------------------------|-------------------------------------|
| Deal Name: Ampato | Date Completed: December 20th, 2000 |
| Expected Closing Date: 12/20/00 | Investment Analyst: Ace Roman |
| Expected Funding Date: 12/20/00 | Investment Type: Equity |

LJM2 Investment **\$8,024,061.00**

Deal Description

LJM2 will contribute \$3 million to Annapurna LLC ("Annapurna"), which, along with a commitment of \$42 million from Chase Manhattan Bank ("Chase"), will purchase 20% of Fishtail LLC ("Fishtail"). The remaining 80% of Fishtail will be capitalized by Enron's contribution of the resultant activity of its Pulp and Paper business (the "Business"). The Business operates trading activity in the following products: Newsprint, Packaging, Printing and Writing, Pulp and Lumber. Fishtail will receive the net result of all activity in the Business that occurs in the next five years. By contributing the Business to Fishtail, selling 20% to an outside investor and relinquishing operating control, Enron will be able to deconsolidate its ownership of the Business. Accounting rules regarding deconsolidation require Fishtail to meet a 4:1 ratio of Enron capital to outside capital (\$200 million Enron capital : \$50 million outside capital). The outside capital requires 3% true equity at risk (3% of \$250 million = \$7.5 million outside equity investment). Deconsolidation of the Business changes Enron's interest in the Business from an interest in an operating asset to an interest in a financial asset, thus qualifying that interest for a FASB-125 monetization. Enron plans to monetize its interest in Fishtail for \$200 million immediately after LJM2 invests in this structure. Enron plans to unwind the FASB-125 transaction and repurchase LJM2's interest in order to contribute this asset to the NetWorks LP (the "Fund") during the 1st Quarter of 2001.

Transaction Summary

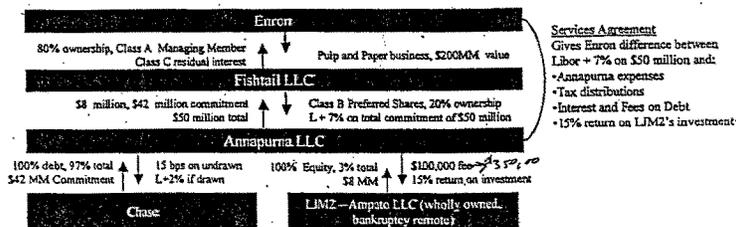
LJM2 will set up a wholly owned, bankruptcy remote entity, LJM2 - Ampato LLC. LJM2 - Ampato LLC will purchase 100% of the equity of Annapurna for \$3 million. Enron will set up Fishtail LLC with Class A, B and C interests. The Class A interest is the managing member interest. The Class B interest receives:

- Libor + 7% on its entire commitment (\$50 million) Note: In no case is L + 7% on \$50 million insufficient to pay Ampato and Chase a return on capital (see Exhibit A).
- 20% ownership of the Business,
- at any time, the ability to appoint, without cause, two members to a 4 member board of directors which will control Fishtail,
- after six months, the ability to sell all of the vehicle's interests, including the Class A and C interests,
- consent rights for any refinancing of Fishtail's interests.

The Class C interest will receive all cash flows after expenses of Fishtail, tax distributions for any unrealized income allocated to Annapurna, Annapurna's preferred return of Libor + 7% and any capital contribution above the initial \$3 million.

Enron will convey and transfer the Business to Fishtail for a term of five years. With the conveyance, Enron agrees to not pursue activity related to the Business through any other subsidiaries for the length of the term (a "non-compete" restriction). With LJM2's equity and Chase's commitment, Annapurna will contribute \$3 million and make a \$42 million capital commitment to Fishtail.

Annapurna will enter into a services agreement with Enron that effectively sweeps the excess of any allocation from Fishtail to Annapurna over the amount necessary to satisfy Annapurna's expenses, tax distributions for any unrealized income allocated to Annapurna, Chase's commitment fee or yield on debt and LJM2's 15% return.



Investment Return Summary

Accounting guidelines governing off-balance sheet entities require 3% equity at risk (LJM2 must fund 3% of \$250 million = \$7.5 million). For this transaction, Enron's auditors have required that LJM2 overfund this amount so that capital contributions from the General Partner do not reduce the amount of outside equity in the structure (Enron has requested that LJM2 fund \$7.5 million / 98% = \$7,653,061). In order to comply with the 3% equity rule, the equity holder in Annapurna must gross up its 3% commitment 100% for any fees directly received and 3% for any fees paid by Fishtail to outside entities on its behalf (\$7,653,061 + \$350,000 fee grossed up 100% + 3% of \$500,000 fee to Chase + 3% of \$200,000 estimated transaction costs = \$8,024,061). LJM2 will receive a \$350,000 upfront fee and a 15% annualized return on its funded investment through 6/30/01. If LJM2's interest is outstanding at 6/30/01, LJM2 will receive an additional \$500,000 fee and the annualized return will increase to 30%.

Compound/Annualized IRR – 25% 1.12X (If B certificates repurchased at 6/30/01)

Compound/Annualized IRR – 35% 1.08X (If B certificates repurchased at 3/31/01)

Compound/Annualized IRR – 35% 1.34X (If B certificates repurchased at 12/31/01)

| Risks | Mitigants |
|--------------------------------------|--|
| Paper & Pulp business operation risk | Within the structure, Enron absorbs the first \$200 million of realized losses. Annapurna then absorbs the next \$50 million. If, upon liquidation of Fishtail's membership interests, the Business has produced less than \$200 million of realized losses, LJM2 will receive its return of and on capital. In September of 2000, LJM2 went through a due diligence exercise related to an investment in the Business. As of 12/31/00, the pulp and paper trading book consists of over 2000 contracts with over 200 counterparts. The largest net position of any one contract is \$21 million (PV \$17 million). That contract is also the largest exposure to any one counterpart. LJM2 believes that the Business will not generate \$200 million of realized losses during the term of the investment. |
| Fund execution risk | Enron is marketing the P&P assets as part of the Fund. When the Fund closes, Enron will be required to contribute the Business to the Fund, requiring a purchase of LJM2's equity. If the Fund does not close, the investment structure provides significant incentives for Enron to repurchase LJM2's interest (control removal rights at Fishtail, the ability to sell all of the vehicle's interests, including Enron's, Enron non-compete in the Business, re-financing consent rights, etc.). |
| Enron abandonment of the Business | Enron agreed to not pursue the Business through any subsidiaries other than Fishtail (a "non-compete" restriction) for the five-year length of the conveyance. Additionally, Enron plans to monetize its Class C interest in a FASB-125 structure for \$200 million dollars. The transaction will give Enron earnings and funds flow of \$200 million. Chase's commitment to fund the remainder of Annapurna's capital expires at 6/30/01. If Chase's commitment expires, Fishtail fails the 4:1 accounting test mentioned earlier. LJM2 WILL NOT BE REQUIRED TO FUND ADDITIONAL CAPITAL TO FULFILL ANNAPURNA'S COMMITMENT TO FISHTAIL. At that point, Enron would be required to re-consolidate the Business. Re-consolidating the Business would force Enron to reverse \$200 million dollars of earnings and funds flow. This offers a significant incentive for Enron to execute the NetWorks partnership and/or meet commercial objectives that determine the value of the Business. |

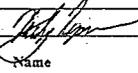
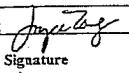
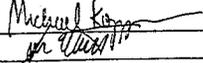
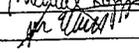
| | | | |
|-----------------|---|---|------|
| ACKNOWLEDGED BY | Kathy Lynn  | Joyce Tang  | |
| | Name | Signature | Date |
| APPROVALS | Michael Kopper  | | 2/1 |
| | Andrew Fastow  | | 2/1 |

Exhibit A

| Libor Analysis for Annapurna | | | | | | | |
|------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Ampato Investment | \$8,024,061 | \$8,024,061 | \$8,024,061 | \$8,024,061 | \$8,024,061 | \$8,024,061 | \$8,024,061 |
| Chase Commitment | \$41,975,939 | \$41,975,939 | \$41,975,939 | \$41,975,939 | \$41,975,939 | \$41,975,939 | \$41,975,939 |
| Ampato Rate | 15% | 15% | 15% | 15% | 15% | 15% | 15% |
| Chase Drawn Spread | 2% | 2% | 2% | 2% | 2% | 2% | 2% |
| Chase Undrawn Spread | 0.15% | 0.15% | 0.15% | 0.15% | 0.15% | 0.15% | 0.15% |
| Libor Rate | 0% | 2% | 4% | 6% | 8% | 10% | 12% |
| Spread | 7% | 7% | 7% | 7% | 7% | 7% | 7% |
| Total | 7% | 9% | 11% | 13% | 15% | 17% | 19% |
| Total Annapurna Capital | \$50,000,000 | \$50,000,000 | \$50,000,000 | \$50,000,000 | \$50,000,000 | \$50,000,000 | \$50,000,000 |
| Interest Due to Annapurna | \$3,500,000 | \$4,500,000 | \$5,500,000 | \$6,500,000 | \$7,500,000 | \$8,500,000 | \$9,500,000 |
| Yield due to Ampato | \$1,203,609 | \$1,203,609 | \$1,203,609 | \$1,203,609 | \$1,203,609 | \$1,203,609 | \$1,203,609 |
| Chase Drawn? | TRUE | | | | | | |
| Due to Chase | 839,519 | 1,679,038 | 2,518,556 | 3,358,075 | 4,197,594 | 5,037,113 | 5,876,631 |
| Remainder | \$1,456,872 | \$1,617,353 | \$1,777,835 | \$1,938,316 | \$2,098,797 | \$2,259,278 | \$2,419,759 |
| | | | | | | | |
| Ampato Investment | \$8,024,061 | \$8,024,061 | \$8,024,061 | \$8,024,061 | \$8,024,061 | \$8,024,061 | \$8,024,061 |
| Chase Commitment | \$41,975,939 | \$41,975,939 | \$41,975,939 | \$41,975,939 | \$41,975,939 | \$41,975,939 | \$41,975,939 |
| Ampato Rate | 15% | 15% | 15% | 15% | 15% | 15% | 15% |
| Chase Drawn Spread | 2% | 2% | 2% | 2% | 2% | 2% | 2% |
| Chase Undrawn Spread | 0.15% | 0.15% | 0.15% | 0.15% | 0.15% | 0.15% | 0.15% |
| Libor Rate | 0% | 2% | 4% | 6% | 8% | 10% | 12% |
| Spread | 7% | 7% | 7% | 7% | 7% | 7% | 7% |
| Total | 7% | 9% | 11% | 13% | 15% | 17% | 19% |
| Total Annapurna Capital | \$50,000,000 | \$50,000,000 | \$50,000,000 | \$50,000,000 | \$50,000,000 | \$50,000,000 | \$50,000,000 |
| Interest Due to Annapurna | \$3,500,000 | \$4,500,000 | \$5,500,000 | \$6,500,000 | \$7,500,000 | \$8,500,000 | \$9,500,000 |
| Yield due to Ampato | \$1,203,609 | \$1,203,609 | \$1,203,609 | \$1,203,609 | \$1,203,609 | \$1,203,609 | \$1,203,609 |
| Chase Drawn? | FALSE | | | | | | |
| Due to Chase | 62,964 | 62,964 | 62,964 | 62,964 | 62,964 | 62,964 | 62,964 |
| Remainder | \$2,233,427 | \$3,233,427 | \$4,233,427 | \$5,233,427 | \$6,233,427 | \$7,233,427 | \$8,233,427 |

Investment Return Summary

Accounting guidelines governing off-balance sheet entities require 3% equity at risk (LJM2 must fund 3% of \$250 million = \$7.5 million). For this transaction, Enron's auditors have required that LJM2 overfund this amount so that capital contributions from the General Partner do not reduce the amount of outside equity in the structure (Enron has requested that LJM2 fund \$7.5 million / 98% = \$7,653,061). In order to comply with the 3% equity rule, the equity holder in Annapurna must gross up its 3% commitment 100% for any fees directly received and 3% for any fees paid by Fishtail to outside entities on its behalf (\$7,653,061 + \$350,000 fee grossed up 100% + 3% of \$500,000 fee to Chase + 3% of \$200,000 estimated transaction costs = \$8,024,061). LJM2 will receive a \$350,000 upfront fee and a 15% annualized return on its funded investment through 6/30/01. If LJM2's interest is outstanding at 6/30/01, LJM2 will receive an additional \$500,000 fee and the annualized return will increase to 30%.

BENEFITS TO ENRON SUMMARY

Deal Name: AMPATO (FISHTAIL) Dollar Amount: \$8.0 million
Date Completed: December 20, 2000
Description of Transaction: \$8.0 million, in equity, to deconsolidate Enron's Pulp & Paper trading business.

Enron Business Unit Benefited: Enron Net Works

Did the deal result in a direct or indirect benefit to Enron: Direct & Indirect

Primary Benefit:

Enron was able to deconsolidate its Pulp & Paper trading business for book purposes and was subsequently able to transact a FAS 125 for financing on its trading book.

Funds Flow Direct: \$8.0 million Funds Flow Indirect: \$200.0 million

Earnings Direct: Earnings Indirect: \$100.0 million

Fees Saved: \$ 500,000 - 750,000

Other equity investors bidding on the transaction: Unknown, potentially, Chase?

- 1.
- 2.
- 3.

Did the deal close with LJM? Yes

Other benefits to Enron:

- LJM contributed an additional \$6.4 million after deal close to fix a structural problem Enron had with AA.
- LJM stepped up to deconsolidate the P&P trading business for Enron, within a two week time period at YR-End, because Enron was unable to consummate the Enron Net Works JV transaction.
- Below market return.

Compiled by: Michael Hinds

LJM2 APPROVAL SHEET

Approval Sheet should be used to approve Enron's participation in any transactions involving LJM Cayman, L.P. ("LJM1") or LJM2 Co-Investment, L.P. ("LJM2"). LJM1 and LJM2 will collectively be referred to as "LJM". This Approval Sheet is in addition to (not in lieu of) any other Enron approvals that may be required.

GENERAL

Deal name: Fishtail

Date Approval Sheet completed: December 18, 2000

Enron person completing this form: Nicole Alvino

Expected closing date: December 19, 2000

Business Unit: Enron Corp.

Business Unit Originator: Barry Schnapper

This transaction relates to LJM1 and/or LJM2.

This transaction is a sale by Enron a purchase by Enron a co-sale with Enron a co-purchase with Enron and/or

other: formation of a Joint Venture (Fishtail).

Person(s) negotiating for Enron: Barry Schnapper

Person(s) negotiating for LJM: Michael Hinds

Legal counsel for Enron: Vinson & Elkins

Legal counsel for LJM: Kirkland & Ellis

L. DESCRIPTION

Fishtail LLC is an off-balance sheet partnership formed by a conveyance of the economic benefits associated with the Pulp and Paper Business by ENA, and a \$50MM commitment by Annapurna LLC, a special purpose entity. Annapurna is capitalized with \$8MM of equity from LJM and a \$42MM revolver from Chase which matures on June 30, 2001. In exchange for its conveyance, ENA receives a Class A and Class C interest. The Class A is the managing member interest, and the Class C represents 79.99% economics. Annapurna, with LJM as its managing member, receives 20% of the economics and the right to remove Enron as the managing member without cause.

TRANSACTION SUMMARY

LJM2 will set up a wholly owned, bankruptcy remote entity, LJM2 - Ampato LLC. LJM2 - Ampato LLC will purchase 100% of the equity of Annapurna for \$8 million. Enron will set up Fishtail LLC with Class A, B and C interests. The Class A interest is the managing member interest. The Class B interest receives:

- Libor + 7% on its entire commitment (\$50 million)
- 20% ownership of the Business,
- at any time, the ability to appoint, without cause, two members to a 4 member board of directors which will control Fishtail,
- after six months, the ability to sell all of the vehicle's interests, including the Class A and C interests,
- consent rights for any refinancing of Fishtail's interests.

The Class C interest will receive all cash flows after expenses of Fishtail, tax distributions for any unrealized income allocated to Annapurna, Annapurna's preferred return of Libor + 7% and any capital contribution above the initial \$8 million.

Enron will convey and transfer the Business to Fishtail for a term of five years. With LJM2's equity and Chase's commitment, Annapurna will contribute \$8 million and make a \$42 million capital commitment to Fishtail.

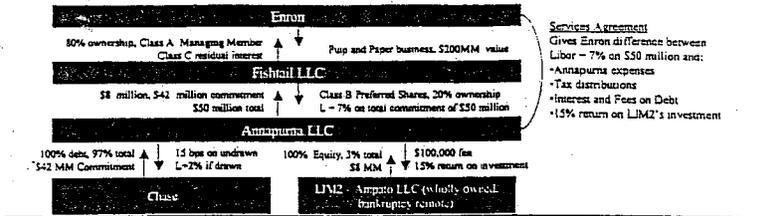
Permanent Subcommittee on Investigations

EXHIBIT #309

LJM APPROVAL SHEET

Page 2

Annapurna will enter into a services agreement with Enron that effectively sweeps the excess of any allocation from Fishtail to Annapurna over the amount necessary to satisfy Annapurna's expenses, tax distributions for any unrealized income allocated to Annapurna, Chase's commitment fee or yield on debt and LJM2's 15% return.



ECONOMICS

Annapurna receives a preferred distribution equal to L-7% annually on its \$50MM commitment. As the administrative services agent for Annapurna, ENA can sweep any cash in excess LJM's agreed upon return and Chase's revolver fees. The first \$200MM of net realized losses from the Pulp and Paper business is allocated to ENA, and then to Annapurna until its capital account is extinguished.

ISSUES CHECKLIST

1. Sale Options
 - a. If this transaction is a sale of an asset by Enron, which of the following options were considered and rejected:
 Condor JEDI II Third Party Direct Sale. Please explain: Not a sale of an asset by Enron
 - b. Will this transaction be the most beneficial alternative to Enron? Yes No. If no, please explain: _____
 - c. Were any other bids/offers received in connection with this transaction? Yes No. Please explain: Structured deconsolidation transaction
2. Prior Obligations
 - a. Does this transaction involve a Qualified Investment (as defined in the JEDI II partnership agreement)? Yes No. If yes, please explain how this issue was resolved: _____
 - b. Was this transaction required to be offered to any other Enron affiliate or other party pursuant to a contractual or other obligation? Yes No. If yes, please explain: _____
3. Terms of Transaction
 - a. What are the benefits (financial and otherwise) to Enron in this transaction? Cash flow Earnings
 Other: Provide potential liquidity for a commodity risk management business.
 - b. Was this transaction done strictly on an arm's-length basis? Yes No. If no, please explain: _____

LJM APPROVAL SHEET

Page 3

- c. Was Enron advised by any third party that this transaction was not fair, from a financial perspective, to Enron?
 Yes No. If yes, please explain: _____
- d. Are all LJM expenses and out-of-pocket costs (including legal fees) being paid by LJM? Yes No. If no, is this market standard or has the economic impact of paying any expenses and out-of-pocket costs been considered when responding to items 1.b. and 3.b. above? Yes No.
4. Compliance
- a. Will this transaction require disclosure as a Certain Transaction in Enron's proxy statement? Yes No.
- b. Will this transaction result in any compensation (as defined by the proxy rules) being paid to any Enron employee?
 Yes No.
- c. Have all Enron employees' involvement in this transaction on behalf of LJM been waived by Enron's Office of the Chairman in accordance with Enron's Conduct of Business Affairs Policy? Yes No. If no, please explain: _____
- d. Was this transaction reviewed and approved by Enron's Chief Accounting Officer? Yes No.
- e. Was this transaction reviewed and approved by Enron's Chief Risk Officer? Yes No.
- f. Has the Audit Committee of the Enron Corp. Board of Directors reviewed all Enron/LJM transactions within the past twelve months? Yes No. Have all recommendations of the Audit Committee relating to Enron/LJM transactions been taken into account in this transaction? Yes No.

LTM APPROVAL SHEET
Page 4

| APPROVALS | Name | Signature | Date |
|----------------------|---------------|-----------|----------|
| Business Unit | Ben Glisan | | |
| Business Unit Legal | | | |
| Enron Corp. Legal | Rex Rogers | | 2-5-01 |
| Global Finance Legal | Jordan Mintz | | 1-25-01 |
| RAC | Rick Buy | | 2-5-2001 |
| Accounting | Rick Causey | | |
| Executive | Jeff Skilling | | |

Project Fishtail/125 Structure

- Project Fishtail relates to the Pulp & Paper FAS 125 transaction that was done in December 2000 to increase EWS earnings. The gain was \$110MM which was split between EIM and ENW.
- The facility cost (financing charges) for the existing structure is \$4MM per quarter.
- When the 2001 Plan was developed, EIM assumed they would have a partnership with a possible FAS 125 deal in 2001. As a result, EIM has some net expense in the Plan but not 100% of the \$16MM annual facility costs. ENW has nothing in the Plan since this deal was done after plans were submitted.
- The expectation is that in the second quarter, the FAS 125 structure will be undone and put into an off balance sheet vehicle (Sundance). When this is done, goodwill of 90-100MM will be created which will need to be amortized until expected new accounting regulations are implemented (which could be as early as third quarter.)
- When the FAS 125 structure is undone, the external facility costs will cease, but Corporate will charge capital costs (which will be below EBIT).
- See the attached for a financial summary.

DEC-18-2000 08:19

CHASE BANK

713 216 8870 P.02

Global Syndicated Finance - Confidential

Date: 12/18/00

Prepared By: Josh Rogers

STRUCTURING SUMMARY

Project Grinch

GIB Deal Team: Walker, Serice Lender: Traband, Rogers
Credit Executive: Biello, Wardell, Wright Timing: December 2000

| | | | |
|---------------------------------------|---|----------------------------|---|
| Maximum Exposure for Approval (\$MM): | \$ 2.64 Bn (\$743 MM adjusted) | Industry Description: | Diversified Energy |
| Transaction for Approval (\$MM): | \$48.5 MM | Primary SIC Code: | 1321 |
| Customer Name: | Enron Corp. | | |
| Obligor/Facility Risk Grade: | 4/4 | Major Plant Locations: | Texas/Gulf Coast, Oregon |
| Parent Name: | Enron Corp. | Major Overseas Ops: | Europe, India, Brazil, Argentina, Bolivia, Colombia, Caribbean, Philippines |
| Parent Risk Grade: | 3+ | TREND: | Stable |
| Public Ratings (LT & ST): | CP: A2/P2 Sen. Uns: BBB+/Baa1 Sub: BBB/Baa3 | Improving/Stable/Declining | |
| Data Ratings Last Changed: | 3/23/00 (Moody's) | Outlook/Trend? | Positive |
| Stock Price (as of 06/06/00): | \$73.00 | \$2 Wk High/Low: | \$90.75 / \$34.88 |
| Market Capitalization: | \$53.7 Billion | Market Cap/Book Cap: | X |

Executive Summary:

We are requesting approval to provide a \$48.5MM bilateral commitment to an SPV which will be formed by Enron in order to deconsolidate its existing Paper Business, with a mark-to-market portfolio value of \$65 million and a going concern FMV of \$200 million, prior to year end. It is expected that the commitment will be unfunded. The final maturity will be June 29, 2001. The activation of this commitment will only occur if the formation of Enron Net Work Partners (ENW) does not occur prior to year-end 2000.

Transaction Overview:

Enron proposes to commit to contribute its pulp and paper trading business valued at \$200 million to Grinch LP for the purpose of deconsolidating the Paper Business prior to its contribution to ENW. The Paper Business is a going concern pulp and paper trading business and is a key component to Enron's Net Works strategy.

This deconsolidation will allow Enron to monetize this LP asset via a separate FAS 125 transaction, which will generate funds flow and allow for the repayment of corporate debt. An additional benefit may be the ability to realize a gain on the sale of the Paper Business. Arthur Anderson has confirmed the accounting integrity of the proposed transaction because of Enron's existing plans to contribute the Paper Business to ENW. Recall that Chase is acting as an exclusive financial advisor and private equity placement agent in the formation of ENW. Our fee expectation for the ENW transaction is \$5-\$10MM.

Grinch will be owned 50% by Enron and 50% by a to-be-formed SPV proposed to be capitalized with 3% equity and 97% debt. Because the deconsolidation will be affected as a result of the "commitment" to contribute the Paper Business, the capitalization of the SPV will likewise be accomplished through the funding of the 3% equity component while there will be no requirement to fund the debt component.

The \$48.5 million commitment would be supported by 1) Enron's obligation to support the first \$200 million in losses (the FMV of the business) in the portfolio, providing Grinch with 4:1 asset coverage, and 2) the fact that the Paper Business is strategic to Enron's business plan whether NetWorks is formed or not.



1

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Revised 8/97FOIA CONFIDENTIAL TREATMENT
REQUESTED BY JPMC

Permanent Subcommittee on Investigations

EXHIBIT #311

JPM-1-00437

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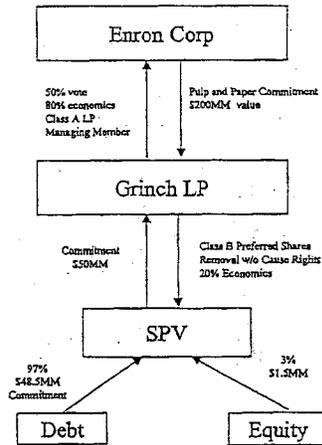
Date:12/13/00

Summary of Terms & Conditions:

Borrower: To be formed SPV
Amount: \$48.5 million
Chase Role: Sole lender
Upfront Fee: [\$250,000]
Drawn Pricing: 100 bps increasing to [] after [].
Purpose: To provide 97% of the capitalization of SPV to purchase Class B Preferred Shares in Grinch LP.
Equity Investor: LJM2 Co Investors LP to provide a commitment to the SPV for \$1.5MM. LJM 2 is managed by Andy Fastow, Enron's EVP and CFO.
Maturity: June 29, 2001
Security: The loan will be secured by the Class B preferred shares in Grinch LP.
Conditions to Fund: Only in the event that losses in Grinch LP exceed \$200 million. Enron Corp. as general partner of Grinch will bear 100% of the first \$200 million in losses at Grinch.
Covenants & Other:

- Strict prohibitions on Grinch's ability to incur other debt, make capital expenditures etc. without lender's consent.
- Grinch will enter into a service agreement with Enron specifying high standards of care relating to management of Grinch. We will seek a covenant regulating the counterparty credit risk exposure.
- In addition to our note maturity, at the end of [6] months, the class B Preferred share may vote to sell Grinch in the open market.

Transaction Diagram:



Project Grinch LP

Request

We are requesting approval to provide a \$48.5MM bilateral commitment to an SPV which will be formed by Enron in order to deconsolidate its existing Paper Business with a FMV of \$200 million prior to year end. **It is expected that the commitment will be unfunded** and the final maturity will be June 29, 2001. The activation of this commitment will only occur if the formation of Enron Net Work Partners (ENW) does not occur prior to year-end 2000.

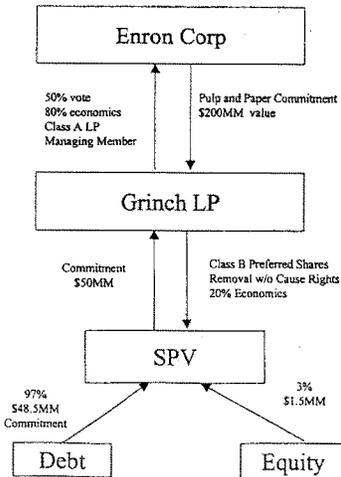
Transaction Overview

Enron proposes to **commit** to contribute its pulp and paper trading business valued at \$200 million to Grinch LP for the purpose of deconsolidating the Paper Business prior to its contribution to ENW. The Paper Business is a going concern pulp and paper trading business and is a key component to Enron's Net Works strategy.

This deconsolidation will allow Enron to monetize this LP asset via a separate FAS 125 transaction, which will generate funds flow and allow for the repayment of corporate debt. An additional benefit may be the ability to realize a gain on the sale of the Paper Business. Arthur Anderson has confirmed the accounting integrity of the proposed transaction because of Enron's existing plans to contribute the Paper Business to ENW. Recall that Chase is acting an exclusive financial advisor and private equity placement agent in the formation of ENW. Our fee expectation for the ENW transaction is \$5-\$10MM.

Grinch will be owned by 50/ 50 by Enron and a to-be-formed SPV proposed to be capitalized with 3% equity and 97% debt. Because the deconsolidation will be affected as a result of the "commitment" to contribute the Paper Business, the capitalization of the SPV will likewise be accomplished through the funding of the 3% equity component while there will be no requirement to fund the debt component.

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JPMC



SENATE
ANNA - 00397

Risk Assessment

The risk of the \$48.5MM commit is substantially the same as that of the "B" tranche of an A-B-C synthetic lease transaction given that the Paper Business is (1) strategic to Enron's business plan whether or not ENW is ultimately formed and (2) the value of the Paper Business at \$200MM provides 4:1 asset coverage (albeit not a secured interest). The value of the Paper Business is supported by (a) valuation work conducted by Chase Securities in conjunction with our private equity/M&A assignment for ENW and (b) the active negotiation with a third party investor with a target price of \$200MM for these contributed assets.

Risk of an actual funding under the commitment is primarily mitigated by air tight restrictions on Grinch's activity including prohibition a capital expenditures, etc. without the lender's consent and the asset coverage provided by the Paper Business – i.e. The value of the Paper Business would have to decline by \$200 million.

Transaction Terms

Borrower: To be formed SPV
 Amount: \$48.5 million
 Chase Role: Sole lender
 Upfront Fee: [\$250,000]
 Drawn Pricing: 100 bps increasing to [] after [].
 Purpose: To provide 97% of the capitalization of SPV to purchase Class B Preferred Shares in Grinch LP.
 Equity Investor: LJM 2 Co Investors LP to provide a commitment to the SPV for \$1.5MM. LJM 2 is managed by Andy Fastow, Enron's EVP and CFO.
 Maturity: June 29, 2001
 Security: The loan will be secured by the Class B preferred shares in Grinch LP.
 Conditions to Fund: Only in the event that losses in Grinch LP exceed \$200 million. Enron Corp. as general partner of Grinch will bear 100% of the first \$200 million in losses at Grinch.
 Covenants & Other:

- Strict prohibitions on Grinch's ability to incur other debt, make capital expenditures etc. without lender's consent.
- Grinch will enter into a service agreement with Enron specifying high standards of care relating to management of Grinch. We will seek a covenant specifying that no more than 20% of Grinch's counterparty exposure may be in Enron's E-5 (BB+) category (i.e. 80% of exposure must be investment grade).
- In addition to our note maturity, at the end of [6] months, the class B Preferred share may vote to sell Grinch in the open market.

Revised: December 16, 2000 (3:45PM)

LJM2 Co-Investment, L.P./Fund Formation

CONTACT LIST

| <u>Company Name/Address</u> | <u>Name/Title/Telephone</u> | <u>Home Address/Telephone</u> |
|--|--|--|
| LJM2 CO-INVESTMENT, L.P. 333 Clay Street, Suite 1203 Houston, TX 77002-7361 Fax: 713-646-8656 | Michael Hinds Managing Director Phone: 713-345-5869 michael.hinds@ljinvestments.com Asst: Amy Flores 713-345-5867 | 3065 Reba Drive Houston, TX 77019 Phone: 713-874-0166 Cell: 713-851-4898 Pager: 888-506-4761 |
| | Ace Roman Analyst Phone: 713- 843-9587 ace.roman@ljinvestments.com | 2350 Bagby #3202 Houston, TX 77006 Phone: 713-520-9116 Cell: 713-515-3613 Pager: 800-670-1420 |
| KIRKLAND & ELLIS 655 Fifteenth Street, NW, Suite 1200 Washington, D.C. 20005 Phone: 202-879-5000 Fax: 202-879-5200 | Michael T. Edsall Partner Phone: 202-879-5028 michael_edsall@dc.kirkland.com Asst.: Kathy Liboro 202-879-5072 kathy_liboro@dc.kirkland.com | 6424 Wood Haven Road Alexandria, VA 22307 Phone: 703-765-0354 Fax: 703-765-1159 Cell: 202-276-3253 |
| | Robert G. Marks Partner Phone: 202-879-5127 robert_marks@dc.kirkland.com Asst.: Beth T. May 202-879-5957 beth_may@dc.kirkland.com | 1400 East-West Highway Apt. #306 Silver Spring, MD 20910 Phone: 301-587-4543 Cell: 703-967-7740 |

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 JPMC

SENATE
 ANNA - 00399

 Michael K Patrick
01/04/2001 10:59 AM

To: Wes Colwell/HOU/ECT@ECT
cc:
Subject: 2000 Accomplishments

I am forwarding my list of 200 accomplishments to you also. It should be noted, that the \$100 million transaction at year end enabled two wholesale business units to make their budgets (EIM and ENW). It was also done with "new accounting technology" by using unfunded capital to meet the "at risk requirement". This idea is something we are starting to incorporate in other deals at ENW and EIM because its easier and cheaper for the banks.

Also, although the IT stuff was a mess, as you can see we have taken some steps in getting this thing on track for 2001

Let me know if you have any questions.

Thanks,

Mike.

Forwarded by Michael K Patrick/NA/Enron on 01/04/2001 09:07 AM

 Michael K Patrick
12/29/2000 04:14 PM

Sent by: Diane Latson

To: Richard Causey/Corp/Enron@ENRON
cc:
Subject: 2000 Accomplishments

Mr. Causey,

I am forwarding the attached to you per Mike Patrick's instructions.


Mike Patrick 2000 Accomplishments.d

Mike will be in the office on Tuesday, January 2, 2000.

Thank you,

Diane Latson x57681

Permanent Subcommittee on Investigations
EXHIBIT #314

Mike Patrick
 VP & CAO – Enron Net Works
 2000 Accomplishments

In my accounting structuring role at Enron Net Works

- ◆ Developed the structure that could result in the non-consolidation of over \$3 billion of future financing for the Net Works' pulp and paper fund. This was done in light of four significant commercial issues which have historically been problematic for accounting 1) Enron retaining over 75% of the economics of the fund, 2) the inclusion of a fixed price call option that will allow Enron to buy out the other partners, 3) Enron guaranteeing the performance of every single trade done on behalf of the fund without having to disclose it in the footnotes and 4) the inclusion of a put option that will allow the investors to sell their partnership interests back to Enron.
- ◆ Developed an alternative structure within a very short time-frame to recognize approximately \$100 million of income and funds flow in 2000 when the above fund structure was not able to close by year-end. The transaction was primarily accounting driven and the structure was heavily negotiated with Arthur Andersen. Ultimately the quick timing issue was addressed by achieving de-consolidation of a business with only a minimal amount of cash (\$7 million) contributed from a third party and a commitment to contribute more (\$43 million) in certain situations. Creating a structure that allowed third party investors to commit instead of actually funding its contribution represented a significant win for the accounting group and allowed the commercial team to close the transaction quicker and cheaper.
- ◆ Led accounting structuring support in executing the True Quote, Houston Street and Klodex transactions in 2000 which should allow Enron Net Works to recognize \$10-\$20 million in income in 2001.
- ◆ Worked with several commercial groups within Net Works (Houston and London) to provide alternative structures that should yield positive income statement results in 2001 if closed.

In addition to my accounting structuring role, I also led the Enron Net Works' accounting team that:

- ◆ Completed the 2001 Operating Plans for 3 Commercial Groups, 3 Support Groups, 6 Trading Platform Groups, approximately 45 IT Operating Groups (over 1,200 people in all) with limited resources
- ◆ Established a comprehensive plan for Global IT costs in order to better determine cost structure and monitor monthly operating costs.
- ◆ Determined a solution for converting 80% of IT allocations to SAP allocations (currently performed external to SAP) thereby eliminating 1.5 FTE's
- ◆ Established standard ENW project tracking template for capturing IT project costs consistently across business units
- ◆ Performed detailed analysis of IT operating expenses resulting in approximately \$15-20 million that was previously expensed that was reclassified to capital.

December 20, 2000

Enron Corp.
1400 Smith St.
Houston, Tx 77002

Attention: Mr. Barry Schnapper

Ladies and Gentlemen:

As consideration for Chase Securities, Inc.'s ("CSI") role in structuring the financing for Annapurna LLC, you agree to pay to CSI, an advisory fee in an amount equal to \$500,000 payable on the date the contemplated transaction documents, including the Credit Agreement are executed.

You agree that, once paid, the fees or any part thereof payable shall not be refundable under any circumstances, regardless of whether the transactions or borrowings contemplated by the Credit Agreement are consummated, except to the extent that any Agent fails to honor its commitments under the Credit Agreement. All fees payable hereunder and under the Credit Agreement shall be paid in immediately available funds.

This Fee Letter may not be amended or waived except by any instrument in writing signed by CSI and you. This Fee Letter shall be governed by, and construed in accordance with, the laws of the State of New York. This Fee Letter may be executed in any number of counterparts, each of which shall be an original, and all of which, when taken together, shall constitute one agreement. Delivery of an executed signature page of this Fee Letter by facsimile transmission shall be effective as delivery of a manually executed counterpart hereof.

SENATE
ANNA - 00360

o:\legal\gbahlmann\networks\csi-fee-ltr.doc
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Treatment Requested by
JPMC

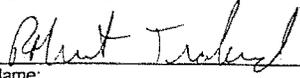
Permanent Subcommittee on Investigations
EXHIBIT #315

Enron Corp.
December 20, 2000
Page 2

Please confirm that the foregoing is our mutual understanding by signing and returning to us an executed counterpart of this Fee Letter.

Very truly yours,

CHASE SECURITIES INC.

By: 

Name:
Title:

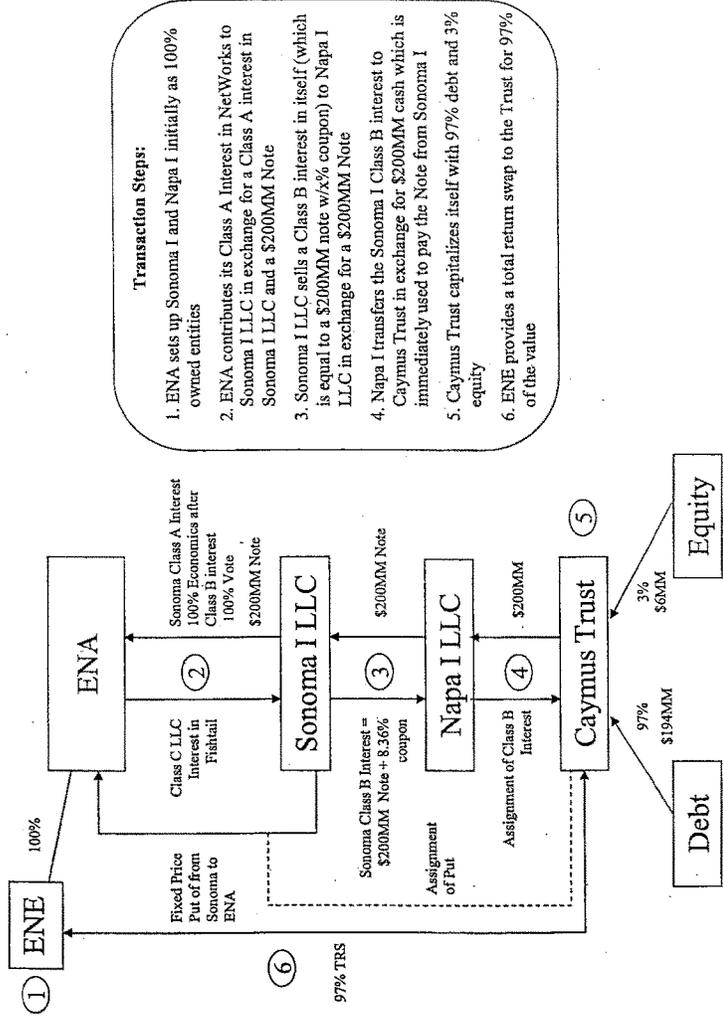
ROBERT W. TRABAND
VICE PRESIDENT

Accepted and agreed to as of
the date first written above by:

ENRON CORP.

By: 
Name: Corey J. Schnapper
Title: Deputy Treasurer

Project Brachios



Transaction Steps:

1. ENA sets up Sonoma I and Napa I initially as 100% owned entities
2. ENA contributes its Class A Interest in NetWorks to Sonoma I LLC in exchange for a Class A interest in Sonoma I LLC and a \$200MM Note
3. Sonoma I LLC sells a Class B interest in itself (which is equal to a \$200MM note w/x% coupon) to Napa I LLC in exchange for a \$200MM Note
4. Napa I transfers the Sonoma I Class B interest to Caymus Trust in exchange for \$200MM cash which is immediately used to pay the Note from Sonoma I
5. Caymus Trust capitalizes itself with 97% debt and 3% equity
6. ENE provides a total return swap to the Trust for 97% of the value

Permanent Subcommittee on Investigations
EXHIBIT #316

ECa000196027

DRAFT. CONFIDENTIAL.

Transaction Descriptions

Project Bacchus

Summary

Project Bacchus was a monetization of 100% of Enron North America's Class C member interest in Fishtail LLC (the "Fishtail Interest"), a Delaware corporation on December 20, 2000. The monetization was effective as of December 20, 2000, through the use of the Caymus Trust, in compliance with SFAS No. 125. Wilmington Trust Company was the Owner Trustee of the Caymus Trust and Citibank was the primary lending institution under the Facility Agreement. The amount of the Facility Agreement was \$193,979,000 and was requested drawn as of December 21, 2000. Beneficial ownership interests in the Trust aggregated \$6,021,000 and were held by Long Lane Master Trust IV. Approximately \$114.6 million of gain was recognized with this transaction.

Structure Description

The limited liability company agreements of Sonoma, L.L.C. ("Sonoma"), and Napa, L.L.C. ("Napa") were dated as of December 20, 2000 ("Effective Date"). Enron North America (ENA) was admitted as the initial member of Sonoma on December 13, 2000. ENA capitalized Sonoma with the aforementioned Class C member interest and in exchange received a Class A and Class B member interest in Sonoma representing .01% and 99.99% economics, respectively. The Sonoma LLC agreement was subsequently amended to admit Napa as a member such that ENA has a .01% economic Class A member interest in Sonoma and Napa has a 99.99% economic Class B member interest in Sonoma.

ENA was admitted as the initial Class A member of Napa on December 13, 2000 for a capital contribution of \$100. The Napa LLC agreement was amended to admit Camus Trust as a Class B member in exchange for \$200,000,000. ENA and Caymus Trust owned .01% and 99.99% economic interests in Napa, respectively subsequent to the amendment.

The aforementioned sharing ratios remain the same until the aggregate of all distributions made to a Class B member equals or exceeds the cut-off amount (defined below) at which time the Class A member will automatically receive a sharing ratio of 100%.

The "Cut Off Amount" means an amount equal to the amount required to pay 1) all principal and interest and all other amounts (if any) payable by the Trust to the agent and lenders and 2) all certificate base amount and certificate yield and all other amounts (if any) payable by the Trust to the certificate holders.

Wilmington Trust as Owner Trustee formed Caymus Trust on December 20, 2000 for a capital contribution of \$75. Caymus Trust borrowed \$193,979,000 from Citibank. This debt is secured by a Total Return Swap written by Enron to the trust.

EC2 00009786

Permanent Subcommittee on Investigations

EXHIBIT #317

EC 00003739

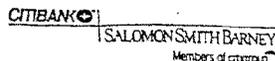
DRAFT. CONFIDENTIAL.

Transaction Descriptions

Caymus Trust used the Facility and certificate proceeds to acquire the membership interest in Napa. Napa used the proceeds received from Caymus Trust to acquire the Class B membership interest in Sonoma. Sonoma made a special capital distribution of \$200,000,000 to ENA from the proceeds received from Napa.

EC2 000009787

EC 000037395



GLOBAL LOANS APPROVAL MEMORANDUM

MEMO DATE: DECEMBER 6, 2000 APPROVAL DUE DATE: DECEMBER 11, 2000

Bookrunner Agent-only Co-Agent Lender

A. KEY STATISTICS
 Borrower: SPV with Enron Net Works LLC as Sponsor ("Caymus Trust")
 Citibank Commitment (\$MM): Debt: \$242.5MM, Equity: \$7.5MM
 *Citibank Hold (\$MM): Debt: \$242.5MM, Equity: \$7.5MM
 Deal Size (\$MM): \$250MM *UW Amount (\$MM): N/A
 Facilities(MM) Type/ Tenor: \$242.5MM term loan/ 1 year (97% of facility) *B/E Amount (\$MM): N/A
 \$7.5MM equity interest/ 1 year (3% of facility)
 Legal Vehicle: Citibank, N.A.
 Origination Unit: GEM - Houston Expected Launch Date: December 13, 2000
 Control Unit: GEM - Houston Expected Closing date: December 20, 2000
 Bookrunner(s) / Amount: Salomon Smith Barney Sell Down date: N/A
 Administrative Agent / Amt: Citibank, N.A.
 Syndication Agent / Amt: N/A
 Documentation Agent / Amt: N/A

| PRICING (BPS) Facilities | Pricing Grid Y/N | Undrawn CF | Undrawn FF | LIBOR Spread | Drawn | Utilization Fee | Fully Drawn | Upfront Fee (Range) |
|--------------------------|------------------|------------|------------|---------------|-------|-----------------|-------------|---------------------|
| Term loan | N | - | - | LIBOR + 65bps | 65bps | - | 65bps | \$500,000 |
| Equity | N | - | - | - | 15% | - | 15% | |

Deal Leader: Chris Lyons Tel: 713-654-2862 Back-up Contact: Lydia Junek Tel: 713-654-3447

LT UNSECURED RR for Facility Adverse Classification
 RATINGS: (DRM) (IA, II, or III)
 BBB+/Baa1 4+ N/A

APPROVALS:
 STEVEN HANJE
 Citicorp North America, Inc.
 Approval Level Required: Level 1/CPSM

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CONFIDENTIAL

CITI-SPSI 0015991

Permanent Subcommittee on Investigations
EXHIBIT #318

PURPOSE:

This memorandum seeks approval for a \$250MM facility ("the facility") to Caymus Trust ("the Trust") with Enron Net Works LLC ("Net Works") as the sponsor. The main purpose of the transaction is to allow Enron Corp. to bring its debt levels down over year-end through the monetization of its pulp and paper trading business. The facility will have 2 components - a debt piece of 97% or \$242.5MM and an equity piece of 3% or \$7.5MM. The debt portion, which we will book and hold, will be secured by way of a total return swap with Enron N.A., which is ultimately covered by a guaranty from Enron Corp. The equity portion will sit on the books of a separate balance sheet provider who will receive compensation for assuming what will essentially be Citibank risk. RBC has indicated receptiveness to being the Balance Sheet provider as they are already familiar with this type of transaction. From our perspective, the equity portion of the facility will be at risk and there is consequently a large element of trust and relationship rationale involved, however, this equity risk is largely mitigated by verbal support received from Enron Corp. as per its CFO, Andrew S. Fastow.

The facility will be set up with a 1 year tenor, however we expect it to be taken out with the proceeds of asset sales which should be completed by the end of 1Q2001. Enron anticipates these proceeds to amount to roughly \$6 billion. One of the disposition transactions, for example, involves the purchase of Portland General Electric of Oregon, a unit of Enron Corp., by Nevada-based Sierra Pacific Resources for \$2.1 billion. If the proceeds from asset disposition are not received as expected by March 31, 2001, we will syndicate the facility.

TRANSACTION SUMMARY (REFER TO ATTACHED SCHEMATIC FOR PROJECT BACCHUS):**PROGRAM SPONSOR - ENRON NET WORKS LLC**

Enron Net Works will be set up initially as a wholly owned subsidiary of Enron Corp. with a view to bringing in third party investors in short order. The investors will contribute cash equity of approx. \$600MM and Enron will invest a like amount split between cash and assets, with Enron's pulp and paper business representing the bulk of assets contributed.

PULP/PAPER ASSETS

Enron values its pulp and paper business at \$275MM. The only other valuation for the pulp and paper assets available thus far is one done by Chase, which acted as an advisor on raising equity for Net Works from third party investors. Chase's valuation range is \$225MM-\$300MM and their valuation presentation is attached.

GUARANTOR - ENRON CORP.

Enron Corp. has agreed to guarantee the obligations of Enron N.A. in this transaction, as well as to provide verbal support for the equity component.

Enron is one of the largest integrated natural gas and electricity companies in the world, with a market capitalization of more than \$60 billion, assets of more than \$50 billion and annual revenues of more than \$40 billion. Enron's pipeline/electric utility businesses are "hard assets" and provide a stable earnings base. The wholesale energy segment builds upon these "hard assets", as well as assets owned directly in the segment, by adding commercial supply and product expertise. This integrated strategy has made Enron the leading wholesale power and gas marketer in the U.S. Near term growth will come from merchant activities, electricity sales, telecommunications, and retail. Enron is rated BBB+/Baa1 by S&P and Moody's.

TRANSACTION SEQUENCE

1. On Day 1, Net Works will be set up as a 100% owned entity of Enron Corporation at the outset. Opus 1 LLC ("Opus") and Napa 1 LLC ("Napa") will also initially be established as wholly owned entities of Enron Corp.
2. Opus will give Net Works a Class A interest (.01% Economic, 99.99% Vote) in Opus 1 LLC and a \$250MM Note in exchange for a limited partnership ("LP") interest in Net Works supported by the paper business or an LP interest in a partnership containing those paper assets.
3. Opus will then sell a Class B interest in itself to Napa in exchange for a \$250MM note.
4. Napa transfers the Opus Class B interest to Caymus Trust in exchange for \$250MM cash, which is then used to immediately repay the Opus note.
5. Caymus Trust assumes \$250MM in capital, composed of 97% debt (\$242.5MM) and 3% equity (\$7.5MM).
6. The debt component is protected by a total return swap ("TRS") with Enron N.A. (a wholly owned subsidiary of Enron Corp.) which is ultimately guaranteed by Enron Corp.

Further, a put will be established between Opus and Net Works for the principal amount of the debt plus the interest expense over the life of the deal. The put serves to provide solvency for Opus and it can also be exercised if Enron N.A. does not fulfill its obligations under the total return swap. The rights for the put will be assigned down to the Trust and run back to the underlying

LP interest and not just the Opus Class B interest. The equity component we provide will be based on verbal support as committed by Andrew S. Fastow, Enron Corp.'s CFO, to Bill Fox, GEM Industry Head.

| DEAL TEAM: | | | | | |
|-----------------------------|--|--------------------------------|---------------------------|-----------------------------|------------------------------|
| Global Loans: | Origination: | Research: | Risk Manager: | Loan Investor Services: | Credit Admin: |
| Chris Lyons 713-654-2862 | Lydia Junek 713-654-3447 Steve Baillie 713-654-2887 | Nisha Mohammed 713-654-2885 | Tom Stott 212-559-6987 | Karen Riley 302-894-6084 | Carol Rooney 713-654-3590 |

B. SUMMARY

EXPOSURE SUMMARY

(in \$ millions)

| Facility Description | Current | Proposed | Change |
|----------------------------------|----------|--------------|------------|
| \$242.5MM 1-year term loan | 0 | 242.5 | 242.5 |
| \$7.5MM equity in "Caymus Trust" | 0 | 7.5 | 7.5 |
| TOTAL | 0 | 250.0 | 250 |

Financial Covenants (List):

TBD

Law Firm:

TBD

CPC Documentation Exceptions:

C. SYNDICATION STRATEGY

N/A

D. RISKS AND MITIGANTS

Valuation Risk

One risk is that the actual value of Enron's pulp and paper business turns out to be worth less than \$250MM.

Mitigant

The primary mitigant is that the debt component (97% of the deal size) is protected by a total return swap, which is further supported by an Enron Corp. guaranty. Hence, the credit risk in the transaction consists of unsecured Enron Corp. risk rather than looking to the assets.

Equity Risk

The 3% equity component is at risk as it is "last dollar" and this investment will only be recovered after the debt is paid out. If the total return swap is used, Enron will become the sole lender and rank ahead of the equity holders.

Mitigant

Enron's CFO, Andrew S. Fastow, has given his verbal commitment to Bill Fox, GEM Industry Head, that Enron Corp. will support the 3% equity piece of this transaction.

Enron Corporate Credit Risk

Enron Corp. will essentially support the entire facility, whether through a guaranty or verbal support.

Mitigants:

Enron is an investment grade company with a BBB+/Baa1 rating. Enron has a proven historic ability to sell assets and issue equity to improve its capital structure when necessary. Enron is also a very liquid company, with cash and cash equivalents of \$697 MM at September 30, 2000 and contractual backstop facilities of nearly \$3 billion.

E. RETURNS TO CITICORP**Return on Entire Enron Relationship:**

During 1999, Citibank had revenues totaling \$32.5 million and a RORAP of 6.04; Citigroup had total revenues of \$44.7 million and a RORAP of 7.63. Year to date revenues for GEM from Enron through September 30, 2000 total \$36.5 MM and we expect revenues to exceed \$50MM by year-end.

Return on Transaction:

Upfront fees on the total commitment will be \$500,000. The \$242.5MM debt component will be priced at LIBOR + 65bps and the \$7.5MM equity certificates will earn a return of 15% per annum.

F. MANAGEMENT AND RELATIONSHIP BACKGROUND

Management is considered to be among the best in the Energy Industry. They are consistently cited for their innovative strategies and have helped the company expand and become a frontrunner in telecommunications and trading, among other things. We maintain regular contact at all levels of management, including CEO, COO, CFO, and SVP Finance. As a part of Cit's broader relationship with Enron, we have been asked to support this transaction. Given the importance of this relationship to GEM, it is difficult if not impossible to deny this request.

G. APPROVAL PROFILE

An Annual Review was completed in June 2000 and is attached as an Exhibit. Also attached is a Credit Update, current through September 30, 2000.

H. SUMMARY OF PROJECTIONS

N/A

I. SECURITY/COLLATERAL

The debt portion (97% or \$242.5MM) will be protected by a total return swap to the Trust and Enron will provide a performance guaranty. A put will also be put in place between Opus and Net Works, serving the purpose of providing solvency for Opus and it can also be exercised if Enron does not make good on the total return swap. The remaining 3% equity or \$7.5MM will be at risk, but is mitigated by the verbal support of Enron Corp., as provided by CFO Andrew S. Fastow.

J. RAAC COMPLIANCE/KEY COVENANTS

TBD

K. WAYS OUT

The main way out is a take out by Enron using a portion of expected proceeds from asset sales of approximately \$6 billion. These asset sales should be completed by the end of 1Q2001. If these proceeds are not received as expected by March 31, 2001 we will syndicate the facility.

L. EXHIBITS

1. DIAGRAM OF PROJECT BACCHUS SCHEMATIC
2. ENRON NETWORKS VALUATION ANALYSIS AS DONE BY CHASE SECURITIES
3. CA
4. ENRON ANNUAL REVIEW DATED 6/30/2000
5. ENRON CREDIT UPDATE AS OF SEPTEMBER 30, 2000

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CITI-SPSI 0015994

CONFIDENTIAL

Unknown

From: Fox, William
 Sent: Wednesday, April 18, 2001 4:29 PM
 To: Stott, Thomas
 Subject: Enron Credit Approval

As you know Enron is pressing us to go to market with the renewal and increase of their flagship RC as well as the increase in the Rawhide transaction. The existing deal expires May 16 and Rawhide needs to be resolved by April 30. There is no question that Enron cashflow has become more dependent on Price Management Activities. For 2000 EBIT from PRM was \$1.9B up \$1B from 1999. Nevertheless, they still have substantial fixed assets, non PRM cashflow and substantial capital: \$22B; \$1.7B; and \$12.5B respectively. As you know we are committed to undertake an indepth review of all the energy marketing companies including the use of outside accounting and technical advisors to deal with transparency and PRM accounting.. This should be completed by mid/end of May. At that time we can make an informed judgement as to how much exposure we want with these clients, on what basis, and how we should manage any transition/change going forward. As part of this review Enron as in the past will be more than willing to review with all interested Citi parties their PRM strategies and risk management process. Enron generates substantial GCIB revenue (\$50mm in 2000); any decision to limit/reduce credit availability will significantly reduce revenues going forward both at Cit and SSB and permanently impair the relationship. Let's discuss.

Further to the Enron approval memo total OSUC to Enron is \$795mm broken down as follows:

\$200mm - Bacchus: SPV where we have a total return swap from Enron for \$180mm and verbal support for the balance

- 100mm - Enron 364 day RC
- 100mm - Rawhide: SPV consisting of both 100% Enron notes and merchant assets
- 75mm - Turbo Park: synthetic lease (ADP) on series of gas power plant turbines; 85% Enron guaranteed
- 54mm - Yosemite 1,2: CLN structure with 100% Enron risk through prepaids
- 42mm - Enron Funding: SPV with Enron guaranty and AAA insurance company credit wrap
- 41mm - Dabhol: power plant project financing in India
- 30mm - JT Holdings: ADP on gas liquids assets with 85% Enron guarantee
- 25mm - Garden State: loan against paper assets with verbal support of Enron
- 24mm - Nahanni: SPV 100% supported by US Tres. bills
- 10mm - JEDI II: SPV consisting of Enron oil & gas properties
- 6mm - Coal Monetization: coal contract monetization from Houston Lighting & Power (Reliant)
- 68mm - misc PSR
- 20mm - misc facilities

Recommend that we approve the two requests at hand. They are 100% Enron risk with the RC being a 364 day facility.

Executive Summary

Purpose: The purpose of this memo is to approve the following facilities for Enron:

1. **Tubopark/Next Generation, LLC Financing** - Citibank has been asked to commit \$200MM with an expected hold of \$75MM out of a \$600MM financing lead by CSFB. The facility will be syndicated by the bookrunner (CSFB) by 3/31/01. The transaction consists of a 3-phase structure to finance the construction and development of gas fired electric generating assets including fixed and soft costs related to future projects. The structure operates in a manner similar to a synthetic lease. It has a drawdown period of 4 years and a final maturity of 8 years.
2. **Garden State Paper Facility** - Citibank and Chase have each been asked to commit and hold \$24.5MM for a total of \$50MM in facilities with a 2-year drawdown period and a 5 year term out. The assets financed in this transaction consist of pulp and paper facilities acquired by Enron to provide an asset base for its paper and pulp trading business.
3. **Bacchus/Caymus Trust Facility** - Citibank has been asked to approve and hold the \$250MM facility consisting of Notes and Certificates. The purpose of the financing is to monetize Enron's pulp and paper trading business over year end in anticipation of its ultimate financing through a joint venture between Enron and equity investors which is expected to close in the first quarter of 2001. The Notes (\$24.5MM) will be supported by a total return swap with Enron Corp as the credit risk. The Certificates are supported by verbal support obtained by Bill Fox from Andy Fastow, Enron Corp's Chief Financial Officer. This facility has a one year termination date. However, the company expects to repay it in full by 3/31/01. If it is not repaid by 3/31/01, we will syndicate it.
4. To request approval for a new Clearing Limit of \$200 million for Enron Metals, Ltd. in London to facilitate early metals transaction payments.
5. To request approval to extend our \$35MM share of a 364 day revolving credit for Enron Funding Corp. from December 27, 2000 to March 28, 2001 to coincide with insurance policy termination dates contained in the structure. The obligations of Enron Funding Corp. are guaranteed by Enron Corp.
6. To request approval to extend and decrease our share from \$14.4MM to \$8.2MM in the Coal Monetization Facility for an additional 364 day period terminating on 12/21/01.
7. To request approval for a new derivatives trading line for Enroncredit.com in the amount of \$10MM to cover existing trades. London is negotiating ISDA. We are requesting a 90-day deferral.
8. To request approval to increase derivative trading lines for Enron North America Corp from \$82 MM to \$150MM to cover existing passive and active excesses and allow additional trades.
9. To request approval to increase SSG trading line for futures from \$25MM to \$50MM.

Total Exposure:



Enron Relationship:

S&P and Moody's rate Enron Corp as BBB+/Ba1, respectively and Enron has an internal risk rating of 4+. The revenue and RCRAP figures from Enron below include both Citibank and SSB:

| Year to Date Revenue (in millions) | | | | RCRAP (bps) | | | |
|------------------------------------|----------|----------|----------|-------------|----------|----------|----------|
| 9/30/00 | 12/31/99 | 12/31/98 | 12/31/97 | 9/30/00 | 12/31/99 | 12/31/98 | 12/31/97 |
| \$36.5 | \$44.7 | \$18.2 | \$17.1 | 4,620 | 763 | 148 | 302 |

Total revenue for 2000 from Enron for Citibank and SSB combined are expected to exceed \$50 million. Citibank revenues in 2000 are expected to be \$41 million of the \$50 million.

Recommendation:

The three new transactions described above are strategic transactions for Enron. Given the breadth of our relationship with the company we have been told by Enron that it is important that we participate in these strategic initiatives. Each transaction has been structured to protect the bank as lender and yield a market return. In addition, we expect a significant amount of the incremental exposure (\$375MM) will be reduced by 3/31/00.

Permanent Subcommittee on Investigations
EXHIBIT #320

CITI-SPSI 0128937

Confidential Treatment Requested by Arthur Andersen LLP

NOV 17 2001 10:44AM ARTHUR ANDERSEN LLP

NO. 946 P. 7
Attachment I
Appendix B

Project Bacchus

3% Test and Gain Calculation

| | | |
|-------------------------------------|-----------------------|-------------------------------|
| Purchase Price/Trust Capitalization | \$ 200,000,000 | |
| Req'd Equity % | <u>3.00%</u> | |
| Req'd Equity | \$ 6,000,000 | |
| Plus: Fees Paid to Citibank | \$ 21,000 | (Requires 3% equity gross-up) |
| Actual Trust Equity | <u>\$ 6,021,000</u> | <i>P</i> |
| Debt Amount | \$ 193,979,000 | <i>P</i> |
| Proceeds from Sale | \$ 200,000,000 | <i>F</i> |
| Basis in Fishtail Interest | <u>\$ 88,000,000</u> | <i>/</i> |
| Pretax Gain | <u>\$ 112,000,000</u> | <i>+</i> |

RESPECT
CASUMMARY
DOCUMENTS
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NOV 17 2001 10:24

Integrity Communication Excellence

Permanent Subcommittee on Investigations
EXHIBIT #321

From: Steve.Baillie@citicorp.com [mailto:Steve.Baillie@citicorp.com]
 Sent: 24 November 2000 20:47
 To: William.Fox@citicorp.com; Lydia.Junek@citicorp.com;
 niels.kirk@citi.com; john.lyons@citicorp.com; james.f.reilly@ssmb.com
 Cc: Steve.Baillie@citicorp.com
 Subject: Enron update

Where we are relative the various Enron deals w are looking at:

Garden State: We are proceeding, \$24.5MM exposure. CA should circulate this week.

JT Holdings: We are proceeding, but we need resolution on the arrangement fee issue very soon. After "feeling the company out" again, Enron is still resistant to paying more than \$100K. \$25MM incremental exposure. CA should circulate this week.

Baachus: We have found out a little more information about the deal specifics. A bridge of up to \$250MM looks quite likely given that the negotiations with the private equity for the new paper company (LP units in which will be the underlying asset we will probably be monetizing - Enron to confirm it will not be the trading business itself) could be delayed as late as mid-December. Enron's motivation in the deal now appears to be writing up the asset in question from a basis of about \$100MM to as high as \$250MM, thereby creating earnings.

It appears the sequence of events will be as follows:
 - day one, Enron contributes trading business which will be deemed to have a value of up to \$250MM, and then we provide \$250MM, of which \$242.5MM will be supported by an Enron total return swap, and \$7.5MM by the "bottom" 3% value in the asset.
 - day 2: (timing/certainty to be confirmed by Enron) Enron will contribute Garden State Paper, whose value will be at least \$40MM. It is unclear what the "other" assets that Enron will contribute are. More to follow. At this point Enron will own 100% of the business as it is the only party to have contributed anything yet.
 - day x: when another paper asset is identified, the initial \$300MM will come from the private equity (to bring its contribution up to the value of Enron's contribution to date), after which contributions will be 50/50 between Enron and the private equity. This is relevant since, to the extent the next asset(s) identified require contribution(s) of more than \$300MM, the value of our asset (i.e. LP unit) should increase accordingly.

Rick Caplan has told me that sourcing a balance sheet provider should still be

2

CITI-SPSI 0119040

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Permanent Subcommittee on Investigations

EXHIBIT #322a

achievable.

Conclusion: I see three key concerns here: (1) loaning the "bottom" 3% on a deal which day 1 has 1:1 asset cover, and day 2 has 1.2x asset cover. Clearly a large trust me element to our \$7.5MM of exposure (2) appropriateness since there is now an earnings dimension to this deal, which was not there before, and (3) up to \$250MM-funded over year end.

Turbopark: See other email for details. Large hold (as high as \$200MM, but with Q1 setdown to \$75MM). We are told the deal presents synthetic lease type risks.

Trading line increase: will probably now be around 80MM.

London deals: Possible prepaid (200MM) and Nahanni 2. Have not heard from London yet. However Nahanni2 is relatively small credit exposure (5% last time). Neils - anything?

Coal JV: We passed. Small deal, and the deal would need to be run by mining (two of three sponsors were mining, plus there was a potential non-recourse piece), and they were not interested.

EBS: (the telecom/IRU monetization). We passed. No hard feelings conveyed.

Falcon/Crane: Jim heard from Net Works, who said it was "highly unlikely" we would need to provide a commitment (relative to a possible bid for an asset)

before year end. Such a commitment however is likely early in 2001, and could be sizeable.

Conclusion - We have managed to simplify the situation somewhat, having passed on EBS and Coal JV, as well as Falcon likely slipping into next year. Although

the permutations are endless, Bacchus and Turbopark strike me as the key deals we will need to decide on. We are further down the road with Bacchus (Enron

changing the fundamentals of the deal mid-stream aside), and Ben has asked that we take a good look at Turbopark.

3
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CITI-SPSI 0119041

Unknown

From: Fox, William
Sent: Monday, November 27, 2000 12:44 PM
To: 'Kirk, Niels CCI.'; 'steve.baillie'; 'william.fox'; 'lydia.junek'; Lyons, Chris; 'Reilly, James F. SSB.'
Cc: Conway, Elliot S.
Subject: RE: Enron update

If Baachaus and the Falcon bridge materialize, that's about a \$1B incremental over year end; that's enough; maybe Nahanni since it will be small exposure but it will be major appropriateness issue as will the first two.

Somewhat annoying that we get a black eye with Enron for not delivering on TXU and Prepaid and yet their chosen winner seems unable to deliver or if deliver on a somewhat different basis.

-----Original Message-----

From: Kirk, Niels CCI. [SMTP:niels.kirk@citi.com]
Sent: Sunday, November 26, 2000 12:55 PM
To: steve.baillie; william.fox; lydia.junek; Lyons, Chris; Reilly, James F. SSB.
Cc: Kirk, Niels CCI.; Conway, Elliot S.
Subject: RE: Enron update

Finally spoke to Chivers and the pipeline status is as follows:

TXU CTA credit linked note - Deutsche's pricing has sprung to somewhere around 250 to 350 bps on their \$500 MM underwriting. Enron commercial guys are now balking at that and are exploring a commercial negotiation with TXU Europe to reduce Enron's credit exposure - so, once again, the solution that "blew Citi out of the water" probably won't get done. I doubt that Enron will re-address this with us.

\$400 MM 3 year oil prepaid - awarded to TD and Morgan Stanley (?) has run into difficulties. TD are apparently having trouble pricing the deal Enron wants. Enron may however approach us for a \$200 MM ST prepaid this year but done as a swap. I haven't seen the structure yet but it apparently uses PSR instead of credit lines so exposure would be a % of the \$200 MM notional. Chivers will revert.

Nahanni 2 seems to be in Ben Glissan's court. Elliot, any update?

Arcos will be a 2001 deal. RBS (NatWest)/BSCH will not be able to close it this year. Enron have worked up some structure that allows them to defer recognition of the related GE turbine contract liability until next year. Enron are still interested in our willingness to participate in the debt (again a 2001 event).

Otherwise our only other call on credit for this year could be additional DCLs to cover our transaction banking (e-commerce) with Enron Europe as MG Ltd accounts have now been transferred and we expect to win their Far East accounts as well.

regards,

Niels

-----Original Message-----

Permanent Subcommittee on Investigations
EXHIBIT #322b

CITI-SFSI 01190

Re: Enron/Bacchus Summary
From: Reilly, James F [IBD]
Sent: Tuesday, November 28, 2000 8:12 PM
To: Hendricks, Maureen A [IBD]; Keller, Dean [IBD]; Becton, Steven [FI]; Caplan, Rick [FI]; Angelini, Amanda [FI]; Fox, William [CITI]; Junek, Lydia [CITI]; Baillie, Steve [CITI]; Lyons, Chris [CIT]
Subject: Enron/Bacchus Summary

Enron is seeking to monetize their paper/pulp trading business in a financial transaction to close before YE. The business will be sold from Enron to a trust ("Bacchus") for roughly \$200/250MM, funded via 97% debt and 3% equity. Ultimately the debt will be placed in the capital markets via unrated, non-registered private debt. Initially, however, we will need to bridge the debt into next year. We will also place the equity with an investor and backstop it via a total return swap, as done in the Yosemite transactions. In effect, at closing, we will hold the full \$200/250MM of risk exposure. Enron has done a series of these type of transactions with other financial institutions. To the best of my knowledge, only one -- the DLJ Iguana deal -- was placed outside of the bank market.

Enron is in the process of raising \$600+MM in cash equity from third party financial investors for a joint venture with Enron ("NetWorks JV"). Enron will invest a like amount, half in cash and half in assets. The paper/pulp operation represents the bulk of the assets to be contributed. It is possible, therefore, that we will actually monetize the paper/pulp business indirectly by purchasing the LP interests in the JV received by Enron in return for their contribution of the assets. In any event, the following will be present in the transaction in any construction:

- Debt: Enron credit as the debt will be backstopped by Enron via a total return swap with the trust. The issue here is the bridge over YE. Capital Markets believes that the paper will sell given the Enron support, altho they may want the ability to get a rating, if deemed necessary. We need to determine who provides the bridge and its terms/conditions/pricing.

- Equity: Roughly \$67.5MM. We cannot hold the equity directly. Derivatives will find a balance sheet provider and take the risk for our account via a total return swap. The equity is "last dollar", recovering the investment only after the debt is paid out (after paying out the lenders via the total return swap, Enron becomes the sole lender, ranking ahead of the equity). It is expected that the deal will unwind via the sale of the LP interests/assets. Absent that, the deal will unwind via the liquidation of the assets at final maturity.

The only valuation available is one done by Chase as part of their effort as advisor on raising equity for the JV. If the JV closes beforehand, the outside equity will have agreed to a valuation on the contributed assets, providing at least another benchmark. We will not have anything else by which we can validate the valuation. As the paper/pulp business is a trading activity, much of the assessed value is in the "intangibles". We must, therefore, rely in large measure on Enron selling or ultimately repurchasing the business/LP units. They have offered to have the CFO discuss this at whatever level of our organization we think necessary to obtain the right comfort.

- Impact: Enron states that the objective of the transaction is to reduce debt levels at YE. This is accomplished by using the proceeds to repay ST debt outstanding today. According to them, it is possible that there will be funds flow and/or earnings impacts. Altho not certain at this time, we should assume that there will be FFO/earnings implications.

- Returns: Exclusive of any bridge revenue, we can probably make no more than \$600M in fees plus a return on the equity (post payout to the balance sheet provider). We need to decide and communicate all of the pricing components soon.

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CITI-SPSI 0118432

Permanent Subcommittee on Investigations
 EXHIBIT #322c

From: Reilly, James F. [REDACTED]
Sent: Tuesday, November 28, 2000 8:12 PM
To: Hendricks, Maureen A. [REDACTED]; Keller, Dean [REDACTED]; Secion, Steven [REDACTED]; Caplan, Rick [REDACTED]; Angelini, Amanda [REDACTED]; Fox, William [REDACTED]; Junek, Lydia [REDACTED]; Baillie, Steve [REDACTED]; Lyons, Chris [REDACTED]
Subject: Enron/Bacchus Summary

Enron is seeking to monetize their paper/pulp trading business in a financial transaction to close before YE. The business will be sold from Enron to a trust (Bacchus) for roughly \$200/250MM, funded via 97% debt and 3% equity. Ultimately the debt will be placed in the capital markets via unrated, non-registered private debt. Initially, however, we will need to bridge the debt into next year. We will also place the equity with an investor and backstop it via a total return swap, as done in the Yosemite transactions. In effect, at closing, we will hold the full \$200/250MM of risk exposure. Enron has done a series of these type of transactions with other financial institutions. To the best of my knowledge, only one - the DLJ Iguana deal - was placed outside of the bank market.

Enron is in the process of raising \$600MM in cash equity from third party financial investors for a joint venture with Enron ("NetWorks JV"). Enron will invest a like amount, half in cash and half in assets. The paper/pulp operation represents the bulk of the assets to be contributed. It is possible, therefore, that we will actually monetize the paper/pulp business indirectly by purchasing the LP interests in the JV received by Enron in return for their contribution of the assets. In any event, the following will be present in the transaction in any construction:

- Debt: Enron credit as the debt will be backstopped by Enron via a total return swap with the trust. The issue here is the bridge over YE. Capital Markets believes that the paper will sell given the Enron support, altho they may want the ability to get a rating, if deemed necessary. We need to determine who provides the bridge and its terms/conditions/pricing.

- Equity: Roughly \$67.5MM. We cannot hold the equity directly. Derivatives will find a balance sheet provider and take the risk for our account via a total return swap. The equity is "last dollar" recovering the investment only after the debt is paid out (after paying out the lenders via the total return swap, Enron becomes the sole lender, ranking ahead of the equity). It is expected that the deal will unwind via the sale of the LP interests/assets. Absent that, the deal will unwind via the liquidation of the assets at final maturity.

The only valuation available is one done by Chase as part of their effort as advisor on raising equity for the JV. If the JV closes beforehand, the outside equity will have agreed to a valuation on the contributed assets, providing at least another benchmark. We will not have anything else by which we can validate the valuation. As the paper/pulp business is a trading activity, much of the assessed value is in the "intangibles". We must, therefore, rely in large measure on Enron selling or ultimately repurchasing the Business LP units. They have offered to have the CFO discuss this at whatever level of our organization we think necessary to obtain the right comfort.

- Impact: Enron states that the objective of the transaction is to reduce debt levels at YE. This is accomplished by using the proceeds to repay ST debt outstanding today. According to them, it is possible that there will be funds flow and/or earnings impacts. Altho not certain at this time, we should assume that there will be FFO/earnings implications.

- Returns: Exclusive of any bridge revenue, we can probably make no more than \$600M in fees plus a return on the equity (post payout to the balance sheet provider). We need to decide and communicate all of the pricing components soon.

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CITI-SPSI 0129017

- Relationship: For Enron, this transaction is "mission critical" (their label not mine) for YE and a "must" for us. If we see any de face them immediately.

Approvals

- + Screening Committee
- Lauren Palmer

Drafted by KBD

- + Capital Markets CC (CMAC)
- needed?

NO SEPARATE CC FOR BRIDGE

Docs

- + Bridge agreement
- + Trust Agreement
- + Total Return Swap
- + Equity
- + Prospectus/etc

CONFIDENTIAL

CITI-SPSI 0129018

Unknown

From: Reilly, James F. SSB. [james.f.reilly@ssmb.com]
Sent: Wednesday, December 06, 2000 7:00 PM
To: Becton, Steven SSB.; rick.captan; Angelini, Amanda SSB.; steve.baillie; lydia.junek; Lyons, Chris; Keller, Dean SSB.
Cc: Reilly, James F. SSB.; Hendricks, Maureen A. SSB.; william.fox
Subject: ENE/Bacchus Update

Now sized at \$200MM (\$194MM debt and \$6MM of equity) +/- (according to the company, any movement would be insignificant in amount). Bacchus will monetize the Enron interest in their existing pulp/paper trading business, valued at roughly \$200MM by Chase (in an advisory role with the Enron NetWorks effort); the value will likely have been accepted by an outside sophisticated investor before closing (probably Bain). The actual asset monetized will be LP units in a partnership which owns the business. The deal needs to close before YE. Enron has asked that Citi provide a 9 month bank facility which will be retired either by capital markets refinancing or early retirement of the transaction (from the sale of the underlying units or, more likely, from proceeds from the sale of other Enron assets for which divestiture efforts are underway).

Bacchus is part of a program designed to ensure that Enron will meet its YE debt/cap targets, in effect "bridging" to the proceeds expected to come from a massive divestiture program underway - peakers, Portland General, wind, South America. Proceeds will be used to repay O/S debt. In addition, it is probable that the monetization will add to FFO as a portion of the assets will be from the merchant pool. It is possible, but not certain, that there will be an earnings impact - Enron has suggested, however, that because of their ongoing involvement in the business, it is unlikely that there will be any material earnings benefit.

Permanent Subcommittee on Investigations
 EXHIBIT #322d

CITI-SPSI 0119046

Unknown

From: Reilly, James F [B0]
Sent: Monday, December 11, 2000 5:26 PM
To: Bailis, Steve [CITI]; Lyons, Chris [CITI]; Junek, Lydia [CITI]; Caplan, Rick [FI]; Angelini, Amanda [FI]; Becton, Steven [FI]; Wagman, Steve [FI]
Subject: ENE/Bacchus

From a conversation with Barry Schnapper: There are "technical" issues with NetWorks which MAY make Bacchus unworkable - Enron continues to try to resolve these unnamed issues but may not know for certain until the end of this week. IF Bacchus is withdrawn, Enron is likely to ask for CITI to provide a \$200MM prepaid instead.

CITI-SPSI 0119155

Permanent Subcommittee on Investigations
EXHIBIT #322e

Unknown

From: Elliott, Shirley S.
 Sent: Wednesday, December 13, 2000 12:52 PM
 To: Fox, William
 Cc: Tiilikainen, Tero A.; Stott, Thomas; Baillie, Steve; Junek, Lydia
 Subject: Enron

Bill,

In response to some of your questions that you asked last night during the Enron Package call, Tero and I have compiled the following information in the attached document:

1. September 30, 2000 vs. December 31, 1999 vs. September 30, 1999 numbers
2. How much EBITDA was non-cash for the above periods
3. Segment information—I believe that both the Energy Wholesale and Retail Services divisions perform trading activities. Price risk management information is also included for the above periods.
4. Materiality of the Bacchus transaction.

Conclusions:

EBITDA/Revenue has decreased from 9/30/99. Total Debt/EBITDA has increased dramatically for 9/30/00 in comparison to the other two periods. Though Enron may "tidy up" their balance sheet for year end, when including 9/30/99 figures in the comparison, it appears that the change from 12/31/99 to 9/30/00 is more substantial rather than cosmetic.

The non-cash portion of EBITDA coming from price risk management activities has jumped from 18.7% at 12/31/99 to 51.4% at 9/30/00.

Over 90% of Revenues come from the Energy Wholesale and Retail Service divisions for the three periods presented. Over 80% for 9/20/00 and over 60% for 12/31/99 and 9/30/99 of income before interest and minority interest and income taxes come from these two divisions.

In terms of total balance sheet size, it appears that Bacchus is immaterial; however, the \$200 million represents 16.3% and 22.4% of operating cash flow and net income, respectively, for the 12 months ended December 31, 1999. Bacchus represents 22.2% and 11.6% of cash EBITDA for nine months ended 9/30/00 and twelve months ended 12/31/00, respectively.



EnronFigures.doc
 (36 KB)

Shirley S. Elliott

Citibank, N.A. - Global Energy & Mining
 Two Allen Center
 1200 Smith Street, Suite 2000
 Houston, Texas 77002

Tel: (713)
 Fax: (713)

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CITI-SPSI 011906

Permanent Subcommittee on Investigations
 EXHIBIT #322f

| | Enron | | |
|---|---------------------|-----------------------|---------------------|
| | 9 Months 9/30/00 | 12 Months 12/31/99 | 9 Months 9/30/99 |
| Revenue | 60,038 | 40,112 | 29,139 |
| EBITDA | 1,853 | 2,113 | 1,699 |
| Interest | 604 | 656 | 537 |
| Cash Flow from Operations | 100 | 1,228 | (43) |
| Capital Expenditures | (1,549) | (2,363) | (2,022) |
| Dividends & Distributions | (396) | (467) | (346) |
| Free Cash Flow | (1,845) | (1,602) | (2,411) |
| Total Debt | 13,781 | 9,152 | 8,592 |
| Total Equity | 11,278 | 9,570 | 9,345 |
| EBITDA/Revenue | 3.1% | 5.30% | 5.8% |
| EBITDA/Interest (x) | 3.1 | 3.2 | 3.2 |
| Total Debt/EBITDA (x) | 7.4 | 4.3 | 5.1 |
| Total Debt/Total Book Capitalization | 55.0% | 43.30% | 47.9% |
| Price Risk Management Information | | | |
| Current Assets from Price Risk Mgmt | 7,294 | 2,205 | 2,156 |
| LT Assets from Price Risk Mgmt | 7,367 | 2,929 | 3,052 |
| Current Liab from Price Risk Mgmt | (5,187) | (1,836) | (2,829) |
| LT Liab from Price Risk Mgmt | (7,314) | (2,990) | (2,521) |
| Net Position: | 1,160 | 308 | (142) |
| Cash Provided by (used in) Risk Mgmt | (952) | (395) | 55 |
| Non Cash Portion of EBITDA* | 51.4% | 18.7% | n/a |
| Revenue by Business Segment | | | |
| Transportation & Distribution | 1,933 | 2032 | 1,461 |
| Wholesale Energy Ops & Serv | 54,787 | 36287 | 25,751 |
| Retail Energy Services | 2,852 | 1807 | 1,009 |
| Broadband Services | 345 | 526 | 429 |
| Corporate and Other | 311 | (540) | 489 |
| Total | 60,038 | 40,112 | 29,139 |
| Income(loss) before interest, minority interests and income taxes: | | | |
| Transportation & Distribution | 529 | 685 | 483 |
| Wholesale Energy Ops & Serv | 1,483 | 1317 | 1,054 |
| Retail Energy Services | 70 | (68) | (75) |
| Broadband Services | (28) | 65 | 65 |
| Corporate and Other | (155) | (4) | (5) |
| Total | 1,699 | 1,995 | 1,522 |
| Bacchus Information—\$200 MM | | | |
| As a % of Entire Balance Sheet | 0.38% | 0.60% | 0.60% |
| As a % of Operating Cash Flow | 200.00% | 16.29% | -465.12% |
| As a % of Free Cash Flow | -10.84% | -12.48% | -8.30% |
| As a % of Net Income | 21.76% | 22.40% | 26.14% |
| As a % of Cash EBITDA | 22.20% | 11.64% | 11.77% |

CITI-SPSI 0119068

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Enron Wholesale provides reliable commodity delivery and predictable pricing to its customers through forward and other contracts. This market making activity includes the purchase, sale, marketing and delivery of nat. gas, electricity, liquids and other commodities as well as the management of Enron Wholesale' own portfolio of contracts.

Retail Energy Services sells or manages the delivery of nat. gas, electricity, liquids and other commodities to industrial and commercial customers located throughout the US and UK.

Enron's value at risk for trading commodity price risk increased to \$55 million at September 30, 2000 as compared to \$21 million at December 31, 1999. This increase is attributable to increased natural gas prices, combined with increased price volatility in the power and gas markets related to overall market conditions.

Unknown

From: Fox, William
Sent: Wednesday, December 13, 2000 9:32 PM
To: Elliott, Shirley S.; Fox, William
Cc: Baillie, Steve; Junek, Lydia; Stott, Thomas; Tilkainen, Tero A.
Subject: RE: Enron

Many thanks;

1. Based on 1999 numbers would appear that Enron significantly dresses up its balance sheet for year end; suspect we can expect the same this year.
2. Can we tell of the cash portion of EBITDA how much of it comes from the different business segments ie how much cash is generated by the different business segments as opposed to reported earnings.
3. Where do you find the VAR numbers, what is it at El Paso, Williams, Dynegy, Coastal; how should we view the absolute level of VAR in relative terms; EBITDA, net income, etc in order to have a view on the relative risk the different clients are assuming.

-----Original Message-----

From: Elliott, Shirley S.
Sent: Wednesday, December 13, 2000 12:53 PM
To: Fox, William
Cc: Baillie, Steve; Junek, Lydia; Stott, Thomas; Tilkainen, Tero A.
Subject: Enron

Bill,

In response to some of your questions that you asked last night during the Enron Package call, Tero and I have compiled the following information in the attached document:

1. September 30, 2000 vs. December 31, 1999 vs. September 30, 1999 numbers
2. How much EBITDA was non-cash for the above periods
3. Segment Information—I believe that both the Energy Wholesale and Retail Services divisions perform trading activities. Price risk management information is also included for the above periods.
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Conclusions:

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Over 90% of Revenues come from the Energy Wholesale and Retail Service divisions for the three periods presented. Over 80% for 9/20/00 and over 60% for 12/31/99 and 9/30/99 of income before interest and minority interest and income taxes come from these two divisions.

In terms of total balance sheet size, it appears that Bacchus is immaterial; however, the \$200 million represents 16.3% and 22.4% of operating cash flow and net income, respectively, for the 12 months ended December 31, 1999. Bacchus represents 22.2% and 11.6% of cash EBITDA for nine months ended 9/30/00 and twelve months ended 12/31/00, respectively.

Permanent Subcommittee on Investigations
EXHIBIT #322g

CITI-SPSI 0128912

Shirley S. Elliott

Citibank, N.A. - Global Energy & Mining
Two Allen Center
1200 Smith Street, Suite 2000
Houston, Texas 77002

Tel: (713) [Redacted]
Fax: (713) [Redacted]

Redacted by Permanent Subcommittee on Investigations

<< File: EnronFigures.doc >>

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CITI-SPSI 0128913

Unknown

From: Angelini, Amanda [F]
Sent: Thursday, December 21, 2000 3:51 PM
To: Francois, Tom [CRRM]
Cc: Caplan, Rick [F]
Subject: RE: Enron/ Bacchus

The Sponsor sets up two LLC entities in Delaware. ENA as Sponsor then contributes a class A interest to Sonoma LLC - the Class A interest consists of ENA's interest in Enron's pulp and paper business. It has an obligation to transfer this interest to the LLCs who in turn transfer the economic rights to this interest to the Trust. This interest can be put back to the Sponsor at the end of the term to provide the Trust with funds to repay loans etc. if the assets are not auctioned. However - Citibank looks to the total return swap with Enron Corp for repayment of the debt.

Amanda

-----Original Message-----
From: Francois, Tom [CRRM]
Sent: Thursday, December 21, 2000 1:54 PM
To: Angelini, Amanda [F]
Subject: RE: Enron/ Bacchus

What obligations does the "sponsor" have?

Regards,

Tom

-----Original Message-----
From: Angelini, Amanda [F]
Sent: Thursday, December 21, 2000 11:21 AM
To: Juneke, Lydia [CIT]; Fox, William [CIT]
Cc: Lee, Andrew P [FIN]; Keller, Dean [BD]; Bendemagel, Donald [GCO]; Warren, Doug [F]; Reilly, James F [BD]; Lyons, Chris [CIT]; Caplan, Rick [F]; Bernstein, Saul [CIT]; Baillie, Steve [CIT]; Holmes, Suzanne [CIT]; Francois, Tom [CRRM]
Subject: RE: Enron/ Bacchus

Just to clarify a couple of points on the structure that we went through with Steve Baillie -

The total return swap is being written by Enron Corp. Enron North America is now the sponsor. There is no guarantee by Enron Corp of Enron North America's obligations. The obligations under the swap are for principal and interest.

We will send an email regarding our review of the total return swap.

Amanda

-----Original Message-----
From: Juneke, Lydia [CIT]
Sent: Thursday, December 21, 2000 11:07 AM
To: Fox, William [CIT]
Cc: Angelini, Amanda [F]; Lee, Andrew P [FIN]; Keller, Dean [BD]; Bendemagel, Donald [GCO]; Warren, Doug [F]; Reilly, James F [BD]; Juneke, Lydia [CIT]; Lyons, Chris [CIT]; Caplan, Rick [F]; Bernstein, Saul [CIT]; Baillie, Steve [CIT]; Holmes, Suzanne [CIT]; Francois, Tom [CRRM]
Subject: RE: Enron/ Bacchus

Area. The arrangement described by Amanda is as agreed. We have also agreed that Derivatives will confirm via e-mail that the total return swap is properly documented and provides for the direct obligation of

CITI-SPSI 0128944

Permanent Subcommittee on Investigations

EXHIBIT #322h

Enron Corp through its guarantee of Enron North America's obligations. The obligations of Enron North America under the total return swap include both both principal and interest on the debt portion. The equity component has been approved on the basis of verbal support verified by Enron CFO, Andy Fastow.

Reply Separator

Subject: RE: Enron/ Bacchus
 Author: William.Fox (William.Fox@citicorp.com) at INTERNET
 Date: 12/21/2000 7:08 AM

Agreed but Derivatives needs to confirm the TRS accomplishes the intended objective of having full recourse to Enron Corp for repayment of the debt portion of the transaction and all documentation is acceptable and in good order.

-----Original Message-----

From: Angelini, Amanda SSB. [SMTP:amanda.angelini@ssmb.com]
 Sent: Tuesday, December 19, 2000 5:04 PM
 To: steve.baillie; lydia.junek; william.fox; Lyons, Chris; Reilly, James F. SSB.; Keller, Dean SSB.; doug.warren; Francois, Tom SSB.; Bendernagel, Donald SSB.; saul.bernstein; Lee, Andrew P. SSB.; suzanne.holmes
 Cc: Angelini, Amanda SSB.; rick.caplan
 Subject: Enron/ Bacchus

One clarification to the memorandum below - T the extent Credit Derivatives makes a payment under the TRS (to cover any fees, expenses or losses) GRB will pay an identical amount in cash to Credit Derivatives for reimbursement of such payments.

> -----Original Message-----

> From: Angelini, Amanda [F]
 > Sent: Friday, December 15, 2000 1:05 PM
 > To: Baillie, Steve [CIT]; Junek, Lydia [CIT]; Fox, William [CIT];
 > Lyons, Chris [CIT]; Reilly, James F [IBD]; Keller, Dean [IBD]; Warren,
 > Doug [F]; Francois, Tom [CRRM]; Bendernagel, Donald [GCO]; Bernstein,
 > Saul [CIT]; Lee, Andrew P [FIN]; Holmes, Suzanne [CIT]
 > Cc: Caplan, Rick [F]
 > Subject: Re: Enron/ Bacchus

>
 >
 > This email is to confirm the RAP treatment and booking procedures
 > for the \$194 million debt portion (the "Loan") and approximately \$6
 > million equity portion (the "Certificates") of the Enron/Bacchus
 > transaction.

>
 > Citibank, N.A. (Global Energy and Mining) will incur an increase of
 > approximately \$200 million to RAP assets upon closing of this trade (which
 > is expected to be the week of December 18, 2000 but definitely prior to
 > year end). Funding for the Certificates will be provided by a third party
 > balance sheet provider. The risk associated with the Certificates has
 > been approved through the standard GRB loan approval process. Derivatives
 > has not been asked to opine on the risk associated with the Certificates.
 > To address certain structural components of the transaction, the form of
 > the instrument required for Citibank, N.A. to assume the economic risk on
 > the Certificates will be a total return swap and not a debt obligation
 > (e.g., loan agreement). To facilitate the booking of this transaction,
 > Credit Derivatives has been asked to face the third party balance sheet
 > provider. Thus, Credit Derivatives should be viewed as simply a booking

CITI-SPSI 0128945

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- > entity. The risk on the equity will remain with the bank book.
- >
- > After discussing with Accounting Policy, the RAP treatment should be
- > that the Banking Book will view the Certificates as if it made a loan in
- > the face amount of the Certificates. Credit Derivatives will not hold a
- > RAP asset and will not mark to market the TRS for RAP purposes.

>
>
>
>
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>
>
>
>
>
>
>

> Amanda Angelini
> Salomon Smith Barney
> Credit Derivatives
> Tel: 212 Redacted by Permanent Subcommittee on Investigations
> Fax: 212
> amanda.angelini@ssmo.com

Unknown

From: Caplan, Rick [FI]
Sent: Wednesday, December 27, 2000 2:08 PM
To: Wagman, Steve [FI]; Angelini, Amanda [FI]
Subject: RE: Enron/Bacchus

yeah, sure, good luck...

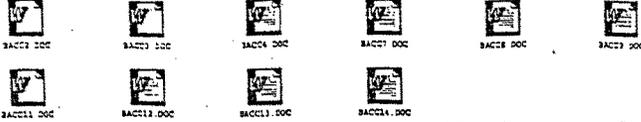
-----Original Message-----
From: Wagman, Steve [FI]
Sent: Wednesday, December 27, 2000 2:05 PM
To: Angelini, Amanda [FI]
Cc: Caplan, Rick [FI]
Subject: Re: Enron/Bacchus

Sounds like we made a lot of exceptions to our standard policies, I am sure we have gone out of our way to let them know that we are bending over backwards for them...let's remember to collect this iou when it really counts...happy holidays to all

Permanent Subcommittee on Investigations
EXHIBIT #322i

CITI-SPSI 0119009

From: Sullivan, Danny [dannysullivan@aktip.com]
Sent: Wednesday, May 16, 2001 3:47 PM
To: Niebruegge, Michael E.
Subject: Bacchus Unwind



Mike, further to my voicemail yesterday,

attached are drafts of the following:

1. Certificate Purchase Agreement
2. Certificate Assignment
3. Investment Letter
4. Prepayment Agreement
5. Direction Letter
6. Swap Termination Agreement
7. Termination of Independent Auctioneer Agreement
8. Receipt of Long Lane
9. Receipt of Citibank
10. Receipt of Trust

The idea is for Sundance Industrial Partners L.P. to purchase the certificate from Long Lane, then as certificateholder make a capital contribution to the Trust in an amount sufficient for the Trust to prepay the notes in full plus break costs. This will take place on Friday of this week, so please could you give me a call at 214 659 4645 as soon as possible so we can co-ordinate.

Thanks

Permanent Subcommittee on Investigations
EXHIBIT #322j

CITI-SPS! 0118785

Capital Markets Approval Committee
New Product/Complex Transaction Description Guidelines
Enron Corp.
Project Bacchus FAS 125 Transaction

Below is information about the proposed new product or complex transaction that should generally be provided in the transaction description. These are *guidelines* — depending on the product or transaction being proposed, certain items may not be relevant, or in some cases other additional information may be required. It is not necessary to follow the form, but all relevant requested information should be provided.

1. **Brief Description.**

- Enron Corp., a GRB client, has requested off-balance financing that is intended to eventually be used to purchase limited partnership interests in its existing pulp and paper trading business. Citigroup will execute a FAS 125 structure, whereby the assets will be sold into a special purpose vehicle which will not be consolidated onto Enron's financials.
- A special purpose Delaware business trust (the "Caymus Trust") will be established. The Caymus Trust will be capitalized with 3% of equity (\$6 million) and 97% of debt (approx. \$194 million) raising approximately \$200 million. The Caymus Trust will have a 0.01% voting interest and 99.9% economic interest in limited partnership interests in Enron Networks which it owns via Class B Interests assigned to it by another special purpose vehicle ("Napa I LLC"). Napa I LLC purchases a similar Class B Interest from another special purpose company (Opus I LLC) that has acquired the limited partnership interest from Enron. (See diagram attached.)
- The equity will be purchased by a balance sheet provider that will enter into a total return swap (the "Citibank TRS") with Citibank, N.A. The equity will have an expected life of 9 months with a possible extension for an additional 2 years upon a capital markets take-out. The Citibank TRS will initially be for a period of 9 months with two mutual three month puts at the end of the first and second 90 day periods. The Citibank TRS will be booked in the Citibank Credit Derivatives Trading Book. The equity will not receive a principal or yield return until maturity of the transaction.
- The debt will be funded by a 9 month bank facility provided by Citibank (Global Energy and Mining). Enron and the Caymus Trust enter into a 9 month total return swap for the notional amount of the debt. If a capital markets take-out occurs, the Caymus Trust will issue approximately \$[197] million of notes (the "Notes") into the capital markets. Salomon Smith Barney will be the placement agent for the Notes. Enron will enter into a total return swap (the "Enron TRS") with the purchasers of the Notes. The debt will have an expected life of 2 years. The Enron TRS will be for a period of 12 months.
- The equity may also be repaid early through early retirement of the transaction (from the sale of the underlying limited partnership units or, more likely, from proceeds from the sale of other Enron assets for which divestiture efforts are underway).
- The expected revenue for the transaction for Citigroup will be:
 - Up front fee of \$500,000
 - LIBOR + 65 bps for the debt
 - 15% on the equity less the return to the balance sheet provider under the Citibank TRS.
- The transaction is expected to be executed in 4Q2000.

2. **Financial Considerations.**

- We have relied on information provided to us by Enron in valuing the equity. The pulp and paper trading assets have been valued at approximately \$200 million by Chase Manhattan Bank. Chase is advising Enron with respect to establishing the equity fund for Enron Networks. The valuation may have been accepted by an outside sophisticated investor before closing of this transaction.

3. Market Risk Considerations.

- The GRB (Global Energy and Mining) will be taking the risk on execution of the transaction.

4. Credit Risk Considerations.

- The GRB (Global Energy and Mining) will take credit risk of the swap counterparty on the Citibank TRS for the amount and premium payable to the balance sheet provider. SSB Credit Derivatives will be entitled to all yield on the equity received at maturity under the Citibank TRS.
- Return on the equity is only due upon maturity of the transaction. Therefore, if there is a decline in value of the assets the debt will be repaid and remaining amounts (if any) will be paid to Citibank as the beneficial holder of the equity. Therefore, Citibank is taking the credit risk of the underlying Enron assets.

5. Legal/Compliance Considerations.

- We have reviewed the structure with internal legal, internal accounting and internal regulatory groups. Each group concurs that the structure works from a legal, accounting and regulatory point of view, respectively.
- Outside counsel is reviewing the FAS 125 structure.

6. Operational and Technology Considerations.

- This transaction will operate no differently to a standard credit derivative.
- This transaction settles no differently to a standard total return swap. There are no special provisions needed.

Please see the attached diagram outlining the transaction.

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ARTHUR ANDERSEN
Arthur Andersen LLC

To: The Files

From: Tom H. Bauer
Kate E. Agnew

Date: December 29, 2000

Subject: Fishtail LLC Formation/Securitization

Transaction Description (see attached diagram)

- Enron North America (ENA), a wholly owned subsidiary of Enron, formed a joint venture, Fishtail LLC (the Venture),
- The Venture issued Class A, B and C membership interests, of which the A interest represents the Managing Member. The initial sharing ratios of the A, B, and C membership interests are .01%, 20% and 79.99%, respectively.
- ENA contributed its existing Pulp and Paper trading business with a value of approximately \$200 mm to the Venture in return for 100% of the Class A and Class C membership interests.
- Annapurna LLC (Annapurna), a recently created special-purpose entity with LJM and Chase Manhattan Bank as the equity holder and debt holder, respectively, contributed \$50 MM, \$7.5 mm of which was funded in cash and \$42.5 of which was committed to the Venture as a line of credit with a third party bank on which the Venture can call upon without involving Annapurna, in return for 100% of the Class B membership interest.
- After formation ENA sold its C membership interest in the Venture to an unrelated third party for a gain.
- ENA takes first \$200 MM loss, Annapurna has a capped equity-like return of approximately 17 percent.

The purpose of the Venture is to engage in the Pulp & Paper and Lumber business including the purchase, ownership, and operation of physical assets and financial and physical trading operations.

Accounting Issues:

1. Is the Venture a joint venture or an SPE?
2. Does Enron meet the capitalization and control requirements for off balance sheet accounting of the Venture?

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3. Does the securitization by Enron of their Class C interest in the Venture meet the requirements of SFAS 125?

Issue 1 : Is the Venture a joint venture of an SPE?

In determining whether the Venture is a joint venture or an SPE, consideration should be given as to whether the Venture meets the definition of a joint venture as defined in APB 18. Because risks and rewards will be shared by the investors of the Venture and the Venture will work to develop the trading business for pulp and paper, it appears that the Venture does meet the definition of a joint venture as defined in APB 18.

Another consideration is whether the Venture meets the definition of a business as defined in EITF 98-3. EITF 98-3 sets forth the critical elements in determining a business including inputs, processes and outputs. The following sets forth the analysis performed on the Venture:

Inputs: The Venture will have a portfolio of paper trading contracts with the intent and ability to enter into additional contracts to increase the paper portfolio. Intellectual property will be contributed 1) directly by ENA as the managing member and 2) indirectly through joint control and participation in decision making. As the managing member, ENA will be compensated for costs incurred to manage the Pulp & Paper and Lumber trading business. The amount of the compensation will be determined by the Members.

Processes: ENA is contributing its existing pulp and paper trading business. Included in that business is the financial trading system, together with the associated commercial activities, encompassing the execution and delivery of trading contracts relating to the purchase and sale of physical products in the Pulp & Paper and Lumber businesses, and the marketing of financial risk management services or contracts. Additionally, the Venture will initially have available capital to acquire physical assets.

Outputs: Assignment of the existing paper trading contracts give the Venture access to its customer base.

Because the business of the Venture was in existence prior to the contribution into the Venture as well as the information above, the client believes the Venture qualifies as a business. We concur with this view.

Issue 2: Does Enron meet the capitalization and control requirements for off balance sheet accounting of the Venture?

Based upon our historical experience in considering this area and various discussions with members of the PSG, both generally and specifically to this transaction, we considered the following factors in this area:

Capitalization

1. Specific authoritative guidance surrounding the necessary amount of capital-at-risk to be considered a substantive investment is available only in literature surrounding SPE's. Although the Venture appears to be a business/strategic joint venture, and is not by definition an SPE, we believe the SPE guidance (EITF 90-15) establishes a good reference point as a minimum standard for our

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consideration. We had numerous discussions both internally and with the client on if and how this test should be applied (i.e., 3% of what, Annapurna vs Fishtail). The advice we provided was that, although one might argue that this test was not applicable in the instance of a strategic venture, we believe the 3% test is the minimum that should be applied to any venture if a parties's investment is to be held out as substantive. Further, we believe the calculation should be based upon 3% of fair value of the assets owned by the Venture (vs. incurred or historical cost or some other measure). As a result, Annapurna was capitalized based on 3% of the fair value of the Venture's assets.

We also considered the unfunded nature of the commitment. Enron believes that the commitment is fully at risk because it is secured with a letter of credit that can be called by the venture directly without approval of its venture partner. The venture is presently cash positive and therefore Enron did not see the commercial need for funds to be contributed to the venture and then invested in short term paper. There is no guidance in the accounting literature for funding requirements for a joint venture. SPE's however, are required to have the entire equity strip funded upon formation. We advised Enron that our preference would be to have the amount computed pursuant to the 4 to 1 test to be fully funded upon formation but would not insist, since the request for the 4 to 1 test is not mandatory in the literature. In keeping with the minimum standard established for SPE's, we advised that the 3% outside equity strip must be fully funded at formation. Enron agreed with our suggestion and capitalized the venture accordingly.

2. Historically, we have recommended, and followed, based on guidance provided by the PSG, an additional "capital-at-risk" test for ventures that contain disproportionate economic sharing. In this test, we have required that, in a 50/50 voting venture, the parties capital-at-risk at formation is weighted to no more than a 4-to-1 ratio (e.g., a parties interest would be considered substantive enough to support a 50% vote if they had at least 20% of the capital-at-risk in the venture).

The venture meets the definition of the 4-to-1 test, as ENA contributed \$200 MM of value and Annapurna contributed \$50 MM of value (\$7.5 MM funded and \$42.5 MM committed).

Control

EITF 96-16 provides guidance on determining when minority shareholder (voting) rights should overcome the presumption of consolidation by the majority shareholder. The guidance in EITF 96-16 focuses on whether or not a minority shareholder's rights are "participating" or "protective" in nature and whether or not such rights are substantive. ENA is the Venture's sole Managing Member; however the Venture governance provisions require consent by the Class B members for specific operating decisions such as approval of significant contract modifications, debt issuances, etc.. Further, the Class B member can, with or without cause, establish a Board of Directors to replace the Class A member as the managing member. Due to the existence of these participating rights and Annapurna's ability to remove the Class A member as the managing member without cause, the client believes that ENA does not control Venture and therefore should not consolidate the Venture. We concur with this view.

Issue 3: Does the securitization by Enron of their Class C interest in the Venture meet the requirements of SFAS 125?

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ENA securitized a portion of its interests (and recognized a \$112M gain) by selling 100% of its Class C membership interest in the Venture to a third party under SFAS 125. The Venture creation and subsequent securitization is consistent with Enron's business model of originating deals structured to achieve current revenue and cash flow recognition.

The transferee was a special purpose entity (SPE), capitalized with 3% equity and 97% debt. The debt is effectively guaranteed through a total return swap (TRS) between the SPE and ENA. Gain will be calculated based on the gross proceeds received. ENA has a third party valuation for the Venture that supports the value of the entity. This valuation was obtained from a party who was not involved in the purchase of the equity. See Attachment I. The TRS will be accounted for at fair value on Enron's books and marked to market prospectively. This transfer structure is consistent with structures used in Enron's other 125 securitizations.

We assessed this transaction based on the conditions set forth in 9a, 9b and 9c in SFAS 125 noting that all conditions were met. We reviewed the true sale/deconsolidation opinions noting them to be adequate. See Attachment II. Based on our testwork, the sale is appropriately accounted for.

Conclusion:

We concur with the client's conclusion that the Venture represents a business, to be accounted for under the equity method of accounting. Accordingly, we concur with the client's application of SFAS 125 to the securitization and believe the value assigned to the securitization is reasonable. We have also audited the gain calculation and believe the approximate \$112 million gain was calculated appropriately.

To: Carl E. Bass@ANDERSEN WO
CC: John E. Stewart@ANDERSEN WO; Debra A. Cash@ANDERSEN WO; Patricia S. Grutzmacher@ANDERSEN WO; Clint Carlin@ANDERSEN WO; James J. Brown@ANDERSEN WO; James F. Green@ANDERSEN WO
BCC:
Date: 11/30/1999 12:11 PM
From: Michael K. Patrick
Subject: Re: Total Return Swaps
Attachments:

A couple of points:

1: What if the SPE issue 100% equity certificates that were legal equity in form and substance to two third parties. One party received 97% of the equity certificates and the other received 3% of the equity certificates. At this point the two owners share pro-rata in the gains/losses of the SPE. The party that holds 97% of the equity certificates enters into a total return swap with Enron. The 3% party remains unhedged.

Does Enron consolidate?

2: Are we saying an SPE can never mitigate some of its risk because it indirectly protects the equity holder? No more insurance contracts, interest rate swaps, commodity price swaps, etc.. I guess these would be o.k. if you somehow structured it where the equity holder would not benefit from these hedges or the equity holder put in more than 3% to compensate for the hedges. On our prepays the SPE always hedges 97% of the price risk with a third party who then does a back-end swap with Enron.

Deb asked me to set up a time when we could talk to you and John about this issue. Let me know a time that is convenient.

To: Michael K. Patrick@ANDERSEN WO
cc: John E. Stewart@ANDERSEN WO
Date: 11/30/99 11:52 AM
From: Carl E. Bass, Houston, 237 / 2314
Subject: Re: Total Return Swaps

John checked his notes from the famous Armando speech and phone call around the time of the Sutton Bridge transaction. You are correct in that the SEC at that time accepted pro rata loss (i.e., 97% of the 3%) as opposed to first loss (i.e., the entire 3%) for a particular registrant matter that they were dealing with. Subsequently, we inquired of the SEC staff in October 1999 whether that is still their policy. They no longer like that answer. In fact, we do not know whether they like the first loss approach, but we know that they do not like the pro rata loss. In effect, under the pro rata loss the entire 3% is not at risk which would be a problem under EITF 90-15 and D-66.

Our advice is to update your client on this recent change in attitude at the SEC staff and have them structure the total return swap or debt guarantee so that the residual equity owner of the SPE has first loss.

To: John E. Stewart@ANDERSEN WO, Carl E. Bass@ANDERSEN WO
cc:
Date: 11/30/99 09:26 AM
From: Michael K. Patrick, Houston, 237 / 2303

Page 1 of 3

Subject: Total Return Swaps

We wanted to confirm our thinking related to the use of total return swaps with SPE's in SFAS 125 transactions.

Facts:

Enron is selling an equity method investment, that has a FMV of \$10 million. Because a QSPE's can not hold equity method investments, Enron will transfer the investment to an SPE.

The SPE will be capitalized with \$300,000 equity (3%) and \$9.7 million of debt (97%).

The SPE will enter into a total return swap with Enron where, upon settlement, the SPE will pay Enron 97% of the FMV of the investment as of that date and Enron will pay SPE \$9.7 million (representing 97% of the FMV of the investment on day 1)

Issue:

Is the equity holder meet the at risk requirements of EITF 90-15 and D-14 given the TRS?

Discussion:

Interpretation 26-3 of our SFAS 125 Interpretations considers a situation where an SPE swaps out 100% of its risk. In this instance the SEC Staff concluded that the SPE must be consolidated because the equity holder did not have the requisite 3% at risk. It also states, "had the total return swap resulted in the retention by the transferor of 97% of the risks and rewards, sale accounting and nonconsolidation would have been appropriate."

Based on 26-3 this structure should work because Enron retains only 97% of the risk and rewards of the investment while the equity holder has 3%, e.g., a \$1 million loss in value of the investment results in ENE losing \$970,000 and the equity investor losing \$30,000. However, in comparing this structure to a debt guarantee structure ENE has done in the past, you get different result.

We have thrown out the term "97% total return swap", but to my knowledge we have not done one of those yet. Instead, Enron typically does a guarantee directly with the debt holder, with no benefit going to the equity holder. We were initially thinking that a 97% TRS should not provide any more protection to the equity holder as a guarantee would. But the above structure does. Unlike a guarantee, the above 97% total return swap, as the case with any risk management instrument done by the SPE, will indirectly benefit the equity holder. In a scenario where Enron did a debt guarantee in the above structure instead of a TRS, Enron would make a payment to the bank to keep them whole but the equity holder would lose its entire investment instead of only \$30,000.

To summarize the effect of both structures: While the effect of the 97% TRS exposes the equity holder to its pro-rata share (3%) of the changes in the asset value and is effectively pari per su with Enron has the TRS counterparty, the gurantee structure exposes the equity holder to the risk of first loss, that is, 100% of the changes in value of the asset (its capital being a floor for losses).

I guess the fundamental question is can an SPE hedge 97% of its risk, which I

think we have answered YES to in the past, but I wanted to make sure everyone knew that a 97% TRS(as outlined above) is not equal to a guarantee of debt representing 97% of the SPE's capital.

I look forward to any comments you might have.

10/29/01

Description of the Sundance Transaction

Sundance is a partnership arrangement that allows Enron to manage its paper and pulp physical assets and trading business off-balance sheet. In the structure, we each contributed assets to the partnership in exchange for a partnership interest. Enron's contributed assets must lose all of their value before our investment is at risk.

Enron contributed certain physical assets and Salomon Brothers Holding Company ("SBHC") contributed \$28.5 million and a commitment to contribute additional capital (\$160 million) if losses in the partnership exceed a certain level.

Description of the Assets (valuation at time of contribution):

- Fishtail - pulp and paper trading business (\$200 million)
- Garden State - New Jersey newsprint operation (\$60-75 million)
- SATCO - Maine timberlands (\$14 million)
- Stadacona - Newsprint mill in Quebec (\$375 million)

Structural Protections:

The transaction is structured to safeguard against the possibility that we need to retribute our contingent equity and to ensure that there is sufficient liquidity at all times to repay our \$28.5 million investment. These objectives are accomplished in several ways:

- At all times the partnership must have \$28.5 million invested in high quality short term investments or in Enron paper, as long as Enron is investment grade.
- Enron will fund up to \$65 million in cash flow needs for debt service and capital expenditures.
- Enron has committed (via a promissory note) to make available a Liquidity Facility in the amount of \$25 million. (Note this facility is separate from the \$28.5 million in cash which must be invested at all times).
- SBHC has the ability to terminate the partnership at any time by activating a four person Board of Directors ("Board") in which we elect two of the members. Any voting deadlock of the Board is a dissolution event of the partnership.
- Enron bankruptcy or significant payment defaults will allow SBHC to terminate the transaction without further funding liability.
- A call on our contingent capital comes only after all of the following have occurred: the partnership has had GAAP net losses in excess of \$657 million, Enron has funded its \$65 million commitment for debt service and cap ex, and Enron has funded the \$25 million Liquidity Facility. If all these events come to pass and SBHC has not

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called for a dissolution of the partnership, then we must fund our contingent capital up to the amount of such excess losses.

- Enron has a right to put the paper trading business to SBHC by giving notice on a date from November 19, 2001 to November 21, 2001 for exercise on December 5, 2001 to December 7, 2001. If Enron exercises this right, we would be obligated to purchase the trading business for \$20 million. We can avoid this result by calling a board and electing to dissolve the partnership prior to December 5, 2001.

Summary:

Currently we have \$28.5 million invested in the partnership in a priority position. All of the assets of the partnership are available to repay our partnership interest. We can effectively dissolve the partnership at any time and force the liquidation of the assets in order to repay our interest. Our risk is that the assets yield less than \$28.5 million upon disposition, i.e., a complete loss in value since formation (June 2001).

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CAPITAL MARKETS APPROVAL COMMITTEE (CMAC)
MINUTES TO MEETING
MAY 16, 2001

*updates
list for
CMAC
re: 1*

Attendance (see below)

Project Sundance (Enron Corp.)

Listed below are the follow-up items identified at the meeting. Approval for the transaction was not granted, as several relevant items remain open. The Committee requested the deal team to come back to CMAC once the outstanding items are resolved.

1. Obtain credit approval for the transaction (Rick Caplan/Doug Warren, Tom Stout/Lydia Junck)
2. Determine group/identify individual(s) who will have overall responsibility for the transaction. Determine group/identify individuals who will have specific responsibilities for reviewing risk/PL reports from Enron, and for monitoring value of the partnership assets. Define specific responsibilities and document procedures to ensure the information flows to all relevant parties (Rick Caplan/Doug Warren).
3. Provide additional information on Daishowa plant and associated SPV requested by Credit and Legal Depts. Review agreements in place and implications of liquidation (Rick Caplan/Doug Warren, Tom Francois, Don Bendernagel)
4. Provide Legal/Credit Depts with transaction docs for review, including Enron guarantee, debt covenants, etc. Legal/Credit needs to sign-off on docs (Rick Caplan/Doug Warren, Don Bendernagel, Tom Francois)
5. Review 23A affiliate issue, and limitations on firm transactions with Sundance (if any) and with partnership assets, i.e. FX, interest rate, commodity hedging transactions with Daishowa (Rick Caplan/Doug Warren, Don Bendernagel)
6. Confirm booking entities — SBHC/SBIL/Citi — of equity interest in partnership, credit default swap (Rick Caplan/Doug Warren, Andy Lee, Don Bendernagel/Andy Alter).
7. Confirm regulatory capital requirements on Salomon entities (Rick Caplan/Doug Warren, Andy Lee on behalf of Financial Division).
8. Provide Internal Tax with tax-related information on partnership and underlying assets/companies (Rick Caplan/Doug Warren, Mark Perwitz).

Additional item identified subsequent to CMAC meeting (May 21):

9. The investment in the Sundance partnership is an equity investment. However based on the way the deal is structured it is more like debt rather than equity. Policy states that equity/firm investments over \$5MM require approval from the CFO (B. Yastine), and additionally from M. Carpenter if over \$25MM. Obtain the required approvals, even though the equity investment in the Sundance partnership is more like debt than equity (Rick Caplan, Doug Warren in conjunction with Financial Division/Andy Lee).

ATTENDANCE

NY Committee Members:

| | |
|----------------|-----------------------|
| K. Anandasagar | Audit and Risk Review |
| Susan Hayward | NY CMAC Coordinator |

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Permanent Subcommittee on Investigations
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| | | |
|---------|---------|--|
| Mark | Perwien | Tax |
| Eleanor | Wagner | NY CMAC Chairperson and Credit Risk Management |

NY Committee Members Absent (Represented by):

| | | | |
|---------|----------|-------------------------|------------------|
| Mike | Day | Financial Division | Andy Lee |
| Marcy | Engel | Legal/Compliance | Don Bendersnagel |
| Jim | Garnett | Risk Architecture | |
| Mark | Kleinman | SSB Treasury | Craig Leslie |
| Bill | Mackey | Financial Control | Saul Bernstein |
| Jessica | Palmer | Commitment Committee | |
| Joe | Perrotta | Operations & Technology | Rich Tantone |
| David | Wagner | Tax | |

Guests:

| | | |
|-------|---------------|--|
| John | Chrysiopoulos | Investment Banking - Paper, Forest Products |
| Tom | Francois | Capital Markets Credit |
| Paul | Gregg | Market Risk Management |
| Lydia | Junek | Relationship Management |
| Elena | Matrullo | Capital Markets Credit |
| John | Mugno | Relationship Management |
| Frank | Pulco | External Counsel - Milbank, Tweed, Hadley and McCloy |
| Jim | Reilly | Investment Banking - Energy |
| Tom | Stott | Credit Risk Management |

Presenters:

| | | |
|------|----------|------------------------------------|
| Rick | Caplan | Credit Derivatives - North America |
| Lynn | Feintech | Derivatives Marketing - Corporates |
| Doug | Warren | Credit Derivatives - North America |

Outcome:

- ENA's aggregate contribution is \$748,900,000.
The Breakdown is: \$60mm Garden State, \$375mm Stadacona, \$13.9mm SATCO, \$210mm cash, \$25mm liquidity Facility, \$65mm Additional Capital Commitment.
- Salomon Smith Barney's aggregate contribution is \$188,500,000.
The Breakdown is: \$20mm Sonoma Class A shares, \$8.5mm Cash, \$160mm unfunded capital commitment.

Cash Steps at closing date and To Do's

| STEP | ACTION | ISSUE | WHO |
|---|--|---|---------------|
| Step 6: ENA gets \$20mm from Salomon. | Wire transfer from SSMB to ENA. | Cathy needs contact person. | Jaime |
| Step 7: Salomon contributes, among other, \$8.5mm in cash to Sundance. | Wire transfer from SSMB to Sundance | | |
| Step 9: ENA contributes \$210mm in cash to Sundance. | Wire transfer from ENA to Sundance | | |
| Step 12 a): Sundance pays [\$199.4mm] plus [\$1.5mm] (breakage cost) to Caymus (Who pays Citibank). | Wire transfer from Sundance to Caymus. | Finalize definition of interest & breakage costs for step 12 | Jaime / Cathy |
| Step 12 b): Sundance pays [\$6.4mm] to Long Lane. | Wire transfer from Sundance to Long Lane | Cathy needs contact person or instructions. | Gina/Cathy |
| Step 13: ENA pays \$8mm note plus interest to Fishtail. | Wire transfer from ENA to Fishtail | Find Note / Send email with interest to be paid | Gina / Cathy |
| Step 13: Fishtail buys from Annapurua Fishtail class B shares by paying \$8.5mm to LJM on behalf of Annapurua (Since Cathy said Annapurua has no bank account). | Wire transfer from Fishtail to LJM | Make sure Fishtail class B Sale agreement (Between Fishtail and Annapurua) reflects this. | Gina / Gareth |
| Step 17: Any significant cash remaining in Sundance account is invested in an Enron Corp. on demand note. | Wire transfer from Sundance to ENA | Find out what document needs to be signed | Gina / Cathy |
| OTHER: Create Funds Flow chart and circulate. | | | Cathy |

Sundance Steps

Updated May 11 2001 5:44pm

All these steps should happen at the closing date. The order of the following should not be altered since Fishtail CANNOT touch Enron's Balance Sheet before Sundance is deconsolidated (Langtry has invested in Sundance). The steps highlighted in **bold** are the unwinding of Fishtail into Sundance.

1. Sundance Industrial Partners LP (Sundance) is created with Enron Industrial Markets Corporation GP (EIM GP) as the General Partner and Enron North America (ENA) as a limited partner.
2. ENA contributes its interest in Enron Industrial Partners LP (EIP) to Sundance.
3. EIM GP contributes its interest in EIP into Sundance.
4. Enron Industrial Partners is dissolved, therefore EIM I BV (Stadacona) and EIM Holdings Inc. (SATCO) are directly owned by Sundance.
5. ENA contributes its 100% Garden State Paper Co. (GSP) interest into Sundance LP.
6. ENA sells Sonoma Class A shares to Langtry for \$20MM.
7. Langtry gets 20% of Sundance for [\$178MM] by contributing [\$7MM] in cash, the Sonoma class A shares (\$20MM), and a [\$151MM] unfunded capital commitment.
8. Sundance grants a 7 day call for \$20MM on the Sonoma Class A shares to Langtry (price to be determined).
10. ENA contributes \$200 MM to Sundance.
11. ENA contributes Sonoma Class A shares into Sundance.
12. Sundance Pays off \$200MM to Caymus trust (\$194MM to Citibank and \$6MM to outside equity investor) and receives Sonoma Class B shares. Now Sundance owns Fishtail Class C shares.
13. Sundance causes Fishtail to call \$8MM Demand Note with Enron Corp. and pays Annapurna (pays \$8 MM to LJM and cancels commitment from Chase) getting Fishtail Class B shares.
14. Amend Conveyance to reflect Net Income/Loss being conveyed.
15. ENA signs a management and administrative services agreement with Langtry.
16. EIM GP signs a management services agreement with Sundance.
17. ENA contributes to Sundance a \$25MM liquidity facility and a [\$78MM] unfunded capital commitment.

Outcome:

- ENA has a 79.9% interest in Sundance. Aggregate contribution [].
- EIM GP Corp. has a 0.1% interest in Sundance. Aggregate contribution [].
- Langtry has a 20% interest in Sundance. Aggregate contribution [].

Sundance Steps **Updated June 1, 2001**

All these steps should happen Friday June 1st, 2001. The order of the following CANNOT be altered. The steps highlighted in bold are the unwinding of Fishtail into Sundance.

| |
|--|
| 1- Sundance Industrial Partners LP (Sundance) is created with Enron Industrial Markets Corporation GP (EIM GP) as the General Partner and Enron North America (ENA) as a limited partner. |
| 2- ENA contributes its interest in Enron Industrial Partners LP (EIP) to Sundance. |
| 3- EIM GP contributes its interest in EIP into Sundance. |
| 4- Enron Industrial Partners is dissolved, therefore EIM LBV (Sladacina) and EIM Holdings Inc. (SAICO) are directly owned by Sundance. |
| 5- ENA contributes its 100% Garden State Paper Co. (GSP) interest into Sundance LP. |
| 6- ENA sells Sonoma Class A shares to Salomon Smith Barney (SSMB) for \$20MM. |
| 7- Salomon Smith Barney gets 20% of Sundance for \$188,500,000 by contributing \$6,500,000 in cash, the Sonoma class A shares (Worth \$20MM), and a \$160,000,000 unfunded capital commitment. |
| 8- Sundance grants a call to SSMB, and SSMB grants a Put to Sundance, on the Sonoma Class A shares for \$20mm. |
| 9- ENA contributes \$208,000,000 to Sundance. |
| 10- ENA contributes Fishtail Class A shares into Sundance. |
| 11- Sundance Pays: <ul style="list-style-type: none"> a) \$201,362,414 to Caymus trust (that pays Citi), b) and \$6,721,000 to Caymus trust (that pays Long Lane). Sundance then gets Sonoma Class B shares from Caymus, thus owns 100% of Sonoma that owns 100% of Fishtail Class C shares. |
| 12- Sundance causes Fishtail to call \$8,538,887.56 Demand Note with Enron Corp. and pays Annapurna \$8,538,887.56 by paying LJM on behalf of Annapurna getting Fishtail Class B shares. |
| 13- Amend Conveyance to reflect Net Income/Loss being conveyed. |
| 14- ENA signs an administrative services agreement with Salomon Smith Barney. |
| 15- ENA contributes to Sundance a \$25MM liquidity facility. |
| 16- ENA contributes a \$65,000,000 unfunded capital commitment. |
| 17- Sundance invests any significant cash remaining in its account in an Enron Corp. on demand note (Permitted Investment, 4.03(b) of the Partnership agreement). |

Permanent Subcommittee on Investigations

EXHIBIT #328c

CITI-SPSI 0128886



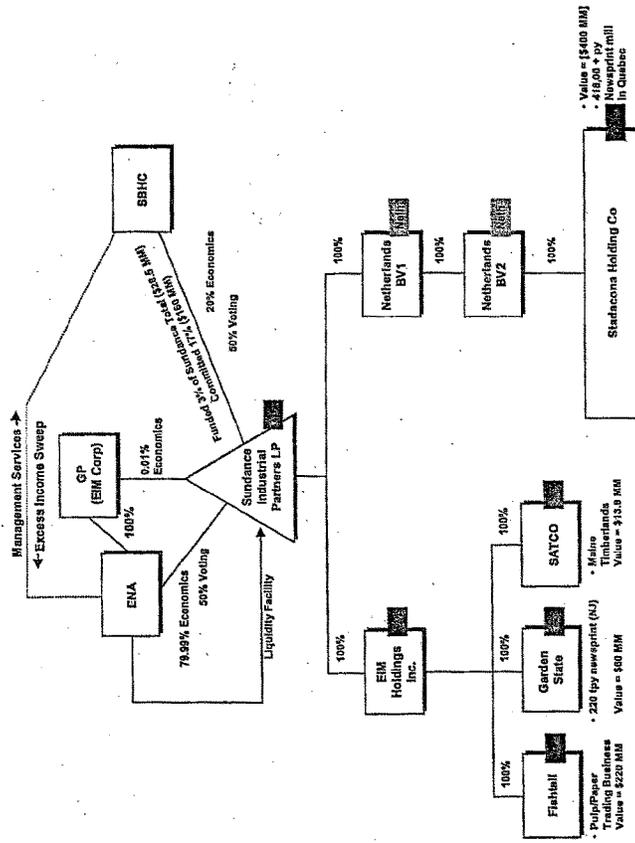
**Enron Industrial Markets
Finance Presentation of
Sundance Industrial Partners**

June 1, 2001

Permanent Subcommittee on Investigations
EXHIBIT #329

ECa000169833

Sundance Structure



Sundance Highlights

- **Earnings on sale of Fishtail A Shares of \$20mm**
 - Obtained last-minute True Sale Opinion from V&E
- **Total Cost of Capital < 2%**
 - not L + 2%
- **Structure flexible and expandable with SSB consent**



Enron Industrial Markets - Finance

264

**Presentation of
Sundance Industrial Partners to
Salomon Smith Barney**

Permanent Subcommittee on Investigations

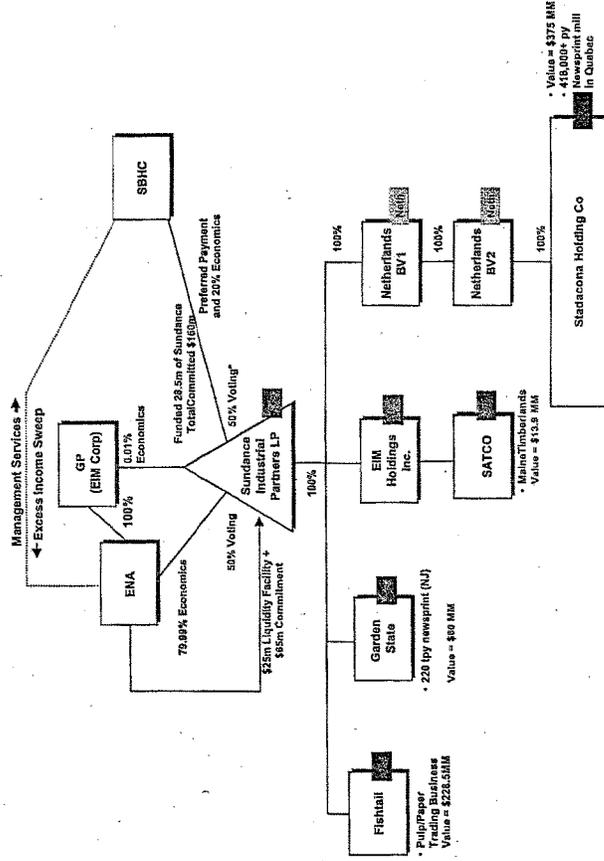
EXHIBIT #330

NY, August 2001

Strictly Confidential

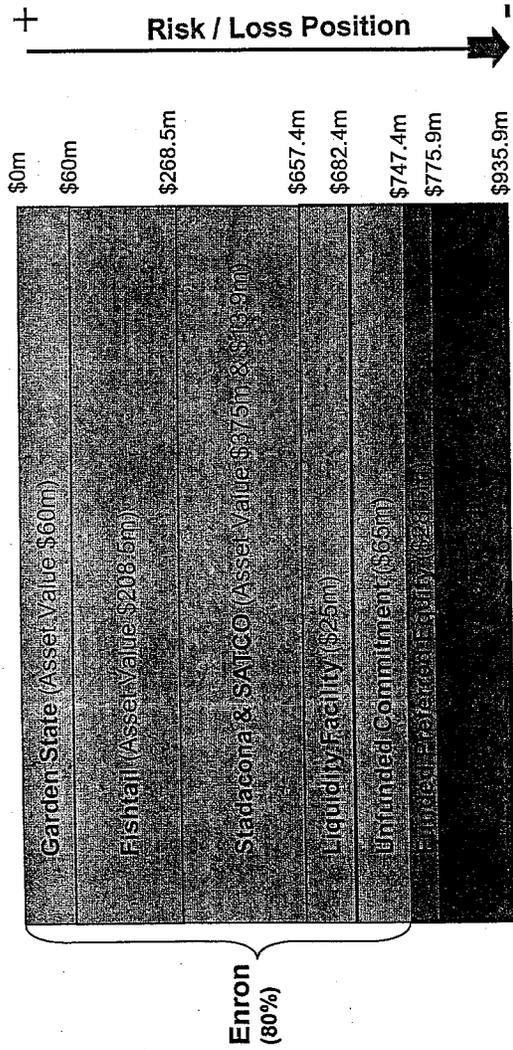
ECa000169826

Sundance Structure



Strictly Confidential

SBHC's Cushion



**Enron contributed a total of \$747m into Sundance.
(\$657m in assets and \$90m in liquidity sources).**

Strictly Confidential

SBHC's risk mitigation mechanisms

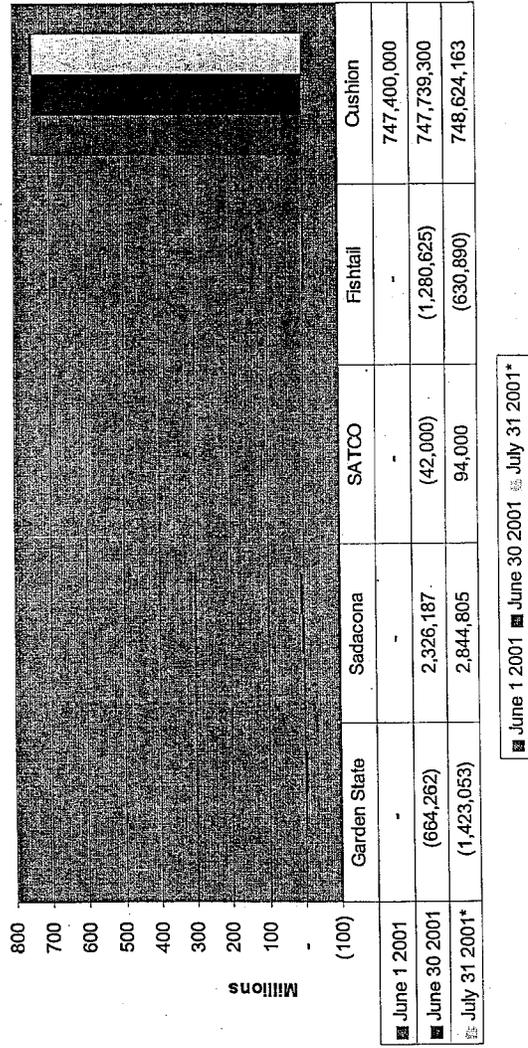
- SBHC's contribution is preferred to Enron's \$747m funded and committed contribution.
 - ⇒ Enron takes the first \$747m in US GAAP losses.
- SBHC has the right, with or without cause to appoint a 50/50 voting Board of Directors. Upon the occurrence of a deadlock**, the partnership dissolves.
 - ⇒ SBHC has the power to dissolve the partnership at will.
- SBHC is receiving adequate periodic reporting and notices.
 - ⇒ SBHC has adequate information to assess ongoing risk.
- Enron indemnifies SBHC for any losses above the Value at Risk limits set.
 - ⇒ Daily trading loss cannot exceed \$5.5m* (6.7 months to erode cushion through trading losses).
- SBHC's funded equity investment is invested in liquid permitted investments that can be called anytime (Investment grade notes (Enron) / deposits).
 - ⇒ Sundance has enough liquidity to repay SBHC anytime.

*Based on actual VaR limits approved by Enron's Chief Risk Officer.

**Deadlock means the failure for a continued period of 15 days (or before December 4 2001, 1 day) of the Board of directors to achieve a majority in respect to any decision requiring approval of a majority of the board.

Strictly Confidential

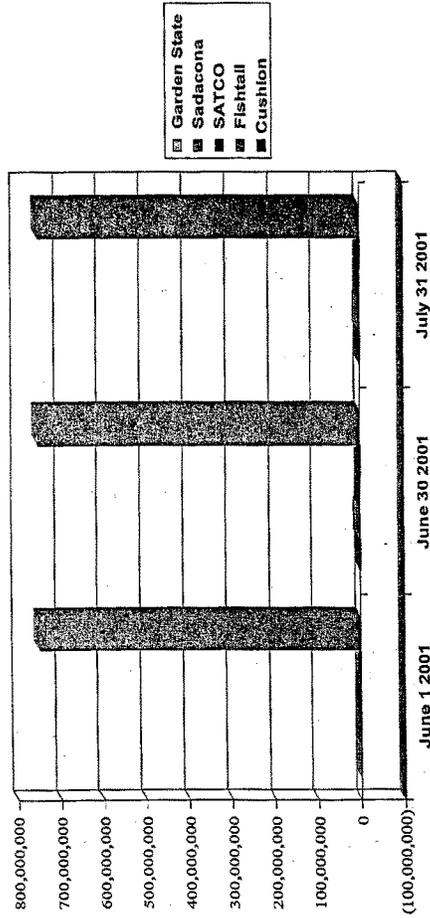
Year to date cushion situation



■ June 1 2001 ■ June 30 2001 ▣ July 31 2001*

Strictly Confidential

Year to date cushion situation



| | June 1 2001 | June 30 2001 | July 31 2001 |
|--------------|-------------|--------------|--------------|
| Garden State | - | (664,262) | (1,423,053) |
| Sadacona | - | 2,326,187 | 2,844,805 |
| SATCO | - | (42,000) | 94,000 |
| Fishtail | - | (1,280,625) | (630,890) |
| Cushion | 747,400,000 | 747,739,300 | 748,624,163 |

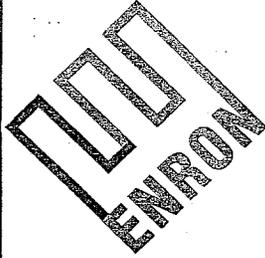
* Estimate for GSP, Sadacona and SATCO. Actuals for Trading book.

Strictly Confidential

Changes in Enron's Risk Management Policy

- There has been NO CHANGE to paper or lumber's VaR limits
- The changes, in general, have made the policy a firmwide notion and are more comprehensive, including:
 - The DASH Process
 - The Credit Process
 - Additional risk evaluating criteria, such as Expected Tail Loss, Return on Risk
- The Approval Process has changed slightly, with Board approval of the overall portfolio and new Concentration Limits only
 - The Risk Committee (CEO, COO and CRO of Enron Corp) now has the ability to approve individual commodity VaR limits within the Concentration Limits set by the Board
 - Same formal write-up and review process to request additional VaR limits
- PriceWaterhouseCoopers best practices opinion to be issued shortly

Strictly Confidential



Enron Industrial Markets - Finance

**Potential paper mill acquisition
presentation to Salomon Smith Barney**

September 2001



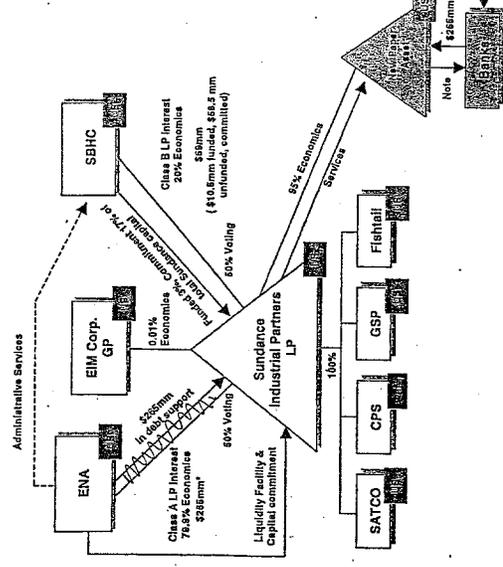
Permanent Subcommittee on Investigations
EXHIBIT #331

CITI-SPSI 0044989

Sundance structure - new acquisition

New Paper Asset

- State of the art Pulp Mill. Low cost producer.
- Approximately 500,000 TMI/yr of Market Pulp.
- Acquisition price of around \$265mm*
- Asset acquisition financed with 100% debt.
- Debt will be supported by Enron. Non recourse to Sundance.
- Enron would be contributing \$265mm* of debt support.
- SBHC would contribute around \$69mm:
 => \$10.5mm funded (9%)
 => \$58.5mm unfunded commitment (17%).



* Preliminary price. Enron is still negotiating.

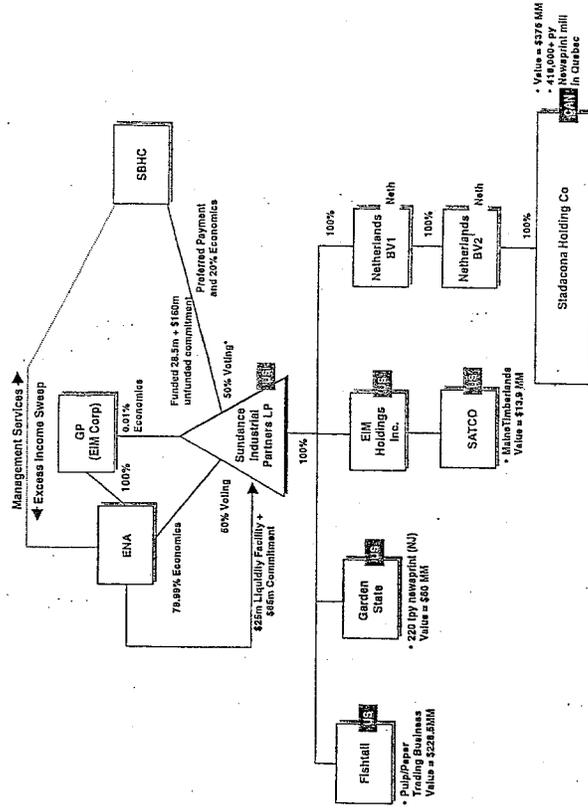
CONFIDENTIAL

CONFIDENTIAL

CITI-SPSI 0044990

1 second deal: payor has the "telling" requirement

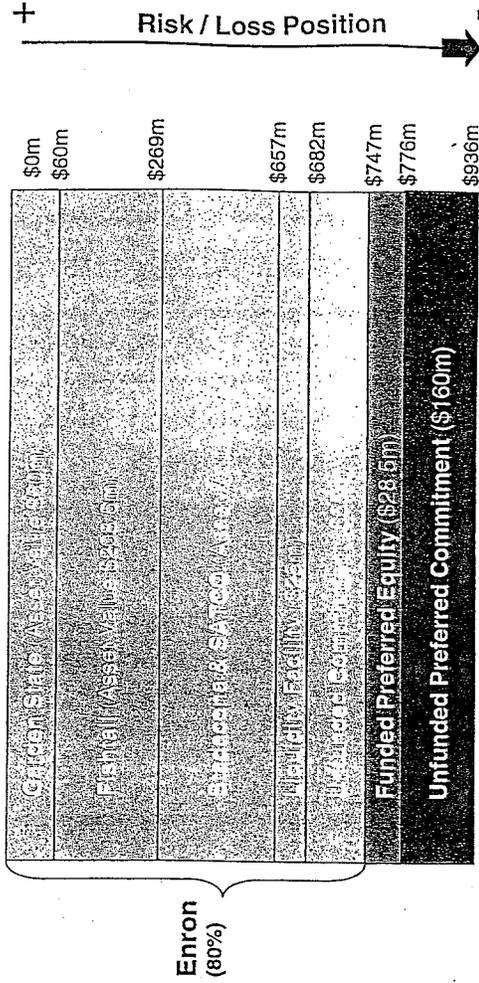
Sundance Structure



Value = 375 MM

CONFIDENTIAL

SBHC's initial cushion



Enron contributed a total of \$747m into Sundance.
(\$657m in assets and \$90m in liquidity sources).

0011010101100100
Confidential 0110011001

SBHC's risk mitigation mechanisms

- SBHC's contribution is preferred to Enron's \$747m funded and committed contribution.
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- SBHC's funded equity investment is invested in liquid permitted investments that can be called anytime (Investment grade notes (Enron) / deposits).
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*Deadlock means the failure for a continued period of 15 days (or before December 4 2001, 1 day) of the Board of directors to achieve a majority in respect to any decision requiring approval of a majority of the board.
 **Based on actual ... limits approved by Enron's Chief Risk Officer.

CONFIDENTIAL

Year to date cushion situation

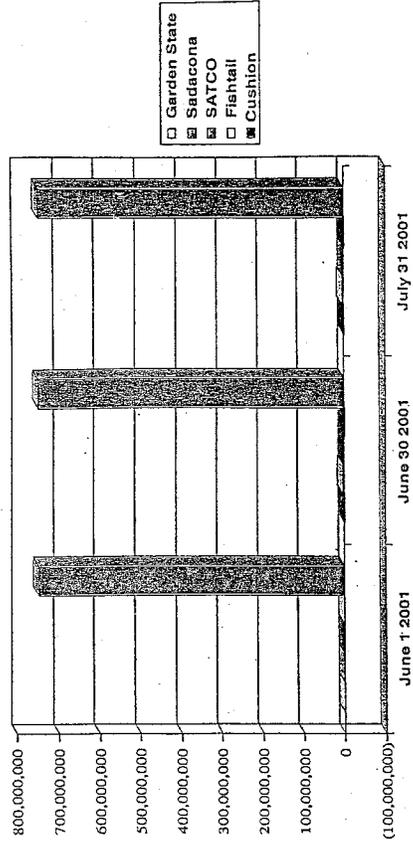
entire pulp/paper

| | Garden State | Sadacona | SATCO | Fishtail | Cushion |
|-----------------|--------------|-----------|----------|-------------|-------------|
| Est June 1 2001 | - | - | - | - | 747,400,000 |
| June 30 2001 | (664,262) | 2,326,187 | (42,000) | (1,280,625) | 747,739,300 |
| July 31 2001* | (1,423,053) | 2,844,805 | 84,000 | (630,890) | 748,624,163 |

June 1 2001 June 30 2001 July 31 2001*
 - Net Income / primary
 "June" (0/0/20)
 6/1

* Estimate for GSP, Sadacona, and SATCO. Actuals for the trading business.

Year to date cushion situation



| | June 1 2001 | June 30 2001 | July 31 2001 |
|--------------|-------------|--------------|--------------|
| Garden State | - | (664,262) | (1,423,053) |
| Sadacona | - | 2,326,187 | 2,844,805 |
| SATCO | - | (42,000) | 94,000 |
| Fishtail | - | (1,280,625) | (630,890) |
| Cushion | 747,400,000 | 747,739,300 | 748,624,163 |

* Estimate for GSP, Sadacona, and SATCO. Actuals for trading business.

CONFIDENTIAL

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 - Additional risk evaluating criteria, such as Expected Tail Loss, Return on Risk
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 - Same formal write-up and review process to request additional VaR limits
- PriceWaterhouseCoopers best practices opinion to be issued shortly

First cut at questions re Sundance

I. Fishtail

1. Why is it in the deal if the purpose is to achieve off b/s financing? Does it have debt?
2. What business is it involved with, and how does it define its activities? How long has this business been operating?
3. Are historical and projected financials available?
4. What are the risk management policies and RMA position?
5. What is Enron's role? What is the interaction with Garden State and Daishowa?
6. What justifies the value of \$200 MM? How has the value varied over time?

II. Garden State

1. What are the cash flow drivers?
2. The \$100 MM Enron commitment for capex and debt service seems aimed at Daishowa. How does Garden State fund its capex if it needs to invest to be competitive and justify what Enron paid?
3. What has been the recent financial performance of Garden State?

III. SATCO

1. Justification for valuation?
2. Historical and projected financials
3. Business plan?
4. How long has Enron owned it?
5. Enron's role? Strategic justification for owning?
6. Is Daishowa a customer?

IV. Daishowa

1. Business and asset description
2. Rationale for financial projections
3. Cash flow drivers
4. Valuation rationale
5. Purpose of "Slapshot Structure"
6. How does the Enron debt guaranty function? (We have not yet read the document you sent on this, which may answer this question.)

V. Sundance

1. How are partnership accounts affected if cash moves from operating assets to Sundance?

2. What is the expected utilization of the \$25 MM liquidity facility?
3. What can Sundance do? Can it, for example, make investments?
4. It looks as if the \$100 MM Enron commitment is intended to be fully used for Daishowa. True?

VI. Due diligence

Please copy us on the legal, asset and environmental due diligence memos.

CONFIDENTIAL

CITI-SPSI 0044782

Leroux, Timothy [F]

From: Angelini, Amanda [F]
Sent: Friday, April 27, 2001 11:52 AM
To: Leroux, Timothy [F]
Subject: sundance

this may help

the argument for why it is debt even if we take a partnership interest that it is more debt like than equity

- * No upside
- * 1st priority
- * Ltd tenor
- * certain events (liquidity facility) require a liquidation of the entire transaction and this should happen before we are ever asked for more capital
- * we do not control via voting power the partnership (sundance)

ama

Amanda Angelini
Salomon Smith Barney
Credit Derivatives Structuring
Tel: 212 723-6484
Fax: 212 723-8334
amanda.angelini@smb.com

From: Koerner, Jonathan [F]
Sent: Wednesday, May 09, 2001 5:35 PM
To: Laroux, Timothy [F]
Subject: FW: Enron Slapshot Structure
Importance: High

Jonathan Koerner
Credit Derivatives Trading
Salomon Smith Barney
ph: 212 723 6118
fax: 212 723 8578
cell: 917 689 1908

-----Original Message-----
From: Feintech, Lynn [F]
Sent: Wednesday, May 09, 2001 5:28 PM
To: Koerner, Jonathan [F]
Cc: Laroux, Timothy [F]
Subject: FW: Enron Slapshot Structure
Importance: High

For doug

-----Original Message-----
From: Coulter, Jodi [mailto:Jodi.Coulter@enron.com] <mailto:Jodi.Coulter@enron.com>
Sent: Monday, May 07, 2001 11:53 AM
To: Feintech, Lynn [F]; Warren, Doug [F]
Subject: FW: Enron Slapshot Structure
Importance: High

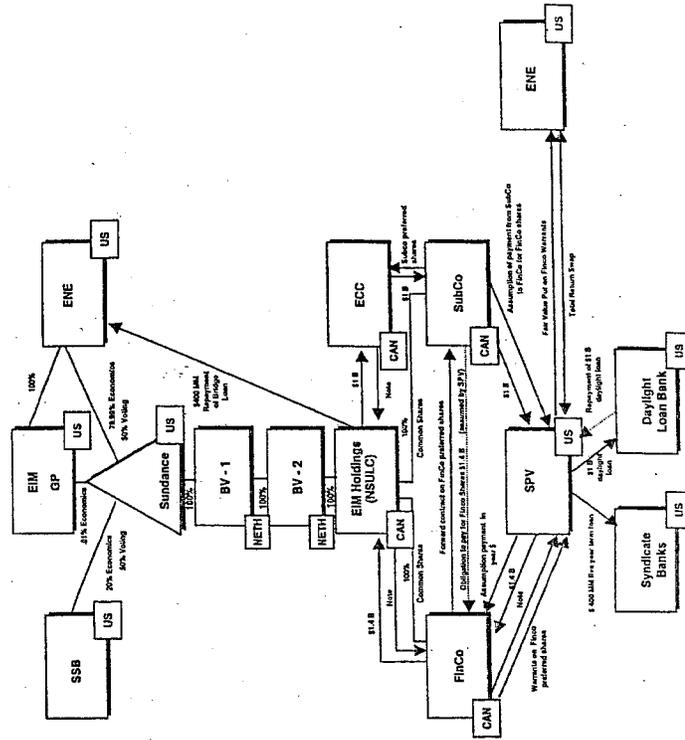


Slapshot Structure
5_07_01.ppt...

> -----Original Message-----
> **From:** Pernot, Catherine
> **Sent:** Monday, May 07, 2001 10:36 AM
> **To:** 'dean.keller@ssmb.com, lynn.feintech@ssmb.com,
> rick.caplan@ssmb.com'
> **Cc:** Coulter, Jodi; McDowell, Doug
> **Subject:** Enron Slapshot Structure
>
> Please see the attached chart for the 12:00 conference call.
> <<Slapshot Structure 5_07_01.ppt>>

Slapshot Structure

Confidential



CONFIDENTIAL

CITI-SPSI 012504

Bakshiyeva, Diana

From: Hayward, Susan [CRRM]
 Sent: Tuesday, May 15, 2001 2:33 PM
 To: Anandasagar, K [AUDT]; Day, Mike [FIN]; Engel, Marcy [GCO]; Gamett, James [CITI]; Kleinman, Mark I [FIN]; Mackey, William J [CITI]; Palmer, Jessica A [CRRM]; Perrotta, Joe [OPS]; Perwien, Mark S [FIN]; Wagner, Eleanor [CRRM]; Ryan, Patrick [CRRM]; Feintech, Lynn [FI]; Warren, Doug [FI]; Caplan, Rick [FI]; Angeini, Amanda [FI]; Leroux, Timothy [FI]; Forese, James A [FI]; Bendemagel, Donald [GCO]; Francois, Tom [CRRM]; Reilly, James F [IBD]; Keller, Dean [IBD]; Chrysiopoulos, John S [IBD]; Handelman, Ed [CITI]; Duke, Ellen [CRRM]; Wallace, Dominic [CRRM]; Gregg, Paul [CRRM]; O'Donnell, Michael [CRRM]; McCall-Bowen, Susan [FIN]; Butler-Kentzig, Patricia [FIN]; Browne, Timothy N [CRRM]; Reynolds, Ann F [FIN]; Tartone, Richard [OPS]; Charles, Evan [GCO]; Cooper, Rosalind [GCO]; McDonald, Carmen S [FIN]; Fox, William [CITI]; Stuckey, Richard A [FI]
 Cc:
 Subject: Materials for CMAC meeting tomorrow, Wednesday May 16

There will be a CMAC meeting tomorrow, **May 16, Wednesday at 4pm.**
 The meeting will take place in the **San Francisco Conference Room on the 4th floor at 390 Greenwich.**

The agenda is as follows:

4:00pm Project Sundance (Enron Corp.)
 Presenters: Rick Caplan, Credit Derivatives
 Lynn Feintech, Derivatives Capital Markets



Project Sundance.doc

A call in number has also been arranged for those unable to attend in person:

Number: US Toll Free 1-888-371-7182
 International 1-212-547-0208
 Passcode: CMAC
 Conference Leader: Susan Hayward

Please call me at 212-723-4675 if you have any questions.

Permanent Subcommittee on Investigations
EXHIBIT #333c

CITI-SPSI 0044827

Capital Markets Approval Committee
New Product/Complex Transaction Description Guidelines
Enron Corp.
Project Sundance Transaction

✓ **Client Need and Transaction Overview:** Enron Corp. ("Enron") owns certain pulp and paper assets (the "Assets"), which have been purchased by Enron in a manner that the assets are off-balance sheet for GAAP accounting purposes. Enron has proposed a limited partnership, Sundance Industrial Partners, L.P. ("Sundance"), into which Enron will contribute approximately \$689 million in Assets and SBHC will contribute 1) \$25 million and 2) a contingent capital commitment of \$140 million. The term of the proposed transaction is 3 years; however, we have the ability to terminate early at our discretion. Enron will continue to manage the assets.

The transaction is structured to safeguard against the possibility that we need to contribute our contingent equity and to ensure that there is sufficient liquidity at all times to repay our \$25 million investment. These objectives are accomplished in several ways:

- At all times the partnership must have \$25 million invested in high quality short term investments or in Enron paper, as long as Enron is investment grade. This investment is likely to fund our exit from the partnership. We intend to purchase default protection on Enron to mitigate our exposure to an Enron bankruptcy.
- Enron will fund up to \$[100] million in cash flow needs for debt service and capital expenditures.
- Enron will commit (via a promissory note) to make available a Liquidity Facility in the amount of \$25 million. (Note this facility is separate from the \$25million in cash, which must be invested at all times).
- SBHC has the ability to terminate the partnership at any time by activating a four person Board of Directors ("Board") in which we elect two of the members. A deadlock of the Board for 15 business days is a dissolution event of the partnership.
- A call on our contingent capital comes only after all of the following have occurred: the partnership has had GAAP net losses in excess of \$689 million, Enron has funded its [\$100 million] commitment for debt service and cap ex, and Enron has funded the \$25 million Liquidity Facility. If all these events come to pass and SBHC has not called for a dissolution of the partnership, then we must fund our contingent capital up to the amount of such excess losses.

Upon the closing of this transaction, Citibank's \$200 million exposure under the "Bacchus" transaction (which funded the Fishtail assets being contributed to the partnership) will be reduced to zero. Our exposure will then be \$165 million under this transaction.

The transaction is expected to close by May 18, 2001.

✓ **Description of the Assets:**

- Fishtail - pulp and paper trading business (\$200 million)
- Garden State - New Jersey newsprint operation (\$60-75 million)
- SATCO - Maine timberlands (\$14 million)
- Daishowa - Newsprint mill in Quebec (\$400 million)

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CITI-SPSI 0044828

The valuation for Daishowa has been reviewed and agreed to by IBD (John Chrysiopoulos and Dean Keller). The IBD advised Enron on its purchase of Daishowa in late 2000. The IBD believes Garden State to be worth \$10-20 million because of required cap ex; however, for the purposes of this valuation process, a higher valuation provides us with a greater cushion in the transaction. SSB's outside counsel, Milbank, Tweed, is also completing an independent review of the Assets. The IBD and both external and internal counsel are also reviewing the environmental indemnifications.

Daishowa will enter the partnership with \$400 million in debt. That debt is with recourse to Enron. We expect that the cashflow from Daishowa will be insufficient to cover debt service and cap ex. It is for this reason that Enron has committed \$[100] million of additional capital contributions to cover these costs. If there were a failure to pay by Daishowa, the banks have recourse to Enron. If Enron fails to pay, the banks would then have recourse to the assets of Daishowa. Therefore, as long as Enron is fulfilling its obligations, we are ahead of the Daishowa debt; however, if Enron fails to perform, the banks will have a first priority interest in the Daishowa asset.

The profitability and therefore the value of Fishtail are heavily dependent upon the market for paper products. SSB (Doug Warren) is compiling information regarding the trading practices, procedures, risk mitigation, and compliance practices of this trading business. Enron (as GP) will provide an indemnity for losses suffered by Sundance as a direct result of the failure to conduct the business within the value at risk and position limits set forth in the Enron Risk Management Policy in effect from time to time. We have required monthly reporting on the P&L of Fishtail and will require a 2 day notification of month-to-date cumulative losses in excess of \$[] million.

- **Structure of the Transaction:** The partnership interests in Sundance will be held as follows: the limited partners will be Enron North America ("ENA"), which will have a 79.9% Class A economic partnership interest and SBHC which will hold a 20% Class B economic partnership interest. Enron Industrial Markets ("GP") will be the general partner with a 0.01% economic interest.

- **Risk Mitigants:**

SBHC will purchase default protection on Enron in an amount to be determined (\$25-50million). Having analyzed the risks to this transaction, we believe we have sufficient control to address greater-than-expected losses in the business through the reporting requirements. However, a cliff bankruptcy of Enron would eliminate the cushion we have in our Daishowa asset. For this reason, we view default protection on Enron to be a significant risk mitigant to our exposure.

SBHC, through its partnership interest, will have the right to appoint at least half of the members of a Board of Directors that will control the partnership. That Board is dormant until activated by one of the partners. We can activate the Board at any time, for any reason, although it is our business understanding that we will not exercise rights over the Assets unless events occur that could negatively impact the value of the Assets. *If we activate the Board and it is deadlocked for 15 days, it is a dissolution event of the partnership.*

SBHC's commitment for the \$140 million is contingent upon "Losses" (defined as GAAP net losses) being incurred by Sundance of an amount greater than \$689 million million (the "Asset Value Threshold") of Assets and the \$25 million initial contribution of SBHC. Additionally, ENA has agreed to contribute additional capital to Sundance (\$[100] million) to be drawn upon once the

cashflow of the business is insufficient to support the debt requirements and capital expenditure needs of the Assets. Under the cashflow models we have been given, we expect the [\$100] million to be drawn down for debt service and capital expenditures. This Enron contribution will be made prior to the contingent SBHC contribution.

Enron has also agreed to provide a \$25 million liquidity facility designed to cover working capital needs of Sundance.

At all times the Partnership must have \$25 million invested in liquid paper (expected to be Enron paper, as long as Enron has at least one investment grade issue outstanding).

SBHC will receive indemnities from Enron protecting us against the failure to conduct Fishtail within the value at risk ("VAR") and position limits set forth in the Enron Risk Management Policy, essentially protecting SBHC from negligence or rogue trading. Enron will agree to notify us within 2 business days of any change to the Policy.

SBHC's interest will be in a preferred position. In other words, for distributions and return of capital, SBHC will be paid prior to any distributions to Enron.

- > **Revenues:** The expected revenue for the transaction for Citigroup will be \$1.65 million p.a., composed of:
- LIBOR + [100] bpps for the \$25 million initial capital contribution
 - [100] bpps on the undrawn committed facility
 - Minimum revenue of \$[] on the transaction

The cost of any default protection we purchase will be borne by SBHC.

In both contributions to Sundance, SBHC has no potential upside, and receives a senior priority for distribution. The investment has been structured to act like debt in form and substance.

- > **Additional Business Risk Considerations:** SBHC will receive monthly reports on the trading business. In addition, we will be notified within two business days of any violation of the Risk Management Policy. We are also requesting 2 day notification of any cumulative month-to-date loss in excess of \$[] million. On all physical assets, we will receive quarterly reports. The ability of Sundance in any way change its assets, liabilities, capital structure or the policies governing any of these will be subject to prior notice to us and our right to call a BoD for Sundance.

Enron bankruptcy or significant payment defaults will allow SBHC to terminate the transaction without further funding liability.

Enron has agreed to assign, to the extent possible, all rights of indemnity and all representations and warranties made to it when it purchased the Assets. In addition, Enron has agreed to provide representations and warranties as to the Assets from the time of purchase to the Effective Date of this transaction.

- > **Additional Legal/Compliance Considerations:** We have reviewed the structure with internal legal, internal accounting, and internal regulatory. [Each group concurs that the structure works from a legal, accounting, and regulatory point of view, respectively]. Outside counsel is reviewing

the transaction and should opine that the ownership structure is legally sound and provides us with a preferred position that is debt-like.

- > **Operational and Technology Considerations:** This transaction requires monitoring of the results of the various businesses. Monthly reports on Fishtail will be received and reviewed by the Credit Derivatives trading desk (Doug Warren). Quarterly reports on the physical businesses will be received by Credit Derivative Operations and reviewed by the trading desk and IBD senior pulp and paper industry experts (currently John Chrysikopoulos).
- > **Deal Team:**
 - Credit Derivatives: Doug Warren, Rick Caplan, Amanda Angelini, and Tim LeRoux
 - Derivatives Capital Markets: Lynn Feintech
 - Internal Legal: Don Bendemagel
 - Credit: Tom Francois
 - IBD: Jim Reilly, Dean Keller, and John Chrysikopoulos
 - Regulatory: Ed Handleman
 - External Legal Counsel: Milbank, Tweed, Hadley and McCloy

From: Feintech, Lynn [F]
 Sent: Tuesday, May 15, 2001 1:29 PM
 To: Caplan, Rick [F]
 Cc: Leroux, Timothy [F]
 Subject: RE: cmac memo

perwein wanted to say that this is a funky deal (accounting-wise), he is amazed that they can get it off balance sheet. he had a few tax questions and was calling tad. said they were minor.

he would like to have in the agreement that we have will review the tax filings for the partnership before they are submitted. pls make sure that this goes into the agreement.

john c. called. he is most concerned about garden state. I will get that info to jody. maybe we can get indemnified just on that. i am trying to set up an environmental call for 1:30 my time on wed (that's when john is free. he will also be on the cmac call). also, john wants the cmac memo changed to say that the fbd says the value of garden state is 10-20mm--but that for our purposes, a higher valuation is better.

re the new \$600K deal: my guess is i'll say "pass", but i'll wait to hear about it. also, just spoke with lydia. let's catch up on houston deals as a whole--it seems like there's a lot to close before july.

-----Original Message-----
 From: Caplan, Rick [F]
 Sent: Tuesday, May 15, 2001 10:09 AM
 To: Feintech, Lynn [F]
 Subject: Re: cmac memo
 Importance: High

Probably not. What did perwein say? They have another deal they are trying to close for \$600k, I will fill you in. Not sure we want to get involved.

-----Original Message-----
 From: Feintech, Lynn [F] <#52835@imcnam.ssmc.com>
 To: Caplan, Rick [F] <rc52842@imcnam.ssmc.com>
 Sent: Tue May 15 13:07:24 2001
 Subject: cmac memo

should saul barnstein really be listed as being on the deal team?

Permanent Subcommittee on Investigations
 EXHIBIT #333d

CITI-SPSI 0122412

Unknown

From: Wagner, Eleanor [CRRM]
 Sent: Tuesday, May 15, 2001 6:29 PM
 To: Forese, James A [FI]
 Subject: RE: sundance

His view is that, if we are putting up money and issuing commitments, even with hedges and structuring to mitigate/eliminate the risk, he feels that this is the correct process. I didn't go into great detail, but explained that the \$25 is hedged and the basis for the \$140 commitment is a structure that insures, insofar as possible, that it will never get drawn. He will probably call you on this, but please call him if you would like more texture.

Regards,

Eleanor

-----Original Message-----
 From: Forese, James A [FI]
 Sent: Tuesday, May 15, 2001 6:08 PM
 To: Wagner, Eleanor [CRRM]
 Subject: Re: sundance

Based on a view that we do indeed have credit exposure to enron, or just for good measure?

-----Original Message-----
 From: Wagner, Eleanor [CRRM] <ew15838@imcnam.smb.com>
 To: Forese, James A [FI] <jf04410@imcnam.smb.com>; Feintech, Lynr [FI] <lf52835@imcnam.smb.com>; Caplan, Rick [FI] <rc52842@imcnam.smb.com>; Stott, Thomas [CITI] <tthomas.stott@citicorp.com>; Fox, William [CITI] <william.fox@citicorp.com>
 CC: Francois, Tom [CRRM] <tf53654@imcnam.smb.com>
 Sent: Tue May 15 17:44:02 2001
 Subject: sundance

I spoke with Dave Bushnell who confirmed that this does need to go through the credit process.

Regards,

Eleanor

Permanent Subcommittee on Investigations

EXHIBIT #333e

CITI-SPSI 0124648

Unknown

From: Feintech, Lynn SSB. [lynn.feintech@ssmb.com]
 Sent: Wednesday, May 16, 2001 10:41 AM
 To: Fox, William
 Cc: Feintech, Lynn SSB.; Junek, Lydia; lydiagjunek; Stott, Thomas; rick.caplan; Francois, Tom
 SSB.; doug.warren; Wagner, Eleanor SSB.; james.a.forese
 Subject: RE: sundance

Bill: While I agree total revenues are not large, the deal is priced at Libor + 6.7% on the drawn amount of the equity (this is not clear from my memo, because the revenue numbers assume the \$140MM will never be drawn--just \$25MM is drawn).

The transaction repays Bacchus by Enron putting \$200MM in cash into Sundance which goes to repay the Citibank loan.

On the accounting: AA has agreed that by maintaining an 80/20 split on ownership with equal voting they can achieve off b/s treatment. We have not advised nor opined on the accuracy of that. However, according to Rick Caplan, it is identical to what Dynegy did in the gas deal for abg gas.

Tax is being reviewed by Mark Perwien (internal tax) and has been reviewed by Millbank to insure that we have no phantom income.

The deal is going to be monitored by 2 groups: the operations of the physical assets will be reviewed quarterly by the IBD (John Chryiskopoulos--MD specialist in pulp and paper) and the trading operations of fishtail will be monitored by Doug Warren in credit derivatives.

Regards,

Lynn

-----Original Message-----

From: Fox, William [CITI]
 Sent: Wednesday, May 16, 2001 3:42 AM
 To: Fox, William [CITI]; Feintech, Lynn [FI]
 Cc: Junek, Lydia [CITI]; lydiagjunek@aol.com; Stott, Thomas [CITI]
 Subject: RE: sundance

I will reach you tomorrow before the Cmac meeting but I do not understand why we are proposing to do this transaction. We are not making any real money and I think we are disenfranchising any future Capital Structuring opportunities with Enron by promoting this cheap alternative. What is the impact of this transaction on Bacchus with respect to our outstanding loans. How is Enron funding the payoff of Bacchus. Also not clear to me how this structure achieves Enron's off balance sheet objectives. Do we have a full understanding of this aspect of the transaction. What is tax impact on Citigroup of this deal? Who is going to monitor this deal on an ongoing basis?

---Original Message---

From: Feintech, Lynn SSB. [mailto:lynn.feintech@ssmb.com]
 Sent: Tuesday, May 15, 2001 10:38 AM
 To: Fox, William
 Cc: Feintech, Lynn SSB.; Stott, Thomas
 Subject: sundance

Bill--further to our call last night, here's the writeup on Sundance. My schedule tonight is open, so call at any time that works for you. I will be in the San Fran office until about 2:30, if you want to try to talk before your dinner. Office is 415-~~415-415-415~~ Home is 510

Redacted by Permanent Subcommittee on Investigations

Permanent Subcommittee on Investigations
 EXHIBIT #333f

CITI-SPSI 011901

293

Tom--Bill asked that I send it to you. It's the same draft as you saw yesterday.
Regards,
Lynn

2

CITI-SPSI 0119012

CONFIDENTIAL

Unknown

From: Keller, Dean [IBD]
 Sent: Friday, May 18, 2001 11:44 AM
 To: Reilly, James F [IBD]
 Subject: RE: Sundance

When you get a chance, can you and I discuss this with Dave Bushnell. I spoke with him the other day and he wants to have some earon discussions with us. I don't really think he is an enemy.

-----Original Message-----
 From: Reilly, James F [IBD]
 Sent: Friday, May 18, 2001 11:34 AM
 To: Keller, Dean [IBD]
 Subject: Fw: Sundance

Fyi

-----Original Message-----
 From: Reilly, James F [IBD] <jr01724@imcnam.smb.com>
 To: Caplan, Rick [FI] <rc52842@imcnam.smb.com>; Feintech, Lynn [FI] <lf52835@imcnam.smb.com>
 Sent: Fri May 18 11:26:13 2001
 Subject: Sundance

Met with hendricks and fox. On the surface the real problem centers on booking/approving in trading book. Game plan: we will do the deal. We will continue to push to book in trading book. If goes on grb, we will work with ene to either price up to a grb return or move to another provider in comfortable time frame. This was communicated to bill last night.

I encourage bill to be happy for now with the commitment to do the deal. It is clear he will be very unhappy if we have to reprice/bring in another provider.

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CITI-SPSI 0128984

Permanent Subcommittee on Investigations

EXHIBIT #333g

Bernstein, Saul
 From: Mccall-Bowen, Susan SSB. [susan.mccallbowen@ssmb.com]
 Sent: Friday, May 18, 2001 1:54 PM
 To: Bernstein, Saul
 Cc: Mccall-Bowen, Susan SSB.
 Subject: FW: RBC Treatment for Project Sundance

Hi Saul,
 I understand you are looking at the acctg for this transaction. Do you have any issues?
 I don't think the investment in the LP doesn't belong in a trading acct - do you agree? *Yes*
 Thanks,
 Sue

-----Original Message-----
Mccall-Bowen, Susan [FIN]
 From: Mccall-Bowen, Susan [FIN]
 Sent: Friday, May 18, 2001 10:19 AM
 To: Butler-Kenzig, Patricia [FIN]
 Cc: Lee, Andrew P [FIN]
 Subject: FW: RBC Treatment for Project Sundance

Hi Pat -
 The below emails discuss the RBC treatment for this transaction. The transaction is:
 1. Will be executed on the credit derivatives desk (Andy Lee went to the CMAC meeting).
 2. Involves SBHC, having a LP interest in a partnership - Sundance Industrial Partners, LP
 3. Enron contributes \$689 million of assets to the partnership (assets consist of pulp and paper trading business, newsprint operations and timberlands). SBHC will contribute \$25 million plus has a contingent capital commitment of \$140 million. *160M in but cannot be defined*
 4. The partnership is being set up to avoid balance sheet treatment. *Since SBHC will dissolve Partnership if dissolved triggers etc being approached.*
 Note that these assets are owned by Enron today in other partnerships. We were involved in one partnership on Cit's books referred to as "Bacchus". Our exposure on that is \$200 million. Our exposure on this new partnership is \$165 million (thus our exposure is being reduced). *1-25 (for Rick Lashin, Yes) 140-165 (for Rick Lashin, Yes) 25M.*
 5. Our return is structured so that we receive ~~libor plus 2%~~ *LIBOR* on the \$25 million. I think we would receive the same on the \$145 million if we have to contribute. We have no upside (can't get additional returns based on the performance of the assets). We have credit risk. I think the desk is going to ~~get~~ *get* a credit default option for credit protection.
 6. The partnership can be terminated by either us or Enron, subject to a 15 day period (we would have to activate the board...if board is deadlocked for 15 days, it is a dissolution event of the partnership).
 7. Questions - RBC treatment - see below emails for answer
 • Acctg - since this is an investment in a LP, I'm not sure if it should reside in trading (don't think it should). The hedge (credit protection) would be in trading, but I think this should be in investments. Do you agree??
 • If it's a firm investment, approved by the business, it would have to be approved by Barbara and Mike. Should we have them approve or do we regard this as a trading strategy?
 Pls let me know what you think.
 Thanks.

*from 3/17
 and Enron
 will fund
 cost
 The transaction
 will be
 expected to be
 true 1/25.*

-----Original Message-----
Hayward, Susan [CRM]

Lee, Andrew P [FIN]

From: Leroux, Timothy [FJ]
Sent: Friday, May 25, 2001 3:58 PM
To: Lee, Andrew P [FIN]
Subject: RE: Enron/Sundance

Still an equity investment of sorts (acctg and tax basis for partnership) but is structured in such a way that the 670 bps is guaranteed or we blow the deal. Also our "invest" is so subordinated and controlled that it is "unimaginable" how our principal is not returned.

Permanent Subcommittee on Investigations
EXHIBIT #333i

CITI-SPSI 0044874

Hayward, Susan [CRRM]

From: Hayward, Susan [CRRM]
 Sent: Wednesday, May 23, 2001 6:14 PM
 To: Wagner, Eleanor [CRRM]
 Subject: FW: Sundance/Firm Investment

more up-to-date, with Doug's response

-----Original Message-----

From: Warren, Doug [FJ]
 Sent: Wednesday, May 23, 2001 6:11 PM
 To: Lee, Andrew P [FIN]; Caplan, Rick [FJ]
 Cc: Hayward, Susan [CRRM]
 Subject: RE: Sundance/Firm Investment

Please send me the memo.

Yick, I will take care of this.

The Eagle deals were approved by senior management for balance sheet and for risk, not as equity investments. I worked on them for 5 years.

Doug Warren
 Credit Derivative Trading
 SalomonSmithBarney
 : 212 723 6118
 : 212 723 8578
 n: 917 685 8465

-----Original Message-----

From: Lee, Andrew P [FIN]
 Sent: Wednesday, May 23, 2001 6:06 PM
 To: Caplan, Rick [FJ]
 Cc: Warren, Doug [FJ]; Hayward, Susan [CRRM]
 Subject: RE: Sundance/Firm Investment

Hi Rick,

I had some follow-up conversations today with Sue McCall, Pat Butler and Shawn Feeney.

In order to comply with the policy over firm investments, it does appear that we will need to have approval at some point from Mike Carpenter, Barbara Yastine and Tom Maheras on Project Sundance.

However, Shawn told us that he can help get these necessary approvals (he has done so for firm investments entered into by other trading desks). Perhaps you can talk to him to coordinate how this can be done. If you think it would be useful, I can give you a copy of a memo that another desk prepared to request approval for a firm investment.

Also, the Eagle trades apparently did go through an approval process that required approvals from senior management.

Please let me know if you have any questions.

1

CITI-SPSI 0044869

Permanent Subcommittee on Investigations

EXHIBIT #333j

Wagner, Eleanor [CRRM]

From: Wagner, Eleanor [CRRM]
 Sent: Friday, May 25, 2001 2:51 PM
 To: Bushnell, David C [CRRM]
 Subject: Project Sundance

Dave, here is a draft memo. I'm hoping to leave about 3:00 today, but can be reached at home later or over the weekend (212-

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Memo

To: Mike

From: Dave

cc: ?

Re: Enron -- Project Sundance Transaction

This is a follow up to our conversation on the transaction for Enron. The purpose of this memorandum is to describe the transaction briefly and to express Risk Management's concerns.

Transaction Description

Enron Corp. owns certain pulp and paper assets which have been purchased by the company in a manner such that the assets are off-balance sheet for GAAP accounting purposes. The assets, total book value of approximately \$700MM, are a pulp and paper trading business, two paper plants (we advised them on the purchase of one of them from Daishowa at year end) and some timber properties.

To keep these assets off-balance sheet, Enron is setting up a limited partnership into which they will contribute the stock of the operating companies that hold these assets. We (Saion Brothers Holdings), as limited partner, would contribute approx. \$28.5MM in cash and make a contingent capital commitment of approx. \$160MM. The sum of our cash contribution and contingent commitment is 20% of the partnership's assets, sufficient, per Enron's external auditors, for off-balance sheet treatment.

Enron will be general partner and will continue to manage the assets. There will be no debt in the partnership. Enron will raise debt of approximately \$350MM with respect to the Daishowa plant (structure yet to be determined), although the plant itself will not be encumbered. The partnership will dissolve at the end of three years. We have the unilateral right, however, to terminate early, by convening a board of directors -- we would hold two seats and Enron would hold two seats -- and forcing a dissolution of the partnership.

The transaction contains numerous structural elements to safeguard against our need to contribute the contingent equity, although it is not certain that there would be sufficient asset value to pay us out if this were to happen. There are also liquidity commitments by Enron

5/25/01

Permanent Subcommittee on Investigations

EXHIBIT #333k

CITI-SPSI 0044872

designed to protect our cash investment. The Credit Derivatives Desk intends to purchase default protection against Enron to hedge the \$28MM cash contribution.

Details of the structure can be provided. Bottom line, it is unlikely, although not impossible, that our commitment would be called in, or that the \$28MM in cash would not be returned in the event of a dissolution.

The transaction will be booked on the Credit Derivatives desk.

Risk Management Concerns

Risk Management has not approved this transaction for the following reasons:

- o This is a limited partnership investment, with the fiduciary responsibilities that this entails, including, potentially, board representation. To make sure the structural safeguards work, there is a lot of maintenance and follow up required by the business. In other words, this trade puts a lot of stress on the business's infrastructure.
- o The customer side is divided. While Fixed Income Derivatives and the Investment Banking team are in favor of the transaction, the GRB Relationship team is not.
- o We already have extensive credit exposure to Enron. This is highly correlated, if not direct, Enron exposure. [Dave, it's still not clear whether we would get paid out of \$200 in Bacchus exposure after this. Scott/Fox aren't sure]
- o The GAAP accounting is aggressive and a franchise risk to us if there is publicity (a la Xerox).
- o The returns are suboptimal for an equity-type investment.
- o Lastly, our internal process on this left a lot to be desired. This is a complex transaction with a complex company and we very far ahead with the customer on this trade before the bankers, risk managers and others were brought into this.

5/25/01

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CITI-SPSI 0044873

From: Warren, Doug [F1]
Sent: Tuesday, May 29, 2001 4:21 PM
To: Caplan, Rick [F1]; Forese, James A [F1]
Cc: Laroux, Timothy [F1]
Subject: RE: sundanca

Since the only issue would be a customer problem and they understand what we intend to do, I think we should not let this prevent us from closing. We do still need Barbara Yastine and Mika Carpenter to approve before we close?

Doug Warren
Credit Derivative Trading
SalomonSmithBarnes

t: 212 [Redacted by Permanent Subcommittee on Investigations]
f: 212 [Redacted by Permanent Subcommittee on Investigations]
m: 917 [Redacted by Permanent Subcommittee on Investigations]

-----Original Message-----

From: Caplan, Rick [F1]
Sent: Tuesday, May 29, 2001 1:17 PM
To: Forese, James A [F1]; Warren, Doug [F1]
Cc: Laroux, Timothy [F1]
Subject: sundanca

Spoke to the client. They intend and expect to close tomorrow whether the put issue is resolved or not. They fully understand that we will blow the deal up if we are at risk for the put. We will continue to work towards a contractual solution in the meantime. Can we close tomorrow?

Permanent Subcommittee on Investigations
EXHIBIT #3331

CITI-SPSI 012390

Lee, Andrew P [FIN]

From: Leroux, Timothy [F]
Sent: Thursday, May 31, 2001 11:10 AM
To: Lee, Andrew P [FIN]
Subject: RE: Sundance

Looks like we are trying to close.
Approval sits in front of Carpenter waiting for signature.
We would likely close today but move money tomorrow.

—Original Message—
From: Lee, Andrew P [FIN]
Sent: Thursday, May 31, 2001 8:59 AM
To: Leroux, Timothy [F]
Subject: Sundance

Hi Tim,

Greetings!

How's our favorite trade (Sundance) looking?
(I need to update the legal entity manager for SBHC).

Thanks,
Andy

Unknown

From: alan.s.macdonald@citi.com
Sent: Thursday, May 31, 2001 11:41 AM
To: =SMTP:michael.carpenter@ssmb.com
Cc: =SMTP:david.bowerin@citi.com; William Fox
Subject: FW: Memo on Enron-Project Sundance



MC - Project
Sundance.doc (25 ..

We (Bill Fox and I) share Risk's view and if anything, feel more strongly that suitability issues and related risks when coupled with the returns, make it unattractive. It would also be an unfortunate precedent if both GRB relationship management and Risk's views were ignored.

Alan

> <<MC - Project Sundance.doc>>
>

RISK MANAGEMENTciti**group**

Global Corporate & Investment Bank

TO: Mike Carpenter
 FROM: Dave Bushnell
 CC: Alan MacDonald
 DATE: May 30, 2001
 RE: Enron - Project Sundance Transaction

This is a follow-up to our lunch conversation on the transaction for Enron. If you recall, this is a complex structured transaction, which I have refused to sign-off on. The purpose of this memorandum is to describe the transaction briefly and to express Risk Management's concerns.

Transaction Description

Enron Corp. owns certain pulp and paper assets, which have been purchased by the company in a manner such that the assets are off-balance sheet for GAAP accounting purposes. The assets, total book value of approximately \$700MM, are a pulp and paper trading business, two paper plants (we advised them on the purchase of one of them from Daishowa at year-end) and some timber properties. To keep these assets off-balance sheet, Enron is setting up a limited partnership into which they will contribute the stock of the operating companies that hold these assets. We (Salomon Brothers Holdings), as limited partner, would contribute approx. \$28.5MM in cash and make a contingent capital commitment of approximately \$160MM. The sum of our cash contribution and contingent commitment is 20% of the partnership's assets, sufficient, per Enron's external auditors, for off-balance sheet treatment. Enron will be general partner and will continue to manage the assets. There will be no debt in the partnership. Enron will raise debt of approximately \$350MM with respect to the Daishowa plant (structure yet to be determined), although the plant itself will not be encumbered. The partnership will dissolve at the end of three years. We have the unilateral right, however, to terminate early, by convening a board of directors - we would hold two seats and Enron would hold two seats - and forcing a dissolution of the partnership. The transaction contains numerous structural elements to safeguard against our need to contribute the contingent equity, although it is not certain that there would be sufficient asset value to pay us out if this were to happen. There are also liquidity commitments by Enron designed to protect our cash investment. The Credit Derivatives Desk intends to purchase default protection against Enron to hedge the \$28MM cash contribution. Details of the structure can be provided. Bottom line, it is unlikely, although not impossible, that our commitment would be called in, or that the \$28MM in cash would not be returned in the event of a dissolution. The transaction will be booked on the Credit Derivatives desk.

CITI-SPSI 0124615

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Risk Management Concerns

Risk Management has not approved this transaction for the following reasons:

- This is a limited partnership investment, with the fiduciary responsibilities that this entails, including, potentially, board representation. To make sure the structural safeguards work, there is a lot of maintenance and follow up required by the business. In other words, this trade puts a lot of stress on the business's infrastructure.
- The customer side is divided. While Fixed Income Derivatives and the Investment Banking team are in favor of the transaction, the GRB Relationship team is not. You should talk to Bill Fox or Alan MacDonald for their views on this deal, and the lack of interaction/cooperation between the GRB relationship managers and the fixed income derivatives team.
- We already have extensive credit exposure to Enron. This is highly correlated, if not direct, Enron exposure. One side of the house has told this to Enron, and is trying to be strict, while the other is committing capital to the company.
- The GAAP accounting is aggressive and a franchise risk to us if there is publicity (a la Xerox)
- The returns are sub-optimal for an equity-type investment.
- Lastly, our internal process on this left a lot to be desired. This is a complex transaction with a complex company and the product side was far ahead with the customer on this trade before the bankers, risk managers and others were brought into this deal. The mismanagement of the process raises real questions about the discipline and adherence to policies in the fixed income division.

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CITI-SPSI 0124616

From: Caplan, Rick [F]
Sent: Thursday, May 31, 2001 6:00 PM
To: Feeney, Shawn K [F]
Subject: sundance
any word? am getting a significant amount of pressure from enron to execute. if no word, any
advice on what to communicate to the company? thx

Permanent Subcommittee on Investigations
EXHIBIT #333o

CITI-SPSI 01289

Lee, Andrew P [FIN]

From: Leroux, Timothy [F]
Sent: Friday, June 01, 2001 3:43 PM
To: Feintech, Lynn [F]; Warren, Doug [F]; Francois, Tom [CRRM]; Bendernagel, Donald [GCO]; Wagner, Eleanor [CRRM]; Chrysikopoulos, John S [IBD]; Forese, James A [F]; Hendricks, Maureen A [IBD]; Keller, Dean [IBD]; Bernstein, Saul [CITI]; McCall-Bowen, Susan [FIN]; Lee, Andrew P [FIN]
Cc: Caplan, Rick [F]; Cheng, Grace [F]
Subject: Sundance Closing

I wanted to thank everyone involved in structuring and approving the Sundance transaction and congratulate all on the successful closing of this trade today. Everyone's hard work was appreciated in bringing this demanding trade to a close in the compressed timeframe.

Enron has also expressed their appreciation and gratitude for the hard work and commitment once again exhibited by this institution.

Thanks and best regards,

Timothy LeRoux
Salomon Smith Barney
Global Credit Derivatives

Tel: (212)

Fax: (212) Redacted by Permanent Subcommittee on Investigations

email: timoth

1/25/2002

Permanent Subcommittee on Investigations
EXHIBIT #333p

CITI-SPSI 0044911

Lee, Andrew P [FIN]

From: Leroux, Timothy [F]
Sent: Wednesday, June 06, 2001 1:25 PM
To: Lee, Andrew P [FIN]
Subject: RE: Sundance Approvals

No...was given a verbal go ahead...Understand signed is to follow.

-----Original Message-----
From: Lee, Andrew P [FIN]
Sent: Wednesday, June 06, 2001 12:32 PM
To: Leroux, Timothy [F]
Subject: Sundance Approvals

Hi Tim,

Would you happen to have a copy of the management approvals for the Sundance trade? (The Firm Investments group needs it for their files.)

Thanks,
Ardy

CITI-SPSI 0044918

Permanent Subcommittee on Investigations
EXHIBIT #333q

Unknown

From: Feeney, Shawn K [FJ]
Sent: Friday, June 29, 2001 10:44 AM
To: Lee, Andrew P [FIN]
Subject: RE: Sundance

If you recall, Mike Carpenter was out of the country the day that transaction closed. The approval memo was given to Mike's assistant and faxed to him. Mike then had a conversation with Dave Bushnell, who shared with us Mike's feedback. We proceeded to close the transaction that day, given the absence of instructions from Mike or Dave to the contrary.

The original approval memo may still be with Caribel Ortiz, Mike's assistant. It wasn't returned to me.

-----Original Message-----
From: Lee, Andrew P [FIN]
Sent: Thursday, June 28, 2001 8:48 PM
To: Feeney, Shawn K [FJ]
Subject: Sundance

Hi Shawn,

I'm trying to tie-up some loose ends.
Do you happen to have the approval documentation
for Sundance? (or know where I can find it)

Thanks,
Andy

Permanent Subcommittee on Investigations
EXHIBIT #333r

CITI-SPSI 012294

Unknown

From: Leroux, Timothy [FI]
 Sent: Thursday, October 18, 2001 8:31 AM
 To: Wagman, Steve [FI]
 Cc: Caplan, Rick [FI]
 Subject: RE: Sundance Revenues

Sundance Revenue for 2001
 Structuring Fees \$500,000
 Capital Fee \$225,000

 Total Fees \$725,000

2001 Drip Revenue (Dividends on Investment)
 670 bps for 7 months on \$28.5MM = \$1.114 MM

Sundance Total for 2001 = \$1.839 MM

et Merci beaucoup a vous

Timothy LeRoux
 Salomon Smith Barney
 Global Credit Derivatives
 Tel: (212) 723-6436
 Fax: (212) 723-8334
 email: timothy.leroux@ssmb.com

-----Original Message-----
 From: Caplan, Rick [FI]
 Sent: Thursday, October 18, 2001 6:34 AM
 To: Leroux, Timothy [FI]
 Subject: Fw: Sundance

Can u do this

-----Original Message-----
 From: Wagman, Steve [FI] <sw54249@imcnam.ssmb.com>
 To: Caplan, Rick [FI] <rc52842@imcnam.ssmb.com>
 Sent: Wed Oct 17 22:04:02 2001
 Subject: Sundance

Sundance. Keller is filling out his review for this year and I reconciled all the ene
 rev's for him except for the sundance. Can you refresh my memory on the revenues here.
 Merci beaucoup.

Permanent Subcommittee on Investigations

EXHIBIT #333s

CITI-SPSI 0123217

Unknown

From: Caplan, Rick [F]
Sent: Monday, October 29, 2001 12:49 PM
To: Fox III, William T; Reilly, James F [BD]
Subject: sundance redux



well memo.doc (29 KB)

CITI-SPSI 0127647

Permanent Subcommittee on Investigations
EXHIBIT #333t

10/29/01

Description of the Sundance Transaction

Sundance is a partnership arrangement that allows Enron to manage its paper and pulp physical assets and trading business off-balance sheet. In the structure, we each contributed assets to the partnership in exchange for a partnership interest. Enron's contributed assets must lose all of their value before our investment is at risk.

Enron contributed certain physical assets and Salomon Brothers Holding Company ("SBHC") contributed \$28.5 million and a commitment to contribute additional capital (\$160 million) if losses in the partnership exceed a certain level.

Description of the Assets (valuation at time of contribution):

- Fishtail - pulp and paper trading business (\$200 million)
- Garden State - New Jersey newsprint operation (\$60-75 million)
- SATCO - Maine timberlands (\$14 million)
- Stadacona - Newsprint mill in Quebec (\$375 million)

Structural Protections:

The transaction is structured to safeguard against the possibility that we need to contribute our contingent equity and to ensure that there is sufficient liquidity at all times to repay our \$28.5 million investment. These objectives are accomplished in several ways:

- At all times the partnership must have \$28.5 million invested in high quality short term investments or in Enron paper, as long as Enron is investment grade.
- Enron will fund up to \$65 million in cash flow needs for debt service and capital expenditures.
- Enron has committed (via a promissory note) to make available a Liquidity Facility in the amount of \$25 million. (Note this facility is separate from the \$28.5 million in cash which must be invested at all times).
- SBHC has the ability to terminate the partnership at any time by activating a four person Board of Directors ("Board") in which we elect two of the members. Any voting deadlock of the Board is a dissolution event of the partnership.
- Enron bankruptcy or significant payment defaults will allow SBHC to terminate the transaction without further funding liability.
- A call on our contingent capital comes only after all of the following have occurred: the partnership has had GAAP net losses in excess of \$657 million, Enron has funded its \$65 million commitment for debt service and cap ex, and Enron has funded the \$25 million Liquidity Facility. If all these events come to pass and SBHC has not

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CITI-SPSI 0127648

called for a dissolution of the partnership, then we must fund our contingent capital up to the amount of such excess losses.

- Enron has a right to put the paper trading business to SBHC by giving notice on a date from November 19, 2001 to November 21, 2001 for exercise on December 5, 2001 to December 7, 2001. If Enron exercises this right, we would be obligated to purchase the trading business for \$20 million. We can avoid this result by calling a board and electing to dissolve the partnership prior to December 5, 2001.

Summary:

Currently we have \$28.5 million invested in the partnership in a priority position. All of the assets of the partnership are available to repay our partnership interest. We can effectively dissolve the partnership at any time and force the liquidation of the assets in order to repay our interest. Our risk is that the assets yield less than \$28.5 million upon disposition, i.e., a complete loss in value since formation (June 2001).

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CITI-SPSI 0127649

Unknown

From: Warren, Doug [F]
 Sent: Monday, October 22, 2001 6:42 PM
 To: Gragg, Paul [CRRM]; Trears, Anthony [F]
 Cc: Warren, Doug [F]
 Subject: Re: Enron Exposure on NA Credit Derivs

Please do not go to Pat and Dominic with these numbers until you have spoken with me as they do not appear to be correct. I am leaving for London tonight and can be reached at the Structured Credit trading desk there. Doug Warren
 Credit Derivative Trading
 SalomonSmithBarney

t: 212 [Redacted by Permanent Subcommittee on Investigations]
 f: 212 [Redacted by Permanent Subcommittee on Investigations]
 m: 917 [Redacted by Permanent Subcommittee on Investigations]

-----Original Message-----
 From: Gregg, Paul [CRRM] <pg52917@imcnam.smb.com>
 To: Trears, Anthony [F] <at52468@imcnam.smb.com>
 CC: Warren, Doug [F] <dw52469@imcnam.smb.com>
 Sent: Mon Oct 22 17:59:04 2001
 Subject: Enron Exposure on NA Credit Derivs

Tony,

Thanks for the help. Please have Doug review and let me know if he agrees.

Paul

DRAFT
 Dominic/Pat,

There was more bad news for Enron today. The SEC had requested documentation on the partnerships run by CFO Andrew Fastow, LJM and LJM2. I culled through the documentation I have on the Enron transactions that went through CMAC and also reviewed (again) the Credit Derivatives desk positions.

Market risk - We have a current long protection/short bond position of \$(3MM). Total CR01 on Enron is \$10901 per basis point since we are long protection in increasing amounts over the next three years. The high point is \$(83)MM in May 2004. The desk is short protection for \$12MM on a tail risk basis in 2006. Enron has widened out again to 390 bid - 450 offer.

There were two CMAC Transactions related to Enron.
 Sundance - A limited partnership which allows Enron to own certain pulp and paper assets on an off-balance sheet basis. SBHC is a 20% owner of the limited partnership. Enron North America is 79.9% owner. Enron Industrial Markets is the General partner with a 0.1% interest. Enron IM is a corporate vehicle and is not related to LJM or LJM2 partnerships. (Note that these equity partnerships, are designed to act as debt exposure due to numerous triggers built in which allow us to terminate.)

Yosemite - A series of transactions done by Enron which used an SPV structure to free up bank credit facilities by shifting Enron credit risk from the banking market to the capital market. To accomplish this, the SPV (Yosemite) would purchase assets/loans from Enron banks (ie GRB and Chase) with the proceeds from the issuance of credit linked notes sold in the capital markets and an equity certificate held by Enron and GRB. The equity certificate is subordinate to the credit linked notes and is designed to allow the assets to be held outside of Enron's balance sheet. (Similar to the equity partnership in Sundance, these certificates are de facto debt instruments.)

These two transactions are not an issue for market risk and do not appear to be related to the LJM or LJM2 partnerships.

Permanent Subcommittee on Investigations
 EXHIBIT #333u

CITI-SPSI 0123218

314

This was a very abbreviated discussion of the transactions noted. If you have any questions about them, give me a call.

Regards,
Paul

2

CONFIDENTIAL

CITI-SPSI 0123219

Unknown

From: Caplan, Rick [F]
 Sent: Tuesday, October 30, 2001 2:06 PM
 To: Coley, Geoffrey O [F]; Forese, James A [F]
 Cc: Warren, Doug [F]
 Subject: ene transactions

As we discussed, the following is a brief history of the transactions in the Credit Derivatives book:

Yosemite/ECLNs

Yosemite and the ECLNs were designed as a way in which we could move credit exposure from ene's banks to the capital markets.

In fact, due to the first Yosemite deal, we were able to terminate a \$500 mm prepaid that the Bank had on its books and reconstitute as a hedged position in the Yosemite trust.

All of the deals were reviewed by a laundry list of people, culminating in a presentation to Petros and Onno Ruding. Other luminaries outside of Fixed Income included Bushnell, Boland, Eleanor Wagner, Tom Francois, Engel, Fox, Stott, Bendemagel, Jessica Palmer, Garnett, and many others. When we did the first deal, it was shortly after the merger and everyone viewed this deal as an example of the openness between the Bank and SSB. Therefore, it received the highest level of scrutiny.

As for the prepaids that each of the deals has hedged, they have been a bank market product for 4 or 5 years. Citibank had done a number of them for one and others before Credit Derivatives became involved and was asked to create a hedge for the product.

Through the program of deals, we have hedged approximately \$2.5 billion of prepaids for the Bank. In addition, one of ene's stated goals was extension of tenor for the liability side of its balance sheet, something they sorely need now, which our structure accomplished as most of their other prepaid are very short term.

Sundance

Sundance is a partnership arrangement that allows Enron to manage its paper and pulp physical assets and trading business off-balance sheet. In the structure, we each contributed assets to the partnership in exchange for a partnership interest. Enron's contributed assets must lose all of their value before our investment is at risk.

Enron contributed certain physical assets and Salomon Brothers Holding Company ("SBHC") contributed \$28.5 million and a commitment to contribute additional capital (\$160 million) if losses in the partnership exceed a certain level.

This structure is similar to a number of deals that they have done in the bank market in the last few years. The major difference is that we don't really take ene risk as we are structurally senior to the value of all of the assets in the partnership. In other words, if ene were to default, this structure would exist independently of ene, although I guess there is some risk of substantive consolidation.

In addition, we have the right to terminate the deal really at any time by convening a board of directors and electing to terminate. Our \$28.5 million investment is currently held in ene short-term paper. I have asked that they move it to cash or a cash equivalent. One risk that we should be aware of is that they have a put to us of the paper trading business. We can avoid the put by terminating the structure upon their exercise (its built into the mechanics of the termination).

Let me know if you would like additional info.

Regards,

Rick

Permanent Subcommittee on Investigations

EXHIBIT #333v

CITI-SPSI 0123500

Unknown

From: Caplan, Rick [FI]
 Sent: Tuesday, October 30, 2001 9:31 PM
 To: Warren, Doug [FI]
 Subject: Re: sundance

They are checking where it is. Have already suggested.

-----Original Message-----

From: Warren, Doug [FI] <dw52469@imcnam.smb.com>
 To: Caplan, Rick [FI] <rc52842@imcnam.smb.com>; Bushnell, David C [CRRM] <db01704@imcnam.smb.com>; Stuckey, Richard A [FI] <rs13746@imcnam.smb.com>; Barker, Randolph [FI] <rb00683@imcnam.smb.com>; Coley, Geoffrey O [FI] <gc02404@imcnam.smb.com>; Fox III, William T <wf17075@imcnam.smb.com>; Reilly, James F [IBD] <jr01724@imcnam.smb.com>
 CC: Warren, Doug [FI] <dw52469@imcnam.smb.com>
 Sent: Tue Oct 30 18:51:43 2001
 Subject: Re: sundance

Wouldn't it make sense to have them move the deposit to Citibank?

Doug Warren
 Credit Derivative Trading
 SalomonSmithBarney

t: 212

f: 212 [Redacted by Permanent Subcommittee on Investigations]

m: 917 [Redacted by Permanent Subcommittee on Investigations]

-----Original Message-----

From: Caplan, Rick [FI] <rc52842@imcnam.smb.com>
 To: Bushnell, David C [CRRM] <db01704@imcnam.smb.com>; Stuckey, Richard A [FI] <rs13746@imcnam.smb.com>; Barker, Randolph [FI] <rb00683@imcnam.smb.com>; Coley, Geoffrey O [FI] <gc02404@imcnam.smb.com>; Fox III, William T <wf17075@imcnam.smb.com>; Reilly, James F [IBD] <jr01724@imcnam.smb.com>
 CC: Warren, Doug [FI] <dw52469@imcnam.smb.com>
 Sent: Tue Oct 30 17:30:52 2001
 Subject: sundance

According to Enron, our \$28.5MM is being held in bank deposits. I have asked them not to move it out, and that if they intend to, we would expect advance notice. In addition, we will receive next round of monthly financials in mid-November. I have asked them to accelerate the process at least orally (with Stuckey on any call) and to give us a VaR for the pulp and paper trading business. I will let you know of any further developments.

Unknown

From: Leroux, Timothy [F]
Sent: Wednesday, November 07, 2001 12:55 PM
To: Caplan, Rick [F]
Subject: Sundance Paper

ENE wants to "discuss"
I have reiterated the imperative nature of request,
did NOT waive the BoD stick.
They requested you call Jodi/Bill ASAP
They love you...they dont love me, what can I
say

Permanent Subcommittee on Investigations
EXHIBIT #333x

CITI-SPSI 0124156

Unknown

From: Fox III, William T
Sent: Friday, November 30, 2001 7:48 AM
To: Caplan, Rick [FI]; Forese, James A [FI]; Coley, Geoffrey O [FI]; Barker, Randolph [FI]; Bushnell, David C [CRRM]; Stuckey, Richard A [FI]; Wagner, Eleanor [CRRM]; Stott, Thomas D [CRRM]
Cc: Warren, Doug [FI]; Bendernagel, Donald [GCO]; Leroux, Timothy [FI]
Subject: RE: Enron Sundance - the paper trading partnership

Well done.

-----Original Message-----

From: Caplan, Rick [FI]
Sent: Friday, November 30, 2001 7:33 AM
To: Forese, James A [FI]; Coley, Geoffrey O [FI]; Barker, Randolph [FI]; Bushnell, David C [CRRM]; Fox III, William T; Stuckey, Richard A [FI]; Wagner, Eleanor [CRRM]; Stott, Thomas D [CRRM]
Cc: Warren, Doug [FI]; Bendernagel, Donald [GCO]; Leroux, Timothy [FI]
Subject: Enron Sundance - the paper trading partnership

Last night we came to terms with Enron for the purchase of our interest in the Sundance partnership. We received par plus accrued through yesterday, and were released from the obligation to make any remaining contingent capital contributions. Fed wires have cleared so the money is in our accounts.

Regards,

Rick

CONFIDENTIAL

CITI-SPSI 0125273

Permanent Subcommittee on Investigations
EXHIBIT #333y

*is a Corporation of DNE -
 mine - I had a didst
 IOP - newton Hides -
 the Sun*

*Clearer
 wanted to
 check deal
 yesterday
 interest
 would like to
 clear*

*Does
 Brumwell
 would like to
 clear*

*Bill Boyzett
 Do you have any
 issues with this one?
 MJS SAB*

*not comparable with
 with issues with this one?*

*Tom Forese
 Tom Forese
 Tom Forese*

SALOMON SMITH BARNEY
 A member of Citigroup

Interoffice Memo

DATE: May 29, 2001
TO: Barbara Yastine
FROM: Jim Forese, Rick Caplan and Doug Warren
RE: Enron Corp. - Project Sundance

Derivatives is seeking to make an investment that, but for its form (a limited partnership interest), would be in the ordinary course of its business. Due to the form of the investment, it will be subject to the proposed merchant banking rules, and therefore, your approval of the investment is hereby requested. The investment has been reviewed and approved by CMAC, the Energy and Power Group in Investment Banking and Citibank Global Energy.

> Transaction Overview:

- > Enron Corp. ("Enron") owns certain pulp and paper assets (the "Assets"), which have been purchased by Enron in a manner that the assets are off-balance sheet for GAAP accounting purposes. Enron wishes to maintain that off-balance sheet treatment.
- > Enron has proposed a limited partnership, Sundance Industrial Partners, L.P. ("Sundance"), into which Enron, as one partner, will contribute approximately \$689 million in Assets and SBHC, as the other partner, will contribute \$28.5 million. Sundance will own the equity interests in each of the Assets. Enron will continue to manage the Assets and will be required to seek SBHC's consent prior to encumbering the Assets.
- > SBHC's investment will be in a senior position to Enron's investment. SBHC will receive a cumulative, preferred distribution and will be in a preferred position in a liquidation of the partnership. In other words, notwithstanding the form of the investment, the investment is debt-like.
- > The term of the proposed transaction is three years; however, SBHC, in its sole discretion, has the ability to terminate early.

*see page 3
 for approvals*

*transaction has also been approved
 by Tom Mahoney. MJS*

*proceeding plan in
 an Enron
 deal -
 contribute
 assets
 to the
 partnership.*

yastine approval name

Permanent Subcommittee on Investigations
EXHIBIT #334

CITI-SPSI 0122753

SALOMON SMITH BARNEY
 A member of citigroup

- > The transaction is structured to safeguard that there is sufficient liquidity to repay the SBHC investment.
 - At all times, Sundance must have \$28.5 million invested in high quality short term investments or in Enron paper, as long as Enron is investment grade. This investment is likely to fund SBHC's exit from the partnership. SBHC intends to purchase default protection on Enron to mitigate its exposure to an Enron bankruptcy.
 - Enron will fund up to \$90 million in cash flow needs for debt service and capital expenditures.
 - SBHC has the ability to terminate the partnership at any time by activating a four person Board of Directors ("Board") in which we elect two of the members. A deadlock of the Board for 15 business days is a dissolution event of the partnership.
 - SBHC has the remote potential to be required to contribute additional capital (up to \$160 million). However, a call on this contingent capital comes only after all of the following have occurred: SBHC has not exercised its discretionary right to terminate the partnership, the partnership has had GAAP net losses in excess of \$689 million and Enron has funded its \$90 million additional capital commitment.

> Description of the Assets:

- Fishtail - pulp and paper trading business (\$200 million)
- Garden State - New Jersey newsprint operation (\$60-75 million)
- SATCO - Maine timberlands (\$14 million)
- Daishowa - Newsprint mill in Quebec (\$400 million)

> Economics:

- LIBOR + 6.62 bppa for any capital contribution
- Upfront fees of \$725,000
- The cost of any purchased default protection will be borne by SBHC.

ysline approval memo

2

CONFIDENTIAL

CITI-SPSI 0122754



- SBHC has no potential upside, and receives a senior priority for distribution. The investment has been structured to act like debt in substance.

Please acknowledge your approval of the investment by signing below.

Approved: _____

By:

*Pat - R/I.
Su*

SALOMON SMITH BARNEY
A member of Citigroup

*Sincerely Paul
v. Warren*

Interoffice Memo

DATE: May 29, 2001
TO: Barbara Yastine
FROM: Jim Forese, Rick Caplan and Doug Warren

[Signature]

RE: Enron Corp. - Project Sundance

Derivatives is seeking to make an investment that, but for its form (a limited partnership interest), would be in the ordinary course of its business. Due to the form of the investment, it will be subject to the proposed merchant banking rules, and therefore, your approval of the investment is hereby requested. The investment has been reviewed and approved by CMAC, the Energy and Power Group in Investment Banking and Citibank Global Energy.

↳ transaction has also been approved by Tom Mahores. RT.

> Transaction Overview:

- > Enron Corp. ("Enron") owns certain pulp and paper assets (the "Assets"), which have been purchased by Enron in a manner that the assets are off-balance sheet for GAAP accounting purposes. Enron wishes to maintain that off-balance sheet treatment.
- > Enron has proposed a limited partnership, Sundance Industrial Partners, L.P. ("Sundance"), into which Enron, as one partner, will contribute approximately \$889 million in Assets and SBHC, as the other partner, will contribute \$28.5 million. Sundance will own the equity interests in each of the Assets. Enron will continue to manage the Assets and will be required to seek SBHC's consent prior to encumbering the Assets.
- > SBHC's investment will be in a senior position to Enron's investment. SBHC will receive a cumulative, preferred distribution and will be in a preferred position in a liquidation of the partnership. In other words, notwithstanding the form of the investment, the investment is debt-like.
- > The term of the proposed transaction is three years; however, SBHC, in its sole discretion, has the ability to terminate early.

see page 3 for approvals
in copy all items need end of

yastine approval memo

CONFIDENTIAL

CITI-SPSI 0016035

SALOMON SMITH BARNEY
A member of citigroup

SBHC has no potential upside, and receives a senior priority for distribution. The investment has been structured to act like debt in substance.

Please acknowledge your approval of the investment by signing below.

Approved: *[Signature]*
By:

*Contingent upon resolution of the outstanding
accounting issues re consolidation of Sonoma LLC*

M.P. [Signature]

Roger
4/27/01

Accounting for Investments in Limited Partnerships
and Other Joint Ownership Entities

*Copy to Tom
Bauer*

BACKGROUND

As Enron continues to expand its business strategy to new markets the complexity of transactions in these markets and the related accounting also expand. One area of particular complexity is the accounting for an investment in an entity in which Enron and one or more 3rd parties hold voting and economic interests in the entity. The accounting for these transactions may be further complicated by the existence of puts, calls, total return swaps and disproportionate economic sharing arrangements.

The purpose of this memorandum is to define Enron's accounting policy with respect to these transactions at the time of entity formation and continuing thereon as appropriate. The discussion in the memorandum is only to be considered a general guideline and further discussion on these types of transactions will continue as issues arise. Given the evolving nature of the accounting literature regarding consolidation policies, consultation with Enron's Chief Accounting officer is required.

AUTHORITATIVE ACCOUNTING GUIDANCE

- SFAS 94, "Consolidation of all Majority-Owned Subsidiaries"
- ARB 51, "Consolidated Financial Statements"
- APB 18, "The Equity Method of Accounting for Investments in Common Stock"
- SOP 78-9, "Accounting for Investments in Real Estate Ventures"
- EITF 96-16, "Investor's Accounting for an investee when the Investor has a Majority of the Voting Interests but the Minority Shareholder or Shareholders have Certain Approval of Veto Rights"
- EITF 98-6, "Investors Accounting for an Investment in a Limited Partnership when the Investor is the Sole General Partner and the Limited Partners have Certain Approval Rights"
- EITF 90-15, "Impact of Non-substantive Lessors, Residual Value Guarantees, and other Provisions in Leasing Transactions"
- EITF 96-21, "Implementation Issues in Accounting for Leasing Transactions Including Special Purpose Entities"
- Topic D-14, "Transactions Involving Special Purpose Entities"
- EITF 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or a Business"
- SEC Staff Speech, Dominick Ragone III, December 4, 2000
- International Accounting Standards Committee, Discussion on Special Purpose Entities and Consolidation

is CAO approval required for exceptions to the policy? (ie is policy a bright-line model with exceptions to be approved by CAO?)

DISCUSSION**I. Special Purpose Entities**

There have been extensive discussions on whether an entity is a special purpose entity and what impact, if any does that fact have on the accounting for that entity. SPE's tend to be structured (e.g., pre-programmed) such that it is not apparent who has the authority to do things. They typically are created to accomplish a narrow and well-defined objective and operate in a predetermined way such that virtually all rights, obligations, and aspects of activities that could be controlled are predefined and limited by contractual provisions specified or scheduled at inception.

We believe the determination as to whether an entity is an SPE or a business should be based on the specific facts and circumstances. As a guideline, we believe that if an entity, or its subsidiary(s), meet the definition of a business as described in EITF 98-3, then the entity would not be considered an SPE. However, we also believe that certain activities not contemplated in EITF 98-3 have qualifying characteristics of a business.

EITF 98-3 defines a business as a "self-sustaining integrated set of activities and assets conducted and managed for the purpose of providing a return to investors." This guidance further describes a business as consisting of (a) inputs (b) processes and (c) outputs. We believe that entities such as investment companies and funds established for the purpose of investing in certain activities or industries have the necessary characteristics to qualify as a business. For instance, with respect to an investment company: (a) -capital investments made by the equity investors are the required inputs, (b) investing, holding and the eventual liquidation of investments is the process applied to those inputs (the qualitative and quantitative analysis applied to pre-investment activities may be outsourced to third parties to determine which investments meet pre-determined investment qualifications as agreed to by equity participants at the fund's inception) and (c) the exposure to market conditions and the ability to generate a return on invested capital associated with holding investments are the expected outputs of the entity. As such, we believe application of this accounting policy to such entities is appropriate.

Further considerations that ^{MAY?} *PSG will have concerns about developing new 98-3 criteria, suggest softening* would indicate an entity is has the necessary inputs, processes and outputs to qualify as a business under EITF 98-3 a business rather than an SPE would include the following:

- ~~more than a de minimus amount of the entity's fair value is generated from sources other than contractual agreements with the entity's equity owners~~ *the primary/sole source of the entity's revenue or earnings activity is generated from sources other than contractual agreements with the entity's equity owners*
- the entity's revenue or earnings activity is generated from multiple sources of contracts, investments or activities
- the entity has non-recourse debt (however, it is not unusual for some partnerships to have a guarantee from one or more of the equity owners)

If, based on the analysis above, the entity is deemed to be a business, then the guidance in this memorandum shall apply. Otherwise, the entity will be accounted for as an SPE, with all the relevant SPE rules to be applied. Absent the existence of an SPE, we believe that SPE guidance does not apply and the factors discussed above should be taken into consideration when determining whether an entity is an SPE or a business. Enron's shall apply the appropriate guidance discussed below for those entities determined to be a business.

II. Limited Partnerships and Other Joint Ownership Entities

The accounting for investments in real estate joint ventures is addressed in SOP 78-9. This memorandum does not address the accounting for those investments and Enron will continue to account for those investments in accordance with SOP 78-9. This memorandum applies to investment in non-real estate entities.

Prior to the consensus in Issue No. 96-16, many practitioners applied the guidance contained in SOP 78-9 to consolidation questions involving investments in both incorporated entities and unincorporated entities, whether or not the partnership was engaged in real estate activities. Issue 96-16 embraces a concept of participating rights that some would argue is different from the concept of important rights as contemplated by SOP 78-9. Thus, non-real estate limited partnership situations could result in different conclusions as to consolidation depending on whether SOP 78-9 or Issue 96-16, by analogy, is applied.

08/28/016/8/20016/24/2004

Page 4

96-16 says reassessment of minority rights

96 made if there is a significant change

in terms or in exercisability of the rights of minority shareholders.

EITF 98-6

In EITF No. 98-6, the Task Force addressed the feasibility of integrating the important limited partner rights described in SOP 78-9 and the substantive participating rights described in Issue 96-16 to determine what rights held by the limited partner(s) preclude consolidation in circumstances in which the sole general partner would consolidate the limited partnership in accordance with generally accepted accounting principles absent the existence of the rights held by the limited partner(s).

the

In EITF No. 98-6, The Task Force agreed that a partnership agreement that provides for the removal of the general partner by a reasonable vote of at least two-thirds of the limited partners, without cause, and without the limited partners or partnership incurring a significant penalty, indicated that the sole general partner does not control the limited partnership. The scope of EITF 98-6 is specifically limited to limited partnerships with a sole general partner; however, Enron shall apply the guidance of EITF 98-6 when the voting rights of the investors in other legal entities such as limited liability companies and limited liability partnerships are essentially the same as a limited partnership with a sole general partner. Furthermore, in the event that the partnership agreement does not provide for the removal of the general partner (or the managing member if an LLC) without cause, we believe that EITF 96-16 provides the best guidance in determining whether a sole general partner in a limited partnership should consolidate the partnership.

EITF 96-16

For the purpose of the following discussion, the terms majority and minority shareholders used in EITF 96-16 have been replaced by general partner and limited partner as appropriate.

In EITF 96-16, the Task Force agreed that the assessment of whether the rights of a limited partner should overcome the presumption of consolidation by the general partner should be based on whether the limited partner rights, individually or in the aggregate, provide for the limited partner to effectively participate in significant decisions that would be expected to be made in the "ordinary course of business".

Effective participation means the ability to block significant decisions proposed by the investor who has a majority voting interest. That is, control does not rest with the general partner because the general partner cannot cause the partnership to take an action that is significant in the ordinary course of business if it has been vetoed by the limited partner. This assessment of limited partner rights should be made at the time a general partner interest is obtained and should be reassessed if there is a significant change to the terms or in the exercisability of the rights of limited partners. *absent a change in terms or a change in the terms of the right to vote* Enron believes that reassessment should be performed when it is questionable whether the third party investor will exercise its right to vote contemporaneous with a change in the market conditions or a change in the underlying value of the entity. There shall be a rebuttable presumption that the third party investor will exercise the right to vote unless the change in the underlying value of the entity is "other than temporary". Reassessment should be performed when it is unlikely that the third party investor will exercise the right to vote due to a change in the market conditions or a change in the underlying value of the entity. There shall be a rebuttable presumption that the third party investor will exercise the right to vote unless the change in the underlying value of the entity is "other than temporary".

The Task Force observed that all limited partner rights could be described as "protective" of the limited partner's investment in the partnership but that some limited partner rights also allow the limited partner to participate in determining certain financial and operating decisions of the partnership that are made in the ordinary course of business (subsequently referred to as "participating rights"). The Task Force agreed that limited partner rights that are only protective in nature (subsequently referred to as "protective rights") would not overcome the presumption in Statement 94 that the general partner should consolidate its partnership. The Task Force agreed that substantive limited partner rights that provide the limited partner with the right to effectively participate in significant decisions that would be expected to be related to the partnership's ordinary course of business, although also protective of the limited partner's investment, should overcome the presumption in Statement 94 that the investor with a majority voting interest should consolidate its partnership.

EITF 96-16 states that the following limited partner rights would allow the limited partner to effectively participate in the following partnership actions and should be considered substantive participating rights and would preclude consolidation by the general partner.

- Selecting, terminating, and setting the compensation of management responsible for implementing the partnership's policies and procedures.
- Establishing operating and capital decisions of the partnerships, including budgets, in the ordinary course of business.

The above rights may be modified to reflect the underlying business activities contemplated by the entity.

With respect to the above rights, EITF 96-16 states that "the likelihood that the veto right will be exercised by the minority shareholder, should not be considered when assessing whether a minority right is a substantive participating right". However, it will be Enron's policy that there be a minimum level of participation by the third party investor, which must include an appointment of a non-Enron member to a minimum of one Board seat, or operating committee as appropriate, and that member will actively participate in the operations of the entity. The investor should also have the ability to appoint/replace additional Board/Committee members as appropriate in order to control at least 50% of the entity. The appointment of at least one Board/committee member by the third party investor validates the assertion that the investor will have an active say in the operations of the entity rather than just removal rights that may be considered protective. Because this element is not required under EITF 96-16 there may be situations where a deviation from Enron's policy with respect to this specific issue will occur. In those situations, the deviation must be approved by Enron Corp.'s Chief Accounting Officer.

EITF 96-16 also states several "Factors to Consider" that should be considered in evaluating whether limited partner rights that appear to be participating are substantive rights. These factors are described in Exhibit II.

While all these factors will be considered, several of these factors require further discussion.

Factor #1 - Consideration should be given to situations in which a general partner owns such a significant portion of the partnership that the limited partner has a small economic interest. As the disparity between ownership interest increases, the limited partner rights are presumptively more likely to be protective rights.

We believe the third party investor must have sufficient economics in the entity in order to validate that its participating rights are substantive, with consideration given to both upside economics as well as downside. The amount of third party capital that will be required will be based on a sliding scale to reflect the risks/rewards assumed by the investor. The presumption is that as the third party investor accepts more risk or has the opportunity to achieve a larger reward then the investor is more likely to participate in the entity's operations and therefore the minimum investment required by the investor decreases.

Minimum 3rd Party Investment Range

| | |
|------------------------------|---|
| Residual Risk ⁽¹⁾ | 3% of total contributions made by all equity holders |
| 4:1 Coverage ⁽²⁾ | 10% - 20% of total contributions made by all equity holders |

(1) Where the third party investor is taking residual, first dollar of loss, commensurate with its equity percentage

(2) Where the profit/loss sharing arrangement allocates first losses to Enron equal to four times the investor's initial investment before the investor suffers losses. However, this coverage is limited to 80% of the fair value of the entity's assets when the minimum investment equals 20%.

Low of equity

06/26/016/0/20045/24/2004

Page 5

including discussion with the CEO,

These percentages represent the "minimum" amount of investment required by the third party. In situations where the entity holds volatile assets where the value of the entity can change dramatically and therefore possibly triggering a "reassessment", consideration should be given to capitalizing the entity with more than the minimum to mitigate this issue.

To illustrate the determination of the minimum percentages required under the economics criteria see the decision tree at Exhibit III.

Once the third party investor's minimum investment percentage is determined base upon its risk/reward attributes then that percentage is used to determine the dollar amount the third party investor must contribute. This percentage is applied to all equity contributions, including the third party investors, based on the guidelines below.

1. The economic assessment will be based on the fair value of the items contributed (Not maximum exposure) and will be calculated as the fair value of the investor's contribution divided by the fair value of all contributions made by all equity investors. We believe the use of fair value versus maximum exposure provides a better measure of what each investor is contributing to the entity in return for their ownership interest in the entity. For example, assume it is the intent of Enron and another investor to share 50/50 on voting and economics in exchange for each party contributing equal value to the entity. If a component of Enron's contribution includes a guarantee of the entity's debt that has a fair value less than its maximum exposure, then the use of maximum exposure to determine proper capitalization of the entity would require the other investor to contribute additional value resulting in the other investor receiving greater than 50% of the economics. The sharing of venture economics will always be driven by fair value of the items contributed, not maximum exposure, and therefore fair value should also be used when determining capitalization.
2. The economic assessment will consider all items of value contributed by the investor and Enron regardless of its form (i.e. guarantees, commitments, letters of credit, derivatives); however, in all cases the fair value of the contributions must be objectively determined and verifiable. Certain contributed intangibles may be difficult to objectively measure and therefore maybe deemed to be valued at zero for the purposes of the economic assessment. The intent is that the third party should not necessarily get "equity credit" for "soft" contributions. It is not the intent to allow Enron to contribute "soft" items that are valued at zero therefore requiring little or no capital from Enron or the other equity holders.
3. The third party investor's investment should be exposed to all of the entity's risk, e.g., the third party's capital should not be invested in/exposed to only T-Bills while Enron's capital is exposed to the entity's risk. This concept is meant to share underlying entity risk between Enron and the third party investor commensurate with their exposure (residual or collateralized) in the entity (i.e. Cannot be target stock).
4. In cases where the entity's profit/loss sharing arrangement calls for Enron to take the first loss (i.e., not the residual case), the third party investor should not contribute an amount less than 10% of the fair value of the entity. In any event, the first loss provision cannot be greater than 80% of the fair value of the assets at inception and shall be reduced accordingly by capital contributions below 20% (e.g. If the investor contributes 10% of the fair value of the entity's assets, Enron can sustain the first 40% decline in value of the assets before the third party suffers losses).

Furthermore, attached as Exhibit V-III are hypothetical structures that illustrate the application of the third party investor's economic assessment using these guidelines.

Factor # 3 - Relationships between the general and limited partners that are of a related-party nature in determining if the-participating rights of the limited partner are substantive.

There may be cases where Enron forms an entity with related parties including limited partnerships whose general partner's managing member is a senior officer of Enron. In these instances, the limited partners of

06/26/01 6/8/2001 5/24/2001

Page 7

the related party are unrelated to Enron. These partnership agreements provide for the two-thirds of the unrelated limited partners to remove the Enron senior officer as managing member without cause and without incurring a significant penalty, thereby meeting the provisions contained in ETP-98-6. In addition, it is Enron Corp.'s policy that each transaction with any related party be subject to the same approval process as transactions with non-affiliates and that terms of all related party transactions are reasonable compared to those which could have been negotiated with unrelated third parties.

*(For purposes of determining minimum capital contributions,
~~the~~ ~~employee~~ employee contributions would be excluded.) for
the term*

Factor #6 – An owner of a majority voting interest who has a contractual right to buy out the interest of the minority shareholder in the investee for fair value or less should consider the feasibility of exercising that contractual right when determining if the participating rights of the minority shareholder are substantive.

CALLS & PUTS – DISCUSSION TO COME



Finally, similar to EITF 96-16 we have our own "Other Factors to Consider" with respect to the accounting for these investments:

1. When evaluating whether the third party investor would exercise its rights to participate in the entity's operations, consideration should also be given to "other non-financial" factors (e.g., the potential impact of the entity on the investor's strategic business objectives outside of this entity) that are specific to the investor that may further incite the investor to participate in the entity's operations.---
2. The terms surrounding the payment of dividends to the third party investor could create a situation where, as a result of a dividend payment, the investor's required investment amount is below the minimum percentage. With respect to the payment of dividends to the third party investor we believe the following: 1) Upon formation of the entity, it should contemplate that the entity will have enough GAAP earnings to support any planned dividends and 2) if a dividend is paid when there are not enough GAAP earnings, then the issue of consolidation should be reassessed.
3. Enron shall not execute a SFAS No. 140 transaction on its equity method investment if ANY of the following apply:
 - (a) the entity's assets are substantially all real estate (FIN 43) or the sale constitutes a sale of future revenues as defined in EITF 88-18
 - (b) Enron's equity investment is the result of an overcollateralized structured transaction where there the value of the entity is not validated by a third party residual investor (see example 2 in the table above – this factor may be overcome if the value is objectively determined by a third party appraisal) or
 - (c) greater than 50% of the underlying value of the entity is derived substantially all from Enron.

Handwritten signature or initials.

06/26/016/8/20015/24/2001

Page 9

Summary

In summary, in order to rebut the presumption that a sole general partner/managing member in a limited partnership/limited liability company controls the entity and therefore should consolidate the entity the guidelines below should be followed. Exhibit IV illustrates a consolidation decision tree that encompasses these guidelines.

1. The entity must not be deemed to be a special purpose entity ~~be deemed a business~~ (SPE) for the purposes of applying the consolidation guidance outlined in this memorandum. If the entity is an SPE, follow the guidance in EITF 90-15, Topic D-14, etc.
2. The third party investor must have substantive limited partner rights that provide the limited partner with the right to effectively participate in significant decisions that would be expected to be related to the partnership's ordinary course of business.
3. The third party investor must appoint a non-Enron member to a minimum of one Board seat, or operating committee as appropriate, and that member will actively participate in the operations of the entity. The investor will also have the ability to appoint/replace additional Board /Committee members as appropriate in order to control at least 50% of the entity. Because this element is not required under EITF 96-16 there may be situations where a deviation from Enron's policy with respect to this specific issue will occur. In those situations, the deviation must be approved by Enron Corp.'s Chief Accounting Officer.
4. The third party investor must have sufficient economics in the entity in order to validate that its participating rights are substantive, with consideration given to both upside economics as well as downside. The amount of third party capital that will be required will be based on a sliding scale to reflect the risks/rewards assumed by the investor. However, in a non-residual equity structure there should be no case where the 3rd party investor contributes an amount less than 10% of the fair value of the entity. In any event the first loss provision cannot be greater than 80% of the fair value of the assets.
5. The economic assessment will consider all items of value contributed by the investor and Enron regardless of its form (i.e. guarantees, commitments, letters of credit, derivatives); however, in all cases the fair value of the contributions must be objectively determined and verifiable. Certain contributed intangibles may be difficult to objectively measure and therefore maybe deemed to be valued at zero for the purposes of the economic assessment.
6. The economic assessment will be based on the fair value of the items contributed (Not maximum exposure) and will be calculated as the fair value of the investor's contribution divided by the fair value of all contributions made by all equity investors.
7. The third party investor's investment should be exposed to all of the entity's risk, e.g., the third party's capital should not be invested in/exposed to only T-Bills while Enron's capital is exposed to the entity's risk. This concept is meant to share underlying entity risk between Enron and the third party investor commensurate with their exposure (residual or collateralized) in the entity (i.e. Cannot be target stock).
8. The third party investor's participating rights should be reassessed if there is a significant change to the terms or in the exercisability of the rights of limited partners. Reassessment should ^{also} be performed when it is unlikely that the third party investor will exercise the right to vote due to a change in the market conditions or a change in the underlying value of the entity. There shall be a rebuttable presumption that the third party investor will exercise the right to vote unless the change in the underlying value of the entity is "other than temporary".

About a change in terms

9. Enron shall not execute a SFAS No. 140 transaction on its equity method investment if ANY of the following apply:

- (a) the entity's assets are substantially all real estate (FIN 43) or the sale constitutes a sale of future revenues as defined in EITF 88-18 (b) Enron's equity investment is the result of an overcollateralized structured transaction where there the value of the entity is not validated by a third party residual investor (see example 2 in the table above - this factor may be overcome if the value is objectively determined by a third party appraisal) or (c) greater than 50% of the underlying value of the entity is derived from Enron.
- the underlying value of the entity is derived substantially all from Enron.

0:naes/mkp/corres/accountingforinvestmemo2

(715% of time)
 (i.e. usually not
 everything can be attributed
 to be a business
 under 98-3)

Open points for Paulsen to consider

1. min investment may be less than required if entity is SPE. My vote is that I'm OK with this because the entity is a "business". However, my ~~previous~~ belief is that such business should usually have employees that get ~~record~~ recorded for how that business performs.

2. 3% vs something higher as minimum. My vote is 5% S/A minimum for a ~~the~~ protective business (no basis for this) other than SPE's require 3% which seem reasonable. Also on Exhibit II, I believe 20% S/A ^{minimum} required by 2 out of 3 conditions as met for ABC, not all 3, i.e. capital return = pay and distrib. would require min 20%

3. Do commitments hold for invest. - If more than 60% then my vote is yes.

To: John E. Stewart@ANDERSEN WO; Benjamin S. Neuhausen@ANDERSEN WO; Richard R. Petersen@ANDERSEN WO; Carl E. Bass@ANDERSEN WO; Jeffrey H. Ellis@ANDERSEN WO; Roger D. Willard@ANDERSEN WO; Debra A. Cash@ANDERSEN WO; Patricia S. Grutzmacher@ANDERSEN WO; Michael D. Jones@ANDERSEN WO

CC:

BCC:

Date: 08/21/2000 12:12 PM

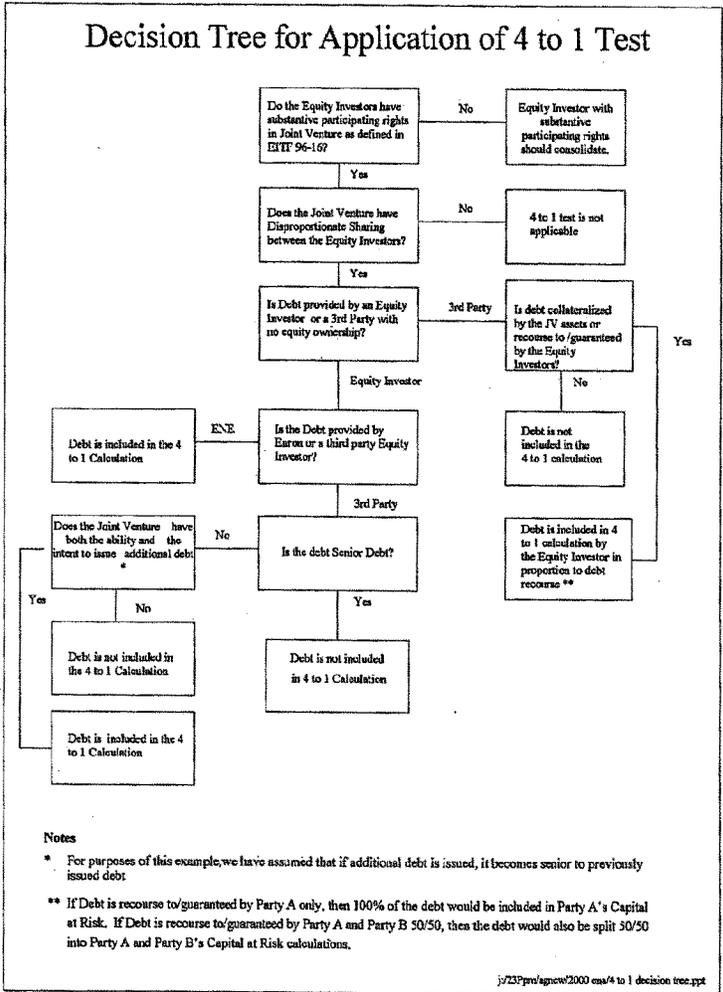
From: Kate E. Agnew

Subject: 4 to 1 Test

Attachments: 4 to 1 decision tree.ppt; derek_scenarios revised.doc

Attached is the information for the three o'clock conference call to discuss the 4 to 1 Test

Decision Tree for Application of 4 to 1 Test



Notes

- * For purposes of this example, we have assumed that if additional debt is issued, it becomes senior to previously issued debt.
- ** If Debt is recourse to/guaranteed by Party A only, then 100% of the debt would be included in Party A's Capital at Risk. If Debt is recourse to/guaranteed by Party A and Party B 50/50, then the debt would also be split 50/50 into Party A and Party B's Capital at Risk calculations.

Memo

ARTHUR ANDERSEN

Date August 21, 2000
 Subject 4 To 1 Test Criteria
 Page 1 of 12

To Tho Files
 From Deb Cash
 Patty Grutzmacher
 Kate Agnew
 Date August 21, 2000
 Subject 4 to 1 Test Criteria

Objective: Develop a consensus regarding application of the 4 to 1 test and use in assessing consolidation. In addition, document treatment of certain variables in determining inclusion/exclusion of the 4 to 1 Test.

P5G Members John Stewart
Consulted: Rick Petersen
 Ben Neuhausen
 Carl Bass
 Jeff Ellis

General Assumptions:

- 1) 50/50 voting rights in Joint Venture
- 2) Joint Venture meets the 3% outside exposure test
- 3) Bank is not considered a strategic player

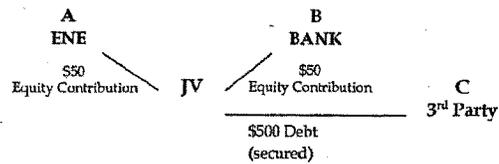
General Formula:

Company's % At Risk $\frac{\text{Company's Equity at Risk}}{\text{Summation of Total Equity Holders Capital at Risk in JV}}$

Date August 21, 2000
 Subject 4 To 1 Test Criteria
 Page 2 of 12

Example 1

Scenario A



I. Summation of Total Equity Holders Capital At Risk in Joint Venture:

| | |
|--------------|----------------------|
| \$300 | ENE Equity |
| <u>\$300</u> | Bank Equity |
| \$600 | Total Equity at Risk |

II. Each Company's Equity at Risk

| | |
|-------|------|
| \$300 | ENE |
| \$300 | Bank |

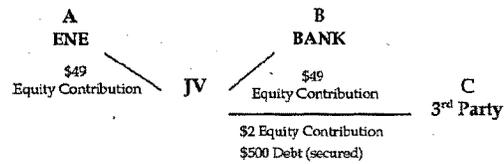
III. Percentage of Equity At Risk

| | |
|-----|------|
| 50% | ENE |
| 50% | Bank |

Conclusion: Neither party consolidates. Debt is included in the calculation because debt is secured by the assets of the Joint Venture. However, the percentage of Equity at Risk would not differ if the debt was not secured by the assets of the Joint Venture.

Date August 21, 2000
 Subject 4 To 1 Test Criteria
 Page 3 of 12

Scenario B Debt is secured by the assets of the Joint Venture



I. Summation of Total Equity Holders Capital At Risk in Joint Venture:

| | |
|------------|-----------------------|
| \$49 | ENE Equity |
| \$49 | Bank Equity |
| <u>\$2</u> | 3 rd Party |
| \$100 | Total Equity at Risk |

II. Each Company's Equity at Risk

| | |
|------|-----------------------|
| \$49 | ENE |
| \$49 | Bank |
| \$2 | 3 rd Party |

III. Percentage of Equity At Risk

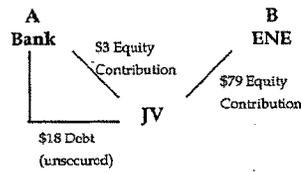
| | |
|-----|-----------------------|
| 49% | ENE |
| 49% | Bank |
| 2% | 3 rd Party |

Conclusion: No party consolidates. Debt is not included in the calculation because C is a financial player and the debt is secured.

Date August 21, 2000
 Subject 4 To 1 Test Criteria
 Page 4 of 12

Example 2

Scenario A



I. Summation of Total Equity Holders Capital At Risk in Joint Venture:

| <u>A*</u> | | <u>B*</u> | |
|-------------|----------------------|------------|----------------------|
| \$79 | ENE Equity | \$79 | ENE Equity |
| <u>\$21</u> | Bank Equity | <u>\$3</u> | Bank Equity |
| \$100 | Total Equity at Risk | \$82 | Total Equity at Risk |

II. Each Company's Equity at Risk

| | | | |
|------|------|------|------|
| \$79 | ENE | \$79 | ENE |
| \$21 | Bank | \$3 | Bank |

III. Percentage of Equity At Risk

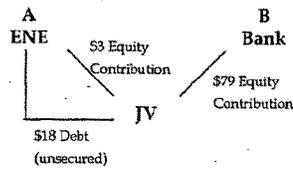
| | | | |
|----------------------------|------|------------------|------|
| 79% | ENE | 96% | ENE |
| 21% | Bank | 4% | Bank |
| Neither Party Consolidates | | ENE Consolidates | |

A* JV is prohibited from issuing additional debt

B* JV is prohibited from issuing additional debt

Date August 21, 2000
 Subject 4 To 1 Test Criteria
 Page 5 of 12

Scenario B



I. Summation of Total Equity Holders Capital At Risk in Joint Venture:

| <u>A</u> | | <u>B</u> | |
|-------------|----------------------|-------------|----------------------|
| \$21 | ENE Equity | \$21 | ENE Equity |
| <u>\$79</u> | Bank Equity | <u>\$79</u> | Bank Equity |
| \$100 | Total Equity at Risk | \$100 | Total Equity at Risk |

II. Each Company's Equity at Risk

| | | | |
|------|------|------|------|
| \$21 | ENE | \$21 | ENE |
| \$79 | Bank | \$79 | Bank |

III. Percentage of Equity At Risk:

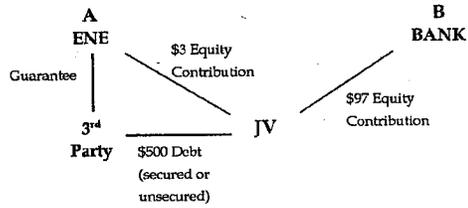
| | | | |
|----------------------------|------|----------------------------|------|
| 21% | ENE | 21% | ENE |
| 79% | Bank | 79% | Bank |
| Neither Party Consolidates | | Neither Party Consolidates | |

Conclusion: Characteristics of financing provided by the equity holder is a factor in determining whether to included in the 4 to 1 test.

Date August 21, 2000
 Subject 4 To 1 Test Criteria
 Page 6 of 12

Example 3

Scenario A



I. Summation of Total Equity Holders Capital At Risk in Joint Venture:

| | |
|-------------|----------------------|
| \$503 | ENE Equity |
| <u>\$97</u> | Bank Equity |
| \$600 | Total Equity at Risk |

II. Each Company's Equity at Risk

| | |
|-------|------|
| \$503 | ENE |
| \$97 | Bank |

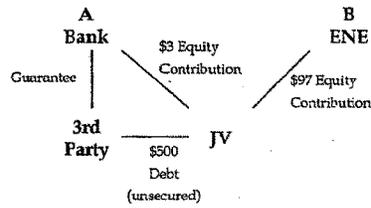
III. Percentage of Equity At Risk

| | |
|-----|------|
| 84% | ENE |
| 16% | Bank |

ENE Consolidates

Date August 21, 2000
 Subject 4 To 1 Test Criteria
 Page 7 of 12

Scenario B



I. Summation of Total Equity Holders Capital At Risk in Joint Venture:

| | | | |
|--------------|----------------------|------------|----------------------|
| | <u>A</u> | | <u>B</u> |
| \$97 | ENE Equity | \$97 | ENE Equity |
| <u>\$503</u> | Bank Equity | <u>\$3</u> | Bank Equity |
| \$600 | Total Equity at Risk | \$100 | Total Equity at Risk |

II. Each Company's Equity at Risk

| | | | |
|-------|------|------|------|
| \$97 | ENE | \$97 | ENE |
| \$503 | Bank | \$3 | Bank |

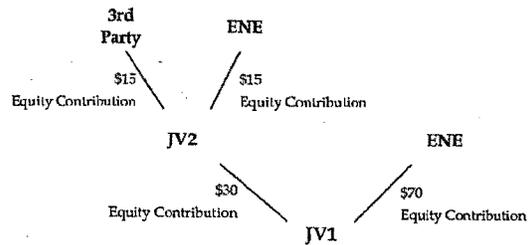
III. Percentage of Equity At Risk

| | | | |
|-----|-------------------|-----|------------------|
| 16% | ENE | 97% | ENE |
| 84% | Bank | 3% | Bank |
| | Bank Consolidates | | ENE Consolidates |

Conclusion: When the guarantor is the operational party, the debt is included in the calculation whether secured or unsecured. When the guarantor is the financial party, the debt characteristics determine whether debt is included in 4 to 1 calculation.

Date August 21, 2000
 Subject 4 To 1 Test Criteria
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Example 4



I. Summation of Total Equity Holders Capital At Risk in Joint Venture:

| | |
|-------------|----------------------|
| \$30 | JV2 Equity |
| <u>\$70</u> | ENE Equity |
| \$100 | Total Equity at Risk |

II. Each Company's Equity at Risk

| | |
|------|-----------------------|
| \$85 | ENE |
| \$15 | 3 rd Party |

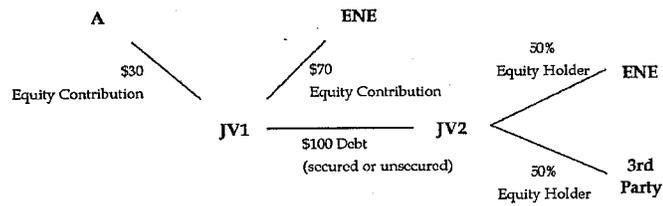
III. Percentage of Equity At Risk

| | |
|-----|-----------------------|
| 85% | ENE |
| 15% | 3 rd Party |
| | ENE Consolidates |

Conclusion: ENE Consolidates as equity from both Joint Ventures 1 and 2 is included in ENE's Capital at Risk

Date August 21, 2000
 Subject 4 To 1 Test Criteria
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Example 5



I. Summation of Total Equity Holders Capital At Risk in Joint Venture:

| | |
|-------------|----------------------|
| \$50 | ENE Debt |
| \$70 | ENE Equity |
| <u>\$30</u> | A Equity |
| \$150 | Total Equity at Risk |

II. Each Company's Equity at Risk

| | |
|-------|-----------------------|
| \$120 | ENE |
| \$50 | 3 rd Party |
| \$30 | A |

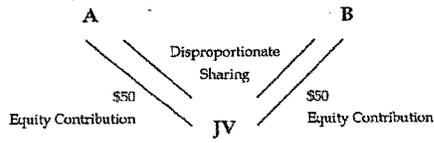
III. Percentage of Equity At Risk

| | |
|-----------------------|-----------------------|
| 60% | ENE |
| 25% | 3 rd Party |
| 15% | A |
| No Party Consolidates | |

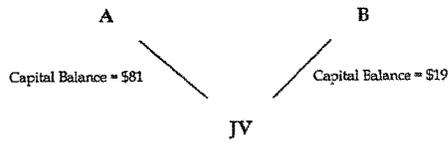
Date August 21, 2000
 Subject 4 To 1 Test Criteria
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Example 6

Day 1



Later



- There have been no distributions
- Co A has obtained increase

Question: • When do you reassess consolidation?

Conclusion: Only reassess upon event of recapitalization which is defined as additional equity infusion and borrowings, not sales, purchases or normal distributions based on GAAP earnings

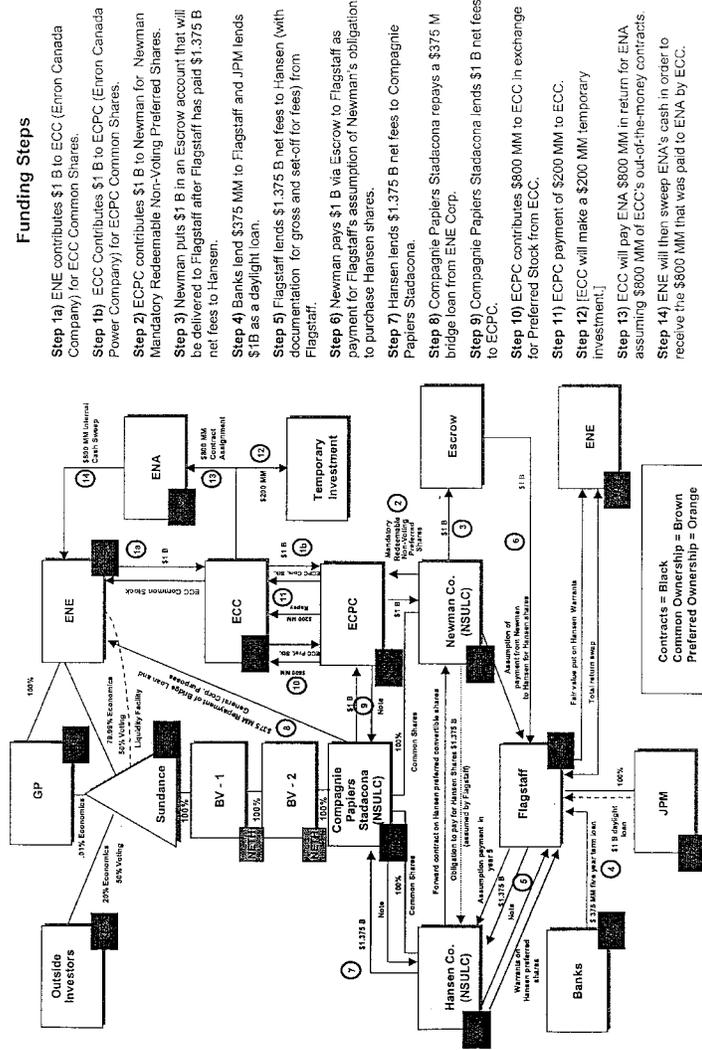
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OVERALL

4 To 1 Questions:

- Under what circumstances does the Joint Venture meet the 3% outside equity-at-risk calculation based on balance sheet footings of the Joint Venture exposure versus the SPE exposure?
- Under what circumstances is the 4 to 1 Test irrelevant? For example, if the JV has 2 equity holders, both which have significant participating rights, is it necessary to apply the 4 to 1 Test?

Flagstaff Funding Flows



Funding Steps

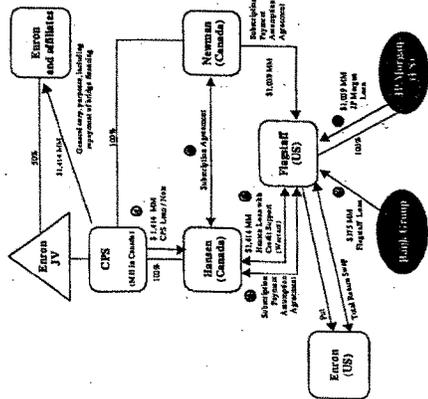
- Step 1a) ENE contributes \$1 B to ECC (Enron Canada Company) for ECC Common Shares.
- Step 1b) ECC contributes \$1 B to ECPC (Enron Canada Power Company) for ECPC Common Shares.
- Step 2) ECPC contributes \$1 B to Newman for Newman Mandatory Redeemable Non-Voting Preferred Shares.
- Step 3) Newman puts \$1 B in an Escrow account that will be delivered to Flagstaff after Flagstaff has paid \$1.375 B net fees to Hansen.
- Step 4) Banks lend \$375 MM to Flagstaff and JPM lends \$1 B as a daylight loan.
- Step 5) Flagstaff lends \$1.375 B net fees to Hansen (with documentation for gross and set-off for fees) from Flagstaff.
- Step 6) Newman pays \$1 B via Escrow to Flagstaff as payment for Flagstaff's assumption of Newman's obligation to purchase Hansen shares.
- Step 7) Hansen lends \$1.375 B net fees to Compagnie Papiers Stadacona.
- Step 8) Compagnie Papiers Stadacona repays a \$375 M bridge loan from ENE Corp.
- Step 9) Compagnie Papiers Stadacona lends \$1 B net fees to ECPC.
- Step 10) ECPC contributes \$800 MM to ECC in exchange for Preferred Stock from ECC.
- Step 11) ECC will make a \$200 MM temporary investment.
- Step 12) ECC will pay ENE \$800 MM in return for ENE assuming \$800 MM of ECC's out-of-the-money contracts.
- Step 14) ENE will then sweep ENE's cash in order to receive the \$800 MM that was paid to ENE by ECC.

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TRANSACTION SUMMARY

DIAGRAM

FLAGSTAFF / ENRON TRANSACTION (CLOSED ON JUNE 22, 2001)



Permanent Subcommittee on Investigations
EXHIBIT #338

- **Flagstaff:** Newly-created US special purpose vehicle, owned 100% by Chase Manhattan Bank.
- **Hensen:** Newly-created Canadian special purpose vehicle 100% owned by CPS
- **CPS:** Enron Canadian operating company owned by a JV of which Enron has 50%+ economic ownership
- **Newman:** Canadian company 100% owned by CPS

** Enron (US) parent company effectively guarantees the payment of principal and interest under the syndicate's credit facility, using a combination Warrant/FUT/Total Return Swap.

SENATE
FL-00809

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TRANSACTION SUMMARY

RECEPTION

Step 1: Fund Flagstaff

JPMorgan established a US special purpose vehicle ("Flagstaff") to act as a party to Hansen (a newly created special-purpose subsidiary of the ultimate borrower, CPS). Flagstaff is a bankruptcy remote entity 100% owned by Chase Manhattan Bank. The lenders (a bank syndicate) lent \$375MM to Flagstaff. In order for Hansen to borrow the full amount of the gross loan, however, an additional \$1,039 Bn is needed on day one. Chase Manhattan Bank made this through a daylight overdraft (i.e. intra-day) loan of \$1,039 Bn, which was fully repaid by the end of day one via Newman. When added to the \$375MM from the lenders, Flagstaff had the \$1,414 Bn needed on day one to effect the transaction. As described below, only a \$375MM net loan from Flagstaff was outstanding at the end of day one.

Enron Corp. (US parent company) effectively guarantees the \$375MM loan from the bank group to Flagstaff. This is done through a combination of a warrant/put/total return swap that gives credit support equivalent to a guarantee, but that does not constitute a guarantee for GAAP accounting for Enron's purposes, thus providing an accounting benefit to Enron.

Step 2: Flagstaff Loan to Hansen and Share Subscription Agreement

Flagstaff lent \$1,414 Bn to Hansen, a newly-created special purpose vehicle 100% owned by CPS. In return, Hansen gave Flagstaff a relatively plain-vanilla note (Hansen Note).

Step 3: Hansen Loan to CPS

Upon receipt of the \$1,414 Bn from Flagstaff, Hansen on-lent the \$1,414 Bn loan proceeds to its parent company, CPS. The terms of the loan are similar to (and essentially pari passu with) those between CPS and its existing bank syndicate.

Step 4: Share Subscription Agreement

Flagstaff and Newman entered irrevocably into a Share Subscription Agreement. Under the agreement, at maturity Newman is obligated to pay a subscription price of \$1,414 Bn to Hansen for 99.99% of Hansen's Class A preferred stock.

Step 5: CPS contribution to Newman

CPS used the \$1,414 of funds to repay interim bridge financing due to Enron Corp., and uses \$1,039 to make an intercompany loans to another Enron subsidiary.

TRANSACTION SUMMARY*Confidential***Step 6: Subscription Payment Assumption Agreement**

Flagstaff and Newman entered into a Subscription Payment Assumption Agreement under which Newman paid \$1,039 Bn to Flagstaff at inception, in return for Flagstaff assuming Newman's obligation under the Subscription Agreement to purchase Hansen's Class A Preferred shares at maturity. Under the Subscription Payment Assumption Agreement, Newman continues to be the recipient of the Hansen shares at maturity, but Flagstaff is obligated to pay the \$1,414 Bn purchase price at maturity. This \$1,039 Bn that Newman paid to Flagstaff at inception to irrevocably assume this obligation represents the present value (using the Flagstaff/Hansen term loan coupon of 6.12% as the discount rate) of \$1,414 Bn in 5 years. Since Newman will receive Hansen shares worth exactly \$1,414 Bn at maturity (as Flagstaff will have just paid Hansen \$1,414 Bn for the shares), the \$1,039 Bn present value of this amount is considered fair. Flagstaff will use the proceeds of Hansen's loan repayment of \$1,414 Bn to Flagstaff at maturity to pay for the shares, or may effect set-off of these mutual obligations at maturity.

Important aspects of the agreement are:

- The agreement represents a novation of Newman's obligation to purchase the shares. Newman retains the right to receive Hansen's stock at maturity, but the obligation to pay Hansen for the stock rests with Flagstaff.
- Flagstaff will be obligated to pay for the shares only if Hansen has repaid in full its \$1,414 Bn loan to Flagstaff at maturity. In reality, set-off will occur and the money will not actually have to change hands between Hansen and the Flagstaff.
- The documentation will stipulate that Newman has recourse only to Hansen in the event that Hansen does not deliver its stock to Newman at maturity. This would happen in the event that Hansen fails to repay the loan to Flagstaff and consequently Flagstaff refuses to pay Hansen under the Subscription Payment Assumption Agreement for the stock deliverable to Newman.

Step 7: Flagstaff repays the daylight overdraft to JPMorgan

Flagstaff used the \$1,039 Bn prepayment from Newman to permanently repay the \$1,039 Bn daylight overdraft to Chase Manhattan Bank prior to close on day one.

TAX AND ACCOUNTING RESULTS AND SUBSEQUENT YEARS

Each quarter CPS will pay a "coupon" of approximately \$22MM (6.12% * \$1,414 Bn * # days/360) to Hansen, which Hansen passes onto Flagstaff. Flagstaff will use the coupon to pay the principal and interest due to the bank syndicate. As described below, a portion of each \$22MM payment to Flagstaff will be used to pay down the \$375MM principal borrowing from the bank syndicate each period, as the \$375MM net loan will amortize to zero over the five-year tenor.

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FL-00911

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TRANSACTION SUMMARY

For tax purposes

Hansen, CPS and Newman (the Canadian subsidiaries) file separate unconsolidated tax returns. Per the legal documents CPS has a debt of \$1,414 Bn. Consequently, CPS shows a quarterly interest expense on its separate individual tax return of approximately \$22MM (6.12% * \$1,414 Bn gross loan * # days/360).

Economically, and for consolidated book purposes

CPS point of view: CPS shows a net loan of \$375MM (since \$1,039 Bn was returned to Flagstaff at inception via the Subscription Payment Assumption Agreement). Consequently, the \$22MM payment will constitute both interest on the \$375MM loan and principal amortization for the rest of the payment (e.g. 6.25% * \$375MM * # days = \$22,0MM of interest; with \$16MM representing payment of principal in quarter 1, leaving a \$359MM net loan balance at the end of quarter 1. The result is that the net \$375MM borrowing will be paid back over five years and one day on a mortgage style basis, with interest being paid at 6.12% on a declining principal amount. The net loan will have amortized down to zero over the 5-year + one day tenor.

It is important to understand that the \$1,414 Bn on CPS's unconsolidated books reduces to a net \$375MM loan upon consolidation (as it is netted against the \$1,039 Bn prepayment made to Flagstaff under the Subscription Payment Assumption Agreement). The \$22MM quarterly payment thus constitutes both interest and principal from the perspective of CPS's consolidated book (GAAP equivalent) financial statements.

Flagstaff point of view: Flagstaff will have lent \$1,414 Bn to Hansen and Flagstaff will have received \$1,039 Bn from Newman, for a net cash outflow to Flagstaff of \$375MM. Consequently Flagstaff will have a net \$375MM loan outstanding to CPS at the end of day one. Flagstaff's treatment of the payments received, from both a cash basis and an accounting (GAAP) basis, will mirror that of CPS from a consolidated book accounting perspective (as just described). Flagstaff will receive gross payments of approximately \$22MM per quarter, part of which represents interest and part of which is principal payment on its net \$375MM loan. The \$375MM loan will amortize to zero over the five year + one day tenor, with interest received each year on the declining balance.

On a practical basis, the \$22MM payments from Hansen will be passed through by Flagstaff to the syndicate of banks from which Flagstaff borrowed the net \$375MM on day one. Just as Flagstaff's economic loan will be paid down to zero by maturity, so will the individual loans by the banks in the syndicate.

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TRANSACTION SUMMARY

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UNWIND

At maturity, CPS will (from an unconsolidated, legal/tax perspective) repay its \$1.414 Bn gross loan to Hansen (funds to be obtained from operations or short-term borrowings), which Hansen uses to repay its loan from Flagstat. Flagstat will return the \$1.414 Bn to Hansen for Hansen's Class A shares under the terms of the Subscription Payment Assumption Agreement with Newman. Hansen will deliver its shares to Newman under the Subscription Agreement. Flagstat will have never owned or have had the right to own the Hansen shares.

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by JPMG

SENATE
FL-00913

Flagstaff Capital Corporation (Enron)
\$375,000,000 Amortizing Credit Facility
Illustrative Payment and Amortization Table

| Payment Date | Hansen Pmt. to Financial | Interest on Credit Facility ⁽¹⁾ | | Credit Facility Amortization | | Credit Facility Principal Balance | Swap Notional Balance | Credit Facility / Swap Average Life Calculation | Time | Principal Amortization | Weighted Principal |
|---------------------------|--------------------------|--|---------------|------------------------------|--------------|-----------------------------------|-----------------------|---|---------------|------------------------|--------------------|
| | | Principal | Amortization | Principal | Amortization | | | | | | |
| 6/22/01 | \$ 22,603,779 | \$ 5,965,500 | \$ 16,611,279 | \$ 386,366,721 | 0.26 | \$ 16,611,279 | \$ 4,277,973 | 0.26 | \$ 16,611,279 | \$ 4,277,973 | |
| 12/24/01 | 21,882,382 | 5,544,274 | 16,338,109 | 342,050,612 | 0.61 | 16,338,109 | 6,260,659 | 0.61 | 16,338,109 | 6,260,659 | |
| 3/22/02 | 21,160,985 | 5,117,077 | 16,043,909 | 326,008,704 | 0.76 | 16,043,909 | 11,689,864 | 0.76 | 16,043,909 | 11,689,864 | |
| 6/24/02 | 22,603,779 | 5,208,567 | 17,394,192 | 306,812,512 | 1.01 | 17,394,192 | 17,469,603 | 1.01 | 17,394,192 | 17,469,603 | |
| 9/23/02 | 21,882,382 | 4,774,236 | 17,108,147 | 291,604,365 | 1.26 | 17,108,147 | 21,467,203 | 1.26 | 17,108,147 | 21,467,203 | |
| 12/23/02 | 21,882,382 | 4,509,573 | 17,372,810 | 274,181,555 | 1.50 | 17,372,810 | 26,130,610 | 1.50 | 17,372,810 | 26,130,610 | |
| 3/24/03 | 21,882,382 | 4,240,815 | 17,641,567 | 256,486,988 | 1.75 | 17,641,567 | 30,833,159 | 1.75 | 17,641,567 | 30,833,159 | |
| 6/23/03 | 21,882,382 | 3,967,900 | 17,914,482 | 238,576,506 | 2.00 | 17,914,482 | 35,878,045 | 2.00 | 17,914,482 | 35,878,045 | |
| 9/22/03 | 21,882,382 | 3,690,763 | 18,191,819 | 220,388,687 | 2.25 | 18,191,819 | 40,988,523 | 2.25 | 18,191,819 | 40,988,523 | |
| 12/22/03 | 21,882,382 | 3,409,339 | 18,473,044 | 201,910,843 | 2.50 | 18,473,044 | 46,207,914 | 2.50 | 18,473,044 | 46,207,914 | |
| 3/22/04 | 21,882,382 | 3,123,581 | 18,758,822 | 183,152,022 | 2.75 | 18,758,822 | 51,586,608 | 2.75 | 18,758,822 | 51,586,608 | |
| 6/22/04 | 22,122,848 | 2,864,488 | 19,268,360 | 163,889,671 | 3.00 | 19,268,360 | 57,827,814 | 3.00 | 19,268,360 | 57,827,814 | |
| 9/22/04 | 22,122,848 | 2,632,287 | 19,550,651 | 144,304,130 | 3.25 | 19,550,651 | 64,862,319 | 3.25 | 19,550,651 | 64,862,319 | |
| 12/22/04 | 21,882,382 | 2,432,849 | 19,846,533 | 123,864,587 | 3.50 | 19,846,533 | 72,654,116 | 3.50 | 19,846,533 | 72,654,116 | |
| 3/22/05 | 21,641,917 | 1,907,974 | 18,734,242 | 104,360,645 | 3.75 | 18,734,242 | 80,816,812 | 3.75 | 18,734,242 | 80,816,812 | |
| 6/22/05 | 22,122,848 | 1,641,423 | 20,481,425 | 84,486,920 | 4.00 | 20,481,425 | 89,507,189 | 4.00 | 20,481,425 | 89,507,189 | |
| 9/22/05 | 22,122,848 | 1,321,094 | 20,801,754 | 65,967,168 | 4.25 | 20,801,754 | 98,705,169 | 4.25 | 20,801,754 | 98,705,169 | |
| 12/22/05 | 21,882,382 | 984,931 | 20,897,451 | 42,769,719 | 4.50 | 20,897,451 | 108,970,551 | 4.50 | 20,897,451 | 108,970,551 | |
| 3/22/06 | 21,641,917 | 654,377 | 20,987,540 | 21,762,175 | 4.75 | 20,987,540 | 119,288,766 | 4.75 | 20,987,540 | 119,288,766 | |
| 6/22/06 | 22,122,848 | 340,673 | 21,762,175 | 0 | 5.00 | 21,762,175 | 130,663,766 | 5.00 | 21,762,175 | 130,663,766 | |
| / Principal: \$75,000,000 | | | | | | | | | | | |
| Avg. Life: 2.75 yrs | | | | | | | | | | | |

(1) Swapped to Floating Rate in order to pay appropriate coupons to Bank Group.

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 Treasury Requested
 by JHRC

Snapshot Savings

- Tax interest deduction at Daishowa on gross US\$1.4 billion
- ➡ Deduction effectively eliminates cash taxes over next five years, resulting in a tax savings NPV of **US\$60 million** (assuming 100% utilization) *
- GAAP treatment: Net debt of US\$400 million and interest expense on US\$400 million
- Tax depreciation delay next five years
- ➡ Tax depreciation delay creates deferred tax benefit, resulting in net income improvement over the next five years of NPV **US\$65 million** *

** (5 year NPV @ 6.69%)*

| |
|---|
| Permanent Subcommittee on Investigations EXHIBIT #339 |
|---|

Global Syndicated Finance - Confidential

Date: 02/21/01

Prepared By: Josh Rogers

STRUCTURING SUMMARY
 Flagstaff Capital Corporation
 CIB Deal Team: Walker, Serice Lender: Traband, Rogers
 Credit Executive: Wright Timing: February 2001

| | | | |
|---------------------------------------|--|------------------------|---|
| Maximum Exposure for Approval (\$MM): | \$2.789 Bn (\$727.1 MM adjusted) | Industry Description: | Diversified Energy |
| Transaction for Approval (\$MM): | Underwrite: \$133.3MM Final Hold: \$40 MM | Primary SIC Code: | 1321 |
| Customer Name: | Enron Corp. | | |
| Obligor/Facility Risk Grade: | 3+ / 3+ | Major Plant Locations: | Texas/Gulf Coast, Oregon |
| Parent Name: | Enron Corp. | Major Overseas Ops: | Europe, India, Brazil, Argentina, Bolivia, Colombia, Caribbean, Philippines |
| Parent Risk Grade: | 3+/3+ | TREND: | Stable |
| Public Ratings (LT & ST): | CP: A2/P2 Sen. Uns: BBB+/Baa1 Sub: BBB/Baa3 3/23/00 (Moody's) | Outlook/Trend? | Positive |
| Date Ratings Last Changed: | | | |
| Stock Price (as of 2/12/01): | \$79.73 | 52 Wk. High/Low: | \$90.75 / \$62.00 |
| Market Capitalization: | \$59.5 Billion | Market Cap/Book Cap: | 5.2x |

Executive Summary (Overall Transaction)

We are requesting approval to arrange a \$400MM 5 year + 1 day amortizing (3 yr avg life) club pre-funded U.S. term loan facility guaranteed by Enron Corp. to support a tax-structured transaction sponsored by Enron Corp. ("Enron"). This facility is part of a \$1.53 Bn transaction arranged by JPMorgan's Structured Finance group, which will be used in connection with the acquisition of a Canadian Pulp & Paper Mill (the "Mill"). Enron is purchasing the Mill from Daishewa Forest Products Ltd. The deal will give Enron ownership of 60,000 acres (24, 300 hectares) of forest in the state of Maine as well as a \$15,000 ton/year newsprint and paperboard plant.

Deal Terms

Amount: US\$400MM
 Term: 5 years + 1 Day
 Drawn: L+ 85bps (subject to syndication feedback from Enron's Turbo Park deal; see Enron Forward Calendar attachment),
 Guarantor: Enron Corp. (BBB+ / Baa1)
 JPMorgan Upfront Fee: \$6MM
 GSF Upfront Fee: \$750,000 *
 CMB Pre-fund: \$133MM (1/3 of deal)
 CMB Target Hold: \$40MM
 Fees to Club Banks: 25 bps on hold at primary closing date
 Fees to Retail: - 35 bps (1 bp per million of commitment)

* Credit is requiring that an Enron credit derivative be purchased to offset CMB exposure on this transaction. The approximate \$550,000 cost is being paid by the Tax Structuring Group.



FOIA CONFIDENTIAL TREATMENT
 REQUESTED BY JPMC

Permanent Subcommittee on Investigations
EXHIBIT #341

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 Revised 6/97

JPM-1-00455

Syndication Strategy: Enron has proposed going to two or three of their second tier banks (IBJ, RBC, etc.) for the club opportunity. They think this strategy will enable them to 1) avoid approaching other top tier which may have ongoing pre-funded positions and 2) minimize underwriting fees. Enron has proposed a 25 bp fee (about \$333,000 on a \$133MM commitment) for pre-funding the deal. This fee would be net to the Clubs as Enron would pick-up fees to retail.

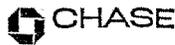
The Transaction will encompass two major steps (a more detailed description is outlined in the Transaction Overview section below):

1. A borrowing of approximately \$1.53 Bn from JPM. JPM will set up a special purpose vehicle to lend these funds, and will raise \$400 MM of the funds through the syndicated loan market, with the remainder in the form of an inter-company loan of approximately \$1.13 Bn. Enron will use the proceeds to acquire the Mill and to enter into an equity derivative transaction (next step).
2. An equity derivative transaction, entered into by two of Enron's subsidiaries and the JPM special purpose vehicle.

In order to facilitate the mechanics of this transaction, Chase is requesting three separate approvals:

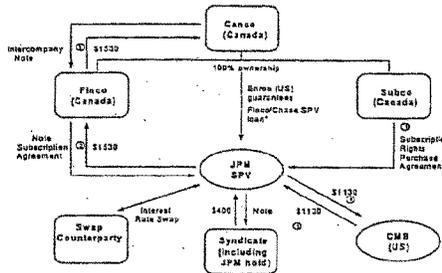
1. **Approval to arrange a \$400 MM funded bank facility.** Chase is proposing to underwrite a \$133.3 MM portion of the \$400 MM facility in a club-style execution, and will sell down to a final hold of \$40MM (10.0%) of this facility. We will have strong market flex specifying Underwriter target holds of \$40 MM by 80 days past the Primary Closing Date. Drawn prices will be at LIBOR + 85.0 bps and upfronts of 25.0 bps. The facility will fully amortize over the tenor of five years + 1 day. In an effort to manage exposure to Enron, JPM plans to purchase a credit derivative to lay off the risk on our \$40 MM commitment.
2. **Approval to make a daylight overdraft loan from Chase in an amount up to \$1.13 Bn.** Chase will use the proceeds it receives under the equity derivative to repay this loan at the end of the day on the closing date, effectively making the loan a daylight overdraft line for credit purposes. In addition, Chase would extend to Enron up to a [\$MM] daylight overdraft loan at maturity of 5-years and 1-day in order to facilitate the termination of the facility.
3. **Approval for a \$520 MM Interest Rate Derivative line** at the level of Chase SPV with maturities out to 5 years. This exposure is needed to effect an interest rate swap with Chase SPV. Any liabilities arising from derivatives transactions will be guaranteed by Enron Corp. The pay fixed/receive floating swap will hedge the amortizing \$400 MM facility.

Chase will receive a fee of approximately \$8.0 million at the close of the deal, with an additional 25.0 bps upfront on our commitment.



FOIA CONFIDENTIAL TREATMENT
REQUESTED BY JPMC

Transaction Overview



- JPM SPV: Newly-created US special purpose vehicle, owned 100% by JPMorgan Chase
- Finco: Newly-created Canadian special purpose vehicle 100% owned by Canco
- Canco: Enron Canadian operating company
- Subco: Newly-created Canadian special purpose vehicle 100% owned by Enron (US)

Note: Exact amounts of transactions will be based on swap rates at closing date.

The following steps will be executed to complete the Transaction:

Step 1: Fund JPMorgan SPV

JPMorgan will establish a US special purpose vehicle ("JPMorgan SPV") to act as party to Finco (a newly created special purpose subsidiary of the ultimate borrower, Canco). JPMorgan SPV will be a bankruptcy remote entity 100% owned by JPMorgan Chase & Co. The lenders (e.g., bank syndicate) lend \$400MM to JPMorgan SPV. In order for Finco to borrow the full amount of the gross loan, however, an additional \$1.13 Bn is needed on day one. JPMorgan will make this through a daylight overcrack (i.e. intra-day) loan of \$1.13 Bn, which will be fully repaid by the end of day one via Subco. When added to the \$400MM from the lenders, JPMorgan SPV will have the \$1.53 Bn needed on day one to effect the transaction. As described below, only a \$400MM net loan from JPMorgan will be outstanding at the end of day one.

Enron will guarantee \$400MM of the \$1.53 Bn Finco Note to JPMorgan SPV. Enron will not, however, guarantee the JPMorgan SPV's \$400MM Note to the lenders. It is anticipated that the bank lenders will be comfortable with the Finco/JPMorgan SPV guarantee and a representation from CMB that the cash flows into the JPMorgan SPV will be only for the benefit of the lenders.

Step 2: JPMorgan SPV Loan to Finco and Share Subscription Agreement

JPMorgan SPV lends \$1.53 Bn to Finco, a newly-created special purpose vehicle 100% owned by Canco. In return, Finco gives JPMorgan SPV a relatively plain-vanilla note (Finco Note). JPMorgan SPV and Finco also enter irrevocably into a Share Subscription Agreement. Under the agreement, at maturity JPMorgan SPV will pay the subscription price of \$1.53 Bn to Finco for 99.99% of Finco's common stock, which it will direct Finco to deliver directly to Subco in satisfaction of JPMorgan SPV's contract with Subco (described in Step 1). JPMorgan SPV will pay this \$1.53 Bn subscription price to Finco using the \$1.53 Bn loan repayment proceeds from Finco.



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Date: 02/21/01

Step 3: Finco Loan to Canco

Upon receipt of the \$1.53 Bn from JPMorgan SPV, Finco will on-lend the \$1.53 Bn loan proceeds to its parent company, Canco. The terms of the loan are similar to (and essentially will be pari passu with) those between Canco and its existing bank syndicate.

Step 4: Finco Loan to Canco

MOC makes an intercompany loan of \$1.13 Bn to Subco, a newly-created SPV owned by Canco.

Step 5: Subco acquires JPMorgan SPV's right to receive Finco stock at maturity

Subco purchases JPMorgan SPV's right to receive Finco's stock at maturity. Subco does this by entering into a Subscription Rights Purchase Agreement with JPMorgan SPV under which it prepays JPMorgan SPV \$1.13 Bn at inception. This \$1.13 Bn represents the present value (using the JPMorgan SPV/Finco term loan coupon as the discount rate) of \$1.53 Bn in 5 years. Since Subco will receive Finco shares worth exactly \$1.53 Bn at maturity (as JPMorgan SPV will have just returned to Finco \$1.53 Bn for the shares), the \$1.13 Bn present value of this amount is considered fair. Important aspects of the agreement are:

- Subco purchases JPMorgan SPV's right to receive Finco's stock at maturity. The obligation to pay Finco for the stock, however, remains with JPMorgan SPV as previously described.
- JPMorgan SPV will be obligated to purchase the shares only if Finco has repaid in full its \$1.53 Bn loan to JPMorgan SPV at maturity. In reality, set-off will occur and the money will not actually have to change hands between Finco and the JPMorgan SPV.
- The documentation will stipulate that Subco has recourse only to Finco in the event that Finco does not deliver its stock to Subco at maturity. This would happen in the event that Finco fails to repay the loan to JPMorgan SPV and consequently JPMorgan SPV refuses to pay Finco under the Subscription Agreement for the stock it owes to Subco.

Step 6: JPMorgan SPV repays the daylight overdraft to JPMorgan

JPMorgan SPV will use the \$1.13 Bn prepayment from Subco to permanently repay the \$1.13 Bn daylight overdraft to Chase Manhattan Bank prior to close on day one.

ECONOMIC RESULT:

The economic result is a level-payment, self-amortizing net debt of \$400 MM at closing. Interest and principal on the net debt are serviced by the stated coupons on the Note (similar to a mortgage).

TAX BENEFIT:

The coupons on the full principal amount of the Note are tax-deductible interest in Canada. The forward contract does not create an asset that generates taxable income on an accrual basis in Canada.

Enron Pulp & Paper Overview:

Enron's pulp and paper initiative is housed on Enron Industrial Markets. The objective is to bring the same trading and risk management skills Enron has used in its gas and power trading businesses to the pulp and paper industry. Enron has been providing financially settled hedges to the P&P industry since 1997, having completed _____ transactions with a notional value of \$8 billion. To help develop the ability to trade the physical commodity, Enron felt the need to establish a hard asset position in the P&P industry. Specifically, Enron has completed the following steps since September 2000.

Garden State. In September, Enron purchased a 30-year-old 210,000-ton/year newsprint facility and four recycling centers that collect old newsprint (ONP) for use as feedstock at the plant. Planned CAPEX will increase capacity to 220,000-ton/year and reduce operating expenses.

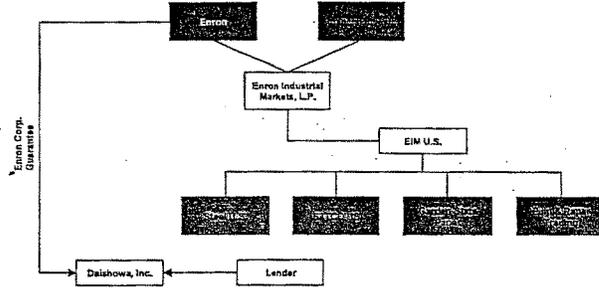
Clickpaper.com. In conjunction with the purchase of Garden State Paper, Enron introduced Clickpaper.com. Clickpaper.com provides a transactional platform to buy and sell physical and financial pulp, paper, and wood products, which is principal-based, commission-free, and real-time. It also provides news, resources and information directly related to the industry. Enron intends to expand the product offering on Clickpaper.com as it expands its physical position in pulp & paper.

Daishowa. Most recently, Enron has agreed to purchase Toronto-based Daishowa Forest Products Ltd., a Quebec newsprint mill and sawmill. It is this acquisition that will be financed through the above structure. The deal will give Enron



ownership of 50,000 acres (24,300 hectares) of forest in the state of Maine as well as Dalshowa's primary asset, a 515,000 ton a year newsprint and paperboard plant.

Enron's pulp and paper assets, along with the other products targeted by Enron Industrial Markets, will be held in the structure below. As a result of this structure, CMS's unfunded commitment to the Pulp & Paper business and our funded facility to Garden State Paper will both be refinanced.



Company Business

ENRON CORP.

Enron is the leading Risk Merchant. Traditionally considered a natural gas pipeline company, Enron's core business is now the management of price risk in fast-growing and deregulating commodity markets. The Risk Merchant franchise accounts for 75% of operating income, and is growing at a 30%-40% annual rate. Enron grows by expanding this business model into new geographies and commodities. Market shares: No. 1 in relatively mature \$80 billion U.S. natural gas market; No. 1 in \$235 billion U.S. electricity market, opened in 1996 and rapidly growing. Enron also has first mover advantage in the \$276 billion European market, opened in February 1999, where it is already profitable and has seen volumes grow ten-fold. Enron expects to solidify its position by using the Internet EnronOnline already drives over half of total commodity volumes. Also, Enron expects to successfully develop the bandwidth commodity market, where it already has first mover advantage.

Enron's operations are classified into the following business segments:

- **Wholesale Energy Operations and Services** engages primarily in the trade and marketing of natural gas, electricity, and other energy sources and risk management products in North America and Europe, as well as energy asset investments worldwide.
- **Transportation and Distribution** operations engage in the transmission of natural gas across the Company's nine major pipelines and the generation and distribution of electricity.
- **Retail Energy Services** engages in the sale of natural gas and electricity directly to end-use customers, particularly in the commercial and industrial sectors, including the outsourcing of energy-related activities.
- **Broadband Services** was recently developed to establish a communications bandwidth trading market.

WHOLESALE ENERGY OPERATIONS and SERVICES:

Enron's wholesale business (Enron Wholesale) includes its wholesale energy businesses around the world. Enron Wholesale operates in developed and deregulated markets such as North America and Europe, as well as developing or newly deregulating markets including South America, India and Japan.

Enron builds its wholesale businesses through the creation of networks involving asset ownership, contractual access to third-party assets and market-making activities. Each market in which Enron Wholesale operates utilizes these components in a slightly different manner and is at a different stage of development. This network strategy has enabled Enron



Global Syndicated Finance - Confidential

Date:02/21/01

Key Deal Terms:

| | |
|------------------------|-------------------|
| Amount | \$400.0 million |
| Maturity | 5 years and 1 day |
| Commitment Amount | \$133.3 million |
| Hold Amount | \$40.0 million |
| Undrawn Cost | N/A |
| Drawn Cost | 85.0 bps |
| Upfront Fees to Market | 25.0 bps |
| Funded ? | Yes |
| Guaranteed ? | Yes - Enron Corp. |
| Secured ? | Yes |
| Administrative Agent | JPM |

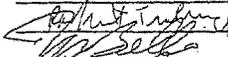
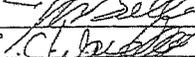
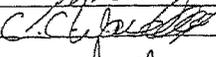
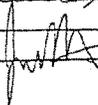
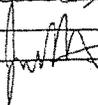
Highlights:

- *Strong Credit* - BBB+/Ba1 investment grade ratings.
- *Marquee Name* - one of the world's largest integrated natural gas and electricity companies.
- *Financial Strength* - \$53 billion in Assets, Market capitalization of \$59.5 billion.
- *Strong bank following* - Approximately 80 banks currently provide financing to Enron and related entities.

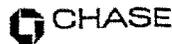
Cross-Sell Opportunities and Strategy:

Chase continues to be a first tier bank to Enron (Blue Client) and is one of its top two agents (Citibank being our principal competitor). For fiscal year 2000, Chase has earned over \$23.1 million in revenues from the Enron relationship. Anticipated opportunities moving forward include Investment Grade Securities, M&A advisory and Derivatives.

Approval Signatures:

| | | |
|-------------------|--------------------|--|
| Associate: | Josh Rogers | |
| Senior Banker: | Robert Traband |  |
| Credit Executive: | Jim Bletto |  |
| Credit Executive: | Chris Wardell |  |
| Credit Executive: | Gary K. Wright |  |
| Credit Executive: | James H. Bellentia |  |

FOIA CONFIDENTIAL TREATMENT
REQUESTED BY JPMC



Enron Corp.

Stadacona

Permanent Subcommittee on Investigations
EXHIBIT #342



FOIA Confidential
Treatment Requested
By JPMC

SENATE
FL-02057



The Offering

Sponsor: Enron
Borrower: Flagstaff
Size: \$375 million sr. unsecured note
Tenor: Five Years and One Day
Interest: LIBOR + 112.5 bps, payable quarterly
Amortization: Mortgage--style, fully amortizing
Prepayability: Pre-pay in whole at anytime including accrued and unpaid interest
Rationale: Permanent financing of Stadacona, Enron's recent newsprint mill acquisition from Daishowa Inc.
Arranger: JP Morgan Chase

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2

FOIA Confidential
Treatment Requested
by JPAC

SENATE
FL-02058

Stadacona Paper Mill

- Enron acquired Daishowa Forest Products, recently renamed "Stadacona," from Daishowa Inc. in March 2001 for approximately US\$375MM
- Located in Quebec City, Canada, the mill produces a total of 515,000 tonnes of paper per year including newsprint paper, directory paper and paperboard
- Stadacona alone is the 1th largest North American newsprint producer. With Stadacona, Enron now is the 7th largest North American newsprint producer when combined with Enron's Garden State Paper newsprint facilities in New Jersey
- The acquisition of Stadacona provides Enron Industrial Markets the necessary access to physical newsprint supplies in order to implement its wholesale business model strategy in the forest products industry

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By JPLIC

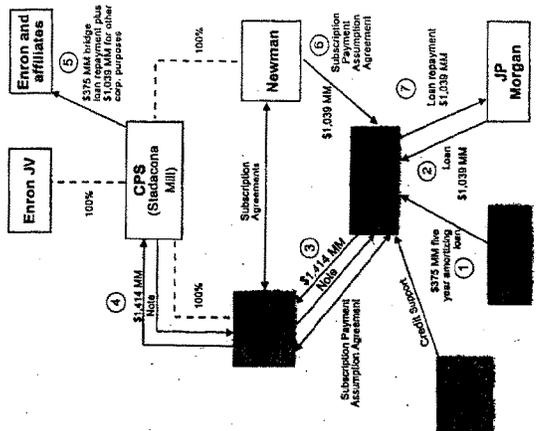
SENATE
FL-02059

3

The Transaction

- Refinances bridge acquisition financing of Stadacona
- First Major Enron Industrial Markets financing
- Credit Support Package = Enron Credit Risk (BBB+/Baa1)

Transaction Description



- The Bank Group provided \$375 MM under the Credit Facility to Flagstaff Capital Corp (100% JP Morgan owned entity)
 - Flagstaff's activities and access to cash flows are restricted by covenants
- JP Morgan provided a loan to Flagstaff
- Flagstaff lent proceeds including \$375 MM to Hansen, 100% owned subsidiary of CPS (Stadacona newsprint mill)
- Hansen lent proceeds to CPS
- CPS sent proceeds to Enron Corp. for repayment of bridge financing and other corporate purposes
- Newman paid Flagstaff \$1,039 MM to assume Newman's obligation to pay \$1,414 MM for Hansen shares in five years
- Flagstaff repaid loan to JP Morgan

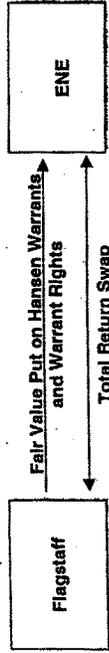
FOIA Confidential Treatment Requested by JPM3

SENATE FL-02061

Enron Credit Support

- Enron Credit Support includes a combined put and total return swap that allows lenders to look to Enron for full interest and principal payments after an Event of Default.
- In addition, Enron entered into the Enron Agreement which is for the benefit of Flagstaff and the lenders and provides for standard covenants, representations and warranties provided in the Enron Revolver as summarized in the Information Memorandum

Enron Credit Support Mechanics



- Warrant:** Hansen issued a Warrant to Flagstaff as a security for Flagstaff to put to Enron
- Warrant Value:** The Warrant and Warrant Rights created a claim equal to the Make-Whole (outstanding principal plus accrued and unpaid interest) in the Hansen Credit Agreement
- Put:** Flagstaff has the right to put the Warrants to Enron in return for the Fair Market Value of the Warrant and Warrant Rights at an Event of Default
- Total Return Swap:** Flagstaff has a Total Return Swap with Enron to swap the floating payment of Fair Market Value received under the Put for the fixed Make-Whole Amount. The Total Return Swap provides a back-stop to Flagstaff should the Fair Market Value of the Warrant and Warrant Rights received under the put not equal actual outstanding principal and accrued and unpaid interest under the Flagstaff Note

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Treatment Requested
By JPH/KC

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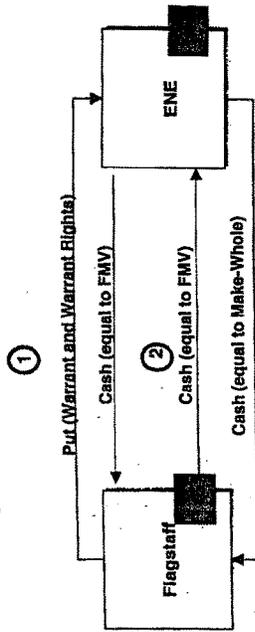
SENATE
FL-02063

Enron Credit Support Steps

Upon the occurrence of:

• Event of Default → Flagstaff will:

- Put Warrants to Enron in return for Fair Market Value of Warrant Rights which include rights to the Make-Whole
- Swap Fair Market Value received under the Put with Enron in return for the fixed Make-Whole amount which includes all outstanding principal and accrued and unpaid interest to the actual swap date



Result → Lenders rely upon Enron for repayment of principal and interest

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SENATE
FL-02084

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Investment Highlights

- First Enron Industrial Markets Financing
- Entrance into Enron's New Wholesale business without Operating Risk
- Enron Credit Risk
- Fully Amortizing

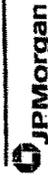
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FL-02065

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**Transaction Detail
Appendix**

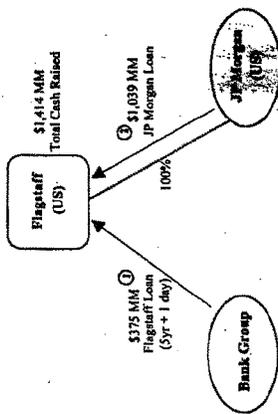


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No. 1234

TRANSACTION DESCRIPTION SUBJECT TO CONFIDENTIALITY AGREEMENT

At Inception

Step 1 - Flagstaff Funding



| | |
|---|---|
| 1 | <ul style="list-style-type: none"> The Bank Group (which includes JP Morgan) provided a \$375MM amortizing term loan (the "Flagstaff Loan") under the Credit Facility to Flagstaff Capital Corp (a wholly-owned JP Morgan subsidiary). <ul style="list-style-type: none"> Flagstaff's activities and access to cash flows are restricted by covenants. Enron Corp. ("Enron") provides credit support for the repayment of principal and interest to Bank Group. (See "Credit Support"). |
| 2 | <ul style="list-style-type: none"> JP Morgan lent \$1,039 MM to Flagstaff ("JP Morgan Loan"). <ul style="list-style-type: none"> JP Morgan was repaid before the end of day 1 (see item 10 below). |

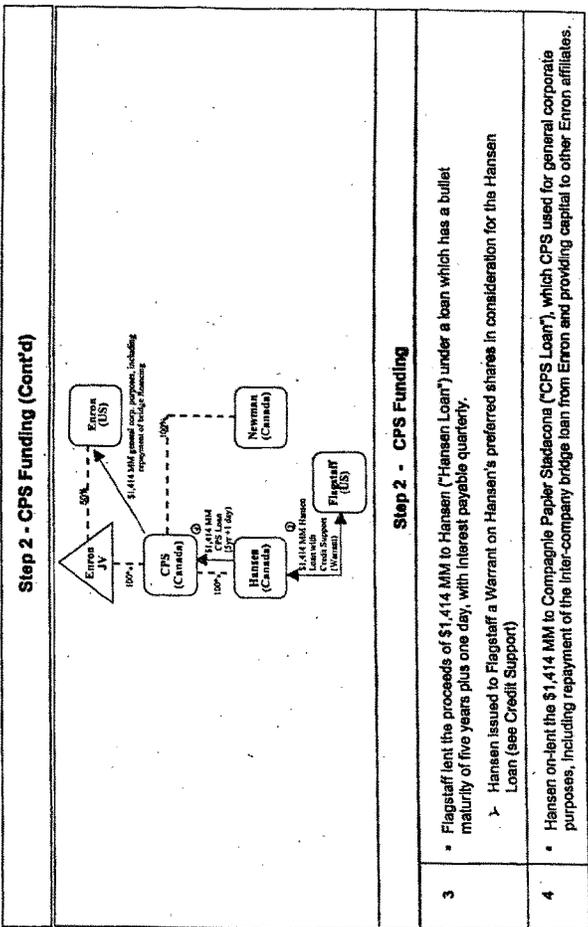


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TRANSACTION DESCRIPTION

At Inception

SUBJECT TO CONFIDENTIALITY AGREEMENT



Step 2 - CPS Funding

- 3 • Flagstaff lent the proceeds of \$1,414 MM to Hansen ("Hansen Loan") under a loan which has a bullet maturity of five years plus one day, with interest payable quarterly.
 - Hansen issued to Flagstaff a Warrant on Hansen's preferred shares in consideration for the Hansen Loan (see Credit Support)
- 4 • Hansen on-lent the \$1,414 MM to Compagnie Papler Stadacona ("CPS Loan"), which CPS used for general corporate purposes, including repayment of the inter-company bridge loan from Ernon and providing capital to other Ernon affiliates.



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TRANSACTION DESCRIPTION SUBJECT TO CONFIDENTIALITY AGREEMENT

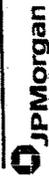
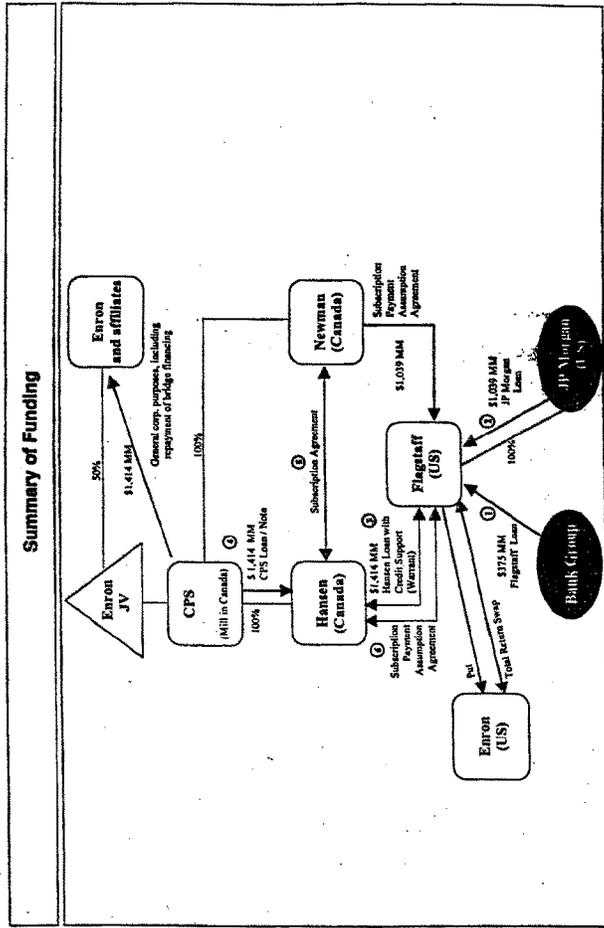
| At Inception | <p style="text-align: center;">Step 3 – Share Subscription</p> |
|--------------|--|
| 5 | <ul style="list-style-type: none"> Hansen and Newman entered into a Share Subscription Agreement by which Newman agreed to pay \$1,414MM at maturity (five years and one day) for Hansen's preferred stock, to be delivered at maturity. |
| 6 | <ul style="list-style-type: none"> Flagstaff and Newman entered into a Subscription Payment Assumption Agreement under which Newman paid \$1,039 MM to Flagstaff at inception, in exchange for Flagstaff assuming Newman's obligation to pay the Hansen stock subscription price of \$1,414 MM at maturity. |
| 7 | <ul style="list-style-type: none"> Flagstaff repaid the \$1,039 MM to JP Morgan. |



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TRANSACTION DESCRIPTION SUBJECT TO CONFIDENTIALITY AGREEMENT

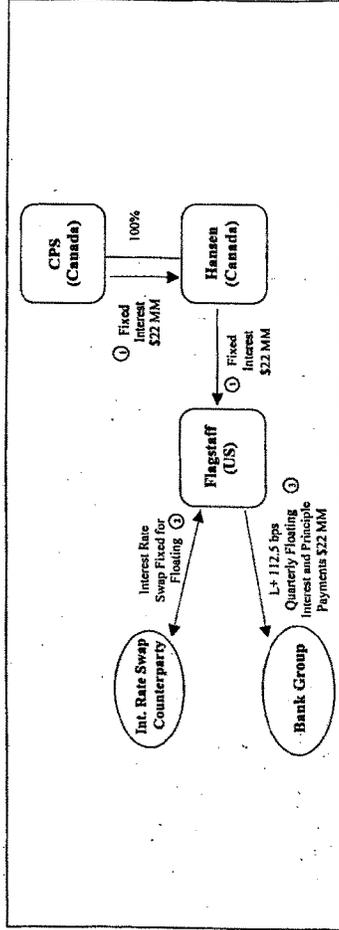
At Inception



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TRANSACTION DESCRIPTION SUBJECT TO CONFIDENTIALITY AGREEMENT

Periodic Cash Flows



| | |
|---|--|
| 1 | <ul style="list-style-type: none"> CPS and Hansen make interest payments under their respective loans. |
| 2 | <ul style="list-style-type: none"> Flagstaff engages in a fixed for floating interest rate swap. |
| 3 | <ul style="list-style-type: none"> Coupon payments received by Flagstaff are used to service the interest and principal due to the Bank Group. Bank Group's principal amortizes to zero over the 5 years plus one day tenor. |



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TRANSACTION DESCRIPTION SUBJECT TO CONFIDENTIALITY AGREEMENT

Sources & Uses

| Transaction Sources and Uses (CPS) | |
|---|--|
| (US \$ in millions) | |
| CPS Sources and Uses | |
| Sources of Funds: | Uses of Funds: |
| Loan from Hansen/Flagstaff* \$1,414 | Repay Enron Inter-company bridge loan and general corporate purposes \$1,414 |
| Total <u>\$1,414</u> | Total <u>\$1,414</u> |

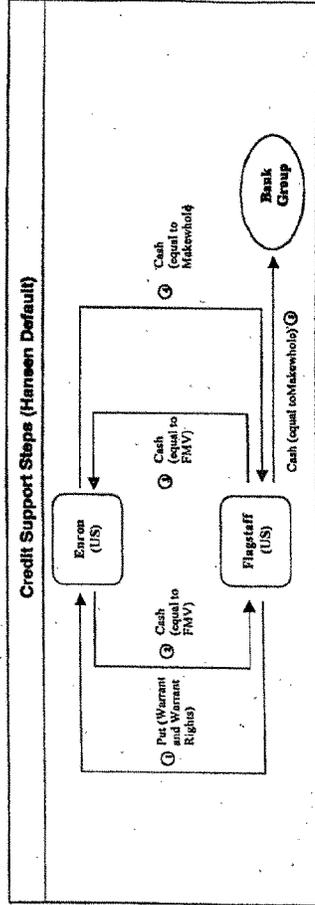
Flagstaff's sources of funds are the Flagstaff Loan of \$375 million and the JP Morgan Loan of \$1,039 million.



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TRANSACTION DESCRIPTION SUBJECT TO CONFIDENTIALITY AGREEMENT

Credit Support, cont'd



| | |
|---|--|
| 1 | Under the Put Option, Flagstaff puts the Warrant and Warrant Rights to Enron (US). |
| 2 | Enron (US) pays Flagstaff cash equal to the FMV of the Warrant and Warrant Rights (the right to the Hansen Makewhole payment). |
| 3 | Under the Total Return Swap, Flagstaff pays back to Enron (US) the cash (FMV) just received via the put. |
| 4 | In return, Enron pays Flagstaff cash equal to the Makewhole. |
| 5 | Flagstaff uses the cash to repay the amount due to the Bank Group. |



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Proposal to



ENRON INDUSTRIAL MARKETS

STRUCTURED CANADIAN FINANCING TRANSACTION
(PROJECT "SLAPSHOT")

January 11, 2001

Permanent Subcommittee on Investigations
EXHIBIT #343

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FL-00992

Important Notice

JP Morgan makes no representations as to the tax and accounting treatment of this Transaction. Enron Industrial Markets represents to JP Morgan that it shall consult its own tax advisors, accountants and attorneys with respect to the Transaction and shall make its own independent determination as to the tax effectiveness and advisability of the Transaction.

The pricing in this presentation is for indicative purposes only and does not reflect a commitment by the J.P. Morgan Chase & Co. or its affiliates to extend any credit or underwrite a financing.

JP Morgan is a marketing name for investment banking businesses of J.P. Morgan Chase & Co. and its subsidiaries worldwide. Securities, syndicated loan arranging, financial advisory and other investment banking activities are performed by J.P. Morgan Securities Inc. the JP Morgan division of Chase Securities Inc. and their securities affiliates, and lending, derivatives and other commercial banking activities are performed by Morgan Guaranty Trust Company of New York. The Chase Manhattan Bank and their banking affiliates. JP Morgan deal team members may be employees of any of the foregoing entities.

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FL-00933

(i)

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| Results and Cash Flows | 4-13 |
| Conclusion | 14 |

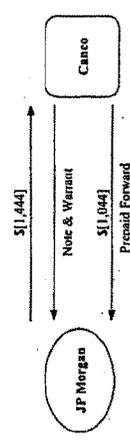
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FL-00934

(H)

SUMMARY

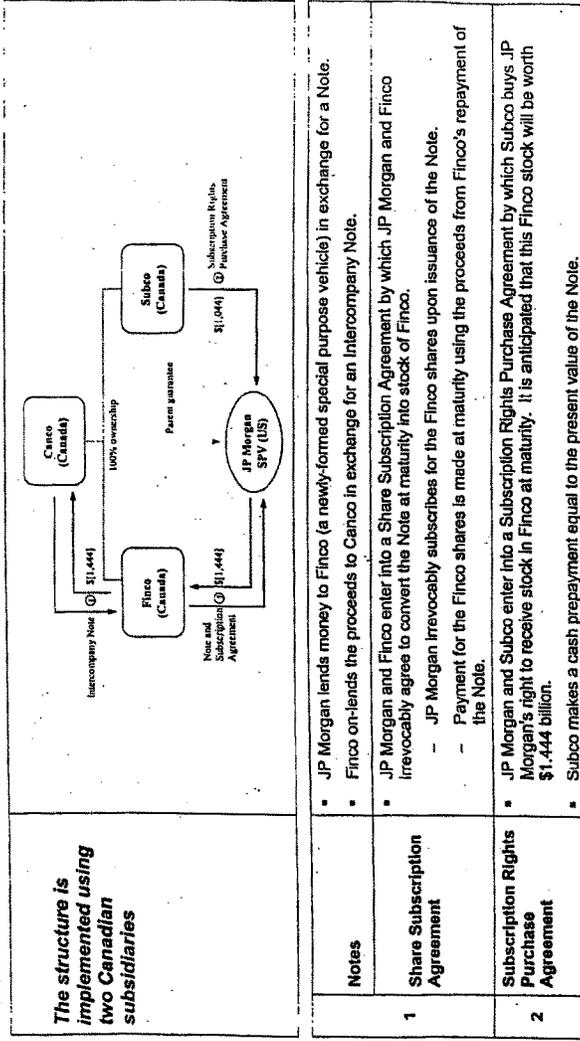
| | |
|---------------------|--|
| Introduction | <ul style="list-style-type: none"> A proprietary financing structure that allows a Canadian company to raise low-cost financing. |
| Transaction Concept |  <p>The diagram illustrates the transaction concept. On the left is a circle labeled "JP Morgan" and on the right is a rounded rectangle labeled "Canco". An arrow points from JP Morgan to Canco, labeled "Note & Warrant" with "\$1,444" above it. A return arrow points from Canco to JP Morgan, labeled "Prepaid Forward" with "\$1,044" above it.</p> |
| Economic Result | <ul style="list-style-type: none"> A Canadian company ("Canco") borrows money by issuing a Note and a Stock Warrant. Canco "deleverages" its principal repayment obligation on the Note by entering into a prepaid forward contract over its stock. The economic result is a level-payment, self-amortizing net debt. Interest and principal on the net debt are serviced by the stated coupons on the Note (similar to a mortgage). |
| Tax Benefit | <ul style="list-style-type: none"> The coupons on the full principal amount of the Note are tax-deductible interest in Canada. The forward contract does not create an asset that generates taxable income on an accrual basis in Canada. |
| Savings | <ul style="list-style-type: none"> The present value of the total incremental benefit of the structure is approximately \$125MM, based on a net borrowing of \$400MM. |

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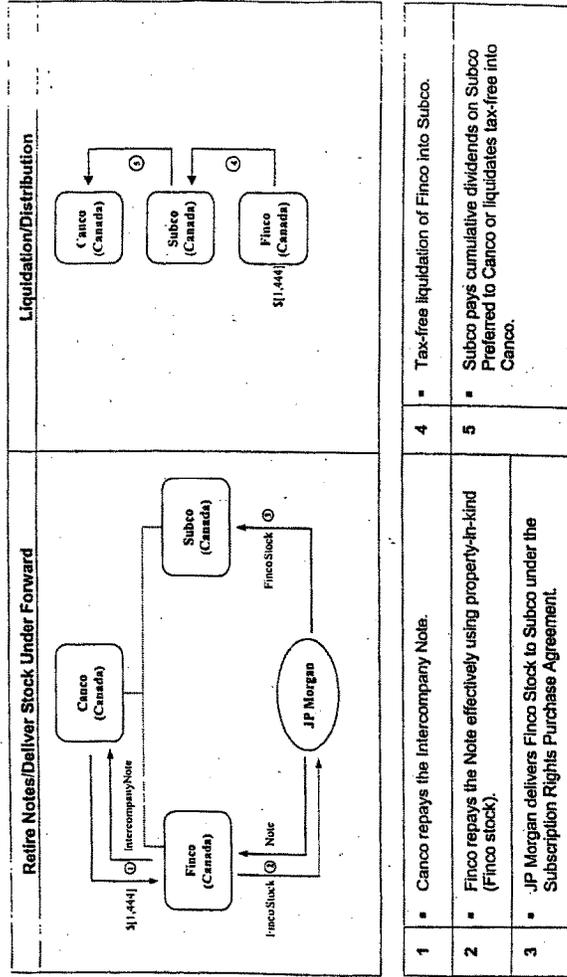
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DIAGRAMS
At Inception



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DIAGRAMS
Unwind



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by JP Morgan



MODEL

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FL-00688

RESULTS AND CASH FLOWS

Summary of Consolidated Results

| | Base Case | Structure | Incremental Benefit (Cost) |
|------------------------------------|-----------------|-----------------|----------------------------|
| Gross Borrowing | \$400.00 | \$1,443.50 | n/a |
| Net Borrowing (after expenses) | \$396.38 | \$384.03 | (\$12.35) |
| Pre-Tax Cost of Funds (Coupon) | 6.40% | 6.71% | -0.31% |
| NPV of Net Cash Flows | (\$5.86) | \$119.94 | \$125.80 |
| Annualized After-Tax Rate Benefit* | | | 7.07% |
| Pre-Tax Equivalent Rate Benefit** | | | 11.78% |

* Annualized after-tax rate benefit calculated by finding level payments needed to amortize NPV benefit over five years, given the after-tax discount rate. The level payments were then divided by notional amount of borrowing before expenses.

** Pre-tax equivalent rate calculated by dividing annualized after-tax benefit by 1 less Canadian tax rate.

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ASSUMPTIONS

| 1/9/01 | | Cansub Share Purchase Agreement | |
|---|-------------------|---------------------------------|------------|
| Issuer | Canco | Cansub Stock Amount | \$1,443.50 |
| Rating | Baa1/BBB+ | Prepayment Amount | 72.29% |
| Security | 5-Year Bond Issue | Percent Paid at Maturity | 0% |
| Comparative Base Case Yield (Interpolated Enron Bond Yield)* | 6.400% | Percent Paid at Inception | 100.00% |
| Normal Issuance Cost | 0.50% | | |

| Loan Note | | Intercompany Note | |
|------------------------------------|---------------------|------------------------------------|------------|
| Issuer | Finco | Issuer | Canco |
| Purchaser | JP Morgan/Syndicate | Purchaser | Finco |
| Rating | Baa1/BBB+ | Rating | ria |
| Tenor | 5 | Tenor | 5 |
| Fixed/Floating | Floating | Fixed/Floating | Floating |
| Amount | \$1,443.50 | Amount | \$1,443.50 |
| LIBOR swapped to 5-Year Fixed Rate | 5.58% | LIBOR swapped to 5-Year Fixed Rate | 5.58% |
| Gross Margin** (indicative) | 1.26% | Gross Margin | 1.225% |
| Coupon | 6.705% | Coupon | 5.81% |

| Transaction Costs** | | Tax Information | |
|---------------------|-------|----------------------------|--------|
| JP Morgan Fee | 3.00% | Canadian Tax Rate (Canco) | 40% |
| | | Canadian Tax Rate (Finco) | 40% |
| | | Canadian Tax Rate (Cansub) | 40% |
| | | Capital Tax (Federal) | 0.225% |
| | | Capital Tax (Provincial) | 0.300% |

* From Bloomberg
 ** Gross margin includes a structuring premium but does not include up front fees that may be required in a syndication.
 *** Ignoring legal and other costs

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CANCO CASH FLOWS

| Period | Intercompany Note | | Transaction Costs | | Federal Income Tax | | Federal Capital Tax | |
|--------|-------------------|----------|-------------------|--------------|-------------------------|-------------------------------|---------------------|--------|
| | Principal | Interest | Cash Payment | Amortization | Marginal Taxable Income | Federal Tax Benefit (Payment) | Amount | Amount |
| 0 | \$1,443.50 | \$0.00 | (\$12.00) | \$0.00 | \$0.00 | \$0.00 | (\$0.00) | |
| 1 | 0.00 | (88.23) | 0.00 | (8.86) | (108.89) | 42.78 | (8.99) | |
| 2 | 0.00 | (88.23) | 0.00 | (8.86) | (108.89) | 42.78 | (8.99) | |
| 3 | 0.00 | (88.23) | 0.00 | (8.86) | (108.89) | 42.78 | (8.99) | |
| 4 | 0.00 | (88.23) | 0.00 | (8.86) | (108.89) | 42.78 | (8.99) | |
| 5 | (1,443.50) | (88.23) | 0.00 | (8.86) | (108.89) | 42.78 | 0.00 | |

| Period | Provincial Capital Tax | | Federal Tax | | Net Cash Flow |
|--------|------------------------|-------------------------------|-------------------|------------|---------------|
| | Gross Amount | Federal Tax Benefit (Payment) | Benefit (Payment) | Net Amount | |
| 0 | (\$1.20) | \$0.48 | (\$0.72) | (\$0.72) | \$1,429.88 |
| 1 | (1.20) | 0.48 | (0.72) | (0.72) | (57.09) |
| 2 | (1.20) | 0.48 | (0.72) | (0.72) | (57.09) |
| 3 | (1.20) | 0.48 | (0.72) | (0.72) | (57.09) |
| 4 | (1.20) | 0.48 | (0.72) | (0.72) | (57.09) |
| 5 | 0.00 | 0.00 | 0.00 | 0.00 | (1,488.96) |

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Notes
 (A) Canco borrows gross amount from Fincor. Canco pays off the intercompany note to Fincor at maturity.
 (B) Canco pays Fincor interest on the intercompany note.
 (C) A percentage of the principal amount of intercompany note.
 (D) Transaction costs are tax deductible over the tenure of intercompany note on a straight line basis.
 (E) Federal income tax on marginal taxable income.
 (F) Federal capital tax on marginal taxable income.
 (G) Federal capital tax on net borrowing (the principal of borrowing less prepaid forward).
 (H) Provincial capital tax on effect of net borrowing (the principal of borrowing less prepaid forward).
 (I) Federal income tax savings on provincial capital tax, which is deductible.
 (J) Net provincial capital tax, after federal income tax savings.
 (K) Sum of federal income tax, federal capital tax and net provincial capital tax (F+G+J).
 (L) Sum of columns A, B, C and K.

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 FL-00941

FINCO CASH FLOWS

| Period | Loan Note - Including Effective Economic Amortization | | | Finco Stock (non-cash) | | | Intracompany Note | | | Federal Income Tax | | | Federal Capital Tax | | |
|--------|---|--------------|----------|------------------------|----------|------------|-------------------|----------|-------------------------|--------------------|-------------|--------|---------------------|---|--|
| | M | N | O | P | Q | R | S | T | U | V | W | X | Y | Z | |
| | Drawdown | Debt Service | Interest | Principal Amortization | Balance | (non-cash) | Principal | Interest | Marginal Taxable Income | Federal Tax | Federal Tax | Amount | Amount | | |
| 0 | \$1,443.50 | \$0.00 | \$0.00 | (\$1,043.50) | \$400.00 | \$0.00 | (\$1,443.50) | \$0.00 | \$0.00 | \$0.00 | \$0.00 | \$0.00 | \$0.00 | | |
| 1 | 0.00 | (96.79) | (26.82) | (69.57) | 330.03 | 0.00 | 0.00 | 98.23 | 1.44 | (0.50) | 0.00 | 0.00 | 0.00 | | |
| 2 | 0.00 | (96.79) | (22.13) | (74.66) | 255.37 | 0.00 | 0.00 | 98.23 | 1.44 | (0.50) | 0.00 | 0.00 | 0.00 | | |
| 3 | 0.00 | (96.79) | (17.12) | (79.66) | 176.71 | 0.00 | 0.00 | 98.23 | 1.44 | (0.50) | 0.00 | 0.00 | 0.00 | | |
| 4 | 0.00 | (96.79) | (11.78) | (85.01) | 90.71 | 0.00 | 0.00 | 98.23 | 1.44 | (0.50) | 0.00 | 0.00 | 0.00 | | |
| 5 | 0.00 | (96.79) | (6.09) | (90.71) | 0.00 | (1,443.50) | 1,443.50 | 98.23 | 1.44 | (0.50) | 0.00 | 0.00 | 0.00 | | |

NOTES

- (M) Finco borrows gross amount from JP Morgan. The terms of the Loan Note provide that it may be converted at maturity into shares representing 100% of Finco. A warrant agreement is exercised at closing whereby JP Morgan agrees to purchase the shares at maturity.
- (N) Effective debt service on the net borrowing, equal to the interest on the gross borrowing.
- (O) Periodic interest expense on remaining principal balance from the net borrowing.
- (P) Amortization of principal on the net borrowing. Difference of N and O.
- (Q) Remaining principal balance on the net borrowing.
- (R) Finco delivers its shares to JP Morgan, pursuant to the warrant (non-cash item).
- (S) Finco lends gross amount to Canco. Canco pays off the loan to Finco at maturity.
- (T) Canco pays interest to Finco.
- (U) Finco taxable income, equal to interest on gross borrowing received from Canco, minus interest on gross borrowing paid to JP Morgan (N-T).
- (V) Taxable income times federal tax rate.
- (W) Federal capital tax rate times net assets (assets minus liabilities at Finco equals zero).

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FINCO CASH FLOW (CONT'D)

| Period | Provincial Capital Tax | | Y | Z | AA | AB |
|--------|------------------------|---------------------------|--------|--------|--------|----------|
| | Gross Amount | Federal Income Tax Shield | | | | |
| 0 | \$0.00 | | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| 1 | 0.00 | | 0.00 | 0.00 | (0.58) | 0.87 |
| 2 | 0.00 | | 0.00 | 0.00 | (0.58) | 0.87 |
| 3 | 0.00 | | 0.00 | 0.00 | (0.58) | 0.87 |
| 4 | 0.00 | | 0.00 | 0.00 | (0.58) | 0.87 |
| 5 | 0.00 | | 0.00 | 0.00 | (0.58) | 1,444.37 |

Notes
 (X) Provincial capital tax rate times net assets (assets minus liabilities at Finco equals zero).
 (Y) Gross Provincial capital tax is deductible for federal income tax purposes.
 (Z) Gross Provincial capital tax minus federal income tax shield (X-Y).
 (AA) Net tax equals Federal Income Tax (Y) plus Federal Capital Tax (W) plus Net Provincial Capital Tax (Z). Note that companies with high taxable income which are subject to a surtax will effectively pay no federal capital tax, since federal capital tax is creditable against the surtax. This, however, is a special case and is not modeled here.
 (AB) Net Cash Flow = M + N + S + T + AA.

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 FL-00843

CANSUB CASH FLOWS

| Period | Federal Income Tax | | Federal Income Tax | | Federal Income Tax | | Federal Income Tax | |
|--------|----------------------------|-----------------------------|----------------------------|-----------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
| | Fincos Stock (non-cash) AC | Payment for Fincos Stock AD | Marginal Taxable Income AE | Federal Income Tax AF | Federal Capital Tax Amount AG |
| 0 | \$0.00 | (\$1,043.50) | \$0.00 | \$0.00 | | | | |
| 1 | 0.00 | 0.00 | 0.00 | 0.00 | | | | |
| 2 | 0.00 | 0.00 | 0.00 | 0.00 | | | | |
| 3 | 0.00 | 0.00 | 0.00 | 0.00 | | | | |
| 4 | 0.00 | 0.00 | 0.00 | 0.00 | | | | |
| 5 | 1,443.50 | 0.00 | 0.00 | 0.00 | | | | |

| Period | Provincial Capital Tax | | Provincial Capital Tax | | Provincial Capital Tax | | Provincial Capital Tax | |
|--------|------------------------|-----------------------|------------------------|--------------------------|------------------------|------------------|------------------------|------------------|
| | Gross Amount AH | Federal Tax Shield AI | Net Amount AJ | Tax Benefit (Payment) AK | Net Cash Flow AL | Net Cash Flow AL | Net Cash Flow AL | Net Cash Flow AL |
| 0 | \$0.00 | \$0.00 | \$0.00 | (\$2.35) | | | | |
| 1 | 0.00 | 0.00 | 0.00 | (2.35) | | | | |
| 2 | 0.00 | 0.00 | 0.00 | (2.35) | | | | |
| 3 | 0.00 | 0.00 | 0.00 | (2.35) | | | | |
| 4 | 0.00 | 0.00 | 0.00 | (2.35) | | | | |
| 5 | 0.00 | 0.00 | 0.00 | (2.35) | | | | |

Notes:
 (AC) Fincos delivers its shares to Cansub.
 (AD) Cansub pays JP Morgan the present value of the Fincos shares that JP Morgan has a right to receive for JP Morgan's promise to deliver these shares at maturity.
 (AE) Cansub has no taxable income.
 (AF) Federal income tax rate times marginal taxable income.
 (AG) Cansub pays federal capital tax on the forward contract.
 (AH) Through (AJ) Cansub pays no provincial capital tax since it is assumed that Cansub is an Alberta corporation and Alberta does not impose a provincial capital tax.
 A possibility exists that Cansub may not be located in Alberta and may instead be incorporated in Halifax.
 (AK) Federal Income Tax plus Federal Capital Tax plus Provincial Capital Tax (AF + AG + AJ).
 (AL) Prepayment under forward contract plus net taxes (AD + AK).

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SENATE
 FL-00944

CONSOLIDATED NET CASH FLOWS

| Period | 1/9/01 | | | |
|--------|-------------|-------------|--------------|--------------------|
| | Canco AM | Finco AN | Cansub AO | Consolidated AP |
| 0 | \$1,429.9 | \$0.0 | (\$1,045.9) | \$384.0 |
| 1 | (97.1) | 0.9 | (2.3) | (58.6) |
| 2 | (97.1) | 0.9 | (2.3) | (58.6) |
| 3 | (97.1) | 0.9 | (2.3) | (58.6) |
| 4 | (97.1) | 0.9 | (2.3) | (58.6) |
| 5 | (1,489.0) | 1,444.4 | (2.3) | (57.0) |

| | |
|---------------------------------|----------|
| Pre-tax Discount Rate: | 6.71% |
| Tax Rate: | 40.00% |
| After-Tax Discount Rate: | 4.02% |
| NPV of Consolidated Cash Flows: | \$119.94 |

Notes
 (AM) Canco's after-tax cashflows.
 (AN) Finco's after-tax cashflows.
 (AO) Cansub's after-tax cashflows.
 (AP) Sum of columns AM, AN and AO.

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CANCO BASE CASE CASH FLOWS

| Period | Base Case Self-Amortizing Loan Note | | | | Transaction Costs | | |
|--------|-------------------------------------|--------------------------|----------------|------------------------------|---------------------------------|------------------------|--|
| | Drawdown AQ | Debt Service AR | Interest AS | Principal Amortization AT | Cash Payment AV | Tax Amortization AW | |
| 0 | \$400.00 | \$0.00 | \$0.00 | \$0.00 | (\$2.00) | \$0.00 | |
| 1 | 0.00 | (96.79) | (26.82) | (69.97) | 0.00 | (0.40) | |
| 2 | 0.00 | (96.79) | (22.13) | (74.66) | 0.00 | (0.40) | |
| 3 | 0.00 | (96.79) | (17.12) | (79.66) | 0.00 | (0.40) | |
| 4 | 0.00 | (96.79) | (11.78) | (85.01) | 0.00 | (0.40) | |
| 5 | 0.00 | (96.79) | (6.08) | (90.71) | 0.00 | (0.40) | |
| | | | | | | | |
| Period | Federal Income Tax | | | Federal Capital Tax | | Provincial Capital Tax | |
| | Marginal Taxable Income AX | Federal Income Tax AY | Amount AZ | Gross Amount BA | Federal Income Tax Shield BB | Net Amount BC | |
| 0 | \$0.00 | \$0.00 | (\$0.90) | (\$1.20) | \$0.46 | (\$0.72) | |
| 1 | (27.23) | 10.89 | (0.74) | (0.99) | 0.40 | (0.59) | |
| 2 | (22.53) | 9.01 | (0.57) | (0.77) | 0.31 | (0.46) | |
| 3 | (17.52) | 7.01 | (0.40) | (0.53) | 0.21 | (0.32) | |
| 4 | (12.16) | 4.87 | (0.26) | (0.27) | 0.11 | (0.16) | |
| 5 | (6.46) | 2.59 | (0.09) | (0.06) | 0.00 | (0.00) | |

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Notes:
 (AR) Self-amortizing (mortgage-style) debt service on the borrowing.
 (AS) Periodic interest expense on remaining principal balance from the borrowing.
 (AT) Amortization of principal on the borrowing. (AR minus AS)
 (AU) Remaining principal balance on the borrowing.
 (AV) Issuance cost for stand-alone Loan Note.
 (AW) Tax amortization of Loan Note issuance costs.
 (AX) Canco taxable income, equal to interest on Loan Note plus amortization of issuance costs. (AS + AW).
 (AY) Taxable income times federal tax rate
 (AZ) Federal capital tax rate times outstanding principal of Loan Note.
 (BA) Provincial capital tax rate times outstanding principal of Loan Note.
 (BB) Gross Provincial capital tax is deductible for federal income tax purposes.
 (BC) Gross Provincial capital tax minus federal income tax shield (BA - BB).

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CONSOLIDATED BASE CASE NET CASH FLOWS

| Period | Tax Benefit (Payment) BD | 12/01 Net Cash Flow BE |
|--------|--------------------------------|---------------------------------|
| 0 | (\$1.62) | \$396.38 |
| 1 | 9.55 | (87.24) |
| 2 | 7.98 | (86.81) |
| 3 | 6.30 | (90.49) |
| 4 | 4.51 | (92.28) |
| 5 | 2.59 | (94.19) |

| | |
|--------------------------|----------|
| Pre-Tax Discount Rate: | 6.71% |
| Tax Rate: | 40% |
| After-Tax Discount Rate: | 4.02% |
| NPV of Net Cash Flows: | (\$5.96) |

Notes:
 (BD) Net tax equals Federal Income Tax (AV) plus Federal Capital Tax (AZ) plus Net Provincial Capital Tax (BC). Note that companies with high taxable income which are subject to a surtax will effectively pay no federal capital tax, since federal capital tax is creditable against the surtax. This, however, is a special case and is not modeled here.
 (BE) Net Cash Flow = AQ + AR + AV + BD.

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CONCLUSION

Next Steps

- Refine deal to fit into corporate structure.
- Consider existing debt covenants.
- Discuss refined structure with tax advisors.
- Consider financing alternatives and discuss pricing.
 - Bank syndication
 - Commercial paper conduit
 - Private placement

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FL-00948



STRUCTURED CANADIAN FINANCING TRANSACTION
ORGANIZATIONAL MEETING

SENATE
FL-00881

Emp

FEBRUARY 8, 2001

Permanent Subcommittee on Investigations
EXHIBIT #344

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| SECTION I | Agenda |
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| SECTION IV | Swap |
| SECTION V | Term Sheets |
| SECTION VI | Timetable |

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SECTION I - AGENDA

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- **TRANSACTION SUMMARY**
 - Transaction Structure and Fund Flows
 - Tax and Accounting Discussion
 - Advisor Issues
 - Enron Guarantee
 - Enron Indemnity of Intra-day Loan
 - Existing Credit Agreement and Indenture Covenant Analysis
- **FUNDING DISCUSSION**
 - Bank Syndication
 - Terms and Placement Strategy
- **INTEREST RATE SWAP**
 - Swaps at Enron and JPMorgan SPV
 - Enron guarantee of JPMorgan Swap
- **TERM SHEETS**
 - Business Issues
 - Legal Issues (e.g., Set-Off)
- **TIMETABLE**
 - Drafting of Transaction Documents
 - Syndication Process
 - Potential Interim Financing Need
- **OTHER**

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SECTION II - TRANSACTION SUMMARY

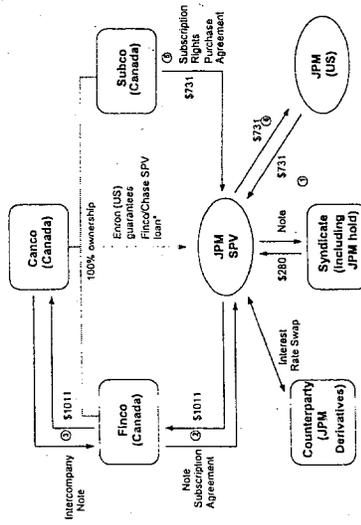
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TRANSACTION SUMMARY - DIAGRAM

DIAGRAM



- JPM SPV: Newly-created US special purpose vehicle, owned 100% by JPMorgan Chase
- Finco: Newly-created Canadian special purpose vehicle 100% owned by Canco
- Canco: Canadian parent company (operating company)
- Subco: Newly-created Canadian special purpose vehicle 100% owned by Enron (US)

Note: For illustrative purposes, \$731MM and \$280MM are used as the gross loan and net loan amounts, respectively.

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Step 1: Fund JPMorgan SPV
 JPMorgan will establish a US special purpose vehicle ("JPMorgan SPV") to act as party to Finco (a newly created special-purpose subsidiary of the ultimate borrower, Canco). JPMorgan SPV will be a bankruptcy remote entity 100% owned by JPMorganChase & Co. The lenders (e.g., bank syndicate) lend \$280MM to JPMorgan SPV. In order for Finco to borrow the full amount of the gross loan, however, an additional \$730MM is needed on day one. JPMorgan will make this through a daylight overdraft (i.e., intra-day) loan of \$730MM, which will be fully repaid by the end of day one via Subco. When added to the \$280MM from the lenders, JPMorgan SPV will have the \$1010MM needed on day one to effect the transaction. As described below, only a \$280MM net loan from JPMorgan will be outstanding at the end of day one.

Enron will guarantee \$280MM of the \$1010MM Finco Note to JPMorgan SPV. Enron will not, however, guarantee the JPMorgan SPV's \$280MM Note to the lenders. It is anticipated that the bank lenders will be comfortable with the Finco/JPMorgan SPV guarantee and a representation from CMB that the cash flows into the JPMorgan SPV will be only for the benefit of the lenders.

Step 2: JPMorgan SPV Loan to Finco and Share Subscription Agreement
 JPMorgan SPV lends \$1010MM to Finco, a newly-created special purpose vehicle 100% owned by Canco. In return, Finco gives JPMorgan SPV a relatively plain-vanilla note (Finco Note).

JPMorgan SPV and Finco also enter irrevocably into a Share Subscription Agreement. Under the agreement, at maturity JPMorgan SPV will pay the subscription price of \$1010MM to Finco for 99.99% of Finco's common stock, which it will direct Finco to deliver directly to Subco in satisfaction of JPMorgan SPV's contract with Subco (described in Step 4). JPMorgan SPV will pay this \$1010MM subscription price to Finco using the \$1010MM loan repayment proceeds from Finco.

Step 3: Finco Loan to Canco
 Upon receipt of the \$1010MM from JPMorgan SPV, Finco will on-lend the \$1010MM loan proceeds to its parent company, Canco. The terms of the loan are similar to (and essentially will be pari passu with) those between Canco and its existing bank syndicate.

Step 4: Finco Loan to Canco
 MOC makes an intercompany loan of \$730MM to Subco, a newly-created SPV owned by Canco.

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TRANSACTION SUMMARY – INCEPTION – CONT'D

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Step 5: Subco acquires JPMorgan SPV's right to receive Finco stock at maturity
Subco purchases JPMorgan SPV's right to receive Finco's stock at maturity. Subco does this by entering into a Subscription Rights Purchase Agreement with JPMorgan SPV under which it prepays JPMorgan SPV \$730MM at inception. This \$730MM represents the present value (using the JPMorgan SPV/Finco term loan coupon as the discount rate) of \$1010MM in 5 years. Since Subco will receive Finco shares worth exactly \$1010MM at maturity (as JPMorgan SPV will have just returned to Finco \$1010MM for the shares), the \$730MM present value of this amount is considered fair.

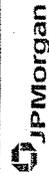
Important aspects of the agreement are:

- Subco purchases JPMorgan SPV's right to receive Finco's stock at maturity. The obligation to pay Finco for the stock, however, remains with JPMorgan SPV as previously described.
- JPMorgan SPV will be obligated to purchase the shares only if Finco has repaid in full its \$1010MM loan to JPMorgan SPV at maturity in reality, set-off will occur and the money will not actually have to change hands between Finco and the JPMorgan SPV.
- The documentation will stipulate that Subco has recourse only to Finco in the event that Finco does not deliver its stock to Subco at maturity. This would happen in the event that Finco fails to repay the loan to JPMorgan SPV and consequently JPMorgan SPV refuses to pay Finco under the Subscription Agreement for the stock it owes to Subco.

Step 6: JPMorgan SPV repays the daylight overdraft to JPMorgan
JPMorgan SPV will use the \$730MM prepayment from Subco to permanently repay the \$730MM daylight overdraft to JPMorgan Bank prior to close on day one.

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SECTION III - FUNDING DISCUSSION

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FUNDING ALTERNATIVES - FINANCING CONSIDERATIONS

[TO COME]

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SWAP

SECTION IV - SWAP

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SWAP – EXECUTIVE SUMMARY

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- Background:**
- The back-to-back loans in the "Slapshot" structure must be fixed rate to properly self-amortize the loans
- Swap Objectives:**
- To swap Enron's interest payment obligations from fixed to floating in a cost effective manner
 - To consider any adverse effects on Enron's Canadian tax position
- Swap Economics:**
- The swap is on the "economic" interest payable under the structure. As illustrated below, the swap is based on the declining \$280MM (US) net principal balance

(US\$ in millions)

| Yr | "Coupon" Payment (A) | Principal Amortization (B) | Net Principal Balance | "Economic" Interest (1) (A) - (B) | Fixed Swapped to Floating: |
|----|----------------------|----------------------------|-----------------------|-----------------------------------|----------------------------|
| 0 | | | 280.00 | | |
| 1 | 67.74 | 48.98 | 231.02 | 18.76 | [L + 125] times |
| 2 | 67.74 | 52.26 | 178.75 | 15.48 | |
| 3 | 67.74 | 55.77 | 122.98 | 11.98 | Net Principal |
| 4 | 67.74 | 59.50 | 63.49 | 8.24 | Balance |
| 5 | 67.74 | 63.49 | (0.00) | 4.25 | |

(1) Economic interest, equal to fixed interest rate multiplied by Net Principal Balance. Fixed interest rate assumed to be 6.70%, equal to L + 125 bp swapped to fixed

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Swap Alternatives:

JPMorgan proposes the following 3 swap alternatives:

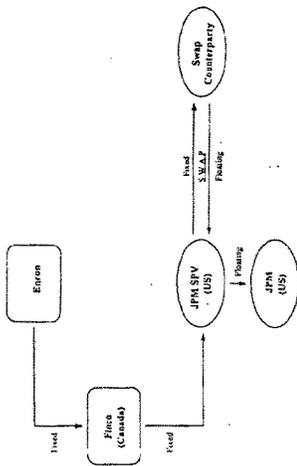
External JPMorgan Swap - Enron pays fixed on loan (no swap). JP Morgan SPV swaps from fixed to floating with a third party

Internal Swap - "Internal" swap between Enron and JPMorgan SPV converts fixed to floating for both parties

Back-to-Back Swaps - Enron and JPMorgan SPV execute back-to-back swaps with a counterparty (JPMorgan Derivatives or a third party) to convert each party to floating

SWAP – ALTERNATIVE 1 – EXTERNAL CHASE SWAP

Enron pays fixed, but JPMorgan SPV swaps to floating:



Description:

- Enron pays fixed (does not swap to floating)
- JPMorgan SPV enters into a swap with a swap counterparty (JPMorgan's Derivatives Desk or third party) to swap fixed to floating

Advantages:

- No "road map" for Revenue Canada (no swap by Enron on economic interest)

Disadvantages:

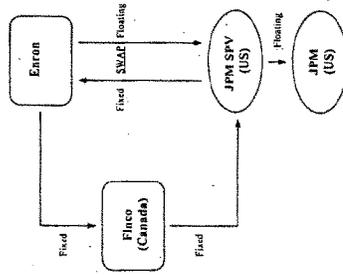
- Requires Enron to pay fixed
- Break fee for early unwind of JPMorgan swap (via make whole)

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"Internal" swap converts fixed to floating for both Enron and JPMorgan:

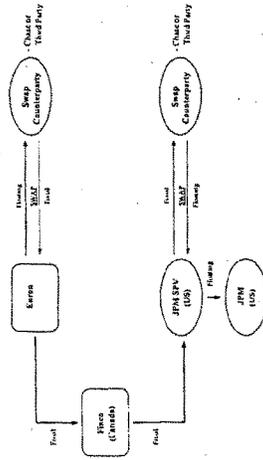


- Description:**
- "Internal" swap between Enron and JPMorgan (no swap with JPMorgan Derivatives Desk or a third party is required)
 - Net result of swap is that Enron pays floating and JPMorgan receives floating
- Advantages:**
- No Swap fees
 - On early unwind, the swap agreement can permit early unwind with no gain or loss to either party, eliminating both early unwind fees and gain/loss on swap
 - Better control over the swap language and mechanics
- Disadvantage:**
- Swap on the economic interest produces a potential "road map"

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SWAP – ALTERNATIVE III – BACK-TO-BACK SWAPS



Back-to-back swaps convert Enron and JPMorgan to floating:

- Enron enters into a swap with a swap counterparty (JPMorgan Derivatives Desk or a third party) whereby it swaps fixed for floating payments
- JPMorgan SPV enters into a swap with a swap counterparty (JPMorgan Derivatives Desk or a third party) whereby it swaps fixed for floating receipts
- Enron pays floating
- Separate and distinct swaps with a swap counterparty may help obviate the economics of the transaction
- Swap fees
- Break fee for early unwind of swaps (Enron to indemnify JPMorgan via makewhole)
- A swap at Enron level may be a "road map"

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SWAP – COMPARISON OF ALTERNATIVES

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| Description | External JPMorgan Swap (Alternative 1) | Internal Swap (Alternative 2) | Internal Swap (Alternative 3) |
|---------------|--|---|--|
| Advantages | <ul style="list-style-type: none"> Enron pays fixed (no swap) JPMorgan SPV swaps to floating No "road map" No swap fees (no swap by Enron) Most preferable alternative Canadian tax perspective | <ul style="list-style-type: none"> Enron swaps with JPMorgan SPV ("internal" swap) Enron pays floating and JPMorgan receives floating No swap fees No swap break costs on early unwind Ease of execution | <ul style="list-style-type: none"> Enron swaps to pay floating JPMorgan SPV swaps to receive floating |
| Disadvantages | <ul style="list-style-type: none"> Enron pays floating Swap break costs on early unwind (indemnify JPMorgan) | <ul style="list-style-type: none"> Potential "road map" Least preferable alternative from Canadian tax perspective | <ul style="list-style-type: none"> As compared to Alternative 2, separate swaps with swap counterparty may produce less of a "road map" Possible "road map" Swap break costs on early unwind (indemnify JPMorgan) |

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FL-00897



SWAP – CONCLUSION

- Recommendations:
- If Enron is willing to pay fixed, then we recommend the first alternative
 - If Enron requires floating, then we recommend Enron consider the second alternative based on simplicity and cost. This assumes that Enron's advisors are comfortable with the second alternative from a Canadian tax perspective

The third alternative likely would improve Enron's tax position, but it adds complexity and potential costs

- Next Steps:
- Reconsider willingness for Enron to pay fixed
 - Review the alternatives with Enron's tax advisors

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FL-00898



- Background:**
- The back-to-back loans in the "Slapshot" structure must be fixed rate to properly self-amortize the loans
 - The fixed rate is determined at inception by swapping L+125 to fixed
 - The fixed rate is multiplied by the gross loan of \$[101]MM to obtain the gross coupon payment
 - This gross coupon payment acts as a "mortgage" style payment when applied to the net loan of \$280MM; part of the payment constitutes amortization and part is interest (at the fixed rate)
 - The net principal of \$280MM is able to be amortized to zero by maturity under this method

(US\$ in millions)

| Yr | "Coupon" Payment (A) | Fixed "Economic" Interest (B) | Principal Amortization (A) - (B) | Net Principal Balance |
|----|----------------------|-------------------------------|----------------------------------|-----------------------|
| 0 | | | | 280.00 |
| 1 | 67.74 | 18.76 | 48.98 | 231.02 |
| 2 | 67.74 | 15.48 | 52.26 | 178.75 |
| 3 | 67.74 | 11.98 | 55.77 | 122.99 |
| 4 | 67.74 | 8.24 | 59.50 | 63.49 |
| 5 | 67.74 | 4.25 | 63.49 | (0.00) |

⁽¹⁾ Economic interest, equal to fixed interest rate multiplied by Net Principal Balance.
 Fixed interest rate assumed to be 6.70%, equal to L + 125 bp swapped to fixed

Floating Rate Discussion:

- A floating-rate of interest (e.g. L+125) would not amortize the net loan of \$200MM to zero
- The "gross" coupon payment of (L+125 * \$1011MM) would vary each period as LIBOR fluctuates, generating amortization that would NOT result in a zero balance at maturity

(US\$ in millions)

| Yr | Assumed LIBOR | LIBOR + Spread | LIBOR + Spread | Gross Principal | Gross "Coupon" Payment | "Economic" Interest ⁽¹⁾ | | Principal Amortization (A) - (B) | Net Principal Balance |
|----|---------------|----------------|----------------|-----------------|------------------------|------------------------------------|-------|----------------------------------|-----------------------|
| | | | | | | (A) | (B) | | |
| 0 | | | | | | | | | 280.00 |
| 1 | 5.75% | 0.500% | 6.25% | 1,011 | 63.19 | 17.50 | 45.69 | 234.31 | |
| 2 | 6.75% | 0.500% | 7.25% | 1,011 | 73.30 | 16.99 | 56.32 | 177.99 | |
| 3 | 6.50% | 0.500% | 7.00% | 1,011 | 70.77 | 12.46 | 58.32 | 119.68 | |
| 4 | 6.00% | 0.500% | 6.50% | 1,011 | 65.72 | 7.78 | 57.94 | 61.74 | |
| 5 | 5.50% | 0.500% | 6.00% | 1,011 | 60.66 | 3.70 | 56.96 | 4.78 | |

⁽¹⁾ Economic interest, equal to floating interest rate (L+125) multiplied by Net Principal Balance. Fixed interest rate assumed to be 6.70%, equal to L + 125 bp swapped to fixed

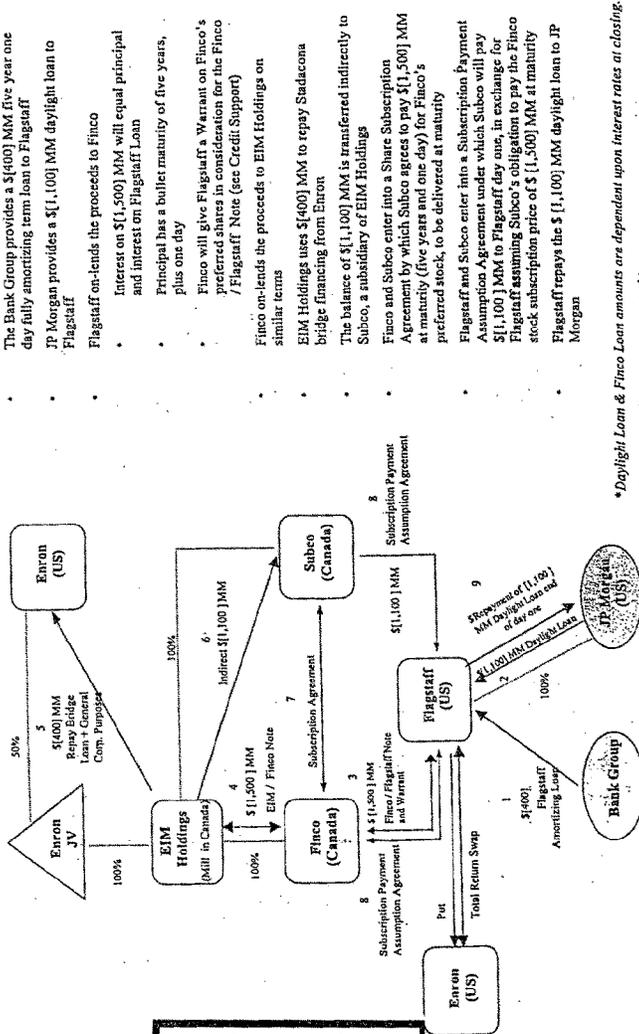
Alternative Considered:

- A floating-rate, amortizing loan was considered
- This method would provide for a floating rate on the net principal while amortizing the net principal to zero by maturity
- Each period a formula would generate a gross coupon payment constituting floating interest on the net economic loan plus the required net principal amortization for that period
- E.g., Year 1 Gross Coupon Payment = [(L+125)*\$280m] + (fixed rate)*\$280m
- This complex formula, which would change each period, would provide a potential "road map"

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Transaction Diagram



Permanent Subcommittee on Investigations
EXHIBIT #345

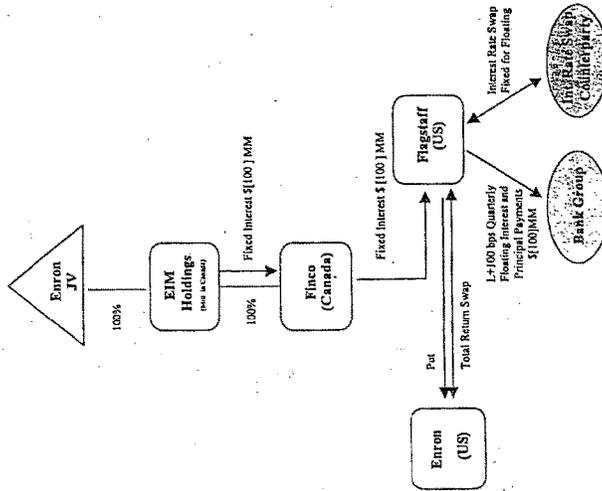
- The Bank Group provides a \$400 MM five year one day fully amortizing term loan to Flagstaff
- JP Morgan provides a \$1,100 MM daylight loan to Flagstaff
- Flagstaff on-lends the proceeds to Finco
- Interest on \$1,500 MM will equal principal and interest on Flagstaff Loan
- Principal has a bullet maturity of five years, plus one day
- Finco will give Flagstaff a Warrant on Finco's preferred shares in consideration for the Finco / Flagstaff Note (see Credit Support)
- Finco on-lends the proceeds to EIM Holdings on similar terms
- EIM Holdings uses \$400 MM to repay Stadacona bridge financing from Enron
- The balance of \$1,100 MM is transferred indirectly to Subco, a subsidiary of EIM Holdings
- Finco and Subco enter into a Share Subscription Agreement by which Subco agrees to pay \$1,500 MM at maturity (five years and one day) for Finco's preferred stock, to be delivered at maturity
- Flagstaff and Subco enter into a Subscription Payment Assumption Agreement under which Subco will pay \$1,100 MM to Flagstaff day one, in exchange for Flagstaff assuming Subco's obligation to pay the Finco stock subscription price of \$1,500 MM at maturity
- Flagstaff repays the \$1,100 MM daylight loan to JP Morgan

* Daylight Loan & Finco Loan amounts are dependent upon interest rates at closing.
* Ownership reflects common ownership

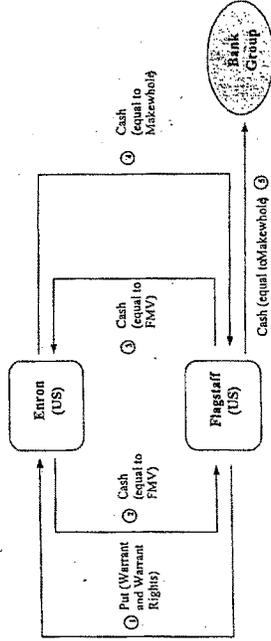
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FL-00001

Periodic Cash Flows Years 1 - 5



Credit Support Steps (Finco Default)



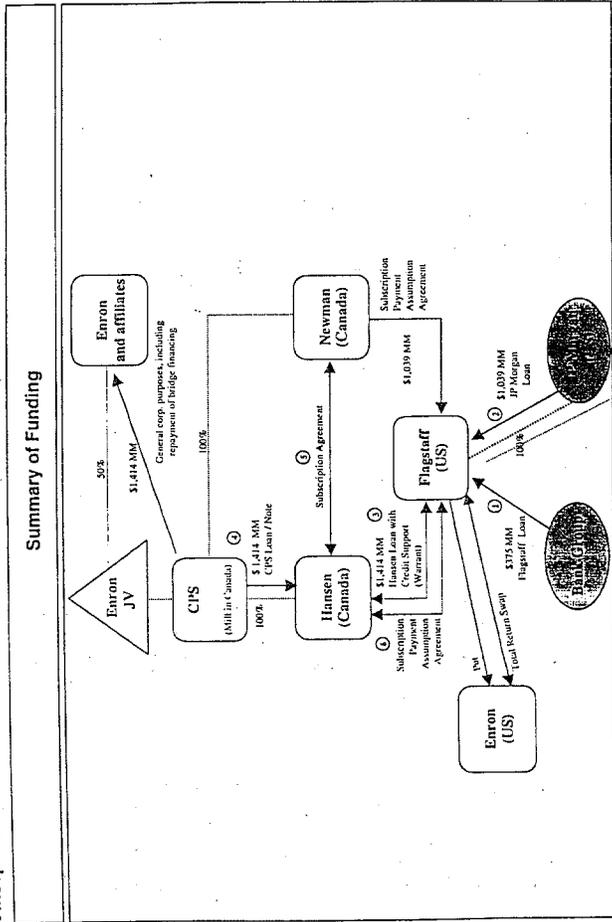
418

- 1 Under the Put Option, Flagstaff puts the Warrant and Warrant Rights to Enron (US).
- 2 Enron (US) pays Flagstaff cash equal to the FMV of the Warrant and Warrant Rights (the right to the Finco Makewhole payment).
- 3 Under the Total Return Swap, Flagstaff pays back to Enron (US) the cash (FMV) just received via the put.
- 4 In return, Enron pays Flagstaff cash equal to the Makewhole.
- 5 Flagstaff uses the cash to repay the amount due to the Bank Group.

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FL-00003

TRANSACTION DESCRIPTION SUBJECT TO CONFIDENTIALITY AGREEMENT

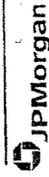
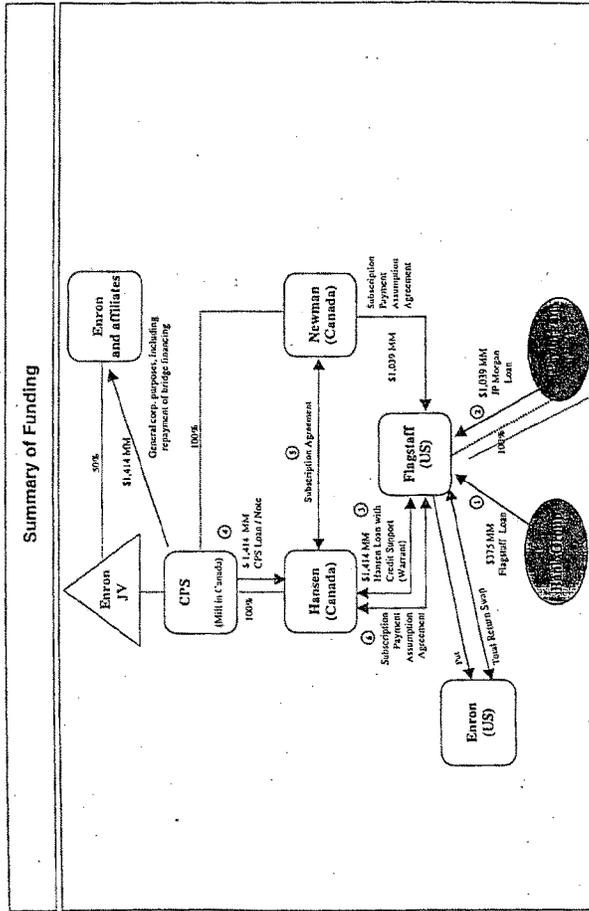
At Inception



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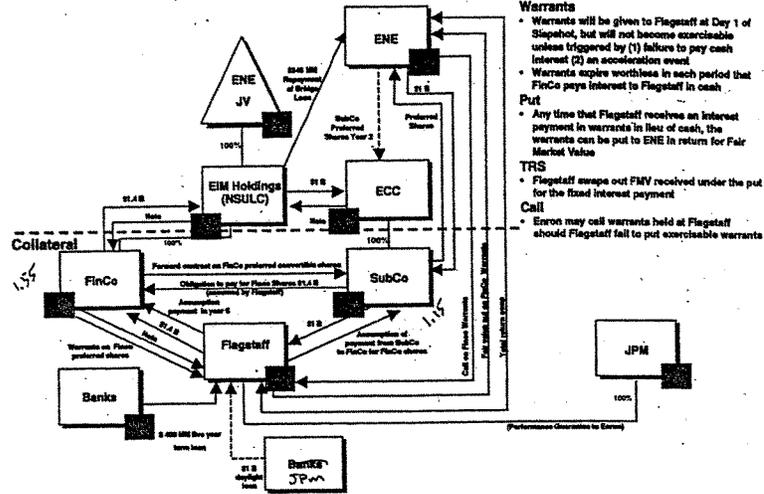
TRANSACTION DESCRIPTION SUBJECT TO CONFIDENTIALITY AGREEMENT

At Inception

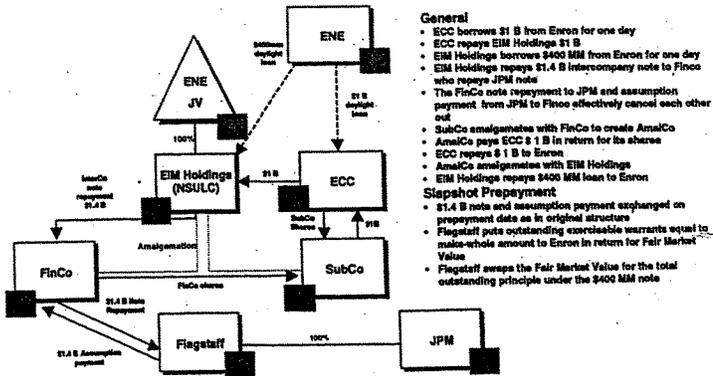


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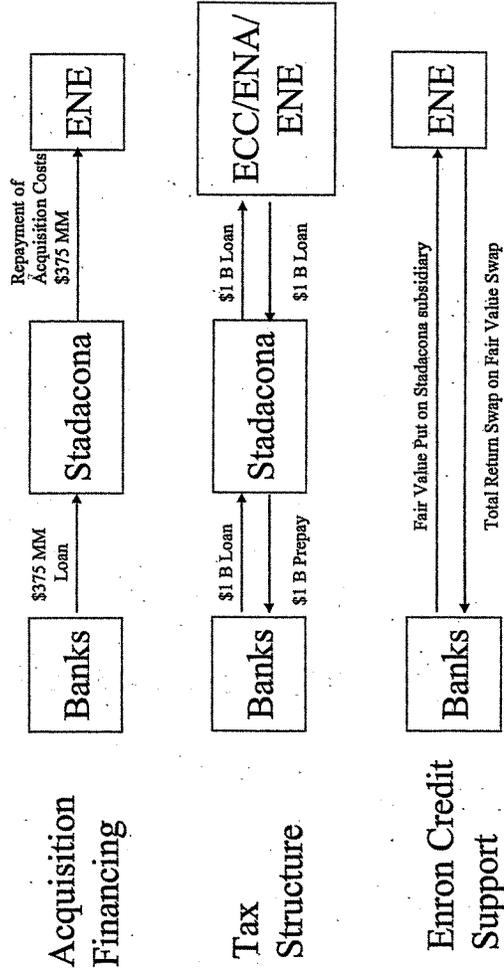
Snapshot Funding of Daishowa Quebec Mill



Snapshot Unwind



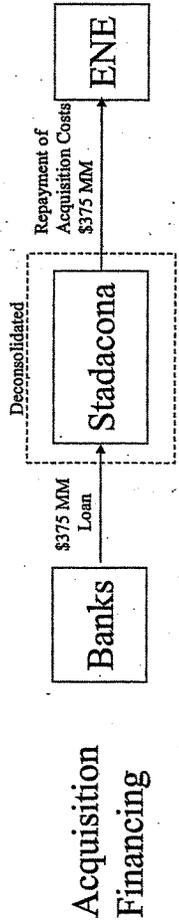
Project Slapshot Transaction Components



Permanent Subcommittee on Investigations
EXHIBIT #346



Project Slapshot Financing Transaction



Acquisition Financing

Tax Issues

- Business purpose of loan.

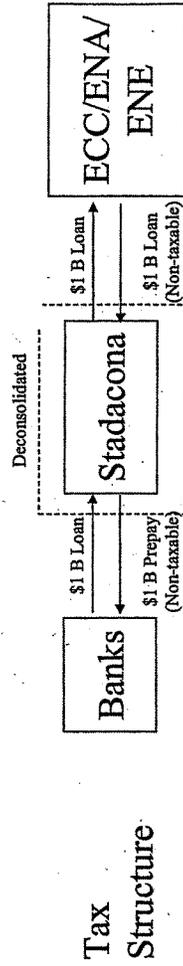
Accounting Issues

- Debt covenants.



Project Slapshot

Tax Transaction



Tax Structure

Tax Issues

- Business purpose of loans/prepayments.
- Interest withholding taxes if transaction disallowed.
- Incurrence of Canadian capital tax.
- Unwinding of transaction.

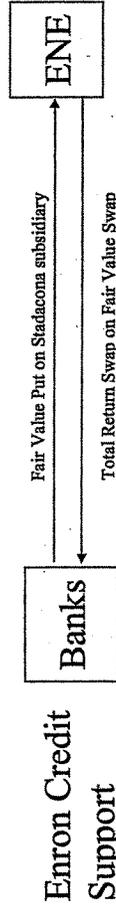
Accounting Issues

- Right of set-off for Stadacona/Enron asset and liability.
- Right of set-off for Banks/Stadacona asset and liability.
- Funds flow impact to Enron and Stadacona.
 - ECC repayment of Canadian PPAs
 - Payment to ENA to assume out of the money positions



Project Slapshot

Enron Credit Support



Tax Issues

- Business purpose for Put and Swap

Accounting Issues

- Enron footnote disclosure



June 22, 2001

Private and Confidential

Enron Corp.
1400 Smith Street
Houston, Texas 77002

Attention: Stephen Douglas

Re: Tax Comfort Letter - Enron Structured Financing

Ladies and Gentlemen:

This letter confirms, at your request, that the employees of J.P. Morgan Securities Inc. and its affiliates ("JPMorgan") who have been involved in structuring, arranging, and syndicating your senior revolving credit facility closing on this date (the "Transaction") have no knowledge of any event, development, or change in circumstance that should cause the expected principal Canadian federal income tax consequences of the Transaction to Enron Corp. and its affiliates ("Enron") to be other than those set out generically in the opinion dated November 7, 2000 from Blake, Cassels & Graydon LLP addressed to Chase Securities Inc. (the "Blakes Opinion"), subject to any changes in the tax consequences resulting from factual differences in the Transaction as compared to the assumed facts in the Blakes Opinion.

This letter is subject to our understanding that neither JPMorgan nor its counsel has provided or is providing tax, accounting, or legal advice to Enron or any other party in connection with the Transaction, that Enron is obtaining its own tax, accounting, and legal advice and coming to its own views as to the tax consequences of the Transaction to Enron, and that neither JPMorgan nor its counsel has conducted an independent review of the expected principal Canadian federal income tax consequences of the Transaction to Enron.

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Permanent Subcommittee on Investigations
EXHIBIT #347

SENATE
FL-01933

Please confirm that the foregoing accurately sets forth our understanding by signing in the space provided below.

Very truly yours,

J.P. MORGAN SECURITIES INC.

By: Bruce Handrick
Name: Bruce Handrick
Title: VP

ENRON CORP.

By: Douglas L. McDowell
Name: Douglas L. McDowell
Title: Attorney-in-Fact DS

June 22, 2001

Enron Corp
 1400 Smith Street
 Houston, TX 77002-7361
 Attention: Stephen H. Douglas
 Senior Tax Director

Re: U.S. Tax Matters - Enron Structured Financing

Ladies and Gentlemen:

We refer to, and this letter is provided in connection with, (i) that certain credit agreement, dated as of the date hereof, among Flagstaff Capital Corporation as the lender (the "Lender"), Hansen Investments Co. as the borrower ("Hansen") and The Chase Manhattan Bank as the Administrative Agent (the "Credit Agreement"), (ii) that certain stock subscription agreement, dated as of the date hereof, between the Lender and Hansen (the "Subscription Agreement") and (iii) that certain subscription payment assumption agreement, dated as of the date hereof, between the Lender, Newman Investments Co. ("Newman") and Hansen (the "Subscription Payment Assumption Agreement," and together with the Credit Agreement and the Subscription Agreement, the "Transaction"). This letter is to confirm our agreement with respect to treatment of the Transaction by Enron Corp. and its Affiliates and J.P. Morgan Securities Inc. ("J.P. Morgan") and its Affiliates (collectively, the "Companies" for US federal tax purposes) that Lender is making a net loan of \$375 million to Hansen. Capitalized terms used herein but not otherwise defined shall have the meanings ascribed to such terms in the Credit Agreement. NOW, THEREFORE, for and in consideration of the premises and other good and valuable consideration, the sufficiency of which is acknowledged, the Companies hereby agree that, for US federal tax purposes, the Companies will treat the Operative Documents as giving rise to an integrated transaction. In particular, the Companies agree that, unless either of the Companies receives an opinion of nationally recognized counsel indicating that no reasonable basis (within the meaning of Section 6662 of the Internal Revenue Code of 1986, as amended) exists for such treatment, the Transaction shall be treated as follows:

1. as a result of entering into the Transaction, Hansen will borrow a net amount of \$375 million (the "Net Loan") from the Lender;
2. the Net Loan will constitute a self-amortizing loan (upon which the quarterly interest payments shall be made and calculated at an annual rate equal to 6.12 percent) and the quarterly payments of interest under the Credit Agreement will be treated in part for U.S. federal tax purposes as quarterly payments of interest equal to 153.100 percent of the outstanding Net Loan amount, with the excess of

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SENATE
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each such payment made under the Credit Agreement over each quarterly interest payment made (and characterized as such for U.S. federal tax purposes) characterized for U.S. federal tax purposes as payment of principal on the Net Loan.

If one of the Companies determines that it will seek an opinion of outside tax counsel regarding the U.S. tax characterization of the Transaction, the Companies shall keep each other informed of issues which arise and provide each other with sufficient opportunities to present their views to the selected outside U.S. tax counsel. In addition, the Companies shall keep each other apprised of any issues that they become aware of or are raised by any taxing authority that could adversely affect the other's ability to report the Transaction for U.S. federal tax purposes as described herein. J.P. Morgan hereby represents and warrants that neither it nor its Affiliates have any present knowledge (whether direct, indirect, or constructive) that could negatively impact the expected U.S. tax characterization of the Transaction or the Operative Documents as a net loan in the amount of \$375 million.

This letter may be executed in one or more counterparts and delivery of an executed counterpart of this letter by telecopier shall be effective as delivery of a manually executed counterpart.

This letter shall be governed and construed in accordance with the law of the State of New York.

For purposes of this Agreement, the following terms shall have the following meanings:

"Affiliates" means, with respect to a specified Person, another Person that directly, or indirectly through one or more intermediaries, Controls or is Controlled by or is under common Control with the Person specified.

"Control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of a Person, whether through the ability to exercise voting power, by contract or otherwise. "Controlling" and "Controlled" have meanings correlative thereto.

"Person" means any natural person, corporation, limited liability company, trust, joint venture, association, company, partnership, governmental authority or other entity

IN WITNESS WHEREOF, the undersigned have signed this Agreement this 22nd day of June, 2001.

J.P. Morgan Securities Inc.

By: Bruce Hendrik
Bruce Hendrik
Vice President

AGREED AND ACCEPTED:

ENRON CORP.

By: Douglas McDowell
Douglas McDowell
Attorney-in-Fact 12/2

2.06(f) AGREEMENT

Reference is hereby made to the Credit Agreement (as amended, supplemented or otherwise modified from time to time, the "Hansen Credit Agreement"), dated as of June 22, 2001, among Hansen Investments Co. ("Hansen"), as borrower, Flagstaff Capital Corporation ("Flagstaff"), as lender, and The Chase Manhattan Bank, as administrative agent. Capitalized terms used herein and not otherwise defined herein shall have the same meanings herein as ascribed thereto in the Hansen Credit Agreement.

Reference is made to Section 2.06(f) of the Hansen Credit Agreement which applies where the Borrower has paid or is obligated to pay an amount thereunder that would result in interest payable under the Loan being ineligible for a certain withholding tax exemption for certain reasons.

Attached as Appendix I to this Agreement is a spreadsheet setting out the results intended by the parties should the conditions to the operation of the said Section 2.06(f) of the Hansen Credit Agreement be found to apply and accordingly the said Section 2.06(f) of the Hansen Credit Agreement apply.

The undersigned hereby agree that the said spreadsheet accurately reflects the results intended by the parties should the said Section 2.06(f) of the Hansen Credit Agreement apply, including the amount of the increase in the principal amount of the loan by Flagstaff to Hansen and interest and principal payments on the said loan, and the amount of the deemed loan by Hansen to Flagstaff and interest and principal payments on the said loan, and the set-off of (I) the amount of the increase in the principal amount of the loan by Flagstaff to Hansen, and (II) the amount of the deemed loan by Hansen to Flagstaff and interest on the said loan. Nothing in this Agreement shall affect any of the obligations of Hansen in respect of the Loan, and in the event of any inconsistency between the provisions of the Hansen Credit Agreement and this Agreement, the Hansen Credit Agreement shall prevail.

FLAGSTAFF CAPITAL CORPORATION

By *Bruce Hendrick* 6/22/01
Name Bruce Hendrick
Title VP

HANSON INVESTMENTS CO.

By _____
Name _____
Title _____

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Permanent Subcommittee on Investigations
EXHIBIT #349

SENATE
FL-01940

2.06(f) AGREEMENT

Reference is hereby made to the Credit Agreement (as amended, supplemented or otherwise modified from time to time, the "Hansen Credit Agreement"), dated as of June 22, 2001, among Hansen Investments Co. ("Hansen"), as borrower, Flagstaff Capital Corporation ("Flagstaff"), as lender, and The Chase Manhattan Bank, as administrative agent. Capitalized terms used herein and not otherwise defined herein shall have the same meanings herein as ascribed thereto in the Hansen Credit Agreement.

Reference is made to Section 2.06(f) of the Hansen Credit Agreement which applies where the Borrower has paid or is obligated to pay an amount thereunder that would result in interest payable under the Loan being ineligible for a certain withholding tax exemption for certain reasons.

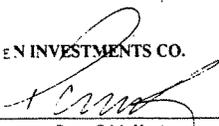
Attached as Appendix I to this Agreement is a spreadsheet setting out the results intended by the parties should the conditions to the operation of the said Section 2.06(f) of the Hansen Credit Agreement be found to apply and accordingly the said Section 2.06(f) of the Hansen Credit Agreement apply.

The undersigned hereby agree that the said spreadsheet accurately reflects the results intended by the parties should the said Section 2.06(f) of the Hansen Credit Agreement apply, including the amount of the increase in the principal amount of the loan by Flagstaff to Hansen and interest and principal payments on the said loan, and the amount of the deemed loan by Hansen to Flagstaff and interest and principal payments on the said loan, and the set-off of (I) the amount of the increase in the principal amount of the loan by Flagstaff to Hansen, and (II) the amount of the deemed loan by Hansen to Flagstaff and interest on the said loan. Nothing in this Agreement shall affect any of the obligations of Hansen in respect of the Loan, and in the event of any inconsistency between the provisions of the Hansen Credit Agreement and this Agreement, the Hansen Credit Agreement shall prevail.

FLAGSTAFF CAPITAL CORPORATION

By: _____
Name:
Title:

HANSEN INVESTMENTS CO.

By:  _____
Name Peter C. M. Keohane
Title Vice President and Secretary



CREDIT AGREEMENT

dated as of

June 22, 2001

among

HANSEN INVESTMENTS CO.,
as Borrower,

FLAGSTAFF CAPITAL CORPORATION,
as Lender

and

THE CHASE MANHATTAN BANK,
as Administrative Agent

FOIA CONFIDENTIAL TREATMENT
REQUESTED BY JPMC

Permanent Subcommittee on Investigations
EXHIBIT #350

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EXHIBITS:

- Exhibit A – Form of Promissory Note
- Exhibit B-1 – Form of Opinion of Blake, Cassels & Graydon LLP, Counsel for the Borrower
- Exhibit B-2 – Form of Opinion of McInnes Cooper, Counsel to the Borrower
- Exhibit B-3 – Form of Opinion of Bracewell & Patterson, L.L.P., Counsel to Enron
- Exhibit B-4 – Form of Opinion of James V. Derrick, Jr.
- Exhibit C – Compliance Certificate

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CREDIT AGREEMENT dated as of June 22, 2001 among HANSEN INVESTMENTS CO., FLAGSTAFF CAPITAL CORPORATION, and THE CHASE MANHATTAN BANK, as Administrative Agent.

The parties hereto agree as follows:

ARTICLE I
Definitions

SECTION 1.01 Defined Terms. Capitalized terms used herein and otherwise defined herein shall have the meanings given such terms in the Flagstaff Credit Agreement. As used in this Agreement, the following terms have the meanings specified below:

"Administrative Agent" means Chase, in its capacity as administrative agent for the Lender hereunder.

"Advance" has the meaning set forth in Section 2.06(f).

"Agreement" means this Credit Agreement, as amended, supplemented or otherwise modified from time to time.

"Borrower" means Hansen Investments Co., a company formed under the Nova Scotia Companies Act.

"Borrower Obligor" means CPS or any other Person to the extent any of the foregoing has an Obligation for the payment of money to the Borrower or makes a payment in respect of any such Obligation.

"Borrowing" means the making of a Loan hereunder.

"Borrowing Request" means a request by the Borrower for a Borrowing in accordance with Section 2.02.

"Canadian Dollars" means the lawful currency of Canada.

"Charges" has the meaning set forth in Section 10.12.

"Chase" means The Chase Manhattan Bank.

"Closing Date" means June 22, 2001.

"Commitment" means the commitment of the Lender to make a Loan pursuant to Section 2.01 to the Borrower on the Effective Date in an amount not to exceed \$1,414,504,347.

"Cost of Funds Adjustment Amount" means, with respect to each Interest Period, the amount, if any, by which the Actual Cost of Funds exceeds the Base Amount for such period. For the purpose of this definition, (a) "Actual Cost of Funds" means the amount of

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interest actually accrued for such Interest Period pursuant to Section 2.08(a) of the Flagstaff Credit Agreement, and (b) "Base Amount" means the amount of interest and fees that would have accrued for such Interest Period pursuant to Section 2.08(a) of the Flagstaff Credit Agreement if the "Loans" under and pursuant to the Flagstaff Credit Agreement were "Eurodollar" Loans.

"CPS Intercompany Note" means the Note dated as of the Closing Date issued by CPS to the Borrower, in the form delivered to the Administrative Agent on the Closing Date, as such note may be amended, supplemented, or otherwise modified as permitted hereby.

"Currency Due" has the meaning set forth in Section 10.03(f).

"Default" means any event or condition which constitutes an Event of Default or which upon notice, lapse of time or both would, unless cured or waived, become an Event of Default.

"Designated Party" shall have the meaning set forth in the Enron Agreement.

"dollars" or "United States Dollars" or "\$" refers to lawful money of the United States of America.

"Effective Date" means the date on which the conditions specified in Section 4.01 are satisfied (or waived in accordance with Section 10.02) and the initial Loan is requested to be made pursuant to Section 2.02.

"Event of Default" has the meaning assigned to such term in Article VII.

"Excluded Payments" means (a) any indemnification payments under the Operative Documents payable to Persons other than the Flagstaff Administrative Agent, the Flagstaff Collateral Agent, the Flagstaff Lenders, the Lender or the Swap Counterparty, (b) that portion of the interest payable to the Borrower pursuant to the CPS Intercompany Note in excess of the interest payable by Borrower under this Agreement, provided that the interest payable under this Agreement has actually been paid, (c) interest on the foregoing paid pursuant to the terms of the applicable Operative Document as a result of any late payment thereof by the applicable obligor, and (d) the principal portion of the Loan.

"Excluded Taxes" has the meaning set forth in Section 2.08(a).

"Final Debt Collection Date" means the date on which the aggregate outstanding principal amount of the Loan shall have been paid in full by the Borrower together with all interest accrued thereon, and the Borrower shall have paid in full all Supplemental Costs and other amounts payable by the Borrower under this Agreement (but excluding contingent obligations not yet due and payable) accrued through the date of such payment of such principal and interest.

"Flagstaff" means Flagstaff Capital Corporation, a Delaware corporation.

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"Flagstaff Administrative Agent" means the administrative agent under the Flagstaff Credit Agreement.

"Flagstaff Collateral Agent" means the collateral agent under the Flagstaff Credit Agreement.

"Flagstaff Credit Agreement" means the Credit Agreement, dated as of the Closing Date, among Flagstaff Capital Corporation, as borrower, the Flagstaff Administrative Agent, the Flagstaff Collateral Agent, and the lenders named therein.

"Flagstaff Lenders" means the "Lenders" under and as defined in the Flagstaff Credit Agreement.

"Flagstaff Loan" means the "Loans" (collectively) as defined in and made pursuant to the Flagstaff Credit Agreement.

"Indemnified Taxes" has the meaning set forth in Section 2.08(a).

"Indemnitee" has the meaning set forth in Section 10.03(b).

"Interest Period" means the period commencing on the Effective Date and ending on the initial Payment Date, and thereafter, each subsequent period commencing on the last day of the immediately preceding Interest Period and ending on the next succeeding Payment Date; provided, that (i) if any Interest Period would end on a day other than a Business Day, such Interest Period shall be extended to the next succeeding Business Day unless such next succeeding Business Day would fall in the next calendar month, in which case such Interest Period shall end on the next preceding Business Day and (ii) any Interest Period that commences on the last Business Day of a calendar month (or on a day for which there is no numerically corresponding day in the last calendar month of such Interest Period) shall end on the last Business Day of the last calendar month of such Interest Period.

"Lender" means Flagstaff Capital Corporation, a Delaware corporation.

"Loan" means the loan made by the Lender to the Borrower pursuant to this Agreement.

"Loan Documents" means this Agreement, the Note, the Process Agent Agreement, the Enron Agreement, the Warrant Agreement, the Put Option Agreement, and the Total Return Swap Agreement each in the form delivered to the Administrative Agent on the Closing Date, as each such agreement may be amended, supplemented or otherwise modified from time to time as permitted hereby, and all instruments, certifications, or other agreements delivered in connection with the foregoing.

"Make-Whole Amount" means, on the date that any voluntary or involuntary prepayment of principal under the Note becomes due other than the Maturity Date, an amount equal to the sum of (a) the accrued and unpaid interest due on or before the date of any such

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voluntary or involuntary payment in accordance with the provisions of Section 2.06(a), plus (b) the present value of all payments of interest under the Note that would have been payable on such principal so prepaid after such date if such voluntary or involuntary prepayment of principal had been paid on the Maturity Date, rather than on the date of prepayment (using a discount rate equal to the rate of interest under the Note), provided that the Make-Whole Amount may in no event be less than zero.

"Material Adverse Effect" means a material adverse effect on (a) the business, assets, operations, or condition, financial or otherwise, of the Borrower, (b) the ability of the Borrower to perform any of its Obligations under any Loan Document or (c) the rights of or benefits available to the Administrative Agent or the Lender under any Loan Document.

"Maturity Date" means June 23, 2006.

"Maximum Rate" has the meaning set forth in Section 10.12.

"Note" means a promissory note of the Borrower payable to the Lender, in substantially the form of Exhibit A, evidencing the indebtedness of the Borrower to the Lender resulting from the Loan made by the Lender.

"Obligation" means, with respect to any Person, any obligation of such Person of any kind, including, without limitation, any liability of such Person on any claim, whether or not the right of any creditor to payment in respect of such claim is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, disputed, undisputed, legal, equitable, secured or unsecured, and whether or not such claim is discharged, stayed or otherwise affected by any proceeding referred to in clause (e) of Article VII. Without limiting the generality of the foregoing, the Obligations of the Borrower under the Loan Documents include (a) the obligation to pay principal, interest, costs, expenses, fees, attorneys' fees and disbursements, indemnities and other amounts payable by the Borrower under any Loan Document and (b) the obligation to reimburse any amount in respect of any of the foregoing that the Administrative Agent or the Lender, in any of such Person's sole discretion, may elect to pay or advance on behalf of the Borrower pursuant to the terms of any Loan Document.

"Operative Documents" means, collectively, the Loan Documents, the Flagstaff Credit Agreement, the Subscription Agreement, the Subscription Payment Assumption Agreement, the CPS Intercompany Note and all other documents, agreements and instruments delivered in connection therewith.

"Other Taxes" has the meaning set forth in Section 2.08(b).

"Permitted Liens" has the meaning set forth in Section 6.01.

"Process Agent" has the meaning set forth in Section 10.09(b).

"Process Agent Agreement" means a letter dated as of the Closing Date from the Process Agent evidencing its obligation to accept service of process pursuant to Section 10.09(b)

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(or any agreement with any successor Process Agent as provided therein) in the form delivered to the Administrative Agent on the Closing Date, as such letter may be amended, supplemented or otherwise modified from time to time as permitted hereby.

"Put Option Agreement" means the Put Option Agreement dated as of the Closing Date between the Lender and Enron.

"Responsible Officer" means, as to any Person, the chief executive officer, the president, the chief financial officer, the treasurer, the assistant treasurer, the secretary, the deputy corporate secretary, any assistant secretary or any vice president or other executive officer of such Person. Unless otherwise specified, all references to a "Responsible Officer" herein means a Responsible Officer of the Borrower.

"Subscription Agreement" means the Share Subscription Agreement dated as of the Closing Date between the Borrower and Newman.

"Subscription Payment Assumption Agreement" means the Subscription Payment Assumption Agreement dated as of the Closing Date among the Borrower, Newman and the Lender.

"Supplemental Costs" means, without duplication, any and all interest, fees, costs, expenses, indemnities, and other Obligations of the Borrower payable hereunder or under the other Loan Documents (including, without limitation, amounts payable under Sections 2.07 or 2.08 or Section 10.03, Cost of Funds Adjustment Amounts payable under Section 2.06(b), interest payable under Section 2.06(c), and all "Supplemental Costs" (as defined in the Flagstaff Credit Agreement) payable by Flagstaff pursuant to the Flagstaff Credit Agreement, expenses and similar items and amounts that are required to be paid by (or any Obligation to pay that has been incurred by) the Borrower under the Loan Documents) other than (a) interest payable pursuant to Section 2.06(a), (b) the principal amount of the Loan, and (c) any Make-Whole Amount payable hereunder.

"Tangible Net Worth" means, as of any date of determination thereof, the net worth of the Borrower, as determined in accordance with GAAP without giving effect to any increase or decrease in net worth as a result of accumulated other comprehensive income (or loss), less the sum of the book value of all assets of the Borrower that would be treated as intangibles under GAAP, including, without limitation, goodwill, research and development costs, trademarks, tradenames, copyrights, patents and unamortized debt discount expenses.

"Total Return Swap Agreement" means the ISDA Master Agreement, and schedule and confirmation thereto, dated as of the Closing Date between Enron and the Lender.

"Transactions" means the execution, delivery and performance by the Borrower of this Agreement and the other Loan Documents.

"Warrant" means the warrant issued pursuant to the Warrant Agreement.

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"Warrant Agreement" means the Warrant Agreement dated as of the Closing Date between the Borrower and the Lender.

SECTION 1.02 Computation of Time Periods. In this Agreement in the computation of periods of time from a specified date to a later specified date, the word "from" means "from and including" and the words "to" and "until" each means "to but excluding". Unless otherwise indicated, all references to a particular time are references to New York City time.

SECTION 1.03 Terms Generally. The definitions of terms herein shall apply equally to the singular and plural forms of the terms defined. Whenever the context may require, any pronoun shall include the corresponding masculine, feminine and neuter forms. The words "include", "includes" and "including" shall be deemed to be followed by the phrase "without limitation". The word "will" shall be construed to have the same meaning and effect as the word "shall". Unless the context requires otherwise (a) any definition of or reference to any agreement, instrument or other document herein shall be construed as referring to such agreement, instrument or other document as from time to time amended, supplemented or otherwise modified (subject to any restrictions on such amendments, supplements or modifications set forth herein), (b) any reference herein to any Person shall be construed to include such Person's successors and assigns, (c) the words "herein", "hereof" and "hereunder", and words of similar import, shall be construed to refer to this Agreement in its entirety and not to any particular provision hereof, (d) all references herein to Articles, Sections, Exhibits and Schedules shall be construed to refer to Articles and Sections of, and Exhibits and Schedules to, this Agreement and (e) the words "asset" and "property" shall be construed to have the same meaning and effect and to refer to any and all tangible and intangible assets and properties, including cash, securities, accounts and contract rights.

SECTION 1.04 Accounting Terms; GAAP. Except as otherwise expressly provided herein, all terms of an accounting or financial nature shall be construed in accordance with GAAP, as in effect from time to time; provided that, if the Borrower notifies the Administrative Agent that the Borrower requests an amendment to any provision hereof to eliminate the effect of any change occurring after the date hereof in GAAP or in the application thereof on the operation of such provision (or if the Administrative Agent notifies the Borrower that the Lender requests an amendment to any provision hereof for such purpose), regardless of whether any such notice is given before or after such change in GAAP or in the application thereof, then such provision shall be interpreted on the basis of GAAP as in effect and applied immediately before such change shall have become effective until such notice shall have been withdrawn or such provision amended in accordance herewith.

ARTICLE II The Credits

SECTION 2.01 Loans. Subject to the terms and conditions set forth herein, the Lender agrees to make on the Effective Date a Loan to the Borrower in an aggregate amount not to exceed the Lender's Commitment. Any portion of the Lender's Commitment not utilized

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on the Effective Date shall be permanently cancelled. Any portion of the Loan that is repaid or prepaid may not be reborrowed. Unless the Loan has been made on or before July 31, 2001, the Commitment shall terminate in full on such date.

SECTION 2.02 Requests for a Borrowing. To request the Borrowing, the Borrower shall notify the Administrative Agent of such request by delivery to the Administrative Agent of a written Borrowing Request not later than 11:00 a.m., New York City time, three Business Days before the Effective Date. Such Borrowing Request shall be irrevocable and shall be in a form approved by the Administrative Agent and signed by the Borrower. Each such written Borrowing Request shall specify the following information:

- (a) the aggregate amount of the requested Borrowing;
- (b) the Effective Date, which shall be a Business Day; and
- (c) the location and number of the Borrower's account to which funds are to be disbursed.

Promptly following receipt of the Borrowing Request in accordance with this Section, the Administrative Agent shall advise the Lender of the details thereof and of the amount of the Lender's Loan to be made as part of the requested Borrowing.

SECTION 2.03 Funding of Borrowings. The Lender shall make the Loan to be made by it hereunder on the Effective Date by wire transfer of immediately available funds, to an account of the Borrower maintained with the Administrative Agent in New York City and designated by the Borrower in the Borrowing Request.

SECTION 2.04 Repayment of Loans; Evidence of Debt. (a) The Borrower hereby unconditionally promises to pay to the Administrative Agent for the account of the Lender on the Maturity Date the principal amount of the Loan that remains outstanding on such date.

(b) The Administrative Agent shall maintain accounts in which it shall record (i) the amount of the Loan made hereunder, (ii) the amount of any principal or interest due and payable or to become due and payable from the Borrower to the Lender hereunder and (iii) the amount of any sum received by the Administrative Agent hereunder for the account of the Lender.

(c) The entries made in the accounts maintained pursuant to paragraph (b) of this Section shall be prima facie evidence of the existence and amounts of the obligations recorded therein absent manifest error, provided that the failure of the Lender or the Administrative Agent to maintain such accounts or any error therein shall not in any manner affect the obligation of the Borrower to repay the Loan in accordance with the terms of this Agreement.

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(d) The Loan made hereunder shall be evidenced by the Note. The Borrower shall prepare, execute and deliver to the Lender the Note.

SECTION 2.05 Prepayment of Loans.

(a) The Borrower may upon at least three Business Days' notice to the Administrative Agent stating the proposed date, and if such notice is given the Borrower shall, prepay in full the entire outstanding principal amount (and not less) of the aggregate Loan, together with (i) the Make-Whole Amount, and (ii) all other Supplemental Costs.

(b) Upon receipt of notice of any prepayment, the Administrative Agent shall notify the Borrower of the Make-Whole Amount and any other Supplemental Costs to be paid in connection therewith.

SECTION 2.06 Interest. (a) The Loan shall bear interest at a rate equal to 6.12% per annum, payable on each Payment Date; provided, however, that notwithstanding the foregoing, if the Borrower pays the Make-Whole Amount to the Lender, the Loan shall cease to accrue interest.

(b) Upon demand by the Administrative Agent, the Borrower shall, on each applicable Payment Date, pay the Cost of Funds Adjustment Amount, if any, for such Payment Date.

(c) Notwithstanding the foregoing, if any interest on any Loan or any fee or other amount (other than principal) payable by the Borrower hereunder is not paid when due, whether at stated maturity, upon acceleration or otherwise, such overdue amount shall bear interest, from the date on which such amount is due until such amount is paid in full, at a rate per annum equal to the sum of 2% per annum plus the interest rate per annum set forth in Section 2.06(a) applicable to the Loan.

(d) Accrued interest on the Loan shall be payable in arrears on each Payment Date for the Loan and on the earlier of (i) the Maturity Date and (ii) the payment of the Make-Whole Amount.

(e) All computations of interest and fees hereunder shall be made on the basis of a year of 360 days and shall be payable for the actual number of days (including the first day but excluding the last day) elapsed. Each determination by the Administrative Agent of an interest rate hereunder shall be conclusive and binding for all purposes, absent manifest error. For the purposes of this Agreement, whenever interest to be paid hereunder is to be calculated on the basis of a year having a number of days other than the actual number of days in the relevant year, the yearly rate of interest to which the rate determined pursuant to such calculation is equivalent is the rate so determined multiplied by a fraction the numerator of which is the actual number of days in the year in which the same is to be ascertained and the denominator of which is the number of days deemed by the Agreement to be in such year. The foregoing sentence is for disclosure purpose only and will not otherwise affect the terms of this Agreement or the Note as set forth herein or therein. To the extent the Interest Act (Canada) is deemed applicable to this

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Agreement and the Note, all interest that accrues under this Agreement or the Note will be calculated using the nominal rate method and not the effective rate method and the deemed reinvestment principle will not apply to such calculations.

(f) Subject to Section 2.08, to the extent the Borrower has paid or is obligated to pay any amount hereunder at a time that would result in interest payable under the Loan being ineligible for the exemption from withholding tax provided in Section 212(1)(b)(vii) of the *Income Tax Act* (Canada) by reason of the Borrower being obligated to pay principal, within the meaning of such provision, earlier than that which would not cause such withholding tax exemption not to apply, then, to the extent such amount has been paid, such amount shall be deemed not to have been paid and shall be deemed to have been advanced by the Borrower to the Lender, and, to the extent such amount has not yet been paid, the Borrower will be obligated to advance such amount to the Lender (collectively, the "Advance"). The Advance shall bear interest at any time at a rate identical to the applicable interest rate in respect of the Loan at that time. The recourse of the Borrower in respect of the Advance shall be limited to amounts owing by the Borrower to the Lender pursuant to the Loan and that, but for this provision, would be or would be considered to have been paid by the Borrower, and the Borrower shall have no recourse of any nature whatsoever against any other assets of the Lender. The Lender shall have the right to set off the Advance against amounts owing pursuant to the Loan.

SECTION 2.07 Increased Costs; Capital Adequacy, Etc. (a) If, due to either (i) the introduction of or any change in or in the interpretation of any law or regulation by any governmental authority, central bank or comparable agency charged with the interpretation or administration thereof or (ii) the compliance with any guideline or request from any governmental authority, central bank or comparable agency (whether or not having the force of law), there shall be any increase in the cost to the Lender of agreeing to make or making, funding or maintaining the Loan (other than increased costs described in Section 2.07(b) and other than, in respect of payments to be made to the Lender or the Administrative Agent, any such increased costs resulting from taxes, levies, imposts, deductions, charges or withholdings, and all liabilities with respect thereto (as to which Section 2.08 shall govern)), then the Borrower shall from time to time, upon demand by the Lender (with a copy of such demand to the Administrative Agent), pay to the Administrative Agent for the account of the Lender additional amounts sufficient to compensate the Lender for such increased cost.

(b) If the Lender shall have determined that, after the date hereof, the adoption of any applicable law, rule or regulation regarding capital adequacy, or any change therein, or any change in the interpretation or administration thereof by any governmental authority, central bank or comparable agency charged with the interpretation or administration thereof, or compliance by the Lender (or its lending office) with any request or directive regarding capital adequacy (whether or not having the force of law) of any such authority, central bank or comparable agency (except to the extent such request or directive arises as a result of the individual creditworthiness of the Lender), has the effect of increasing the amount of capital required or expected to be maintained as a result of its Commitment hereunder, the Lender shall have the right to give prompt written notice and demand for payment thereof to the Borrower with a copy to the Administrative Agent (which notice and demand shall show in reasonable

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detail the calculation of such additional amounts as shall be required to compensate the Lender for the increased cost to the Lender as a result of such increase in capital and shall certify that such costs are generally being charged by the Lender to other similarly situated borrowers under similar credit facilities), although the failure to give any such notice shall not, unless such notice fails to set forth the information required above, release or diminish any of the Borrower's obligations to pay additional amounts pursuant to Section this 2.07(b), the Borrower shall pay such additional amounts.

(c) The Lender shall use its best efforts (consistent with its internal policies and legal and regulatory restrictions) to select a jurisdiction for its lending office or change the jurisdiction of its lending office, as the case may be, so as to avoid the imposition of any increased costs under this Section 2.07 or to eliminate the amount of any such increased cost which may thereafter accrue; provided that no such selection or change of the jurisdiction for its lending office shall be made if, in the reasonable judgment of the Lender, such selection or change would be disadvantageous to the Lender.

(d) The Lender shall not be entitled to recover increased costs pursuant to Section 2.07, (i) incurred or accruing more than 90 days prior to the date on which the Lender sent to the Borrower a written notice and demand for payment as specified in this Section 2.07, or (ii) to the extent that such increased costs have resulted from the failure of the Lender to have complied with Section 2.07(c).

SECTION 2.08 Taxes

(a) (i) Any and all payments or crediting of amounts by the Borrower hereunder or under any other agreement relevant to the payment or crediting of amounts hereunder to each Indemnitee shall be made, in accordance with Section 2.09, free and clear of and without deduction for all Indemnified Taxes. "Indemnified Taxes" shall mean any and all present or future taxes, levies, imposts, deductions, charges or withholdings, and all liabilities with respect thereto, other than Excluded Taxes. "Excluded Taxes" shall mean, in respect of payments to the Lender or the Administrative Agent, (A) all taxes imposed on its net income (and capital and franchise taxes imposed on it in lieu thereof or otherwise applicable as of the date hereof) by the United States or by any state or foreign jurisdiction under the laws of which the Lender or the Administrative Agent is organized, domiciled, resident or doing business or any political subdivision thereof or by any jurisdiction in which such Indemnitee holds any interest in connection with this Agreement (including, without limitation, in the case of the Lender, the jurisdiction of the Lender's lending office) or any political subdivision thereof, to the extent such taxes arise by reason of such organization, domicile, residence, doing business or holding an interest (other than any net income taxes imposed by any jurisdiction with which the Indemnitee's connection arises solely from having executed, delivered or performed obligations or received a payment under, or enforced, this Agreement other than to the extent that such net income taxes would be applicable, on the date hereof, to a payment to be made to the Lender or the Administrative Agent) and (B) any taxes imposed by the United States by means of withholding at source if and to the

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extent that such taxes shall be in effect and shall be applicable, on the date hereof, to payment to be made to the Lender or the Administrative Agent. If the Borrower shall be required by law to deduct any taxes from or in respect of any sum payable hereunder to any Indemnitee, (1) the sum payable shall be increased as may be necessary so that after making all required deductions in respect of Indemnified Taxes (including deductions applicable to additional sums payable under this Section 2.08) such Indemnitee receives an amount equal to the sum it would have received had no such deductions been made, (2) the Borrower shall make or cause to be made such deductions and (3) the Borrower shall pay or cause to be paid the full amount deducted to the relevant taxation authority or other authority in accordance with applicable law. For greater certainty, any taxes under Division D of Part I and Part XIII of the *Income Tax Act* (Canada) and corresponding provisions of applicable provincial income tax legislation (other than net income taxes from, or from dispositions of property used in, carrying on business in Canada for purposes of the *Income Tax Act* (Canada)) shall not be considered taxes by reason of holding an interest in Canada.

(ii) If, upon filing of documentation prescribed by applicable law, any Indemnitee is entitled to an exemption from or reduction of United States withholding tax with respect to payments under this Agreement that would otherwise be subject to United States withholding tax or United States withholding tax at an increased rate, then, upon written request by the Borrower, such Indemnitee shall deliver to the Borrower (with a copy to the Administrative Agent), at the time or times prescribed by applicable law, such properly completed and executed documentation prescribed by applicable law as will permit such payments to be made without withholding or at a reduced rate. If any such Indemnitee fails to meet its obligation under this subsection (ii), the Borrower shall not be required to pay to such Indemnitee any additional amount relating to United States withholding tax (and shall be relieved of any liability with respect thereto) pursuant to Section 2.08(a)(i) and 2.08(c) that would not have been payable but for such failure.

(iii) If payment required pursuant to Section 2.08(a)(i) is paid by the Borrower for the benefit of the Lender and the Lender determines in its reasonable, good faith discretion that it has received or been granted (and has derived full or partial use and benefit from) a credit against, a remission for, or a refund or a repayment of, any Indemnified Tax, then, if and to the extent that the Lender determines in its reasonable, good faith discretion that such credit, remission, refund or repayment is in respect of or calculated with reference to the deduction or withholding giving rise to the gross-up payment made pursuant to Section 2.08(a)(i), the Lender shall, to the extent that it determines in its reasonable, good faith discretion that it can do so without prejudice to the retention of the amount of such credit, remission, refund or repayment, pay to the Borrower such amount in respect of such credit, remission, refund or repayment as the Lender in its reasonable, good faith discretion shall have concluded to be attributable to such deduction or withholding (and which will leave the Lender in no better or worse position, after such payment, than it would have been in had no such deduction or withholding been required); provided that the Lender shall not be required to make any payment under this Section 2.08(a)(iii) until the Lender in its reasonable, good faith

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discretion is satisfied that its tax affairs for its tax year in respect of which such credit, remission, refund or repayment was received have been finally settled to the satisfaction of the appropriate tax authorities. Any such payment to the Borrower shall be conclusive evidence of the amount due to the Borrower and shall be accepted in full and final settlement of the right of reimbursement hereunder, absent manifest error. Nothing herein contained shall require the Lender to disclose any information relating to its tax affairs (or any computations in respect thereof) or interfere with the right of the Lender to arrange its tax affairs in whatever manner it thinks fit; provided, however, that the Lender shall use reasonable, good faith efforts (consistent with legal and regulatory restrictions) to obtain any such benefit to which it may be entitled. The Lender shall be under no obligation to do anything that would prejudice its ability to benefit from any other credit, remission, refund, repayment or benefit to which it may be entitled.

(b) In addition, the Borrower agrees to pay all Other Taxes that arise from any payment made or crediting of amounts hereunder or under any other agreement relevant to the payment or crediting of amounts hereunder or from the execution, delivery or performance of, or otherwise with respect to, any such agreement. "Other Taxes" shall mean any present or future transfer, ad valorem, registration, title, licensing, stamp or documentary taxes or any other excise or property taxes, charges or similar levies, and all liabilities with respect thereto.

(c) The Borrower, to the fullest extent permitted by law, will indemnify each Indemnitee on an after-tax basis for the full amount of Indemnified Taxes or Other Taxes (including, without limitation, Indemnified Taxes or Other Taxes imposed by any jurisdiction on amounts payable under this Section 2.08) paid by such Indemnitee, and any liability (including penalties, interest and expenses) arising therefrom or with respect thereto, that arise from any payment made or crediting of amounts hereunder or under any other agreement relevant to the payment or crediting of amounts hereunder or from the execution, delivery or performance of, or otherwise with respect to, any such agreement, except as a result of the gross negligence (which shall in any event include the failure of such Indemnitee to provide to the Borrower any form or certificate that it was required to provide pursuant to subsection (a)(ii) above) or willful misconduct of such Indemnitee, whether or not such Indemnified Taxes or Other Taxes were correctly or legally asserted. This indemnification shall be made within 30 days from the date such Indemnitee makes written demand therefore. Except to the extent that it would be duplicative of tax indemnities in other Operative Documents, references in this Section 2.08(c) to the Lender and to this Agreement shall include the "Lenders" under the Flagstaff Credit Agreement and the Flagstaff Credit Agreement, respectively.

(d) Without prejudice to the survival of any other agreement of the Borrower or the Lender hereunder, the agreements and obligations of the Borrower and each Indemnitee contained in this Section 2.08 shall survive the payment in full of principal of and interest on the Loan made hereunder.

SECTION 2.09 Payments Generally. (a) The Borrower shall make each payment required to be made by it hereunder (whether of principal, interest or fees, or of amounts payable under Section 2.07 or 2.08, or otherwise) prior to 11:00 a.m., New York City

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time, on the date when due, in immediately available funds. Any amounts received after such time on any date may, in the discretion of the Administrative Agent, be deemed to have been received on the next succeeding Business Day for purposes of calculating interest thereon. All such payments (other than Excluded Payments) shall be made to the Administrative Agent at its offices at 270 Park Avenue, New York, New York. The Administrative Agent shall distribute any such payments received by it for the account of any other Person to the appropriate recipient promptly following receipt thereof. If any payment hereunder shall be due on a day that is not a Business Day, the date for payment shall be extended to the next succeeding Business Day (provided, however, that if such extension would cause payment of interest on or principal of Loans to be made in the next following calendar month, such payment shall be made on the next preceding Business Day), and, in the case of any payment accruing interest, interest thereon shall be payable for the period of such extension. All payments hereunder shall be made in dollars.

(b) Unless the Administrative Agent shall have received notice from the Borrower prior to the date on which any payment is due to the Administrative Agent for the account of the Lender hereunder that the Borrower will not make such payment in full, the Administrative Agent may assume that the Borrower has made such payment on such date in full in accordance herewith and may, in reliance upon such assumption, distribute to the Lender on such due date an amount equal to the amount due then due to the Lender. In such event, if the Borrower has not in fact made such payment, then the Lender agrees to repay to the Administrative Agent forthwith on demand the amount so distributed to the Lender with interest thereon, for each day from and including the date such amount is distributed to it to but excluding the date of payment to the Administrative Agent, at the greater of the Federal Funds Effective Rate and a rate determined by the Administrative Agent in accordance with banking industry rules on interbank compensation.

(c) If the Lender shall fail to make any payment required to be made by it pursuant to Section 2.03(b) or 2.09(b), then the Administrative Agent may, in its discretion (notwithstanding any contrary provision hereof), apply any amounts thereafter received by the Administrative Agent for the account of the Lender to satisfy the Lender's obligations under such Sections until all such unsatisfied obligations are fully paid.

SECTION 2.10 Reimbursement of Supplemental Costs. Upon demand by the Administrative Agent, or by (with a copy of such demand to be provided to the Administrative Agent) the Flagstaff Collateral Agent, or the Lender, the Borrower shall promptly pay to the Administrative Agent any and all Supplemental Costs owing hereunder. Failure or delay on the part of the Administrative Agent, the Flagstaff Collateral Agent, or the Lender to demand compensation for Supplemental Costs pursuant to this Section 2.10 shall not constitute a waiver of any such agent's or Lender's right to demand such Supplemental Costs.

SECTION 2.11 Certificate of the Lender. Without limitation to the requirements of Section 2.07(c), if the Lender demands or gives notice of Supplemental Costs due to the Lender under this Article II, the Lender shall, as part of each demand or notice for payment required under this Article II, deliver to the Borrower (with a copy to the Administrative Agent) a certificate setting forth in reasonable detail the amount and basis of the Supplemental

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Costs payable to the Lender hereunder and such certificate shall be conclusive and binding on the Borrower, absent manifest error.

SECTION 2.12 Payments to the Operating Account. Any payments to be made by the Borrower hereunder (other than Excluded Payments) shall be made to the Operating Account. Payment to the Operating Account shall constitute payment to the Administrative Agent or the Lender, as applicable.

SECTION 2.13 Currency of Payment. (a) All payments of principal, interest, fees, and Make-Whole Amount by Borrower under this Agreement and the other Loan Documents shall be made in United States Dollars.

(b) Any expenses or other Supplemental Costs required to be reimbursed or indemnified by the Borrower pursuant to this Agreement or any other Loan Document, if incurred in Canadian Dollars, will be paid by the Borrower in Canadian Dollars, and if incurred in United States Dollars, will be paid by the Borrower in United States Dollars.

ARTICLE III **Representations and Warranties**

The Borrower represents and warrants to the Lender on the Effective Date that:

SECTION 3.01 Organization; Powers. The Borrower (a) has been duly formed and is validly existing and in good standing as an unlimited liability company under the Nova Scotia Companies Act with all requisite company power and authority under its Constituent Documents to execute, deliver and perform its obligations under this Agreement, each other Operative Document to which it is a party and to conduct its business as described in its Constituent Documents, and (b) is duly qualified and is authorized to do business and is in good standing in each other jurisdiction in which the conduct of its business requires it to be so qualified or authorized except where the failure to be so qualified or authorized is not reasonably likely to have a Material Adverse Effect.

SECTION 3.02 Authorization; Enforceability.

(a) The execution, delivery and performance by the Borrower of this Agreement, each other Operative Document to which it is a party, and the transactions contemplated thereby, are within the Borrower's corporate powers, have been duly authorized by all necessary corporate action of the Borrower, and do not (i) contravene, violate, breach or constitute a default under, the Borrower's Constituent Documents, (ii) violate any law (including, without limitation, the Securities Exchange Act of 1934, as amended), rule, regulation (including, without limitation, Regulations T, U or X of the Board), order, writ, judgment, injunction, decree, determination award, license, permit or consent of the United States or Canada, or any state, territory or province thereof, applicable to it or its assets, (iii) conflict with or result in the breach of, or constitute a default under, any Operative Document or (iv) except for the Liens created under any Operative Document to which the Borrower is a party, result in

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or require the creation or imposition of any Lien upon or with respect to any of the properties of the Borrower.

(b) This Agreement has been, and each other Operative Document to which it is a party when delivered hereunder will have been, duly executed and delivered by the Borrower. This Agreement is, and each other Operative Document to which it is a party when delivered hereunder will be, the legal, valid and binding obligation of the Borrower, enforceable against the Borrower in accordance with its terms, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws relating to or limiting creditors' rights generally or by equitable principles relating to enforceability.

SECTION 3.03 Consents and Approvals; No Conflicts. No consent of any other Person and no authorization or approval or other action by, and no notice to or filing with, any Governmental Authority or any other third party is required for (a) the due execution, delivery or performance by the Borrower of this Agreement, any other Operative Document to which it is a party, or for the consummation of the transactions contemplated thereby, or (b) the exercise by the Administrative Agent or the Lender of its respective rights under the Operative Documents pursuant hereto except such consents, authorizations, approvals, actions, notices, and filings as (i) have been obtained, made, taken or given, are in full force and effect and copies of which have been furnished to the Administrative Agent or (ii) are not yet required to be obtained, made, taken or given under the terms of the Operative Documents to which the Borrower is a party.

SECTION 3.04 No Activity; No Subsidiaries; Business Activity. (a) Since the date of its formation, the Borrower has not engaged in any activity, entered into any commitment or incurred any Indebtedness other than that contemplated by its Constituent Documents or by the Operative Documents. The Borrower has no obligation to declare or pay any Distributions (other than Distributions payable in its own equity) other than pursuant to the Operative Documents.

(b) The Borrower has no Subsidiaries.

(c) The Borrower does not own any Securities, other than the CPS Intercompany Note.

(d) Since the date of its formation, there has been no event with respect to the Borrower that has resulted, or that could reasonably be expected to result, in a Material Adverse Effect.

(e) The Borrower is a "private issuer" within the meaning of the Securities Act (Alberta).

(f) The Borrower is not a non-resident of Canada within the meaning of the Income Tax Act (Canada).

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(g) Interest under this Agreement does not constitute United States source income.

SECTION 3.05 Properties. The Borrower has good title to, or other valid interests in, all its real and personal property material to its business, except for minor defects in title that do not interfere with its ability to conduct its business as currently conducted or to utilize such properties for their intended purposes.

SECTION 3.06 Litigation. There is (i) no action, suit, litigation or proceeding pending or, to the best of the Borrower's knowledge, threatened, and (ii), to the best of the Borrower's knowledge, no investigation pending or threatened, before any court, governmental agency or arbitrator that (A) purports to affect the Borrower or, to the best knowledge of the Borrower, any of its assets or properties or (B) purports to affect the legality, validity or enforceability of this Agreement, any other Loan Document or the consummation of the transactions contemplated hereby.

SECTION 3.07 Compliance with Laws and Agreements. The Borrower is in compliance with all laws, regulations and orders of any Governmental Authority applicable to it or its property and all Operative Documents binding upon it or its property, except where the failure to do so, individually or in the aggregate, could not reasonably be expected to result in a Material Adverse Effect. No Default has occurred and is continuing.

SECTION 3.08 Investment and Holding Company Status.

(a) The Borrower is not an "investment company", or a company "controlled" by an "investment company", as such terms are defined in the Investment Company Act of 1940, as amended.

(b) The Borrower is not a "holding company" or a "subsidiary company" of a "holding company", or an "affiliate" of a "holding company" or of a "subsidiary company" of a "holding company" within the meaning of the Public Utility Holding Company Act of 1935, as amended.

SECTION 3.09 Taxes. The Borrower has filed, has caused to be filed or has been included in all tax returns (Federal, provincial, state, local and foreign) required to be filed by the Borrower and has paid or caused to be paid all taxes due for the periods covered thereby, including interest and penalties, other than any filings or payments the failure of which to file or pay would not result in a Material Adverse Effect.

SECTION 3.10 Disclosure. No report, financial statement or other written information, exhibit or report furnished by the Borrower to the Lender or the Administrative Agent pursuant to the requirements of this Agreement or in connection with the transaction contemplated hereby, or in connection with the negotiation of, or compliance with, this Agreement contained any material misstatement of fact or omitted to state a material fact necessary to make the statements contained therein not misleading.

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SECTION 3.11 Solvency. As of the date hereof, and upon the closing of the transactions contemplated by the Operative Documents (after giving effect to such transactions), the Borrower shall (a) have an aggregate fair market value of assets that equals or exceeds liabilities (whether contingent, subordinated, unmatured, unliquidated or otherwise), (b) have sufficient cash flow to enable it to pay its liabilities as they mature, and (c) not have unreasonably small capital to conduct such Person's business. In computing the amount of contingent liabilities at any time (for purposes of determining solvency) it is intended that such liabilities will be computed at the amount that, in light of all the facts and circumstances existing at such time, represents the amount that can reasonably be expected to become an actual matured liability.

SECTION 3.12 No Other Obligations. The Borrower is not a party to any contract, loan agreement, indenture, mortgage, deed of trust, lease or other instrument, other than those Operative Documents to which the Borrower is a party.

ARTICLE IV **Conditions**

SECTION 4.01 Effective Date. The obligation of the Lender to make the Loan hereunder shall not become effective until each of the following conditions is satisfied or waived:

(a) Since the Borrower's formation, nothing shall have occurred that has resulted in a Material Adverse Effect.

(b) The Administrative Agent shall have received the following documents, each dated as of the Closing Date and duly executed by the respective party or parties thereto, and otherwise in form and substance reasonably satisfactory to the Lender and the Administrative Agent, and (except for the documents listed in clauses (i), (x), (xiii) and (xviii)) in the number of copies necessary to provide the Lender and the Administrative Agent each with original counterparts of such documents plus three additional original counterparts:

- (i) the Note;
- (ii) the Enron Agreement;
- (iii) the Warrant Agreement;
- (iv) the Put Option Agreement;
- (v) the Total Return Swap Agreement;
- (vi) a favorable opinion of Blake, Cassels & Graydon LLP, counsel to the Borrower, in substantially the form of Exhibit B-1;
- (vii) a favorable opinion of McInnes Cooper, counsel to the Borrower, in substantially the form of Exhibit B-2;

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(viii) a favorable opinion of Bracewell & Patterson, L.L.P., counsel to Enron, in substantially the form of Exhibit B-3;

(ix) the Interest Rate Swap Agreement;

(x) the CPS Intercompany Note;

(xi) a favorable opinion of James V. Derrick, Jr., Executive Vice President and General Counsel of the Borrower, in substantially the form of Exhibit B-4 hereto;

(xii) a compliance certificate, in substantially the form of Exhibit C, properly executed by a Responsible Officer and dated as of the Effective Date;

(xiii) a Borrowing Request as required by Section 2.02;

(xiv) the Subscription Agreement;

(xv) the Subscription Payment Assumption Agreement;

(xvi) each other Operative Document;

(xvii) the Enron Consent and the Hansen Consent;

(xviii) with respect to each of CPS, Hansen and Newman, a certificate issued by the appropriate Governmental Authority of the jurisdiction of incorporation, organization or formation of such Person, certifying that the copies of the currently effective certificate of incorporation, certificate of formation or other applicable instrument or document evidencing the formation of each such Person, and all amendments thereto, are true, correct and complete (dated on, or a recent date prior to the Closing Date); and with respect to each of Enron, CPS, Hansen and Newman, a certificate issued by the appropriate Governmental Authority, if available, that such Person is in good standing and has paid all franchise taxes to the date of such certificate;

(xix) certificates of each of Enron, CPS, Hansen and Newman, signed on behalf of each such Person by a Responsible Officer of each such Person (the statements made in which certificate shall be true and correct on and as of the Closing Date), certifying as to:

(A) the absence of any amendments to the Constituent Documents of such Person since the date of the respective certificate referred to in Section 4.01(b)(xviii);

(B) a true and correct copy of the Constituent Documents of such Person as in effect on the Closing Date;

(C) the due incorporation or formation and good standing of such Person as a corporation, under the laws of the jurisdiction of its organization,

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and the absence of any proceeding for the dissolution or liquidation of such Person;

(D) that attached thereto is a true and complete copy of resolutions duly adopted by the board of directors, executive (or other) committee of the board of directors, managing member or manager, as applicable, of such Person authorizing the execution, delivery and performance of the Operative Documents to which it is or is to be a party;

(E) in the case of each such Person, that such resolutions have not been revoked, annulled or modified in any manner and are in full force and effect; and

(F) in the case of each such Person, the incumbency and specimen signature of each Responsible Officer or an authorized representative of a managing member, as applicable, of such Person executing the documents described in clause (D) above, and a certification of another Responsible Officer of each such Person as to the signature of the Responsible Officers signing certificates referred to in this Section 4.01(b)(xix).

(c) The Lender shall have received the "Loan" under the Flagstaff Credit Agreement, and all conditions precedent to the making of such "Loan" set forth in Section 4.01 of the Flagstaff Credit Agreement have been (or simultaneously with the making of the Loan hereunder, will be) satisfied or waived.

(d) All fees and reasonable out-of-pocket costs and expenses including, without limitation, reasonable legal fees and out-of-pocket expenses payable to the Lender or the Administrative Agent required to be paid by the Borrower that have been invoiced and are payable on or before the Effective Date shall have been paid to the extent due.

(e) The Administrative Agent and the Lender shall be reasonably satisfied with all legal issues including tax and regulatory matters.

(f) The Administrative Agent shall have received such other approvals, opinions or documents as the Administrative Agent or the Lender may reasonably request.

(g) On the Effective Date the following statements shall be true (and each of the giving of the applicable Borrowing Request and the acceptance by the Borrower of the proceeds of the Loan shall constitute a representation and warranty by the Borrower that on the Effective Date such statements are true):

(i) The representations and warranties of the Borrower contained in each Operative Document to which it is a party are correct in all material respects in each case by reference to the facts and circumstances then subsisting on and as of the Effective Date, before and immediately after giving effect to such Loan and to the application of the proceeds therefrom, as though made on and as of such date (except to the extent that

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such representations and warranties relate solely to an earlier date (in which case such representations and warranties shall have been correct in all material respects on and as of such earlier date));

(ii) No event has occurred and is continuing, or would result from the making of such Loan or from the application of the proceeds therefrom, that constitutes an Event of Default or a Default; and

(iii) 100% of the proceeds of the Loan shall be loaned by the Borrower pursuant to the CPS Intercompany Note.

(h) The Lender and the Administrative Agent will have received and reviewed a copy, (i) with respect to the fiscal year ended December 2000 of Enron's annual report which it sends to its public security holders, and a copy of Enron's report on Form 10-K (or any comparable form), for such year, which annual report will include Enron's annual audited consolidated financial statements as of the end of and for such year and (ii) unaudited balance sheet of the Borrower as of the Effective Date after giving effect to the transactions contemplated by the Operative Documents.

(i) Newman shall have paid to the Lender the full amount owed pursuant to Section 2.1 of the Subscription Payment Assumption Agreement.

SECTION 4.02 Determinations Under Section 4.01. For purposes of determining compliance with the conditions specified in Section 4.01, the Lender at such time shall be deemed to have consented to, approved or accepted or to be satisfied with each document or other matter required thereunder to be consented to or approved by or acceptable or satisfactory to the Lender unless a Responsible Officer of the Administrative Agent responsible for the transactions contemplated by this Agreement shall have received notice from the Lender prior to the date specified in the Borrowing Request for the making of the Loan, specifying its objection thereto.

ARTICLE V

Affirmative Covenants

Until the Final Debt Collection Date, the Borrower will, at all times, unless consented to in writing by the Administrative Agent and the Lender:

SECTION 5.01 Reporting Requirements. Furnish to the Administrative Agent:

(a) Default Notice. Promptly after a Responsible Officer of the Borrower obtains actual knowledge thereof, a notice setting forth details of any Default or Event of Default and the action that the Borrower has taken and proposes to take with respect thereto.

(b) Annual Reports. With respect to each calendar year, as soon as available, but not later than 120 days after the end of each calendar year, a copy of the audited balance

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sheet of the Borrower as at the end of such year and the related audited statement of income, stockholders' equity and cash flows for such year, setting forth in each case in comparative form the figures for the previous year, and accompanied by the opinion of a nationally-recognized independent public accounting firm acceptable to the Administrative Agent, which opinion shall state that such financial statements present fairly the financial position for the periods indicated in conformity with GAAP applied on a basis consistent with prior years.

(c) Quarterly Reports. As soon as available, but not later than 60 days after the end of each of the first three calendar quarters of each calendar year, a copy of the unaudited balance sheet of the Borrower as of the end of such quarter and the unaudited related statement of income, stockholders' equity and cash flows for the period commencing on the first day and ending on the last day of such quarter, and certified by a Responsible Officer of the Borrower as fairly presenting, in accordance with GAAP (subject to ordinary, good faith year-end audit adjustments and the absence of footnotes), the financial position and the results of operations of the Borrower.

(d) Litigation. Promptly upon a Responsible Officer of the Borrower obtaining actual knowledge thereof, notice of all actions, suits, investigations, litigation and proceedings before any Governmental Authority affecting the Borrower or any Operative Document.

(e) Other Notices. Promptly upon receipt thereof, copies of any other notices, requests, reports, financial statements and other information and documents received by the Borrower under or pursuant to any other Operative Document (other than those issued or sent by the Administrative Agent or the Lender) and, from time to time upon request by the Administrative Agent (other than those already required to be delivered by the Borrower to the Administrative Agent or the Lender), such information and reports required under such other Operative Documents as the Administrative Agent may reasonably request.

(f) Other Information. Such other information respecting the business, condition (financial or otherwise), operations, performance, properties or prospects of the Borrower in the possession or control of the Borrower promptly after the Administrative Agent's reasonable request in writing therefor.

SECTION 5.02 Compliance with Laws, Etc. Comply with, and cause its properties to be maintained and used in accordance with, all laws, rules, regulations and orders applicable to it or its properties, except where the failure to do so could not reasonably be expected to have a Material Adverse Effect.

SECTION 5.03 Payment of Taxes, Etc. Pay and discharge before the same shall become delinquent, (a) all taxes, assessments and governmental charges or levies imposed upon it or upon its property and (b) all lawful claims that, if unpaid, might by law become a Lien upon its property; provided, however, that the Borrower shall not be required to pay or discharge any such tax, assessment, charge or claim (i) that is being contested in good faith and by proper proceedings and as to which appropriate reserves are being maintained (in the reasonable judgment of the Borrower), unless and until any Lien resulting therefrom attaches to its property

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and becomes enforceable against its other creditors or (ii) that, if unpaid or undischarged, could not reasonably be expected to have a Material Adverse Effect.

SECTION 5.04 Preservation of Existence, Etc. Preserve and maintain its corporate existence, and its material rights (charter and statutory) and authority.

SECTION 5.05 Inspection Rights. Upon reasonable prior written notice, at any reasonable time during normal business hours and not more often than is reasonable under the circumstances, permit the Administrative Agent or the Lender or any agents or representatives thereof to examine and make copies of and abstracts from the records and books of account of the Borrower; provided that the Administrative Agent and the Lender and any such agents or representatives shall keep confidential all nonpublic information obtained pursuant to the terms of Section 10.11. The Borrower shall assume or pay all reasonable costs and expenses associated with any such examination, discussion or copying.

SECTION 5.06 Keeping of Books. Keep complete, proper and separate books of record and account, including a record of all costs and expenses incurred, all charges made, all credits made and received, and all income derived in connection with the operation of the business of the Borrower, all in accordance with GAAP, in each case to the extent necessary to enable the Borrower to comply with the periodic reporting requirements of this Agreement.

SECTION 5.07 Maintenance of Licenses and Permits. Maintain all licenses and permits necessary to own its properties and to conduct its activities in accordance with all laws, rules, regulations and orders applicable to the Borrower or its properties, except for such failures as would not result in a Material Adverse Effect.

SECTION 5.08 Claims for Supplemental Costs and Make-Whole Amount. Upon any Supplemental Cost or Make-Whole Amount becoming due pursuant to the terms hereof or otherwise upon demand from the Administrative Agent or the Lender (with a copy to the Administrative Agent) for the payment by the Borrower of any Supplemental Cost or Make-Whole Amount, make demand on CPS for payment of any such Supplemental Cost or Make-Whole Amount, as applicable.

SECTION 5.09 Tangible Net Worth. The most recent financial statements delivered pursuant to Section 5.01(b) or (c) shall reflect a positive Tangible Net Worth.

ARTICLE VI Negative Covenants

Until the Final Debt Collection Date, the Borrower will not, at any time, unless consented to in writing by the Administrative Agent and the Lender:

SECTION 6.01 Liens, Etc. Create, incur, assume or suffer to exist any Lien on or with respect to any of its properties of any character whether now owned or hereafter acquired, or sign or file, under the UCC or equivalent law of any jurisdiction, a financing statement that names the Borrower as debtor, excluding, however, from the operation of the

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foregoing restrictions the following (such exclusions collectively being "Permitted Liens"): (a) bankers' rights of set-off for uncollected items and routine fees and expenses arising in the ordinary course of business, (b) Liens for taxes and other governmental charges and assessments (and other Liens imposed by law) not yet delinquent or being contested in good faith and by proper proceedings and as to which appropriate reserves (in the reasonable judgment of the Borrower) are being maintained, unless and until any Lien resulting therefrom attaches to its property and becomes enforceable against its other creditors, (c) restrictions on transfers of Securities under applicable laws and (d) Liens created by or permitted under any Operative Document.

SECTION 6.02 Indebtedness. Create, incur, assume or suffer to exist, any Indebtedness other than (a) Indebtedness arising under the Operative Documents, or (b) immaterial Indebtedness incurred in connection with the maintenance of the existence of the Borrower and in the ordinary course of its activities permitted under this Agreement.

SECTION 6.03 Mergers, Etc. Enter into amalgamation, continuance, arrangement, reconstruction or any transaction of consolidation or merger with or into any other Person or wind up, liquidate or dissolve its affairs or take any act, step or proceeding in furtherance of the foregoing.

SECTION 6.04 Sales, Etc., of Assets. Enter into any partnership, joint venture or sale-leaseback transaction, or purchase or otherwise acquire (in one or a series of related transactions) all or any portion of the property or assets of any Person or make any expenditures (by long term or operating lease) or otherwise for capital assets (either real or personal property) or sell, lease, transfer, exchange, assign (by operation of law or otherwise) or otherwise dispose of, or grant any option with respect to, directly or indirectly (or agree to any of the foregoing at any future time), all or any material portion of its property or assets, except as permitted under any other provision of this Agreement or any other Operative Document.

SECTION 6.05 Investments in Other Persons. Make or hold any Investment in any Person other than as contemplated by the Operative Documents.

SECTION 6.06 Amendment, Etc., of Operative Documents. Cancel or terminate any Operative Document or consent to or accept any cancellation or termination thereof, amend, modify or change in any manner any term or condition of any Operative Document or give any consent, waiver or approval thereunder, waive any default under or any breach of any term or condition of any Operative Document, or agree in any manner to any other amendment, modification or change of any term or condition of any Operative Document, other than (i) any amendment, supplement, cancellation, termination, consent, approval, waiver or modification consented to or waived as provided in Section 10.02 hereof or (ii) any such amendment, supplement, consent, approval, change, waiver or modification that is ministerial or immaterial or non-substantive in nature, not adverse to the Lender and has been consented to by the Administrative Agent.

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SECTION 6.07 Negative Pledge. Enter into or suffer to exist any agreement prohibiting or conditioning the creation or assumption of any Lien upon any of its property or assets other than (a) any such agreement in favor of the Administrative Agent or the Lender and (b) as provided in Operative Documents.

SECTION 6.08 Subsidiaries. Establish, create, acquire or permit to exist any Subsidiary.

SECTION 6.09 Nature of Activities. Engage in any activity other than the management and protection of its rights under the Operative Documents to which it is a party and such other activities as are incidentally related thereto or as otherwise required or expressly contemplated in the Operative Documents to which it is a party.

SECTION 6.10 Distributions; Securities. (a) Declare or pay any Distributions, (b) call for redemption, redeem, purchase, acquire or otherwise pay-off or retire for value any Securities or set aside or otherwise segregate any amounts for such purpose, (c) except as provided in the Operative Documents, create, allot or issue any additional Securities, or (d) make any payment or distribution out of any stated capital account of the Borrower or any reduction of any stated capital account of the Borrower in respect of any of its Securities or any similar payment, distribution or reduction in the stated capital of the Borrower, or, in each case in this Section 6.10, enter into any agreement or obligation with respect to the foregoing other than as provided in the Operative Documents.

SECTION 6.11 Affiliate Transactions. Enter into any transaction or series of related transactions, with any of its Affiliates or Enron or any of its Affiliates, other than the transactions contemplated by the Operative Documents to which it is a party.

SECTION 6.12 Bankruptcy. Commence voluntary proceedings for dissolution, liquidation or winding-up, or under the Companies Creditors Arrangement Act (Canada), the Bankruptcy and Insolvency Act (Canada), the Winding-up Act (Canada), or any other bankruptcy, insolvency or similar law now or hereafter in effect, or consent to the entry of an order in an involuntary proceeding under any such law, or give consent to the appointment or taking possession by a receiver, liquidator, assignee, custodian, trustee, sequestrator or similar official of the Borrower or for any substantial part of its assets, or make any general assignment for the benefit of creditors, or fail generally to pay its debts as such debts become due, or take any action in furtherance of any of the foregoing.

SECTION 6.13 Prepayments. Accept any prepayment of the principal of the note issued by CPS under the CPS Intercompany Note, unless substantially contemporaneously therewith, Borrower prepays the entire amount of the Obligations of Borrower hereunder.

Anything herein to the contrary notwithstanding, the parties hereto agree that the execution, delivery and performance of the Operative Documents will not contravene the provisions of this Article VI.

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ARTICLE VII
Events of Default

If any of the following events ("Events of Default") shall occur:

(a) the Borrower shall fail to pay (i) any principal on the Loans when the same becomes due and payable, (ii) any interest on the Loans or Cost of Funds Adjustment Amount for more than five days after the same becomes due and payable, or (iii) or any other amount payable by it under this Agreement or under any other Loan Document for more than 15 days after the same becomes due and payable;

(b) any written representation or warranty made or deemed made by the Borrower under or in connection with any Loan Document or any other certificate or report made by or on behalf of the Borrower hereunder shall prove to have been incorrect in any material respect when made or deemed made and such materiality is continuing;

(c) the Borrower shall fail to perform or observe any term, covenant or agreement contained in Section 5.01(a), (d) or (e) or Article VI;

(d) the Borrower shall fail to perform any other term, covenant or agreement contained in any Loan Document on its part to be performed or observed if such failure shall remain unremedied for thirty days after written notice thereof shall have been given to the Borrower by the Administrative Agent or the Lender;

(e) the Borrower or Newman shall generally not pay its debts as such debts become due, or shall admit in writing its inability to pay its debts generally, or shall make a general assignment for the benefit of creditors; or any proceeding shall be instituted by or against the Borrower seeking to adjudicate it a bankrupt or insolvent, or seeking liquidation, winding up, reorganization, arrangement, adjustment, protection, relief, or composition of it or its debts under any law relating to bankruptcy, insolvency or reorganization or relief of debtors, or seeking the entry of an order for relief or the appointment of a receiver, trustee, or other similar official for it or for any substantial part of its property and, in the case of any such proceeding instituted against it (but not instituted by it) that is being diligently contested by it in good faith, either such proceeding shall remain undismissed or unstayed for a period of 60 days or any of the actions sought in such proceeding (including, without limitation, the entry of an order for relief against, or the appointment of a receiver, trustee, custodian or other similar official for, it or any substantial part of its property) shall occur; or the Borrower shall take any action to authorize any of the actions set forth above in this subsection (e);

(f) any judgment or order for the payment of money in excess of \$50,000 (or the equivalent in any foreign currency) shall be rendered against the Borrower and either (i) enforcement proceedings shall have been commenced by any creditor upon such judgment or order and such proceedings shall not have been stayed within 30 days or (ii) there shall be any period of 30 consecutive days during which a stay of enforcement of such judgment or order, by reason of a pending appeal or otherwise, shall not be in effect:

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(g) the Borrower shall for any reason dissolve or its directors or its stockholder(s) shall have consented to the dissolution of the Borrower;

(h) any material provision of any Operative Document at any time after its execution and delivery shall cease, in any material respect, to be in full force and effect in any material respect, or its validity or enforceability shall be contested by the Borrower, any other Designated Party or Enron, or the Borrower, any other Designated Party or Enron shall deny that it has any further liability or obligations under any Operative Document to which it is a party;

(i) an Enron Event shall have occurred and be continuing; or

(j) CPS shall fail for any reason to comply with any obligation under the CPS Intercompany Note;

then, (1) and in every such event (other than an event with respect to the Borrower described in clause (2) below), and at any time thereafter during the continuance of such event, the Administrative Agent may, and at the request of the Lender shall, by notice to the Borrower, declare the Loans then outstanding, accrued interest thereon, Supplemental Costs, the Make-Whole Amount and all fees and other Obligations of the Borrower accrued hereunder to be due and payable in whole (or in part, in which case any principal not so declared to be due and payable may thereafter be declared to be due and payable), and thereupon the principal of the Loans so declared to be due and payable, together with accrued interest thereon, Supplemental Costs, the Make-Whole Amount and all fees and other Obligations of the Borrower accrued hereunder, shall become and be forthwith due and payable immediately, without presentment, demand, protest or other notice of any kind, all of which are hereby waived by the Borrower; and (2) in case of any event with respect to the Borrower described in clause (e) of this Article or in the event of an actual or deemed entry of an order for relief with respect to the Borrower under the United States Bankruptcy Code as then in effect, or in the event that the Borrower is adjudicated bankrupt under the Bankruptcy and Insolvency Act (Canada), the principal of the Loan then outstanding, together with accrued interest thereon and all fees, Supplemental Costs, the Make-Whole Amount and other Obligations of the Borrower hereunder, shall automatically become due and payable, without presentment, demand, protest or other notice of any kind, all of which are hereby waived by the Borrower. The Administrative Agent and the Lender shall have, in addition to all other rights and remedies under this Agreement or otherwise, all other rights and remedies provided under applicable laws, which rights shall be cumulative.

ARTICLE VIII

The Administrative Agent

The Lender hereby irrevocably appoints Chase as Administrative Agent and authorizes the Administrative Agent to take such actions on its behalf and to exercise such powers as are delegated to the Administrative Agent by the terms hereof, together with such actions and powers as are reasonably incidental thereto.

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The bank serving as the Administrative Agent and its Affiliates may accept deposits from, lend money to and generally engage in any kind of business with the Borrower or other Affiliate thereof as if it were not the Administrative Agent.

The Administrative Agent shall not have any duties or obligations except those expressly set forth herein. Without limiting the generality of the foregoing, (a) the Administrative Agent shall not be subject to any fiduciary or other implied duties, regardless of whether a Default has occurred and is continuing, (b) the Administrative Agent shall not have any duty to take any discretionary action or exercise any discretionary powers, except discretionary rights and powers expressly contemplated hereby that the Administrative Agent is required to exercise in writing by the Lender, and (c) except as expressly set forth herein, the Administrative Agent shall not have any duty to disclose, and shall not be liable for the failure to disclose, any information relating to the Borrower that is communicated to or obtained by the bank serving as Administrative Agent or any of its Affiliates in any capacity. The Administrative Agent shall not be liable for any action taken or not taken by it with the consent or at the request of the Lender or in the absence of its own gross negligence or willful misconduct. The Administrative Agent shall not be deemed to have knowledge of any Default unless and until written notice thereof is given to the Administrative Agent by the Borrower or the Lender, and the Administrative Agent shall not be responsible for or have any duty to ascertain or inquire into (i) any statement, warranty or representation made in or in connection with this Agreement, (ii) the contents of any certificate, report or other document delivered hereunder or in connection herewith, (iii) the performance or observance of any of the covenants, agreements or other terms or conditions set forth herein, (iv) the validity, enforceability, effectiveness or genuineness of this Agreement or any other agreement, instrument or document, or (v) the satisfaction of any condition set forth in Article IV or elsewhere herein, other than to confirm receipt of items expressly required to be delivered to the Administrative Agent.

The Administrative Agent shall be entitled to rely upon, and shall not incur any liability for relying upon, any notice, request, certificate, consent, statement, instrument, document or other writing believed by it to be genuine and to have been signed or sent by the proper Person. The Administrative Agent also may rely upon any statement made to it orally or by telephone and believed by it to be made by the proper Person, and shall not incur any liability for relying thereon. The Administrative Agent may consult with legal counsel (who may be counsel for the Borrower), independent accountants and other experts selected by it, and shall not be liable for any action taken or not taken by it in accordance with the advice of any such counsel, accountants or experts.

The Administrative Agent may perform any and all its duties and exercise its rights and powers by or through any one or more sub-agents appointed by the Administrative Agent. The Administrative Agent and any such sub-agent may perform any and all its duties and exercise its rights and powers through their respective Related Parties. The exculpatory provisions of the preceding paragraphs shall apply to any such sub-agent and to the Related Parties of the Administrative Agent and any such sub-agent, and shall apply to their respective activities in connection with the syndication of the credit facilities provided for herein as well as activities as Administrative Agent.

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Subject to the appointment and acceptance of a successor Administrative Agent as provided in this paragraph, the Administrative Agent may resign at any time by giving 15 Business Days' prior written notice to the Lender, the Borrower, and Enron. Such resignation shall be effective upon the appointment of a successor Administrative Agent, as provided below. Upon any such notice of resignation, the Lender shall have the right, in consultation with the Borrower, to appoint a successor, which successor shall be a commercial bank or trust company reasonably acceptable to the Borrower and Enron. If no successor shall have been so appointed by the Lender and shall have accepted such appointment within such 15 Business Day period, then the retiring Administrative Agent, with the consent of the Borrower and Enron (which consent may not be unreasonably withheld) may, on behalf of the Lender, appoint a successor Administrative Agent, which agent shall be a bank with an office in New York, New York, or an Affiliate of any such bank, who shall serve as Administrative Agent until such time, if any, as the Lender appoints a successor Administrative Agent, as provided above. Upon the acceptance of its appointment as Administrative Agent hereunder by a successor, such successor shall succeed to and become vested with all the rights, powers, privileges and duties of the retiring agent, and the retiring agent shall be discharged from its duties and obligations hereunder. The annual fees payable by the Borrower to a successor Administrative Agent shall be the same as those payable to its predecessor unless otherwise agreed between the Borrower and such successor. After the Administrative Agent's resignation hereunder, the provisions of this Article and Section 10.03 shall continue in effect for the benefit of such retiring Administrative Agent, its sub-agents and their respective Related Parties in respect of any actions taken or omitted to be taken by any of them while it was acting as Administrative Agent.

The Lender acknowledges that it has, independently and without reliance upon the Administrative Agent and based on such documents and information as it has deemed appropriate, made its own credit analysis and decision to enter into this Agreement. The Lender also acknowledges that it will, independently and without reliance upon the Administrative Agent and based on such documents and information as it shall from time to time deem appropriate, continue to make its own decisions in taking or not taking action under or based upon this Agreement, any related agreement or any document furnished hereunder or thereunder.

ARTICLE IX

Administration; Settlement; Collection

SECTION 9.01 The Operating Account. The Borrower acknowledges that (a) the Operating Account shall be subject to the dominion and control of the Flagstaff Collateral Agent and (b) except as set forth in the Flagstaff Credit Agreement, no amount shall be paid or released from the Operating Account to or for the account of, or withdrawn by or for the account of, the Borrower or any other Person. The Operating Account shall be subject to applicable laws, and applicable regulations of any Governmental Authority, as may now or hereafter be in effect. The Borrower agrees to be bound by the terms and provisions of Article X of the Flagstaff Credit Agreement with respect to the administration and ownership of the Operating Account and with respect to the disposition of funds therein as if it were a party thereto. Except as otherwise provided herein or in the other Operative Documents, the Borrower shall take no action inconsistent with the provisions of Article X of the Flagstaff Credit Agreement.

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SECTION 9.02 Deposit of Funds into the Operating Account. On or prior to the date hereof, the Borrower shall give to Enron and CPS written notice (such notice to be in form and substance satisfactory to the Flagstaff Collateral Agent) irrevocably instructing Enron and CPS that all payments (other than Excluded Payments) due to the Borrower from Enron or CPS, respectively, shall be deposited directly into the Operating Account. The Borrower shall notify the Administrative Agent of any such deposit made pursuant to this Section 9.02.

SECTION 9.03 Investing of Amounts in the Operating Account. The Borrower may give instructions to the Lender (and the Lender shall forward such instructions in the form received to the Flagstaff Collateral Agent as provided for in Section 10.03 of the Flagstaff Credit Agreement) with respect to the investment of amounts on deposit in the Operating Account pursuant to the terms and provision of Section 10.03 of the Flagstaff Credit Agreement. The Borrower agrees to give no instruction to the Lender that would be inconsistent with the terms and provisions of the Flagstaff Credit Agreement. If, but only to the extent, the Lender actually receives payment of any such investment yield, then, pursuant to Sections 10.04(a) or (b) of the Flagstaff Credit Agreement, it agrees that such amounts shall be for the account of the Borrower and will promptly pay such amounts to the Borrower.

SECTION 9.04 Deposit Constitutes Payment. All funds deposited in the Operating Account by the Borrower (or by Enron or CPS on behalf of the Borrower) in consideration of Obligations of the Borrower hereunder or under any other Loan Document, shall constitute payment of such Obligations to the same extent as if any such payment were made directly to the Lender.

SECTION 9.05 Return of Excess Funds. So long as no Default has occurred and is continuing, on each Payment Date after payment in full of all Obligations of the Borrower hereunder due and payable on such date, the balance of any funds in the Flagstaff Account shall be deposited in an account of the Borrower maintained with the Administrative Agent in New York City and designated by the Borrower in writing as the account into which deposits required pursuant to this Section 9.05 are to be made.

ARTICLE X Miscellaneous

SECTION 10.01 Notices. Except in the case of notices and other communications expressly permitted to be given by telephone, all notices and other communications provided for herein shall be in writing (including telecopier communication) and shall be delivered by hand or overnight courier service, mailed by certified or registered mail or sent by telecopy, as follows:

- (a) if to the Borrower, to it at its address at 3500, 400-3rd Avenue S.W., Calgary, Alberta T2P 4H2, Attention: Vice President - Legal, facsimile no. (403) 974-6707; with copies to Enron Corp., 1400 Smith Street, Houston, Texas 77002, Attention: Deputy Treasurer, Corporate Finance, facsimile no. (713) 646-3422;

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(b) if to the Administrative Agent, at The Chase Manhattan Bank, 1 Chase Manhattan Plaza, 8th Floor, New York, New York, 10081, facsimile no. (212) 552-5777. Attention: Lisa Pucciarelli;

(c) if to the Lender, to it at its address at Flagstaff Capital Corporation, 270 Park Avenue, 35th Floor, New York, New York 10017, Attention: Lisa Lee, facsimile no. (212) 270-2676; with copies to The Chase Manhattan Bank, 1 Chase Manhattan Plaza, 8th Floor, New York, New York, 10081, facsimile no. (212) 552-2261 Attention: Muniram Appanna.

Any party hereto may change its address or telecopy number for notices and other communications hereunder by written notice to the other parties hereto. All notices and other communications given to any party hereto in accordance with the provisions of this Agreement shall be effective, if mailed, two Business Days after deposit in the mails; if sent by overnight courier, one Business Day after delivery to the courier company; and if sent by telecopier, when received by the receiving telecopier equipment, respectively.

SECTION 10.02 Waivers; Amendments. (a) No failure or delay by the Administrative Agent or the Lender in exercising any right or power hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of any such right or power, or any abandonment or discontinuance of steps to enforce such a right or power, preclude any other or further exercise thereof or the exercise of any other right or power. The rights and remedies of the Administrative Agent and the Lender hereunder are cumulative and are not exclusive of any rights or remedies that they would otherwise have under applicable law. No amendment or waiver of any provision of this Agreement or consent to any departure by the Borrower therefrom shall in any event be effective unless the same shall be permitted by paragraph (b) of this Section, and then such amendment, waiver or consent shall be effective only in the specific instance and for the specific purpose for which given. Without limiting the generality of the foregoing, the making of the Loan shall not be construed as a waiver of any Default, regardless of whether the Administrative Agent or the Lender may have had notice or knowledge of such Default at the time.

(b) Neither this Agreement nor any provision hereof may be waived, amended or modified except pursuant to an agreement or agreements in writing entered into by the Borrower and the Lender or by the Borrower and the Administrative Agent with the consent of the Lender; provided that no such agreement shall amend, modify or otherwise affect the rights or duties of the Administrative Agent hereunder without the prior written consent of the Administrative Agent.

SECTION 10.03 Expenses; Indemnity; Damage Waiver. (a) The Borrower shall pay (i) all reasonable out-of-pocket expenses incurred by the Administrative Agent and its Affiliates, including the reasonable fees and out-of-pocket expenses of counsel for the Administrative Agent, in connection with the preparation and administration of this Agreement and the other Operative Documents or any amendments, modifications or waivers of the provisions hereof or thereof (whether or not the transactions contemplated hereby or thereby shall be consummated), and (ii) all out-of-pocket expenses incurred by the Administrative Agent

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or the Lender, including the reasonable fees and out-of-pocket expenses of any counsel for the Administrative Agent or the Lender, in connection with (A) the enforcement or protection of its rights in connection with this Agreement, including its rights under this Section 10.03, or in connection with the Loan made hereunder or in connection with any Loan Document, including all such out-of-pocket expenses incurred during any workout, restructuring or negotiations in respect of such Loans, and (B) the negotiation, execution, delivery and performance of the Interest Rate Swaps, including, without limitation, the cost of entering into the Interest Rate Swaps, indemnity obligations and any and all other obligations of the Lender in connection therewith.

(b) The Borrower shall, to the extent permitted by law and subject to the last sentence of this section 10.03(b), indemnify the Administrative Agent and the Lender, and each Related Party of any of the foregoing Persons (each such Person being called an "Indemnitee") against, and hold each Indemnitee harmless from, any and all losses, claims, damages, liabilities and related expenses, including the reasonable fees and out-of-pocket expenses of any counsel for any Indemnitee (excluding Taxes which are dealt with in Section 2.08), incurred by or asserted against any Indemnitee (other than by another Indemnitee) arising out of, in connection with, or as a result of any investigation, litigation, or proceeding, whether or not such Indemnitee is a party thereto, arising out of, related to or in connection with (i) the execution or delivery of this Agreement, any other Loan Document, or the Operative Documents, the performance by the parties hereto of their respective obligations hereunder or the consummation of the Transactions, or (ii) any Loan or the use of the proceeds therefrom; provided that such indemnity shall not, as to any Indemnitee, be available to the extent that such losses, claims, damages, liabilities or related expenses resulted from the gross negligence, willful misconduct, bad faith of, or breach of contract by such Indemnitee. NOTWITHSTANDING ANYTHING HEREIN TO THE CONTRARY, EXCEPT AS SET FORTH IN THE NEXT SUCCEEDING SENTENCE, THE BORROWER SHALL NOT BE LIABLE FOR, AND SHALL NOT BE OBLIGATED TO INDEMNIFY ANY INDEMNITEE FOR, LOSSES CONSTITUTING TREBLE, EXEMPLARY, OR PUNITIVE DAMAGES. IF (A) AN INDEMNITEE HAS BECOME LIABLE TO A THIRD PARTY (THAT IS NOT ANOTHER INDEMNITEE) FOR LOSSES CONSTITUTING DAMAGES SPECIFIED IN THE PRECEDING SENTENCE, AND (B) SUCH INDEMNITEE WOULD BE ENTITLED TO INDEMNIFICATION UNDER THIS AGREEMENT BUT FOR THE LIMITATION SET FORTH IN THE PRECEDING SENTENCE, THEN SUCH INDEMNITEE SHALL NONETHELESS BE ENTITLED TO INDEMNIFICATION FOR SUCH LOSSES INCURRED TO SUCH THIRD PARTY.

(c) To the extent that the Borrower fails to pay any amount required to be paid by it to the Administrative Agent or under paragraph (a) or (b) of this Section, the Lender severally agrees to pay to the Administrative Agent of such unpaid amount; provided that the unreimbursed expense or indemnified loss, claim, damage, liability or related expense, as the case may be, was incurred by or asserted against the Administrative Agent in its capacity as such.

(d) Except as set forth in the next succeeding sentence, and to the extent permitted by applicable law, the Borrower shall not assert, and hereby waives, any claim against any Indemnitee, on any theory of liability, for special, indirect, consequential or punitive damages (as opposed to direct or actual damages) arising out of, in connection with, or as a result of, any breach by such Indemnitee of this Agreement, any Operative Document, the Transactions

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or the use of the proceeds thereof. If the Borrower becomes liable to a third party for amounts constituting special, indirect, consequential or punitive damages as a result of a breach of an obligation hereunder by an Indemnitee, the Borrower shall be entitled to a claim and to recover (and does not waive its rights to claim and recover) such amounts from such Indemnitee to the extent such Indemnitee would be liable to the Borrower for such amounts but for the limitation in the preceding sentence.

(e) All amounts due under this Section shall be payable promptly after written demand therefore.

(f) If, for the purposes of obtaining judgment in any court in any jurisdiction with respect to the Note, this Agreement or any other Loan Document, it becomes necessary to convert into the currency of such jurisdiction (the "Judgment Currency") any amount due under the Note, this Agreement or under any other Loan Document in any currency other than the Judgment Currency (the "Currency Due"), then conversion will be made at the rate of exchange prevailing on the Business Day before the day on which judgment is given. For this purpose, "rate of exchange" means the rate at which the Lender is able, on the relevant date, to purchase the Currency Due with the Judgment Currency at the head office of The Chase Manhattan Bank of Canada in Toronto, Ontario. In the event that there is a change in the rate of exchange prevailing between the Business Day before the day on which the judgment is given and the date of receipt by the Lender of the amount due, the Borrower will, on the date of receipt by the Lender, pay such additional amounts, if any, or be entitled to receive reimbursement of such amount, if any, as may be necessary to ensure that the amount received by the Lender on such date is the amount in the Judgment Currency which when converted at the rate of exchange prevailing on the date of receipt by the Lender is the amount then due under the Note, this Agreement or such other Loan Document in the Currency Due. If the amount of the Currency Due which the Lender is so able to purchase is less than the amount of the Currency Due originally due to it, the Borrower will indemnify and save the Lender harmless from and against all loss or damage arising as a result of such deficiency. This indemnity will constitute an obligation separate and independent from the other obligations contained in this Agreement and the other Loan Documents, will give rise to a separate and independent cause of action, will apply irrespective of any indulgence granted by the Lender from time to time and will continue in full force and effect notwithstanding any judgment or order for a liquidated sum in respect of an amount due under the Note, this Agreement or any other Loan Document or under any judgment or order.

SECTION 10.04 Successors and Assigns. Neither the Lender nor the Borrower may assign, participate or subparticipate any of its rights or obligations hereunder without the prior written consent of the other such Person and the Administrative Agent. Notwithstanding the foregoing, (a) the Borrower hereby consents to the granting and assignment by the Lender of a Lien in all of the Lender's right, title, and interest in this Agreement and the other Loan Documents pursuant to the Flagstaff Credit Agreement and to any additional assignments or transfers resulting from the exercise of remedies as provided in the Flagstaff Credit Agreement or any other Loan Document (as defined in the Flagstaff Credit Agreement), (b) the Borrower hereby consents to the assignment by the Lender of all of the Lender's right,

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title, and interest in the Make-Whole Amount resulting from the exercise of its rights under the Put Option Agreement, and (c) any consent of the Borrower otherwise required under this paragraph shall not be required if an Event of Default has occurred and is continuing. ANY ATTEMPTED ASSIGNMENT OR GRANT OF A PARTICIPATION OR SUBPARTICIPATION IN VIOLATION OF THIS SECTION 10.04 SHALL BE VOID. TO THE EXTENT THE LENDER ASSIGNS OR PARTICIPATES ANY PORTION OF ITS ADVANCE IN VIOLATION OF THIS SECTION 10.04, THE LENDER AND THE PROPOSED PURCHASER OR PARTICIPANT, AS THE CASE MAY BE, SHALL UPON NOTICE BY THE ADMINISTRATIVE AGENT TAKE ALL STEPS NECESSARY OR ADVISABLE TO AVOID THE BORROWER BEING OR BECOMING AN "INVESTMENT COMPANY" WITHIN THE MEANING OF THE INVESTMENT COMPANY ACT OF 1940, INCLUDING BUT NOT LIMITED TO, ALL STEPS NECESSARY TO TRANSFER SUCH ASSIGNED OR PARTICIPATED INTEREST THEREUNDER TO THE LENDER SELECTED BY THE BORROWER AND THE ADMINISTRATIVE AGENT. NO PURCHASER OR PARTICIPANT SHALL (UNLESS SUCH ASSIGNMENT OR PARTICIPATION HAS BEEN CONSENTED TO IN WRITING BY THE BORROWER) BE ENTITLED TO RECEIVE ANY GREATER BENEFIT PURSUANT TO SECTIONS 2.07, 2.08 AND 10.03 THAN THE LENDER WOULD HAVE BEEN ENTITLED TO RECEIVE WITH RESPECT TO THE RIGHTS TRANSFERRED.

SECTION 10.05 Survival; Continued Effectiveness.

(a) All covenants, agreements, representations and warranties made by the Borrower herein and in the certificates or other instruments delivered in connection with or pursuant to this Agreement shall be considered to have been relied upon by the other parties hereto and shall survive the execution and delivery of this Agreement and the making of the Loan, regardless of any investigation made by any such other party or on its behalf and notwithstanding that the Administrative Agent or the Lender may have had notice or knowledge of any Default or incorrect representation or warranty at the time any credit is extended hereunder, and shall continue in full force and effect as long as the principal of or any accrued interest on the Loan or any fee or any other amount payable under this Agreement is outstanding and unpaid and so long as the Commitment has not expired or terminated. The provisions of Sections 2.07, 2.08 and 10.03 and Article VIII shall survive and remain in full force and effect regardless of the consummation of the transactions contemplated hereby, the repayment of the Loan, the expiration of the Commitment or the termination of this Agreement or any provision hereof.

(b) The Borrower's obligations under this Agreement shall continue to be effective or be reinstated, as the case may be, if at any time any payment by the Borrower in satisfaction of any of the obligations of the Borrower under this Agreement is rescinded or must otherwise be returned upon the insolvency, bankruptcy or reorganization of the Borrower, or otherwise, all as though such payment had not been made.

SECTION 10.06 Counterparts; Integration; Effectiveness. This Agreement may be executed in counterparts (and by different parties hereto on different counterparts), each of which shall constitute an original, but all of which when taken together shall constitute a single contract. This Agreement, the Loan Documents and any separate letter agreements with respect to fees payable to the Administrative Agent constitute the entire contract among the parties relating to the subject matter hereof and supersede any and all previous agreements and

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understandings, oral or written, relating to the subject matter hereof. Except as provided in Section 4.01, this Agreement shall become effective when it shall have been executed by the Administrative Agent and when the Administrative Agent shall have received counterparts hereof which, when taken together, bear the signatures of each of the other parties hereto, and thereafter shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns. Delivery of an executed counterpart of a signature page of this Agreement by telecopy shall be effective as delivery of a manually executed counterpart of this Agreement.

SECTION 10.07 Severability. Any provision of this Agreement held to be invalid, illegal or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such invalidity, illegality or unenforceability without affecting the validity, legality and enforceability of the remaining provisions hereof; and the invalidity of a particular provision in a particular jurisdiction shall not invalidate such provision in any other jurisdiction.

SECTION 10.08 Right of Setoff. Subject to Section 4.2(b) of the Warrant Agreement and Section 2.4 of the Subscription Payment Assumption Agreement, (a) if an Event of Default shall have occurred and be continuing, the Lender and each of its Affiliates is hereby authorized at any time and from time to time, to the fullest extent permitted by law, to set off and apply any and all deposits (general or special, time or demand, provisional or final) at any time held and other obligations at any time owing by the Lender or Affiliate to or for the credit or the account of the Borrower against any of and all the obligations of the Borrower now or hereafter existing under this Agreement held by the Lender, irrespective of whether or not the Lender shall have made any demand under this Agreement and although such obligations may be unmaturing and (b) the rights of the Lender under this Section are in addition to other rights and remedies (including other rights of setoff) which the Lender may have.

SECTION 10.09 Governing Law; Consent to Service of Process. (a) This Agreement shall be construed in accordance with and governed by the law of the State of New York.

(b) The Borrower hereby irrevocably and unconditionally submits, to the nonexclusive jurisdiction of the Supreme Court of the State of New York sitting in the Borough of Manhattan and to the extent possible, the Commercial Division, Civil Branch thereof and of the United States District Court of the Southern District of New York sitting in the Borough of Manhattan, in any action or proceeding arising out of or relating to this Agreement, or for recognition or enforcement of any judgment therefrom, and each of the parties hereto hereby irrevocably and unconditionally agrees that all claims in respect of any such action or proceeding may be heard and determined in such New York State court or, to the extent permitted by law, in such Federal court. Each of the parties hereto agrees that a final judgment in any such action or proceeding may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law. Nothing in this Agreement shall affect any right that the Administrative Agent, the Flagstaff Collateral Agent or the Lender may otherwise have to bring any action or proceeding relating to this Agreement against the Borrower or its properties in the courts of any jurisdiction.

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(c) The Borrower hereby irrevocably and unconditionally waives, to the fullest extent it may legally and effectively do so, any objection which it may now or hereafter have to the laying of venue of any suit, action or proceeding arising out of or relating to this Agreement in any court referred to in paragraph (b) of this Section. Each of the parties hereto hereby irrevocably waives, to the fullest extent permitted by law, the defense of an inconvenient forum to the maintenance of such action or proceeding in any such court.

(d) The Borrower hereby irrevocably appoints National Registered Agents, Inc. with offices on the date hereof at 440 9th Avenue, 5th Floor, New York, NY 10001 (or any successor appointed by the Borrower, provided that such successor shall be located in New York City and engaged in the business of acting as a Process Agent and shall be a company of national recognition, and provided further that notice of such successor Process Agent shall be promptly given to the Administrative Agent by the Borrower, the "Process Agent") as its designee, appointee and agent to receive, accept and acknowledge on its behalf and its property service of copies of the summons and complaint and any other process that may be served in any action or proceeding under paragraph (b) of this Section. Such service may be made by delivering a copy of such process to the Borrower in care of the Process Agent at the Process Agent's address, and the Borrower hereby authorizes and directs the Process Agent to accept such service on its behalf.

(e) Each party to this Agreement irrevocably consents to service of process in the manner provided for notices in Section 10.01. Nothing in this Agreement will affect the right of any party to this Agreement to serve process in any other manner permitted by law.

SECTION 10.10 Headings. Article and Section headings and the Table of Contents used herein are for convenience of reference only, are not part of this Agreement and shall not affect the construction of, or be taken into consideration in interpreting, this Agreement.

SECTION 10.11 Confidentiality. The Lender agrees that it will use reasonable efforts not to disclose without the prior consent of the Borrower (other than to the Lender's Affiliates in the ordinary course of business in connection with any Operative Document, the administration thereof or any transaction contemplated hereby, employees, auditors or counsel or to a Flagstaff Lender if the Lender or the Administrative Agent in its sole discretion determines that any such party should have access to such information) any information with respect to the Borrower or its Subsidiaries which is furnished pursuant to this Agreement or any other Operative Document and which is designated by the Borrower to the Lender in writing as confidential, provided that the Lender may disclose any such information (a) as has become generally available to the public, (b) as may be required or appropriate in any report, statement or testimony submitted to any municipal, state or federal regulatory body having or claiming to have jurisdiction over the Lender or the Administrative Agent or to the Board or the Federal Deposit Insurance Corporation or similar organizations (whether in the United States or elsewhere), (c) as may be required or appropriate in response to any summons or subpoena or in connection with any litigation, (d) in order to comply with any law, order, regulation or ruling applicable to the Lender, and (e) to the prospective transferee in connection with any contemplated transfer (permitted pursuant to the terms hereof) of the Note or any

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interest therein by the Lender, provided, that such prospective transferee executes an agreement with the Borrower containing provisions substantially identical to those contained in this Section.

SECTION 10.12 Interest Rate Limitation. Notwithstanding anything herein to the contrary, if at any time the interest rate applicable to any Loan, together with all fees, charges and other amounts which are treated as interest on such Loan under applicable law (collectively the "Charges"), shall exceed the maximum lawful rate (the "Maximum Rate") which may be contracted for, charged, taken, received or reserved by the Lender holding such Loan in accordance with applicable law, the rate of interest payable in respect of such Loan hereunder, together with all Charges payable in respect thereof, shall be limited to the Maximum Rate and, to the extent lawful, the interest and Charges that would have been payable in respect of such Loan but were not payable as a result of the operation of this Section shall be cumulated and the interest and Charges payable to the Lender in respect of other Loans or periods shall be increased (but not above the Maximum Rate therefor) until such cumulated amount, together with interest thereon at the Federal Funds Effective Rate to the date of repayment, shall have been received by the Lender. Any excess shall be cancelled automatically and, if theretofore paid, shall be at the option of the Administrative Agent or the Lender, as the case may be, be applied on the principal amount of the obligations owed to the Administrative Agent or the Lender, as the case may be, by the Borrower or refunded by the Administrative Agent or the Lender, as the case may be, to the Borrower.

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EXHIBIT A

FORM OF PROMISSORY NOTE

\$1,414,504,347

June 22, 2001

HANSEN INVESTMENTS CO., a Nova Scotia company (the "Company"), for value received, promises and agrees to pay to FLAGSTAFF CAPITAL CORPORATION, a Delaware corporation (the "Lender"), or order, at the office of THE CHASE MANHATTAN BANK (the "Administrative Agent"), at 1 Chase Manhattan Plaza, 8th Floor, New York, New York 10081, the principal sum of ONE BILLION, FOUR HUNDRED FOURTEEN MILLION, FIVE HUNDRED FOUR THOUSAND, THREE HUNDRED FORTY SEVEN AND NO/100 DOLLARS, in lawful money of the United States of America and in immediately available funds, on the dates and in the principal amounts provided in the Hansen Credit Agreement referred to below, and to pay interest on the unpaid principal amount as provided in the Hansen Credit Agreement for such Advance made by the Lender to the Company under the Hansen Credit Agreement, at such office, in like money and funds, at the rates per annum and on the dates provided in the Hansen Credit Agreement.

In addition to and cumulative of any payments required to be made against this Note pursuant to the Hansen Credit Agreement, this Note, including all principal and accrued interest then unpaid, shall be due and payable on the Maturity Date and the Company shall repay to the Lender the principal amount of the Advance that remains outstanding on such date. All payments on this Note shall be applied in the manner set forth in the Hansen Credit Agreement.

This Note is the Note referred to in the Credit Agreement dated as of June 22, 2001, among the Company, as borrower, the Lender, and The Chase Manhattan Bank, as administrative agent (such Credit Agreement, together with all amendments or supplements thereto, being the "Hansen Credit Agreement"). This Note evidences the Advance made by the Lender thereunder and shall be governed by the Hansen Credit Agreement. Capitalized terms used but not defined in this Note and which are defined in the Hansen Credit Agreement shall have the respective meanings herein as are assigned in the Hansen Credit Agreement.

Except only for any notices which are specifically required by the Hansen Credit Agreement or the other Operative Documents, the Company and any and all co-makers, endorsers, guarantors and sureties severally waive notice (including but not limited to notice of intent to accelerate and notice of acceleration, notice of protest and notice of dishonor), demand, presentment for payment, protest, diligence in collecting and the filing of suit for the purpose of fixing liability, and consent that the time of payment hereof may be extended and re-extended from time to time without notice to any of them. Each such Person agrees that his, her or its liability on or with respect to this Note shall not be affected by any release of or change in any guaranty or security at any time existing or by any failure to perfect or maintain perfection of any lien against or security interest in any such security or the partial or complete enforceability of any guaranty or

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other surety obligation, in each case in whole or in part, with or without notice and before or after maturity.

The Hansen Credit Agreement provides for the acceleration of the maturity of this Note upon the occurrence of certain events and for prepayment of the Advance upon the terms and conditions specified therein. Reference is made to the Hansen Credit Agreement for all other pertinent purposes.

This Note is issued pursuant to and is entitled to the benefits of the Hansen Credit Agreement.

THIS NOTE SHALL BE CONSTRUED IN ACCORDANCE WITH AND BE GOVERNED BY THE LAWS OF THE STATE OF NEW YORK.

[Signature Page Follows]

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REQUESTED BY JPMC

[Signature Page to Promissory Note]

HANSEN INVESTMENTS CO.

By: _____
Name:
Title:

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JPM-14-00519

FORM OF OPINION OF BLAKE, CASSELS & GRAYDON LLP,
COUNSEL FOR THE BORROWER

Each of the Addresses Listed
in the Attached Schedule I

Ladies and Gentlemen:

We act as Canadian counsel to Hansen Investments Co. ("Finco"), a Nova Scotia company, and Newman Investments Co. ("Subco"), a Nova Scotia company, in connection with the transactions contemplated by the Credit Agreement (the "Finco Credit Agreement") of even date herewith among Finco, as borrower, Flagstaff Capital Corporation ("Flagstaff"), as lender, and The Chase Manhattan Bank, as administrative agent. This opinion is being rendered pursuant to Section 4.01(b)(vi) of the Finco Credit Agreement. Capitalized terms used herein and not otherwise defined herein shall have the same meanings herein as ascribed thereto in the Finco Credit Agreement, including those defined terms incorporated therein by reference to other documents.

In rendering the opinions set forth below, we have reviewed the documents set forth on Schedule II attached hereto and such other records, certificates and documents as we have deemed relevant for the purposes of such opinions. The term "Transaction Documents" shall mean: (a) the Finco Credit Agreement and the Note delivered pursuant thereto; (b) the Subscription Agreement; (c) the Subscription Payment Assumption Agreement and (d) the Warrant Agreement. We have also reviewed the documents set forth in Schedule III attached hereto (the "U.S. Documents").

As to any facts material to our opinion, we have made no independent investigation of such facts and have relied, to the extent that we deem such reliance proper, upon certificates of public officials and officers or other representatives of Finco and Subco and on the representations and warranties set forth in the Transaction Documents.

In rendering the opinions expressed below, we have assumed: (a) the legal capacity of all natural persons, the genuineness of all signatures, the authenticity of all documents submitted to us as originals, and the conformity to authentic original documents of all documents submitted to us as copies; (b) that the Transaction Documents and the U.S. Documents have been duly authorized, executed and delivered by each party thereto (other than Finco and Subco) and constitute legal, valid and binding obligations of such parties (other than Finco and Subco) enforceable against such parties in accordance with their terms and that the laws of any jurisdiction other than Alberta Laws (as defined below) do not affect the terms of the Transaction Documents; (c) there is nothing in the documents referred to in any of the Transaction Documents which would affect the opinions expressed herein; (d) insofar as any obligation under any of the Transaction

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Documents is to be performed in any jurisdiction other than in the Province of Alberta, its performance will not be illegal or unenforceable under the laws of that jurisdiction; (e) the Finco Credit Agreement and the Note constitute or will on execution constitute legal, valid and binding obligations of the parties under the laws of the State of New York enforceable in competent courts of that jurisdiction; (f) the formalities for execution by each party required by the law of the place of execution of each of the Transaction Documents have been or will be complied with; and (g) physical delivery of each of the Transaction Documents on behalf of each of Finco and Subco has occurred free from escrow or any similar arrangement or restriction (other than any such escrow or similar arrangement that is set forth in the Transaction Documents).

The opinions expressed below in paragraphs 1 to 6 are based solely upon and in reliance upon the opinion of McInnes Cooper of even date hereto (the "Nova Scotia Opinion"), a copy of which has been delivered to you. We have examined the Nova Scotia Opinion and such opinion is in form and scope satisfactory to us and we believe we and you are justified in relying thereon. However, we have made no independent investigation in respect of such opinion and have assumed its accuracy and completeness. To the extent that the Nova Scotia Opinion is based upon an assumption or is made subject to any limitation, qualification or exception, our opinion given solely in reliance thereon is based upon such assumptions and is subject to such limitations, qualifications or exceptions. We do not, however, assume any liability for any opinion expressed in the Nova Scotia Opinion.

We are members of the Law Society of Alberta and are qualified to practice law in the Province of Alberta. Except to the extent that this opinion is rendered solely in reliance on the Nova Scotia Opinion, this opinion is rendered solely with respect to the laws of the Province of Alberta and the federal laws of Canada applicable therein.

Based upon and subject to the foregoing and subject to the qualifications hereinafter expressed, we are of the following opinion:

1. Finco is an unlimited company duly formed and validly subsisting and in good standing as to the payment of annual fees and filing of annual returns under the laws of the Province of Nova Scotia with the corporate power to execute and deliver the Transaction Documents executed by it and perform its obligations thereunder.
2. Subco is an unlimited company duly formed and validly subsisting and in good standing as to the payment of annual fees and filing of annual returns under the laws of the Province of Nova Scotia with corporate power to execute and deliver the Transaction Documents executed by it and perform its obligations thereunder.
3. The execution and delivery by each of Finco and Subco of each Transaction Document to which it is a party and the performance by it of its obligations thereunder have been duly authorized by all necessary corporate action of each of Finco and Subco, as the case may be.

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4. The execution and delivery by each of Finco and Subco of each Transaction Document to which it is a party and the performance by it of its obligations thereunder will not conflict with or result in the breach of any of the terms, conditions or provisions of their respective memorandum of association and articles of association.
5. The execution and delivery by each of Finco and Subco of each Transaction Document to which it is a party and the performance by it of its obligations thereunder do not result in a violation of "Applicable Laws" (as such term is defined in the Nova Scotia Opinion).
6. No Governmental Approval (as such term is defined in the Nova Scotia Opinion) is or will be required to authorize or is or will be required (a) in connection with the execution and delivery of any of the Transaction Documents by Finco or Subco or the performance of their obligations thereunder or (b) to ensure the validity, effectiveness or enforceability of the Transaction Documents.
7. The execution and delivery by each of Finco and Subco of each Transaction Document to which it is a party and the performance by it of its obligations thereunder do not result in a violation of Alberta Laws (as defined below).

"Alberta Laws" means those laws, rules and regulations of the Provinces of Alberta and the federal laws, rules and regulations of Canada applicable therein and the rules and regulations adopted thereunder which, in our experience, are normally applicable to the transactions of the type contemplated by the Transaction Documents. Furthermore, the term "Alberta Laws" does not include, and we express no opinion in regard to: (a) any Alberta or federal law, rule or regulation relating to: (i) pollution or protection over the environment; (ii) zoning, land use, building or construction; (iii) occupational, safety and health or other similar matter; or (iv) labour, employment rights and benefits; (b) the regulation of utilities; (c) anti-trust laws; and (d) tax laws, rules or regulations.

8. No Governmental Approval (as defined below) is or will be required to authorize or is required (a) in connection with the execution and delivery of any of the Transaction Documents by Finco or Subco or the performance of their obligations thereunder or (b) to ensure the validity, effectiveness or enforceability of any of the Transaction Documents.

"Governmental Approval" means any consent, approval, license, authorization or validation of, or filing, recording or registration with any Governmental Authority pursuant to any Alberta Laws (as defined in paragraph 7 above).

9. There is no registration or transfer tax, stamp duty or similar levy payable in respect of the execution, delivery, validity, performance or enforcement of any of the Transaction Documents under Alberta Laws.

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10. Each of Finco and Subco is subject to civil and commercial law with respect to its obligations under the Transaction Documents to which it is a party, and the execution, delivery and performance by any such entity of any such Transaction Document constitutes private and commercial acts rather than public or governmental acts. None of Finco or Subco, nor any of their respective properties or assets, has any sovereign immunity or any other immunity from the jurisdiction of any court or from any legal process (whether through service or notice, attachment prior to judgment, attachment in and of judgment, execution or otherwise).
11. Each of the Subscription Agreement, the Subscription Payment Assumption Agreement and the Warrant Agreement to which Finco or Subco is a party constitutes a legal, valid and binding obligation of Finco or Subco, as applicable, enforceable against each of Finco and Subco in accordance with its terms.
12. The choice of New York law as the governing law of the Finco Credit Agreement and the Note delivered pursuant thereto will be upheld as a valid choice of law by Alberta courts provided the choice of law is bona fide in the sense that it was not made with a view to avoiding the law of any other jurisdiction. In an action brought before a court of competent jurisdiction in Alberta to enforce and interpret the Finco Credit Agreement and the Note delivered pursuant thereto, the laws of New York would, to the extent specifically pleaded and proved as a fact by expert evidence, be recognized and applied by such court to all issues that, under the conflict of laws rules of Alberta, are to be determined in accordance with the proper or governing law of a contract. Notwithstanding any such valid choice of law, the courts of Alberta will not apply those laws of New York:
- (a) which it characterizes as being of a governmental revenue or penal law nature;
 - (b) relating to matters of a procedural nature; or
 - (c) the application of which would be inconsistent with "public policy", as such term is applied by the courts in Alberta.
- In addition, a court of competent jurisdiction in Alberta may reserve to itself an inherent power to decline to hear any such action if it is contrary to public policy for it to do so, or if it is not the proper forum to hear such action, or if concurrent proceedings in respect of such matter are being brought elsewhere.
13. It is not necessary under Alberta Law (i) in order to enable either of Flagstaff or the Administrative Agent to enforce its rights under any Transaction Document or (ii) by reason only of the execution, delivery or performance by any of Flagstaff or the Administrative Agent of any Transaction Document, that such Person for such purposes only should be licensed, qualified or entitled to carry on business in Alberta, provided that Flagstaff or the Administrative Agent, as applicable, has no other contact with Alberta.

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14. A judgment *in personam* against any of Finco or Subco by a court of the State of New York may be enforced in an Alberta court by an action or counterclaim for the amount due under such judgment provided that:
- (a) such court had jurisdiction over Finco or Subco, as applicable, as recognized by the courts of Alberta;
 - (b) such judgment is for a sum certain and is not impeachable as void or voidable under the internal laws of New York;
 - (c) such judgment was not obtained by fraud or any manner contrary to natural justice and the enforcement thereof would not be inconsistent with public policy, as that term is understood under Alberta law;
 - (d) the enforcement of such judgment in Alberta does not constitute, directly or indirectly against Finco or Subco, as applicable, the enforcement of any law characterized by an Alberta court as being of a governmental revenue, penal, expropriatory or public law nature;
 - (e) no new admissible evidence relevant to the action which is the subject matter of such judgment is discovered or arises prior to the rendering of such judgment by the Alberta court;
 - (f) the application to enforce such judgment is made against Finco or Subco, as applicable, in Alberta within the applicable limitation period;
 - (g) the action giving rise to such judgment is recognizable under Alberta law;
 - (h) no order affecting the judgment has been made by the Attorney General of Canada under the *Foreign Extra-Territorial Measures Act* (Canada) based on his opinion as to the adverse effect of the judgment to significant Canadian interests in relation to international trade and commerce involving a Canadian business or the infringement of Canadian sovereignty;
 - (i) no order has been made by the Competition Tribunal under the Competition Act (Canada) relating to the enforcement of the judgment as a result of its finding of an adverse effect, restraint or injury to competition in Canada or the domestic or foreign trade and commerce of Canada;
 - (j) Finco or Subco, as applicable, was duly served with process in accordance with the laws of New York;

Houston 4****8

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- (k) the judgment is not in respect of a cause of action that, for reasons of public policy or for some other similar reason, would not have been entertained by the courts of Alberta;
 - (l) the judgment has not been satisfied and is a subsisting judgment; and
 - (m) such judgment is final and conclusive.
15. The choice of New York law as the governing law of the U.S. Documents will be upheld as a valid choice of law by Alberta courts provided the choice of law is bona fide in the sense that it was not made with a view to avoiding the law of any other jurisdiction. In an action brought before a court of competent jurisdiction in Alberta to enforce and interpret the U.S. Documents, the laws of New York would, to the extent specifically pleaded and proved as a fact by expert evidence, be recognized and applied by such court to all issues that, under the conflict of laws rules of Alberta, are to be determined in accordance with the proper or governing law of a contract. Notwithstanding any such valid choice of law, the courts of Alberta will not apply those laws of New York:
- (i) which it characterizes as being of a governmental revenue or penal law nature;
 - (ii) relating to matters of a procedural nature; or
 - (iii) the application of which would be inconsistent with "public policy", as such term is applied by the courts in Alberta; notwithstanding the foregoing, we are of the opinion that the courts of Alberta would not seek to apply "public policy", as such term is applied by the courts in Alberta, to invalidate any of the rights and remedies of the parties to the U.S. Documents.

In addition, a court of competent jurisdiction in Alberta may reserve to itself an inherent power to decline to hear any such action if it is contrary to public policy for it to do so, or if it is not the proper forum to hear such action, or if concurrent proceedings in respect of such matter are being brought elsewhere.

The opinion set forth in this paragraph 15 is based on the assumption that (a) none of the U.S. Documents relate to any Enron Corp. business of Enron Corp. carried on in Canada, if any, or to any establishment of Enron Corp., if any, in Canada; and (b) the U.S. Documents will be performed in the United States of America.

The opinions expressed herein are subject to the following qualifications:

- (a) the enforceability of the Subscription Agreement, the Subscription Payment Assumption Agreement and the Warrant Agreement (collectively, the "Documents") and the rights and remedies set out therein or any judgment arising out of or in connection therewith may be limited by any applicable bankruptcy, reorganization, winding-up, insolvency, arrangement, preference, moratorium or other laws and judicial decisions of general application affecting the enforcement of creditors' rights from time to time in effect, and is subject to general principles

Houston 4****3

of equity, whether considered in a proceeding in equity or at law (including the equitable or statutory powers of the courts to stay proceedings before them, to stay the execution of judgments and to grant relief against forfeiture), and in particular no opinion is expressed as to the availability of the remedy of specific performance, injunctive relief or other equitable or discretionary remedies in any particular instance;

- (b) provisions in the Documents providing for recovery of fees and expenses may be restricted by a court to a reasonable amount and counsel fees are subject to taxation;
- (c) the *Currency Act* (Canada) precludes a court in Canada from giving a judgment in any currency other than Canadian currency and such judgment may be based on a rate of exchange in existence on a day other than the day of payment of such judgment;
- (d) the *Interest Act* (Canada) and the *Judgment Interest Act* (Alberta) may limit the rate of interest which a judgment debt bears, and any waiver of the *Interest Act* (Canada) and the *Judgment Interest Act* (Alberta) may not be enforceable;
- (e) provisions in the Documents which purport to exclude unwritten variations, amendments, waivers or consents or exclude rights to receive notices may not be enforceable;
- (f) failure to exercise a right of action under any of the Documents within applicable limitation periods may act as a bar to the enforcement of such rights at any time thereafter;
- (g) the exercise of rights to accelerate the performance of obligations or otherwise seek the enforcement of the Documents based upon the occurrence of a default deemed immaterial may not be enforceable; and
- (h) provisions in the Documents which purport to effect waivers of the benefits or protection of doctrines, principles or statutory provisions viewed by a court as based on public policy may not be enforceable.

We disclaim any responsibility to update or supplement this opinion with respect to any changes in law or future events affecting the transactions contemplated by the Transaction Documents and the U.S. Documents. This opinion may be relied upon by you only in conjunction with the Transaction Documents and the U.S. Documents and may not be used or relied upon by you for any other purpose or by any other person for any purpose whatsoever, without in each instance our prior written consent.

Yours truly,

Houston *****

JPM-14-00526

SCHEDULE I

to

OPINION OF BLAKE, CASSELS & GRAYDON LLP

ADDRESSEES

Flagstaff Capital Corporation

The Chase Manhattan Bank, as Administrative Agent under the Finco Credit Agreement

The Chase Manhattan Bank, as Administrative Agent (as defined in the Credit and Security Agreement dated as of the date here among Flagstaff Capital Corporation, the Lenders named therein, and The Chase Manhattan Bank, as administrative agent and collateral agent (the "Flagstaff Credit Agreement"))

The Chase Manhattan Bank, as Collateral Agent (as defined in the Flagstaff Credit Agreement)

Each Lender now or hereafter party to the Flagstaff Credit Agreement

The Swap Counterparty (as defined in the Flagstaff Credit Agreement)

Houston 4****3

JPM-14-00527

FOIA CONFIDENTIAL TREATMENT
REQUESTED BY JPMC

SCHEDULE II

to

OPINION OF BLAKE, CASSELS & GRAYDON LLP

1. the Finco Credit Agreement;
2. the Subscription Agreement;
3. the Subscription Payment Assumption Agreement;
5. the Warrant Agreement; and
6. the other Operative Documents.

Houston 4****3

JPM-14-00528

SCHEDULE III

to

OPINION OF BLAKE, CASSELS & GRAYDON LLP

1. the Enron Agreement;
2. the Put Option Agreement;
3. the Total Swap Confirmation Agreement.

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FOIA CONFIDENTIAL TREATMENT
REQUESTED BY JPMC

JPM-14-00529

FORM OF OPINION OF McINNES COOPER,
COUNSEL TO THE BORROWER

[to be on letterhead of McInnes Cooper]

June 22, 2001

Blake, Cassels & Graydon LLP
Suite 3500
East Tower, Bankers Hall
855 2nd Street Southwest
Calgary, Alberta, Canada
T2P 4J8

Each of the addressees
listed in Schedule I hereto

Ladies and Gentlemen:

Re: Compagnie Papiers Stadacona, Hansen Investments Co.
and Newman Investments Co.

We act as Nova Scotia counsel to Compagnie Papiers Stadacona, a Nova Scotia unlimited company ("CPS"), Hansen Investments Co. ("Finco"), a Nova Scotia unlimited company, and Newman Investments Co. ("Subco"), a Nova Scotia unlimited company, in connection with the transactions contemplated by the Credit Agreement (the "Finco Credit Agreement") of even date herewith among Finco, as borrower, Flagstaff Capital Corporation ("Flagstaff"), as lender, and The Chase Manhattan Bank, as administrative agent. This opinion is being rendered pursuant to Section 4.01(b)(vii) of the Finco Credit Agreement.

In rendering the opinions set forth below, we have reviewed the following documents:

- (a) the Finco Credit Agreement and Note delivered pursuant thereto;
- (b) the Subscription Agreement (as described in the Finco Credit Agreement);
- (c) the Subscription Payment Assumption Agreement (as described in the Finco Credit Agreement);

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- (d) the Warrant Agreement (as described in the Finco Credit Agreement);
 - (e) the CPS Intercompany Note (as described in the Finco Credit Agreement);
- (collectively, items (a) - (e) are hereinafter referred to as the "Transaction Documents"),
- (f) the memorandum of association and articles of association of each of CPS, Finco and Subco;
 - (g) special resolutions of the shareholder of each of Finco and Subco approving amendments to the respective articles of association;
 - (h) directors' resolutions of each of CPS, Finco and Subco authorizing the entering into of the Transaction Documents to which each is a party; and
 - (i) such other records, certificates and documents as we have deemed relevant for the purposes of such opinions.

For purposes of this opinion we have assumed that:

- A. all signatures on all documents and agreements, including the Transaction Documents, submitted to us are genuine and all copies of such documents and agreements are complete, authentic and conform to the original instruments;
- B. each of the Transaction Documents is within the capacity and powers of, has been validly authorized by and have been duly executed and delivered by the parties to it other than CPS, Finco and Subco and that each of the Transaction Documents is binding on the parties thereto other than CPS, Finco and Subco;
- C. no party is, or will be, engaging in misleading or unconscionable conduct or seeking to conduct any relevant transaction or any associated activity in a manner or for a purpose that is not in compliance with of any of the Transaction Documents and that might render any of the Transaction Documents or any relevant transaction or associated activity illegal, void or voidable;
- D. insofar as any obligation under any of the Transaction Documents is to be performed in any jurisdiction other than in the Province of Nova Scotia, its performance will not be illegal or unenforceable under the laws of that jurisdiction;
- E. each of the Transaction Documents that is governed by either the laws of the State of New York or the laws of the Province of Alberta constitutes or will on execution constitute legal, valid and binding obligations of the parties under such respective laws enforceable in competent courts of that jurisdiction, provided

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however this assumption does not assume due authorization, execution or delivery of the Transaction Documents by CPS, Finco and Subco;

- F. where a document has been submitted to us as a final copy it will be executed in the form of that copy;
- G. the formalities for execution by each party required by the law (other than the laws of Nova Scotia, if applicable) of the place of execution of each of the Transaction Documents have been or will be complied with;
- H. the information provided by government officials, agencies and authorities is complete and accurate;
- I. physical delivery of each of the Transaction Documents on behalf of each of CPS, Finco and Subco has occurred free from escrow or any similar arrangement or restriction (other than any such escrow or similar arrangement that is set forth in the Transaction Documents); and
- J. all facts set forth in the certificates supplied by the respective officers and directors of each of CPS, Finco and Subco including, without limitation, the Officers' Certificates are true and accurate.

As to any facts material to our opinion, we have made no independent investigation of such facts and have relied, to the extent that we deem such reliance proper, upon certificates of public officials and officers or other representatives of CPS, Finco and Subco, including certificates of William W. Brown and Peter C. Keohane dated June , 2001 (the "Officers' Certificates"), and on the representations and warranties set forth in the Transaction Documents.

In rendering the opinions expressed below, we have assumed the legal capacity of all natural persons, the genuineness of all signatures, the authenticity of all documents submitted to us as originals, and the conformity to authentic original documents of all documents submitted to us as copies. Except as stated above, we have not reviewed any of the documents referred to in any of the Transaction Documents and have assumed there is nothing in such documents which would affect the opinions expressed herein.

This opinion is rendered solely with respect to the laws of the Province of Nova Scotia.

Based upon and subject to the foregoing and subject to the qualifications hereinafter expressed, we are of the following opinion:

- 1. CPS is an unlimited company duly incorporated and validly subsisting and in good standing as to the payment of annual fees and the filing of annual returns under the laws of the Province of Nova Scotia with the corporate power to execute and deliver the Transaction Documents executed by it and perform its obligations thereunder.

Houston 4****3

2. Finco is an unlimited company duly incorporated and validly subsisting and in good standing as to the payment of annual fees and the filing of annual returns under the laws of the Province of Nova Scotia with the corporate power to execute and deliver the Transaction Documents executed by it and perform its obligations thereunder.
3. Subco is an unlimited company duly incorporated and validly subsisting and in good standing as to the payment of annual fees and the filing of annual returns under the laws of the Province of Nova Scotia with the corporate power to execute and deliver the Transaction Documents executed by it and perform its obligations thereunder.
4. The authorized capital of Finco consists of Two Billion (2,000,000,000) Common Shares without nominal or par value, One Billion Five Hundred Million (1,500,000,000) Class A Preferred Shares without nominal or par value and Five Hundred Million (500,000,000) Class B Preferred Shares without nominal or par value, all with the rights, restrictions, conditions and limitations set forth in the articles of association of Finco. There is a total of one (1) Common Share, of Finco issued and outstanding, which is issued and registered in the name of CPS. There are Class A Preferred Shares and Class B Preferred Shares of Finco issued and outstanding, all of which are issued and registered in the name of Subco.
5. The authorized capital of Subco consists of One Hundred Thousand (100,000) Common Shares without nominal or par value and One Billion Two Hundred Million (1,200,000,000) Debenture Shares without nominal or par value, all with the rights, restrictions, conditions and limitations set forth in the articles of association of Subco. There is a total of one (1) Common Share of Subco issued and outstanding, which is issued and registered in the name of CPS. There are Debenture Shares of Subco issued and outstanding, all of which are issued and registered in the name of Enron Canada Power Corp.
6. The execution and delivery by each of CPS, Finco and Subco of the Transaction Documents to which it is a party and the performance by it of its obligations thereunder have been duly authorized by all necessary corporate action of each of CPS, Finco and Subco, as the case may be.
7. The execution and delivery by each of CPS, Finco and Subco of each Transaction Document to which it is a party and the performance by it of its obligations thereunder will not conflict with or result in the breach of any of the terms, conditions or provisions of their respective memorandum of association and articles of association.
8. The execution and delivery by each of CPS, Finco and Subco of each Transaction Document to which it is a party and the performance by it of its obligations thereunder do not result in a violation of Applicable Laws (as defined below).

"Applicable Laws" means those laws, rules and regulations of the Province of Nova Scotia and the rules and regulations adopted thereunder

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which, in our experience, are normally applicable to the transactions of the type contemplated by the Transaction Documents. Furthermore, the term "Applicable Laws" does not include, and we express no opinion in regard to:

- a. any Nova Scotia law, rule or regulation relating to:
 - (i) pollution or protection over the environment;
 - (ii) zoning, land use, building or construction;
 - (iii) occupational, safety and health or other similar matter; or
 - (iv) labour, employment rights and benefits; and
 - b. the regulation of utilities;
 - c. anti-trust laws;
 - d. tax laws, rules or regulations.
9. No Governmental Approval (as defined below) is or will be required to authorize or is or will be required (a) in connection with the execution and delivery of any of the Transaction Documents by CPS, Finco or Subco or the performance of their obligations thereunder or (b) to ensure the validity, effectiveness or enforceability of the Transaction Documents.
- "Governmental Approval" means any consent, approval, license, authorization or validation of, or filing, recording or registration with any Governmental Authority (as defined in the Finco Credit Agreement) in the Province of Nova Scotia pursuant to any Applicable Laws (as defined in paragraph 8 above);
10. There is no registration or transfer tax, stamp duty or similar levy or similar taxes, fees or charges payable in respect of the execution, delivery, validity, performance or enforcement of any of the Transaction Documents in the Province of Nova Scotia.
 11. Each of CPS, Finco and Subco is subject to civil and commercial law with respect to its obligations under the Transaction Documents to which it is a party, and the execution, delivery and performance by any such entity of any such Transaction Document constitutes private and commercial acts rather than public or governmental acts. None of CPS, Finco or Subco, nor any of their respective properties or assets, has any sovereign immunity or any other immunity from the jurisdiction of any court or from any legal process (whether through service or notice, attachment prior to judgment, attachment in and of judgment, execution or otherwise).
 12. If any of the Transaction Documents are sought to be enforced in any action or proceeding in the Province of Nova Scotia in accordance with the laws applicable thereto

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as chosen by the parties, namely the laws of the State of New York, one of the United States of America, in the case of the Finco Credit Agreement and Note delivered pursuant thereto, and the laws of the Province of Alberta for the other Transaction Documents (in each case, respectively the "Foreign Laws"), the Courts of the Province of Nova Scotia,

- a. would recognize the choice of laws provided that such choice of laws is bona fide (in the sense that it was not made with a view to avoiding the consequences of the laws of any other jurisdiction) and is not contrary to public policy, as such term is applied by the Province of Nova Scotia, and
 - b. would apply the Foreign Laws in any such action or proceeding, to the extent specifically pleaded and proved as a fact by expert evidence, to all issues which, under the conflicts of laws rules of the Province of Nova Scotia, are to be determined in accordance with the proper or governing law of contract, except that in any such proceedings, such court:
 - (i) will apply those laws of the Province of Nova Scotia which it characterizes as procedural and will not apply those Foreign Laws as such court characterizes as procedural; and
 - (ii) will not apply those Foreign Laws which a court of the Province of Nova Scotia would characterize as expropriatory, penal, governmental revenue or similar laws or the application of which would be inconsistent with public policy, as such term is applied by such court.
 - (iii) A court in the Province of Nova Scotia has, however, an inherent power to decline to hear such an action if it is not the proper forum to hear such action or if concurrent proceedings are being brought elsewhere.
13. It is not necessary under the laws of the Province of Nova Scotia (i) in order to enable either of Flagstaff or the Administrative Agent to enforce its rights under any Transaction Document or (ii) by reason only of the execution, delivery or performance by any of Flagstaff or the Administrative Agent of any Transaction Document, that such Person for such purposes only should be licensed, qualified or entitled to carry on business in Nova Scotia, provided that Flagstaff or the Administrative Agent, as applicable, has no other contact with Nova Scotia.
14. The laws of the Province of Nova Scotia permit an action to be brought based upon a final and conclusive in personam judgment for a definite sum of money rendered by any court of the State of New York or of the United States located in the State of New York having jurisdiction under its own domestic laws (the "Foreign Jurisdiction") in respect of any suit, action or proceeding against CPS, Finco or Subco based upon any instruments or agreements entered into for the consummation of the transactions contemplated in the Finco Credit Agreement, without re-examination, review of the merits of the cause of action in respect of which the judgment was given or relitigation of the matters

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adjudicated upon or payment of any stamp, registration or similar tax or duty, provided that

- a. the judgment is neither void or voidable under the laws of the Foreign Jurisdiction,
- b. the judgment was not given or obtained by fraud or in a manner contrary to natural justice;
- c. the enforcement of the judgment would not be inconsistent with
 - (i) public policy, as such term is understood under the laws of the Province of Nova Scotia and the federal laws of Canada, or
 - (ii) contrary to any order made by
 - (A) the Attorney General of Canada under the Foreign Extraterritorial Measures Act (Canada) or
 - (B) the Competition Tribunal under the Competition Act (Canada) in respect of certain judgments referred to therein,
- d. the judgment was not based on a clear mistake of law or fact,
- e. the judgment was not directly or indirectly for the payment of taxes or other charges of a like nature or of a fine or other penalty,
- f. there has been no prior judgment in another court between the same parties concerning the same issues as are dealt with in the judgment to be enforced in the Province of Nova Scotia,
- g. the enforcement of such judgment does not involve the enforcement of any laws of the Foreign Jurisdiction which a Nova Scotia court would characterize as expropriatory, penal, governmental revenue or similar laws, and
- h. there has been compliance with the Limitation of Actions Act (Nova Scotia) which requires that any action to enforce a foreign judgment must be commenced within six years of the date of the foreign judgment.

The opinions expressed above are subject to the following qualifications:

- a. Enforceability of the Transaction Documents may be limited by applicable bankruptcy, reorganization, insolvency, moratorium, fraudulent conveyance or transfer and other similar laws now or hereafter in effect relating to or affecting creditors' rights generally;

Houston 4 *****

- b. Enforcement of rights and remedies may be limited by general principles of equity, regardless of whether such enforcement is considered in a proceeding in equity or at law, and in this regard we have assumed that every party will exercise its rights and remedies under the Transaction Documents in good faith and in circumstances and in a manner which is commercially reasonable;
- c. Enforceability of the Transaction Documents is subject to the discretion of a court of competent jurisdiction to apply principles of equity or public policy, as such term is understood under the laws of the Province of Nova Scotia;
- d. A court in the Province of Nova Scotia may exercise discretion in the granting of equitable remedies such as specific performance and injunction;
- e. A court in the Province of Nova Scotia may decline to enforce those provisions of the Transaction Documents which purport to allow a determination, calculation or certificate of a party thereto as to any matter provided for therein to be final, conclusive and binding upon any other party thereto if such determination is found to be inaccurate on its face or to have been reached or made on an arbitrary or fraudulent basis;
- f. A court in the Province of Nova Scotia may consider the conduct or course of conduct of a party and require that it act with reasonableness. By way of example, and notwithstanding that any provision of the Transaction Documents purports to be due on demand, a party may be required to give reasonable time to a debtor to meet any demand for payment of its obligations before enforcing such provision;
- g. A court in the Province of Nova Scotia might not allow a party to exercise rights to accelerate the performance of obligations or otherwise seek the enforcement of the Transaction Documents based upon the occurrence of a default deemed immaterial;
- h. We express no opinion as to the enforceability of any provision of the Transaction Documents providing for the severance of illegal or unenforceable provisions from the remaining provisions of the Transaction Documents;
- i. We express no opinion as to the enforceability of any provision of the Transaction Documents which requires a party to pay, or to indemnify any person for, the costs and expenses in connection with judicial proceedings, since those provisions may derogate from a court's discretion to determine by whom and to what extent those costs should be paid;
- j. We express no opinion as to the enforceability of any provision of any of the Transaction Documents which states that modifications, amendments or waivers are not binding unless in writing.

Houston 4****8

- k. We express no opinion as to the enforceability of provisions of the Transaction Documents which may be characterized by a Court as an unenforceable penalty and not as a genuine pre-estimate of damage, or as an unenforceable forfeiture;
- l. We express no opinion as to the enforceability of any provisions in the Transaction Documents authorizing the exercise of "self help" remedies, or to any provisions therein constituting a waiver of constitutional or non-waivable statutory rights; and
- m. The Currency Act (Canada) precludes a court in the Province of Nova Scotia from giving judgment in any currency other than lawful money of Canada and such judgment may be based on a rate of exchange in existence on a date other than the date of payment.

We disclaim any responsibility to update or supplement this opinion with respect to any changes in law or future events affecting the transactions contemplated by the Finco Credit Agreement. This opinion may be relied upon by you (and any of your successors and assignees pursuant to an assignment by you of any rights under any Transaction Document pursuant to the terms thereof) only in conjunction with the Finco Credit Agreement and the Transaction Documents and may not be used or relied upon by you for any other purpose or by any other person for any purpose whatsoever, without in each instance our prior written consent.

Yours truly,

Houston 477773

**SCHEDULE I
TO THE
NOVA SCOTIA OPINION**

ADDRESSEES

Flagstaff Capital Corporation

The Chase Manhattan Bank, as Administrative Agent under the Finco Credit Agreement

The Chase Manhattan Bank, as Administrative Agent (as defined in the Credit and Security Agreement dated as of the date here among Flagstaff Capital Corporation, the Lenders named therein, and The Chase Manhattan Bank, as administrative agent and collateral agent, (the "Flagstaff Credit Agreement"))

The Chase Manhattan Bank, as Collateral Agent (as defined in the Flagstaff Credit Agreement)

Each Lender now or hereafter party to the Flagstaff Credit Agreement

The Swap Counterparty (as defined in the Flagstaff Credit Agreement)

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FORM OF OPINION OF BRACEWELL & PATTERSON, L.L.P.

COUNSEL TO ENRON

[LETTERHEAD OF BRACEWELL & PATTERSON, L.L.P.]

Each of the Addressees Listed in
the Attached Schedule I

Ladies and Gentlemen:

We have acted as New York counsel for Enron Corp., an Oregon corporation (the "Company"), for Hansen Investments Co., a Nova Scotia unlimited liability company ("Hansen"), and for Newman Investments Co., a Nova Scotia unlimited liability company ("Newman"), in connection with the transactions contemplated by the Credit Agreement (the "Hansen Credit Agreement") of even date herewith among Hansen, as borrower, Flagstaff Capital Corporation, as lender, and The Chase Manhattan Bank, as administrative agent. This opinion is being rendered pursuant to Section 4.01(b)(vii) of the Hansen Credit Agreement. Capitalized terms used herein and not otherwise defined herein shall have the same meanings herein as ascribed thereto in the Hansen Credit Agreement.

In rendering the opinions set forth below, we have reviewed the documents set forth on Schedule II attached hereto (collectively referred to herein as the "Transaction Documents"), and items 1 through 7 on Schedule II are referred to herein as the "New York Documents") and such other records, certificates and documents as we have deemed relevant for the purposes of such opinions.

As to any facts material to our opinion, we have made no independent investigation of such facts and have relied, to the extent that we deem such reliance proper, upon certificates of public officials and officers or other representatives of the Company and on the representations and warranties set forth in the Transaction Documents, all of which we assume to be true, correct and complete.

In rendering the opinions expressed below, we have assumed (i) the legal capacity of all natural persons, (ii) the genuineness of all signatures, (iii) the authenticity of all documents and records submitted to us as originals, and (iv) the conformity to authentic original documents and records of all documents and records submitted to us as copies. In addition we have assumed that the Transaction Documents have been duly authorized, executed and delivered by each party thereto (other than the Company, Hansen and Newman) and constitute valid, binding and enforceable obligations of such parties (other than the Company, Hansen and Newman) and that (i) the laws of any jurisdiction other than the jurisdictions that are the subject of this opinion do not affect the terms of the Transaction Documents and (ii) each party thereto (other than the Company, Hansen and Newman) have complied with all legal requirements that are applicable to

Houston 4****3

them to the extent necessary to make the Transaction Documents enforceable. We have also assumed that each party to the Transaction Document (other than the Company, Hansen and Newman) was duly organized and is validly existing under the laws of such party's jurisdiction of formation, has full power and authority to execute, deliver and perform the Transaction Documents to which it is a party and has taken all necessary legal action to authorize the execution, delivery and performance of each Transaction Document to which it is a party, and that each such Transaction Document does not contravene the constitutive documents of such party.

The opinions expressed below in paragraphs 4 and 5 are based upon and in reliance upon the opinion of James V. Derrick, Jr. of even date hereto (the "Enron Opinion"), a copy of which has been delivered to you. We have examined the Enron Opinion and such opinion is in form and scope satisfactory to us and we believe we and you are justified in relying thereon. However, we have made no independent investigation in respect of such opinion and have assumed its accuracy and completeness. To the extent that the Enron Opinion is based upon an assumption or is made subject to any limitation, qualification or exception, our opinion given in reliance thereon is based upon such assumptions and is subject to such limitations, qualifications or exceptions. We do not, however, assume any liability for any opinion expressed in the Enron Opinion.

Based upon the foregoing, and subject to the assumptions, qualifications, exceptions and limitations set forth herein, it is our opinion that:

1. The execution and delivery by the Company, Newman and Hansen of each Transaction Document to which it is a party and the performance by each of the Company, Hansen and Newman of its respective obligations thereunder, do not result in a violation of Applicable Laws (as defined below).

"Applicable Laws" means those laws, rules and regulations of the State of New York and the United States of America and the rules and regulations adopted thereunder, which, in our experience, are normally applicable to transactions of the type contemplated by, as applicable, the Transaction Documents. Furthermore, the term "Applicable Laws" does not include, and we express no opinion with regard to (a) any New York or federal law, rule or regulation relating to (i) pollution or protection of the environment, (ii) zoning, land use, building or construction, (iii) occupational, safety and health or other similar matters, or (iv) labor, employee rights and benefits, including the Employment Retirement Income Security Act of 1974, as amended, (v) intellectual property laws, (vi) the regulation of utilities, (vii) antitrust laws, (viii) tax laws, rules or regulations, (ix) state or federal securities laws, and (b) laws of any counties, cities, towns, municipalities and special political subdivisions and agencies thereof.

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2. No Governmental Approval (as defined below) which has not been obtained or taken and is not in full force and effect, is required to authorize or is required in connection with the execution, delivery or performance of any of the Transaction Documents by the Company, Hansen or Newman.

"Governmental Approvals" means any consent, approval, license, authorization or validation of, or filing, recording or registration with, any Governmental Authority pursuant to any Applicable Laws (as defined in paragraph 1 above).

3. Each New York Document to which the Company, Hansen or Newman is a party constitutes the legal, valid and binding obligation of the Company, Hansen or Newman, as applicable, enforceable against such Person in accordance with its respective terms.

4. Neither of Hansen nor Newman is a "holding company", or a "subsidiary company" of a "holding company", or an "affiliate" of a "holding company" or of a "subsidiary company" of a "holding company" within the meaning of the Public Utility Company Act of 1935, as amended.

5. Neither the Hansen nor Newman is an "investment company" or a company "controlled" by an "investment company", as such terms are defined in the Investment Company Act of 1940, as amended.

6. The choice of New York law as the governing law that is contained in any New York Document will be recognized by the courts of the State of New York, the State of Texas and federal courts applying New York law as a valid choice of law in any action to enforce such New York Document.

7. The execution and delivery by Hansen and Newman of each of the Transaction Documents to which it is a party do not, and the performance by Hansen and Newman of their respective obligations thereunder will not (a) breach or result in a default of under any of the Transaction Documents, (b) to our knowledge, result in any violation of any order, writ, judgment or decree or (c) to our knowledge, result in the creation or imposition of any lien on any properties of either Hansen or Newman, other than as may be contemplated by the Transaction Documents.

8. To our knowledge, neither Hansen nor Newman is a party to any pending or overtly threatened in writing action or proceeding that (a) may adversely affect the transactions contemplated by the Transaction Documents or (b) if determined adversely, involve a reasonable possibility of materially and adversely affecting the business, condition or operations of either Hansen or Newman.

The opinions set forth above are subject to the following qualifications and exceptions:

SECTION 4

(a) The enforceability of each Transaction Document and the provisions thereof may be limited by (i) bankruptcy, insolvency, reorganization, fraudulent transfer and conveyance, preferential transfer, moratorium or other laws now or hereinafter in effect relating to or affecting enforcement of creditors' rights and remedies generally; (ii) general principles of equity (including without limitation, concepts of materiality, reasonableness, good faith and fair dealing), regardless of whether such enforcement is considered in a proceeding in equity or at law; (iii) commercial reasonableness and unconscionability and an implied covenant of good faith and fair dealing; (iv) the power of the courts to award damages in lieu of equitable remedies; (v) public policy underlying Applicable Laws with respect to rights to indemnification and contribution and (vi) possible unavailability of specific performance or injunctive relief.

(b) With respect to our opinion set forth in paragraph 3 above, we express no opinion with respect to the validity or enforceability of the following provisions to the extent that they are contained in the Transaction Documents: (i) provisions releasing, exculpating or exempting a party from, or requiring indemnification or contribution of a party for, liability for its own negligence or to the extent that the same are inconsistent with the public policy underlying any law, rule or regulation; (ii) enforceability of provisions purporting to restrict access to legal or equitable remedies or purporting to establish evidentiary standards; (iii) provisions relating to subrogation rights, delay or omission of enforcement of rights or remedies, waivers or ratifications of future acts, the rights of third parties, prohibitions against the transfer, alienation, or hypothecation of property, indemnity, severance, marshalling of assets, transferability of assets which by their nature are non-transferable, or sales in inverse order of alienation; (iv) provisions restricting access to courts or to legal or equitable remedies or purporting to affect the jurisdiction or venue of courts, including the waiver of a right to a hearing on forum non conveniens (other than the courts of the State of New York with respect to the New York Documents); (v) provisions setting out methods or procedures for service of process; (vi) provisions purporting to vest jurisdiction over any property in any court to the extent that such property is not in such jurisdiction; (vii) provisions purporting to waive, subordinate or not give effect to rights to notice, demands, legal defenses, immunities, statutes of limitations, trial by jury or other laws, rights or benefits that cannot be waived, subordinated or rendered ineffective under applicable law; (viii) provisions relating to powers of attorney, severability, subrogation or set-offs; (ix) provisions providing that decisions by a party are conclusive or based on its sole or absolute discretion; and (x) provisions that require the payment of liquidated damages, if and to the extent actual damages are not difficult to determine or the liquidated damages stipulated are disproportionate to the actual loss of the party claiming such damages or which would otherwise constitute a penalty.

(c) We have assumed that no undue influence, deceit, fraud, dishonesty, forgery, coercion, duress or breach of fiduciary duty exists or will exist with respect to matters relevant to the transactions contemplated by the Transaction Documents.

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JPM-14-00543

FOIA CONFIDENTIAL TREATMENT
REQUESTED BY JPMC

(d) We express no opinion as to (i) the compliance of the transactions contemplated by the Transaction Documents with any regulations or governmental requirements applicable to any party other than the Company, Hansen or Newman; (ii) the financial condition or solvency of the Company, Hansen or Newman; (iii) the ability (financial or otherwise) of the Company, Hansen or Newman or any other party to meet their respective obligations under the Transaction Documents; (iv) the value of any security provided to secure the payment of obligations contemplated by the Credit Agreement; and (v) the conformity of the Transaction Documents to any term sheet or commitment letter.

(e) With respect to the enforceability of the Transaction Documents, we have assumed that value has been given by the parties thereto.

(f) With respect to our opinion set forth in paragraph 3 above (insofar as such opinion relates to the enforceability under New York law of the choice-of-law provision of any Transaction Document choosing New York law as the governing law thereof) is rendered in reliance upon the Act of July 19, 1984, ch. 421, 1984 McKinney's Sess. Law of N.Y. 1406 (codified at N.Y. Gen. Oblig. Law §§5-1401, 5-1402 (McKinney 1989) and N.Y. CPLR 327(b) (McKinney (1990)) (the "Act") and is subject to the qualification that such enforceability (i) as specified in the Act, does not apply to the extent provided to the contrary in subsection two of Section 1-105 of the New York Uniform Commercial Code and (ii) as specified in the Act, does not apply to a contract for labor or personal services.

(g) Our opinion in paragraph 6 above is based upon Section 35.51 of the Texas Business and Commerce Code. To our knowledge, Section 35.51 of the Texas Business and Commerce Code has never been judicially construed, and we are relying on the literal working of such statute.

(h) To the extent our opinion in paragraph 6 regarding the choice of New York law under the Transaction Documents relates to our opinions in paragraph 3 above with respect to Applicable Laws of the State of Texas and Governmental Approvals of Texas state courts or governmental bodies or authorities of the State of Texas, are rendered based upon, and are qualified in all respects by, such opinion in paragraph 6.

In addition, we wish to point out that courts applying New York conflict of law rules may determine that the following matters are governed by laws of jurisdictions other than the State of New York: (i) the due formation and existence of the parties to the Transaction Documents, their respective power to enter into the Transaction Documents, their respective authorization, execution and delivery of the Transaction Documents, and similar matters governed by the applicable laws of the jurisdictions under which such parties were formed; (ii) whether a transaction transfers or creates an interest in property for security purposes or otherwise, the nature of an interest in property that is transferred or created by a transaction, the manner and effect of recording or failing to record evidence of a transaction that transfers or creates an interest in property, and similar matters relating to title to property or the creation, assignment,

Houston 477778

conveyance, foreclosure or other transfer of interests in property, which matters may be governed by the laws of jurisdictions where such property (or the holder thereof) is or is deemed to be located (including, without limitation, Section 9-103 of the New York Uniform Commercial Code); and (iii) remedies as against principals, rights of subrogation, and similar matters that may be considered to be governed by procedural laws.

We express no opinion as to the laws of any jurisdiction other than: (i) the laws of the State of New York; (ii) the General Corporation Law of the State of Delaware; (iii) the federal laws of the United States of America and (iv) as indicated in paragraph 6 above and the related qualifications, the laws of the State of Texas.

This law firm is a registered limited liability partnership organized under the laws of the State of Texas.

This opinion letter is rendered as of the date set forth above and we expressly disclaim any obligation to update this letter after the date hereof.

This opinion letter is given solely for your benefit in connection with the transactions contemplated by the Transaction Documents and may not be relied upon by any person other than you or for any other purpose without our prior written consent. This opinion letter may not be furnished, without our prior consent, to any person other than you. The opinions expressed herein are of the date hereof only, and we specifically disclaim any responsibility to update such opinions or to advise you of subsequent developments affecting such opinions that hereafter may come to our attention.

Very truly yours,

BRACEWELL & PATTERSON, L.L.P.

SCHEDULE I
to
OPINION OF BRACEWELL & PATTERSON, L.L.P.

ADDRESSEES

Flagstaff Capital Corporation

The Chase Manhattan Bank, as Administrative Agent under the Hansen Credit Agreement

The Chase Manhattan Bank, as Administrative Agent under and as defined in the Flagstaff Credit Agreement

The Chase Manhattan Bank, as Collateral Agent under and as defined in the Flagstaff Credit Agreement

Each Lender now or hereafter party to the Flagstaff Credit Agreement

The Swap Counterparty

SCHEDULE II
to
OPINION OF BRACEWELL & PATTERSON, L.L.P.

TRANSACTION DOCUMENTS

We have reviewed executed copies of the following, each dated of even date herewith:

1. the Hansen Credit Agreement;
2. the Note delivered pursuant to the Hansen Credit Agreement;
3. the Hansen Consent;
4. the Enron Consent;
5. the Put Option Agreement;
6. the Total Return Swap Agreement;
7. the Enron Agreement;
8. the Subscription Agreement;
9. the Subscription Payment Assumption Agreement; and
10. the Warrant Agreement.

FORM OF OPINION OF JAMES V. DERRICK, JR.

[TO COME]

June __, 2001

To the addressees listed on
Schedule I hereto

Ladies and Gentlemen:

As Executive Vice President and General Counsel of Enron Corp., an Oregon corporation ("Enron"), I am familiar with the documents listed in Schedule II hereto (the "Transaction Documents"). This opinion is being furnished to you pursuant to Section 4.01(b)(xi) of the Credit Agreement dated June __, 2001 among Hansen Investments Co., as Borrower, Flagstaff Capital Corporation, as Lender, and The Chase Manhattan Bank, as Administrative Agent (the "Credit Agreement").

In rendering the opinions hereinafter set forth, I (or other attorneys in the Enron legal department) examined the Transaction Documents and relied upon original, photostatic or certified copies of such agreements, documents, instruments, corporate records, and certificates of officers of Enron and of public officials as I (or such attorneys) deemed relevant and necessary as the basis for the opinions hereinafter expressed. In such examination, I (or such attorneys) assumed the genuineness of all signatures (other than signatures of officers of Enron on the Transaction Documents), the authenticity of all documents submitted to me (or such attorneys) as originals, and the conformity to original documents of all documents submitted to me (or such attorneys) as photostatic or certified copies.

Based on the foregoing, and subject to the assumptions, qualifications and explanations set forth herein, I am of the opinion that:

1. Enron is a corporation duly incorporated, validly existing and in good standing under the laws of the State of Oregon.
2. The execution, delivery and performance by Enron of the Transaction Documents to which it is a party are within its corporate powers. The Transaction Documents to which Enron is a party have been duly authorized by all necessary corporate action of Enron, and have been duly executed and delivered by Enron.

Houston 4-11-01

3. The execution, delivery and performance by Enron of the Transaction Documents to which it is a party, and the consummation by Enron of the transactions evidenced thereby do not constitute a contravention or default by Enron under (a) Enron's Amended and Restated Articles of Incorporation or Bylaws, each as amended, (b) any judgment, injunction, order or decree known to me to be binding upon Enron, or (c) any contractual restriction contained in any material (meaning for the purposes of this opinion those creating a monetary liability of \$100,000,000 or more) contract, agreement, indenture, mortgage, bond, note or any guaranty of any of such obligations, in each case known to me and to which Enron is subject.

4. The execution, delivery and performance by Enron of the Transaction Documents to which it is a party will not result in the creation or imposition of any lien, security interest, or other charge or encumbrance on any asset of Enron, other than (a) pursuant to the Transaction Documents or (b) those that would not materially and adversely affect (i) the business, consolidated financial position or consolidated results of operations of Enron and its subsidiaries taken as a whole, or (ii) the ability of Enron to perform its obligations under the Transaction Documents.

5. Except as disclosed in Enron's (i) Annual Report to Shareholders for the year ended December 31, 2000, (ii) Annual Report on Form 10-K for the year ended December 31, 2000, (iii) Quarterly Report on Form 10-Q for the period ended March 31, 2001 (iv) definitive proxy statement with respect to its Annual Meeting of Stockholders held May 1, 2001, to my knowledge there is no action, suit or proceeding pending or threatened against Enron or any of its subsidiaries before any court or arbitrator, or any governmental body, agency or official (a) with respect to the Transaction Documents, or (b) in which there is a reasonable possibility of an adverse decision that would materially and adversely affect (i) the business, consolidated financial position or consolidated results of operations of Enron and its subsidiaries taken as a whole, or (ii) the ability of Enron to perform its obligations under the Transaction Documents.

6. Enron is not an "investment company" within the meaning of the Investment Company Act of 1940, as amended.

7. Enron is not subject to, or is exempt from regulation as a "holding company", or a "subsidiary company" of a "holding company", in each case under the Public Utility Holding Company Act of 1935, as amended.

The opinions set forth above are subject in all respects to the following qualifications:

(a) In rendering the opinion expressed in paragraph 3 above, neither I nor any other attorney in the Enron legal department has made any examination of any accounting or financial matters related to covenants contained in certain documents to which Enron may be subject, and I express no opinion with respect thereto.

Houston 4/27/01

JPM-14-00549

(b) In rendering the opinion expressed in paragraph 5 above, I (or other attorneys in the Enron legal department) have only reviewed the files and records of Enron, and have consulted with such senior Enron officers as I (or such attorneys) have deemed necessary.

(c) The opinions expressed herein are as of the date hereof only, and I assume no obligation to update or supplement such opinions to reflect any fact or circumstance that may hereafter come to my attention, or any changes in law that may hereafter occur or become effective.

(d) I am a member of the bar of the State of Texas. This opinion relates solely to matters of Texas law, federal law and the Oregon Business Corporation Act.

This opinion is furnished in connection with the transactions contemplated by the Transaction Documents and may not be relied upon in connection with any other transaction or by any person other than you; provided, however, Bracewell & Patterson, L.L.P. may rely upon this opinion for purposes of rendering its opinion in connection with the Transaction Documents.

Very truly yours,

Houston 4-11-03

JPM-14-00550

FOIA CONFIDENTIAL TREATMENT
REQUESTED BY JPMC

**Schedule I
Addressees**

The Chase Manhattan Bank, as Administrative Agent under the Credit Agreement

The Chase Manhattan Bank, as Administrative Agent (as defined in the Credit and Security Agreement dated as of June ___, 2001, among Flagstaff Capital Corporation, as borrower, the financial institutions named as Lenders therein, and The Chase Manhattan Bank, as administrative agent and as collateral agent, (the "Flagstaff Credit Agreement))

The Chase Manhattan Bank, as Collateral Agent (as defined in the Flagstaff Credit Agreement)

Each Lender now or hereafter party to the Flagstaff Credit Agreement

The Swap Counterparty (as defined in the Flagstaff Credit Agreement)

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JPM-14-00551

Schedule II

ISDA Master Agreement dated June __, 2001 between Enron Corp. and Flagstaff Capital Corporation;

Schedule to the ISDA Master Agreement dated June __, 2001 between Enron Corp. and Flagstaff Capital Corporation;

Total Return Swap Confirmation dated June __, 2001 between Enron Corp. and Flagstaff Capital Corporation;

Put Option Agreement dated June __, 2001 between Enron Corp. and Flagstaff Capital Corporation;

Enron Consent dated June __, 2001 executed by Enron Corp.; and

Enron Agreement dated June __, 2001 by Enron Corp. in favor of Flagstaff Capital Corporation and the Indemnified Persons referred to therein.

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FOIA CONFIDENTIAL TREATMENT
REQUESTED BY JPMC

JPM-14-00552

EXHIBIT C

FORM OF
COMPLIANCE CERTIFICATE

This Certificate is furnished pursuant to Section 4.01(b)(xii) of the Credit Agreement, dated as of June 22, 2001 (as amended, modified, renewed or extended from time to time, the "Hansen Credit Agreement"), among Hansen Investments Co., as borrower (the "Borrower"), Flagstaff Capital Corporation, as lender, and The Chase Manhattan Bank, as administrative agent. Capitalized terms used but not otherwise defined herein shall have the meanings given such terms in the Hansen Credit Agreement.

The undersigned hereby certifies that he is the Vice President and Secretary of the Borrower, and that as such he is authorized to execute this certificate on behalf of the Borrower. The undersigned represents and warrants, to the best of his knowledge, in such capacity, as follows:

- (a) As of the date hereof, the Borrower is in compliance with all terms, conditions and agreements applicable to it in the Operative Documents.
- (b) As of the date hereof, there exists no Default or Event of Default.

Executed and delivered this 22nd day of June, 2001.

[Signature Page Follows]

[Signature Page to Compliance Certificate]

HANSEN INVESTMENTS CO.

By: _____
Name:
Title:

FOIA CONFIDENTIAL TREATMENT
REQUESTED BY JPMC

JPM-14-00554

[Signature Page to Credit Agreement]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed by their respective authorized officers as of the day and year first above written.

HANSEN INVESTMENTS CO.
as Borrower

By: 
Name: Peter C.M. Keohane
Title: Vice President and Secretary

FLAGSTAFF CAPITAL CORPORATION,
as Lender

By: _____
Bruce Hendrick
President

THE CHASE MANHATTAN BANK,
as Administrative Agent

By: _____
Robert W. Traband
Vice President

Houston 47778

FOIA CONFIDENTIAL TREATMENT
REQUESTED BY JPMC

JPM-14-00515

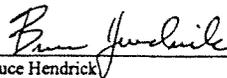
[Signature Page to Credit Agreement]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed by their respective authorized officers as of the day and year first above written.

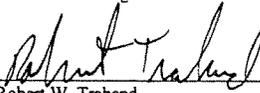
HANSEN INVESTMENTS CO.
as Borrower

By: _____
Name:
Title:

FLAGSTAFF CAPITAL CORPORATION,
as Lender

By: 
Bruce Hendrick
President

THE CHASE MANHATTAN BANK,
as Administrative Agent

By: 
Robert W. Traband
Vice President

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**PROJECT SLAPSHOT
DISCUSSION SESSION**

MARCH 2001

Permanent Subcommittee on Investigations
EXHIBIT #351

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FL-00066



Prepayment through 2 Touches,

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AGENDA

Agenda

- SUBCO FUNDING
- COLLATERAL
- GUARANTEE OF FLAGSTAFF
- ENRON CREDIT SUPPORT
- INTEREST RATE SWAP
- AMORTIZATION MECHANICS
- PREPAYMENT MECHANICS
- PARTIAL PREPAYMENT
- "5/25 RECHARACTERIZATION" RIDER
- ACCOUNTING: DOCUMENTATION OF INTENT TO SET OFF
- ENGAGEMENT LETTER
- TIMETABLE

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10/07



Subco Funding; Collateral; Flagstaff Guarantee

- **Subco Funding**
 - Enron Progress Update
 - Mechanics on Closing Date (Fund Escrow Account prior to Finco Loan)
 - Effect on Unwind (via prepayment or at maturity)
- **Collateral**
 - Discuss necessity of Canco Note being pledged as collateral for Finco Loan, in light of Enron credit support
 - Consideration: Bank Group's need for collateral in addition to the Enron Credit Support (consider bankruptcy scenario)
- **Guarantee of Flagstaff**
 - Chase Manhattan Bank (Flagstaff's parent) to provide Guarantee
 - Guarantee to cover Performance of Flagstaff under its Reqs & Warranties, Covenants, et cetera
 - Does not extend to payment of Principal/Interest to Bank Group or other Counterparties should Finco fail to pay Flagstaff



Enron Credit Support

- **Discuss structure / term sheets**
 - Mechanics of put vesting, exercise and expiration
 - Does exercise of put trigger Section 116 Certificate (transfer of Canadian property). Enron indemnity needed?
- **Put Option Considerations**
 - Ownership transfer
 - Collateral Agent
 - Irrevocable exercise by Flagstaff
 - Class and Valuation of Shares covered by Put Option
- **Early unwind mechanics**
 - "Makewhole" calculation
- **Enron indemnities of Cancos:** for performance under Put Option (delivery of Shares), Total Return Swap, timely payment in event Section 116 Certificate is required
- **Bank Group Considerations:** Complexity, Pricing, Security (Canco Loan)
- **Impact of partial prepayment on partial unwind of Credit Support**

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Interest Rate Swap (Flagstaff)

- Swap Directly affects Finco Coupon Rate, Finco Amount and Flagstaff Debt Assumption Payment
 1. Flagstaff swaps Fixed Rate for LIBOR on Closing Date (based on amortizing net notional schedule).
 - Final amortization schedule for Swap and Flagstaff Loan results from this rate
 - Iteration of notional schedule requires working closely with counterparty to amend the swap notional schedule immediately after execution
 2. Fixed Rate is added to Flagstaff Loan spread (e.g., 85 bps) to determine rates on Flagstaff Loan and Finco Loan
 3. Amounts for Finco Loan, Subscription Payment, and Debt Assumption Payment are calculated based on the Flagstaff/Finco Rate
 - Calculation: Debt Assumption Payment accrued for 5 years at Flagstaff/Finco Rate equals the Finco Loan and Subscription Payment
 4. [2-5] bps added to Finco Rate to determine Canco Rate
- Swap Collateral: Same security (i.e., the Finco Loan) and Credit Support as applies to Bank Group.
 - Counterparty needs to be comfortable with form of Enron Credit Support being applied to swap.
- Need to select Counterparty
 - ISDA process, indicative quotes
 - Need to amend notional schedule necessitates having an amenable counterparty

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Transaction Spreadsheet

• Rates and Amounts are determined as outlined in the Interest Rate Swap discussion above

| Payment Date | Fico Pmt to Fico | Interest on Bank Loan | Bank Spread: \$5.0 bp | Fixed Interest @ (to be swapped) | Bank Loan Amortization | Bank Loan Principal | Fico Substitution |
|--------------|------------------|-----------------------|-----------------------|----------------------------------|------------------------|---------------------|-------------------|
| 3/20/01 | \$ 23,545,557 | \$ 6,184,444 | \$ 888,889 | \$ 5,315,555 | \$ 17,381,113 | \$ 430,000,000 | \$ 1,122,959,059 |
| 6/20/01 | 24,057,417 | 6,044,832 | 849,248 | 5,195,584 | 15,012,785 | 322,038,897 | 1,140,200,171 |
| 9/20/01 | 23,288,827 | 5,676,247 | 783,440 | 4,892,808 | 12,713,360 | 244,638,102 | 1,159,262,357 |
| 12/20/01 | 23,545,557 | 5,363,656 | 753,572 | 4,610,084 | 10,181,901 | 248,710,422 | 1,173,976,336 |
| 3/20/02 | 23,033,687 | 4,972,054 | 698,553 | 4,273,501 | 8,081,843 | 310,869,176 | 1,194,158,237 |
| 6/20/02 | 23,288,827 | 4,751,081 | 667,607 | 4,083,474 | 6,538,548 | 293,130,432 | 1,212,219,860 |
| 9/20/02 | 23,288,827 | 4,467,570 | 627,675 | 3,839,895 | 5,122,057 | 273,308,676 | 1,230,758,428 |
| 12/20/02 | 23,288,827 | 4,179,723 | 587,234 | 3,652,489 | 3,939,804 | 254,188,672 | 1,249,660,483 |
| 3/20/03 | 23,288,827 | 3,887,474 | 546,174 | 3,341,300 | 3,000,171 | 234,786,518 | 1,269,890,387 |
| 6/20/03 | 23,288,827 | 3,590,756 | 504,468 | 3,086,270 | 2,098,471 | 215,097,846 | 1,291,410,410 |
| 9/20/03 | 23,288,827 | 3,298,500 | 462,181 | 2,827,319 | 1,608,127 | 195,997,422 | 1,314,291,537 |
| 12/20/03 | 23,288,827 | 2,993,837 | 419,189 | 2,574,648 | 1,043,968 | 174,141,532 | 1,338,697,327 |
| 3/20/04 | 23,545,557 | 2,702,471 | 379,696 | 2,322,785 | 630,843 | 152,184,406 | 1,364,940,619 |
| 6/20/04 | 23,545,557 | 2,390,214 | 334,410 | 2,045,804 | 311,655,343 | 130,783,109 | 1,393,105,955 |
| 9/20/04 | 23,288,827 | 2,030,659 | 285,299 | 1,745,360 | 21,259,868 | 111,524,136 | 1,417,364,363 |
| 12/20/04 | 23,033,687 | 1,686,903 | 236,889 | 1,449,014 | 31,346,884 | 93,177,244 | 1,442,911,816 |
| 3/20/05 | 23,545,557 | 1,394,240 | 195,885 | 1,198,355 | 22,151,317 | 69,025,625 | 1,469,661,034 |
| 6/20/05 | 23,545,557 | 1,051,756 | 147,787 | 903,969 | 22,493,801 | 45,532,124 | 1,497,358,236 |
| 9/20/05 | 23,288,827 | 696,325 | 97,831 | 598,494 | 22,593,322 | 22,838,822 | 1,525,950,238 |
| 12/20/05 | 23,288,827 | 350,865 | 49,287 | 301,578 | 22,838,822 | 0 | 1,554,789,035 |

(1) Actual amounts subject to change based on market interest rates at time of close.
 (2) Based on estimated closing date. Dates are Modified Next Business Day (London/NY) and are adjusted for London and NY holidays.

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AGENDA

Prepayment Mechanics

- The Transaction Documentation must provide for repayment to the Bank Group should Enron choose to unwind the Transaction prior to maturity
- Payment of principal and accrued interest to Flagstaff for benefit of the Bank Group can be effected by an accruing Subscription Payment or by the Makewhole (as currently contemplated in the documents)

| Date | Finco Loan | | Finco Subscription Payment (B) | Net Payment to Flagstaff (A) - (B) | | Flagstaff Amortization Schedule | MAKEWHOLE CALCULATION | | |
|----------|------------------|------------------|--------------------------------|------------------------------------|----------------|---------------------------------|-----------------------|------------|--|
| | (A) | (B) | | (A) - (B) | Calc | | Should Be | Difference | |
| 3/23/01 | \$ 1,522,889,059 | \$ 1,122,889,059 | \$ 400,000,000 | \$ 400,000,000 | \$ 400,000,000 | 400,183,450 | 406,184,141 | (995) | |
| 6/28/01 | 1,522,889,059 | 1,140,250,171 | 382,638,887 | 382,638,887 | 382,638,887 | 398,683,923 | 398,683,313 | 404 | |
| 10/1/01 | 1,522,889,059 | 1,158,232,967 | 364,656,102 | 364,656,102 | 364,656,102 | 370,202,665 | 370,202,343 | 316 | |
| 1/23/02 | 1,522,889,059 | 1,175,875,339 | 346,912,722 | 346,912,722 | 346,912,722 | 352,277,057 | 352,276,373 | 678 | |
| 4/2/02 | 1,522,889,059 | 1,194,156,237 | 329,730,822 | 329,730,822 | 329,730,822 | 333,703,064 | 333,702,373 | 189 | |
| 7/1/02 | 1,522,889,059 | 1,212,219,860 | 310,669,178 | 310,669,178 | 310,669,178 | 315,420,370 | 315,420,253 | 111 | |
| 9/30/02 | 1,522,889,059 | 1,230,756,428 | 292,130,632 | 292,130,632 | 292,130,632 | 296,598,240 | 296,598,202 | 37 | |
| 12/30/02 | 1,522,889,059 | 1,249,550,483 | 273,306,575 | 273,306,575 | 273,306,575 | 277,488,266 | 277,488,269 | (33) | |
| 3/31/03 | 1,522,889,059 | 1,268,890,387 | 254,186,672 | 254,186,672 | 254,186,672 | 258,086,047 | 258,086,148 | (99) | |
| 6/30/03 | 1,522,889,059 | 1,288,992,540 | 234,796,519 | 234,796,519 | 234,796,519 | 238,387,114 | 238,387,275 | (161) | |
| 9/29/03 | 1,522,889,059 | 1,307,781,410 | 215,087,648 | 215,087,648 | 215,087,648 | 218,388,829 | 218,388,143 | (686) | |
| 12/29/03 | 1,522,889,059 | 1,327,781,537 | 185,087,522 | 185,087,522 | 185,087,522 | 189,080,885 | 189,081,159 | (273) | |
| 3/29/04 | 1,522,889,059 | 1,348,987,527 | 174,781,532 | 174,781,532 | 174,781,532 | 177,483,906 | 177,484,003 | (97) | |
| 6/29/04 | 1,522,889,059 | 1,369,840,613 | 153,948,446 | 153,948,446 | 153,948,446 | 156,328,720 | 156,328,660 | 60 | |
| 9/29/04 | 1,522,889,059 | 1,390,105,955 | 132,783,103 | 132,783,103 | 132,783,103 | 134,813,789 | 134,813,851 | (62) | |
| 12/29/04 | 1,522,889,059 | 1,411,364,923 | 111,584,136 | 111,584,136 | 111,584,136 | 113,210,765 | 113,210,934 | (169) | |
| 3/29/05 | 1,522,889,059 | 1,432,711,818 | 90,177,241 | 90,177,241 | 90,177,241 | 91,571,430 | 91,571,481 | (51) | |
| 6/29/05 | 1,522,889,059 | 1,454,663,134 | 68,026,925 | 68,026,925 | 68,026,925 | 69,077,698 | 69,077,881 | (183) | |
| 9/29/05 | 1,522,889,059 | 1,477,956,935 | 45,532,124 | 45,532,124 | 45,532,124 | 46,228,455 | 46,228,443 | 12 | |
| 12/29/05 | 1,522,889,059 | 1,499,950,236 | 22,938,822 | 22,938,822 | 22,938,822 | 23,289,687 | 23,289,687 | 0 | |
| 3/30/06 | 1,522,889,059 | 1,522,889,059 | 0 | 0 | 0 | 0 | 0 | 0 | |

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FL-00072

Partial Prepayment

- A prepayment does work mathematically if all transactions are prepaid / unwound at the same % of face value.
- Steps (assuming 50% Prepayment):
 1. 50% Prepayment of the Finco Note (Finco pays Flagstaff)
 2. Acceleration and payment of 50% of Accreted Purchase Price under the Subscription Agreement (Flagstaff pays Finco) or vesting of 50% of puts at a PV amount
 3. (1) – (2) = 50% of “net loan.” Flagstaff uses the net proceeds to repay 50% of the Flagstaff Loan (Flagstaff pays Bank Group)
 4. Flagstaff unwinds 50% of its Interest Rate Swap
 - Enron to indemnify for any loss on unwind
 5. Enron and Flagstaff unwind 50% of credit support
 - 50% cancellation of Irrevocable Put Option and 50% unwind of Total Return Swap

- Considerations

Closer tying of Documents: Subscription Payment, Flagstaff Loan, Flagstaff Swap, and Credit Support (Put Option and Total Return Swap) all are prepaid / unwound in the same % as that by which the Finco Loan is repaid

Bank Group considerations: additional document complexity, marketability

Partial Prepayment (cont.)

EXAMPLE: 50% PREPAID IN 2.5 YEARS

3-MO LIBOR Swap to Fisco: 3.500% Swap for L Brj
 All-in Fixed Rate on Fisco Note & Bank Loan to Plaintiff: 3.500%

Bank Loan rate (Fico = 4 bps): 6.07800%

| Payment Date | Fisco Paid to Plaintiff | Interest on Bank Loan | Bank Prepayment | Fixed Interest @ 4.500% | Principal Amortized | Bank Loan Principal | Bank Loan Prepayment | Fisco Subscription Value | Fisco Loan - Subscription Value |
|--------------|-------------------------|-----------------------|-----------------|-------------------------|---------------------|---------------------|----------------------|--------------------------|---------------------------------|
| 3/29/01 | \$ 23,545,557 | \$ 6,184,444 | \$ 689,810 | \$ 18,361,114 | \$ 1,348,113 | \$ 22,197,413 | \$ 1,348,113 | \$ 1,122,862,039 | \$ 403,000,000 |
| 6/29/01 | \$ 24,027,417 | \$ 6,044,432 | \$ 949,248 | \$ 18,077,185 | \$ 1,300,127 | \$ 20,897,286 | \$ 1,300,127 | \$ 1,130,292,857 | \$ 454,258,102 |
| 9/29/01 | \$ 23,286,827 | \$ 5,974,247 | \$ 783,440 | \$ 17,713,280 | \$ 1,247,171 | \$ 19,666,109 | \$ 1,247,171 | \$ 1,176,978,236 | \$ 346,812,722 |
| 12/29/01 | \$ 23,545,557 | \$ 5,833,658 | \$ 753,072 | \$ 17,300,485 | \$ 1,181,901 | \$ 18,418,586 | \$ 1,181,901 | \$ 1,194,158,237 | \$ 378,130,822 |
| 3/29/02 | \$ 23,033,887 | \$ 4,972,894 | \$ 893,925 | \$ 16,126,962 | \$ 1,105,143 | \$ 17,232,125 | \$ 1,105,143 | \$ 1,212,193,869 | \$ 310,998,178 |
| 6/29/02 | \$ 23,286,827 | \$ 4,847,571 | \$ 847,602 | \$ 15,279,369 | \$ 1,018,471 | \$ 16,290,896 | \$ 1,018,471 | \$ 1,240,500,463 | \$ 275,008,575 |
| 9/29/02 | \$ 23,286,827 | \$ 4,718,723 | \$ 827,224 | \$ 14,452,145 | \$ 918,369 | \$ 15,400,514 | \$ 918,369 | \$ 1,268,690,387 | \$ 254,186,872 |
| 12/29/02 | \$ 23,286,827 | \$ 4,591,174 | \$ 817,174 | \$ 13,664,971 | \$ 812,163 | \$ 14,477,134 | \$ 812,163 | \$ 1,288,002,340 | \$ 234,186,519 |
| 3/29/03 | \$ 23,286,827 | \$ 4,465,758 | \$ 806,468 | \$ 12,918,203 | \$ 700,000 | \$ 13,618,203 | \$ 700,000 | \$ 1,307,791,410 | \$ 215,007,448 |
| 6/29/03 | \$ 23,286,827 | \$ 4,342,310 | \$ 795,310 | \$ 12,202,893 | \$ 582,000 | \$ 12,836,893 | \$ 582,000 | \$ 1,327,000,000 | \$ 195,000,000 |
| 9/29/03 | \$ 23,286,827 | \$ 4,220,813 | \$ 784,153 | \$ 11,518,040 | \$ 459,000 | \$ 12,277,040 | \$ 459,000 | \$ 1,346,250,000 | \$ 174,250,000 |
| 12/29/03 | \$ 23,286,827 | \$ 4,100,267 | \$ 773,000 | \$ 10,864,240 | \$ 332,000 | \$ 11,836,240 | \$ 332,000 | \$ 1,364,550,000 | \$ 152,550,000 |
| 3/29/04 | \$ 23,286,827 | \$ 3,980,672 | \$ 761,847 | \$ 10,231,393 | \$ 200,000 | \$ 11,031,393 | \$ 200,000 | \$ 1,381,900,000 | \$ 130,000,000 |
| 6/29/04 | \$ 23,286,827 | \$ 3,861,935 | \$ 750,694 | \$ 9,620,500 | \$ 60,000 | \$ 10,620,500 | \$ 60,000 | \$ 1,398,300,000 | \$ 107,000,000 |
| 9/29/04 | \$ 23,286,827 | \$ 3,744,058 | \$ 739,541 | \$ 9,030,559 | \$ 0 | \$ 10,230,559 | \$ 0 | \$ 1,413,750,000 | \$ 83,750,000 |
| 12/29/04 | \$ 23,286,827 | \$ 3,628,041 | \$ 728,388 | \$ 8,460,672 | \$ 0 | \$ 9,858,672 | \$ 0 | \$ 1,428,250,000 | \$ 59,250,000 |
| 3/29/05 | \$ 23,286,827 | \$ 3,513,884 | \$ 717,235 | \$ 7,910,739 | \$ 0 | \$ 9,308,739 | \$ 0 | \$ 1,441,800,000 | \$ 33,800,000 |
| 6/29/05 | \$ 23,286,827 | \$ 3,401,587 | \$ 706,082 | \$ 7,380,762 | \$ 0 | \$ 8,778,762 | \$ 0 | \$ 1,454,400,000 | \$ 7,000,000 |
| 9/29/05 | \$ 23,286,827 | \$ 3,291,140 | \$ 694,929 | \$ 6,870,741 | \$ 0 | \$ 8,268,741 | \$ 0 | \$ 1,466,050,000 | \$ 0 |
| 12/29/05 | \$ 23,286,827 | \$ 3,181,553 | \$ 683,776 | \$ 6,380,676 | \$ 0 | \$ 7,778,676 | \$ 0 | \$ 1,476,750,000 | \$ 0 |
| 3/29/06 | \$ 23,286,827 | \$ 3,072,826 | \$ 672,623 | \$ 5,910,563 | \$ 0 | \$ 7,308,563 | \$ 0 | \$ 1,486,500,000 | \$ 0 |
| 6/29/06 | \$ 23,286,827 | \$ 2,964,459 | \$ 661,470 | \$ 5,460,402 | \$ 0 | \$ 6,858,402 | \$ 0 | \$ 1,495,300,000 | \$ 0 |
| 9/29/06 | \$ 23,286,827 | \$ 2,857,451 | \$ 650,317 | \$ 5,030,293 | \$ 0 | \$ 6,428,293 | \$ 0 | \$ 1,503,150,000 | \$ 0 |
| 12/29/06 | \$ 23,286,827 | \$ 2,751,794 | \$ 639,164 | \$ 4,620,136 | \$ 0 | \$ 6,018,136 | \$ 0 | \$ 1,510,050,000 | \$ 0 |
| 3/29/07 | \$ 23,286,827 | \$ 2,647,487 | \$ 628,011 | \$ 4,230,031 | \$ 0 | \$ 5,628,031 | \$ 0 | \$ 1,516,000,000 | \$ 0 |
| 6/29/07 | \$ 23,286,827 | \$ 2,544,530 | \$ 616,858 | \$ 3,859,978 | \$ 0 | \$ 5,257,978 | \$ 0 | \$ 1,521,000,000 | \$ 0 |
| 9/29/07 | \$ 23,286,827 | \$ 2,443,023 | \$ 605,705 | \$ 3,509,977 | \$ 0 | \$ 4,907,977 | \$ 0 | \$ 1,525,000,000 | \$ 0 |
| 12/29/07 | \$ 23,286,827 | \$ 2,342,966 | \$ 594,552 | \$ 3,179,928 | \$ 0 | \$ 4,577,928 | \$ 0 | \$ 1,528,000,000 | \$ 0 |
| 3/29/08 | \$ 23,286,827 | \$ 2,244,359 | \$ 583,400 | \$ 2,869,833 | \$ 0 | \$ 4,267,833 | \$ 0 | \$ 1,530,000,000 | \$ 0 |
| 6/29/08 | \$ 23,286,827 | \$ 2,147,202 | \$ 572,247 | \$ 2,579,792 | \$ 0 | \$ 3,977,792 | \$ 0 | \$ 1,531,000,000 | \$ 0 |
| 9/29/08 | \$ 23,286,827 | \$ 2,051,495 | \$ 561,094 | \$ 2,309,705 | \$ 0 | \$ 3,707,705 | \$ 0 | \$ 1,531,000,000 | \$ 0 |
| 12/29/08 | \$ 23,286,827 | \$ 1,957,238 | \$ 550,000 | \$ 2,059,672 | \$ 0 | \$ 3,457,672 | \$ 0 | \$ 1,530,000,000 | \$ 0 |
| 3/29/09 | \$ 23,286,827 | \$ 1,864,431 | \$ 538,957 | \$ 1,829,593 | \$ 0 | \$ 3,227,593 | \$ 0 | \$ 1,528,000,000 | \$ 0 |
| 6/29/09 | \$ 23,286,827 | \$ 1,773,074 | \$ 527,914 | \$ 1,619,468 | \$ 0 | \$ 3,017,468 | \$ 0 | \$ 1,525,000,000 | \$ 0 |
| 9/29/09 | \$ 23,286,827 | \$ 1,683,167 | \$ 516,871 | \$ 1,429,297 | \$ 0 | \$ 2,827,297 | \$ 0 | \$ 1,521,000,000 | \$ 0 |
| 12/29/09 | \$ 23,286,827 | \$ 1,594,810 | \$ 505,828 | \$ 1,249,070 | \$ 0 | \$ 2,647,070 | \$ 0 | \$ 1,516,000,000 | \$ 0 |
| 3/29/10 | \$ 23,286,827 | \$ 1,508,013 | \$ 494,785 | \$ 1,078,787 | \$ 0 | \$ 2,486,787 | \$ 0 | \$ 1,510,000,000 | \$ 0 |
| 6/29/10 | \$ 23,286,827 | \$ 1,422,776 | \$ 483,742 | \$ 918,444 | \$ 0 | \$ 2,346,444 | \$ 0 | \$ 1,503,000,000 | \$ 0 |
| 9/29/10 | \$ 23,286,827 | \$ 1,339,099 | \$ 472,699 | \$ 768,051 | \$ 0 | \$ 2,216,051 | \$ 0 | \$ 1,495,000,000 | \$ 0 |
| 12/29/10 | \$ 23,286,827 | \$ 1,256,982 | \$ 461,656 | \$ 627,608 | \$ 0 | \$ 2,095,608 | \$ 0 | \$ 1,486,000,000 | \$ 0 |
| 3/29/11 | \$ 23,286,827 | \$ 1,176,425 | \$ 450,613 | \$ 497,115 | \$ 0 | \$ 1,985,115 | \$ 0 | \$ 1,475,000,000 | \$ 0 |
| 6/29/11 | \$ 23,286,827 | \$ 1,097,428 | \$ 439,570 | \$ 376,572 | \$ 0 | \$ 1,884,572 | \$ 0 | \$ 1,462,000,000 | \$ 0 |
| 9/29/11 | \$ 23,286,827 | \$ 1,019,991 | \$ 428,527 | \$ 266,029 | \$ 0 | \$ 1,794,029 | \$ 0 | \$ 1,447,000,000 | \$ 0 |
| 12/29/11 | \$ 23,286,827 | \$ 944,124 | \$ 417,484 | \$ 165,486 | \$ 0 | \$ 1,713,486 | \$ 0 | \$ 1,430,000,000 | \$ 0 |
| 3/29/12 | \$ 23,286,827 | \$ 869,837 | \$ 406,441 | \$ 74,943 | \$ 0 | \$ 1,642,943 | \$ 0 | \$ 1,411,000,000 | \$ 0 |
| 6/29/12 | \$ 23,286,827 | \$ 797,120 | \$ 395,398 | \$ 0 | \$ 0 | \$ 1,582,398 | \$ 0 | \$ 1,389,000,000 | \$ 0 |
| 9/29/12 | \$ 23,286,827 | \$ 725,983 | \$ 384,355 | \$ 0 | \$ 0 | \$ 1,531,855 | \$ 0 | \$ 1,363,000,000 | \$ 0 |
| 12/29/12 | \$ 23,286,827 | \$ 656,326 | \$ 373,312 | \$ 0 | \$ 0 | \$ 1,491,312 | \$ 0 | \$ 1,333,000,000 | \$ 0 |
| 3/29/13 | \$ 23,286,827 | \$ 588,149 | \$ 362,269 | \$ 0 | \$ 0 | \$ 1,461,269 | \$ 0 | \$ 1,299,000,000 | \$ 0 |
| 6/29/13 | \$ 23,286,827 | \$ 521,452 | \$ 351,226 | \$ 0 | \$ 0 | \$ 1,441,226 | \$ 0 | \$ 1,261,000,000 | \$ 0 |
| 9/29/13 | \$ 23,286,827 | \$ 456,235 | \$ 340,183 | \$ 0 | \$ 0 | \$ 1,431,183 | \$ 0 | \$ 1,219,000,000 | \$ 0 |
| 12/29/13 | \$ 23,286,827 | \$ 392,508 | \$ 329,140 | \$ 0 | \$ 0 | \$ 1,431,140 | \$ 0 | \$ 1,173,000,000 | \$ 0 |
| 3/29/14 | \$ 23,286,827 | \$ 330,271 | \$ 318,097 | \$ 0 | \$ 0 | \$ 1,441,097 | \$ 0 | \$ 1,123,000,000 | \$ 0 |
| 6/29/14 | \$ 23,286,827 | \$ 269,534 | \$ 307,054 | \$ 0 | \$ 0 | \$ 1,461,054 | \$ 0 | \$ 1,069,000,000 | \$ 0 |
| 9/29/14 | \$ 23,286,827 | \$ 210,307 | \$ 296,011 | \$ 0 | \$ 0 | \$ 1,491,011 | \$ 0 | \$ 1,011,000,000 | \$ 0 |
| 12/29/14 | \$ 23,286,827 | \$ 152,580 | \$ 285,000 | \$ 0 | \$ 0 | \$ 1,531,000 | \$ 0 | \$ 950,000,000 | \$ 0 |
| 3/29/15 | \$ 23,286,827 | \$ 96,353 | \$ 274,000 | \$ 0 | \$ 0 | \$ 1,581,000 | \$ 0 | \$ 885,000,000 | \$ 0 |
| 6/29/15 | \$ 23,286,827 | \$ 41,126 | \$ 263,000 | \$ 0 | \$ 0 | \$ 1,641,000 | \$ 0 | \$ 816,000,000 | \$ 0 |
| 9/29/15 | \$ 23,286,827 | \$ 0 | \$ 252,000 | \$ 0 | \$ 0 | \$ 1,711,000 | \$ 0 | \$ 743,000,000 | \$ 0 |
| 12/29/15 | \$ 23,286,827 | \$ 0 | \$ 241,000 | \$ 0 | \$ 0 | \$ 1,791,000 | \$ 0 | \$ 666,000,000 | \$ 0 |
| 3/29/16 | \$ 23,286,827 | \$ 0 | \$ 230,000 | \$ 0 | \$ 0 | \$ 1,881,000 | \$ 0 | \$ 586,000,000 | \$ 0 |
| 6/29/16 | \$ 23,286,827 | \$ 0 | \$ 219,000 | \$ 0 | \$ 0 | \$ 1,981,000 | \$ 0 | \$ 503,000,000 | \$ 0 |
| 9/29/16 | \$ 23,286,827 | \$ 0 | \$ 208,000 | \$ 0 | \$ 0 | \$ 2,091,000 | \$ 0 | \$ 417,000,000 | \$ 0 |
| 12/29/16 | \$ 23,286,827 | \$ 0 | \$ 197,000 | \$ 0 | \$ 0 | \$ 2,211,000 | \$ 0 | \$ 328,000,000 | \$ 0 |
| 3/29/17 | \$ 23,286,827 | \$ 0 | \$ 186,000 | \$ 0 | \$ 0 | \$ 2,341,000 | \$ 0 | \$ 236,000,000 | \$ 0 |
| 6/29/17 | \$ 23,286,827 | \$ 0 | \$ 175,000 | \$ 0 | \$ 0 | \$ 2,481,000 | \$ 0 | \$ 141,000,000 | \$ 0 |
| 9/29/17 | \$ 23,286,827 | \$ 0 | \$ 164,000 | \$ 0 | \$ 0 | \$ 2,631,000 | \$ 0 | \$ 46,000,000 | \$ 0 |
| 12/29/17 | \$ 23,286,827 | \$ 0 | \$ 153,000 | \$ 0 | \$ 0 | \$ 2,791,000 | \$ 0 | \$ 0 | \$ 0 |
| 3/29/18 | \$ 23,286,827 | \$ 0 | \$ 142,000 | \$ 0 | \$ 0 | \$ 2,961,000 | \$ 0 | \$ 0 | \$ 0 |
| 6/29/18 | \$ 23,286,827 | \$ 0 | \$ 131,000 | \$ 0 | \$ 0 | \$ 3,141,000 | \$ 0 | \$ 0 | \$ 0 |
| 9/29/18 | \$ 23,286,827 | \$ 0 | \$ 120,000 | \$ 0 | \$ 0 | \$ 3,331,000 | \$ 0 | \$ 0 | \$ 0 |
| 12/29/18 | \$ 23,286,827 | \$ 0 | \$ 109,000 | \$ 0 | \$ 0 | \$ 3,531,000 | \$ 0 | \$ 0 | \$ 0 |
| 3/29/19 | \$ 23,286,827 | \$ 0 | \$ 98,000 | \$ 0 | \$ 0 | \$ 3,741,000 | \$ 0 | \$ 0 | \$ 0 |
| 6/29/19 | \$ 23,286,827 | \$ 0 | \$ 87,000 | \$ 0 | \$ 0 | \$ 3,961,000 | \$ 0 | \$ 0 | \$ 0 |
| 9/29/19 | \$ 23,286,827 | \$ 0 | \$ 76,000 | \$ 0 | \$ 0 | \$ 4,191,000 | \$ 0 | \$ 0 | \$ 0 |
| 12/29/19 | \$ 23,286,827 | \$ 0 | \$ 65,000 | \$ 0 | \$ 0 | \$ 4,431,000 | \$ 0 | \$ 0 | \$ 0 |
| 3/29/20 | \$ 23,286,827 | \$ 0 | \$ 54,000 | \$ 0 | \$ 0 | \$ 4,681,000 | \$ 0 | \$ 0 | \$ 0 |
| 6/29/20 | \$ 23,286,827 | \$ 0 | \$ 43,000 | \$ 0 | \$ 0 | \$ 4,941,000 | \$ 0 | \$ 0 | \$ 0 |
| 9/29/20 | \$ 23,286,827 | \$ 0 | \$ 32,000 | \$ 0 | \$ 0 | \$ 5,211,000 | \$ 0 | \$ 0 | \$ 0 |
| 12/29/20 | \$ 23,286,827 | \$ 0 | \$ 21,000 | \$ 0 | \$ 0 | \$ 5,491,000 | \$ 0 | \$ 0 | \$ 0 |
| 3/29/21 | \$ 23,286,827 | \$ 0 | \$ 10,000 | \$ 0 | \$ 0 | \$ 5,781,000 | \$ 0 | \$ 0 | \$ 0 |
| 6/29/21 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 6,081,000 | \$ 0 | \$ 0 | \$ 0 |
| 9/29/21 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 6,391,000 | \$ 0 | \$ 0 | \$ 0 |
| 12/29/21 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 6,711,000 | \$ 0 | \$ 0 | \$ 0 |
| 3/29/22 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 7,041,000 | \$ 0 | \$ 0 | \$ 0 |
| 6/29/22 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 7,381,000 | \$ 0 | \$ 0 | \$ 0 |
| 9/29/22 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 7,731,000 | \$ 0 | \$ 0 | \$ 0 |
| 12/29/22 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 8,091,000 | \$ 0 | \$ 0 | \$ 0 |
| 3/29/23 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 8,461,000 | \$ 0 | \$ 0 | \$ 0 |
| 6/29/23 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 8,841,000 | \$ 0 | \$ 0 | \$ 0 |
| 9/29/23 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 9,231,000 | \$ 0 | \$ 0 | \$ 0 |
| 12/29/23 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 9,631,000 | \$ 0 | \$ 0 | \$ 0 |
| 3/29/24 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 10,041,000 | \$ 0 | \$ 0 | \$ 0 |
| 6/29/24 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 10,461,000 | \$ 0 | \$ 0 | \$ 0 |
| 9/29/24 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 10,891,000 | \$ 0 | \$ 0 | \$ 0 |
| 12/29/24 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 11,331,000 | \$ 0 | \$ 0 | \$ 0 |
| 3/29/25 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 11,781,000 | \$ 0 | \$ 0 | \$ 0 |
| 6/29/25 | \$ 23,286,827 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 12,241,000 | \$ 0 | \$ 0 | \$ 0 |
| 9/29/25 | \$ 23, | | | | | | | | |

5/25 Recharacterization Rider

- Upon a recharacterization, the Rider attempts to recast any principal paid in excess of 25% of the recharacterized loan as instead being a loan from Finco to Flagstaff.
- Enron and JPMorgan should consider a "side letter" confirming the numerical interpretation of the Rider (with reference to a model such as the following)

| Switch Ending | Bills Case: Finco Loan recharacterized as a bill loan | | Recharacterized Loan with "Reformation Clause" Applied | | | | | | | | |
|---------------|---|-------------------------|--|------------------------|--|--|---|---|-----------------------------------|---|---|
| | Finco Coupon A | Flagstaff Interest B | Flagstaff Principal C | Flagstaff Balance D | Finco / Flagstaff Loan Balance E-Previous G | Finco Coupon Payment to Flagstaff F-A | Flagstaff Principal Paid to Enron (\$400mm) G-C* | Interest Due on Loan to Finco H-E-Cou Rate | Deemed Finco Flagstaff J-F-G-H | Zero Coupon Interest on Cumulative to Flagstaff K-F-Cou Rate | Cumulative Finco Flagstaff H-Beginning |
| 0 | \$0 | \$0 | \$0 | \$400 | \$400 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
| 1 | \$96 | \$25 | \$71 | \$329 | \$329 | \$96 | \$71 | \$25 | \$0 | \$0 | \$0 |
| 2 | \$96 | \$21 | \$75 | \$254 | \$300 | \$96 | \$29 | \$21 | \$48 | \$0 | \$48 |
| 3 | \$96 | \$18 | \$80 | \$174 | \$300 | \$96 | \$0 | \$18 | \$77 | \$3 | \$128 |
| 4 | \$96 | \$11 | \$85 | \$89 | \$300 | \$96 | \$0 | \$19 | \$77 | \$6 | \$211 |
| 5 | \$96 | \$8 | \$90 | \$0 | \$300 | \$96 | \$0 | \$19 | \$77 | \$13 | \$201 |

* Cumulative limited to 25% = \$400MM.
** Deemed interest is to be zero coupon interest.

| Gross Finco / Set-off | | Net Cash Paid from Flagstaff | |
|--|--------------------------------|-----------------------------------|------------------------------|
| Flagstaff Interest Paid (25% of \$400mm) | Deemed Finco Loan to Flagstaff | Interest Due on Loan to Flagstaff | Net Cash Paid from Flagstaff |
| J-K | J-L | M-N | L-I-N-K |
| \$0 | \$0 | \$0 | \$0 |
| \$71 | \$0 | \$25 | \$96 |
| \$29 | \$48 | \$21 | \$96 |
| \$0 | \$77 | \$18 | \$96 |
| \$0 | \$77 | \$19 | \$96 |
| \$0 | \$77 | \$19 | \$96 |

FOIA Confidential
Treatment Requested by JPMC

SENATE
FL-00075

JPMorgan

10

Timetable; Engagement Letter

- **Engagement Letter**
 - Enron to provide comments on revised Engagement Letter / Fee Letter / Term Sheets
- **Timetable**
 - Drafting of Transaction Documents
 - Syndication Process
 - Enron time requirements for De-consolidation vehicle and Subco funding.
 - Any "Drop Dead" Dates?

blake

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T2P 4J8

June 23, 2001

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Wallace Y. Shaw
Barrister & Solicitor
Direct Dial: 403.260.9766
E-mail: wally.shaw@blakes.com

Reference: 84411/16

Enron North America Corp.
1400 Smith Street
Houston, Texas
77002
U.S.A.

Attention: Stephen Douglas, Senior Director

Dear Sirs:

Re: Canadian Tax Consequences of Proposed Financing

You have asked for our opinion concerning the principal Canadian federal tax considerations under the *Income Tax Act* (Canada) (the "Act") in connection with the proposed financing structure (the "Financing") as described below.

I. **FACTS ASSUMED**

Following is our understanding of the relevant facts including the terms of the documents (the "Operating Agreements") described in Section II(d) hereof:

1. *Compagnie Papiers Stadacona, Ltee*, a private Canadian unlimited liability company ("Canco") indirectly controlled by a limited partnership (the "Partnership") (the General Partner of which is controlled by Enron Corp. ("Parent")) acquired all of the shares of Daishowa Forest Products Limited, a Canadian private operating company ("Target") which had a wholly owned operating subsidiary *Compagnie de Papiers Stadacona, Ltee* (the "Subsidiary"). The purchase price was initially to be funded by a loan from Parent (the "Parent Loan"). Following the acquisition and Financing, a series of transactions will take place resulting in substantially all of the assets of Target and Subsidiary being held by Canco. Canco will continue to have substantial Canadian business operations through the life of the financing described below. None of Canco and any of its subsidiaries is a "financial institution" as defined in subsection 142.2(1) of the Act or as defined in subsection 181(1) of the Act.
2. J.P. Morgan ("JP") has established Flagstaff Capital Corporation ("SPV") as a special purpose entity under the laws of Delaware. SPV is a corporation resident in the United States and entitled to the benefits of the *Canada-United States Income Tax Convention* (the "Treaty").
3. Canco has incorporated two new wholly owned Canadian subsidiaries ("Finco") and ("Subco") which are unlimited liability corporations.
4. Finco will borrow approximately \$1.5 billion from SPV pursuant to the Finco Credit Agreement (the "Finco Loan"). The Finco Loan is subject to support agreements (the "Support Agreements") between SPV and Parent as reflected in the Warrant, the Put Option Agreement, the Enron Agreement, the ISDA Master Agreement, the Total Return Swap Confirmation and the Performance Guarantee pursuant to which Parent

30359430.11

Blake, Cassels & Graydon LLP is a limited liability partnership under the laws of Ontario

Toronto

Ottawa

London, U.K.

Beijing

Permanent Subcommittee on Investigations

EXHIBIT #352

EC2 000047037

blake

Page 2

supports the ultimate payment of the Finco Loan. The maturity date of the Finco Loan is five years plus one day from the date of drawdown. All of the Finco Loan principal is payable at maturity. Interest on the Finco Loan is payable at a fixed market rate:

5. Finco will on lend the borrowed funds to Canco (the "Canco Loan") which will use a portion of the borrowed funds to repay the Parent Loan and the balance will be loaned (the "Opco Loan") to an existing Canadian private corporation ("Opco") controlled by Parent which carries on business in Canada. Opco will use the Opco Loan for the purpose of earning income from its Canadian business, including repaying loans, the proceeds from which were used for the purpose of earning income from its Canadian business or as subscription proceeds for preferred shares of a Canadian private corporation related to it (Opco II). Opco II will in turn use the proceeds of the share subscription for the purpose of earning income from its Canadian business, including paying an affiliate of Parent to terminate "out-of-the-money" contracts between Parent and Opco II. The interest rate on the Opco Loan will exceed by .01% the interest rate on the Canco Loan which will in turn exceed the interest rate on the Finco loan by [.0%]. The dividend rate on such preferred shares of Opco II will exceed the interest rate on the Opco Loan by .01%.
6. Parent will subscribe and pay Opco II approximately \$1 billion (the "Opco Capitalization") in consideration of the issuance by Opco II of that number of redeemable, retractable preferred shares of Opco II which have a redemption amount equal to the Opco Capitalization. Opco II will use the Opco Capitalization to subscribe and pay for one billion \$1.00 redeemable, retractable preferred shares of Opco which have an aggregate redemption amount equal to the Opco Capitalization (the "Opco Preferred Shares"). Opco will use the Opco Capitalization to subscribe and pay for that number of \$1.00 redeemable, retractable cumulative preferred shares of Subco which have an aggregate redemption amount equal to the Opco Capitalization (the "Subco Shares").
7. Subco and Finco will then enter into an agreement (the "Subscription Agreement") pursuant to which Subco agrees to subscribe for and Finco agrees to issue that number of non-voting \$1.00 redeemable retractable convertible preferred shares of Finco which have an aggregate redemption amount equal to the principal amount of the Finco Loan (the "Class A Preferred Shares") for an amount equal to such aggregate redemption amount (the "Subscription Price"). At the inception of the agreement, Subco pays Finco \$10, and the remaining subscription price (the "Subscription Balance") is payable immediately after the Finco Loan is repaid in full. Subco's obligation to pay the Subscription Balance is subject to the condition that SPV has received repayment of the Finco Loan.
8. Subco will enter into an agreement with SPV (the "Assumption Agreement") pursuant to which SPV assumes Subco's obligation to pay the Subscription Balance to Finco in consideration for the current payment by Subco to SPV of an amount equal to the Opco Capitalization (the "Assumption Payment"). Subco will retain the right to receive the Class A Preferred Shares. Finco will acknowledge the assumption and release Subco from its obligations under the Subscription Agreement such that Finco may look only to SPV to receive the Subscription Balance. SPV's obligation to pay the Subscription Balance will be subject to the same conditions that applied to Subco's obligations under the Subscription Agreement. [The Assumption Payment will be deposited with an escrow agent for release to SPV upon SPV having made the Finco Loan].
9. Upon the Finco Loan becoming payable:
 - (a) Canco will repay the principal of the Canco Loan to Finco. The funds to repay the Canco Loan will be provided from the repayment by Opco of the Opco Loan and from Canco's available funds. It is expected that any shortfall would be funded by Parent.
 - (b) Finco will repay the principal amount of the Finco Loan to SPV;
 - (c) SPV will pay the Subscription Balance under the Assumption Agreement to Finco;

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- (d) Finco will issue the Class A Preferred Shares to Subco.
- (e) The obligations under (b) and (c) may be set off upon the Finco Loan becoming payable.

II. SCOPE OF REVIEW

(a) Basis of Opinion

Our opinions are based upon the current provisions of the Act, the current regulations under the Act (the "Regulations"), all specific proposed amendments to the Act and Regulations detailed in public statements issued by the Department of Finance, Canada prior to the date hereof and our understanding of the current administrative policies and assessing practices of the Canada Customs and Revenue Agency ("Revenue Canada"). The opinion does not address capital tax issues other than the large corporation tax pursuant to Part I.3 of the Act. Our opinions do not otherwise anticipate any changes in law or administrative or assessing practices, whether by legislative or other governmental or judicial action, nor do they take into account or consider any sales, use, or goods and services taxes or any provincial, territorial or foreign income or other tax legislation or considerations (apart from the provincial capital tax issues specifically referred to). In addition, our opinions do not anticipate any changes in judicial interpretation of common law doctrines or the general principles of judicial interpretation applicable to tax legislation. It is possible that, by the time the matters described above are considered by a court, jurisprudence or administrative practice may have developed which would dictate a result at variance from our opinions. Unless otherwise indicated, our opinions are not intended to be and should not be construed as opinions with respect to the likelihood of Revenue Canada challenging the proposed transactions. Rather, our opinions are intended to state our views as to the manner in which these matters would be dealt with by a court in the event that litigation ensues.

Our opinion assumes all transactions contemplated herein are carried out in the manner described, all such transactions are legally effective and, in particular, all funds flow and are sourced and used in the specific manner described herein.

It is to be noted that we have not provided legal or tax advice to any person other than Enron North America Corp. in connection with the proposed transactions and no other person is entitled to rely on this letter.

We also note that any distribution of this letter to any person other than the addressee may cause it to lose its status as a privileged communication. Circulation of this letter should therefore be carefully monitored.

(b) Documents Reviewed

- (i) Enron Agreement by Enron Corp. in favour of SPV and The Indemnified Persons Referred to Therein (the "Enron Agreement");
- (ii) Credit Agreement among, Finco, SPV and The Chase Manhattan Bank (the "Finco Credit Agreement");
- (iii) Credit and Security Agreement among SPV, Lenders and The Chase Manhattan Bank (the "Flagstaff Credit Agreement");
- (iv) Put Option Agreement between Parent and SPV (the "Put Option Agreement");

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- (v) Total Return Swap Confirmation (the "Total Return Swap Agreement");
- (vi) Schedule to the ISDA Master Agreement between Enron Corp. and SPV (the "Total Return Swap Agreement");
- (vii) Warrant Agreement between Finco Inc. and SPV (the "Warrant Agreement");
- (viii) Share Subscription Agreement between Finco and Subco (the "Share Subscription Agreement");
- (ix) Subscription Payment Assumption Agreement among SPV, Subco and Finco (the "Subscription Payment Assumption Agreement");
- (x) Administration Agreement between SPV and The Chase Manhattan Bank (the "Administration Agreement");
- (xi) Performance Guaranty Agreement between The Chase Manhattan Bank in favour of the Beneficiaries Named Therein (the "Performance Guarantees"); and
- (xii) Amended and Restated Limited Partnership Agreement of Sundance Industrial Partners, L.P. (the "Limited Partnership Agreement").

III. SUMMARY OF CONCLUSIONS

Subject to the understandings, assumptions, qualifications, discussions, recommendations and analysis contained herein, in our opinion (unless otherwise defined, capitalized terms have the meaning given thereto in the Documents):

- (a) the interest and Make Whole Payment (if applicable) paid by Finco to SPV in respect of the Finco Loan should be exempt from withholding tax under the Act by reason of the exemption contained in subparagraph 212(1)(b)(vii) of the Act;
- (b) but for the provisions of subsection 18(4) of the Act, the interest payable by Finco to SPV in accordance with the terms of the Finco Loan would be deductible to Finco in computing its income pursuant to paragraph 20(1)(c) of the Act, and such deductibility should not be denied by reason of subsection 18(4) of the Act;
- (c) subsection 17(1) of the Act should not apply to require Finco or Subco to include any imputed interest amount in income with respect to SPV's obligation under the Assumption Agreement;
- (d) neither Subco nor Finco should be required to include any amount in its income on an accrual basis pursuant to subsection 12(3) of the Act and Regulation 7000 by reason of SPV's obligation to Finco under the Assumption Agreement;
- (e) the issuance of the Class A Preferred Shares by Finco and acquisition thereof by Subco pursuant to the Subscription Agreement will not in and of itself result in Subco realizing a capital gain for the purposes of the Act;

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- (f) Subco will not be required to include any amount in its income pursuant to subsection 16(1) of the Act by reason of the acquisition of the Class A Preferred Shares pursuant to the Subscription Agreement;
- (g) the interest paid by Canco to Finco in accordance with the terms of the Canco Loan should be deductible to Canco in computing its income pursuant to paragraph 20(1)(c) of the Act, provided that Canco uses the proceeds of the Canco Loan for the purpose of earning income from a business or property and the use of such proceeds to repay the Parent Loan and make the Opco Loan should qualify for such purposes;
- (h) the interest payable by Opco to Canco in accordance with the terms of the Opco Loan should be deductible to Opco in computing its income pursuant to paragraph 20(1)(c) of the Act, provided that Opco uses the proceeds of the Opco Loan for the purpose of earning income from a business or property (other than borrowed money used to acquire property, the income of which would be exempt, or to acquire a life insurance policy) or to repay existing Loans borrowed for such purposes;
- (i) the Make-Whole Payments payable by Canco to Finco and by Finco to SPV pursuant to the terms of the Canco Loan and the Finco Loan should be deductible by Canco and Finco respectively to the extent that they do not exceed a "reasonable" amount. We render no opinion with respect to the reasonableness of the Make-Whole Payments;
- (j) the amount of all loans and share subscriptions described in the proposed transactions will be included in the taxable capital of the recipient of such amounts for the purposes of the large corporations tax imposed under Part I.3 of the Tax Act and all such loans or share subscriptions will be included in the "investment allowance" of the corporation making such loan or share subscription, provided that the payment of the Assumption Payment by Subco to SPV pursuant to the Assumption Agreement will not be included in the investment allowance of Subco.
- (k) a benefit will not be considered to have been conferred for the purposes of subsection 15(1) and section 246 of the Act by virtue of the issuance of the Class A Preferred Shares by Finco to Subco.
- (l) Section 80 of the Act will not apply to the repayment by Finco of the Finco Loan if the Finco Loan is repaid in full, including if it is repaid by way of set off against the Subscription Payment;
- (m) none of the proposed transactions constitute the acquisition of a "tax shelter" for the purposes of section 237.1 of the Act.
- (n) neither the existing judicial anti-avoidance doctrines nor the statutory general anti-avoidance rule contained in section 245 of the Act should apply to the transactions described herein to redetermine the conclusions set out above.

IV. DISCUSSION

A. Technical Analysts

The analysis and opinions under this part are subject to the application of the anti-avoidance principles and provisions discussed in Section B below.

I. Issues for Finco and SPV

- (a) Withholding Tax Exemption

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No Canadian withholding tax applies to payments of principal under a debt obligation where the debt is issued for an amount which is not less than the principal amount thereof. However, non-resident withholding tax will apply to interest payments on the Finco Loan unless an exemption from withholding tax applies.

The only available exemption from withholding tax on interest payments on the Finco Loan is provided for in subparagraph 212(1)(b)(vii) of the Act. This exemption will apply provided that the following conditions are satisfied:

- (i) SPV and Finco are dealing at arm's length with each other at the time of each payment of interest under the Finco Loan;
- (ii) Finco may not under any circumstances be obliged to pay more than 25% of the principal amount of the Finco Loan within 5 years from the date of advance of the Finco Loan except in the event of a failure or default under the terms of the Finco Loan or any agreement relating thereto or if the terms of the Finco Loan or any agreement relating thereto become unlawful or are changed by virtue of legislation or by a court, statutory board or commission; and
- (iii) no portion of the interest on the Finco Loan is contingent or dependent on the use of or production from property in Canada or is computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion.

In our opinion, items (i) and (ii) above are satisfied.

With respect to item (i) above, the Act provides that related persons are deemed not to deal at arm's length, and that it is a question of fact whether persons not related to each other are at any particular time dealing at arm's length. SPV has at all times no interest or right to acquire any interest in or in respect of (including rights to vote) shares of any of Finco, Subco or Canco, other than its right to acquire non-voting Class B preferred shares of Finco pursuant to the Warrant. While it has obligations under the Assumption Agreement it has no right to subscribe for the Class A Preferred Shares. Therefore, there is no provision of the Act which would deem SPV not to deal at arm's length with Finco.

Whether SPV and Finco in fact deal at arm's length will depend on all of the factual circumstances and the actual conduct of the parties. The case law indicates that two parties will not be considered to be dealing at arm's length if one party has de facto control over the other party, if one person dictates the terms of the transaction, if the parties act in concert and in the same interest to achieve a common objective, if one party is acting merely to accommodate the other or is captive to the interests of the other, or if there is no evidence of true bargaining between parties with independent interests.

In Interpretation Bulletin IT-419, the Canada Customs and Revenue Agency has stated that the following are its guidelines in determining whether a transaction is at arm's-length:

1. the existence of a common mind that directs the bargaining for both parties to a transaction;
2. the parties to the transaction acting in concert without separate interest - different interests are considered to exist when each party has an independent interest from the other parties to a transaction, notwithstanding the fact that each party may have the same purpose, such as economic gain;
3. de facto control - excessive and/or constant advantage, authority or influence can constitute de facto control (i.e. effective without legal control) and merely the ability to exercise an advantage may be a factor; and

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4. failure to carry out a transaction at fair market value, or the lack of separate economic interests which reflect "ordinary commercial dealing between parties acting in their separate interests".

We assume that it will be possible to demonstrate that at all material times, none of the above circumstances existed with respect to the proposed transaction. In particular, we have assumed that (i) SPV is legally controlled by JP and Parent has no representation of any form in the control or management of SPV, and (ii) the Support Agreements reflect ordinary commercial dealings between parties acting at arm's length and are on terms similar to those found in other arrangements between Parent and JP. To the extent we have been involved in the negotiations between the parties, it is our view that none of the criteria described in paragraphs 1 to 4 above have been evident.

We have also considered the nature and amount of the "Make-Whole Payment" which could, on an early repayment of the Finco Loan, be large in comparison to the amount of the Finco Loan. However, in our view the terms of the overall Make-Whole Payment and, in particular (i) the fact it is generally within the control of Finco whether a Make-Whole Payment is ever made, and (ii) the fact that subsection 13(9.1) of the Act specifically contemplates payments of this type in this quantum, will not give rise to a non-arm's length relationship between SPV and Finco.

Based on the foregoing, in our opinion the withholding tax exemption under subparagraph 212(1)(b)(vii) of the Act would be available subject to the issues described below under GAAR.

2. Issues for Finco

(a) Interest Deductibility

Interest is generally not deductible pursuant to the provisions of the Act unless such interest is deductible in accordance with paragraph 20(1)(c) of the Act. Such paragraph provides that a Canadian taxpayer may deduct interest provided (i) it is reasonable, (ii) it is payable pursuant to a legal obligation, and (iii) it is interest on borrowed money used for the purpose of earning income from a business or property. We assume that the interest payable by Finco on the Finco Loan from SPV will be commercially reasonable and will be a legal liability of Finco. This leaves three issues which require further analysis.

- (i) Terms of the Finco Loan - We have reviewed the terms of the Finco Loan which provides for specified principal, interest, term to maturity, covenants, events of default and representations and warranties in standard commercial form. In addition, the interest rate would appear to be reasonable and will be computed by reference to the principal amount and will accrue on a day-to-day basis. We assume that, at maturity, Finco will repay the entire principal amount of the Finco Loan as required under the terms of the Finco Loan. The central indicia of a loan is the shared intention of the debtor and creditor that the amount advanced will be fully repaid. The fact that SPV has an independent contingent obligation pursuant to the Assumption Agreement following repayment of the Finco Loan should not result in the Finco Loan from SPV being re-characterized as equity for purposes of the Act as opposed to borrowed money. [Any treatment of the Finco Loan (or part thereof) as equity for Canco's consolidated accounting purposes will not affect the status of the Finco Loan for tax purposes, which will be dependent on the legal character of the loan.]
- (ii) Purpose - Finco will use the borrowed money for the purpose of making the Canco Loan which will have a higher interest rate than the Finco Loan. Accordingly, Finco will use the borrowed money for the purpose of gaining or producing income from its business. We understand there also existed a motive to obtain the tax benefit of interest deductibility. However, in our opinion it is the purpose for which the borrowed money is used and not such motive which determines the deductibility of the interest.

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- (iii) Thin Capitalization Rules - Subsection 18(4) of the Act provides that a Canadian corporation will not be entitled to deduct interest paid or payable by it on its debts to specified non-residents to the extent that the greatest aggregate amount of the corporation's outstanding debts in the year to specified non-residents exceeds three times its equity (generally determined at the commencement of the year) (the federal budget released on February 28, 2000 proposes to reduce this to two times equity). "Specified non-residents" are generally non-resident persons who alone or together with non-arm's length persons own or have a right to own or vote shares representing more than 25% of the votes or value of all issued shares. However, pursuant to subsection 18(5.1) a person is deemed not to be a "specified non-resident" shareholder if the person's interest in the corporation is provided for the purpose of safeguarding any indebtedness owing to that person and the person will cease to own the interest on the satisfaction of conditions or the occurrence of events that is reasonable to expect will be satisfied or will occur. In the instant case, SPV has the right to acquire Class B preferred shares of Finco which would represent over 25% of the value of all issued shares of Finco. However, we understand that the purpose of SPV's right to acquire the Class B preferred shares pursuant to the Warrant is given in the circumstances described in subsection 18(5.1) of the Act and, in our opinion, the terms of the Support Agreement are consistent with such purposes such that subsection 18(5.1) would deem SPV not to be a "specified non-resident" shareholder by virtue of its rights pursuant to the Warrant. Since SPV has no other right to acquire an interest in any shares of Finco, Subco or Canco, in our opinion it will not be a specified non-resident with respect to Finco and, thus, subsection 18(4) should not be applicable to the Finco Loan.

We have considered whether the payment by Subco of the Assumption Payment pursuant to the Subscription Payment Assumption Agreement would be considered to be a loan made by a non-resident of Canada to Flagstaff on condition that Flagstaff make the loan pursuant to the Finco Credit Agreement, such that subsection 18(6) of the Act would cause the thin capitalization provisions of subsection 18(4) of the Act to apply to the subject transactions. As discussed above, in our opinion, the payment by Subco to Flagstaff is not a loan. In any case, it is our opinion that the fact that the Assumption Payment was indirectly funded to Subco through Opco by Parent and will not be recharacterized so as to constitute a loan by Parent to Flagstaff. There is no basis under the Act to recharacterize the transactions in such a manner. In giving this opinion we have noted, as discussed below, that the Department of Finance has proposed amendments to the Act which would result in the application of the thin capitalization provision where a non-resident parent secures loans made by their Canadian subsidiaries. However, even these amendments as currently proposed would not specifically preclude the equity capitalization of a subsidiary to indirectly support a loan to be made by that subsidiary.

We have also considered whether Flagstaff could be considered to be dealing at non-arm's length with Parent for the purposes of the thin capitalization provisions of subsection 18(4) of the Act. However, for the same reasons as described above with respect to the arm's length relationship between Finco and SPV, it is our opinion that Parent and SPV will not be considered to be dealing at non-arm's length for the purposes of the Act.

Please note that the federal budget released on February 28, 2000 proposed to include in debt that is subject to the thin capitalization rule, debt guaranteed or secured by a "specified non-resident shareholder" (although this proposal was subsequently deferred pending further study). It is quite possible that the Support Agreements would constitute such a guarantee or security if the proposal is enacted. If such proposal is enacted in a form which applies to the Support Agreements, subsection 18(4) will begin to apply to

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the Finco Loan upon the effective date of such change which would effectively result in all interest under the Finco Loan becoming non-deductible under the Act. In such case it is very likely Parent will decide to prepay the Finco Loan and unwind the related transactions.

- (iv) The Make-Whole Payment payable by Finco will be deemed to be interest pursuant to Section 18(9.1) of the Act and, accordingly, will be deductible by Finco to the extent it is reasonable in the circumstances.

(b) Imputed Interest Rules

Subsection 17(1) of the Act applies in some circumstances where "a non-resident person owes an amount" to a Canadian corporation, the amount has been outstanding for more than a year, and the Canadian corporation has not included a reasonable amount of interest in its income. We have considered whether SPV's contingent obligation to pay the Subscription Price for the Class A Preferred Shares in SPV following maturity and repayment of the Finco Loan could be considered an amount that SPV "owes" to Finco for the purposes of subsection 17(1) of the Act during the term of the financing. In our view, SPV does not owe any amount to Finco unless and until (i) the Finco Loan has matured, (ii) Finco has repaid the Finco Loan; and (iii) Finco complies with the closing provisions of the Assumption Agreement. That is there is no legal obligation to pay any amount by SPV to Finco while the Finco Loan remains outstanding. Accordingly, subsection 17(1) should be of no application. We also note that no assets of Finco have been loaned or otherwise provided to SPV in consideration for SPV entering into its obligation under the Assumption Agreement, as Finco is only obligating itself to issue the Class A Preferred Shares after they are fully paid. Accordingly, in our view 17(1) should not apply to the transaction.

We have also considered whether the relationship between Subco and SPV under the Assumption Agreement gives rise to an amount owing by SPV to Subco for the purposes of subsection 17(1) of the Act. Since, under the Assumption Agreement, there is no obligation of SPV to make any payments to Subco and Finco has released Subco fully from any and all obligations it had under the Subscription Agreement, in our view, there is no obligation that constitutes an amount owing by SPV to Subco for the purposes of subsection 17(1) of the Act.

(c) Prescribed Debt Obligation Rules

Subsection 12(3) of the Act requires a corporation to recognize interest that has accrued on each debt obligation held by the corporation (with certain exceptions) up to the end of each year. For these purposes, where a taxpayer acquires an interest in a "prescribed debt obligation", an amount determined in prescribed manner is deemed to accrue to the taxpayer as interest on the obligation. Subsection 7000(1) of the Regulations defines a "prescribed debt obligation" to be a debt obligation which meets any of the conditions set out in such Regulation.

For purposes of determining whether the obligation of SPV to pay the Subscription Balance to Finco is a "prescribed debt obligation" within the meaning of subsection 7000(1) of the Regulations, we have noted that if the Finco Loan is not repaid or Finco does not comply with the closing conditions with respect to the issuance of the Shares pursuant to the Assumption Agreement, SPV will have no obligation to pay the Subscription Balance.

A debt obligation is a debt which represents a sum payable in respect of a liquidated money demand, i.e. it must be an amount in respect of which a creditor has a right to bring and maintain an action (*Fingold v. M.N.R.* [1992] 2 CTC 2392, (T.C.C.)). The debt must be either presently payable or presently due through payment at a future date. Generally speaking, it must constitute an existing obligation, payable either presently or at a future date. It does not include an

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obligation which is subject to conditions (*Barsi v. Farnas*, (1923) [1924] 1 DLR 1144 (Sask.) (C. A.)).

In the instant case the obligations of Subco under the Subscription Agreement are conditional on payment of the Finco Loan, and on Finco complying with the closing conditions on the issuance of the Shares. In our opinion the obligation of Subco under the Subscription Agreement does not constitute a "debt obligation" at law until the conditions to payment are met.

SPV's obligations to Finco under the Assumption Agreement are identical to the obligations that Subco had to Finco under the Subscription Agreement. As described above, it is our view that this obligation is not a "debt obligation" for the purposes of section 12(4) of the Act and Regulation 7000. It is therefore our opinion that the assumption by SPV of that obligation should not turn it into a "debt obligation" for such purposes.

In addition, it is our view that it is not intended by SPV or JP that such obligations be "debt obligations" for the purposes of subsection 12(4) or subsection 7000(1) of the Regulations. There is no policy reason within the Act to deem an interest accrual in situations where two parties have agreed to close a purchase and sale transaction at some time in the future and where no property is transferred by either party to the other party until the time of the future closing.

The issue then becomes whether the obligation of SPV under the Assumption Agreement could constitute a "debt obligation" to Subco for purposes of the Act. SPV has no other obligation to Subco under the Assumption Agreement other than Subco's right to enforce performance of the Assumption Agreement once the conditions have been met. There is no amount owing or other claim of Subco against SPV, except for the unliquidated damages Subco could claim against SPV should it fail to perform under the Assumption Agreement. It is clear at law that an unliquidated claim for damages is not a debt (*Flintgold v. M.N.R.* [1992] 2 CTC 2393, (T.C.C.)), (*Dierwald v. Dierwald* [1941] S.C.R. 35). It is therefore our opinion that SPV does not have a "debt obligation" to Subco for the purposes of the Act.

(d) Subsection 16(1) of the Act

Pursuant to subsection 16(1) of the Act, where, under a contract or other arrangement, an amount can reasonably be regarded as being in part interest or other amount of an income nature and in part an amount of a capital nature, the following rules apply:

- (i) the part of the amount that can reasonably be regarded as interest shall, irrespective of when the contract or arrangement was made or the form or legal effect thereof, be deemed to be interest on a debt obligation held by the person to whom the amount is paid or payable; and
- (ii) the part of the amount that can reasonably be regarded as an amount of an income nature, other than interest, shall, irrespective of when the contract or arrangement was made or the form or legal effect thereof, be included in the income of the taxpayer to whom the amount is paid or payable for the taxation year in which the amount was received or became due to the extent it has not otherwise been included in the taxpayer's income.

Accordingly, where subsection 16(1) of the Act applies, the legal form of a transaction may be ignored for purposes of the Act. In Interpretation Bulletin IT-265R3, Revenue Canada describes subsection 16(1) as follows:

- "1. Subsection 16(1) deals with those situations where, under a contract or arrangement, a payment of income and capital combined is received or is receivable by a taxpayer. This

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type of payment is known as a "blended payment" and is referred to as such throughout the remainder of this bulletin.

2. A blended payment can be described as an amount, the make-up of which is not definitely ascertainable. In other words, there must be some uncertainty as to the portion of the payment that is capital and the portion that can reasonably be regarded as interest or some other type of income, such as the profit on a sale transaction. However, if all the constituent elements of a payment are provided for in a contract or arrangement, and are reasonable, the payment is not a blended payment and subsection 16(1) does not apply."

In the present circumstances, the issue is whether the payment of the Subscription Balance by SPV to Finco pursuant to the Assumption Agreement could be regarded as payment of an "amount", "under a contract or other arrangement", that "can reasonably be regarded as being in part an amount of a capital nature". If so, the result would be an income inclusion for Finco. In our view the Subscription Balance cannot reasonably be regarded as being in part of an income nature. Finco is receiving the full balance of the purchase price for the Shares concurrent with the issuance of the Shares. There is no income element of any type in the receipt by Finco of the Subscription Balance.

3. Issues for Subco

(a) Subco Capital Gain

In our opinion, Subco will not realize a capital gain at the time of the issuance by Finco of the Class A Preferred Shares, notwithstanding that it has received shares arguably worth an amount equal to the Subscription Balance, having only paid the Assumption Payment to SPV pursuant to the Assumption Agreement. Section 49.1 of the Act specifically provides that the acquisition of property in satisfaction of an obligation to provide the property does not constitute a disposition of the rights to acquire such property. Accordingly, Subco has disposed of no property at the time of the issuance of the Shares for the purposes of the Act. Subco's cost, for Canadian tax purposes, in the Shares will be equal to the amount of the Assumption Payment.

- (b) Based on the same analysis as set out in clause 2.(d) above, it is our view that the issuance of the Class A Preferred Shares by Finco to Subco cannot reasonably be regarded as being in part of an income nature. In our view, the Class A Preferred Shares are capital property to Subco and there is no income element in their issuance to Subco by Finco.
- (c) For the reasons described in clause 2.(c) above, it is our view that subsection 12(3) of the Act will not apply to the obligations of SPV to Subco under the Assumption Agreement.
- (d) We have also considered the application of subsection 15(1) and section 246 of the Act and it is our opinion that neither section would apply to the issuance of the Class A Preferred Shares by Finco to Subco. Finco will have received the full Subscription Price in respect of the Class A Preferred Shares, which Subscription Price represented the fair market value of the Class A Preferred Shares at the time the Share Subscription Agreement was entered into. The fact that Subco entered into the Assumption Agreement will not, in our opinion, result in a benefit being considered to have been conferred on Subco on the issuance of the Class A Preferred Shares for the purposes of subsection 15(1) or section 246 of the Act.
- (e) We have also considered the potential application of section 80 to the obligations created pursuant to the Subscription Agreement and the Assumption Agreement and in our opinion none of the proposed transactions result in the settlement of an obligation which would result in the application of sections 80 to 80.04 of the Act. In particular, in our opinion, neither the assumption by SPV of the contingent obligation of Subco to pay the Subscription Balance in the future nor the

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ultimate acquisition of the Finco Class A Preferred Shares by Subco constitute the settlement of an obligation which would result in the application of such sections.

4. Issues for Canco

(a) Deductibility of Interest and Make Whole Payment

For the same reasons and subject to the same conditions and qualifications set out in clause 2(a) (other than clause 2(a)(iii)) above, interest on the Canco Loan and the Make-Whole Payment, if any, on the Canco Loan should be deductible by Canco.

5. Issues for Opco

(a) Deductibility of Interest

The interest payable by Opco to Canco in accordance with the terms of the Opco Loan should be deductible to Opco in computing its income pursuant to paragraph 20(1)(c) of the Act, provided that Opco uses the proceeds of the Opco Loan for the purpose of earning income from a business or property (other than borrowed money to acquire property, the income of which would be exempt, or to acquire a life insurance policy) or to acquire preferred shares of Opco II (as described in paragraph 1.5) and Opco II uses the proceeds of such subscription for such income earning purposes. For this purpose where Opco uses proceeds of the Opco Loan to repay loans which it had previously made, that portion of the Opco Loan will be deemed to have been made for the same purpose for which the repaid loan was made.

(b) Taxability of Preferred Share Dividends

Dividends of the Subco shares held by Opco will be included in the income of Opco for the purposes of the Act, but Opco will be entitled to an offsetting deduction pursuant to section 112 of the Act. In addition, no tax will be payable in respect of such dividends pursuant to the "taxable preferred share" provisions of Part VI.1 of the Act since, in our opinion, Subco is related to Opco for the purposes of such Part. In giving this opinion we have reviewed the Amended and Restated Limited Partnership Agreement of Sundance Industrial Partners LP.

Similarly, the dividends on the preferred shares of Opco held by Opco II will be included in the income of Opco II, but Opco II will be entitled to an offsetting deduction pursuant to section 112(1) of the Act. In addition, no tax will be payable in respect of such dividends pursuant to the "taxable preferred share" provisions of Part VI.1 of the Act since, in our opinion, Opco is related to Opco II for the purposes of such Part.

B. Anti-Avoidance Issues

1. Judicial Principles

The Canadian courts have developed a number of judicial anti-avoidance doctrines which, where applicable, could deny the intended tax consequences of a particular plan. However, these doctrines are very limited in scope. Those doctrines which have been accepted (or not rejected) by the Supreme Court of Canada (the Court of last resort in Canada) are summarized below.

The courts have held that a transaction which was legally ineffective or incomplete could not carry with it the tax consequences intended had the transactions had legal effect. Similarly, a party which was seen as merely an agent or conduit would not have ascribed to it tax consequences in its own right, but rather the transaction would be seen as having been undertaken between the person with whom it contracted and the

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"principal". The Canadian Courts have been reluctant to use the "agent or conduit" principles to alter the tax consequences intended by parties to a transaction and, in our opinion, these principles will not be applied by the Canadian Courts to alter the intended tax consequences of the subject transactions.

While Canadian courts do recognize the concept of a "sham", they define it narrowly as a transaction intended to convey the impression of the creation of legal relationships which are not in fact intended by the parties. The Supreme Court of Canada has specifically rejected, even in the context of tax-motivated transactions, the concept of a "business purpose" test being applied to negate the tax consequences of transactions fully intended to have legal effect and properly implemented, or a concept of economic substance overriding legal form, although lower courts have sometimes purported to apply these types of tests.

According to the existing doctrine of "sham", if the intention of the parties as to their legal relationship, as determined on the factual basis by a Court, differ from the form of the documents, the transactions may be recharacterized to reflect those intentions. The case law suggests that normally this requires an element of deceit. In this connection, it is our opinion that none of the terms and conditions of the Documents, would in and of themselves lead a Court to a conclusion that the legal form of the transactions differs from the legal relationships which the parties intended to create. We also assume that the provisions of those documents will be complied with.

While the matter is not free from doubt, apart from the doctrine of sham as discussed above and the "general anti-avoidance rule" discussed below, in our opinion there is no judicial doctrine of general application in Canadian tax law which would enable the Canada Customs and Revenue Agency (or a Canadian Court) to recharacterize a transaction based solely on the grounds that it is tax motivated or that its overall economic substance could be said to be different from its legal form. We point out that there have been suggestions in the case law that such a principle could be applied, but in our opinion this principle is not presently of general application in Canada.

We note that subsection 247(2) of the Act provides that a transaction between a Canadian taxpayer and a non-resident of Canada may be recharacterized if it would not have been entered into between parties dealing at arm's length. As discussed above, it is our opinion that Finco and SPV are dealing with each other at arm's length, and therefore subsection 247(2) should not apply.

The most relevant example of the judicial approach of the Supreme Court of Canada to tax-motivated financing transactions is the recent case of *Shell Canada Limited v. The Queen*, 99 DTC 1044. In that case, Shell required U.S. dollars for its business. Instead of borrowing U.S. dollars, Shell borrowed New Zealand currency at a high nominal interest rate of 15.4% (higher than the nominal interest rate applicable to a U.S. dollar borrowing), and entered into forward foreign exchange contracts with another party pursuant to which it purchased U.S. dollars with the New Zealand dollars borrowed, and purchased forward New Zealand dollars with U.S. dollars in order to meet the New Zealand dollar interest obligations and principal repayment obligation. Because of the expected decline in value of the New Zealand dollar in relation to the U.S. dollar, Shell expected to have a foreign exchange gain when it closed out the forward foreign exchange contract and repaid the New Zealand dollar principal amount owing on the debentures. If the New Zealand dollar debt obligation and forward foreign exchange contract could be integrated into one transaction, the economic effect would be the equivalent of a borrowing in U.S. dollars at an interest rate of 9.1%. Based on the form of the transactions as carried out, the taxpayer claimed interest expense at the rate of 15.4%, and claimed a capital gain on the close of the forward contract.

It was recognized by the Supreme Court of Canada that the transactions were tax-motivated, that the borrowing and forward exchange contract were linked together in the sense that the borrowing would not have been entered into in the absence of the forward exchange contract, and that if Shell had simply borrowed U.S. dollars, it would have paid 9.1% interest instead of the 15.4% claimed. It was accepted that there was no "sham" involved. The Supreme Court of Canada found in favour of the taxpayer based on an analysis which respected the separate legal obligations created by the documentation and did not

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recharacterize them in any way. The court intended that, as between the lenders and Shell, Shell had actually borrowed New Zealand dollars and was legally obligated to pay the 15.4% interest rate, and there was no element of a synthesized U.S. dollar loan as between these parties.

The Supreme Court of Canada stated that it "has never held that the economic realities of a situation can be used to recharacterize a taxpayer's bona fide legal relationships" and that it has held to the contrary that "absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect". The Court also emphasized that if an unambiguous provision of the Act applies to a taxpayer's transaction (such as the interest deductibility provision), it must simply be applied by the Court, regardless of the "economic realities" of a transaction or the general object and spirit of the provision. The fact that Shell structured its transactions to take advantage of provisions of the Act was of no concern to the Court, which stated that Shell was fully entitled to do so.

The Court further emphasized that the parties to the New Zealand dollar-loan transaction and the parties to the forward foreign exchange contract were different. In fact, the lenders were unrelated to the counterparty to the forward foreign exchange contract. In the instant case, the parties to the Finco Loan are the same as the parties to the Assumption Agreement, albeit Subco is a different party to the Subscription Agreement. Consequently, it could be argued that our situation is distinguishable from the Shell case in this respect. However, in our opinion, in the absence of GAAR described below, the transactions would be respected as separate transactions, and the overall reasoning of the Shell case should apply.

Based on the foregoing, we are of the opinion that no judicially developed anti-avoidance doctrine would apply in the circumstances of the present case.

2. GAAR

A statutory general anti-avoidance rule was added to section 245 of the Act in 1988. Under this rule, if any transaction forming part of the proposed financing could be considered an "avoidance transaction" for purposes of this rule (the "GAAR"), Canco, Finco and their affiliates could be denied any Canadian tax benefits resulting from the transaction unless it may not reasonably be considered that the transactions would result in a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act read as a whole. A transaction will be an "avoidance transaction" if it results, directly or indirectly, in a reduction, avoidance or deferral of tax payable under the Act unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit. If the general anti-avoidance rule is held to apply to a transaction, the tax consequences are to be redetermined as is reasonable in the circumstances in order to deny the intended tax benefit.

On the issue of whether the proposed transactions contain one or more "avoidance transactions", there are clearly tax benefits resulting from the transactions. The tax benefits include (i) the deduction by Finco and Canco of interest expense which, if the corporate group is looked at as a whole, would be limited to interest on Canco group's net financing (i.e. the amount by which the Finco Loan exceeds the Assumption Payment (the "Net Amount")), (ii) the withholding tax exemption for the Finco Loan, given that, based on the Net Amount of financing characterization, arguably more than 25% of the net financing is repaid within the first five years and (iii) the non-taxability of the benefit realized by Subco when it receives the Class A Preferred Shares at the maturity of the transactions having paid the lesser Assumption Payment to SPV at the commencement of the transactions.

A transaction resulting in tax benefits will be an "avoidance transaction" unless it was undertaken for *bona fide* purposes other than to obtain the tax benefits. In the Shell case, which was a pre-GAAR case, the Supreme Court of Canada considered whether Shell entered into its transactions for a bona fide business purpose. The Court specifically declined to express an opinion on whether acquiring funds at the lowest possible after-tax cost is a bona fide business purpose. However, concurrent with the Shell decision, the

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Courts have been considering an almost identical issue in the Canadian Pacific Limited case based upon virtually identical facts, except that the case involves a post-GAAR year. The Tax Court of Canada has now rendered its decision in the Canadian Pacific case and found in favour of Canadian Pacific - i.e. that GAAR did not apply. However, it may be several years before the case is finally decided by the appellate courts.

In finding for Canadian Pacific the Tax Court of Canada relied heavily on its conclusion that the principal purpose of the transactions was not to obtain a tax benefit, but was to obtain the financing underlying the weak currency loan. The Tax Court therefore concluded that the transaction was not an avoidance transaction. In the instant case, the Finco Loan amount is being used for the purpose of earning income from a business or property in Canada to repay the Parent Loan and to be used by Opco and Opco II for the purpose of earning income from their businesses in Canada as discussed above. As alternatives to the proposed transactions, (i) ~~Finco could have borrowed~~ the Finco Loan amount ~~could have been borrowed~~ from SPV with a guarantee of the Assumption Payment amount from Parent, perhaps supported by a pledge of a security interest in a bank deposit of ~~in an amount equal to~~ the Assumption Payment amount from Parent, or (ii) ~~Finco could have borrowed~~ the Net Amount ~~could have been borrowed~~ from SPV and the Assumption Amount ~~could have been borrowed~~ directly from a Canadian bank supported by a Parent guarantee, or (iii) ~~Finco could have borrowed~~ the Net Amount ~~could have been borrowed~~ from SPV and Parent could have funded the Assumption Payment amount to Opco and Opco II by way of debt and equity. We understand that under these alternatives Canco, Opco and Opco II would have received substantially the same (or potentially better) ~~Canadian tax benefits as aggregate deductions for Canadian income tax as would be realized under the proposed transactions and the other Canadian income tax consequences related to the alternatives would not be materially worse and could potentially be better than those they would realize under the proposed transaction.~~ However, under the alternative structures there were significant disadvantages for reasons unrelated to Canadian income tax. These disadvantages included adverse financial statement impact, adverse debt/equity impact and adverse U.S. income tax consequences.

It was under these circumstances that JP initiated the proposed transactions and under that proposal it was a condition of the Finco Loan that an affiliate of Canco enter into transactions substantially in the form of the Subscription Agreement and Assumption Agreement. Applying the analysis in the Shell and Canadian Pacific decisions, it is our position that the principal purpose of the transactions was not to obtain a Canadian tax benefit, but was to obtain the Finco Loan amount to be used for legitimate income earning purposes in Canada without incurring the disadvantages associated with the alternate structures. In our view the subject series of transactions were therefore undertaken not primarily for the purpose of obtaining a tax benefit, but rather to obtain the Finco Loan amount borrowing without the negative consequences, but in a manner which provides tax benefits on a par with (but no greater than) the tax benefits which would have arisen had the transactions been undertaken in a more common manner. In giving this opinion we recognize the risk that the Courts may ultimately determine that each individual transaction in a series of transactions must be considered to determine whether it is an avoidance transaction and that it is possible that the Courts will ultimately hold that a particular transaction within a series of transactions may be an avoidance transaction, even if the series of transactions as a whole does not give rise to a tax benefit. However, it is our opinion that the Courts will not ultimately interpret GAAR in this manner and that the subject series of transactions (and all of the components thereof) do not constitute avoidance transactions, since the series of transactions as a whole do not give rise to a tax benefit when compared to the common borrowing transaction described above which could have been undertaken in the subject circumstances had they not given rise to adverse non-tax consequences. Support for this conclusion is found in the following statement of Bonner J. in the CP decision when considering whether a particular transaction which was part of an inextricably linked series of transaction was an avoidance transaction:

"No transaction forming part of the series can be viewed as having been arranged for a purpose which differs from the overall purpose of the series."

In our opinion this analysis is equally applicable to the subject transaction.

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Notwithstanding our view in this respect, there is a risk that the proposed transactions in this case may be regarded as including one or more "avoidance transactions". As a result, the second issue is whether the transactions result in a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act read as a whole.

In our view, the Shell case strongly suggest, that the Court would have found in favour of the taxpayer even if GAAR had been an issue in that case. As mentioned above, the issue was raised as to whether Shell would even be regarded as having entered into an "avoidance transaction". Furthermore, the Court stated that "a searching inquiry for either the 'economic realities' of a particular transaction or the general object and spirit of the provision at issue can never supplant a court's duty to apply an unambiguous provision of the Act to a taxpayer's transaction. Where the provision at issue is clear and unambiguous, its terms must simply be applied". This suggests that a taxpayer seeking to achieve tax results available based on the application of a clear and unambiguous provision of the Act, should not, in and of itself, be seen as a "misuse" of the provision or an abuse based on the "object and spirit" of the Act on the basis that the intended use and specific object and spirit of the provision are reflected in its clear and unambiguous words. The Supreme Court of Canada criticised the Federal Court of Appeal for its "misplaced reliance on economic realities" which "caused it to stray from the express terms of s. 20(1)(c)(i) and supplement the provision with extraneous policy concerns that were said to form part of its purpose", and warned that courts must "be cautious before finding within the clear provisions of the Act an unexpressed legislative intention". The Supreme Court of Canada emphasized that it is not the Court's role to prevent taxpayers from relying on sophisticated transactions to achieve tax results more favourable than those that might be achieved by less sophisticated taxpayers.

It is important to note that, at the hearing of the Shell case by the Supreme Court of Canada, Canadian Pacific Limited, was represented as an intervenor because of its involvement in the equivalent tax case described above. One would presume that the Supreme Court of Canada was fully aware of Canadian Pacific's circumstances in rendering its appeal decision in favour of Shell. The strong pro-taxpayer statements which form part of the Shell decision use language which is similar to the GAAR rule, particularly the statements regarding "object and spirit" and identifying the purpose of a provision of the Act. It is difficult to believe that the Supreme Court of Canada would use such language, which is highly suggestive of the GAAR provisions, and nevertheless be of the view that GAAR should apply to the transactions carried out by Shell and Canadian Pacific. We understand that most members of the Canadian tax community believe that the Supreme Court of Canada as currently constituted would have found in favour of Shell even if GAAR had been applicable, and would find in favour of Canadian Pacific on the GAAR issue.

In addition, even if the Supreme Court were ultimately to find that the transactions were "avoidance" transactions for the purposes of GAAR, the analysis in the Shell decision should nevertheless result in the conclusion that the transactions do not constitute a misuse or abuse of the provisions of the Tax Act. In particular, the Tax Act contains a number of specific provisions of an anti-avoidance nature (such as 17(1), 12(3) and 15(1)) which would make it difficult for the Court to determine that there has been a misuse or abuse of section 246 of the Tax Act where the specific anti-avoidance provisions did not apply. In addition, further to the position described above to the effect that the subject transactions are not avoidance transactions because they were undertaken primarily for non-tax purposes, even if it is ultimately determined that a particular transaction in the series of transactions was undertaken primarily to obtain a tax benefit and, as such, that particular transaction is an avoidance transaction, it is our view that the fact that no tax benefit ultimately arose from the series of transactions (as compared to a reference series of transactions which is standard within the financing community) would result in the Courts holding that the specific transaction did not give rise to a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act as a whole and that, therefore, GAAR would not apply to the particular transaction or the series of transactions.

There are several other cases in lower courts which have considered GAAR. The analysis of the lower court in these cases does not establish any general guidance on the interpretation of GAAR which, in our

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view, could provide meaningful assistance on whether GAAR applies to the present facts. We regard the Shell case, notwithstanding that it is pre-GAAR, and the Canadian Pacific decision which was rendered in light of the Supreme Court of Canada's comments in the Shell case, as more instructive on the likely approach of the Supreme Court of Canada to GAAR on this proposed transaction. For these reasons, we base our views on the application of GAAR in the present circumstances on our interpretation of the approach to tax avoidance taken by the Supreme Court in the Shell case and the Tax Court of Canada in the Canadian Pacific case and the Tax Court of Canada in the Canadian Pacific case.

Notwithstanding the foregoing, we caution that the Shell and Canadian Pacific transactions are arguably distinguishable from the subject transactions in the following manner:

- (i) Finco is a special purpose entity formed for the purpose of this transaction and carries on limited business, being the transactions described herein; and
- (ii) the Finco Loan and obligation to pay the Subscription Balance are between the same parties (Finco and SPV) – not between different parties as in Shell; and
- (iii) the Assumption Payment by Subco to SPV, while similar to the hedge payments in the overall context of the transaction, is clearly different and therefore can be distinguished.

However, notwithstanding our concern, having regard to the Shell and Canadian Pacific cases, and the clear reluctance by the Supreme Court to interfere with unambiguous provisions of the Act, it is our view that, while the matter clearly involves a degree of risk, the GAAR should not apply to the subject situation on the basis that the transactions either do not constitute an avoidance transaction or, if they do, they do not result in a misuse of the provisions of the Act or in abuse having regard to provisions of the Act as a whole.

We would also note that if it were held that the GAAR did apply to the subject transactions, a possible recharacterization would be to treat the Finco Loan as a net loan and restrict Cenco's interest deduction to interest on the net loan. This recharacterization of the Finco Loan could also lead to the recharacterization of payments under the Finco Loan such that the payments do not qualify for the withholding tax exemption, since the recharacterization would result in more than 25% of the principal being repaid within the first five years in which case interest on the Net Amount would be subject to withholding at 10%. ~~In our view, this risk is significantly mitigated by the inclusion of the provision in the Finco Loan which provides that the Borrower is not required to make any payment pursuant to the Finco Loan Agreement which would result in the Finco Loan not complying with such withholding tax exemption. While it is open to the Courts to determine that that this clause itself is subject to the GAAR and should be ignored, in our opinion the Courts would not apply the GAAR for the reasons stated above, to be deleted with reformation provision in present form.]~~

We would further caution that in our opinion it is very likely that Revenue Canada will become aware of the proposed transactions described herein and, upon becoming aware of them, will challenge them under the GAAR. It is also, in our view, likely that such a Revenue Canada challenge would not be resolved in the Courts at a level below that of the Federal Court of Appeal. It is therefore likely that Exxon will be faced with the decision as to whether to pursue the matter through the Courts or to attempt to reach a settlement with Revenue Canada pursuant to which it would realize a reduced Canadian tax benefit.

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Yours very truly,

BLAKE, CASSELS & GRAYDON LLP

TO COME POST CLOSING:

Wally Shaw memo re amalgamation consequences, consequences of exercising Put Option and discussion of reasonableness of Make-Whole Payment.

Barry Horne memo re Nova Scotia capital tax – not requested as yet.

Permanent Subcommittee on Investigations
NOTE: The facsimile transmission heading has been removed from this exhibit for reprinting purposes. The original, with facsimile transmission heading intact, has been retained in the exhibit files of the Subcommittee.

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Chase Securities Inc.
270 Park Avenue, 9th Floor
New York, NY 10017
USA

ATTN: Mr. Bruce Hendrick, Vice President

Dear Sir:

Re: Canadian Tax Consequences of Proposed Financing

You have asked for our opinion concerning the principal Canadian federal income tax considerations under the *Income Tax Act* (Canada) (the "Act") in connection with the proposed financing structure described below.

I. FACTS ASSUMED

1. The Canadian borrower ("Canco") which may be a public or private corporation incorporates a wholly-owned subsidiary ("Financoco") in Canada. Prior to entering into the transactions described below, none of Canco nor any of its subsidiaries (including Cansub described in 5. below) is a "financial institution" as defined in subsection 142.2(1) of the Act.
2. Financoco borrows \$100 (or a multiple thereof) from a U.S. corporation ("Chase") that is a wholly-owned subsidiary of Chase Manhattan Bank, N.A.. Chase is a corporation resident in the United States and is entitled to the benefits of the *Canada-United States Income Tax Convention* (the "Treaty"). The loan (the "Loan") may be denominated in Canadian or U.S. dollars although the discussion set out below assumes the Loan is in Canadian dollars. The maturity date of the Loan is five years plus one day from the date of drawdown of the Loan. Principal is payable at maturity. Interest on the Loan is payable quarterly at a fixed rate. The interest on the Financoco loan from Chase is a very small spread below the interest rate on the loan that Financoco makes to Canco, as described in 4 below. The terms of the Loan allow Chase, but not Financoco, to

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Permanent Subcommittee on Investigations
EXHIBIT #353

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CHARTERED ACCOUNTANTS / COMPTES & FINANCES AGENTS

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set off its obligation to pay an amount to Financeco described in 3 below against the principal amount of the Loan at the maturity date. As security for the Loan, Financeco pledges to Chase the loan Financeco makes to Canco, as described in 4 below.

3. At the same time that Chase makes the Loan to Financeco, it also enters into an agreement to subscribe for shares (the "Shares") of Financeco having a fair market value equal to the principal amount of the Loan from Chase (\$100 or multiples thereof). The share subscription agreement becomes effective immediately upon the advance of the Loan and represents an obligation of Chase to pay the subscription price for the Shares upon the maturity of the Loan provided that it has received repayment of the Loan from Financeco, and an obligation of Financeco to issue the Shares when it has received payment of the subscription price from Chase.
4. Financeco makes a \$100 loan to Canco for five years. The interest rate on the loan is somewhat higher than on the Loan and is payable at the same time as the interest on the Loan. The principal amount is payable in cash at maturity. This loan contains all the usual covenants, representations and warranties which a borrower like Canco would give in an arm's length financing. The interest rate on this loan is within the normal range for a borrower of Canco's creditworthiness.
5. Canco uses \$30 (or the ultimately determined proportion) to finance its business and the balance of \$70 is used to subscribe for shares of either an existing operating subsidiary of Canco or a newly incorporated Alberta subsidiary ("Cansub") (If a special purpose vehicle is used, it should be incorporated in Alberta because of capital tax considerations - see below).
6. Pursuant to an agreement among Cansub, Chase and Financeco, Cansub acquires from Chase the rights to be issued the Shares of Financeco at maturity following payment of the subscription price by Chase (the "Share Issuance Rights"). Chase acknowledges to Cansub and to Financeco that Chase remains liable, pursuant to its obligation under the share subscription agreement, to pay the subscription price in cash or by way of set-off. Therefore, the Share Issuance Rights represent a fully-paid right to the Shares on issuance at the time the Loan matures and is repaid. Cansub purchases the Share Issuance Rights for their fair market value of \$70.
7. At the maturity date:
 - (a) Canco will repay its \$100 loan to Financeco.
 - (b) Financeco will repay its \$100 loan to Chase.

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TAXPRACTICE & REGULATORY MATTERS & FINANCIAL SERVICES

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- (c) Chase will pay its share subscription obligation to Financoco of \$100.
- (d) Financoco will issue \$100 worth of Shares to Cansub.
- (e) Following the completion of this structure, it would be possible to amalgamate Cansub and Financoco, although not necessary.

II SCOPE OF REVIEW**(a) Basis of Opinion**

Our opinions herein are based upon the current provisions of the Act, the current regulations under the Act (the "Regulations"), all specific proposed amendments to the Act and Regulations detailed in public statements issued by the Department of Finance, Canada prior to the date hereof and our understanding of the current administrative policies and assessing practices of the Canada Customs and Revenue Agency ("CCRA"). Our opinions do not otherwise anticipate any changes in law or administrative or assessing practices, whether by legislative or other governmental or judicial action, nor do they take into account or consider any sales, use, or goods and services taxes or any provincial, territorial or foreign income or other tax legislation or considerations (apart from the provincial capital tax issues specifically referred to). In addition, our opinions do not anticipate any changes in judicial interpretation of common law doctrines or the general principles of judicial interpretation applicable to tax legislation. It is possible that, by the time the matters described above are considered by a court, jurisprudence or administrative practice may have developed which would dictate a result at variance from the opinions expressed herein. The opinions herein are not intended to be and should not be construed as opinions with respect to the likelihood of CCRA challenging the proposed transactions. Rather, the opinions herein are intended to state our views as to the manner in which these matters would be dealt with by a court in the event that litigation ensues.

It is to be noted that we have not provided legal or tax advice to any person other than Chase, Chase Manhattan Bank N.A. and Chase Securities Inc. in connection with the proposed transactions and no other person is entitled to rely on this letter. In particular, we have not provided advice to Canco, Financoco, Cansub or any direct or indirect shareholder or subsidiary of any such company, each of which should rely on its own advisors, and may not rely on this letter or any part thereof.

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We also note that any distribution of this letter to any person other than the addressee may cause it to lose its status as a privileged communication. Circulation of this letter should therefore be carefully monitored.

(b) Documents Reviewed

In preparing this letter, we have reviewed the term sheets developed by Chase Securities Inc. with the assistance of our firm prior to the date hereof and no other documents.

In the event the transactions discussed herein are implemented, the opinions stated herein may need to be updated or amended to reflect the specific terms of the transactions, the final form of documentation, the identity and particular attributes of the parties and any changes in law or the administrative practices of CIRA.

III SUMMARY OF CONCLUSIONS

Subject to the understandings, assumptions, qualifications, discussions, recommendations and analysis contained herein, in our opinion:

- (a) all of the interest payable by Financero to Chase should be exempt from withholding tax under the Act by reason of the exemption contained in subparagraph 212(1)(b)(vii) of the Act,
- (b) all of the interest paid by Financero to Chase in accordance with the terms of the Loan from Chase should be deductible to Financero in computing its income pursuant to paragraph 20(1)(c) of the Act and such deductibility should not be denied by reason of subsection 18(4) of the Act,
- (c) all of the interest paid by Canco to Financero in accordance with the terms of the loan from Financero to Canco should be deductible to Canco in computing its income pursuant to paragraph 20(1)(c) of the Act, and such deductibility should not be denied by reason of subsection 18(4) of the Act,
- (d) the obligation of Chase under the share subscription agreement should not be regarded as an amount which Chase owes to Financero for purposes of subsection 17(1) of the Act until after the maturity of the Loan, and accordingly subsection 17(1) of the Act should not apply to require Financero to include any imputed interest amount in income with respect to Chase's obligation,
- (e) the debt forgiveness rules contained in section 80 of the Act should not apply to Financero by reason of the proposed transactions,
- (f) Canco should not be required to include any amount in its income on an accrual basis pursuant to subsection 12(3) of the Act and Regulation 7000 by reason of its

purchase from Chase and its retention of the Share Issuance Rights in accordance with the proposed transactions.

- (g) Cansub should not be treated as a "financial institution" for purposes of subsection 142.2(1) of the Act and should not be required to treat the Share Issuance Rights on a "mark-to-market" basis for purposes of the Act.
- (h) the overall federal capital tax applicable to Cansub and its subsidiaries will be increased in the manner and to the extent described in the discussion below. The provincial capital tax implications will depend on the provinces in which Canco, Financeco and Cansub carry on business.
- (i) the sale of the Share Issuance Rights by Chase should not result in Chase being subject to tax pursuant to the Act by reason of the Treaty.
- (j) the acquisition of the Shares of Financeco by Cansub should not result in Cansub being subject to tax pursuant to the Act.
- (k) it should be possible to amalgamate Financeco and Cansub on a tax-free basis in order to eliminate the Shares from the corporate structure without Cansub recognizing gain on the Shares.
- (l) the existing judicial anti-avoidance doctrines should not apply to the transactions described herein. The statutory general anti-avoidance rule contained in section 245 of the Act should not be applied to the transactions described herein to redetermine the conclusions set out above, and
- (m) as a result of all of the foregoing, the overall Canadian income tax effect of the transactions under the Act should be that Financeco should have taxable income each year in a maximum amount equal to the spread earned by virtue of the difference in interest rates on the Loan from Chase and the loan to Canco. Canco should be entitled to deduct all of the interest paid to Financeco on the full amount of the loan from Financeco. Cansub should not have any taxable income arising from the transactions, and the payments of principal and interest to Chase on the Loan should not be subject to non-resident withholding tax.

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BARRISTERS & SOLICITORS / ADVISERS & TRADE MARK AGENTS

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IV DISCUSSION

A. TECHNICAL ANALYSIS

1 Issues for Financoco and Chase

(a) Withholding Tax Exemption

No Canadian withholding tax applies to payments of principal under a debt obligation. However, non-resident withholding tax will apply to interest payments on the Loan unless an exemption from withholding tax applies.

The only potentially available exemption from withholding tax on interest payments on the Loan is provided for in subparagraph 212(1)(b)(vii) of the Act. Based on our understanding of the facts, this exemption will apply provided that the following conditions are satisfied:

- (i) Chase and Financoco are dealing at arm's length with each other at the time of each payment of interest under the Loan;
- (ii) Financoco may not under any circumstances be obliged to pay more than 25% of the principal amount of the Loan within 5 years from the date of advance of the Loan except in the event of a failure or default under the terms of the Loan or any agreement relating thereto or if the terms of the Loan or any agreement relating thereto become unlawful or are changed by virtue of legislation or by a court, statutory board or commission; and
- (iii) no portion of the interest on the Note is contingent or dependent on the use of or production from property in Canada or is computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion.

Based on the assumed facts, there would appear to be no difficulties regarding compliance with items (ii) and (iii) above. It will be necessary to review the detailed documentation to ensure compliance with the law and administrative practice.

With respect to item (i) above, the Act provides that related persons are deemed not to deal at arm's length, but that it is a question of fact whether persons not related to each other are at any particular time dealing at arm's length. Chase is not related to Financoco for purposes of the Act, provided that Chase does not have any right to, or to acquire or control the voting of, shares of Financoco representing a majority of the voting shares of Financoco. For greatest certainty that Chase is not related to Financoco, we recommend that the Shares of Financoco be non-voting, so that Canco is the only person who owns or has any rights with respect to the voting shares of Financoco.

Whether Chase and Financeco in fact deal at arm's length will depend on all of the factual circumstances and the actual conduct of the parties. The case law indicates that two parties will not be considered to be dealing at arm's length if one party has de facto control over the other party, if one person dictates the terms of the transaction, if the parties act in concert and in the same interest to achieve a common objective, if one party is acting merely to accommodate the other or is captive to the interests of the other, or if there is no evidence of true bargaining between parties with independent interests. We would expect that none of these factors will be present in the case of the relationship of Chase and Financeco, and in particular that Financeco will be clearly represented by Canco and its appointees and will in fact bargain with Chase regarding the terms of the Loan. Accordingly, we would expect the arm's length test to be met.

Based on the foregoing, the withholding tax exemption under subparagraph 212(1)(b)(vii) of the Act should be available.

2 Issues for Financeco

(a) Interest Deductibility

Interest is generally not deductible pursuant to the provisions of the Act unless such interest is deductible in accordance with paragraph 20(1)(c) of the Act. Such paragraph provides that a Canadian taxpayer may deduct interest provided (i) it is reasonable, (ii) it is payable pursuant to a legal obligation and (iii) it is interest on borrowed money used for the purpose of earning income from a business or property. We assume that the interest payable by Financeco on the loan from Chase will be commercially reasonable and will be a legal liability of Financeco. This leaves three issues which require further analysis.

- (i) Status of the Chase Loan – We assume that the Chase Loan will take the form of a note with specified principal, interest, term to maturity, covenants, events of default and representations and warranties in standard commercial form. In this regard, we assume that, in addition to the interest rate being reasonable, it will be computed by reference to the principal amount and will accrue on a day-to-day basis. We assume that, at maturity, Financeco will repay the entire principal amount of the loan as indicated under the terms of the Note. The central indicia of a loan is the shared intention of the debtor and creditor that the amount advanced will be fully repaid. The fact that Chase has an independent obligation to subscribe for Shares of Financeco and an irrevocable obligation to pay the subscription price following repayment of the Loan should not result in the Loan from Chase being re-characterized as equity for purposes of the Act as opposed to borrowed money. The treatment of the Loan (or part thereof) as equity for accounting purposes will not affect the status of the loan for tax purposes which will be dependent on the legal character of the Loan.

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- (ii) **Purpose** – Financeco will loan the funds which it has borrowed to Canco and will earn a spread over the amount of interest which is payable on the Loan from Chase. We assume that the interest on this inter-company loan will be paid and accordingly, we would expect that there would be no issue as to whether Financeco had borrowed the money for the purpose of gaining or producing income from property, being the inter-company loan.
- (iii) **Thin Capitalization Rules** – Subsection 18(4) of the Act provides that a Canadian corporation will not be entitled to deduct interest paid or payable by it on its debts to specified non-residents to the extent that the greatest aggregate amount of the corporation's outstanding debts in the year to specified non-residents exceeds three times its equity (the federal budget released on February 28, 2000 proposes to reduce this to two times equity). Equity is specifically defined for these purposes (there are technical changes proposed in the budget). The definition of "equity" includes retained earnings of Financeco at the commencement of the year and Financeco's contributed surplus and paid-up capital but only to the extent that it was contributed or related to shares owned by specified non-resident shareholders of Financeco. Based on the proposed structure, Financeco will have minimal equity.

Subsection 18(5) of the Act defines debts to specified non-residents for these purposes as debts owing to a non-resident who owns (or does not deal at arm's length with the owner of) shares of Financeco, where those shares represent 25% or more by votes or value of the total issued shares of Financeco. For purposes of applying the definition, a person is deemed to own shares where such person has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently to or to acquire or to control the voting rights in respect of the shares. Because Chase will have a right under the share subscription agreement to acquire 99.9% of the shares of Financeco, Chase will, in our view (subject to the discussion below), initially be a specified non-resident shareholder of Financeco. However, immediately after the share subscription agreement is entered into, Chase will sell the right to the Shares (the Share Issuance Rights) to Cansub for an amount equal to the fair market value of such rights. The taxation year of Financeco should be established to end immediately following the sale of such right by Chase. Once this occurs, Chase will no longer have any right to acquire or be issued any shares of Financeco and will no longer be a specified non-resident shareholder for purposes of subsection 18(4). Accordingly, the provisions of subsection 18(4) will not apply to deny interest deductibility to Financeco in respect of the Loan from Chase.

CCRA has looked at the definition of "specified shareholder" for these purposes in a different context in a technical interpretation issued November 20, 1993. In that technical interpretation, CCRA came to the conclusion that, in order to be a specified shareholder, it was necessary that the person in question own at least

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one share of the Canadian corporation in question. On a literal reading, this interpretation supports the conclusion that the holding of a right to acquire a share would not be enough, in and of itself, to constitute a person as a specified shareholder for these purposes. However, it is not clear that the same conclusion would be reached in the context of Chase's relationship with Financeco.

Subsection 18(5.1) of the Act deems a person who would otherwise be a specified shareholder not to be a specified shareholder in particular circumstances. This subsection is designed to apply where a creditor owns a share or right subject to an agreement or arrangement under which, upon the satisfaction of a condition or the occurrence of an event that is reasonable to expect will be satisfied or will occur, the creditor will cease to be a specified shareholder. This is clearly the case in this transaction. However, in order for this relieving provision to apply, it is also necessary to demonstrate that the purpose for which the creditor became a specified shareholder was to safeguard its rights or interests in respect of its indebtedness. It is not clear that this is the only reason for Chase entering into the share subscription agreement since Chase is entering into the agreement in order to obtain the Share Issuance Rights which it will sell to Cansub.

Based on the foregoing, while arguments could be made that Chase is not a specified non-resident shareholder of Financeco even if it does not sell the Share Issuance Rights, we would strongly recommend that the Share Issuance Rights be sold immediately and that Financeco's taxation year end immediately following such sale, in order to achieve a higher level of comfort on this issue.

Please note that the federal budget released on February 28, 2000 proposes to include in debt that is subject to the thin capitalization rule, debt guaranteed or secured by a "specified non-resident shareholder" (although this proposal was subsequently deferred pending further study). We assume that the Loan will not be so guaranteed or secured.

(iv) Imputed Interest Rules

Subsection 17(1) of the Act applies in some circumstances where "a non-resident person owes an amount" to a Canadian corporation, the amount has been outstanding for more than a year, and the corporation has not included a reasonable amount of interest in its income. We have considered whether Chase's irrevocable obligation to pay the subscription price for the Shares to Financeco following maturity and repayment of the Loan could be considered an amount that Chase "owes" to Financeco during the term of the structure. In our view, Chase does not owe any amount to Financeco unless and until (i) the Loan has matured, and (ii) Financeco has repaid the Loan, i.e. there is no amount owing by Chase during the term of the structure. Accordingly, subsection 17(1) is of no application. We also note that no assets of Financeco have been loaned or

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otherwise provided to Chase in consideration for Chase entering into its obligation under the share subscription agreement, as Financoco is only obligating itself to issue the Shares after they are fully paid. Accordingly, in our view, there is no commercial reason why any amount on account of interest should be payable in respect of this future contingent obligation and therefore no policy reason why subsection 17(1) should apply.

(v) Potential Application of Section 80

If indebtedness is forgiven, section 80 of the Act provides for the reduction of certain tax pools of the debtor and ultimately for an income inclusion to the extent of any forgiven amount. In the context of this transaction, Financoco will most likely repay its indebtedness entirely in cash. The cash will be utilized by Chase to fulfill its obligation to pay the subscription price for the Shares to Financoco. These two obligations are equal in amount. Therefore, even if one debt is satisfied by set off against the other, provided the documentation is clear and consistent we would not anticipate that any forgiven amount will arise. Even if the Chase Loan could be viewed as being satisfied in shares of Financoco, the provisions of paragraph 80(2)(g) of the Act would apply such that there would be no forgiven amount based on the assumption that the fair market value of the Shares of Financoco when issued is equal to the principal amount of the indebtedness being so satisfied. Accordingly, the provisions of section 80 will not apply in these circumstances (assuming that all amounts of interest in respect of the Loan from Chase are paid when due).

(vi) Capital Tax

We have assumed that Financoco will be incorporated in Alberta and will not have a permanent establishment in any other province for purposes of the relevant provincial tax legislation. We have also assumed that Chase's obligation to pay the subscription price for the Shares at maturity does not constitute "indebtedness" for purposes of Part 1.3 of the Act. In light of the fact that the meaning of "debt" and "indebtedness" is generally similar, we regard this assumption as reasonable, based on the discussion under the heading "Issues for Cansub - (A) Prescribed Debt Obligation".

Financoco's capital will include \$100 in respect of the Loan from Chase for purposes of Part 1.3 of the Act. However, Chase will be entitled to an investment allowance of \$100 in respect of the loan to Canco for those purposes, and accordingly will not be subject to large corporations tax. Alberta does not impose a capital tax on corporations other than financial institutions, and based on the assumptions above, Financoco will not be subject to capital tax in any other province.

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3. Issues for Canco

(a) Interest Deductibility

(i) General – The provisions of paragraph 20(1)(c) of the Act which are discussed above with respect to Financeco apply equally to Canco. Again it will be important that the documentation of the loan by Financeco to Canco be in the form of an ordinary note with standard commercial terms, that the interest be reasonable and that the obligation to pay such interest constitute a legal obligation. This loan will have none of the attributes of equity and should clearly constitute borrowed money which is intended to be and will in fact be repaid. Because the back-to-back provisions contained in subsection 18(6) of the Act will likely apply, Canco's payment of interest will be subject to the same thin capitalization concerns as those set out above with respect to Financeco. We assume that the loan will not be guaranteed or secured by a "specified non-resident shareholder" of Canco. Provided Chase is not a specified shareholder of Financeco at any time when Canco is indebted to Financeco, the thin capitalization rules will not apply to deny the deductibility of interest on the loan to Canco.

(ii) Use of the Borrowed Funds by Canco – To the extent that Canco uses the borrowed funds for general corporate purposes we would expect the funds to qualify as money borrowed for the purpose of gaining or producing income from a business.

However, to the extent that Canco uses the borrowed funds to subscribe for shares of Cansub, which may be a special purpose corporation, and Cansub uses the funds to purchase the Share Issuance Rights, we have some concern with respect to interest deductibility in respect of these funds.

The Act provides that the borrowed money must be used for the purpose of gaining or producing income from (in this case) property. CCRA has generally taken the administrative position that interest on money borrowed to acquire common shares is deductible, as there is the potential for significant income in the form of dividends. However, in the context of certain structured financings, CCRA has not followed that position and has had some success in the courts in arguing that the real or actual purpose of a borrowing to acquire shares of a company was not to earn dividend income but rather to defer tax and transform income into a capital gain (*Lidmer v MNR* [1999] DTC 5133 (CA)). In *Lidmer*, this conclusion was reached notwithstanding the fact that substantial dividends were actually paid, because these were insignificant in relation to the overall interest expense. The court did not find that the tax planning was unlawful or a sham but rather focused on the purpose of the borrowing. Further, the court explicitly found that it was not necessary to find that the investor's dominant

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purpose must be to derive income from the borrowed amounts, rather, the taxpayer needed only to have had a reasonable expectation of income when the investment was made. However, in the facts of the case, the court found that the true purpose of the investment was not to earn income from the shares but to realize a capital gain in respect of the shares. *Mark Resources Inc. v. R.* [1993] DTC 1004 (TCC) takes a similar approach to the purpose of the borrowing.

CRB Logging Co. v. R. [1999] DTC 840 (TCC), while only a lower tax court decision, also raises interest deductibility concerns in light of the proposed structure. In that case, a company, Meager, borrowed funds to acquire the shares of two companies which owned all of the shares of CRB. CRB borrowed funds which it used to subscribe for dividend-paying preferred shares of Meager. Meager used the subscription proceeds to repay its loans. In the next two years, dividends were paid by CRB up to Meager and loaned to CRB and ultimately the shareholder loan was repaid and the preferred shares redeemed. No dividends were in fact paid on the preferred shares. The court again focused on the purpose of the use of the borrowed funds and refused to find an income earning purpose. The court found that CRB had no realistic expectation of dividend income from the preferred shares because Meager had no income source of substance independent of the existence of CRB's business, and CRB in effect financed its own acquisition. While the facts in the current transaction are very different, we have some concern where Cansub is a single purpose vehicle because the funds borrowed by Canco are being used to acquire shares of Cansub, and Cansub is using those funds to acquire as its only asset a right to be issued the Shares, which will have an inherent capital gain and no expectation of dividends during the term of the financing.

These concerns are substantially reduced if Cansub is a significant operating corporation with an active business independent of the proposed financing which could and presumably would pay significant dividends on shares acquired by Canco.

Particularly in the event that it is not possible to utilize an existing substantial company as Cansub in the structure, we would strongly recommend that a cash tracing approach be used. Canco would accumulate cash from business operations in a separate bank account and would borrow using a credit facility to finance all business expenses. Canco would use the segregated cash to purchase shares of Cansub and would use the money loaned to it by Financeco to repay the line of credit. Thus the investment in Cansub would be made with unborrowed money, and the borrowed money would be used by Canco to repay loans incurred to earn business income. Pursuant to subsection 20(3) of the Act, borrowed money used to repay the line of credit advanced would take on the purpose of the original borrowings. On the basis of the analysis of the Federal Court of Appeal in *Singleton v. R.* [1999] DTC 5362, we would expect that such a cash tracing

approach, if carefully carried out, would be successful in demonstrating the appropriate purpose for purposes of the test set out in paragraph 20(1)(c) of the Act. In this regard we note that the Crown has applied for and obtained leave to appeal the *Singleron* case to the Supreme Court of Canada.

(b) Capital Tax

We have assumed that Canco would be an Ontario corporation that does not have a permanent establishment in any other province for purposes of the relevant provincial tax legislation. Canco will be required to include \$100 in its capital in respect of the loan from Financeco, and (for purposes of Part 1.3 of the Act) should be entitled to an investment allowance of \$70 in respect of its investment in Cansub. For Ontario capital tax purposes, the investment allowance will be capped as that proportion of Canco's paid-up capital that the cost of its eligible investments in other corporations is of its total assets, subject to certain adjustments.

4. Issues for Cansub and Chase

(a) s.116

The Share Issuance Rights will constitute "taxable Canadian property" for purposes of the Act. Accordingly, since Chase is a non-resident of Canada for purposes of the Act, it will be required to notify CCRA of the disposition of the Share Issuance Rights to Cansub and apply for a tax clearance certificate under section 116 of the Act. If the tax clearance certificate is not received by the 30th day of the month following the month in which the disposition occurs, Cansub will be liable to remit to CCRA one-third of the purchase price for the Share Issuance Rights on account of the tax potentially payable by Chase in connection with the disposition. This liability arises notwithstanding the fact that any gains on the disposition would be exempt from Canadian tax under the Treaty provided that the shares of Financeco do not derive their value principally from Canadian real property or resource property. However, it is possible to apply for the tax clearance certificate in advance of the date of disposition, and in light of the consequences of a failure to obtain the certificate by closing, it is recommended that Chase in fact apply for the certificate well before the date of disposition.

5. Issues for Cansub

(a) Prescribed Debt Obligation Rules

Subsection 12(3) of the Act requires a corporation to recognize interest that has accrued on each debt obligation held by the corporation (with certain exceptions) up to the end of each year. For these purposes, where a taxpayer acquires an

interest in a "prescribed debt obligation", an amount determined in prescribed manner is deemed to accrue to the taxpayer as interest on the obligation. Subsection 7000(1) of the Regulations under the Act defines a "prescribed debt obligation" to be a debt obligation which meets one of several listed conditions.

For purposes of determining whether the Share Issuance Rights are a "prescribed debt obligation" within the meaning of subsection 7000(1) of the Regulations, we have assumed that the terms of the share subscription agreement will provide that Financeco may only satisfy its obligations by delivering the Shares, and not by delivering cash. It is further assumed that the assignment of the Share Issuance Rights by Chase to Cansub is irrevocable, with no right to a refund in the event that Financeco does not deliver the appropriate shares to the holder of the Share Issuance Rights.

The word "debt" is capable of various interpretations depending on the context. As stated by C.R.B. Dunlop in *Creditor-Debtor Law in Canada*, (2nd ed.) (Scarborough: Carswell, 1994), at page 16, "instead of trying to define a core meaning, it would seem better to agree with the editors of the *Corpus Juris Secundum* that "[the word] takes shades of meaning from the occasion of its use, and color from accompanying use, and it is used in different statutes and constitutions in senses varying from a very restricted to a very general one". Nevertheless, as stated by C.R.B. Dunlop, "one can say that the most common use of the word 'debt' is to describe an obligation to pay a sum certain or a sum readily reducible to a certainty."

This approach is consistent with the view taken by the Saskatchewan Court of Appeal in *Noble v. Lashbrook*, [1918] 40 D.L.R. 93, in which the court reviews various definitions of debt and concludes that a debt requires a sum certain or a sum that can be determined by computation. Similarly, the Saskatchewan Queen's Bench stated in *Royal Trust Co. v. H.A. Roberts Group Ltd.*, [1993] 4 W.W.R. 305 at 341 that debt "means a specific kind of obligation for a liquidated or certain sum incurred pursuant to an agreement." The court was concerned with the interpretation of a particular provision in the *Land Titles Act* which referred to the term "debt". The court held that the word "debt" implied an obligation to pay a sum certain, as a principle of statutory interpretation.

Based on the above, in our view the term "debt obligation" as used in subsection 7000(1) of the Regulations means an enforceable obligation to pay a sum certain. In the present case, the Share Issuance Rights merely represent an obligation of Financeco to deliver the Shares to the holder of the Share Issuance Rights at a specific future date following payment of the subscription price for the Shares by Chase, and can not be satisfied in cash. Also, the value of the shares at the maturity of the structure is not determinable at this time. Based on the foregoing, the better view is that the Share Issuance Rights are not a debt obligation.

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Even if the Share Issuance Rights were considered to be a debt obligation, it is difficult to see how subsection 7000(1) of the Regulations would apply. If it were accepted that the Share Issuance Rights were a debt obligation, the Share Issuance Rights would most likely constitute a "prescribed debt obligation" further to paragraph 7000(1)(a) of the Regulations, which pertains to a particular debt obligation "in respect of which no interest is stipulated to be payable in respect of its principal amount." Subsection 7000(2) of the Regulations provides that the amount of interest that is deemed to accrue to a taxpayer on an obligation that is a prescribed debt obligation under paragraph 7000(1)(a) is, in general terms, a rate equal to the maximum discount rate for which the holder's cost of the Share Issuance Rights is equal to the present value of all maximum payments that may be made under the obligation. However, the only obligation of Financeco under the Share Issuance Rights is to deliver Shares at a specified future date, and the Shares are common shares which have no maximum value. It is therefore difficult to see how subsection 7000(2) of the Regulations could be applied to determine the rate of interest which should be deemed to accrue in respect of the Share Issuance Rights. For this reason, it appears that the Share Issuance Rights are not the type of obligation to which section 7000 of the Regulations is intended to apply.

(b) Mark-to-Market Rules

If Capsub were a "financial institution" within the meaning of subsection 142.2(1) of the Act, and if the Share Issuance Rights were "mark-to-market property" or a "specified debt obligation" within the meaning of that subsection, then special rules in sections 142.2 to 142.6 of the Act might apply to require Capsub to include amounts in income. However, in our view, Capsub's participation in these transactions will not result in Capsub being such a "financial institution" (and we have assumed that Capsub is not a "financial institution" before entering into these transactions). It is possible for a corporation that is not a traditional financial institution to be a "restricted financial institution" under subsection 348(1) of the Act and accordingly a "financial institution", in particular if the "principal business" of the corporation is "the lending of money to persons with whom the corporation is dealing at arm's length or the purchasing of debt obligations issued by such persons or a combination thereof". Capsub's participation in the financing transactions does not involve lending money or purchasing debt obligations issued by arm's length persons. Even if the Share Issuance Rights were regarded as a debt obligation, which in our view they are not, the obligation would have been issued by Financeco and not Chase, since it is Financeco's obligation to issue the Shares to Capsub, and Financeco and Capsub do not deal at arm's length within the meaning of the Act.

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(c) Gain on Financeco Shares

When Cansub receives Financeco's Shares pursuant to the Share Issuance Rights, it should not be considered to have realized a gain, but rather, to have acquired the Shares of Financeco with a cost equal to \$70. The Shares are being acquired pursuant to a subscription agreement, and the ultimate analysis is similar to that applied in the context of a special warrant.

However, Cansub will own Shares with an inherent capital gain. Cansub could avoid realizing such capital gain in a number of ways. For instance, Cansub and Financeco could be amalgamated. On the amalgamation, Cansub would be deemed to have disposed of the Shares for proceeds equal to the adjusted cost base of the Shares, so that no capital gain would be recognized.

(d) Capital Tax

If Cansub is a special purpose vehicle, we have assumed that it would be an Alberta corporation that does not have a permanent establishment in any other province for purposes of the relevant provincial tax legislation. Cansub should be subject to federal large corporations tax in respect of the \$70 dollar capital subscription from Canco, but based on the assumption above, should not be subject to any provincial capital taxes. If Cansub is an operating corporation, it will be subject to provincial capital tax depending on the provinces where it carries on business.

B. ANTI-AVOIDANCE ISSUES**1 Judicial Principles**

The Canadian courts have developed a number of judicial anti-avoidance doctrines which, where applicable, could deny the intended tax consequences of a particular plan. However, these doctrines are very limited in scope. Those doctrines which have been accepted (or not rejected) by the Supreme Court of Canada are summarized below.

The courts have held that a transaction which was legally ineffective or incomplete could not carry with it the tax consequences intended had the transactions had legal effect. Similarly, a party which was seen as merely an agent or conduit would not have ascribed to it tax consequences in its own right, but rather the transaction would be seen as having been undertaken between the person with whom it contracted and the "principal". While the Canadian courts do recognize the concept of a "sham", they define it narrowly as a transaction intended to convey the impression of the creation of legal relationships which were not in fact intended by the parties. The Supreme Court of Canada has

specifically rejected, even in the context of tax-motivated transactions, the concept of a "business purpose" test being applied to negate the tax consequences of transactions fully intended to have legal effect and properly implemented, or a concept of economic substance overriding legal form, although lower courts have sometimes purported to apply these types of tests.

The most relevant example of the judicial approach of the Supreme Court of Canada to tax-motivated financing transactions is the recent case of *Shell Canada Limited v The Queen*, 99 DTC 1044. In that case, Shell required U.S. dollars for its business. Instead of borrowing U.S. dollars, Shell borrowed New Zealand currency at a high nominal interest rate of 15.4% (higher than the nominal interest rate applicable to a U.S. dollar borrowing), and entered into forward foreign exchange contracts with another party pursuant to which it purchased U.S. dollars with the New Zealand dollar borrowed, and purchased forward New Zealand dollars with U.S. dollars in order to meet the New Zealand dollar interest obligations and principal repayment obligation. Because of the expected decline in value of the New Zealand dollar in relation to the U.S. dollar, Shell expected to have a foreign exchange gain when it closed out the forward foreign exchange contract and repaid the New Zealand dollar principal amount owing on the debentures. If the New Zealand dollar debt obligation and forward foreign exchange contract could be integrated into one transaction, the economic effect would be the equivalent of a borrowing in U.S. dollars at an interest rate of 9.1%. Based on the form of the transactions as carried out, the taxpayer claimed interest expense at the rate of 15.4%, and claimed a capital gain on the close of the forward contract.

It was recognized by the Supreme Court of Canada that the transactions were tax-motivated, that the borrowing and forward exchange contract were linked together in the sense that the borrowing would not have been entered into in the absence of the forward exchange contract, and that if Shell had simply borrowed U.S. dollars, it would have paid 9.1% interest instead of the 15.4% claimed. It was accepted that there was no "sham" involved. The Supreme Court of Canada found in favour of the taxpayer based on an analysis which respected the separate legal obligations and did not recharacterize them in any way. The court accepted that, as between the lenders and Shell, Shell had actually borrowed New Zealand dollars and agreed to pay the 15.4% interest rate, and there was no element of a synthesized U.S. dollar loan as between these parties.

The Supreme Court of Canada stated that it "has never held that the economic realities of a situation can be used to recharacterize a taxpayer's bona fide legal relationships" and that they have held to the contrary that "absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular

transaction does not properly reflect its actual legal effect". The Court also emphasized that if an unambiguous provision of the Act applies to a taxpayer's transaction (such as the interest deductibility provision), it must simply be applied by the Court, regardless of the "economic realities" of a transaction or the general object and spirit of the provision. The fact that Shell structured its transactions to take advantage of provisions of the Act was of no concern to the Court, which stated that Shell was fully entitled to do so.

In a number of parts of the judgment, the Supreme Court of Canada emphasized that the parties to the New Zealand dollar loan transaction and the parties to the forward foreign exchange contract were different. In fact, the lenders were unrelated to the counterparty to the forward foreign exchange contract. In our case, the parties to the different transactions which we would seek to have respected as separate legal transactions are also different, i.e. Chase lends to Financeco but the party to the prepaid purchase contract with respect to the Financeco shares is Cansub. Because Financeco and Cansub are related corporations, the situation is not quite as strong as in the *Shell* case; however, in our view they would nevertheless be respected as different parties to the transactions, and the overall reasoning of the Supreme Court of Canada should still apply.

Based on the foregoing, we are of the view that no judicially developed anti-avoidance doctrine should properly be applied in the circumstances of the present case.

2 GAAR

A statutory general anti-avoidance rule was added to section 245 of the Act in 1988. Under this rule, if any transaction forming part of the proposed financing could be considered an "avoidance transaction" for purposes of this rule, Chase, Canco and their affiliates could be denied any Canadian tax benefits resulting from the transaction unless it may not reasonably be considered that the transactions would result in a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act read as a whole. A transaction will be an "avoidance transaction" if it results, directly or indirectly, in a reduction, avoidance or deferral of tax payable under the Act unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit. If the general anti-avoidance rule is held to apply to a transaction, the tax consequences are to be redetermined as is reasonable in the circumstances in order to deny the intended tax benefit.

On the issue of whether the proposed transactions contain one or more "avoidance transactions", there are clearly tax benefits resulting from the transactions, including the deduction by Canco of interest expense which is in economic reality

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a return of a portion of Chase's net \$30 capital investment in the financing, and possibly also the access to the withholding tax exemption for the Loan. The access to the withholding tax exemption would arguably be a tax benefit if one compares the proposed transactions to a transaction involving a simple borrowing of \$30 by Canco from Chase. In that event, the \$30 principal amount would presumably amortize by more than 25% during the first 5 years of the term of the Loan, and so the requirements for the withholding tax exemption would not be met.

A transaction resulting in tax benefits will be an "avoidance transaction" unless it was undertaken for *bona fide* purposes other than to obtain the tax benefits. In the *Shell* case, which was a pre-GAAR case, the Supreme Court of Canada considered whether Shell entered into its transactions for a bona fide business purpose. The Court specifically declined to express an opinion on whether acquiring funds at the lowest possible after-tax cost is a bona fide business purpose. In the subsequent *Canadian Pacific* case, discussed in more detail below, the Tax Court of Canada found in similar circumstances that there was no "avoidance transaction" included in the series of transactions because all transactions were "inextricably linked as elements of a process primarily intended to produce the borrowed capital which the Appellant required for business purposes". Nevertheless, in our view, the proposed transactions in the present case may be regarded as including one or more "avoidance transactions", and we will consider the position under the general anti-avoidance rule in the event that this finding is made. The principle issue would then be whether the transactions would result in a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act read as a whole.

In our view, the reasons of the Supreme Court of Canada in the *Shell* case strongly suggest that the Court would have found in favour of the taxpayer if GAAR had been an issue in that case. As mentioned above, there was certainly some question raised as to whether Shell would even be regarded as having entered into an "avoidance transaction". Furthermore, the Court stated that "a searching inquiry for either the 'economic realities' of a particular transaction or the general object and spirit of the provision at issue can never supplant a court's duty to apply an unambiguous provision of the Act to a taxpayer's transaction. Where the provision at issue is clear and unambiguous, its terms must simply be applied". This strongly suggests that if a taxpayer seeks to achieve tax results which are available based on the application of a clear and unambiguous provision of the Act, then this could not be concluded to be a "misuse" of the provision or an abuse based on the "object and spirit" of the Act, on the basis that the intended use and specific object and spirit of the provision are reflected in its clear and unambiguous words. The Supreme Court of Canada criticised the Federal Court of Appeal for its "misplaced reliance on economic realities" which "caused it to stray from the express terms of s. 20(1)(c)(i) and supplement the

provision with extraneous policy concerns that were said to form part of its purpose", and warned that courts must "be cautious before finding within the clear provisions of the Act an unexpressed legislative intention". The Supreme Court of Canada emphasized that it is not the Court's role to prevent taxpayers from relying on sophisticated transactions to achieve tax results more favourable than those that might be achieved by less sophisticated taxpayers.

It is important to note that, at the hearing of the *Shell* case by the Supreme Court of Canada, another taxpayer, Canadian Pacific Limited, was represented as an intervenor. This is because Canadian Pacific is involved in a tax case on virtually the identical facts to *Shell*, and is therefore directly affected by the results on the non-GAAR issue addressed in the *Shell* case. However, Canadian Pacific's case involves a post-GAAR year. One would presume that the Supreme Court of Canada was fully aware of Canadian Pacific's circumstances in rendering its appeal decision in favour of *Shell*. The strong pro-taxpayer statements which form part of the decision use language which is similar to the GAAR rule, particularly the statements regarding "object and spirit" and identifying the purpose of a provision of the Act. It is difficult to believe that the Supreme Court of Canada would use such language, which is highly suggestive of the GAAR provisions, and nevertheless be of the view that GAAR should apply to the transactions carried out by *Shell* and Canadian Pacific. Most members of the Canadian tax community believe that the Supreme Court of Canada as currently constituted would have found in favour of *Shell* if GAAR had been applicable, and would find in favour of Canadian Pacific on the GAAR issue.

Given that *Shell* has succeeded in the Supreme Court of Canada, the only issue now facing Canadian Pacific is GAAR. The GAAR case was decided by the Tax Court of Canada in favour of the taxpayer on October 13, 2000, and is expected to be appealed. It will likely be several years before the *Canadian Pacific* case is before the Supreme Court of Canada on the GAAR issue.

The Tax Court of Canada decision in the *Canadian Pacific* case was highly favourable to the taxpayer, and the Tax Court of Canada adopted a restrictive interpretation of GAAR, similar to the attitude of the Supreme Court of Canada in the *Shell* case. It was found that none of the transactions included in the series was an "avoidance transaction" because all transactions in the series were intended to be part of a process primarily intended to raise capital for business purposes.

In any event, even if there had been one or more "avoidance transactions", the Tax Court of Canada found that there was no misuse of the Act or abuse having regard to the provisions of the Act read as a whole. The reasoning of the Supreme Court of Canada in the *Shell* case, to the effect that the deduction of interest payments at the actual rate on the New Zealand dollar loan was not contrary to the

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object and spirit of paragraph 20(1)(c) but rather fulfilled its purpose, was specifically quoted and adopted.

The Tax Court of Canada also adopted the following reasoning from the case of *Jabs Construction Ltd. v. R.*, 99 D.T.C. 729 at 739:

Section 245 is an extreme sanction. It should not be used routinely every time the Minister gets upset just because a taxpayer structures a transaction in a tax effective way, or does not structure it in a manner that maximizes the tax.

There are several other cases in lower courts which have considered GAAR. There are two "surplus stripping" cases in which GAAR was applied by the Tax Court of Canada to prevent the taxpayers from converting what would have been a taxable dividend resulting from a liquidating distribution of assets out of a Canadian subsidiary into its U.S. parent into a capital gain exempt from Canadian tax by virtue of the Treaty exemption. GAAR was also applied in another case involving a tax loss transfer scheme. There is one other Tax Court of Canada case in which GAAR was not applied because a very complex series of transactions was found not to involve any "avoidance transaction". The court's reasoning is unclear. In our view, the facts of these lower court GAAR cases are sufficiently different from the facts we are considering that it is not possible to draw any meaningful comparisons. Also, the analysis of the lower court in these GAAR cases does not provide any general guidance on the interpretation of GAAR which provides any meaningful assistance in determining whether GAAR applies to the present facts. We regard the *Shell* case, notwithstanding that it is a pre-GAAR case, and also the *Canadian Pacific* case, as much more relevant to the case at hand.

To summarize, as a result of the decision of the Supreme Court of Canada in the *Shell* case and the decision of the Tax Court of Canada in the *Canadian Pacific* case, and assuming that the judicial approach taken by the members of the Courts in those cases is applied, it is our view that GAAR should not be successfully applied to the proposed transactions. The GAAR issue should be reviewed by Canco and its tax advisors, having regard to all of the detailed facts and circumstances of the transactions and the documentation.

Yours very truly,

BLAKE, CASSELS & GRAYDON LLP

SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP AND AFFILIATES

ATTORNEY WORK PRODUCT
PRIVILEGED AND CONFIDENTIAL

MEMORANDUM

August 15, 2001

TO: Stephen H. Douglas
Senior Director
Enron Wholesale Services

FROM: Mary Sue Butch
Robert McGuirk

RE: Project Sianshot

Issue

Will the transaction described below be treated as a self-amortizing net loan in the amount of \$375 million from Flagstaff Capital Corporation to BV-1 for United States federal income tax purposes?

Conclusion

In our view, the most appropriate treatment for United States federal income tax purposes of the transaction described below is as a self-amortizing net loan in the amount of \$375 million from Flagstaff Capital Corporation to BV-1.

Facts

Flagstaff Loan. On June 22, 2001, Flagstaff Capital Corporation ("Flagstaff"), a Delaware corporation which is wholly-owned by the Chase Manhattan Bank, borrowed \$375 million from a syndicate of banks pursuant to a certain credit and

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Permanent Subcommittee on Investigations
EXHIBIT #354

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security agreement dated as of June 22, 2001 ("Flagstaff Loan"). The members of the bank syndicate are Chase Manhattan Bank, the Royal Bank of Scotland plc, the Industrial Bank of Japan, Limited (New York Branch), and the Bank of Tokyo-Mitsubishi, Ltd ("Flagstaff Lenders"). Each member's respective share of the loan commitment is \$93,750,000. Interest accrues on the unpaid principal amount of the Flagstaff Loan at a variable rate (generally, LIBOR plus 1.125%) payable quarterly. Any overdue amounts accrue at that rate plus an additional 2% per annum. In addition, principal payments are required to be made quarterly according to an amortization schedule. The final payment of any unpaid principal and accrued but unpaid interest is due on June 23, 2006.

93750
4
315,000

Flagstaff irrevocably assigned for the benefit of the Flagstaff Lenders Flagstaff's interest in the Hansen Note, the Enron Agreement, the Warrant Agreement, the Put Option Agreement, the Total Return Swap Agreement, and the Interest Rate Swap Agreement (all described below, and together with the Subscription Agreement, the Subscription Payment Assumption Agreement, hereafter collectively referred to as the Operating Documents). Among other things, the obligation of the Flagstaff Lenders to make the Flagstaff Loan was conditioned upon (i) the execution of the Operative Documents and (ii) Flagstaff using the proceeds of the Flagstaff Loan to make the loan to Hansen ("Hansen Loan") (described below). Flagstaff is not entitled to assign or otherwise transfer its rights or obligations under the Flagstaff Loan without the prior written consent of each of the Flagstaff Lenders.

On June 22, 2001, The Chase Manhattan Bank and Flagstaff entered into a Confirmation and ISDA Master Agreement pursuant to which Flagstaff and the Chase Manhattan Bank entered into a fixed/floating rate swap with respect to payments due by Flagstaff under the Flagstaff Loan. As a consequence of this agreement, Flagstaff effectively converted its obligation under the Flagstaff Loan to

pay variable interest at LIBOR plus 1.25% into an obligation to pay fixed interest at the rate of 6.12% per annum.

Day-Light-Loan. At the beginning of day on June 22, 2001, the Chase Manhattan Bank loaned \$[1,039,504,347] to Flagstaff (the "Day-Light Loan"). Flagstaff repaid the Chase Manhattan Bank the principal amount of the Day-Light Loan (i.e., \$[1,039,504,347]), without interest, before the end of the day, on June 22, 2001. Flagstaff repaid the Day-Light Loan with the proceeds received by Flagstaff from Newman Investment Co. ("Newman") in consideration for Flagstaff entering into the Subscription Payment Assumption Agreement (described below). No instrument was prepared to evidence the Day-Light-Loan.

Hansen Note. On June 22, 2001, Hansen Investments Co. ("Hansen"), a Nova Scotia unlimited liability company (treated as a disregarded entity for United States federal income tax purposes) which is wholly-owned by Compagnie Papiers Stadacona ("CPS Holdings"), drew upon a certain credit agreement dated as of June 22, 2001 between Hansen, as borrower, and Flagstaff, as lender (the "Hansen Note"). The stated principal amount of the Hansen Note is \$1,414,504,347. Repayment of the entire principal amount is due in a single "bullet" payment on June 23, 2006 ("the Maturity Date"), although the repayment date may be accelerated in the case of any default event. Interest accrues on the stated principal amount at the rate of 6.12% per annum. Any overdue amounts accrue interest at the stated rate plus an additional interest of 2% per annum. Accrued interest on the stated principal amount is due on a quarterly basis. In the event of any prepayment of the stated principal amount, whether voluntary or involuntary, Hansen is required to pay the sum of (a) the accrued and unpaid interest due on the stated principal amount on or before the date of any such prepayment, plus (b) the net present value of all payments of interest under the Hansen Note that would have been payable on the purported principal amount so prepaid after such date if such voluntary or involuntary prepayment of the principal had been paid on the Maturity Date, rather than on the date of prepayment.

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(using a discount rate equal to the rate of interest under the Hansen Note) ("Hansen Make-Whole Amount").

Among other things, the obligation of Flagstaff to make the Hansen Loan was conditioned upon (i) the execution of the Operative Documents and the CPS Holdings Note (described below) and (ii) Hansen using the proceeds of the Hansen Loan to make the loan to CPS Holdings ("CPS Holdings Loan") (described below). For purposes of the Hansen Note, a "default event" includes a failure by CPS Holdings to comply with any obligation of CPS Holdings under the CPS Holdings Loan. Neither Flagstaff nor Hansen may assign its rights or obligations under the Hansen Loan without the prior written consent of the other, except that Hansen consents to Flagstaff granting a lien in Flagstaff's interest in the Hansen Note and the Hansen Make-Whole Amount to the Flagstaff Lenders as provided for in the Flagstaff Loan.

*Make Whole
Plus 1% interest
= 1.13%
= 1.13%
= 1.13%*

The net present value as of June 22, 2001 of the interest payments due on the Hansen Loan over its term equal the present value of the principal and interest payments that would be due with respect to a self-amortizing loan in the amount of \$375 million upon which principal and interest payments are made on a quarterly basis through June 23, 2006 and upon which interest is calculated on the unpaid principal balance at a per annum rate equal to 6.12 percent.

CPS Holdings Note. On June 22, 2001, Hansen transferred \$1,414,504,347 to CPS Holdings in exchange for a note issued by CPS Holdings ("CPS Holdings Note"). The principal amount of the CPS Holdings Note is \$1,414,504,347, and the repayment of such principal amount is due upon the earlier of the demand of Hansen or June 23, 2006. Interest is due quarterly on the unpaid principal balance at a rate equal 6.13% per annum. Any overdue amounts accrue interest at the stated rate plus an additional 2% per annum. CPS Holdings may prepay the CPS Holdings Note in whole but not in part, together with the make-whole amount (which is computed in

the same manner as the Hansen Make-Whole Amount), at any time. Upon a default by CPS Holdings in payment of any amounts owing under the CPS Holdings Note, Hansen may cause the principal of the CPS Holdings Note then outstanding, together with all fees, supplemental costs, the Make-Whole Amount and other obligations of CPS Holdings pursuant to the CPS Holdings Note, to become immediately due and payable.

CPS Holdings is a Nova Scotia unlimited liability company (treated as a disregarded entity for United States federal income tax purposes) which is wholly owned by BV-2, a Dutch company. BV-2 is wholly-owned by BV-1. An election has been made to treat BV-2 as a disregarded entity for United States federal income tax purposes. BV-1 is a Dutch company that is wholly-owned by Sundance, a United States partnership. BV-1 is treated as a "controlled foreign corporation" ("CFC") as defined by Section 957(a) of the Internal Revenue Code of 1986, as amended ("the Code").

Enron North America ("ENA"), a Delaware corporation, owns a limited partnership interest in Sundance which provides ENA 50% percent of the voting interest and 79.99% of the economic interest in Sundance. In addition, ENA owns a general partnership interest in Sundance which provides ENA .01% of an economic interest in Sundance. Outside investors who are United States persons and who are unrelated to ENA own limited partnership interests which, in the aggregate, provide them with 50% of the voting interest and 20% of the economic interest in Sundance.

On June 22, 2001, CPS Holdings transferred a total of \$375 million to Enron Corporation ("Enron"), an Oregon corporation. \$346.1 million was in repayment of a previous loan made by Enron to CPS Holdings (the "Enron Loan"). CPS Holdings used the proceeds of the Enron Loan to purchase the stock of Daishowa Forest Products Limited, a Canadian federal corporation, from an unrelated party. The remaining \$28.9 million represented payment of a structuring fee.

On June 22, 2001, CPS Holdings transferred \$1,039,504,347 of Canada Power Corp. ("ECPC") in exchange for a note issued by ECPC (the "ECPC Note"). ECPC is an Ontario, Canada corporation that is treated as a CFC for United States federal income tax purposes. ECPC is wholly-owned by Enron Canada Corporation ("ECC"), an Ontario, Canada corporation. ECC is wholly-owned by ENA, and ENA is wholly-owned by Enron.

The ECPC Note. The principal amount of the ECPC Note is \$1,039,504,347, and the repayment of such principal amount is due on June 23, 2006. Interest is due on the unpaid principal amount at a rate equal [6.709]% per annum (except any overdue amounts accrue interest at the stated rate plus an additional 2% per annum). Consequently, the ECPC Note, the CPS Holdings Note, the Hansen Note and the Flagstaff Note all share the same payment dates. ECPC may prepay the ECPC Note in whole but not in part, together with the make-whole amount (which is computed in the same manner as the Hansen Make-Whole Amount) at any time. If ECPC pays the make-whole amount to CPS Holdings, the unpaid balance of the principal amount will cease to accrue interest. [Upon an occurrence of a default by ECPC with respect to the payment of any amounts owing under the ECPC Note, CPS Holdings may cause the principal of the ECPC Note then outstanding, together with all fees, supplemental costs, the Make-Whole Amount and other obligations of ECPC pursuant to the ECPC Note, to become immediately due and payable.]

According to the ECPC Note, the ECPC Note was issued by ECPC upon the condition that (i) concurrently with the execution of the ECPC Note, ECPC and CPS Holdings execute and deliver a certain guarantee and indemnity agreement ("Guarantee and Indemnity Agreement") wherein CPS Holdings guarantees in favor of ECPC, *inter alia*, the obligations of Newman to ECPC pursuant to the share subscription agreement (the "Newman Subscription Agreement") between ECPC and Newman, and (ii) immediately thereafter the debenture shares described in the

Newman Subscription Agreement (the "Debenture Shares") are issued to ECPC pursuant to the terms of such Newman Subscription Agreement. The ECPC Note is not assignable by CPS Holdings without the prior written consent of ECPC.

The Debenture Shares. On June 22, 2001, ECPC transferred \$1,039,504 to Newman, a Nova Scotia unlimited liability company (treated as a pass-through entity for United States federal income tax purposes) which is wholly-owned by CPS Holdings, in exchange for Debenture Shares. The Debenture Shares are mandatorily redeemable on June 23, 2006 at their face amount of \$1,039,504 and may be redeemed earlier, at the option of Newman. If there is an earlier redemption of the Debenture Shares, Newman is required to pay a "make-whole amount" computed in the same manner as the Hansen Make-Whole amount. The Debenture Shares provide for distributions calculated at the same rate as interest on the ECPC Note. Distributions on the Debenture Shares are due and payable on the same dates, and in the same amounts, as the interest due under the ECPC Note.

Pursuant to the terms of the Debenture Shares and Canadian law, distributions on the Debenture Shares are payable irrespective of whether Newman's board of directors declares any distributions and irrespective of whether Newman has earnings and profits as of the distribution payment date. In addition, in the case of any overdue distributions, the holder of Debenture Shares will be entitled to all the rights of creditors, including the right to sue Newman in court for nonpayment. Any overdue distributions on the Debenture Shares will accrue interest from the required distribution payment date at the same interest rate that would be imposed on overdue payments under the ECPC Note.

The Debenture Shares are non-voting except in the limited circumstances required by Canadian law (such as involving the amalgamation of Newman with another company). In case of the liquidation of Newman, the holder of Debenture Shares is

entitled to proceeds from such liquidation above all other classes of Newman stock issued or to be issued.

Pursuant to the document entitled "Rights, Restrictions, Conditions and Limitations Attaching to the Debenture Shares," Newman acknowledged that the Debenture Shares was issued to ECPC only upon the condition that prior thereto (i) ECPC issues the ECPC Note to CPS Holdings and (ii) the Guarantee and Indemnity Agreement dated June 22, 2001 is entered into between CPS Holdings and ECPC. The Debenture Shares are not transferable by ECPC without the consent of Newman's directors (who are appointed by CPS Holdings).

The Guaranty and Indemnity Agreement. On June 22, 2001, CPS Holdings and ECPC entered into the Guarantee and Indemnity Agreement pursuant to which CPS Holdings agreed to guarantee Newman's obligations to ECPC with regard to the Debenture Shares. The Guarantee and Indemnity Agreement contains an express right of setoff whereby (1) CPS Holdings has the right to setoff ECPC's obligations to CPS Holdings pursuant to the ECPC Note ("ECPC's Obligations") against CPS Holding's obligations to ECPC pursuant to the Guarantee and Indemnity Agreement (CPS Holding's Obligations"), and (2) ECPC has the right to setoff CPS Holding's Obligations against ECPC's Obligations. According to the opinion prepared by Blake, Cassels & Graydon LLP on June [], 2001, the above set-off rights are valid under Canadian law and will not be terminated by reason, in and of itself, of the bankruptcy of ECPC, CPS Holdings or Newman.

According to the Guarantee and Indemnity Agreement, the Guarantee and Indemnity Agreement was executed and delivered by CPS Holdings and ECPC upon the condition that (i) concurrently with the Guarantee and Indemnity Agreement, ECPC issues the ECPC Note to CPS Holdings and (ii) immediately thereafter, ECPC subscribes for the Debenture Shares pursuant to the Newman Subscription

Agreement. CPS Holding's obligation under the Guarantee and Indemnity Agreement cannot be assigned or delegated.

Hansen Share Subscription Agreement. On June 22, 2001, Newman entered into an agreement with Hansen whereby Newman agreed to subscribe for Class A redeemable, retractable, cumulative preferred shares to be issued by Hansen to Newman on June 23, 2006, and Newman agreed to pay Hansen on June 23, 2006 \$1,414,504,357 for such shares ("Hansen Share Subscription Agreement"). The Hansen Share Subscription Agreement may not be assigned, in whole or in part, by either Newman or Hansen without the prior written consent of the other.

Subscription Payment Assumption Agreement. On June 22, 2001, Newman, Flagstaff and Hansen entered into an agreement ("Subscription Payment Assumption Agreement") pursuant to which Newman transferred \$1,039,504,347 to Flagstaff in exchange for Flagstaff's agreement to assume Newman's obligation to pay \$1,414,504,347 to Hansen on June 23, 2006 pursuant to the Hansen Share Subscription Agreement. The Subscription Payment Assumption Agreement contains an express right of setoff whereby (1) Flagstaff is entitled to set-off Hansen's obligation to repay the \$[1,414,504,347] principal amount of the Hansen Note to Flagstaff due on June 23, 2006 ("Hansen's Obligation") against Flagstaff's obligation to pay the \$1,414,504,347 to Hansen on June 23, 2006 pursuant to the Subscription Payment and Assumption Agreement ("Flagstaff's Obligation") and (2) Hansen is entitled to set-off Flagstaff's Obligation against Hansen's Obligation. According to the opinion prepared by Blake, Cassels & Graydon LLP on June [], 2001, the above set-off rights are valid under Canadian law and will not be terminated by reason, in and of itself, of the bankruptcy of Hansen, Flagstaff or Newman.

The obligation of Flagstaff to pay \$1,414,504,347 to Hansen on the subscription payment date is subject to the condition that, at or prior to the subscription payment

date, Flagstaff shall have received payment in full of the principal amount of the Hansen Note either in cash or by way of set-off against the obligation of Flagstaff to pay the subscription price balance. The Subscription Payment Agreement may not be assigned by Hansen, Newman and Flagstaff without the prior written consent of the other parties.

Warrant Agreement. On June 22, 2001, Hansen and Flagstaff entered into an agreement (the "Warrant Agreement") whereby Hansen granted and issued to Flagstaff a warrant (the "Warrant") to acquire non-voting, redeemable, retractable preferred shares ("Class B preferred shares") in Hansen at an exercise price of \$1 per Class B preferred share. In the case of any event of default by Hansen under the Hansen Note, Flagstaff would have the right to acquire the number of Class B preferred shares which have an aggregate redemption amount equal to the amount of the Hansen Make-Whole Amount that would be payable by Hansen pursuant to the Hansen Note. The Warrant may not be transferred or assigned by Flagstaff without the prior written approval of Hansen.

The Put Option Agreement. On June 22, 2001, Enron and Flagstaff entered into an agreement (the "Put Option Agreement") whereby Enron agreed to purchase the Warrant from Flagstaff. Flagstaff may exercise the right to require Enron to purchase the Warrant from Flagstaff (the "Put Option") upon the occurrence and during the continuance of any event of default by Hansen pursuant to the Hansen Note. If Flagstaff exercises the Put Option, Enron will have the right (subject to any objections raised by Flagstaff) to determine the fair market value purchase price Enron will pay Flagstaff for the Warrant. Enron may not assign its rights in the Put Option Agreement without the prior written consent of Flagstaff. Flagstaff may only assign its rights in the Put Option Agreement (i) in connection with an assignment of its rights in the Warrant and then only as permitted under the terms of the Warrant, (ii) as collateral security under the Flagstaff Loan, or (iii) with the prior written consent of Enron.

The Total Return Swap Agreement. On June 22, 2001, Enron and Flagstaff entered into an agreement ("the Total Return Swap Agreement") whereby, upon the earlier of the day that either Flagstaff exercises the Put Option or the Warrant ("the Exercise Date"), (1) Flagstaff agrees to pay Enron, (i) in the case where Flagstaff exercises the Put Option, the amount Enron paid Flagstaff for the Warrant, or (ii) in the case where Flagstaff exercises the Warrant, the subscription price paid by Flagstaff to Hansen for the Class B preferred shares, plus the present value (using a discount rate of 5% per annum) of the cumulative preferred dividend that has accrued or will accrue with respect to such Class B preferred shares; and (2) Enron agrees to pay Flagstaff, the Hansen Make-Whole Amount which would be payable by Hansen pursuant to the Hansen Note if payment of the Hansen Make-Whole Amount were due on the Exercise Date.

? TRS triggers day of warrant so no paid accrual?

Performance Guarantee. On June 22, 2001, the Chase Manhattan Bank entered into an agreement ("the Performance Guarantee") with the Royal Bank of Scotland plc, the Industrial Bank of Japan, Limited (New York Branch), and the Bank of Tokyo-Mitsubishi, Ltd. ("the Beneficiaries") whereby the Chase Manhattan Bank guaranteed the Beneficiaries the timely performance, and full compliance with, all the obligations of Flagstaff pursuant to the Flagstaff Loan.

Enron Agreement. On June 22, 2001, Enron entered into an agreement ("the Enron Agreement") in favor of Flagstaff and the Beneficiaries whereby Enron agreed to indemnify them in the event of any failure by Enron, Hansen or Newman to perform their obligations under the Flagstaff Loan, the Hansen Note, the Hansen Share Subscription Agreement, the Subscription Payment Assumption Agreement, the CPS Holdings Note, the Enron Agreement, the Warrant Agreement, the Put Option Agreement, and the Total Return Swap Agreement.

U.S. Tax Matters Letter. On June 22, 2001, JP Morgan Securities, Inc. and Enron signed an agreement ("U.S. Tax Matters - Enron Structured Financing") whereby JP

Morgan Securities, Inc. and its affiliates and Enron and its affiliates ("the Companies") agreed to treat, for United States federal income tax purposes, the Hansen Note, (ii) the Hansen Share Subscription Agreement between Newman and Hansen and (iii) the Subscription Payment Assumption Agreement between Flagstaff, Newman and Hansen (the "Transaction") as a net loan of \$375 million from Flagstaff to Hansen. In particular, the agreement provides that the Companies will treat the Net Loan as a self-amortizing loan (upon which the quarterly interest payments shall be made and calculated at an annual rate equal to 6.12 percent) and the quarterly payments of interest under the Hansen Note will be treated in part for U.S. federal tax purposes as quarterly payments of interest equal to 1.53125 percent of the outstanding Net Loan amount, with the excess of each such payment made under the Credit Agreement over each quarterly interest payment made (and characterized as such for U.S. federal tax purposes) as payment of principal on the Net Loan. The Companies also agree to treat the operative documents as giving rise to an integrated transaction. However, the Companies are not required to treat the Transaction as a Net Loan if they receive an opinion of nationally recognized counsel indicating that no reasonable basis (within the meaning of Section 6662 of the Internal Revenue Code of 1986, as amended) exists for such treatment.

Discussion

The following authorities have been relied upon for purposes of this memorandum.

I. Cases and Rulings

A. Disregarding Circular Flows of Cash

The IRS disregarded the circular flow of cash in Revenue Ruling 83-142, 1983-2 CB 68. In Revenue Ruling 83-142, 1983-2 CB 68, a domestic company ("U.S. parent") owned all of the stock of FY, a corporation formed under the laws of a foreign country. FY transferred one of its businesses to FZ, a newly formed foreign

corporation, in exchange for all of FZ's stock. Thereafter, U.S. Parent purchased the stock of FZ from FY for an amount of money equal to the fair market value of the FZ stock. Following FY's sale of the FZ stock to U.S. Parent, FY made a cash distribution to U.S. Parent that was treated as a dividend for foreign tax purposes and subject to withholding tax. The amount of the distribution from FY was great enough to allow U.S. Parent to receive, after payment of the foreign withholding tax, an amount equal to the fair market value of the FZ stock.



U.S. Parent treated the transaction as a spin-off of FZ by FY under Section 355 for United States federal income tax purposes. The issue in Revenue Ruling 83-142 was whether the distribution of cash by FY would be treated as money received by U.S. Parent for purposes of Section 356(b). Section 356(b) provides that if Section 355 would apply to a distribution but for the fact that the property received in the distribution consists not only of property permitted by Section 355 to be received without the recognition of gain, but also of other property or cash, then an amount equal to the sum of the money and the fair market value of the other property should be treated as a distribution of property to which section 301 applies.

The IRS held that the payment by U.S. Parent to FY equal to the fair market value of the FZ stock and the dividend distribution by FY to U.S. Parent is a circular flow of cash to the extent that U.S. Parent's payment is returned by FY. According to the IRS, "[t]his circular flow of cash is a transitory step that has no federal income tax consequences." Consequently, the IRS held that the cash returned by FY to X will not be treated as a dividend to the extent it represents a circular flow of cash. However, FY's distribution of additional cash in the amount of the withholding taxes paid to the foreign country is not a circular flow of cash and will be treated as a deemed distribution received by the U.S. Parent.

The IRS also disregarded circular flows of cash in Revenue Ruling 78-357, 1978-2 CB 150; Revenue Ruling 74-564, 1974-2 CB 124; and FSA 200106004.

B. Disregarding Offsetting and Matching Obligations

1. Revenue Rulings 99-14

The IRS disregarded offsetting and matching obligations in Revenue Ruling 99-14, 1999-1 C.B. 835. In Revenue Ruling 99-14, a foreign municipality ("FM") leased property to a U.S. corporation ("X") under a "Headlease," and X immediately leased the property back to FM under a "Sublease." The term of the Headlease was 34 years and required X to make two rental payments to FM during its 34-year term: (1) an \$89 million "prepayment" at the beginning of year 1; and (2) a "postpayment" at the end of year 34 that has a discounted present value of \$8 million. The "primary" term of the Sublease was 20 years and required FM to make fixed, annual rental payments over both the primary term and, if exercised, the put renewal term. At the end of the Sublease primary term, FM would have a "fixed-payment option" to purchase from X the Headlease residual (the right to use the property beyond the Sublease primary term subject to the obligation to make the rent postpayment). If FM does not exercise the option, X may elect to (1) use the property itself for the remaining term of the Headlease, (2) lease the property to another person for the remaining term of the Headlease, or (3) compel FM to lease the property for the 10-year put renewal term of the Headlease. If FM does not exercise the fixed-payment option and X exercises its put renewal option, X can require FM to purchase a letter of credit guaranteeing the put renewal rents. If FM does not obtain the letter of credit, FM must exercise the fixed-payment option.

To partially fund the \$80 million Headlease prepayment, X borrowed \$54 million from BK1 and \$6 million from BK2. Both loans were nonrecourse, have fixed interest rates, and provided for annual debt service payments that fully amortize the loans over the 20-year primary term of the Sublease. The amount and timing of the

debt service payments mirrored the amount and timing of the Sublease payments due during the primary term of the Sublease.

Upon receiving the \$89 million Headlease prepayment, FM deposited \$54 million into a deposit account with an affiliate of BK1 and \$6 million into a deposit account with an affiliate of BK2. The deposits with the affiliates of BK1 and BK2 earned interest at the same rates as the loans from BK1 and BK2. FM directed the affiliate of BK1 to pay BK1 annual amounts equal to 90 percent of FM's annual rent obligation under the Sublease (that is, amounts sufficient to satisfy X's debt service obligation to BK1). In addition, FM pledged the deposit account to X as security for FM's obligations under the Sublease, while X, in turn, pledged its interest in FM's pledge to BK1 as security for X's obligations under the loan from BK1. Similarly, FM directed the affiliate of BK2 to pay BK2 annual amounts equal to 10 percent of FM's annual rent obligation under the Sublease (that is, amounts sufficient to satisfy X's debt service obligation to BK2). Although the FM's deposit in BK2 was not pledged, the parties understood that FM will use the account to pay the remaining 10 percent of FM's annual rent obligation under the Sublease.

X required FM to invest the \$15 million of the Headlease prepayment in highly-rated debt securities that will mature in an amount sufficient to fund the fixed amount due under the fixed-payment option, and to pledge these debt securities to X. Thus, according to the IRS, FM economically defeased both its rental obligations under the Sublease and its fixed payment under the fixed-payment option.

For United States federal income tax purposes, X claimed deductions for interest on the loans from BK1 and BK2 and for the allocated rents on the Headlease. The issue in Revenue Ruling 99-14 was whether X may deduct rent and interest paid or incurred in connection with the transaction. The IRS held that X may not deduct rent and interest in connection with the transaction for the reason that "viewed as a whole, the objective facts of the LILO transaction indicate that the transaction lacks

the potential for any significant economic consequences other than the creation of tax benefits." In reaching this conclusion, the IRS noted that:

"[d]uring the 20-year primary term of the Sublease, X's obligation to make the property available under the Sublease is completely offset by X's right to use the property under the Headlease. X's obligation to make debt service payments on the loans from BK1 and BK2 is completely offset by X's right to receive Sublease rentals from FM. Moreover, X's exposure to the risk that FM will not make the rent payments is further limited by the arrangements with the affiliates of BK1 and BK2. In the case of the loan from BK1, X's economic risk is completely eliminated through the defeasance arrangement. In the case of the smaller loan from BK2, X's economic risk, although not completely eliminated, is substantially reduced through the deposit arrangement. As a result, neither bank requires an independent source of funds to make the loans, or bears, significant risk of nonpayment. In short, during the Sublease primary term, the offsetting and circular nature of the obligations eliminate any significant economic consequences of the transaction.

In addition, facts indicate that there is little economic consequences from X's nominal exposure to FM's credit under the fixed-payment option and, if exercised, the put renewal term. At the inception of the transaction, FM was required to use a portion of the Headlease prepayment to purchase highly-rate debt securities that were pledged to X, ensuring FM's ability to make the payment under the fixed-payment obligation. If FM does not exercise the fixed-payment option and X exercises the put renewal option, X can require FM to purchase a letter of credit guaranteeing FM's obligation to make the put renewal rent payments. If FM does not obtain the letter of credit, FM must exercise the fixed-payment option. Thus, as a practical matter, the transaction is structured so that X is never subject to FM's credit.

The conclusion that X is insulated from any significant economic consequences of the Headlease residual is further supported by several factors indicating that the parties expect FM to exercise the fixed-payment option. First, FM has historically used the property. Second, because the fixed payment obligation is fully defeased, FM need not draw on other sources of capital to exercise the option. However, if FM does not exercise the fixed payment option and X exercised the put renewal option, FM would be required to draw on other sources of capital to satisfy its put renewal obligations."

2. Cases Disregarding Offsetting and Matching Obligations

a. Hammond v. Commissioner

The tax court disregarded offsetting and matching obligations in Hammond v. Commissioner, 1. T.C. 198 (1942). In Hammond, the taxpayer sold shares of stock for a total price of \$965,000 to Press-Scimitar. The taxpayer received in 1936, the year of sale, directly from the Press-Scimitar, cash of \$74,000. The taxpayer also received from Press-Scimitar a note in the amount of \$430,000 ("Purchaser's Purported Note"). The Purchaser's Purported Note was to be paid in 11 installments on January 2 of each of the years 1937 to 1947, the first installment being \$30,000 and the rest \$40,00 each, with interest at 6 percent per annum. In addition, the taxpayer received from Press-Scimitar a note for the balance of \$461,000 to be paid without interest over a period of ten years. Contemporaneously with the execution of the sales agreement, the taxpayer received from Howard Company, an existing creditor of the taxpayer, which was also party to the sales agreement, cash in the amount of \$280,000 and the cancellation of a prior indebtedness of \$150,000. In return, the taxpayer gave Howard Company a note in the amount of \$430,000 ("Seller's Purported Note").

Like the Purchaser's Purported Note, the Seller's Purported Note was to be paid in 11 installments on January 2 of each of the years 1937 to 1947, the first installment being \$30,000 and the rest \$40,000 each, with interest at 6 percent per annum. The taxpayer assigned its rights to receive principal and interest from Press Scimitar on the Purchaser's Purported Note to the Howard Company. The sales agreement provided that, rather than Press-Scimitar making payments on the Seller's Purported Note to the taxpayer, Press-Scimitar or its attorney was to make payments on the Purchaser's Purported Note directly to the Howard Company. In addition, the Howard Company agreed that all payments required to be made by the taxpayer to

the Howard Company with respect to the Seller's Purported Note should be made only out of funds paid by Press Scimitar to the taxpayer on the Purchaser's Purported Note. The facts were not clear, but Press Scimitar may have acquired the Seller's Purported Note from the Howard Company sometime during the year of sale.

Section 44(b) of the 1936 Revenue Act permitted taxpayers to use the installment method in the case of a the casual sale of personal property for a price exceeding \$1,000 where the initial payments do not exceed 30 percent of the selling price. The taxpayer claimed that he was entitled to use the installment method with respect to the sale of shares because he only received \$74,000 in the year of sale (i.e., less than 30% of the selling price). In its notice of deficiency, the IRS claimed that the taxpayer was subject to tax in the year of sale on an amount equal to \$504,000, which amount the IRS determined the taxpayer actually or constructively received in the year of sale. The \$504,000 comprised (1) the \$74,000 cash paid directly to the taxpayer by Press Scimitar and (2) an additional amount of cash in an amount of \$430,000 that the IRS argued the taxpayer constructively received in the year of sale (i.e., \$270,000 cash received from the Howard Company plus relief of a liability in the amount of \$150,000 owed to the Howard Company, both without an offsetting obligation to repay).¹

The court held in favor of the IRS and thereby disregarded the matching and offsetting liabilities of the taxpayer to Howard and Press-Scimitar to the taxpayer. The court determined that the Seller's Purported Note was "a liability in name only, for other provisions of the contract precluded petitioner (i.e., the taxpayer) from personally receiving payments from Press-Scimitar which were scheduled to go to pay his notes. Press-Scimitar was to pay itself or its nominee under an irrevocable

¹ For some reason which is not explained in the tax court's decision, the IRS did not contest the application of the installment method to the remaining balance of the purchase price represented by Press Scimitar's non-interest bearing note in the amount of \$461,000, although the 30% threshold would have been exceeded.

power of attorney from petitioner and was forthwith under a duty to transmit funds to the Howard Co. Thus, in no event could petitioner have been called upon personally to pay his notes in the amount of \$430,000. If Press-Scimitar performed its obligations, the money would be delivered to the Howard Company, and petitioner's note would be paid; if it did not, petitioner was specifically relieved of liability."

In support of its conclusion to disregard the matching and offsetting liabilities of the taxpayer and Press-Scimitar, the court wrote that the "so-called payments by Press-Scimitar to Neave (i.e., its attorney) and by Neave to the Howard Co. were nothing more than bookkeeping entries made in the treasurer's office of [the respective companies]." "Furthermore, from the moment Press-Scimitar acquired petitioner's notes, we would have Press-Scimitar owing petitioner and petitioner owing Press-Scimitar, but Press-Scimitar would make payment only to its nominee, Neave, and could collect only from Neave and then only from what it paid him. This serves to demonstrate how unreal petitioner's alleged liability was."

b. Howard J. Greenfield v. Commissioner

Howard J. Greenfield and Pearl D. Greenfield v. Commissioner, T.C. Memo 1982-617 (1982) is another example of a case in which the court disregarded offsetting and matching obligations. In Howard J. Greenfield, the taxpayers agreed to sell 100 shares of stock for \$400,000 to the Ribon Corporation. The taxpayers received \$100,000 in the year of sale. The Ribon Corporation agreed to pay the taxpayers the balance of \$300,000 in monthly installments of \$5,000 each, together with interest at the rate of 8 ½ % beginning on October 1st, 1975 (the "Ribon's Note"). At the same time, the Ribon Corporation agreed to loan the taxpayers \$60,000 dollars on October 2, 1975, in exchange for a promissory note which called for monthly installments of \$5,000 each, with interest at the rate of 8 ½ %. The loan to the taxpayers was to be secured by the first notes issued by the Ribon Corporation coming due to the taxpayers, and these notes were to be delivered to the Ribon Corporation upon the

making of the loan to the taxpayers. The agreement also provided that the shares of stock were to be held in escrow until the Ribon's Note was paid in full. If the Ribon Corporation defaulted on its obligation, the taxpayers could cause the escrow agent to sell the stock.

The issue in Howard J. Greenfield was whether the taxpayer was entitled to use the installment method to report the sale of stock. The answer to this question depended upon whether the taxpayer's obligation to the Ribon Corporation was bona fide. If the taxpayer's obligation to the Ribon Corporation was not bona fide, then the taxpayers would be treated as receiving the purported \$60,000 loan proceeds in the year of sale in exchange for their stock. In this case, the taxpayers would not be entitled to use the installment method because they would be treated as receiving \$160,000 of the total \$400,000 selling price in the year of sale (i.e., more than 30%).

The court determined that the taxpayers' obligation to pay the Ribon Corporation \$60,000 was not a genuine loan. The taxpayers were treated as receiving the \$60,000 in exchange for the sale of stock and not as proceeds of a loan. Consequently, the Court held that the taxpayers were not entitled to use the installment method to report the sale of stock. The court wrote that:

"[s]ignificant to our determination is the fact that petitioners and Ribon structured the transaction so that the 'loan' was 'repaid' by mere bookkeeping entries. The interest rate and monthly payment on Ribon's and petitioners' notes were identical. The agreement itself provided that petitioners' notes would be 'repaid by the cancellation of Ribon's notes on their due dates.' Petitioners received the immediate and unrestricted use of funds which, due to the structure of the transaction, would never have to be repaid. The fact that no repayment would ultimately be necessary, due to the contemporaneous obligations incurred by Ribon, severely undercut petitioners' characterization of the cash receipt as a loan...The interdependence of the sale and the 'loan' also indicates that the case received was, in fact sales proceeds...There is no evidence indicating that Ribon would have considered loaning any money to petitioners apart from the sales transaction. Additionally, no significant amount

of time elapsed between petitioners' agreement to sell the stock and Ribon's decision to loan petitioners the cash such as might indicate that the two events were independent."

The taxpayers asserted that the cash received from Ribon was a bona fide loan because, if Ribon went bankrupt, they would be liable to Ribon's creditors for the unpaid balance of the loan. However, the court disagreed. First, the court noted that "the record contains no evidence as to Ribon's assets or liabilities; there is no indication that Ribon was even considering filing for bankruptcy or that it was having problems meeting its obligations. Under these circumstances, we do not attach so much significance to what, on the basis of this record, is a purely speculative possibility that Ribon might go bankrupt." Furthermore, the court noted that "it appears to us that, if Ribon were to file for bankruptcy, petitioners could offset their 'debt' against the money owed to them by Ribon."

c. Rickey v. Commissioner

In Rickey v. Commissioner, 502 F2d 748 (CA-9, 1974), aff'g (1970) 54 TC 680, the taxpayer, in anticipation of selling the stock of two corporations he owned ("target corporations"), purchased by way of credit certain unwanted assets from the target corporations. The target corporations established accounts receivable to evidence the amounts owed by the taxpayer for the taxpayer's acquisition of the unwanted assets. Following the acquisition of the unwanted assets, the taxpayer sold the stock of the target corporations to an unrelated corporation for \$1,081,043. Taxpayer received cash in the amount of \$313,000 in 1962, the year of sale, which cash represented approximately 29% of the total sale proceeds. The buyer agreed to pay the taxpayer \$193,541 on January 2, 1963, which was the first day of the taxpayer's next taxable year following the year of the sale (the "deferred obligation"). In addition, the buyer gave the taxpayer an interest bearing note in the amount of \$574,000 for the balance of the purchase price. Immediately following the stock acquisition, the buyer liquidated the acquired company and acquired all its assets and liabilities (including

the accounts receivable owed by the taxpayer for the acquisition of the unwanted assets).

The issue in Rickey v. Commissioner was whether the taxpayer was entitled to report the transaction as an installment sale. The IRS argued that the taxpayer exceeded the 30% threshold under prior law because the taxpayer effectively received payment of the deferred obligation in 1962, the year of sale. In support of its argument, the IRS pointed out that a provision of the sales contract required the parties to offset the buyer's deferred obligation against the amount of the accounts receivable. The tax court held that the contractual agreement to offset the buyer's deferred obligations in the subsequent year by the amount of the seller's debt owed to buyer was payment of such deferred obligation in the amount of \$193,541 in the year of sale. Consequently, the installment method did not apply because the payments received in the year of sale exceeded 30% under prior law.

In reaching its conclusion, the court effectively disregarded the genuineness of the offsetting and matching obligations of the taxpayer and the seller for the amount of the buyer's deferred obligation. The tax court wrote (in language quoted with approval by the 9th Circuit):

"We think it clear that the payment of \$193,541 was effectively received by petitioner in 1962 (the year of sale). We reach this conclusion first by looking to the substance of the transaction rather than the form in which it was cast. As we view the transaction, petitioner deferred payment of that portion of the non-interest bearing payments which exceed 29 percent of the selling price, to wit, \$193,541, solely for the purpose of altering his tax liability. While we recognize that a taxpayer may deliberately arrange the terms of a sale so he will receive less than 30 percent of the sale price in the year of sale, nevertheless to so qualify the arrangements must have substance and reflect the true situation rather than being merely the formal documentation of the terms of the sale. Here petitioner did this with the knowledge that, by virtue of the provision requiring this amount to be offset against his indebtedness to Hyatt, he would never receive

this payment in the form of cash. As far as Hyatt was concerned, its obligation to pay petitioner \$193,541 consisted entirely of making a bookkeeping entry on January 2, 1963."

d. United States v. Ingalls

In United States v. Ingalls, 399 F.2d 143 (C.A. 5, 1968), the taxpayer Ingalls entered into an agreement in compromise of litigation and dispute whereby he sold his employment contract to his employer for \$228,360 payable in equal installments of \$22,836 for the next 10 years. Meanwhile, Ingalls happened to owe his employer the amount of \$222,360 as a result of a previous loan made by the employer to Ingalls. The taxpayer agreed to pay of his \$228,360 indebtedness also in installments of \$22,836 over the same period. A provision in the agreement permitted the employer to make payments to Ingalls by crediting such amounts against the amount he owed. The parties did not dispute that the taxpayer would be taxed on the \$228,360 income. The issue was whether the tax was to be paid in the year of the settlement agreement or over ten years as the checks are exchanged or bookkeeping entries were made. The Fifth Circuit held that the substance of the agreement was the discharge of indebtedness due the employer by Ingalls at the time of the making of the agreement. Consequently, the taxpayer was required to include the entire \$222,360 into income in the current year.

In reaching its conclusion, the Fifth Circuit effectively disregarded the genuineness of the offsetting and matching obligations between Ingalls and the company. In support of its conclusion to disregard these obligations, the Fifth Circuit wrote as follows:

"The taxpayer argues and the District Court held that mutual debts do not cancel each other simply by operation of law, and, thus there was no discharge on January 30, 1961. It is true that set-offs must be pleaded, but once pleaded, the set-off here would be allowed. See Code 3 of Alabama (Recompiled 1958) Title 7, §350 and *Simmons v.*

Williams, 27 Ala. 507, 511-512 (1855). Although the Simmons case involved independent debts which the court would not set-off, the court recognized that equity would set-off mutual debts where 'one debt was contracted on the credit of each other.' Such is the case here. Thus the formality of pleading the set-off would be the only barrier to cancellation of mutual debts contracted on the credit of each other. The agreement here eliminates even the formality of having to plead set-off since by contract the parties agree that if the taxpayer fails to pay the company, the company is authorized to effect a private set-off by making the bookkeeping entry mentioned above. The agreement speaks for itself and makes clear that the taxpayer had to perform no additional act for the debt to be discharged. A simple bookkeeping entry by the company each February 1st was all that was necessary. The exchange of checks by the company and the taxpayer was thus an empty ritual acted out for the benefit of the Commissioner and, in reality, the taxpayer was discharged from his indebtedness on January 30, 1961."

II. The Flagstaff Loan / Subscription Payment Assumption Agreement

On June 22, 2001, Flagstaff purportedly loaned \$1,414,504,347 to Hansen pursuant to the Hansen Loan. However, at the end of the same day, Flagstaff received back \$1,039,504,347 from Newman pursuant to the Subscription Payment Assumption Agreement. As described above, each of Hansen and Newman are wholly-owned by CPS Holdings.¹ Since each of Hansen and Newman are Nova Scotia unlimited liability companies, they will be treated as pass-through entities rather than as corporations for United States federal income tax purposes.² Accordingly, since CPS Holdings is itself treated as a branch of BV-2, which in turn is treated as a branch of BV-1, Newman and Hansen will both be treated as disregarded entities all of the assets and liabilities of which are owned by BV-1 for United States federal income tax purposes. Therefore, BV-1 will be treated as if it borrowed \$1,414,504,347 from Flagstaff on June 22, 2001, and then BV-1 will be treated as if it immediately repaid

¹ As discussed in III below, the Debenture Shares issued by Newman and held by ECPC should be treated as debt for United States federal income tax purposes.

² Treasury Regulation §301.7701-3(b)(2)

\$1,039,504,347 to Flagstaff on the same day, resulting economically in a net amount borrowed by BV-1 of \$375 million. In addition, the obligation of Hansen to repay Flagstaff the purported principal amount of \$1,414,504,347 on June 23, 2006 pursuant to the Hansen Loan exactly matches and offsets the obligation of Flagstaff to pay Hansen \$1,414,504,347 on June 23, 2006 pursuant to the Subscription Payment Assumption Agreement.

According to the documentation, the loan to Hansen from Flagstaff remains outstanding and accrues interest on the full amount of principal outstanding, which does not amortize. The total amount of such interest payable over the 5 year term of the transactions is, however, the precise amount required to repay a loan of \$375 million, the real economic amount of the loan on a self-amortizing based over the period covered at a rate of 6.12% per annum. (The loans from Hansen to CPS Holdings, and from CPS Holdings to ECPC, also remain outstanding and accrue interest on the full amount of the principal outstanding, which does not amortize. The loan from Hansen to CPS Holdings carries an interest rate equal 6.13% per annum, and the loan from CPS Holdings to ECPC carries an interest rate equal [6.709]%. However, since Hansen and CPS Holdings are both treated as branches of BV-1 for United States federal income tax purposes, the loan from Hansen to CPS Holdings is ignored, and as discussed in Section III below, the loan from CPS Holdings to ECPC should be disregarded for United States federal income tax purposes.)

Pursuant to the authorities described above, the circular flow of cash between Flagstaff and BV-1 in the amount of \$1,039,504,347 will be ignored, and the offsetting and matching obligations between Flagstaff and BV-1 to pay the other \$1,414,504,347 on June 23, 2006 will be disregarded. Thus, the proper characterization of the transaction described above for United States federal income tax purposes is as if Flagstaff made a self-amortizing, net loan in the amount of \$375

million to Hansen (i.e., BV-1) which requires quarterly payments of interest and principal through June 23, 2006 ("Net Loan"). The implicit interest rate imposed on the unpaid principal balance of such loan should be 6.12 percent.

III. The Debenture Shares / ECPC Note / Guarantee and Indemnity Agreement

The ECPC Note, the Debenture Shares and the Guarantee and Indemnity Agreement effectively represent offsetting and matching obligations between CPS Holdings and ECPC. Consequently, based on the authorities discussed in 1(B) above, these obligations will be ignored for United States federal income tax purposes.

By their terms, the Debenture Shares issued by Newman to ECPC are properly characterized as debt for United States federal income tax purposes. The Debenture Shares provide for a fixed maturity date (i.e., June 23, 2006) and a fixed limited return. Distributions are required to be paid irrespective of whether the board of directors declares dividends and irrespective of whether the company has sufficient earnings and profits. The holder of Debenture Shares has creditor's rights to sue Newman for the nonpayment of required distributions when due. Unpaid distributions accrue interest. Finally, the Debenture Shares are non-voting except in certain exceptional circumstances (such as involving an amalgamation of the company). All of the foregoing are characteristics of debt.

CPS Holdings will be treated as the obligor of the Debenture Shares for United States federal income tax purposes. Since the Debenture Shares issued by Newman are properly characterized as debt, CPS Holdings will be the only holder of equity in Newman. Under the default entity classification rules, Newman will be treated as a branch of CPS Holdings which, in turn, is treated as a branch of BV-1, for United States federal income tax purposes. Since Newman will be treated as a branch of CPS Holdings, any debt issued by Newman will be effectively treated as debt issued

by CPS Holdings for United States federal income tax purposes. Additionally, CPS Holdings should be treated as the obligor of the Debenture Shares because Newman itself lacks the economic wherewithal to repay the Debenture Shares. Newman does not have the assets or cash flow to repay the Debenture Shares unless CPS Holdings, its sole shareholder, makes additional capital contributions to Newman. Since CPS Holdings has responsibility for payment of the Debenture Shares by virtue of the Guarantee and Indemnity Agreement, pursuant to Plantation Patterns Inc. v. Commissioner, 462 F.2d 712 (5th Cir. 1972), affg. TC Memo. 1970-182, CPS Holdings effectively is the obligor of the Debenture Shares.

The obligations of CPS Holdings and Newman to ECPC pursuant to the Debenture Shares and the Guarantee and Indemnity Agreement exactly offset and match in timing and amount the obligations of ECPC to CPS Holdings pursuant to the ECPC Note. Moreover, the Guarantee and Indemnity Agreement explicitly provides that each party may offset its obligations to the other. Based on the authorities described in Section IB above, these instruments are properly ignored for United States federal income tax purposes. Instead, CPS Holdings will be treated as if it made a capital contribution to Newman equal to the amount of the Debenture Shares (i.e., \$1,039,504,347).

IV. The Put Option Agreement / Total Return Swap Agreement / Enron Agreement

The effect of the Put Option Agreement, the Total Return Swap Agreement and the Enron Agreement is that Enron guarantees Hansen's obligations to Flagstaff with respect to the Net Loan. Enron should not be considered to be the principal on the Net Loan from Flagstaff by virtue of this guarantee under Plantation Patterns. From the inception of the Hansen Loan, Hansen has sufficient assets and prospects of cash flow to repay Flagstaff the Net Loan. In particular, Hansen holds the CPS Holdings

Note. The CPS Holdings Note is a valuable asset that matches by timing and amount Hansen's obligations to Flagstaff under the Hansen Loan. The CPS Holdings Note is a valuable asset for the reason that CPS Holdings owns real and substantial assets. In particular, CPS Holdings owns the assets of the recently acquired Datschowa Corporation which assets include the valuable paper mill.

Project Snapshot
Structured Financing
Fee Letter (Arranger)

June 22, 2001

Private and Confidential

Enron Corp.
1400 Smith Street
Houston, Texas 77002

Attention: Mr. Doug McDowell

Re: Fee Letter (Arranger) - Enron Structured Financing

Ladies and Gentlemen:

Reference is made to the Commitment Letter (together with the Current Drafts described therein, the "Commitment Letter") dated the date hereof between us and you, regarding the Facility described therein. Capitalized terms used but not defined herein are used with the meanings assigned to them in the Commitment Letter. This letter is a Fee Letter referred to in the Commitment Letter.

As consideration for JP Morgan's agreement to arrange the Facility and Chase's agreement to serve as administrative agent, you agree to pay, or to cause Finco to pay, the following fees in US dollars:

- 4,500,000 paid to CSZ & Confirmed by Don McShoarty (i) a structuring/arranging fee for the account of JP Morgan in an amount equal to \$5,250,000, payable on Effective Date;
- (ii) an annual administration fee for the account of Chase as "administrative agent" in an amount equal to \$35,000 per year, which fee will be payable on the Effective Date and annually on each anniversary thereof prior to the maturity or early termination of the Facility and the payment in full of all amounts owing thereunder; and
- (iii) Collateral Agent fees payable to Chase will consist of (A) a one-time transaction acceptance fee of \$12,500, payable on the Effective Date, (B) annual trustee fees equal to \$12,500, payable on the Effective Date and annually on each anniversary thereof prior to the maturity or early termination of the Facility and the payment in full of all amounts owing thereunder and (C) annual internal out-of-pocket expenses equal to 6% of the annual trustee fees.

You agree that, once paid, the fees or any part thereof payable hereunder and under the Commitment Letter shall not be refundable under any circumstances, regardless of

Houston 478744v4

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Enron Corp.
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whether the transactions or borrowings contemplated by the Commitment Letter are consummated, except to the extent that Chase fails to honor its commitments under the Commitment Letter. All fees payable hereunder and under the Commitment Letter shall be paid in immediately available funds. You agree that the Club Lenders and JP Morgan may, in their sole discretion, share all or a portion of any of the fees payable pursuant to this Fee Letter with any of the other Lenders.

This Fee Letter is delivered to you on the understanding that neither this Fee Letter nor any of its terms or substance shall be disclosed, directly or indirectly, to any other person except (a) to your officers, agents and advisors who are directly involved in the consideration of this matter or (b) as may be compelled in a judicial or administrative proceeding or as otherwise required by law (in which case you agree to inform JP Morgan and Chase promptly thereof, if you are legally able to do so). This Fee Letter shall remain in full force and effect regardless of whether definitive financing documentation shall be executed and delivered and shall survive the execution and delivery of such definitive financing documentation.

It is understood and agreed that this Fee Letter shall not constitute or give rise to any obligation to provide any financing; such an obligation will arise only to the extent provided in the Commitment Letter if accepted in accordance with its terms. This Fee Letter may not be amended or waived except by any instrument in writing signed by the Chase, JP Morgan and you. This Fee Letter shall be governed by, and construed in accordance with, the laws of the State of New York. This Fee Letter may be executed in any number of counterparts, each of which shall be an original, and all of which, when taken together, shall constitute one agreement. Delivery of an executed signature page of this Fee Letter by facsimile transmission shall be effective as delivery of a manually executed counterpart hereof.

Please confirm that the foregoing is our mutual understanding by signing and returning to us an executed counterpart of this Fee Letter.

Very truly yours,

THE CHASE MANHATTAN BANK

By: Robert T. Trueman
Name: Robert Trueman
Title: Vice President

J.P. MORGAN SECURITIES INC.

By: Bruce J. Hensel
Name: Bruce Hensel
Title: VP

Enron Corp.
June 22, 2001
Page 3
Accepted and agreed to as of
the date first written above by:

ENRON CORP.

By: Donny L. McDonald
Name: _____
Title: _____

DLS

FEE AGREEMENT

This Agreement ("Agreement") is entered into on June 22, 2001 between J.P. Morgan Securities Inc. ("J.P. Morgan") and Compagnie Papiers Stadacona ("CPS") in connection with a fee payable to J.P. Morgan in respect of the structuring and arranging of the financing transactions (collectively, the "Transaction") closing between J.P. Morgan and CPS on June 22, 2001. In connection with the structuring and arranging of the Transaction, CPS has agreed to pay US\$5,250,000 (the "Fee") on June 22, 2001 ("Closing Date").

I. REPRESENTATIONS AND WARRANTIES

J.P. Morgan represents and warrants that:

A. It is a corporation formed under the laws of Delaware and qualifies as a "resident" of the United States of America within the meaning of the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital.

B. It and its Affiliates that are non-residents of Canada for purposes of the *Income Tax Act* (Canada) (the "Tax Act") have not performed, are not currently performing, and will not perform from the date hereof to and including the Closing Date, services in Canada in connection with, arising from, or related to the Transaction (either directly or through agents, whether such agents are residents or non-residents of Canada for purposes of the Tax Act).

C. The payment of the Fee by CPS to, or credit of the Fee by CPS to the account of, J.P. Morgan will not be subject to withholding under section 105 of the Income Tax Regulations (Canada).

CPS represents and warrants that:

A. It is a corporation formed under the laws of Nova Scotia.

B. No Taxes will be payable in respect of the payment of the Fee by CPS to, or credit of the Fee by CPS to the account of, J.P. Morgan under Part XIII of the Tax Act and corresponding provisions of applicable provincial income tax legislation.

II. COVENANT

CPS covenants that:

A. It will pay the Fee to, or credit the Fee to the account of, J.P. Morgan free and clear of and without deduction for all Taxes.

B. If any Taxes are imposed in respect of the payment of the Fee by CPS to, or credit of the Fee by CPS to the account of, J.P. Morgan, CPS will cooperate with J.P. Morgan and

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provide reasonable assistance to J.P. Morgan as J.P. Morgan may request in connection with any efforts by J.P. Morgan to obtain a refund of or reduction of such Taxes.

III. INDEMNITY

A. J.P. Morgan will indemnify, hold harmless and pay all Taxes, penalties and interest suffered or incurred by CPS, any of its Affiliates or their successor(s) resulting from, arising out of, or caused by any breach by J.P. Morgan of any of its representations and/or warranties contained in this Agreement, and will reimburse CPS for reasonable out of pocket expenses (including, but not limited to, attorney's fees and accountant's fees) incurred by CPS in connection with any such breach.

B. CPS will indemnify, hold harmless and pay all Taxes, penalties and interest suffered or incurred by J.P. Morgan, any of its Affiliates or their successor(s) resulting from, arising out of, or caused by any breach by CPS of any of its representations and/or warranties and/or covenants contained in this Agreement, and will reimburse J.P. Morgan for reasonable out of pocket expenses (including, but not limited to, attorney's fees and accountant's fees) incurred by J.P. Morgan in connection with any such breach.

III. SURVIVAL

A. The representations and warranties made by J.P. Morgan and CPS in this Agreement and in any other certificate and document delivered in connection herewith shall survive the Closing Date and shall continue in full force and effect until 90 days after all applicable statutes of limitation, including waivers and extensions, have expired with respect to the matters addressed therein and, if no statute of limitations exists, forever thereafter. The covenants made by CPS in this Agreement shall exist until J.P. Morgan has no further rights of appeal in respect of any efforts by J.P. Morgan to obtain a refund of or reduction of Taxes referred to in II.B above.

IV. DEFINITIONS

As used in this Agreement, the following terms have the meanings specified below:

"Affiliate" of a Person means any other individual or entity who directly or indirectly controls, is controlled by, or is under common control with that Person. For purposes of such definition, "control", "controlled by", and "under common control with" mean possession, directly or indirectly, of power to direct or cause the direction of management or policies (whether through ownership of voting securities or other interests, by contract, or otherwise).

"Person" means an individual, partnership, corporation, limited liability company, business trust, joint stock company, trust, unincorporated association, joint venture, firm or other entity, or a government or any political subdivision or agency, department or instrumentality thereof.

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583014 1

SENATE
FL-01945

"Taxes" means any and all present or future taxes, levies, imposts, duties, deductions, charges or withholdings imposed by any governmental authority.

J.P. MORGAN SECURITIES INC.

By: *Bruce Henderson*
Name: *Bruce Henderson*
Title: *Vice President*

COMPAGNIE PAPIERS STADACONA

By: _____
Name:
Title:

"Taxes" means any and all present or future taxes, levies, imposts, duties, deductions, charges or withholdings imposed by any governmental authority.

J.P. MORGAN SECURITIES INC.

By: _____
Name:
Title:

COMPAGNIE PAPIERS STADACONA

By: W.W. Brown
Name: William W. Brown
Title: Vice President and
Chief Financial Officer

583014 1

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By JPM/C

SENATE
FL-01947

To: William Demena/JPMORGAN
 From: Robert Rudak/CHASE
 Subject: Some Good News
 Date: Wed, 14 Feb 2001 21:59:59 GMT

Bill,

o As I mentioned to you on Friday, we received a mandate from Enron for a Slapshot transaction. We will be raising \$400M in the bank market to finance a Canadian acquisition. JPM will earn a fee of \$6M at closing, which will be allocated \$.75M to Bank Syndications for the placement, \$.5M to Equity Derivatives to hedge the Bank's \$4M share of the loan, and \$4.75M net to us. The transaction was brought in by Bruce Herzig (MD candidate), Susan MacEachron and Eric Peiffer. Bruce and Eric run the Slapshot product. Susan had been working on a private equity placement for Enron Networks which had been put on hold, spotted the Canadian acquisition and pushed Slapshot as a second prize. The company would like to close the deal by end-March. We are already in documentation phase.

o The Enron transaction brings our total Global Closed and Mandated amount to \$73M, assuming fees on the three deals for the Bank are priced under the historical Chase method. As you know, this already brings us above last year's total revenue of \$70M. We are pressing to keep momentum going, and have a promising pipeline for the second quarter. I will update you shortly on the fees for the three Bank deals, based on the new agreement with Dina.

Bob

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Permanent Subcommittee on Investigations
 EXHIBIT #357a

SENATE FL 004450

- SAVE -

Structured Finance 834-5155 Fax Number: 834-6181

To: Julie Roth@JPMORGAN
 cc: Kathryn D. Ryan@Jpmorgan, Susan Maceachron/Chase@Chase
 Subject: Re: Project Slapshot

The \$400MM "net" loan is repaid in that, each period, the coupon payment from Finco to JPM SPV constitutes interest and principal amortization for the \$400MM borrowing by SPV from the bank syndicate. The \$400MM thus will be paid down to zero on a mortgage-style basis over the five-year tenor.

I agree with your comments below, which seem to nicely summarize what we discussed yesterday. I would like to talk again tomorrow to circle back on this and answer any remaining questions, and to get a formal go-ahead / sign-off on this (subject, of course, to the final documents including the necessary language to effect set-off, mutuality in bankruptcy, etc.). We just want to be assured that the accounting is as close to approved as possible before we speak with all the lawyers late tomorrow and continue the deal execution on the basis of our new tweak.

Thanks again -- we appreciate your work on this.

Eric

Julie Roth @ JPMORGAN 02/22/2001 05:32 PM

Julie Roth @ JPMORGAN 02/22/2001 05:32 PM

To: Eric Peiffer/CHASE@CHASE
 cc: Kathryn D. Ryan@Jpmorgan, Susan Maceachron/Chase@Chase
 Subject: Re: Project Slapshot

Just to quickly confirm our initial reaction yesterday.

Provided the FIN 39 criteria continue to be met (that Joan previously set out), JPMC's balance sheet will only show a loan to FIN CO of \$400 million dollars. Further, JPM will have the liability to pay back the syndicate that provided us with the cash.

The structure was consistent with the one reviewed previously with one exception: JPMC will not initially face FINCO in the subscription agreement that obligates it to purchase FINCO's shares. Instead, Subco will legally have that agreement (obligation to buy FINCO's shares) and will transfer that debt obligation to JPMC. FINCO will have the obligation to deliver the FINCO shares to Subco. Subco is legally released from being the primary obligor.

JPMC's entry
 Dr. Loan Rec. from FINCO
 Cr. Cash

Permanent Subcommittee on Investigations

EXHIBIT #357b

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 FL-02341

Dr. Cash
Cr. Payable to FINCO

As a result, JPM legally has the obligation to pay FINCO. It also has a receivable from FINCO. These appear to continue to meet the FIN 39 criteria. Of course, we rely on Legal to confirm that the legal conditions have been satisfied.

I did have a question...could you please explain again how the \$400 is repaid?

Let us know if you have any questions.

Thanks,
Julie
Eric Peiffer@CHASE

Julie Roth @ JPMORGAN 02/21/2001 10:58 AM

Julie Roth @ JPMORGAN 02/21/2001 10:58 AM

To: Eric Peiffer/CHASE@CHASE
cc: Kathryn D. Ryan@Jpmorgan, Susan Maceachron/Chase@Chase
Subject: Re: Project Slapshot

I am avail. later this afternoon to discuss. I have not had a chance to look through the background, so you are going to have to start at the beginning (for me at least).

What time works for you?
Eric Peiffer@CHASE

To: Kathryn D. Ryan@JPMORGAN, Julie Roth@JPMORGAN
cc: Susan MacEachron/CHASE@CHASE
Subject: Re: Project Slapshot

Kathy / Julie,

I would like to discuss your thoughts today on the accounting for the Enron transaction – is there a time that works for you? I'm going to be under some pressure tomorrow as to whether our proposed tweak to the structure will work. Thanks.

Eric

Forwarded by Eric Peiffer/CHASE on 02/21/2001 10:38 AM

Eric Peiffer@CHASE

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by JPMC

SENATE
FL-02342

Structured Finance 834-5155 Fax Number: 834-6181

To: Kathryn D. Ryan@JPMORGAN
cc: Bruce Hendrick/CHASE@CHASE
Subject: Re: Project Slapshot

Great – much appreciated. Let's just shoot for Monday since I'll be in the office all day (I'll be traveling on Sunday) – if you want to leave me as message (834-5155) over the weekend (or Monday a.m.) to let me know what works for you on Monday that would be helpful.

Thanks again.

Eric

- Kathryn D. Ryan@JPMORGAN

 Kathryn D. Ryan@JPMORGAN
02/16/2001 01:26 PM

To: Eric Pelffer/CHASE@CHASE
cc: Bruce Hendrick/CHASE@CHASE
Subject: Re: Project Slapshot

Eric- I will plan to speak to you sunday/monday- after I have read the documents, so that any open issues can be addressed on mon/tues.

K

Eric Pelffer@CHASE



To: Kathryn D. Ryan@JPMORGAN
cc: Bruce Hendrick/CHASE@CHASE
Subject: Re: Project Slapshot

→ Is Tuesday ok? The lawyers have slammed on the brakes until we confirm that the net accounting for the wist we're contemplating will work. Sorry for the time pressure, but it's a pretty big transaction on an accelerated timeline, and I have several fairly senior people getting on me for an answer.

as I explained, what I've sent to you is already approved (we did a deal using this structure in December). I explain the new twist to you on Tuesday in order to confirm that the accounting is the same. Feel free to all me here on Monday if you need to, or at home during the weekend at 914-771-7199.

Thanks.

Eric

Kathryn D. Ryan@JPMORGAN

 Kathryn D. Ryan@JPMORGAN
02/16/2001 11:02 AM

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SENATE
FL-02343

*Kathryn Ryan - int +
Julie Roth - SF
- IB Accounting Policies
- Erin Doyle*

Structured Finance 834-5155 Fax Number: 834-6181

To: Kathryn D. Ryan@JPMORGAN
cc: Bruce Hendrick/CHASE@CHASE, Susan MacEachron/CHASE@CHASE, Sharon Fiolek/CHASE@CHASE

Subject: Project Slapshot

Kathryn,

Attached is a description of our transaction, as well as the term sheets. As I mentioned, we received approval from Corporate Accounting Policies to net the Chase SPV's receivable and payable, thus showing on Chase's consolidated books a net loan and net interest income. For regulatory purposes we are showing the gross amounts of the receivable and payable, but netting upon consolidation as per FIN 39. E&Y gave us a clean accounting opinion on Canadian GAAP on net treatment as it relates to the client, stating that the client can net. We can forward this if needed.

Corporate Accounting's journal entries are shown below, and are based on a hypothetical loan from Chase SPV to Finco (a client subsidiary) of \$100, with a prepayment by Subco (client subsidiary #2) back to Chase SPV of \$70. The term sheets attached (for this deal) contemplate a \$1.5 bn loan and a \$1.1bn prepayment, with a resulting net \$400MM loan economically and for GAAP. The CMB owned SPV is called Flagstaff, and Canco (Enron's Canadian operating company) is called Daishowa.

As I mentioned, we would like to discuss a slight modification to the structure for the deal we are executing. In the meantime please call if you need any other info while you get up to speed on this. Please limit distribution of this information as appropriate (of course), as this structure is highly proprietary / confidential.

Thanks.

Eric Peiffer
834-5155



Transaction Summary - unabridged, Term Sheets 2-13-01.do

Forwarded by Eric Peiffer/CHASE on 02/16/2001 09:17 AM

Joan Fiorello on 05/08/2000 02:39:57 PM



Corporate Accounting Policies 212 701-7039 Fax Number: 212-701-7047

To: Eric Peiffer/CHASE@CHASE
cc: Patrick O'Brien/CHASE@CHASE, Sharon Fiolek/CHASE@CHASE, Robert Kantowitz/CHASE@CHASE, Scott Hendry/CHASE@CHASE, Leonard Zuckerman/CHASE@CHASE, Marc Lucier/CHASE@CHASE
Subject: Project Slapshot

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SENATE
FL-02344

Eric,

You have requested that Corporate Accounting Policies review the terms of the proposed tax advantaged transaction for a Canadian customer involving:

- Canco, a Canadian company
- Subco, a wholly owned subsidiary of Canco
- Financeco (Finco), a special-purpose company created by Canco
- Chase

The purpose of this review is to determine whether or not the asset and liability held by Chase, as a result of Chase's involvement in the deal, could be netted and to what extent. The steps in this deal and resulting effects on the balance sheet are as follows:

1. Chase lends money to Finco in exchange for a five year note (assume the loan is for \$100). Chase would record the following entry:

| | | | |
|-----|----------------------------|-----|-----|
| Dr. | Loan Receivable from Finco | 100 | |
| Cr. | Cash | | 100 |

2. Chase and Finco also enter into a legally binding warranty agreement where Chase receives warrants whereby once exercised, will be irrevocable. Chase intends to exercise the warrants immediately upon issuance which will entitle Chase to receive nonvoting shares of Finco representing 99.99% of the shares of Finco. The payment of the subscription price is to be provided from the repayment of the principle coupon to be received by Chase in five years as described in #1 above. When the warrant is exercised by Chase, it effectively becomes a forward agreement. Generally, forward agreements are considered to be "off-balance sheet" items until settlement; however, in effect Chase has an unconditional obligation to pay cash and receive shares. This agreement could be recorded similar to certain FX contracts where the receivable and payable are recorded on balance sheet on a net basis. If the receivable and payable are equal, the balance sheet amount is zero; if one or both sides of the transaction is revalued, the net amount is a payable or receivable. In this case Chase will record the payable and receivable at their current values of \$70 as follows:

| | | | |
|-----|-------------------------------------|----|----|
| Dr. | Receivable of Securities from Finco | 70 | |
| Cr. | Payable to Finco for Subscription | | 70 |

3. Chase simultaneously enters into a legally binding warranty rights purchase agreement with Subco whereby Chase agrees to sell Subco the rights it acquired under the warrant agreement for an amount equal to the present value of the loan principal determined in #2 above. This transaction will qualify as a sale of the receivable whereby the right to receive the shares are assigned to Subco, Finco acknowledges that it is obligated to deliver the shares to Subco, and Chase is not legally obligated to make any payment to Subco. Chase would record the following entry:

| | | | |
|-----|-------------------------------------|----|----|
| Dr. | Cash | 70 | |
| Cr. | Receivable of Securities from Finco | | 70 |

At the end of the three transactions above, Chase is left with an asset called "Loan Receivable from Finco" for \$100, and the liability "Payable to Finco for Subscription" for \$70. Under FIN 39, this asset and liability on Chase's books may be offset to the extent of the present value amount which is \$70. This results in a net loan receivable on Chase's balance sheet for the amount of \$30. Over the life of the transaction, Chase will receive payments equal to the interest on the \$100 loan. These amounts will represent interest

income on the net \$30 loan as well as principal payments to reduce that loan to zero at its maturity.

The netting of Chase's receivable and payable described above is subject to the rules of FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts* (FIN 39), which mandates that the offsetting of assets and liabilities on the balance sheet is improper except when the right to setoff exists. Per FIN 39, the right of setoff exists only when *all* of the following conditions are met:

- Each of two parties owes the other determinable amounts.
- The reporting party has the right to set off the amount owed with the amount owed by the other party.
- The reporting party intends to set off.
- The right of setoff is enforceable at law.

The last criterion usually requires a legal opinion from Chase's legal department or external counsel. Also, it should be noted that if Chase's receivable and a payable accounts were held with two separate legal entities, netting would not be permitted under FIN 39 even if they shared a common parent.

The above preliminary conclusion is based on our understanding of the transaction. Please let us know if our understanding is not correct. We will provide a final conclusion after we have reviewed the final legal agreements to ensure that all of the conditions of FIN 39 are met.

It is our understanding that this transaction is designed primarily to provide tax efficient financing for Canco. The Tax Department should review the transaction to ensure that they do not have any issues.

Please let me know if you have any questions or are in need of further interpretation of the requirements listed above.

Regards,

Joan

Kathy 678-9224
Julie 678-3101

Structured Finance 834-5155 Fax Number: 834-6181

To: Kathryn D. Ryan@JPMORGAN, Julie Roth@JPMORGAN
cc: Bruce Hendrick/CHASE@CHASE
Subject: Re: snapshot

Attached is the term sheet for the Finco credit agreement (Flagstaff SPV's loan to Enron Finco). See "III. Repayment," which acknowledges right to set off. Also attached is the first draft of the Payment Assumption Agreement whereby Flagstaff assumes the obligation to pay Enron Finco for the shares. See Sections 2.1 and 2.2. Section 2.2 in particular describes among other things that Flagstaff's payment to Enron Finco under the Subscription Payment Assumption Agreement is conditional on Finco repaying its loan to Flagstaff. Section 6.6 states no restrictions on set-off.

As Flagstaff's payment to Finco is conditional on Finco repaying, Chase can just choose to invoke set-off which is Chase's full intention - to direct Finco to keep its money rather than repay the loan, in return for Flagstaff not having to pay cash for the Finco shares. Clearly there is no benefit to Chase/Flagstaff to have the money move. As discussed, the lawyers (especially the tax lawyers) are hesitant to state explicitly Chase's intent to set-off or to require this set off, as they wish to keep the documents as "arm's length" as possible rather than tie them together (which additional "intent to set-off" language would do).

Hope this helps.

Finco Term Sheet 2-28-01.d Subscr Pmt Assmptn Agrmnt 2-26-01.d

Kathryn D. Ryan@JPMORGAN

Kathryn D. Ryan@JPMORGAN
02/28/2001 02:11 PM

To: Eric Peiffer/CHASE@CHASE
cc:
Subject: snapshot

eric- I spoke to Julie and it would be helpful if you could provide us with some of the wording in the deal that will support the net settlement-
kathy

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Permanent Subcommittee on Investigations
EXHIBIT #357c

SENATE
FL-02335

Structured Finance 834-5155 Fax Number: 834-6181

To: Bruce Hendrick/CHASE@CHASE, Natalie Floyd/CHASE@CHASE, George Serice/CHASE@CHASE,
Robert Traband/CHASE@CHASE

cc:

Subject: RE: Wed conf call -- discussion points

FYI.

Forwarded by Eric Peiffer/CHASE on 05/09/2001 10:43 AM

"Bayazitoglu, Ozgur (Ozzie)" <ozzie@velaw.com> on 05/09/2001 10:18:42 AM



To: Eric Peiffer/CHASE@CHASE
cc: "Anderson, Ken" <kanderson@velaw.com>
Subject: RE: Wed conf call -- discussion points

ERIC: I would like to point out few matters in connection with your points.

1. A technical default by Flagstaff will, unfortunately collapse the structure. We have attempted to reduce this risk from Enron's point of view by (a) the administration agreement pursuant to which Enron itself will comply with certain covenants and (b) the Chase performance guaranty.

2. My initial response is that banks like privity of contract (i.e., a contractual rights directly between parties). That is why we may insist on the Enron Agreement.

3. It is my understanding that none of the reps, warranties or covenants in the Enron revolver were changed this year.

4. You are exactly correct about the credit support concern. For clarity, there are at least two separate concerns: (1) going forward, does the fixed amount adequately cover "all amounts" and (2) even if we have concern (1) correct, please note that the fixed amount decreases over time but the "all amounts" amount would stop decreasing if any coupon payments were not made, thus there is a strong incentive for the banks to accelerate immediately (this would be a concern for Enron).

-----Original Message-----

From: Eric.Peiffer@chase.com [mailto:Eric.Peiffer@chase.com]
Sent: Wednesday, May 09, 2001 8:40 AM
To: kanderson@velaw.com; ozzie@velaw.com; Richard.S.Walker@chase.com;
GEORGE.SERICE@chase.com; ROBERT.TRABAND@chase.com;
Bruce.Hendrick@chase.com; Susan.MacEachron@chase.com;
Natalie.Floyd@chase.com; Roxanne.Powell@chase.com
Subject: Wed conf call -- discussion points

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Permanent Subcommittee on Investigations

EXHIBIT #357d

SENATE FL 004228

Attached is a draft of the discussion points we expect to cover in this morning's call. We will not send this to Enron. Please let me know if there are other major points we should cover.

(See attached file: Conf Call 5-9-01.doc)

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ENRON DISCUSSION POINTS (May 9, 2001)Rabobank

Unfortunately not able to gain approval as originally thought; remote chance presently

Documents

Major discussion issues are:

- Restrictions / covenants on Flagstaff SPV. Whether a technical default by Flagstaff can potentially collapse the structure.
- Indemnities and related provisions. Extent of indemnities. Whether located in the Enron Agreement or in the Finco and Flagstaff credit agreements.
- Elimination / redrafting of other provisions
 - Should recent FAS 125 deal provisions should be incorporated into the Slapshot deal (JPM credit issues and requirements for successful syndication)
 - JPM's suggestion that the provisions in the renewed revolver (close by May 18) should be mirrored
- Enron Credit Support (Total Return Swap)
 - Much progress; all parties fairly comfortable subject to some details
 - Need to nail down the "fixed payment" amount from Enron to Flagstaff under the TRS. Must somehow cover "all amounts due to Flagstaff under the Finco credit agreement."

Timing (documents) - reviewed every 2 weeks or so
must avoid firing back to Enron's lawyers to avoid default(?)

1. Marking up documents vs. preliminary or parallel discussion of conceptual issues
2. Timing for next drafting session (conference call or meeting in Houston - early next week?)
3. Timing for turning next draft

Syndication

- Select banks (Doug & Kelly Boots discuss with George)
- Enron's desire to close de-consolidation structure (Sundance) prior to bank meetings?
- Additional turn of docs likely prior to bank meetings (sufficiently close to final docs)

Miscellaneous

- Update bank slides and info memo for Credit Support
- JPM to distribute revised timeline

- Concept 7

George Serice
05/24/2001 10:56 AM

JP Morgan Global Syndicated Finance, George.Serice@JPMChase.com 713-218-8079 Fax Number: 713-218-4583

To: (see below)
Subject: Project Rio Grande (a.k.a. Flagstaff Capital Corporation) - HEADS UP MEMO #2

I will soon be requesting amended approval to the subject PRE-FUNDED transaction. We have been delayed as we have been pursuing alternative placement strategies of (1) placing entire amount w/ Rabo and (2) institutional placement. Unfortunately, neither option materialized. While the structure of the deal has remained unchanged, pricing and syndication strategy modifications are as follows:

Drawn Cost: 100-112.5 bps (up from 85 bps)
CMB Pre-Fund: \$100MM (down from \$133MM)
Fees to Club Banks: 35 bps on hold at primary closing date (up from 25 bps)
Club Bank Target Hold: \$60MM, or 15% (up from \$40MM, or 10%)

Syndication Strategy: Enron has proposed going to three or four (up from two or three) of their relationship banks (IBJ, BOTM, RBC, RBS) for the club underwrite of \$100MM each.

Depending on Club success, we would have from \$100MM to \$160MM to syndicate in secondary.

Enron has approached the bank market 11 times YTD. They have now cleared out all retail inventory. The forward calendar includes only Project Rio Grande plus a rollover and downsize of an existing deal (JEDI II, reducing from \$250MM to ~ \$150MM, which rollover JPM will lead).

JPM recently co-led a roll of Enron's flagship (\$1.75B) plus a NEW \$500MM L/C facility. We got the deal done with 3-5% oversubscription. While California was a hot topic during our syndication of Zephyrus in the spring (\$500MM receivables monetization), it was not nearly as "hot" during the flagship exercise.

Forwarded by George Serice/CHASE on 05/24/2001 10:19 AM

Roxanne Bianco 02/20/2001 05:38 PM

Global Syndicated Finance 713-218-3510 Fax Number: 713-218-4583

To: David Burnett/CHASE@CHASE, Greg Nelson/CHASE@CHASE, Christopher Teague/CHASE@CHASE, Ann Lane/CHASE@CHASE, Timothy Broadbent/CHASE@CHASE
cc: Tod Benton/CHASE@CHASE, George Serice/CHASE@CHASE, Barrett Eyrnon/CHASE@CHASE, Seth Glogower/CHASE@CHASE
Subject: Project Rio Grande - HEADS UP MEMO

We are requesting approval to arrange a \$400MM 5 year + 1 day club pre-funded U.S. term loan facility guaranteed by Enron Corp. to support a tax-structured transaction sponsored by Enron Corp. ("Enron"). This facility is part of a \$1.53 Bn transaction arranged by JPMorgan's Structured Finance group, which will be used in connection with the acquisition of a Canadian Pulp & Paper Mill (the "Mill"). Enron is purchasing the Mill from Daishowa Forest Products Ltd. The deal will give Enron ownership of 60,000 acres (24, 300 hectares) of forest in the state of Maine as well as a 515,000 ton/year newsprint and paperboard plant.

Deal Terms
Amount: US\$400MM
Term: 5 years + 1 Day
Drawn: L+85bps
Guarantor: Enron Corp. (BBB+ / Baa1)

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Permanent Subcommittee on Investigations
EXHIBIT #357e

SENATE
FL-00958

JPMorgan Upfront Fee: \$6MM
 GSF Upfront Fee: \$750,000 *
 CMB Pre-fund: \$133MM (1/3 of deal)
 CMB Target Hold: \$40MM
 Fees to Club Banks: 25 bps on hold at primary closing date
 Fees to Retail: - 35 bps (1 bp per million of commitment)

* Credit is requiring that an Enron credit derivative be purchased to offset CMB exposure on this transaction. The approximate \$550,000 cost is being paid by the Tax Structuring Group.

Syndication Strategy: Enron has proposed going to two or three of their second tier banks (IBJ, RBC, etc.) for the club opportunity. They think this strategy will enable them to 1) avoid approaching other top tier which may have ongoing pre-funded positions and 2) minimize underwriting fees. Enron has proposed a 25 bp fee (about \$333,000 on a \$133MM commitment) for pre-funding the deal. This fee would be net to the Clubs as Enron would pick-up fees to retail.

To: David Burnett/Chase @Chase
 Greg Nelson/Chase @Chase
 Christopher Teague/Chase @Chase

Ann Lane/Chase @Chase
 Timothy Broadbent/Chase @Chase

cc: Tod Benton/Chase @Chase
 George Serico/Chase @Chase
 Barrett Eynon/Chase @Chase
 Seth Glogower/Chase @Chase

Robert Traband/Chase @Chase
 Roxanne Powell/Jpmchase @Chase
 Susan Cummins/Chase @Chase

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SENATE
 FL-00957

 Mike Addy
06/18/2001 12:41 PM

Credit 713.216.4029 Fax Number: 713.216.4227
To: Peter M. Licalzi/CHASE@CHASE
cc:
Subject: Re: Flagstaff I.D. #'s 

OK.
Peter M. Licalzi

 Peter M. Licalzi
06/18/2001 12:21 PM
.....

Oil & Gas Global Credit and Capital Management (713) 216-8869 Fax Number: (713) 216-4117
To: Mike Addy/CHASE@CHASE
cc: Robert Traband/CHASE@CHASE
Subject: Flagstaff I.D. #'s

Mike:
Potential one day intraday O/D line is requested of approx. \$1.1 billion

thanks
----- Forwarded by Peter M. Licalzi/CHASE on 06/18/2001 12:25 PM -----



Structured Finance 834-5155 Fax Number: 834-6181
To: Peter M. Licalzi/CHASE@CHASE
cc: Robert Traband/CHASE@CHASE
Subject: Flagstaff I.D. #'s

Peter,
The DDA (Acct # below) for Flagstaff Capital Corp is to have an overdraft line of credit of approx. \$1.1 billion in order to execute the correct fund flows on the transaction closing date of June 21. The \$1.1 billion will be repaid same day.
Rob Traband has credit approval for the overdraft. It needs to be operational in time for the deal trustee (Valerie Dunbar) to review it prior to June 21.
What need to be done to make this operational? I'm assuming you're the contact since you were involved with the overdraft credit on Murphy Oil in december.
Thanks.

Permanent Subcommittee on Investigations
EXHIBIT #357f

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SENATE
FL-00090

Munoz, Hilda

From: Sam.Round [Sam.Round@enron.com]
Sent: Wednesday, June 20, 2001 4:13 PM
To: Munoz, Hilda
Cc: Sam.Round
Subject: FW: Additional Daylight Overdraft Request from Enron

-----Original Message-----

From: Round, Samuel
Sent: Wednesday, June 20, 2001 3:59 PM
To: 'hilda.munoz@citicorp.com'
Cc: Moehlman, Cathy; Perry, Pamela; Diane Gould (E-mail)
Subject: Additional Daylight Overdraft Request from Enron

Hilda,

Enron will require additional daylight overdraft protection on Friday 6/22/2001 on account number [Redacted by Permanent Subcommittee on Investigations]

The amount of the request is 1.2 million over and above our current line.

Enron will send this amount to an escrow account at Chase NY with a value date of 6/22/2001 on Thursday afternoon.

This request is related to a structured finance transaction (see attached), which is anticipated to close on 6/22/2001.

The attachment only includes a brief description of the material cash flow movements. The amounts depicted are only for reference purposes and will change.

Thanks again for all of your assistance

Sam

<<Citibank Canada 6-22-01.doc>>



Citibank Canada
6-22-01.doc

FX NL : 788 423 6289 Jun. 15 2001 08:24PM P1
10 913129763387 P.01/02



Name found

Facsimile Cover Sheet

To: *Laura Kapala*
Company: *Citibank*
Phone:
Fax: *312-3*

Redacted by Permanent Subcommittee on Investigations

*A+H+K
Frances
King*

From: Pam Pery
Company: Enron
Phone: 713-853-6946
Fax: 713-646-2667

Date: 6-14-01
Pages including this cover page: 1

Comments:

*Hilda Minz-
fys.
frances
(312)*

Redacted by Permanent Subcommittee on Investigations

Thank you,
Pam

*June 22nd
26th*

3

RECEIVED TIME JUN 15 2:00PM

PRINT TIME JUN 15 2:01PM

CONFIDENTIAL

CITI-SPSI 0044920

Munoz, Hilda

Sam.Round [Sam.Round@enron.com]
Wednesday, June 20, 2001 4:21 PM
Munoz, Hilda
Sam.Round
FW: Additional Daylight Overdraft Request from Enron

cc:

Original Message
Round, Samuel
Wednesday, June 20, 2001 3:59 PM
hilda.monoz@citicorp.com
Moehlman, Cathy; Perry, Pamela; Diane Gould (E-mail)
Additional Daylight Overdraft Request from Enron

will require additional daylight overdraft protection on Friday
001 on account number [REDACTED]86.

to accommodate a closing and the funds will run thru several
nts at Citi NY and Citi Canada and ultimately Citi NY will receive
ds back into the original account [REDACTED]86.

ount of the request is 1.2 billion over and above our current

will send this amount to an escrow account at Chase NY with a
date of 6/22/2001 on Thursday afternoon.

request is related to a structured finance transaction (see
ed), which is anticipated to close on 6/22/2001.

ment only includes a brief description of the material cash
nts. The amounts depicted are only for reference purposes
ll change.

s again for all of your assistance

bank Canada 6-22-01.doc>>


bank Canada
-22-01.doc

Acct. Nos.

Redacted by Permanent Subcommittee on Investigations

Munoz, Hilda

From: Olewe, Hilary
 Sent: Thursday, June 21, 2001 11:50 AM
 To: Aleardi, Michael J. CCI
 Cc: Munoz, Hilda; Junek, Lydia; Risk-Credit, NY
 Subject: ENRON / Additional Daylight Overdraft Request/URGENT

TO: CITIBANK DELAWARE
 ATTN: MICHAEL ALEARDI

THIS IS APPROVAL FOR A DAYLIGHT OVEDRAFT LIMIT EXCESS OF USD 1.2
 BILLION FOR ENRON CORP'S ACCOUNT # [REDACTED] 36. ON FRIDAY, JUNE 22, 2001
 ONLY.

Redacted by Permanent Subcommittee on Investigations

THIS APPROVAL IS ALSO GIVEN BY LYDIA JUNEK, MANAGING DIRECTOR (SCO).

REGARDS,

HILARY OLEWE
 RCAC

PS:
 MICHAEL,
 TO ENSURE THE SMOOTH FLOW OF FUNDS, I BELIEVE YOU SHOULD PUT THE DOL
 INCREASE ON TONIGHT BEFORE YOU LEAVE, SO THAT IT'S EFFECTIVE FIRST
 THING TOMORROW.
 PLEASE CONFIRM RECEIPT OF THIS APPROVAL.

Forward Header

Subject: ENRON / Additional Daylight Overdraft Request/URGENT
 Author: Hilda Munoz at 10USHOU
 Date: 06/21/2001 12:35 PM

Hello,

Could you please approve the subject Daylight Overdraft (1.2 Billion) for Enron
 to accommodate their closing on
 Friday, June 22, 2001 as detailed in the attached e-mail. Lydia Junek, Managing
 Director / Senior Credit Officer has given her verbal approval for the DOD as
 well.

Regards,
 Hilda Munoz
 Global Energy - Houston
 713/654-2827

-----Original Message-----
 From: Sam.Round [SMTP:Sam.Round@enron.com]
 Sent: Wednesday, June 20, 2001 4:21 PM
 To: Munoz, Hilda
 Cc: Sam.Round
 Subject: FW: Additional Daylight Overdraft Request from Enron

-----Original Message-----
 From: Round, Samuel
 Sent: Wednesday, June 20, 2001 3:59 PM
 To: hilda.munoz@citicorp.com
 Cc: Moehman, Cathy; Perry, Pamela; Diane Gould (E-mail)
 Subject: Additional Daylight Overdraft Request from Enron

Hilda,

Enron will require additional daylight overdraft protection on Friday

CONFIDENTIAL

CITI-SPSI 0044923

6/22/2001 on account number 0007-6486.

This is to accommodate a closing and the funds will run thru several accounts at Citi NY and Citi Canada and ultimately Citi NY will receive the funds back into the original account [REDACTED].

Acct. No.

Redacted by Permanent Subcommittee on Investigations

The amount of the request is 1.2 billion over and above our current line.

Enron will send this amount to an escrow account at Chase NY with a value date of 6/22/2001 on Thursday afternoon.

This request is related to a structured finance transaction (see attached), which is anticipated to close on 6/22/2001.

The attachment only includes a brief description of the material cash flow movements. The amounts depicted are only for reference purposes and will change.

Thanks again for all of your assistance

Sam

<<Citibank Canada 6-22-01.doc>>

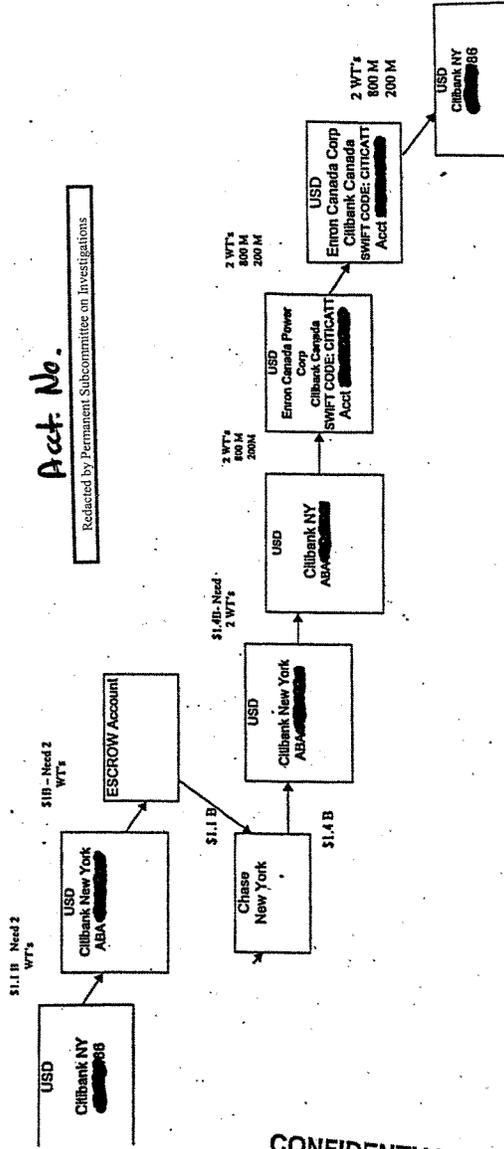


Citibank-Canada-6-22-01.doc



MAP1-Distribution List.TXT

Funding Structure 6-22-01



Citibank Canada 6-22-01.doc

06/21/01 11:55 AM

CONFIDENTIAL

CITI-SPSI 0044925

Eric Peiffer 10/10/2001 04:47 PM

To: George Serice/CHASE@CHASE
 cc: Roxanne Powell/JPMCHASE@CHASE, Robert Traband/CHASE@CHASE, Richard S. Walker/CHASE@CHASE, Christopher Teague/CHASE@CHASE, Donna McGroarty/CHASE@CHASE, Susan Cummins/CHASE@CHASE, Michael GSF Buckley/CHASE@CHASE
 Subject: Re: Flagstaff Syndication Update - 10-10

let's make sure we lock up Citi and Boe on confidentiality agreements, for what they're worth. These may help prevent either's structured finance groups from getting their hands on too much info, including the docs if either participates. Thanks.

George Serice

George Serice
 10/10/2001 03:59 PM

J.P. Morgan Global Syndicated Finance, George.Serice@JPMChase.com 713-216-8079 Fax Number: 713-216-4583

To: Eric Peiffer/CHASE@CHASE, Roxanne Powell/JPMCHASE@CHASE, Robert Traband/CHASE@CHASE, Richard S. Walker/CHASE@CHASE, Christopher Teague/CHASE@CHASE, Donna McGroarty/CHASE@CHASE, Susan Cummins/CHASE@CHASE, Michael GSF Buckley/CHASE@CHASE
 cc:
 Subject: Flagstaff Syndication Update - 10-10

See message below. Obviously, from a proprietary information perspective, Citi and BofA are not ideal targets. I got a heads-up on those two via a voice mail from Eric last night. Both have been shown some materials, but not the whole. The fact that Enron is going to these players demonstrates the tightness of the bank market.

I mentioned to Sarah H. that we told Bruce and Bill (and we also mentioned to Kelly and Sarah) our sensitivities re: such players. I think the ship will keep moving ahead, barring any big-time objections from us. But regardless, we need to get the position sold down.

Forwarded by George Serice/CHASE on 10/10/2001 03:01 PM

George Serice
 10/10/2001 02:52 PM

J.P. Morgan Global Syndicated Finance, George.Serice@JPMChase.com 713-216-8079 Fax Number: 713-216-4583

To: wwillford@bjss.com, moakas@bjss.com, jstanton@btma.com, kclasscock@btmy.com, adam.pettifer@rbs.com, Kevin.Howard@rbs.com, resa.white@rbs.com, Michael GSF Buckley/CHASE@CHASE
 cc:
 Subject: Flagstaff Syndication Update - 10-10

Sarah Heinsman told me they are approaching ABN, Citi, BofA, Barclays and RBC.

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 Treatment Requested
 by 1012A

Permanent Subcommittee on Investigations
 EXHIBIT #357h

SENATE
 FL-03422

To: Lauren Callo/CHASE@CHASE
 From: George Serice/CHASE
 cc: Richard S. Walker/CHASE, Robert T. Laband/CHASE@CHASE, Michael GSF
 Buckley/CHASE@CHASE, Susan Cummins/CHASE@CHASE
 Subject: Re: ENRON FLAGSTAFF
 Date: Thu, 11 Oct 2001 18:00:49 GMT

After failing to fill-out the syndication with a broad retail net, we missed the target date of 9/30 to reduce our exposure to target hold. Enron has approached "top tier" lenders Barclays, ABN, Citi, BofA and RBC to cover the \$80MM shortfall. The message from Enron to them is "you have to do this". There is no misunderstanding between Enron and JPM re: Enron's responsibility to get this sold. We have been in this position with them before, and gotten the situation cleaned up in 30 days. The flex language is explicit. It is a timing issue. We are endeavoring to get this done by October 31, but a more realistic goal is Nov 15. Rick Walker (R.M.) and I will have another conversation with the company to reveal the income statement hit we may be required to take.

The deal needed to be pre-funded in order to meet a tax objective. Historically, we have pre-funded deals for Enron. We may likely reassess that position going forward.

Lauren Callo
 10/11/2001 11:47 AM

Global Syndicated Finance 27C-7314 Fax Number: 270-1063
 To: George Serice/CHASE@CHASE
 cc: Susan Cummins/CHASE@CHASE
 Subject: ENRON FLAGSTAFF

Did you get a chance to prepare a update e-mail for Suzanne?
 ----- Forwarded by Lauren Callo/CHASE on 10/11/2001 12:45 PM -----

Lauren Callo
 10/05/2001 12:16 PM

Global Syndicated Finance 27C-7314 Fax Number: 270-1063
 To: George Serice/CHASE@CHASE
 cc: Susan Cummins/CHASE@CHASE
 Subject: ENRON FLAGSTAFF

George,
 Suzanne Emmett was asking about this deal at our credit meeting. Can you give a me a download as to how the syndication is going? When do we expect to hit target? Purpose of transaction? Why prefunded? Thanks.

FOIA Confidential
 Treatment Requested
 by JPMC

Permanent Subcommittee on Investigations
 EXHIBIT #3571

SENATE FL 004539

From: GEORGE.SERICE@jpmorgan.com
Sent: Thursday, November 15, 2001 10:06 PM
To: Brown, Bill W.; McDowell, Doug; Heineman, Sarah; Kelly.Boots@Enron.Com
Cc: Richard.S.Walker@jpmorgan.com; ROBERT.TRABAND@jpmorgan.com; Josh.Rogers@jpmorgan.com
Subject: Enron - Flagstaff

The co-agents (most notably BOTM) are getting restless re: the \$375MM Flagstaff facility. The papers were signed with a \$56.25MM target hold to be achieved by 9/30. The inventory position for the group, per the fee letter, is \$80MM (20MM x 4).

My thoughts are as follows:

Enron recognizes its obligation to address the issue, but has put it off due to its current situation.

There are no buyers for an Enron structured transaction in this market. Enron could achieve target hold positions by reducing the facility by \$98MM, but that would eat up precious liquidity.

Enron could pay a fee to the lenders based roughly on (Enron's credit default rate - PV of the LIBOR spread) x 80MM. (We will get a view of the amount.)

BOTM - clearly the most vocal. wants something done NOW
IBJ - also vocal, but not to BOTM level ... yet
RBS - Tier One bank for Enron. They are quiet.

For a number of reasons, I think we need to figure out a resolution quickly. BOTM is DEMANDING a call with the co-agents and Enron to occur ASAP.

Regards,

G

To: Eric Peitzer/CHASE@CHASE
From: Bruce Hendrick/CHASE
cc: Robert Hudak/CHASE@CHASE
Subject: Re: enron responsibilities
Date: Wed, 17 Oct 2001 11:36:31 GMT

Bob,

Eric did an outstanding job and took on serious responsibilities. As you know, Enron is very tough to deal with. Eric is fast becoming our best executor!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!

Bruce

Eric Peitzer
10/15/2001 06:33 PM

Structured Finance 834-5155 Fax Number: 834-5181
To: Robert Hudak/CHASE@CHASE
cc: Bruce Hendrick/CHASE@CHASE
Subject: enron responsibilities

Bob,

As briefly discussed, I've attached a page summarizing my responsibilities on the Enron Slapshot transaction for your file.

Thanks,

Eric

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Treatment Requested
by JPM/C

SENATE FL 004540

Permanent Subcommittee on Investigations
EXHIBIT #357k

Bob -- Given the breadth and depth of my involvement on Enron Slapshot, I have summarized the major aspects of my responsibilities (deal closed 6/22/01)

- Worked extensively with Enron on structuring issues such that the Slapshot financing could be executed within Enron's existing Canadian operations and current acquisition
- Very significant role in developing the Enron credit support mechanism (warrant/put/total return swap) used to allow Enron to provide a credit "guarantee" while still falling within GAAP de-consolidation provisions. This structure effectively allowed the Slapshot transaction and Enron's joint-venture structure (both used to acquire the asset paper mill) to be compatible. Credit support structure has proprietary application to future transactions for both JPM and Enron.
- Structured complex interest rate swap and explained to JPMorgan's Swaps Desk. Convinced Enron to do entire swap with JPMorgan (approx. \$200k up-front total profit) for a "handed-over" trade. Directed the swap execution on closing date among Enron, JPMorgan's SPV, and JPMorgan's Swaps Desk.
- Primary Structured Capital responsibility for transaction document review and negotiation on most non-tax issues. Lead several drafting sessions.
- Assisted with numerous tax negotiations. Bruce and I were able to obtain most of the JPM Tax Dept.'s "asks" for the transaction (i.e., Lenny was very satisfied with the outcome).
- Created the transaction models used by both JPM and Enron. Tailored models to Enron's specific acquisition and joint venture structure.
- Pushed through internal approval processes for credit, legal, accounting and operational sign-off. Worked with Bruce to obtain JPM Tax Dept sign-off ..
- Coordinated internally the approval, set-up and monitoring of the SPV (owned by JPM) used in the transaction
- Primary responsibility (rather than Syndications) for creating Bank Slides and Bank InfoMemo for use in bank meetings / bank analysis
- Helped coordinate discussions with and analysis by Rabobank as potential lender into the structure.
- Represented JPM at all Club Bank meetings. Structured Capital responsibility for numerous follow-up calls from banks regarding structure, credit support and document issues
- Coordinated all funds flows at closing
- Subsequent to deal closing, played ongoing role in secondary syndication via structuring discussions with banks
- Persuaded Enron to use Chase Fiduciary Services as Trustee on the deal (\$75k total fees over 5 years)

Bill W. Brown
Accomplishments for the First Half of 2001

The following is a brief summary of accomplishments for the first half of 2001.

1. Execution of the Sundance Industrial Partners transaction that created an off-balance sheet financing vehicle for EIM. Currently Sundance owns Stadacona, Garden State and the economic interest in the Pulp & Paper trading book. The deal was closed without utilizing bank capacity.
 - EIM Booked a \$20MM gain (approximately 1/2 of EIM's quarterly target) upon the close of Sundance,
 - The capital is off-credit (and not included in the ROI target calculation),
 - EIM recorded \$20MM in Funds Flow upon close,
 - Cost of equity in the structure is less than 2%.
2. Execution of the Slapshot financing which finances in a very tax efficient manner Stadacona. (This deal closes next week)
 - The Slapshot deal will create a tax benefit of approximately \$150MM for Enron,
 - EIM will book an approximately \$3MM fee,
 - EIM will record approximately \$20MM in Funds Flow
 - The deal is supported by Enron credit but is off-credit.

(I'm sure the tax department will describe in much more glowing terms the benefit of this deal)
3. Arrangement of and execution of equity in the Huntco transaction.
 - Will enable EIM to record a significant gain related to the transaction.
4. Assisted with various EIM originators, etc. on structures of potential deals.
5. Created a First Class Finance team with execution/structuring capability comparable to anywhere in the company.

Doug McDowell

1221 Wood Hollow Drive Apt. 13309
 Houston, Texas 77057
 Wk : (713) 853-7710
 Hm : (713)

Redacted by Permanent Subcommittee on Investigations

SUMMARY OF PROFESSIONAL QUALIFICATIONS

- Eleven years experience in structured and non-recourse finance as well as corporate lending.
- Knowledgeable of both the capital markets and commercial lending markets.
- Experience in structuring transactions and negotiating documents both as a sponsor and as a commercial lender.
- Multiple industry (domestic & international) knowledge via structured and non-recourse finance experience including independent power, pulp and paper, petrochemical, natural gas pipeline, and natural gas storage, oilfield services, and limited exposure to the E&P sector.
- Thorough understanding of market conditions and broad array of industry contacts and relationships.

PROFESSIONAL EXPERIENCE

Enron Corp. (Houston, Texas)
 Director—Enron Global Finance

8/96 to Present

Worked in a structured finance capacity for Corporate Finance, ECT Treasury (predecessor to Enron North America natural gas & power), Enron Industrial Markets, Enron Global Markets, Enron Broadband .
 Successfully structured and financially closed the following transactions:

- **Credit-Linked Notes (144A Bond Issuance)**
 \$ 750 MM Yosemite 1—Linked Enron Obligations (LEO's)
 — Developed and issued the first, major single-name credit-linked note in the capital markets. The structure provided Enron with blind pool (free substitution rights), long-term funding vehicle for securitizing structured bank transactions and passing along the credit risk to the capital markets while maintaining the structuring risk with the sponsor bank.
 \$ 350 MM (US equivalent)—Yosemite 2 Sterling issue
 — Joint effort with the London office (utilized Yosemite joint effort with London office utilizing Yosemite 1 technology)
 \$ 500 MM Enron Credit-Linked Notes (ECLN)
 — Next-step evolution of the original Yosemite transaction. Improvements included considerably greater transparency which contributed to considerably lower transaction costs and greater distribution capability. The ECLN technology was utilized for additional future financings by Enron in the amount of approximately \$ 900MM.
- **Structured Prepay Transactions**
 Closed several crude oil prepay transactions with Citibank in the amount of approximately \$ 1.5 Billion which were ultimately refinanced via the credit-linked note structures. The prepay transactions provided for greater asset/liability management for the company and utilized an innovative series of derivatives to match the risk profile of the credit-linked note structures and minimize any incremental credit exposure to the Citibank.
- **Project Slapshot—\$ 375 MM**
 Developed and implemented an off-balance sheet, off-credit tax-advantaged financing structure which represented the permanent, takeout financing for the acquisition of a \$ 375 MM newsprint mill located in Canada.
- **Enserco—\$ 125 MM**
 Created an deconsolidated funding vehicle with a investment partner to be utilized to provide all types of capital to the oilfield services sector. The original transaction was closed at \$ 75 MM and later increased to \$ 125 MM. Innovative structure which allowed for access to capital in a difficult sector.

Permanent Subcommittee on Investigations

EXHIBIT #359

EC 000899870

- Provided input on a variety of transactions which eventually did not reach financial closing or did not ultimately require separate financing. Examples are as follows:

The Fuji Bank, Limited (Houston, TX)
VICE PRESIDENT, Project Finance Group

3/92 to 6/96

- Engaged in marketing efforts as calling officer to secure new business for the bank. Primary market included power generation, pipeline, gas storage, petrochemicals, and refineries.
- Prepare credit applications for project finance transactions. Transactions included a lead role as Agent/Arranger for an approximate \$ 250 MM cogeneration project, Lead Manager for an approximate C\$ 193 MM cogeneration project in Canada, and Participant in an international \$ 900 MM cogeneration project. Preparation of credit applications includes extensive cash flow model analysis, review and analysis of contracts, examination and negotiation of documentation, evaluation of financial structure, and risk assessment.
- Serve as primary account officer on two major transactions agented by the bank, a 212 Mw cogeneration project (\$ 250 MM) and a 180 Mw (\$ 130 MM) cogeneration project. Monitored existing project portfolio of approximately \$170 MM.

The Fuji Bank, Limited (Houston, Texas)
Assistant Vice President – Energy Lending Group

6/89 to 02/92

- Analyzed and assisted in the preparation and presentation of credit applications for reserve-based oil and gas, leasing, and corporate energy transactions. Assisted in relationship management via calling efforts and follow-up on requests.
- Performed lead role in the ownership restructuring of a 180 Mw cogeneration project agented by the bank and assisted in the analysis of three project finance transactions.
- Performed credit maintenance and monitoring functions on a variety of project finance and corporate facilities. Responsible for budgeting and planning functions for the group. Initial credit training program consisted of rotations among the corporate finance, public finance, project finance, and energy finance departments.

EDUCATION

University of Texas (Austin, Texas)
Bachelor of Business Administration, May 1987
Major: Finance

EC 000899871

Project Slapshot brief

Project Slapshot Scores!

Enron's project creativity is not limited to the commercial teams. Enron Industrial Markets' (EIM) financial squad found a novel way to slam the puck into the goal with Project Slapshot, an effort to refinance the March purchase of the Stadacona newsprint mill in Quebec City, Canada. [See *eBiz* Feb. 2, 2001.] By using a derivatives package that transferred the credit risk from the asset to Enron Corp., EIM's Bill Brown, Regional CFO, and Doug McDowell, Director, cut 400 basis points – that's 4 percent – off the interest rate most pulp and paper mills currently pay for capital. The financing was transacted by Sundance, a separate Enron partnership with a financial investor, in order to keep the debt off the corporate balance sheet and allow Enron some flexibility with the asset. To top it off, the transaction is 100 percent financed.

Why is this such a champion financing? Just imagine that you could borrow 100 percent of the cost of a house and pay interest rates that are 4 percent less than prevailing mortgage rates. Pretty good, eh? Too bad Bill and Doug don't take on private clients.

Permanent Subcommittee on Investigations

EXHIBIT #360

ECa000109351

**SUNDANCE TRANSACTION
SLAPSHOT FINANCING****Background**

The Sundance Partnership owns equity in Stadacona as a part of the Sundance transaction. Under this Partnership, Stadacona has approximately \$375 million of debt outstanding due to Enron Corp. which debt is contractually subordinated to our interest in Sundance, and therefore, for our purposes has no effect on our investment in Sundance.

As part of the Sundance Partnership Agreement, we have a right to consent to any modification to the debt arrangement at the Stadacona level. Enron has asked our consent to a refinancing as described below.

The Slapshot Refinancing

There is a complex refinancing structure being proposed that is designed to generate certain tax benefits for Enron. From our perspective, after the application of this structure, the Stadacona entity will have borrowed \$1.375 billion from Hansen Co, a Canadian SPV. The proceeds of this senior, unsecured loan will be used to extend a \$1.0 billion senior unsecured loan to ECPC, an Enron subsidiary, with the remaining \$375 million used to repay the outstanding debt to Enron on the Stadacona assets.

Enron Structural Financing Enhancements

Stadacona is subject to a number of default or liquidation scenarios whereby the banks involved in the refinancing through Hansen would potentially have a senior unsecured claim to Stadacona, and the assets thereof, for repayment of the \$1.375 billion. This claim would be senior to our interest in Stadacona. Enron has recognized that the addition of this unsecured interest in Stadacona is a deviation from the current Partnership structure; as such, Enron has agreed to:

- Expressly covenant that following the refinancing of Stadacona, the assets of Stadacona will be unencumbered and will not become encumbered in the future without the prior consent of Citigroup. In other words, the claim will be an unsecured claim on Stadacona.
- Expressly covenant that the implementation of the refinancing of Stadacona will not prohibit Stadacona from making distributions in accordance with the Sundance transaction documents.
- Expressly covenant that prior to the sale of the Stadacona assets Enron will and will cause all other parties to unwind the Flagstaff Financing and settle all outstanding liabilities under the refinancing from sources other than the assets of Stadacona. That is, if Citigroup elects to liquidate Sundance and sell the underlying assets, the debt claim created by the Hansen loan will be extinguished from outside funds provided by Enron.

- Will expressly waive and forego any right to assert any direct or indirect claim or cause of action, or bring any legal or equitable proceeding against Hansen or Stadacona.
- Agree not to amend, assign or waive any of the provisions of the Flagstaff Financing.
- Indemnify Citigroup for all costs, expenses, or other amounts incurred as a result of the Slapshot refinancing, including any tax effects of the transaction.

Citigroup's Position After the Slapshot Refinancing

Given the Enron representations, covenants and indemnity, Citigroup is essentially exposed to Enron for the \$28 million of its initial Sundance Partnership contribution (i.e., we remain in substantially the same position before and after the refinancing).

Existing Sundance Protection

Any liquidation of the Sundance Partnership will not cause our capital to be at risk to satisfy the obligations of the subsidiaries of Sundance (e.g. Stadacona).

Stephen H Douglas@ECT 12/11/2000 10:27

To: Davis Maxey/Corp/Enron@ENRON
cc:

Subject: Re: Canadian Financing Proposal

Thanks for the E-mail - yes, Stephen D has been getting a lot of my mail recently - poor guy. Anyway, I looked at the proposal and it is a similar version of an arrangement that Morris and I have independently been developing with our Canadian counsel (sans investment bank). In fact, we spent several days in Canada two weeks ago to better develop the structure and expect to conclude it shortly. Thanks for the contact and I will contact them during the next week or so. Otherwise, how is the consent process with Apache going? Any news? My best to all. Steve.
Davis Maxey @ ENRON

Davis Maxey @ ENRON
12/08/2000 04:51:14 PM

To: Stephen H Douglas
cc:
Subject: Canadian Financing Proposal

Steve,

I appear to have sent this to the wrong person.

Dave

Forwarded by Davis Maxey/Corp/Enron on 12/08/2000 04:49 PM

Davis Maxey
11/30/2000

To: Stephen D Douglas/NA/Enron@ENRON
cc: williams@nabry.com, Tina Livingston/HOU/ECT@ECT

Subject: Canadian Financing Proposal

Steve,

Attached is the National Bank of Australia proposal that we discussed. Simon Ing (212-) and John Gallagher (212-) are the investment bankers working on this structure. I would be glad to arrange a conference call; alternatively, please feel free to contact them directly.

Regards,

Dave

TELEPHONE ADS.
Redacted by Permanent Subcommittee on Investigations

Permanent Subcommittee on Investigations
EXHIBIT #362

Acct. nos.

Redacted by Permanent Subcommittee on Investigations

FINAL

ENRON CORPORATION
CLOSING FUNDS FLOWS
Closing Date: Friday, 6/22/00

| Account | Source | Amount | Destination | Notes |
|---------|---|-----------------|---|---|
| 1. DM | Corporate Partners Stadcocon ("CPS") Citibank, N.A.] ABA: [REDACTED] Account [REDACTED] Beneficiary: CPS | \$5,250,000 | JP Morgan Fee | CPS |
| 2. | Hansen Investments Co. ("Finco") Citibank, N.A. ABA: [REDACTED] Account [REDACTED] | \$2,084,450 | Flagstaff Capital Corp. Chase Manhattan Bank ABA: [REDACTED] Account [REDACTED] Beneficiary: Flagstaff Capital Corp. | Hansen CPS payment of Flagstaff funding-related fees/expenses: 1. Upfronts to Club Banks 2. Ad Agent Fee 3. Trustee Fee 4. Legal Fees 5. Process Agent Fee |
| 3. VD | Flagstaff Capital Corp. Chase Manhattan Bank ABA: [REDACTED] Account [REDACTED] | \$1,347,500 | Chase Loan & Agency Services ("L&AS") The Chase Manhattan Bank, Houston ABA: [REDACTED] Account [REDACTED] Attn: Agency Services, Munitzam Appara Ref: Flagstaff Capital Corporation | Transfer from Flagstaff to L&AS Account for distribution: 1. Upfronts to Club Banks 2. Ad Agent Fee |
| 4. MA | Chase L&AS (General Clearing Acct) The Chase Manhattan Bank, Houston ABA: [REDACTED] Account [REDACTED] | \$375,000,000 | Flagstaff Capital Corp. Chase Manhattan Bank ABA: [REDACTED] Account [REDACTED] Beneficiary: Flagstaff Capital Corp. | Club Banks: Chase Manhattan Bank Royal Bank of Scotland Industrial Bank of Japan Bank of Tokyo |
| 5. | Newman Investments | \$1,039,504,347 | Escrow Account at Chase | Deposit into Escrow Account for Enron |

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 Treatment Requested
 by JPLC

SENATE
 FL-02261

| | | | | | |
|-------------------|---|--|------------------|--------------------------------|--|
| <p>8. VD</p> | <p>Flagsstaff Capital Corp. Chase Manhattan Bank ABA: [REDACTED] Account [REDACTED]</p> | <p>Vinson & Elkins LLP The Chase Manhattan Bank 712 Main Street Houston, Texas Swift Code: TCBKUS44 Acct Name: Vinson & Elkins L.L.P. Domestic Account ABA #: [REDACTED] Account [REDACTED] Ref: Ken Anderson ([REDACTED])</p> | <p>\$515,000</p> | <p>Legal Fees and Expenses</p> | <p>Chase Fiduciary Services, at the direction of Flagstaff Capital Corp.</p> |
| <p>9. VD</p> | <p>Flagsstaff Capital Corp. Chase Manhattan Bank ABA: [REDACTED] Account [REDACTED]</p> | <p>McCarthy Tetrault Toronto Dominion Bank 55 King St. West Toronto, Ontario MSK 1A2 Transit #: 10202 Swift Code: TDOMCATTOR Account #: [REDACTED] Beneficiary: McCarthy Tetrault Ref: Jerald Weisman (Invoice # 1)</p> | <p>\$133,000</p> | <p>Legal Fees and Expenses</p> | <p>Chase Fiduciary Services, at the direction of Flagstaff Capital Corp.</p> |
| <p>10. VD</p> | <p>Flagsstaff Capital Corp. Chase Manhattan Bank ABA: [REDACTED] Account [REDACTED]</p> | <p>Shearman & Sterling Citibank, N.A. 153 East 53rd St, NY NY 10043 Acct Name: Shearman & Sterling General 11 Account ABA #: [REDACTED] Account: [REDACTED] Ref: Doug McFadyen</p> | <p>\$63,000</p> | <p>Legal Fees and Expenses</p> | <p>Chase Fiduciary Services, at the direction of Flagstaff Capital Corp.</p> |

ACCT NOS.

Reduced by Permission Subcommittee on Investigations

SENATE
FL-02263

FOIA Confidential
Treatment Requested
By JPMC

| | | | | | |
|-----------|--|---|----------|--|---|
| 11. VD | Flagstaff Capital Corp. Chase Manhattan Bank ABA: ██████████ Account ██████████ | CSC PNC Bank Acct: ██████████ ABA: ██████████ Beneficiary: CSC Ref. Order # ██████████ | \$950 | Process Agent Fee | Chase Fiduciary Services, at the direction of Flagstaff Capital Corp. |
| 12. MA | Flagstaff Capital Corp. Chase Manhattan Bank ABA: ██████████ Account ██████████ | Chase Trustee Services Account: V. Dunbar to effect credit | \$25,000 | Trustee Expenses: 12,500 origination 12,500 first-year | Chase Fiduciary Services, at the direction of Flagstaff Capital Corp. |

ACCT. NOS.

Redacted by Permanent Subcommittee on Investigations

SENATE
FL-02284

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VD: Valerie Dunbar (Chase Capital Markets Fiduciary Services) (212) [REDACTED]
MA: Munitram Appanna (Chase Loan and Agency Services, Houston, TX) (212) [REDACTED]
Closing Coordinator for Houston: Donna McGroarty (713) [REDACTED]
BH: Bruce Hendrick (Global Structured Capital, President of Flagstaff Capital Corp) (212) [REDACTED]
John Locher: (212) [REDACTED]

TELEPHONE NOs.

Redacted by Permanent Subcommittee on Investigations

SENATE
FL-02265

FOIA Confidential
Treatment Requested
By JPMC

MEMORANDUM

To: Tim Hensler
Investigator
Senate Subcommittee on Investigations

From: Tim Edgar
Faculty of Law, The University of Western Ontario

Re: Canadian Income Tax Consequences of Flagstaff/Enron Transaction

Date: December 9, 2002

1. The following note summarizes certain of my comments that I made orally regarding the Canadian income tax consequences of a financing transaction that, for convenience, I refer to as the "Flagstaff/Enron transaction." My oral comments were made previously in the context of a conference call with you and two of your colleagues. The conference call was held on December 5, 2002.

2. My understanding of the Flagstaff/Enron transaction is based on a seven-page transaction summary provided to me by fax transmission of December 2, 2002. I also have had the benefit of a review of a written opinion given by Canadian tax counsel ("the opinion") regarding the Canadian income tax consequences of the transaction. A severed copy of the opinion was provided to me by fax transmission on December 6, 2002.

3. The comments that follow should in no way be construed as a legal opinion. In particular, I have not engaged in the kind of thorough review of the transaction documentation and relevant law that would be required to support a formal opinion. The comments should be taken instead as reflecting my initial impressions of the likely Canadian income tax consequences of the Flagstaff/Enron transaction, based on a limited review of the transactions and relevant law.

COIN Transactions and the Flagstaff/Enron Transaction

4. The cash flows associated with the Flagstaff/Enron transaction replicate those associated with certain long-term debt financing transactions commonly referred to as "Canadian Optional Interest Rate Notes" ("COINs"). A number of these transactions were entered into in the early 1990s by a handful of Canadian corporations. These obligations typically were issued for terms of 40 to 99 years. Holders were provided with an option, exercisable within a defined period after issue, to require the prepayment of interest in respect of future years (for example, years 11 through to the maturity of the obligation). The amount of the prepayment, equal to the present value of the future interest obligations, effectively served as a repayment of a portion of the stated principal amount of the obligation. In short, the borrower would ultimately receive as borrowed funds the nominal principal amount less the amount of the prepaid interest. Because the present value of the obligation to repay the nominal principal amount on maturity was negligible, interest was payable, in substance, on this net amount of borrowed funds received by the issuer. However, the borrower would claim a deduction for interest payable on the full amount of the nominal principal. The deduction was based on the legal form of the transaction, which involved a prepayment of interest for future taxation years and not a repayment of the stated principal amount. The economic effect was the conversion of otherwise non-deductible principal repayments into deductible interest expense of the issuer.

5. The Canadian Department of Finance responded to COIN transactions by enacting specific legislation (subsections 18(9.2) to (9.8) of the Income Tax Act) to ensure that the amount of deductible interest for a corporate borrower, as well as a partnership or trust, is based on the nominal principal amount of a debt obligation less any prepaid interest. In effect, the legislation treats such an obligation for an affected borrower as a net loan (principal advanced less any interest prepayment), with nominal interest payments treated as blended payments of principal and interest. Such treatment generally follows the treatment of these prepaid amounts for financial accounting purposes in Canada (see

Canadian Institute of Chartered Accountants, *Abstract EIC-22*). The COIN legislation applies generally for the 1992 and subsequent taxation years.

6. The Flagstaff/Enron transaction provides the same cash flows otherwise associated with a COIN transaction by substituting the \$1.039 billion payment under the Share Subscription Assumption Agreement for what would be a prepayment of interest on a long-term debt obligation. On the assumption that the integrity of the legal form of this agreement is respected and considered determinative, application of the COIN legislation is avoided, since that legislation refers to amounts that are paid "... in satisfaction, in whole or in part, of the obligation to pay interest on [a] debt obligation in respect of a period ... after the beginning of the year .." Although the legislation extends to such payments made either by the issuer of a debt obligation or any person or partnership, the legislation arguably would not apply to treat the Flagstaff/Enron transaction as a net loan of \$375 million, because the payment under the Share Subscription Assumption Agreement is not, as a matter of legal form, a prepayment of interest. Provided that the legal form of the payment is respected, the Enron group would realize a tax benefit attributable to the deduction of principal, as well as interest, payments on the net loan. The blended payments of principal and interest would also not be considered to give rise to an obligation to repay, within 5 years of issue, more than 25 percent of the loan principal. Accordingly, the portfolio interest exemption from non-resident withholding tax in subparagraph 212(1)(b)(vii) of the Income Tax Act would apply to ensure that no such tax was payable on interest payments to Flagstaff. A comparable COIN transaction entered into with a non-resident lender would realize this same result, if the legal form of the cash flows under such a long-term obligation were respected for Canadian income tax purposes.

Application of the General Anti-Avoidance Rule ("GAAR") to the Flagstaff/Enron Transaction

7. The opinion provides a thorough review of various provisions of the Income Tax Act relevant to the Enron/Flagstaff transaction. These provisions include: (i) the portfolio

interest exemption in paragraph 212(1)(b)(vii); (ii) the thin capitalization rule in subsection 18(4); (iii) interest income provisions in subsections 17(1) and 16(1), as well as subsection 12(3) and Regulation 7000; (iv) the interest deductibility rules in paragraph 20(1)(c); (v) the benefit provisions of subsection 15(1) and section 246; and (vi) the debt forgiveness rules in section 80. I have nothing to say regarding the discussion of the application of these provisions to the Flagstaff/Enron transaction. The opinion is on firm ground in its discussion of these provisions, and the transaction is unlikely to be successfully challenged in any of these respects.

8. The Flagstaff/Enron transaction is much more likely to be subject to a successful challenge under the GAAR in section 245 of the Income Tax Act. Indeed, it is the possible application of this provision that supports a characterization of the transaction as "very aggressive." As suggested below, there is recent judicial authority supporting the proposition that the Flagstaff/Enron transaction represents precisely the kind of fact pattern and associated tax planning that the GAAR was intended to address.

9. My comments on the application of the GAAR are obviously directed at the discussion of this provision provided on pages 14-17 of the opinion. The discussion on pages 12-14 of the possible challenge of the Flagstaff/Enron transaction on the basis of Canadian judicial anti-avoidance doctrines is not contentious. It would be highly unlikely that the transaction would be successfully challenged on the basis of these extremely weak doctrines.

10. In its discussion of the possible application of the GAAR, the opinion relies heavily on certain statements by the Supreme Court of Canada in *Shell Canada Limited v. The Queen*, 99 DTC 1044 and the Federal Court of Appeal in *The Queen v. Canadian Pacific Limited*, 02 DTC 6742. These statements certainly provide a measure of support for the non-application of the GAAR to the Flagstaff/Enron transaction. However, I believe the Federal Court of Appeal decision in *OSFC Holdings Limited v. The Queen*, 02 DTC 5471 provides a firm basis for the possible application of the GAAR to the Flagstaff/Enron

transaction. This possibility would appear to be recognized in the last paragraph of the opinion, which describes in strong language, the legal risk associated with the transaction. In fact, counsel would be unlikely to express such reservations in the event that it was believed that a taxpayer has a chance of success that could be characterized as “more likely than not.”

11. The opinion appears to concede that the composite transactions that comprise the Flagstaff/Enron transaction would be considered a series of transactions for the purposes of the GAAR, and that the series provides a tax benefit in the form of those benefits noted above. Although there is some contentiousness regarding the concept of a series for the purposes of the GAAR, the component parts of the Flagstaff/Enron transaction are probably accurately characterized as a series within the narrowest concept of that term developed by UK courts and acknowledged by Canadian courts. Consequently, it is probably unnecessary to rely on the extended statutory concept of the term set out in subsection 248(10) of the Income Tax Act, as considered in *OSFC Holdings*.

12. The problematic aspects of the Flagstaff/Enron transaction would appear to be the non-tax purpose test and the misuse or abuse standard set out in the GAAR. More particularly, there is a strong possibility that one or more of the component parts of the transaction could be characterized as an “avoidance transaction” on the basis that such part or parts:

- cannot be considered to have been carried out primarily for a bona fide purpose other than to obtain the tax benefit; and
- constitute a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act (other than the GAAR) read as a whole.

It is in these two respects that the decision in *OSFC Holdings* is most relevant for the Flagstaff/Enron transaction.

13. The Federal Court of Appeal in *OSFC Holdings* had occasion to consider the application of the GAAR to a series of transactions that used a partnership structure to

transfer losses between unrelated corporations. Although the taxpayer argued that there were non-tax reasons for the transactions, the Court regarded those reasons as incidental or secondary to the primary purpose of gaining access to the tax benefit represented by the losses. The Court also characterized the transactions as an abuse of those specific provisions in the Act intended to prevent the transfer of losses between unrelated corporations. In effect, those provisions did not contemplate the use of a partnership structure to realize such a transfer, and the Federal Court of Appeal applied the GAAR in an effort to maintain the integrity of the specific legislative regime intended to prevent the economic effect of the substituted transactional form used by the taxpayer. The reasoning and result in *OSFC Holdings* has been subsequently applied by the Tax Court of Canada to a similar fact pattern in *Mathew et al. v. The Queen*, 02 DTC 1637. On June 22, 2002, the Supreme Court of Canada refused the taxpayer's application for leave to appeal the Federal Court of Appeal decision in *OSFC Holdings*.

14. On the basis of the decision in *OSFC Holdings*, it is arguable that the Flagstaff/Enron transaction is distinguishable from the fact patterns in both *Shell Canada Limited* and *Canadian Pacific* in the above two respects that are relevant to the characterization of the transaction as an avoidance transaction. First, even accepting an interpretation of the non-tax purpose test that would save a series of transactions if the whole of the series can be considered to have been carried out primarily for such a purpose, it is arguable that the series in the Flagstaff/Enron transaction fails such a standard. In particular, the series appears to have been carried out primarily to refinance an existing \$375 million loan for no apparent non-tax reason. The non-tax purposes described in the opinion for various component parts of the transaction may, at best, be considered incidental to the overriding purpose of refinancing this existing \$375 million loan in order to deduct the outstanding principal as interest and avoid the application of non-resident withholding tax in Canada. In this respect, the Flagstaff/Enron transaction is distinguishable from the weak-currency borrowings in *Shell Canada Limited* and *Canadian Pacific*, which were undertaken for the non-tax reason of injecting additional

funds into the borrower. It is not clear that there was any non-tax reason supporting the refinancing of the existing \$375 million loan in the Flagstaff/Enron transaction.

15. Although the matter remains uncertain, it is also possible that, for the purpose of the GAAR, each step in a series of transactions must be tested against the non-tax purpose test, with any transaction that fails this test being potentially characterized as an avoidance transaction. Under this interpretation of the non-tax purpose test under the GAAR, the Flagstaff/Enron transaction could be challenged by examining the integrity of each of its component parts. The Share Subscription Assumption Agreement would seem to be especially vulnerable to challenge under this test, in which case it would be considered an avoidance transaction if considered to give rise to a misuse or abuse of the provisions of the Act.

16. The second respect in which the Flagstaff/Enron transaction is distinguishable from the fact patterns in both *Canadian Pacific* and *Shell Canada Limited* concerns the misuse or abuse analysis under the GAAR. Unlike the fact patterns in these cases, the Flagstaff/Enron transaction mimics the economic result associated with a specific transaction that is the subject of a specific anti-avoidance regime: that is, COIN transactions and subsections 18(9.2) to (9.8). In effect, substitution of the Share Subscription Assumption Agreement replicates the cash flows associated with a COIN transaction without apparently attracting the application of the COIN legislation. The Flagstaff/Enron transaction may therefore be closer conceptually to the partnership structure used in *OSFC Holdings* to avoid the ostensible application of a set of anti-avoidance rules to transactions that are intended to transfer losses between unrelated corporations.

17. In sum, there is a significant risk for the Flagstaff/Enron transaction that the Share Subscription Assumption Agreement would be considered an avoidance transaction and, if so, the transaction could be collapsed and treated as a net loan with blended payments of principal and interest over its 5-year term. As such, there would be no deduction of

principal repayments, and the interest payments would be subject to non-resident withholding tax in Canada. As suggested above, the Federal Court of Appeal decision in *OSFC Holdings* provides considerable support for this position.



**Enron Industrial Markets
Finance Presentation of Sundance
and Slapshot**

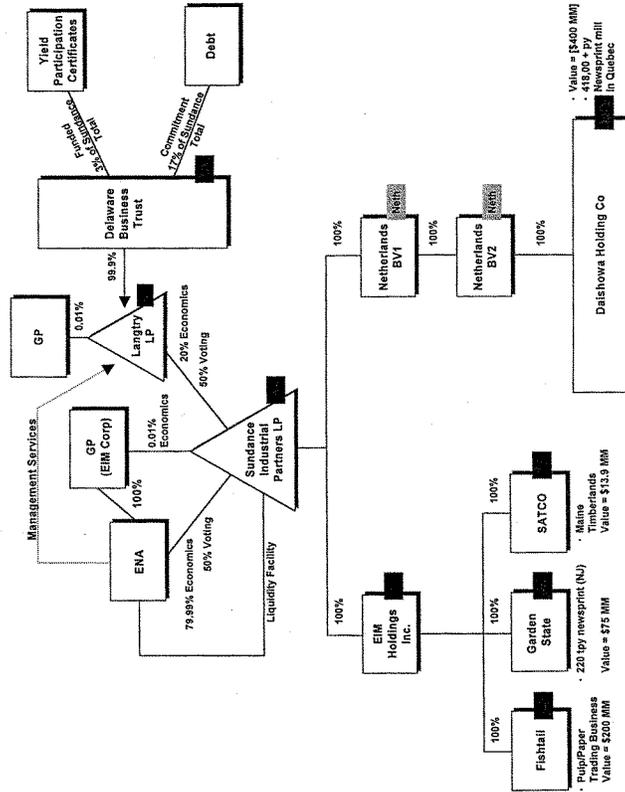
March 21, 2001

Permanent Subcommittee on Investigations

EXHIBIT #365

ECJ000073278

Sundance



Sundance Earnings (Still Under Negotiation)

- **Upfront Structuring Fee (or other earnings) of \$5-10mm**
- **Yearly Management Fee of 2% of total contributed and committed capital (approx. \$3.5mm) with PV(10%,5yrs) = \$13.5mm**
- **Quarterly Administrative Agent Fee from Langtry, dependent on earnings from assets (minimum of approx. \$13mm per year if no additional amounts funded) with PV(10%,5yrs) = \$53.6mm**

Impact

| Tax | GAAP |
|---|--|
| <ul style="list-style-type: none">• Interest deduction on gross \$1.4B loan | <ul style="list-style-type: none">• Net loan of \$400MM• Interest expense on \$400MM loan |
| <ul style="list-style-type: none">• Cash tax savings: \$60MM NPV* | <ul style="list-style-type: none">• P&L benefit \$65MM NPV* |

* assumes 100% utilization

Snapshot Savings

- **Tax interest deduction at Daishowa on gross US\$1.4 billion**
 - Deduction effectively eliminates cash taxes over next five years, resulting in a tax savings NPV of **US\$60 million** (assuming 100% utilization) *
- **GAAP treatment: Net debt of US\$400 million and interest expense on US\$400 million**
- **Tax depreciation delay next five years**
 - Tax depreciation delay creates deferred tax benefit, resulting in net income improvement over the next five years of NPV **US\$65 million** (book) *

* (5 year NPV @ 6.69%)

Administrative Agent Fee Calculation

| | |
|--|------------------|
| Preferred Distribution: | |
| 15% x \$25mm equity | \$3.75mm |
| 10% x \$145mm debt | \$14.5mm |
| Less Actual Debt & Equity from Langtry: | |
| 15% x \$25mm equity | \$3.75mm |
| 1% x \$145mm debt | \$1.45mm |
| Admin Agent Fee to Enron | \$13.05mm |

CITICORP CITIBANK
CREDIT APPROVAL

All Amounts are US\$MM
Unless Otherwise Noted

Board Reporting
Yes No
X

Initial
Relationship Credit Approval
Interim X

| | | | | | | | |
|--|--|--|--|---|--|---|--|
| Relationship / Borrower Name / Location ENRON CORPORATION HOUSTON UNITED STATES | | Responsible Officer LYDIA JUNEK | | Approval Level SCQ(1) CPC SM | | CA No. 2000 / 126771 | |
| Ownership % 19 OTHER PUBLICLY HELD | | 100.0% | | Control Unit for Global Relationship HOUSTON PMMM | | Risk Rating Citi-ORR | |
| Director Relationships | | RCA Expiration Date July 31, 2001 | | RCR Expiration Date MOOOY'S P2 | | 8aa1 STABLE | |
| GFPID # 9000007002 | | GFCID # 9000007002 | | Previous CA Date July 31, 2000 | | W/O's W/O's Adverse Classification IA II III | |
| CAGID # 9000007002 | | Local Ref # 9000007002 | | Final Approval Date | | | |
| Tenor Profile: | | 0-3Mths > 3-6 Mths > 6-12 Mths > 1-3 Yrs > 3-5 Yrs > 5-10 Yrs > 10 Yrs | | Total | | Net Change from Prior CA | |
| Total O/S & Unused Comm | | 863.51 716.42 388.00 387.06 176.32 | | Total Facilities | | 1,122.48 + 438.30 | |
| Purpose/Exception | | Level1 Total Facilities Limit Exception 622.48 | | Direct | | 695.33 + 318.55 | |
| Direct Facilities Limit Exception | | 0.00 | | Contingent | | 117.02 + 3.69 | |
| Cross Border Allocations Between Countries | | 4.04 | | PSR | | 310.13 + 121 | |
| SEE ATTACHED FOR PURPOSE | | | | Unallocated Line | | 24.25 + 5C | |
| | | | | Total O/S & Unused Comm | | 863.51 + 476 | |
| | | | | Underwritten Amt | | 0 | |
| | | | | Settlement Limit | | 235.38 | |
| | | | | Clearing Limit | | 1,152.29 + 198 | |
| | | | | Securitization | | 118.68 + 426 | |
| Relationship/CFR# | | 2000 (w/o) | | 1999 | | 1998 | |
| Client Zone / Status | | (CA) | | (CA) | | PSI (\$M) 7,847.00 719.00 | |
| Domestic Revenue \$M | | 32,063.00 | | 18,117.00 | | RCRAP % 5.98 1.48 | |
| Total Revenues \$M | | 32,063.00 | | 18,117.00 | | Cross Sell Ratio | |
| Originating (Other Unit) \$ | | Approves/Recommends \$ | | Request Approval/Recommends \$ | | Consents \$ | |
| Control Unit (US\$) | | Approves \$ 555.98 | | Recommends to Subs \$ 508.61 | | Consents \$ 59.91 | |
| Other (Designated) \$ | | Other (Designated) \$ | | Other (Designated) \$ | | Other (Designated) \$ | |
| | | STEVEN H. BARLIE Vice President Citibank North America, Inc. (713) 654-2387 | | LYDIA G. JUNEK Managing Director Citibank North America, Inc. (713) 654-3444 | | | |

Printed: 12/06/00 4:17 PM

Permanent Subcommittee on Investigations
EXHIBIT #366

CITI-SPSI 0128915

| | | | | |
|--|-----------------------------|--------------------|----------------------|--------------------|
| ENRON CORPORATION | Originating Unit HOUSTON | GFCID 800007002 | CA No 2009/128771 | Page No 2 of 21 |
| Global CA Page 3 - Facility Support Summary | | | | |
| Amounts in US\$ MM | | | | |

| | | | | | | |
|--------------------------------|----------|----------|-------------|-------------|-----------|-----------------------------|
| Total Credit Facilities | | | | | | |
| | CFA | 0-1 Year | > 1-3 Years | > 3-5 Years | > 5 Years | Net \$ Change from Prior CA |
| Total | 1,122.48 | 1,122.48 | 480.83 | 405.48 | 185.69 | |

| | | | | | | |
|--|--------|----------|-------------|-------------|-----------|-----------------------------|
| A. Parent Facilities & Unconditional Guarantees to Subsidiaries by Parent | | | | | | |
| | CFA | 0-1 Year | > 1-3 Years | > 3-5 Years | > 5 Years | Net \$ Change from Prior CA |
| RR 1 - 4 | 730.82 | 730.82 | 184.86 | 160.41 | 87.58 | |
| RR 5 | | | | | | |
| RR 6 | | | | | | |
| RR 7 - 10 | | | | | | |
| Total | 730.82 | 730.82 | 184.86 | 160.41 | 87.58 | |

| | | | | | | |
|---|------|----------|-------------|-------------|-----------|-----------------------------|
| B. Facilities to Subsidiaries Supported by Other Unconditional Guarantee | | | | | | |
| | CFA | 0-1 Year | > 1-3 Years | > 3-5 Years | > 5 Years | Net \$ Change from Prior CA |
| RR 1 - 4 | | | | | | |
| RR 5 | 4.04 | 4.04 | 4.04 | 4.04 | 2.25 | |
| RR 6 | | | | | | |
| RR 7 - 10 | | | | | | |
| Total | 4.04 | 4.04 | 4.04 | 4.04 | 2.25 | |

| | | | | | | |
|--|------|----------|-------------|-------------|-----------|-----------------------------|
| C. Supported Facilities to Subsidiaries - Excluding Unconditional Guarantee | | | | | | |
| | CFA | 0-1 Year | > 1-3 Years | > 3-5 Years | > 5 Years | Net \$ Change from Prior CA |
| RR 1 - 4 | 7.50 | 7.50 | | | | |
| RR 5 | | | | | | |
| RR 6 | | | | | | |
| RR 7 - 10 | | | | | | |
| Total | 7.50 | 7.50 | | | | |

| | | | | | | |
|--|--------|----------|-------------|-------------|-----------|-----------------------------|
| D. Facilities to Subsidiaries & Managed Affiliates not relying on support | | | | | | |
| | CFA | 0-1 Year | > 1-3 Years | > 3-5 Years | > 5 Years | Net \$ Change from Prior CA |
| RR 1 - 4 | 298.70 | 298.70 | 219.04 | 168.04 | 28.04 | |
| RR 5 | 74.31 | 74.31 | 72.88 | 71.98 | 89.83 | |
| RR 6 | 6.10 | 6.10 | | | | |
| RR 7 - 10 | | | | | | |
| Total | 380.11 | 380.11 | 291.73 | 241.01 | 95.87 | |

| | | | | | | |
|---|-----|----------|-------------|-------------|-----------|-----------------------------|
| E. Supported Facilities to Joint Ventures & Affiliates | | | | | | |
| | CFA | 0-1 Year | > 1-3 Years | > 3-5 Years | > 5 Years | Net \$ Change from Prior CA |
| RR 1 - 4 | | | | | | |
| RR 5 | | | | | | |
| RR 6 | | | | | | |
| RR 7 - 10 | | | | | | |
| Total | | | | | | |

| | | | |
|---------------------------|--------|-------------------------|----------|
| F. Settlement Risk | | G. Clearing Risk | |
| Total | 235.38 | Total | 1,152.29 |

| | | | | | | |
|---|-----|----------|-------------|-------------|-----------|-----------------------------|
| H. Affiliate Obligations (20% - 50% Ownership) which are aggregated to this CA | | | | | | |
| | CFA | 0-1 Year | > 1-3 Years | > 3-5 Years | > 5 Years | Net \$ Change from Prior CA |
| RR 1 - 4 | | | | | | |
| RR 5 | | | | | | |
| RR 6 | | | | | | |
| RR 7 - 10 | | | | | | |
| Total | | | | | | |

CONFIDENTIAL

CITI-SPSI 0128916

| | | | | |
|--|-----------------------------|--------------------|----------------------|--------------------|
| ENRON CORPORATION | Originating Unit HOUSTON | GFCID 900007002 | CA No 2008/128771 | Page No 3 of 21 |
| Global CA Page 3 - Facility Support Summary | | | | |
| Amts in US\$ MM | | | | |

Facilities by Type of Support (Excluding Facilities to Parent)

| | GCCP Unquestioned | GCCP Qualified | Non GCCP |
|------------------------------|-------------------|----------------|----------|
| Unconditional Guarantees | | | 4.04 |
| Qualified Guarantee | | | |
| Letter of Support | | | |
| Letter of Comfort/Awareness | | | |
| Parent / Subs Op. Agreements | | | |
| Verbal Support | | | 7.50 |
| Total | 0.00 | 0.00 | 11.54 |

Top 5 Geographic Locations by Extending Unit Country

| COUNTRY | CFA | Parent & Parent Guar. | Other Supported | Unsupported |
|-------------------|----------|-----------------------|-----------------|-------------|
| UNITED STATES | 949.02 | 889.08 | 7.50 | 252.44 |
| UNITED KINGDOM | 144.28 | 49.01 | | 99.28 |
| INDIA | 10.90 | | | 10.00 |
| PANAMA | 7.50 | | | 7.50 |
| BRAZIL | 6.84 | 0.80 | | 9.04 |
| TOTAL OF TOP FIVE | 1,117.48 | 734.89 | 7.50 | 375.23 |
| TOTAL CFA | 1,122.48 | 734.89 | 7.50 | 380.11 |

Top 5 Product Concentrations by GFMS Product

| PRODUCT FAMILY | CFA | Parent & Parent Guar. | Other Supported | Unsupported |
|----------------------|----------|-----------------------|-----------------|-------------|
| LOAN LIQUIDITY/OTHER | 907.43 | 845.25 | 7.50 | 54.67 |
| TRADING & CAP MKTS | 208.09 | | | 208.09 |
| DOMESTIC COLLECTIONS | 58.81 | 55.90 | | 0.41 |
| LOANS & CORP FIN | 53.71 | 5.02 | | 48.69 |
| DOMESTIC DISBURSMT | 53.61 | 3.98 | | 47.85 |
| TOTAL OF TOP FIVE | 978.64 | 811.72 | 7.50 | 357.41 |
| TOTAL CFA | 1,122.48 | 734.89 | 7.50 | 380.11 |

CONFIDENTIAL

CITI-SPSI 0128917

| | | | | | |
|--|--------------|-----------------------------|--|----------------------|--------------------|
| ENRON CORPORATION | | Originating Unit HOUSTON | GFCID 8000007002 | CA No 2000/128771 | PAGE No 4 of 21 |
| New Facilities Details | | | | | |
| Customer Name : ENRON CORP Business/Activity: 4822 NATURAL GAS TRANSMISSION | | | GFCID: 448044 Obligor Rtg: 4+ Classification: Cur | | |
| Facility No. | GERN: | Risk Type: | Amounts in thousands: | | |
| 148360-8 | US26252202 | Direct | US\$ 0 | | |
| Extending Unit: GRB NY SECURITIZATIO | | DECREASE by | | 3,941 | |
| Commercial Approving Unit: HOUSTON PM&M | | Facility Risk Rating: | | 4+ | |
| Sovereign Approving Unit: | | Classification: | | Cur | |
| Booking Unit: NEW YORK CSNA | | Committed: | | No | |
| STRUCTURED FOR SALE-RESTRICTED - BORROWERS CONSENT ONLY | | Expiry Date | | DECEMBER 27 2000 | |
| Facility Description: | | | | | |
| TERM LOAN | | | | | |
| Citibank's \$26,335,128.88 share of the A Notes on the below mentioned facility. | | | | | |
| Citibank's share of a \$717 MM Securitized Asset Defiance Product (SADP) facility to purchase from CXC Incorporated (CXC), Securitization interests (SI) representing CXC's advances to J.T. Holdings, Inc. (JTH) and Borrower Percentage Interests (BPI) from JTH. Citibank's commitment arises out of its role position in an Asset Purchase Agreement (APA), which serves as a liquidity facility for the SADP facility and which has been syndicated to term to third party banks (the APA Banks) with minimum ratings of A-2P-2. | | | | | |
| The SADP facility was used to refinance two existing Enron Corp. lease transactions which Enron utilized in funding its acquisition of certain assets from Tennessee in 1991 and from the Williams Company in 1993. To finance the assets, which are gas production and distribution facilities, Enron entered into leaseback transactions whereby the assets were sold to trusts, which leased the assets to LRCI and LGMI, both wholly-owned by Enron. To finance the assets, the Trusts issued Notes to JTH which, in turn, funded the purchase of the Notes via advances from CXC (under a Finance Facility). As necessary, funding in the future may be through the purchase of the APA Banks of BPI (which represents an undivided interest in the Notes) under the APA. | | | | | |
| Lessor: A Special Purpose Trust (J.T. Holdings) | | | | | |
| Lessee: | | | | | |
| Liquids Lessee: Enron Gas Processing Company, 100% subsidiary. | | | | | |
| LRC Lessee: Louisiana Resources Company, Inc. and Louisiana Gas Marketing Inc. | | | | | |
| Guarantor: Enron Corp. | | | | | |
| Agent: Citicorp/Citibank | | | | | |
| Trustee: Stone Street Bank and Trust Company | | | | | |
| Deal Size: | | | | | |
| A Notes - \$629,968 (Citibank share \$26,335,129) | | | | | |
| B Notes - \$88,968 (Citibank share \$3,716,616) | | | | | |
| Certificates - \$22,968 - funded by a third party | | | | | |
| Pricing: Applicable margin over LIBOR | | | | | |
| Debt Rating | A Notes | B Notes | Certificates | | |
| A-1/A3 or better | 38.00 | 48.00 | 208.00 | | |
| BBB+/Baar1 | 38.00 | 48.00 | 208.00 | | |
| BBB-/Baar2 | 43.75 | 53.75 | 208.00 | | |
| BBB-/Baar3 | 62.50 | 72.50 | 208.00 | | |
| BB-/Baar1 & below | 87.50 | 97.50 | 358.00 | | |
| Applicable margin over Base Rate | | | | | |
| Debt Rating | A Notes | B Notes | Certificates | | |
| A-1/A3 or better | 0.00 | 0.00 | 30.00 | | |
| BBB+/Baar1 | 0.00 | 0.00 | 30.00 | | |
| BBB-/Baar2 | 0.00 | 0.00 | 30.00 | | |

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|---|--|--------------------------------|----------------------|--------------------|--|--|-----------------------|-------------|--------------------------|---------------------|----------------------|------------|-------------|--------------------------------------|----------|-----------------|-------|-------|---|-------|--------------------------|--|--|---------------------------|--|---------------------|--|--|-----------------------------|--|---------------|--|--|--|--|--------------------------------|--|--|---|--|--|--|--|-----------------------|--|--|--|--|--------------------------|----------------------|----------------------|--|---------------|---|--|--|--|--|------------|---------------|-------------|-------------|-------------|------------|------------|------------|-------------|--------------|----------|-------|-------|-------|-------|-------|--|--|--|--|--|--|--------------------------------------|--|-------------------|--|--|---|--|--------------------------|--|--|---------------------------|--|---------------------|--|--|-----------------------------|--|-------------------------|--|--|--|--|-----------------|--|--|--|--|--------------------------------|--|--|---|--|--|--|--|
| ENRON CORPORATION | Operating Unit HOUSTON | GFCD 1000007002 | CA No 2000 / 2877 | PAGE No 5 of 21 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| New Facilities Details | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <table style="width:100%; border-collapse: collapse;"> <tr> <td style="width:30%;">BBB+/Ba3</td> <td style="width:10%;">0.00</td> <td style="width:10%;">0.00</td> <td style="width:10%;">50.00</td> <td></td> </tr> <tr> <td>BB+/Ba1 & below</td> <td>0.00</td> <td>0.00</td> <td>200.00</td> <td></td> </tr> </table> <p>Comment Fee: 17.5 bps</p> <p>Closing Date: December 27, 1995</p> <p>Maturity Date: Five years from closing (12/27/2000)</p> <p>NOTATION:</p> <p>This facility has been referenced in a Credit Derivative. Portfolio Rebalancing at 212-588-4588 must be informed immediately of any changes, amendments or waivers or any material adverse change affecting the facility.</p> <p>(Reduced from \$3.941MM to zero; Will be replaced by new \$30MM 364 day facility for JT Holdings which was approved from unallocated on 12/5/2000)</p> <p>Support = None</p> | | | | | BBB+/Ba3 | 0.00 | 0.00 | 50.00 | | BB+/Ba1 & below | 0.00 | 0.00 | 200.00 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| BBB+/Ba3 | 0.00 | 0.00 | 50.00 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| BB+/Ba1 & below | 0.00 | 0.00 | 200.00 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <table style="width:100%; border-collapse: collapse;"> <tr> <td style="width:60%;">44684 ENRON CORP Business/Activity: 4922 NATURAL GAS TRANSMISSION</td> <td style="width:40%; text-align:right;">(CONTINUED) Obligor Rtg: 4+ Classification: Cur</td> </tr> <tr> <td colspan="2" style="text-align:right;">Amounts in thousands:</td> </tr> <tr> <td style="width:20%;">Facility No. 146381-6</td> <td style="width:20%;">GFCD: US02853202</td> <td style="width:20%;">Risk Type: Direct</td> <td style="width:20%;"></td> <td style="width:20%; text-align:right;">US\$ 0</td> </tr> <tr> <td colspan="2">Extending Unit: GRB NY SECURITIZATIO</td> <td colspan="3">DECREASE by 556</td> </tr> <tr> <td colspan="2">Commercial Approving Unit: HOUSTON PM&M</td> <td colspan="3">Facility Risk Rating: 4+</td> </tr> <tr> <td colspan="2">Sovereign Approving Unit:</td> <td colspan="3">Classification: Cur</td> </tr> <tr> <td colspan="2">Booking Unit: NEW YORK CSNA</td> <td colspan="3">Committed: No</td> </tr> <tr> <td colspan="2">STRUCTURED FOR SALE: RESTRICTED - BORROWERS CONSENT ONLY</td> <td colspan="3">Expiry Date: DECEMBER 27, 2000</td> </tr> <tr> <td colspan="5"> <p><u>Facility Description:</u> TERM LOAN</p> <p>Citibank's \$3,716,041.58 share of the \$ Note described in the above facility. Transaction closed 12/27/95 and matures 12/27/2000.</p> <p>(Reduced from \$556M to zero; Will be replaced by new \$30MM 364-day facility for JT Holdings which was approved from unallocated on 12/5/2000)</p> <p>Support = None</p> </td> </tr> <tr> <td colspan="5" style="text-align:right;">Amounts in thousands:</td> </tr> <tr> <td style="width:20%;">Facility No. 146442-3</td> <td style="width:20%;">GFCD: USA46084-20</td> <td style="width:20%;">Risk Type: Direct</td> <td style="width:20%;"></td> <td style="width:20%; text-align:right;">US\$ 6,158</td> </tr> <tr> <td colspan="5"> <table style="width:100%; border-collapse: collapse;"> <tr> <td style="width:15%;">0 - 7 Days</td> <td style="width:15%;">8 Dvs - 1 Mth</td> <td style="width:15%;">>1 - 3 Mths</td> <td style="width:15%;">>3 - 6 Mths</td> <td style="width:15%;">>6Mth - 1Yr</td> <td style="width:15%;">>1 - 3 Yrs</td> <td style="width:15%;">>3 - 5 Yrs</td> <td style="width:15%;">>5 - 8 Yrs</td> <td style="width:15%;">>8 - 10 Yrs</td> <td style="width:15%;">>10 - 15 Yrs</td> <td style="width:15%;">> 15 Yrs</td> </tr> <tr> <td style="text-align:right;">6,158</td> <td style="text-align:right;">6,158</td> <td style="text-align:right;">6,158</td> <td style="text-align:right;">6,158</td> <td style="text-align:right;">6,158</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> </table> </td> </tr> <tr> <td colspan="2">Extending Unit: GRB NY SECURITIZATIO</td> <td colspan="3">DECREASE by 8,288</td> </tr> <tr> <td colspan="2">Commercial Approving Unit: HOUSTON PM&M</td> <td colspan="3">Facility Risk Rating: 4+</td> </tr> <tr> <td colspan="2">Sovereign Approving Unit:</td> <td colspan="3">Classification: Cur</td> </tr> <tr> <td colspan="2">Booking Unit: NEW YORK CSNA</td> <td colspan="3">Committed Amount: 6,158</td> </tr> <tr> <td colspan="2">STRUCTURED FOR SALE: RESTRICTED - BORROWERS CONSENT ONLY</td> <td colspan="3">Committed Unit:</td> </tr> <tr> <td colspan="2"></td> <td colspan="3">Expiry Date: DECEMBER 21, 2001</td> </tr> <tr> <td colspan="5"> <p><u>Facility Description:</u> SHORT TERM LOANS</p> <p>Citibank's 364-day share of an original \$150MM Coal Contract Monetization between Enron and H&AP.</p> <p>Admin. Agent: Citicorp North America, Inc. (Agent)</p> <p>Closing Date: September 26, 1997</p> <p>Maturity Date: February 5, 2013</p> </td> </tr> </table> | | | | | 44684 ENRON CORP Business/Activity: 4922 NATURAL GAS TRANSMISSION | (CONTINUED) Obligor Rtg: 4+ Classification: Cur | Amounts in thousands: | | Facility No. 146381-6 | GFCD: US02853202 | Risk Type: Direct | | US\$ 0 | Extending Unit: GRB NY SECURITIZATIO | | DECREASE by 556 | | | Commercial Approving Unit: HOUSTON PM&M | | Facility Risk Rating: 4+ | | | Sovereign Approving Unit: | | Classification: Cur | | | Booking Unit: NEW YORK CSNA | | Committed: No | | | STRUCTURED FOR SALE: RESTRICTED - BORROWERS CONSENT ONLY | | Expiry Date: DECEMBER 27, 2000 | | | <p><u>Facility Description:</u> TERM LOAN</p> <p>Citibank's \$3,716,041.58 share of the \$ Note described in the above facility. Transaction closed 12/27/95 and matures 12/27/2000.</p> <p>(Reduced from \$556M to zero; Will be replaced by new \$30MM 364-day facility for JT Holdings which was approved from unallocated on 12/5/2000)</p> <p>Support = None</p> | | | | | Amounts in thousands: | | | | | Facility No. 146442-3 | GFCD: USA46084-20 | Risk Type: Direct | | US\$ 6,158 | <table style="width:100%; border-collapse: collapse;"> <tr> <td style="width:15%;">0 - 7 Days</td> <td style="width:15%;">8 Dvs - 1 Mth</td> <td style="width:15%;">>1 - 3 Mths</td> <td style="width:15%;">>3 - 6 Mths</td> <td style="width:15%;">>6Mth - 1Yr</td> <td style="width:15%;">>1 - 3 Yrs</td> <td style="width:15%;">>3 - 5 Yrs</td> <td style="width:15%;">>5 - 8 Yrs</td> <td style="width:15%;">>8 - 10 Yrs</td> <td style="width:15%;">>10 - 15 Yrs</td> <td style="width:15%;">> 15 Yrs</td> </tr> <tr> <td style="text-align:right;">6,158</td> <td style="text-align:right;">6,158</td> <td style="text-align:right;">6,158</td> <td style="text-align:right;">6,158</td> <td style="text-align:right;">6,158</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> </table> | | | | | 0 - 7 Days | 8 Dvs - 1 Mth | >1 - 3 Mths | >3 - 6 Mths | >6Mth - 1Yr | >1 - 3 Yrs | >3 - 5 Yrs | >5 - 8 Yrs | >8 - 10 Yrs | >10 - 15 Yrs | > 15 Yrs | 6,158 | 6,158 | 6,158 | 6,158 | 6,158 | | | | | | | Extending Unit: GRB NY SECURITIZATIO | | DECREASE by 8,288 | | | Commercial Approving Unit: HOUSTON PM&M | | Facility Risk Rating: 4+ | | | Sovereign Approving Unit: | | Classification: Cur | | | Booking Unit: NEW YORK CSNA | | Committed Amount: 6,158 | | | STRUCTURED FOR SALE: RESTRICTED - BORROWERS CONSENT ONLY | | Committed Unit: | | | | | Expiry Date: DECEMBER 21, 2001 | | | <p><u>Facility Description:</u> SHORT TERM LOANS</p> <p>Citibank's 364-day share of an original \$150MM Coal Contract Monetization between Enron and H&AP.</p> <p>Admin. 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| 44684 ENRON CORP Business/Activity: 4922 NATURAL GAS TRANSMISSION | (CONTINUED) Obligor Rtg: 4+ Classification: Cur | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Amounts in thousands: | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Facility No. 146381-6 | GFCD: US02853202 | Risk Type: Direct | | US\$ 0 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Extending Unit: GRB NY SECURITIZATIO | | DECREASE by 556 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Commercial Approving Unit: HOUSTON PM&M | | Facility Risk Rating: 4+ | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Sovereign Approving Unit: | | Classification: Cur | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Booking Unit: NEW YORK CSNA | | Committed: No | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| STRUCTURED FOR SALE: RESTRICTED - BORROWERS CONSENT ONLY | | Expiry Date: DECEMBER 27, 2000 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <p><u>Facility Description:</u> TERM LOAN</p> <p>Citibank's \$3,716,041.58 share of the \$ Note described in the above facility. Transaction closed 12/27/95 and matures 12/27/2000.</p> <p>(Reduced from \$556M to zero; Will be replaced by new \$30MM 364-day facility for JT Holdings which was approved from unallocated on 12/5/2000)</p> <p>Support = None</p> | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Amounts in thousands: | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Facility No. 146442-3 | GFCD: USA46084-20 | Risk Type: Direct | | US\$ 6,158 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
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| 0 - 7 Days | 8 Dvs - 1 Mth | >1 - 3 Mths | >3 - 6 Mths | >6Mth - 1Yr | >1 - 3 Yrs | >3 - 5 Yrs | >5 - 8 Yrs | >8 - 10 Yrs | >10 - 15 Yrs | > 15 Yrs | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 6,158 | 6,158 | 6,158 | 6,158 | 6,158 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Extending Unit: GRB NY SECURITIZATIO | | DECREASE by 8,288 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Commercial Approving Unit: HOUSTON PM&M | | Facility Risk Rating: 4+ | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Sovereign Approving Unit: | | Classification: Cur | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Booking Unit: NEW YORK CSNA | | Committed Amount: 6,158 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| STRUCTURED FOR SALE: RESTRICTED - BORROWERS CONSENT ONLY | | Committed Unit: | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | | Expiry Date: DECEMBER 21, 2001 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <p><u>Facility Description:</u> SHORT TERM LOANS</p> <p>Citibank's 364-day share of an original \$150MM Coal Contract Monetization between Enron and H&AP.</p> <p>Admin. Agent: Citicorp North America, Inc. (Agent)</p> <p>Closing Date: September 26, 1997</p> <p>Maturity Date: February 5, 2013</p> | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |

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|--|-----------------------------|---------------------|----------------------|--------------------|--------------------|---------------|-------------|---------------------------|-------------------|---------------------------|-------------------|---------------------------|--------------------|----------------------------|---------------------|----------------------------|---------|---------|---------|---------|--|--|--|--|--|--|
| ENRON CORPORATION | Engineering Unit HOUSTON | GFCID 8000007002 | CA No 2000/128771 | PAGE No 6 of 21 | | | | | | | | | | | | | | | | | | | | | | |
| New Facilities Details | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <p>Guaranty: Enron Corp. will guarantee the performance of (a) DPLP under the Servicer Agreement, (b) DPLP and Seller under the Sale Agreement and (c) ECT under the Swap Agreement.</p> <p>CONDUIT FUNDING FEATURES</p> <p>SPC: The SPC will enter into an uncommitted finance agreement with CXC and will assign a security interest in rights in the Trust to CXC and the APA Purchasers, as security for the SPCs obligations.</p> <p>CXC: Intends to obtain funds for making the loans to the SPC through the issuance of CP.</p> <p>APA Purchasers: The APA Purchasers will provide a committed liquidity facility to CXC.</p> <p>Asset Purchase Agreement: A commitment by the APA Purchasers to purchase, if requested by CXC or SPC, a resale share in undivided interests in the Notes for a purchase price equal to the remaining balance of the Note.</p> <p>APA Rate: If CXC is funding, the CXC Rate and Fees. If the APA funding, interest which is equal to LIBOR plus the applicable margin listed below.</p> <table style="width:100%; border-collapse: collapse;"> <tr> <td style="text-align:left;">Applicable Margin:</td> <td style="text-align:center;">Rating</td> </tr> <tr> <td></td> <td style="text-align:center;">Base Case Downgrade*</td> </tr> <tr> <td style="text-align:center;">Years 1 through 4</td> <td style="text-align:center;">82.5 p.a. 182.5 p.a.</td> </tr> <tr> <td style="text-align:center;">Years 5 through 8</td> <td style="text-align:center;">87.5 p.a. 187.5 p.a.</td> </tr> <tr> <td style="text-align:center;">Years 9 through 12</td> <td style="text-align:center;">112.5 p.a. 212.5 p.a.</td> </tr> <tr> <td style="text-align:center;">Years 13 through 18</td> <td style="text-align:center;">125.0 p.a. 225.0 p.a.</td> </tr> </table> <p>*If Obligors senior unsecured long-term debt ratings fall below BBB- or Baa1 or if Enrons senior unsecured long-term debt ratings fall below BB+ or Baa1 and Enron has not provided a letter of credit from an institution rated at least A or A3 in an amount equal to 6% of the transaction amount.</p> <p>Commitment Fee: 15 bps</p> <p>(Renewal of 364 day facility plus decrease from \$14,428MM to \$6,156MM due to amortization; total deal size now \$113,570,182)</p> <p>Support = None</p> | | | | | Applicable Margin: | Rating | | Base Case Downgrade* | Years 1 through 4 | 82.5 p.a. 182.5 p.a. | Years 5 through 8 | 87.5 p.a. 187.5 p.a. | Years 9 through 12 | 112.5 p.a. 212.5 p.a. | Years 13 through 18 | 125.0 p.a. 225.0 p.a. | | | | | | | | | | |
| Applicable Margin: | Rating | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Base Case Downgrade* | | | | | | | | | | | | | | | | | | | | | | | | | |
| Years 1 through 4 | 82.5 p.a. 182.5 p.a. | | | | | | | | | | | | | | | | | | | | | | | | | |
| Years 5 through 8 | 87.5 p.a. 187.5 p.a. | | | | | | | | | | | | | | | | | | | | | | | | | |
| Years 9 through 12 | 112.5 p.a. 212.5 p.a. | | | | | | | | | | | | | | | | | | | | | | | | | |
| Years 13 through 18 | 125.0 p.a. 225.0 p.a. | | | | | | | | | | | | | | | | | | | | | | | | | |
| <p>448884 ENRON CORP (CONTINUED)</p> <p>Business/Activity: 4922 NATURAL GAS TRANSMISSION Obligor Rtg: 4+ Classification: Cur</p> | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Amounts in thousands: | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Facility No. | GFRN: | Risk Type: | US\$ | | | | | | | | | | | | | | | | | | | | | | | |
| 205252-1 | US205252-1 | Direct | 242,500 | | | | | | | | | | | | | | | | | | | | | | | |
| <table style="width:100%; border-collapse: collapse;"> <tr> <td style="text-align:left;">0 - 7 Dvs</td> <td style="text-align:left;">8 Dvs - 1 Mth</td> <td style="text-align:left;">>1 - 3 Mths</td> <td style="text-align:left;">>3 - 6 Mths</td> <td style="text-align:left;">>6Mth - 1Yr</td> <td style="text-align:left;">>1 - 3 Yrs</td> <td style="text-align:left;">>3 - 5 Yrs</td> <td style="text-align:left;">>5 - 8 Yrs</td> <td style="text-align:left;">>8 - 10 Yrs</td> <td style="text-align:left;">>10 - 15 Yrs</td> <td style="text-align:left;">>15 Yrs</td> </tr> <tr> <td style="text-align:right;">242,500</td> <td style="text-align:right;">242,500</td> <td style="text-align:right;">242,500</td> <td style="text-align:right;">242,500</td> <td style="text-align:right;">242,500</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> </table> | | | | | 0 - 7 Dvs | 8 Dvs - 1 Mth | >1 - 3 Mths | >3 - 6 Mths | >6Mth - 1Yr | >1 - 3 Yrs | >3 - 5 Yrs | >5 - 8 Yrs | >8 - 10 Yrs | >10 - 15 Yrs | >15 Yrs | 242,500 | 242,500 | 242,500 | 242,500 | 242,500 | | | | | | |
| 0 - 7 Dvs | 8 Dvs - 1 Mth | >1 - 3 Mths | >3 - 6 Mths | >6Mth - 1Yr | >1 - 3 Yrs | >3 - 5 Yrs | >5 - 8 Yrs | >8 - 10 Yrs | >10 - 15 Yrs | >15 Yrs | | | | | | | | | | | | | | | | |
| 242,500 | 242,500 | 242,500 | 242,500 | 242,500 | | | | | | | | | | | | | | | | | | | | | | |
| <p>Issuing Unit: HOUSTON PMMM NEW</p> <p>Commercial Approving Unit: HOUSTON PMMM Facility Risk Rating: 4+</p> <p>Sovereign Approving Unit: Classification: Cur</p> <p>Booking Unit: NEW YORK CBNA Committed Amount: 242,500</p> <p>Structured for Sale: RESTRICTED - BORROWERS CONSENT ONLY Committed Unit: DECEMBER 22, 2001</p> <p>Facility Description: Expiry Date: DECEMBER 22, 2001</p> <p>TERM LOAN</p> <p>Borrower: Caymus Trust</p> <p>Uplift Fee: 20 bps</p> <p>Pricing: CBOR + 86 bps</p> <p>Anticipated Closing Date: December 22, 2000</p> <p>Maturity Date: One year from Closing</p> <p>Support = None</p> | | | | | | | | | | | | | | | | | | | | | | | | | | |

CONFIDENTIAL

CITI-SPSI 0128920

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|--|------------|--------------------------------------|-------------------|-----------------------|--------------------|
| ENRON CORPORATION | | Originating Unit HOUSTON | GPCO 900007002 | CA No. 2009/128771 | PAGE No 7 of 21 |
| New Facilities Details | | | | | |
| 446084 ENRON CORP | | (CONTINUED) | | | |
| Business/Activity: 4822 NATURAL GAS TRANSMISSION | | Obliigor Rtg: 4+ Classification: Cur | | | |
| Amounts in thousands: | | | | | |
| Facility No. | GERM: | Risk Types: | US\$ | | |
| 205253-1 | US205253-1 | Direct | 7,500 | | |
| 0 - 7 Days 8 Dns - 1 Mth >1 - 3 Mths >3 - 6 Mths >6Mth - 1Yr >1 - 3 Yrs >3 - 5 Yrs >5 - 8 Yrs >8 - 10 Yrs >10 - 15 Yrs >15 Yrs | | | | | |
| 7,500 7,500 7,500 7,500 7,500 | | | | | |
| Extending Unit: HOUSTON PM&M | | NEW | | | |
| Commercial Approving Unit: HOUSTON PM&M | | Facility Risk Rating: 4+ | | | |
| Sovereign Approving Unit: | | Classification: Cur | | | |
| Booking Unit: NEW YORK CSNA | | Committed Amount: 7,500 | | | |
| | | Committed Unit: DECEMBER 22, 2001 | | | |
| | | Expiry Date: DECEMBER 22, 2001 | | | |
| STRUCTURED FOR SALE: RESTRICTED - BORROWERS CONSENT ONLY | | | | | |
| <u>Facility Description:</u> | | | | | |
| TERM LOAN | | | | | |
| Borrower: Caymus Trust | | | | | |
| Upfront Fee: 20 bps | | | | | |
| Pricing: 18% | | | | | |
| Anticipated Closing Date: December 22, 2009 | | | | | |
| Maturity Date: One year after Closing | | | | | |
| <u>Support:</u> | | | | | |
| Type: VERBAL GUARANTEES | | Percentage: 100.00 | | | |
| Support Provider: 446084 ENRON CORP | | | | | |
| Amounts in thousands: | | | | | |
| Facility No. | GERM: | Risk Types: | US\$ | | |
| 205254-1 | US205254-1 | Direct | 68,300 | | |
| 0 - 7 Days 8 Dns - 1 Mth >1 - 3 Mths >3 - 6 Mths >6Mth - 1Yr >1 - 3 Yrs >3 - 5 Yrs >5 - 8 Yrs >8 - 10 Yrs >10 - 15 Yrs >15 Yrs | | | | | |
| 68,300 68,300 68,300 68,300 68,300 68,300 68,300 68,300 | | | | | |
| Extending Unit: HOUSTON PM&M | | NEW | | | |
| Commercial Approving Unit: HOUSTON PM&M | | Facility Risk Rating: 4+ | | | |
| Sovereign Approving Unit: | | Classification: Cur | | | |
| Booking Unit: NEW YORK CSNA | | Committed Amount: 68,300 | | | |
| | | Committed Unit: MARCH 31, 2008 | | | |
| | | Expiry Date: MARCH 31, 2008 | | | |
| RECYCLING | | | | | |
| STRUCTURED FOR SALE: RESTRICTED - BORROWERS CONSENT ONLY | | | | | |
| <u>Facility Description:</u> | | | | | |
| SHORT TERM LOANS | | | | | |
| Turbo Part | | | | | |
| Borrower: E-Heat Generation, LLC | | | | | |
| Upfront Fee: 50 bps | | | | | |
| Pricing: LIBOR + 75 bps (Phase I and II) | | | | | |
| LIBOR + 125 bps (Phase III) | | | | | |
| Anticipated Closing Date: December 14, 2009 | | | | | |
| Availability Maturity Date: March 31, 2008 | | | | | |
| Final Maturity Date: March 31, 2008 | | | | | |

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| ENRON CORPORATION | | Originating Unit HOUSTON | GPCID 800007002 | CA No 2000/129771 | PAGE No 8 of 21 |
| New Facilities Details | | | | | |
| Support = None | | | | | |
| 44884 ENRON CORP | | (CONTINUED) | | Obligor Rtg: ++ Classification: Cur | |
| Business/Activity: 4822 NATURAL GAS TRANSMISSION | | | | | |
| Amounts in thousands: | | | | | |
| Facility No. | GFERN: | Risk Type: | US\$ | | |
| 205255-1 | US205255-1 | Direct | 6,200 | | |
| 0 - 7 Days 8 Days - 1 Mth >1 - 3 Mths >3 - 6 Mths >6Mth - 1Yr >1 - 3 Yrs >3 - 5 Yrs >5 - 8 Yrs >8 - 10 Yrs >10 - 15 Yrs >15 Yrs | | | | | |
| 6,200 6,200 6,200 6,200 6,200 6,200 6,200 6,200 6,200 | | | | | |
| Extending Unit: HOUSTON PM&M | | NEW | | Facility Risk Rating: 4 | |
| Commercial Approving Unit: HOUSTON PM&M | | | | Classification: Cur | |
| Sovereign Approving Unit: | | | | Committed Amount: 6,200 | |
| Booking Unit: NEW YORK CBNA | | | | Committed Until: MARCH 31, 2008 | |
| | | | | Expiry Date: MARCH 31, 2008 | |
| REVOLVING | | | | | |
| STRUCTURED FOR SALE, RESTRICTED - BORROWERS CONSENT ONLY | | | | | |
| <u>Facility Description:</u> | | | | | |
| SHORT TERM LOANS | | | | | |
| Turbo Park | | | | | |
| Borrower: E-lead Generation, LLC | | | | | |
| Uplift Fee: 50 bps | | | | | |
| Pricing: LIBOR + 100 bps (Phase I, II) | | | | | |
| LIBOR + 300 bps (Phase III) | | | | | |
| Anticipated Closing Date: December 14, 2008 | | | | | |
| Availability Maturity Date: March 31, 2004 | | | | | |
| Final Maturity Date: March 31, 2008 | | | | | |
| Support = None | | | | | |
| Customer Name: ENRON FUNDING CORP | | GPCID: 10924223 | | Obligor Rtg: ++ Classification: Cur | |
| Business/Activity: 4822 NATURAL GAS TRANSMISSION | | | | | |
| Ownership: 109.00% ENRON CORP - 44884 | | | | | |
| Amounts in thousands: | | | | | |
| Facility No. | GFERN: | Risk Type: | US\$ | | |
| 174438-4 | US174438-4 | Direct | 38,000 | | |
| 0 - 7 Days 8 Days - 1 Mth >1 - 3 Mths >3 - 6 Mths >6Mth - 1Yr >1 - 3 Yrs >3 - 5 Yrs >5 - 8 Yrs >8 - 10 Yrs >10 - 15 Yrs >15 Yrs | | | | | |
| 38,000 38,000 38,000 | | | | | |
| Extending Unit: HOUSTON PM&M | | INCREASE by 0 | | Facility Risk Rating: ++ | |
| Commercial Approving Unit: HOUSTON PM&M | | | | Classification: Cur | |
| Sovereign Approving Unit: | | | | Committed Amount: 38,000 | |
| Booking Unit: NEW YORK CBNA | | | | Committed Until: MARCH 28, 2007 | |
| | | | | Expiry Date: MARCH 28, 2007 | |
| REVOLVING | | | | | |
| <u>Facility Description:</u> | | | | | |
| SHORT TERM LOANS | | | | | |
| Citibank's co-arranger's share of the following facility: | | | | | |
| Borrower: Enron Funding Corp. (a new bankruptcy remote special purpose entity specifically established to act as issuer of A1/P1 commercial paper) | | | | | |
| Arranger: Salomon Smith Barney and Barclays Bank | | | | | |

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|--|-----------------------------|-------------------------------------|------------------------------|--------------------|
| ENRON CORPORATION | Originating Unit HOUSTON | GFCD 8000007002 | CA No 1000128771 | PAGE No 9 of 21 |
| New Facilities Details | | | | |
| Admin Agent: Calvert, N.A. | | | | |
| Facility: \$350MM 364-day commercial paper backstop facility | | | | |
| Closing Date: December 31, 1999 | | | | |
| Effective Date: March 8, 2000 | | | | |
| Maturity Date: December 27, 2000 to be extended to March 28, 2001 at the customer's request to coincide with the Insurance Policy Termination | | | | |
| Guarantee: Enron Corp. will guarantee Enron Funding Corp's obligations. | | | | |
| Credit Wrap: Provided on a several basis - \$250MM each by AXA Global Reins S.A. and Winterthur International Insurance Co. Ltd. Each is rated AA. Because the A1P1 CP rating is based on the ratings of the insurance companies, S&P has advised that the liquidity backstop amount only needs to be 75% of the \$500MM program amount. | | | | |
| Proposed Pricing: Undrawn: 8 bps Drawn: 20 bps Usage Fee: 4 bps, if usage is greater than or equal to 33% Uplift Fee: 10 bps for \$405MM and 7 bps for \$250MM | | | | |
| (Extend maturity date from December 27, 2000 to March 28, 2001) Support = None | | | | |
| Customer Name: ENRON METALS LIMITED | | GFCD: 1000418883 | | |
| Business/Activity: 8221 COMMODITY CONTRACTS BROKERS, DEALER | | Obligor Rtg: 4+ Classification: Cur | | |
| Ownership: 100.00% ENRON CORP - 468884 | | | | |
| Facility No. | GFCD | Risk Type | Amounts in thousands: | |
| 204074-1 | US204074-8 | Clearing | USD | 200,000 |
| Extending Unit: | GRS PM&M LCNCCN | | NEW | |
| Commercial Approving Unit: | HOUSTON PM&M | | Facility Risk Rating: | 4+ |
| Sovereign Approving Unit: | | | Classification: | Cur |
| Booking Unit: | LCNCCN | | Committed: | No |
| Facility Description: DAYLIGHT OVERDRAFTS Daylight Overdrafts Support = None | | | | |

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|---|------------------------------|------------------------------|---|---------------------|---------------------|
| ENRON CORPORATION | | Originating Unit HOUSTON | GFCD 900007002 | CA No 2000/12871 | PAGE No 10 of 21 |
| New Facilities Details | | | | | |
| Customer Name: ENRON NORTH AMERICA CORP Business/Activity: 4824 NATURAL GAS DISTRIBUTION Ownership: 100.0% ENRON CORP - 446884 | | | GFCD#: 100147283 Obligor Rtg: 4+ Classification: Cur | | |
| Facility No. | GFCD: | Risk Type: | Amounts in thousands: US\$ | | |
| 121827-8 | US1015419-1 US1015419-1SR | Pre-settlement Settlement | 140,000 | 20,000 | |
| Max Tenor: 10 Years | | | | | |
| 0 - 7 Days 8 Dns - 1 Mth >1 - 3 Mths >3 - 6 Mths >6Mth - 1Yr >1 - 3 Yrs >3 - 5 Yrs >5 - 8 Yrs >8 - 10 Yrs >10 - 15 Yrs >15 Yrs | | | | | |
| 140,000 140,000 140,000 140,000 140,000 140,000 140,000 7,000 1,700 | | | | | |
| Extending Unit: | | GRS CAP MKTS/TR NY | INCREASE by | | 81,000 |
| Commercial Approving Unit: | | HOUSTON PM&M | Facility Risk Rating: | | 4+ |
| Sovereign Approving Unit: | | | Classification: | | Cur |
| Booking Unit: | | NEW YORK CBNA | Committed: | | No |
| Facility Description: | | | | | |
| TRADED PRODUCTS/DERIVATIVES | | | | | |
| For: OPTIONS - COMMODITY, SWAPS - COMMODITIES, COMMODITY FORWARDS, COMMODITY SWAPTION, SAFES, ASSET SWAPS - XCCY, SWAPS - XCCY, SYNTHETICS - XCCY, EQUITY OPTIONS, EQUITY SWAPS, OPTIONS - INDEX, EQUITY FORWARDS, INDEX FORWARDS, ASSET SWAP SINGLE CCY, FRA | | | | | |
| Pre-settlement risk associated with various derivative products available to Enron North America Corp, and other Enron Corp subsidiaries with a tenor up to five years when guaranteed by Enron Corp. | | | | | |
| (Increased 320MM from 35MM to 37MM) 3/22/00 - \$4.1MM to cover existing excess plus \$15.5MM to cover purchase of credit default protection from Enron; increase from 175MM to \$140MM to cover existing excess) | | | | | |
| Support = None | | | | | |
| Facility No. | GFCD: | Risk Type: | Amounts in thousands: US\$ | | |
| 179041-3 | US179041-3 US179041-5 | Pre-settlement Settlement | 10,000 | 0 | |
| 0 - 7 Days 8 Dns - 1 Mth >1 - 3 Mths >3 - 6 Mths >6Mth - 1Yr >1 - 3 Yrs >3 - 5 Yrs >5 - 8 Yrs >8 - 10 Yrs >10 - 15 Yrs >15 Yrs | | | | | |
| 10,000 10,000 10,000 10,000 10,000 10,000 10,000 10,000 | | | | | |
| Extending Unit: | | GRS CAP MKTS/TR NY | INCREASE by | | 7,000 |
| Commercial Approving Unit: | | HOUSTON PM&M | Facility Risk Rating: | | 4+ |
| Sovereign Approving Unit: | | | Classification: | | Cur |
| Booking Unit: | | NEW YORK CBNA | Committed: | | No |
| | | | Expiry Date: | | NOVEMBER 28, 2003 |
| Facility Description: | | | | | |
| TRADED PRODUCTS/DERIVATIVES | | | | | |
| For: SWAPS - COMMODITIES | | | | | |
| (32MM carved out by Cap Markets from the 0121827 to cover long dated transactions; increased 27MM to cover passive excess) | | | | | |
| Support = None | | | | | |

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| ENRON CORPORATION | | Originating Unit HOUSTON | GFCD 900007002 | CA No 2000/128771 | PAGE No 11 of 21 |
| New Facilities Details | | | | | |
| Customer Name: ENRON CREDIT CORP LIMITED Business/Activity: 4911 ELECTRIC SERVICES Ownership: 100.00% ENRON CORP - 446084 | | | GFCD: 100130075 Obligor Rtg: 4+ Classification: Cur | | |
| Facility No. 204045-1 | GFCD: US204045-3 US204045-5 | Risk Type: Prepayment Settlement | Amounts in thousands: USD 10,000 0 | | |
| Max Tenor: 5 Years | | | | | |
| 0 - 7 Days | 8 Days - 1 Mth | >1 - 3 Mths | >3 - 6 Mths | >6Mth - 1Yr | >1 - 3 Yrs >3 - 5 Yrs >5 - 8 Yrs >8 - 10 Yrs >10 - 15 Yrs >15 Yrs |
| 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 |
| Extending Unit: GRB CAP MKTS/TR NY | | NEW | | Facility Risk Rating: 4+ | |
| Commercial Approving Unit: HOUSTON PM&M | | | | Classification: Cur | |
| Sovereign Approving Unit: | | NEW YORK CBNA | | Committed: No | |
| Booking Unit: | | | | | |
| Facility Description: | | | | | |
| TRADED PRODUCTS/DERIVATIVES For: OPTIONS - COMMODITY, SWAPS - COMMODITIES, COMMODITY FORWARDS, COMMODITY SWAPTION, FX, FX OPTIONS, SAFES, ASSET SWAPS - XCCY, SWAPS - XCCY, SYNTHETICS - XCCY, FX LONG DATED, FUTURES - EQUITY, FUTURES - INDEX, FUTURES - FX, FUTURES - DEPOSITS, FUTURES - COMMODITY, FUTURES - BOND, ASSET SWAP - SINGLE CCY, FRA, OPTIONS - INTEREST RATE, SWAPS - INTEREST RATE, SWAPTION - CASH SETTLE, SWAPTION - SWAP SETTLE, OPTION ON FRA, SYNTHETICS - SINGLE CCY, OPTIONS - BOND, OPTIONS - GOVT BOND, OPTIONS ON FUTURES, SWAPY OPTIONS, LOANS TRADED - WITHOUT SETTLEMENT, LOANS TRADED - WITH SETTLEMENT, CREDIT SWAPS, HYBRID SWAPS, HYBRID OPTIONS. | | | | | |
| ISDA in process. Need 90 day deferral. Support # None | | | | | |
| Customer Name: GARDEN STATE PAPER COMPANY, LLC Business/Activity: 1844 INDUSTRIAL BUILDINGS & WAREHOUSES Ownership: 100.00% ENRON CORP - 446084 | | | GFCD: 100295327 Obligor Rtg: 5 Classification: Cur | | |
| Facility No. 203722-1 | GFCD: US203722-1 | Risk Type: Direct | Amounts in thousands: USD 4,000 | | |
| 0 - 7 Days | 8 Days - 1 Mth | >1 - 3 Mths | >3 - 6 Mths | >6Mth - 1Yr | >1 - 3 Yrs >3 - 5 Yrs >5 - 8 Yrs >8 - 10 Yrs >10 - 15 Yrs >15 Yrs |
| 4,000 | 4,000 | 4,000 | 4,000 | 4,000 | 4,000 |
| Extending Unit: HOUSTON PM&M | | NEW | | Facility Risk Rating: 5 | |
| Commercial Approving Unit: HOUSTON PM&M | | | | Classification: Cur | |
| Sovereign Approving Unit: | | NEW YORK CBNA | | Committed Amount: 4,000 | |
| Booking Unit: | | | | Committed Unit: DECEMBER 15, 2007 | |
| | | | | Expiry Date: DECEMBER 15, 2007 | |
| REVCYLING STRUCTURED FOR SALE RESTRICTED - BORROWERS CONSENT ONLY | | | | | |
| Facility Description: REVCYLING CREDIT Borrower: Garden State Paper Company, LLC | | | | | |
| Facility: Secured 58M\$ 7-year revolving credit facility (with a 58M\$ sublimit for borrowings and a 22M\$ sublimit for LCs) | | | | | |
| Security: All property of the Borrower and its subs. Additionally, all membership interests and other equity interests in the Borrower will be pledged, and each sub will unconditionally guarantee the facility. | | | | | |
| Parent Support: Enron Corp. will provide a satisfactory environmental indemnity and a satisfactory warranty of title regarding the Borrower's assets and agree (i) that payments to the Parent under hedging arrangements with the Borrower will be subordinated to the facility, (ii) that the Parent will, at all times, own a majority of the Borrower, (iii) to contribute up to 22M\$ in December, 2002 or, if earlier, upon acceleration of the facility or the occurrence of a bankruptcy event with respect to the Borrower, in each case such contribution to be paid directly to the Paying Agent, and (iv) to provide a six month debt service reserve in the form of an unconditional credit line to the Borrower. | | | | | |

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| ENRON CORPORATION | Originating Unit HOUSTON | GFCID 900007002 | CA No 2000 / 12971 | PAGE No 12 of 21 | | | | | | | | | | | | | | | | | | | | |
| New Facilities Details | | | | | | | | | | | | | | | | | | | | | | | | |
| <p>Amortization: Total \$41MM commitment will amortize straight line from \$24.5MM starting after 2 years to nil after 7 years.</p> <p>Uplift Fee: 1%</p> <p>Co-Arrangers: Salomon Smith Barney Inc. and Chase Securities Inc.</p> <p>Co-Admin Agents: Citibank, N.A. and The Chase Manhattan Bank</p> <p>Paying Agent: Citibank, N.A.</p> <p>Lenders: Citibank, N.A. and The Chase Manhattan Bank</p> <p>Purpose: General corporate purposes, but not to purchase or carry margin stock.</p> <p>Anticipated Closing Date: December 15, 2007</p> <p>Maturity Date: 7 years from Closing</p> <p>Commitment Fee: 14% per annum on the unused commitments</p> <table style="width:100%; border-collapse: collapse;"> <tr> <td style="text-align:left;">Pricing:</td> <td style="text-align:left;">Period</td> <td style="text-align:left;">Base Rate Margin (p.a.)</td> <td style="text-align:left;">LIBOR Margin (p.a.)</td> </tr> <tr> <td></td> <td>Years 1-2</td> <td>0.570%</td> <td>1.370%</td> </tr> <tr> <td></td> <td>Years 3-6</td> <td>0.585%</td> <td>1.505%</td> </tr> <tr> <td></td> <td>Years 8-7</td> <td>0.625%</td> <td>1.625%</td> </tr> </table> <p>*The last day of the relevant interest period will determine which LIBOR margin applies. Support: None</p> | | | | | Pricing: | Period | Base Rate Margin (p.a.) | LIBOR Margin (p.a.) | | Years 1-2 | 0.570% | 1.370% | | Years 3-6 | 0.585% | 1.505% | | Years 8-7 | 0.625% | 1.625% | | | | |
| Pricing: | Period | Base Rate Margin (p.a.) | LIBOR Margin (p.a.) | | | | | | | | | | | | | | | | | | | | | |
| | Years 1-2 | 0.570% | 1.370% | | | | | | | | | | | | | | | | | | | | | |
| | Years 3-6 | 0.585% | 1.505% | | | | | | | | | | | | | | | | | | | | | |
| | Years 8-7 | 0.625% | 1.625% | | | | | | | | | | | | | | | | | | | | | |
| <p>100003537 GARDEN STATE PAPER COMPANY, LLC (CONTINUED) Business Activity: 1541 INDUSTRIAL BUILDINGS & WAREHOUSES Obligor (Type): S Classification: Cur</p> | | | | | | | | | | | | | | | | | | | | | | | | |
| Amounts in thousands: | | | | | | | | | | | | | | | | | | | | | | | | |
| Facility No. | CFRS: | Risk Type: | 1133 | | | | | | | | | | | | | | | | | | | | | |
| 203727-1 | US203727-1 | Direct | 20,500 | | | | | | | | | | | | | | | | | | | | | |
| <table style="width:100%; border-collapse: collapse;"> <tr> <td style="text-align:left;">0-7 Yrs</td> <td style="text-align:left;">8 Yrs - 1 Yr</td> <td style="text-align:left;">>1-1.5 Yrs</td> <td style="text-align:left;">>1.5-2 Yrs</td> <td style="text-align:left;">>2-3 Yrs</td> <td style="text-align:left;">>3-4 Yrs</td> <td style="text-align:left;">>4-5 Yrs</td> <td style="text-align:left;">>5-10 Yrs</td> <td style="text-align:left;">>10-15 Yrs</td> <td style="text-align:left;">>15 Yrs</td> </tr> <tr> <td style="text-align:right;">20,500</td> </tr> </table> | | | | | 0-7 Yrs | 8 Yrs - 1 Yr | >1-1.5 Yrs | >1.5-2 Yrs | >2-3 Yrs | >3-4 Yrs | >4-5 Yrs | >5-10 Yrs | >10-15 Yrs | >15 Yrs | 20,500 | 20,500 | 20,500 | 20,500 | 20,500 | 20,500 | 20,500 | 20,500 | 20,500 | 20,500 |
| 0-7 Yrs | 8 Yrs - 1 Yr | >1-1.5 Yrs | >1.5-2 Yrs | >2-3 Yrs | >3-4 Yrs | >4-5 Yrs | >5-10 Yrs | >10-15 Yrs | >15 Yrs | | | | | | | | | | | | | | | |
| 20,500 | 20,500 | 20,500 | 20,500 | 20,500 | 20,500 | 20,500 | 20,500 | 20,500 | 20,500 | | | | | | | | | | | | | | | |
| <p>Extending Unit: HOUSTON PM63A Commercial Approving Unit: HOUSTON PM63A Sovereign Approving Unit: Booking Unit: NEW YORK CSMA</p> | | | <p>NEW Facility Risk Rating: 5 Classification: Cur Committed Amount: 20,500 Committed Until: DECEMBER 15, 2007 Expiry Date: DECEMBER 15, 2007</p> | | | | | | | | | | | | | | | | | | | | | |
| <p>REVOLVING STRUCTURED FOR SALE RESTRICTED - BORROWERS CONSENT ONLY</p> <p>Facility Description: TERM LOAN Borrower: Garden State Paper Company, LLC</p> <p>Facility: Secured \$41MM 7-year multi-draw term facility, with non-revolving borrowings permitted during the first 2 years.</p> <p>Security: All property of the Borrower and its subsidiaries. Additionally, all membership interests and other equity interests in the Borrower will be pledged, and each will unconditionally guarantee the facility.</p> <p>Parent Support: Enron Corp. will provide a satisfactory environmental indemnity and a satisfactory warranty of title regarding the Borrower's assets and agree (a) that payments to the Parent under hedging arrangements with the Borrower will be subordinated to the facility, (b) that the Parent will, at all times, own a majority of the Borrower, (c) to contribute up to \$20MM in December, 2008 or, if earlier, upon expiration of the facility or the occurrence of a bankruptcy event with respect to the Borrower, in each case such contribution to be paid directly to the Paying Agent, and (d) to provide a six month debt service reserve in the form of an unconditional credit line to the Borrower.</p> | | | | | | | | | | | | | | | | | | | | | | | | |

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|---|-----------------------------|------------------------|-----------------------|---------------------|
| ENRON CORPORATION | Originating Unit HOUSTON | G/FCS 9000007002 | CA No. 2000/128771 | PAGE NO 13 of 21 |
| New Facilities Details | | | | |
| <p>Amortization: Total \$496MM commitment will amortize straight line from \$24.5MM starting after 2 years to nil after 7 years.</p> | | | | |
| <p>Upront Fee: 1%</p> | | | | |
| <p>Co-Arrangers: Salomon Smith Barney Inc. and Chase Securities Inc.</p> | | | | |
| <p>Co-Admin Agents: Citibank, N.A. and The Chase Manhattan Bank</p> | | | | |
| <p>Paying Agent: Citibank, N.A.</p> | | | | |
| <p>Lenders: Citibank, N.A. and The Chase Manhattan Bank</p> | | | | |
| <p>Purpose: General corporate purposes, but not to purchase or carry margin stock. Up to \$32MM may be used to make a distribution to Enron North America at closing.</p> | | | | |
| <p>Anticipated Closing Date: December 15, 2000</p> | | | | |
| <p>Maturity Date: 7 years from Closing</p> | | | | |
| <p>Commitment Fee: 114% per annum on the unused commitments</p> | | | | |
| Pricing: | Period | Base Rate Margin (3-M) | LIBOR Margin (3-M)* | |
| | Years 1-2 | 0.375% | 1.375% | |
| | Years 3-5 | 0.500% | 1.500% | |
| | Years 6-7 | 0.625% | 1.625% | |
| <p>*The last day of the relevant interest period will determine which LIBOR margin applies.</p> | | | | |
| <p>Support = None</p> | | | | |

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| ENRON CORPORATION | | Originating Unit HOUSTON | | GFCID 900607002 | | CA No. 2000 126771 | | Page No. 14 of 21 | | | |
|---|---------------------|-----------------------------|-------------|---------------------|---------|-----------------------|--------------------|----------------------|----------------------|-----------------------|------------------|
| Facilities Summary by Obligor - All amounts are US\$MM | | | | | | | | | | | |
| Customer Id | Extending Unit | Approving Unit | Facility Id | Risk Type Rating | Fac Amt | Up To 6 Mths | 6 Mths - 1 Year | 1 Year - 3 Years | 3 Years - 5 Years | 5 Years - 10 Years | Over 10 Years |
| 100182578 CONTRACTUAL ASSURANCE | | | | | | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | HOUSTON PM&M | 146344-3 | Dir 4+ | 1.90 | 1.90 | 1.90 | | | | |
| HOUSTON PM&M | HOUSTON PM&M | HOUSTON PM&M | 146345-3 | Dir 4+ | 0.64 | 0.64 | 0.64 | | | | |
| HOUSTON PM&M | HOUSTON PM&M | HOUSTON PM&M | 146358-3 | Dir 4+ | 0.20 | 0.20 | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | HOUSTON PM&M | 146359-3 | Dir 4+ | 0.27 | 0.27 | | | | | |
| GRB CAP MKTS/TR NY | HOUSTON PM&M | HOUSTON PM&M | 131069-4 | Pre 4+ | 0.05 | 0.05 | | | | | |
| GRB CAP MKTS/TR NY | HOUSTON PM&M | HOUSTON PM&M | 135843-3 | Pre 4+ | 0.15 | 0.15 | 0.15 | | | | |
| GRB CAP MKTS/TR NY | HOUSTON PM&M | HOUSTON PM&M | 135843-3 | Set 4+ | 0.08 | | | | | | |
| Customer Totals | | | | | 3.20 | 3.20 | 2.69 | | | | |
| 100128278 DASHIC POWER | | | | | | | | | | | |
| GRB PROJ FINANCE LO | GRB PROJ FINANCE LO | GRB PROJ FINANCE LO | 120790-10 | Dir 5 | 33.55 | 33.55 | 33.55 | 33.55 | 33.55 | 33.55 | |
| GRB PROJ FINANCE LO | GRB PROJ FINANCE LO | GRB PROJ FINANCE LO | 126752-6 | Dir 5 | 7.86 | 7.86 | 7.86 | 7.14 | 5.43 | 4.29 | |
| GRB PROJ FINANCE LO | MUMBAI | MUMBAI | 127805-6 | Dir 5 | 0.53 | 0.53 | 0.53 | 0.53 | 0.53 | 0.49 | 0.27 |
| GRB PROJ FINANCE LO | MUMBAI | MUMBAI | 127806-8 | Dir 5 | 3.51 | 3.51 | 3.51 | 3.51 | 3.51 | 3.75 | |
| Customer Totals | | | | | 45.44 | 45.44 | 45.44 | 44.73 | 44.02 | 46.08 | 0.27 |
| 1001248978 DELTA ENERGY CORPORATION | | | | | | | | | | | |
| GRB CAP MKTS/TR NY | HOUSTON PM&M | HOUSTON PM&M | 177815-4 | Pre 4+ | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | | |
| Customer Totals | | | | | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | | |
| 100122291 EMPRESA DE GENERACION ELECTRICA BAHIA LAS PALMAS S A | | | | | | | | | | | |
| EM GRB PANAMA | EM GRB PANAMA | EM GRB PANAMA | 200592-1 | Dir 5+ | 7.50 | 7.50 | 7.50 | 7.50 | 7.50 | 7.50 | |
| Customer Totals | | | | | 7.50 | 7.50 | 7.50 | 7.50 | 7.50 | 7.50 | |
| 100122291 EMPRESA DE GENERACION ELECTRICA BAHIA LAS PALMAS S A | | | | | | | | | | | |
| EM GEN CORP TTLC-SP | HOUSTON PM&M | HOUSTON PM&M | 149131-1 | Con 4+ | 0.05 | 0.05 | | | | | |
| EM GEN CORP TTLC-SP | HOUSTON PM&M | HOUSTON PM&M | 149132-1 | Con 4+ | 0.16 | 0.16 | 0.16 | | | | |
| EM GEN CORP TTLC-SP | HOUSTON PM&M | HOUSTON PM&M | 149133-1 | Con 4+ | 0.08 | 0.08 | 0.08 | | | | |
| EM GEN CORP TTLC-SP | HOUSTON PM&M | HOUSTON PM&M | 149134-1 | Con 4+ | 0.34 | 0.34 | 0.34 | | | | |
| EM GEN CORP TTLC-SP | HOUSTON PM&M | HOUSTON PM&M | 149130-2 | Pre 5- | 0.04 | 0.04 | | | | | |
| EM GEN CORP TTLC-SP | HOUSTON PM&M | HOUSTON PM&M | 149130-2 | Set 6- | 0.90 | | | | | | |
| Customer Totals | | | | | 0.54 | 0.54 | 0.50 | | | | |
| 100122291 EMPRESA DE GENERACION ELECTRICA BAHIA LAS PALMAS S A | | | | | | | | | | | |
| EM LCG SYDNEY | HOUSTON PM&M | HOUSTON PM&M | 149237-1 | Dir 4+ | 0.00 | 0.00 | | | | | |
| EM LCG SYDNEY | HOUSTON PM&M | HOUSTON PM&M | 149235-2 | Con 4+ | 0.11 | 0.11 | | | | | |
| EM GRB SYDNEY | HOUSTON PM&M | HOUSTON PM&M | 149238-1 | Dir 4+ | 2.93 | | | | | | |
| Customer Totals | | | | | 0.11 | 0.11 | | | | | |
| 100122291 EMPRESA DE GENERACION ELECTRICA BAHIA LAS PALMAS S A | | | | | | | | | | | |
| EM GRB SYDNEY | HOUSTON PM&M | HOUSTON PM&M | 149238-1 | Dir 4+ | 2.93 | | | | | | |
| Customer Totals | | | | | 0.00 | | | | | | |
| 100122291 EMPRESA DE GENERACION ELECTRICA BAHIA LAS PALMAS S A | | | | | | | | | | | |
| SOUTH DAKOTA | HOUSTON PM&M | HOUSTON PM&M | 188333-2 | Con 4+ | 1.00 | 1.00 | | | | | |
| Customer Totals | | | | | 1.00 | 1.00 | | | | | |
| 100122291 EMPRESA DE GENERACION ELECTRICA BAHIA LAS PALMAS S A | | | | | | | | | | | |
| GRB PM&M CALGARY | HOUSTON PM&M | HOUSTON PM&M | 191877-1 | Dir 4+ | 3.25 | 3.25 | | | | | |
| Customer Totals | | | | | 3.25 | 3.25 | | | | | |

| ENRON CORPORATION | | Originating Unit | IGCID | CA No. | Page No. | | | | | | |
|---|----------------|------------------|-------------|------------------|----------|--------------|--------|---------|---------|---------------|-------|
| | | HOUSTON | 900007002 | 1200 726721 | 15 of 21 | | | | | | |
| Facilities Summary by Obligor - All amounts are US\$MM | | | | | | | | | | | |
| Customer Id | Extending Unit | Approving Unit | Facility Id | Risk Type Rating | Fac Amt. | Up To 6 Mths | 1 Year | 3 Years | 5 Years | Over 10 Years | |
| 100726721 ENRON CAPITAL TRADE SERVICES INTERNATIONAL CORP | | | | | | | | | | | |
| ORR | | | | | | | | | | | |
| EM GRB SINGAPORE | HOUSTON PM&M | | 148204-2 | Pre 4+ | 0.50 | 0.50 | | | | | |
| EM GRB SINGAPORE | HOUSTON PM&M | | 148204-2 | Set 4+ | 2.00 | | | | | | |
| EM GRB SINGAPORE | HOUSTON PM&M | | 148203-2 | CV 4+ | 20.00 | | | | | | |
| Customer Totals | | | | | | 0.50 | | | | | |
| 100190581 ENRON CAPITAL TRADE SERVICES INTERNATIONAL CORP | | | | | | | | | | | |
| ORR | | | | | | | | | | | |
| GRB PRGX OVO | HOUSTON PM&M | | 129118-1 | CV 4+ | 1.21 | | | | | | |
| Customer Totals | | | | | | 0.00 | | | | | |
| 100726721 ENRON CAPITAL TRADE SERVICES INTERNATIONAL CORP | | | | | | | | | | | |
| ORR | | | | | | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 148437-1 | DR 4+ | 24.25 | 24.25 | 24.25 | 24.25 | | | |
| GRB NY SECURITIZATI | HOUSTON PM&M | | 148442-3 | DR 4+ | 6.16 | 6.16 | 6.16 | | | | |
| INTL PERSONAL BANKI | HOUSTON PM&M | | 148448-1 | DR 4+ | 3.00 | 3.00 | 3.00 | | | | |
| GRB NY SECURITIZATI | HOUSTON PM&M | | 178757-1 | DR 2 | 24.25 | 24.25 | 24.25 | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 184505-1 | DR 4+ | 46.87 | 46.87 | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 184508-1 | DR 4+ | 33.33 | 33.33 | 33.33 | 33.33 | | | |
| GRB NY SECURITIZATI | HOUSTON PM&M | | 202731-2 | DR 4+ | 30.00 | 30.00 | 30.00 | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 205252-1 | DR 4+ | 242.50 | 242.50 | 242.50 | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 205253-1 | DR 4+ | 7.50 | 7.50 | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 205256-1 | DR 4+ | 68.80 | 68.80 | 68.80 | 68.80 | 68.80 | 68.80 | |
| HOUSTON PM&M | HOUSTON PM&M | | 205255-1 | DR 4 | 8.20 | 8.20 | 8.20 | 8.20 | 8.20 | 8.20 | |
| GRB PRXB LONDON | HOUSTON PM&M | | 152384-1 | Con 5+ | 8.04 | 8.04 | | | | | |
| GRB PRXB LONDON | HOUSTON PM&M | | 152387-3 | Con 5+ | 0.01 | 0.01 | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 146024-2 | Con 4+ | 0.20 | 0.20 | 0.20 | | | | |
| GRB GTS CM WRLD LHM | HOUSTON PM&M | | 146440-2 | Con 4+ | 5.60 | 5.60 | | | | | |
| GRB GTS CM CORP ACH | HOUSTON PM&M | | 146447-1 | Con 4+ | 12.50 | 12.50 | | | | | |
| GRB GTS CM CORP ACH | HOUSTON PM&M | | 146448-2 | Con 4+ | 43.00 | 43.00 | | | | | |
| GRB CAP MKTS/TR NY | HOUSTON PM&M | | 128350-2 | Pre 4+ | 5.00 | 5.00 | 5.00 | 5.00 | 5.00 | 3.00 | |
| GRB CAP MKTS/TR NY | HOUSTON PM&M | | 174434-1 | Pre 4+ | 37.50 | 37.50 | 37.50 | 37.50 | 37.50 | | |
| GRB CAP MKTS/TR NY | HOUSTON PM&M | | 181565-1 | Pre 4+ | 15.78 | 15.78 | 15.78 | 15.78 | 15.78 | 15.78 | |
| SSB NEW YORK | HOUSTON PM&M | | 186768-4 | Pre 4+ | 50.00 | 50.00 | 50.00 | 50.00 | | | |
| GRB CAP MKTS/TR NY | HOUSTON PM&M | | 128350-2 | Set 4+ | 2.50 | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 145811-1 | CV 4+ | 500.00 | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 145928-1 | CV 4+ | 75.00 | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 145948-1 | CV 4+ | 0.50 | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 145904-1 | CV 4+ | 25.00 | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 145939-1 | CV 4+ | 40.00 | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 145981-1 | CV 4+ | 5.00 | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 145982-1 | CV 4+ | 10.00 | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 148015-1 | CV 4+ | 5.00 | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 148018-1 | CV 4+ | 5.00 | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | | 148441-3 | CV 4+ | 150.00 | | | | | | |
| Customer Totals | | | | | | 668.21 | 668.21 | 554.47 | 241.06 | 186.91 | 83.78 |
| 100804 ENRON CAPITAL TRADE SERVICES INTERNATIONAL CORP | | | | | | | | | | | |
| ORR | | | | | | | | | | | |
| GECS | HOUSTON PM&M | | 100804-1 | Pre 4+ | 35.00 | 35.00 | 35.00 | | | | |
| GECS | HOUSTON PM&M | | 100804-1 | Set 4+ | 210.00 | | | | | | |
| Customer Totals | | | | | | 35.00 | 35.00 | | | | |
| 100810 ENRON CAPITAL TRADE SERVICES INTERNATIONAL CORP | | | | | | | | | | | |
| ORR | | | | | | | | | | | |
| GRB PRXB LONDON | HOUSTON PM&M | | 100810-5 | Con 4+ | 32.78 | 32.78 | | | | | |
| Customer Totals | | | | | | 32.78 | 32.78 | | | | |

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| ENRON CORPORATION | | Originating Unit HOUSTON | | GFCID 600007062 | | CA No. 2000 726771 | | Page No. 16 of 21 | | | |
|--|-----------------------------|-----------------------------|-------------|--------------------|--------|-----------------------|-----------------|----------------------|----------------------|----------------------|------------------|
| Facilities Summary by Obligor - All amounts are US\$MM | | | | | | | | | | | |
| Customer Id | Extending Unit | Approving Unit | Facility Id | Type | Rating | Fac Amt | Up To 6 Mths | 1 Year - 1 Year | 3 Years - 3 Years | 5 years - 5 Years | Over 10 Years |
| 1002432337 | ENRON FUNDING CORP | HOUSTON PM&M | 174436-4 | Dv | 4+ | 38.00 | 38.00 | | | | |
| Customer Totals | | | | | | | | | | | |
| 1002782359 | ENRON INDIA PRIVATE LIMITED | HOUSTON PM&M | 146721-1 | Dv | 4+ | 10.00 | 10.00 | 10.00 | | | |
| Customer Totals | | | | | | | | | | | |
| 1001675227 | ENRON MEXICO SA DE CV | HOUSTON PM&M | 114160-1 | Ch | 4+ | 0.25 | | | | | |
| Customer Totals | | | | | | | | | | | |
| 1004150929 | ENRON METALS (UK) LTD | HOUSTON PM&M | 204074-1 | Ch | 4+ | 200.00 | | | | | |
| Customer Totals | | | | | | | | | | | |
| 1001073497 | ENRON METALS (UK) LTD | HOUSTON PM&M | 134659-2 | Dv | 4+ | 0.08 | 0.08 | | | | |
| Customer Totals | | | | | | | | | | | |
| 1001073497 | ENRON METALS (UK) LTD | HOUSTON PM&M | 97955-3 | Ch | 4+ | 50.00 | | | | | |
| Customer Totals | | | | | | | | | | | |
| GRB CAP MKT/STR NY | HOUSTON PM&M | | 121827-9 | Pre | 4+ | 148.00 | 148.00 | 148.00 | 148.00 | 148.00 | 7.00 |
| GRB CAP MKT/STR NY | HOUSTON PM&M | | 177814-4 | Pre | 4+ | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| GRB CAP MKT/STR NY | HOUSTON PM&M | | 179041-3 | Pre | 4+ | 10.00 | 10.00 | 10.00 | 10.00 | 10.00 | 10.00 |
| GRB CAP MKT/STR NY | HOUSTON PM&M | | 121827-8 | Set | 4+ | 20.00 | | | | | |
| Customer Totals | | | | | | | | | | | |
| GRB PM&M LONDON | HOUSTON PM&M | | 100739-2 | Dv | 4+ | 0.07 | 0.07 | | | | |
| GRB PM&M LONDON | HOUSTON PM&M | | 100401-2 | Con | 4+ | 0.00 | 0.00 | 0.00 | | | |
| Customer Totals | | | | | | | | | | | |
| GRB PM&M LONDON | HOUSTON PM&M | | *100808-3 | Dv | 4+ | 3.04 | 3.04 | 3.04 | 2.84 | 2.84 | 2.84 |
| Customer Totals | | | | | | | | | | | |
| GRB PM&M LONDON | HOUSTON PM&M | | 87715-4 | Dv | 4+ | 7.09 | 7.09 | | | | |
| GRB PM&M LONDON | HOUSTON PM&M | | 100812-3 | Ch | 4+ | 60.00 | | | | | |
| Customer Totals | | | | | | | | | | | |
| EM GRB ISTANBUL | HOUSTON PM&M | | 148145-1 | Con | 4+ | 0.18 | 0.18 | | | | |
| Customer Totals | | | | | | | | | | | |
| GRB PM&M LONDON | HOUSTON PM&M | | 133366-2 | Con | 4+ | 11.91 | 11.91 | | | | |
| Customer Totals | | | | | | | | | | | |
| GRB CAP MKT/STR NY | HOUSTON PM&M | | 204045-1 | Pre | 4+ | 10.00 | 10.00 | 10.00 | 10.00 | 10.00 | |
| Customer Totals | | | | | | | | | | | |

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| ENRON CORPORATION | | Originating Unit HOUSTON | | GFCID 900007002 | | CA No. 2000 126771 | | Page No. 17 of 21 | | | | |
|---|----------------|-----------------------------|-------------|--------------------|--------|-----------------------|-----------------|----------------------|---------------------|----------------------|-----------------------|------------------|
| Facilities Summary by Obligor - All amounts are US\$MM | | | | | | | | | | | | |
| Customer Id | Extending Unit | Approving Unit | Facility Id | Type | Rating | Fac Amt | Up To 6 Mths | 8 Mths - 1 Year | 1 Year - 3 Years | 3 Years - 5 Years | 5 years - 10 Years | Over 10 Years |
| 1002051287 GARDEA S.A. (CRR - 5) | | | | | | | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | HOUSTON PM&M | 203722-1 | Dir | 5 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 |
| HOUSTON PM&M | HOUSTON PM&M | HOUSTON PM&M | 203727-1 | Dir | 5 | 20.50 | 20.50 | 20.50 | 20.50 | 20.50 | 20.50 | 20.50 |
| Customer Totals | | | | | | 24.50 | 24.50 | 24.50 | 24.50 | 24.50 | 24.50 | 24.50 |
| 1000420138 INDUSTRIAL GASES (CRR - 5) | | | | | | | | | | | | |
| EM GRB JAMAICA | EM GRB JAMAICA | EM GRB JAMAICA | 146570-1 | Dir | 5* | 0.33 | 0.33 | 0.33 | | | | |
| EM GRB JAMAICA | EM GRB JAMAICA | EM GRB JAMAICA | 146571-1 | Dir | 5 | 0.36 | 0.36 | 0.36 | | | | |
| EM GRB JAMAICA | EM GRB JAMAICA | EM GRB JAMAICA | 146571-3 | Con | 5* | 0.15 | 0.15 | 0.15 | | | | |
| GRB GTS CH4 WORLD L2H | EM GRB JAMAICA | EM GRB JAMAICA | 146572-2 | Dir | 5* | 0.07 | 0.07 | | | | | |
| EM GRB JAMAICA | EM GRB JAMAICA | EM GRB JAMAICA | 146572-2 | Pre | 6* | 0.08 | 0.08 | | | | | |
| Customer Totals | | | | | | 0.97 | 0.97 | 0.83 | | | | |
| 1001891142 INDUSTRIAS VENTANE S.A. (CRR - 6) | | | | | | | | | | | | |
| EM GRB VENEZUELA | HOUSTON PM&M | HOUSTON PM&M | 146174-2 | Pre | 4* | 0.05 | 0.05 | | | | | |
| Customer Totals | | | | | | 0.05 | 0.05 | | | | | |
| 1001248815 JOINT ENERGY DEVELOPMENT INVESTMENTS LIMITED PARTNERSHIP (CRR - 6) | | | | | | | | | | | | |
| HOUSTON PM&M | HOUSTON PM&M | HOUSTON PM&M | 146470-1 | Dir | 6 | 10.00 | 10.00 | 10.00 | | | | |
| Customer Totals | | | | | | 10.00 | 10.00 | 10.00 | | | | |
| GRB LONDON (CRR - 6) | | | | | | | | | | | | |
| GRB LONDON | HOUSTON PM&M | HOUSTON PM&M | 187787-3 | Con | 6* | 2.98 | 2.98 | | | | | |
| Customer Totals | | | | | | 2.98 | 2.98 | | | | | |
| 1002191322 RAWHIDE INVESTORS LLC (CRR - 4) | | | | | | | | | | | | |
| GRB NY SECURITIZATI | HOUSTON PM&M | HOUSTON PM&M | 182084-4 | Dir | 4* | 50.00 | 50.00 | | | | | |
| Customer Totals | | | | | | 50.00 | 50.00 | | | | | |
| Report Totals | | | | | | 1,122.48 | 1,122.48 | 860.03 | 488.63 | 405.46 | 185.69 | 0.27 |

Note - Settlement Risk and Clearing Risk amounts are excluded from Totals
 Note - * Allocation(s) have been taken from this facility

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CITI-SPSI 0128931

| ENRON CORPORATION | | Originating Unit HOUSTON | GFCID 8000057002 | CA No. 2006/128771 | Page No. 18 of 21 | | | |
|---|--|-----------------------------|---------------------|-----------------------|----------------------|-------------------------|--------|----------|
| Total Facility Summary (All Amounts US\$ Millions) | | Direct Facilities | | | | Contingent Liability | PSR | Total |
| Customer | | OSTBT | Placement | LLL | Other | | | |
| 446084 | ENRON CORP | | | 492.88 | | 67.27 | 108.28 | 668.21 |
| 1005429138 | INDUSTRIAL GASES LTD. | | | 0.69 | | 0.22 | 0.06 | 0.97 |
| 1001248833 | JOINT ENERGY DEVELOPMENT INVESTMENTS LHM | | | 10.00 | | | | 10.00 |
| 1001248878 | DELTA ENERGY CORPORATION | | | | | | 0.00 | 0.00 |
| 1001472883 | ENRON NORTH AMERICA CORP | | | | | | 150.00 | 150.00 |
| 1001828708 | CONTRACTUAL ASSET SECURITIZATION HOLDING | | | 3.00 | | | 0.20 | 3.20 |
| 1001773798 | ENRON AMERICA DO SUL LTDA | | | | | 0.50 | 0.04 | 0.54 |
| 1001792772 | ENRON CAPITAL & TRADE RESOURCES INTERNAT | | | | | | 0.50 | 0.50 |
| 1001828318 | ENRON PROJE YONETIM LIMITED SIRKETI | | | | | 0.18 | | 0.18 |
| 1001881142 | INDUSTRIAS VENTANE S.A. | | | | | | 0.05 | 0.05 |
| 1001824083 | ENRON EUROPE LTD | | | | | 32.78 | | 32.78 |
| 1001930075 | ENRON CREDIT COM LIMITED | | | | | | 10.00 | 10.00 |
| 1002106023 | ENRON AUSTRALIA ENERGY PTY. LTD. | | | 0.00 | | 0.11 | | 0.11 |
| 1002124218 | DABHOL POWER COMPANY | | | 45.44 | | | | 45.44 |
| 1002169053 | ENRON TEESIDE OPERATIONS LTD | | | | | 11.91 | | 11.91 |
| 1002191322 | RAWHIDE INVESTORS LLC | | | 50.00 | | | | 50.00 |
| 1002214144 | ELEKTRO ELETRICIDADE E SERVICOS S.A. | | | | | | 8.00 | 8.00 |
| 1002285358 | ENRON INDIA PRIVATE LIMITED | | | 10.00 | | | | 10.00 |
| 1002438338 | ENRON FUNDING CORP | | | 38.00 | | | | 38.00 |
| 1002472038 | M.A. TRAPP & PARTNERS LIMITED | | | | | 2.08 | | 2.08 |
| 1002555021 | ENRON CANADA CORP | | | 3.28 | | | | 3.28 |
| 1002578444 | ENRON BROADBAND SERVICES UK LIMITED | | | | | 1.00 | | 1.00 |
| 1002672231 | EMPRESA DE GENERACION ELECTRICA BAHIA LA | | | 7.50 | | | | 7.50 |
| 1002853287 | GARDEN STATE PAPER COMPANY, LLC | | | 24.50 | | | | 24.50 |
| 90011001472883 | ENRON NORTH AMERICA CORP | | | 0.07 | | 0.00 | | 0.07 |
| 90020000448034 | ENRON CORP | | | | | | 35.00 | 35.00 |
| 90031001472883 | ENRON NORTH AMERICA CORP | | | 3.04 | | | | 3.04 |
| 90031001700009 | ENRON NETHERLANDS HOLDING B.V. | | | 0.08 | | | | 0.08 |
| 90041001472883 | ENRON NORTH AMERICA CORP | | | 7.08 | | | | 7.08 |
| Grand Total | | | | 695.33 | | 117.02 | 310.13 | 1,122.48 |

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| | | | | | | |
|---|-------------|-----------------------------|---|------------------------|----------------------|-----------------|
| ENRCH CORPORATION | | Originating Unit HOUSTON | GFCID 900007002 | CA No. 2000/129771 | Page No. 19 of 21 | |
| CA Limit Control | | | | | | |
| Customer Type CORPORATIONS Risk Rating 4+ | | | | | | |
| All Amounts US\$ Millions | Line Amount | | Approved/ Proposed Limit Exception | Date Approved | Actual Facilities | |
| Total Credit Facilities | 500.00 | | 622.48 | | 1,122.48 | |
| Level 1 Total Facilities | | | | | | |
| Direct Sub-Limit | | | | | 895.33 | |
| Aggregate Settlement Limit | 1,000.00 | | | | 235.38 | |
| Aggregate Clearing Limit | 1,000.00 | | | | 1,152.29 | |
| Tenor Sub Limits Profile | | Maximum % Per Tenor | | Maximum % Per Tenor | | % of Facilities |
| <= 6 Months | 1,122.48 | 100.00 | | | 1,122.48 | 100.00 |
| > 6 Months and <= 1 year | 1,122.48 | 100.00 | | | 880.03 | 78.82 |
| > 1 year and <= 3 Years | 1,122.48 | 100.00 | | | 480.83 | 42.82 |
| > 3 Years and <= 5 Years | 1,122.48 | 100.00 | | | 405.46 | 36.12 |
| > 5 Years and <= 8 Years | 1,122.48 | 100.00 | | | 185.69 | 16.54 |
| > 8 Years | 1,122.48 | 100.00 | | | 38.81 | 3.44 |
| Credit Approval Clearing Limit Approval | | | | | | |

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| ENRON CORPORATION | | | Originating Unit HOUSTON | QFCID 900007002 | CA No. 2009 728771 | Page No. 20 of 21 |
|---|----------------|-------------|-----------------------------|--------------------|-----------------------|----------------------|
| Sub Limits Report - All amounts are US\$M | | | | | | |
| Fac Id/Ver Sub Limit | Customer Id | Description | Legal Unit | Amount(s) | Exposure Category | |
| 100804-11 0 | 90020000440084 | ENRON CORP | GECOS EUROPE | 35,000 | Pre-settlement | |
| | | | | 210,000 | Settlement | |
| 100804-11 1 | | | LONDON | 20,000 | Pre-settlement | |
| | | | | 120,000 | Settlement | |
| 100804-11 2 | | | NEWYORK C3NA | 15,000 | Pre-settlement | |
| | | | | 90,000 | Settlement | |

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CITI-SPSI 0128934

| ENRON CORPORATION | | Originating Unit HCLUSTCWA | GFCID 1000007002 | CA No. 2000 /***** | Page No. 21 of 21 |
|---------------------------------|----|-------------------------------|---------------------|-----------------------|----------------------|
| Credit Approval Levels | | | | | |
| Aggregate Approval Level | | | | | |
| CO SCO SCC(1) CPC SM | | | | | |
| Approval Grids | | | | | |
| TOTAL FACILITIES | CO | SCO | SCC(1) | CPC | SM |
| AGGREGATE SETTLEMENT | CO | SCO | SCC(3) | | |
| AGGREGATE CLEARING | CO | SCO | SCC(1) | CPC | SM |
| New / Increase | | | | | |
| TOTAL FACILITIES | CO | SCO | SCC(1) | CPC | SM |
| AGGREGATE CLEARING | CO | SCO | SCC(3) | | |
| Exception Approval Grids | | | | | |
| Tenor Exception Approval | | | | | |

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CITI-SPSI 0128935

CALCULATION OF COMMITTED EXPOSURE

COMPANY NAME: ENRON CORP.
GL/CAL/LOCAL: GLOBAL

| Facility # | Commt | Rating | Maturity | Turner |
|-----------------------|--------|--------|------------|-------------|
| CASH & Loans | 0.000 | ++ | 12/28/2000 | 0.00000000 |
| Enron North PSR | 8.960 | ++ | 11/20/2000 | 1 |
| Enron North PSR | 1.910 | ++ | 11/20/2000 | 5 |
| Enron North PSR | 30.960 | ++ | 11/20/2000 | 5 |
| Enron North PSR | 8.890 | ++ | 11/20/2000 | 8 |
| Enron North PSR | 1.660 | ++ | 11/20/2000 | 10 |
| Sea Day Inc | 40.000 | ++ | 06/18/2000 | 0.46675425 |
| 5 Year A/C | 33.333 | ++ | 06/18/2000 | 4.46675425 |
| Yosemite (1) | 37.500 | ++ | 11/16/2000 | 3.39988094 |
| Yosemite (2) | 18.000 | ++ | 01/15/2001 | 1.61736214 |
| New of Yosemite | 30.000 | ++ | 11/20/2000 | 0.987280271 |
| Coal Monetization | 8.158 | ++ | 07/01/2000 | 0.862753425 |
| Mariners | 24.750 | ++ | 12/07/2000 | 4.00000000 |
| ACR | 1.000 | ++ | 12/07/2000 | 0.002738728 |
| Enron Funding | 28.000 | ++ | 12/07/2000 | 0.013872601 |
| JEDI B Loan | 10.000 | ++ | 06/20/2001 | 0.346218118 |
| Enterprise de Gazaria | 7.500 | ++ | 08/08/2001 | 0.802738728 |
| Reynolds | 50.000 | ++ | 03/30/2001 | 0.328787121 |
| Garrison Basin | 24.500 | ++ | 10/30/2007 | 0.81736214 |
| Spectra (2 year) | 7.500 | ++ | 11/20/2000 | 1 |
| Republic (24 yr) | 20.500 | ++ | 11/20/2000 | 1 |
| Turbo Part | 6.200 | ++ | 03/15/2000 | 7.250150000 |
| Turbo Part | 68.000 | ++ | 03/15/2000 | 7.250150000 |
| Total: 428.246 | | | | |

| Committed Exposure Breakdown by Turner as of: 11/20/2000 | | | | |
|--|---------|------------|------------|-------------|
| As of 11/20/2000 | 1 Year | 2 to 3 Yrs | 3 to 5 Yrs | 5 to 18 Yrs |
| NET_08 | 714,324 | 268,308 | 347,288 | 174,310 |

| Asset Rating | Committed Exposure | | | | Unsettled | | | | Outstanding | | | |
|--------------|--------------------|------------|------------|------------|------------|------------|------------|------------|-------------|------------|------------|------------|
| | Up to 1 Yr | 2 to 3 Yrs | 3 to 5 Yrs | Over 5 Yrs | Up to 1 Yr | 2 to 3 Yrs | 3 to 5 Yrs | Over 5 Yrs | Up to 1 Yr | 2 to 3 Yrs | 3 to 5 Yrs | Over 5 Yrs |
| 10 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 9 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 8 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 7 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 6 | 0.000 | 0.000 | 0.000 | 0.000 | 50.000 | 48.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 5 | 0.000 | 0.000 | 0.000 | 0.000 | 100.000 | 80.000 | 48.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 4 | 0.000 | 0.000 | 0.000 | 0.000 | 100.000 | 100.000 | 58.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 3 | 66.814 | 66.814 | 66.814 | 0.000 | 250.000 | 186.000 | 75.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 2 | 77.115 | 77.115 | 77.115 | 0.000 | 213.000 | 174.000 | 92.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 1 | 83.312 | 77.115 | 43.318 | 0.000 | 750.000 | 485.000 | 175.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| + | 638.258 | 338.248 | 178.318 | 0.000 | 900.000 | 474.000 | 200.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 3 | 658.253 | 338.248 | 178.318 | 0.000 | 1300.000 | 700.000 | 275.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 2 | 432.258 | 238.248 | 178.318 | 0.000 | 1100.000 | 600.000 | 230.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 1 | 383.258 | 288.248 | 178.318 | 0.000 | 2000.000 | 1000.000 | 374.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| + | 863.253 | 388.248 | 178.318 | 0.000 | 2500.000 | 1200.000 | 428.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| 1 | 863.253 | 388.248 | 178.318 | 0.000 | 3000.000 | 1500.000 | 600.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |

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Prepared by: Carol Amery
12/08/2000

CITI-SPSI 0128936

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Executive Summary

Purpose: The purpose of this memo is to approve the following facilities for Enron:

1. Turbopark/E-Next Generation, LLC Financing - Citibank has been asked to commit \$200MM with an expected hold of \$75MM out of a \$600MM financing lead by CSFB. The facility will be syndicated by the bookrunner (CSFB) by 3/31/01. The transaction consists of a 3-phase structure to finance the construction and development of gas fired electric generating assets including fixed and soft costs related to future projects. The structure operates in a manner similar to a synthetic lease. It has a drawdown period of 4 years and a final maturity of 8 years.
2. Garden State Paper Facility- Citibank and Chase have each been asked to commit and hold \$24.5MM for a total of \$50MM in facilities with a 2-year drawdown period and a five year term out. The assets financed in this transaction consist of pulp and paper facilities acquired by Enron to provide an asset base for its paper and pulp trading business. *Based on Client Approval*
3. Bacchus/Caymus Trust Facility- Citibank has been asked to approve and hold the \$250MM facility consisting of Notes and Certificates. The purpose of the financing is to monetize Enron's pulp and paper trading business over year and in anticipation of its ultimate financing through a joint venture between Enron and equity investors which is expected to close in the first quarter of 2001. The Notes (\$242.5MM) will be supported by a total return swap with Enron Corp as the credit risk. The Certificates are supported by verbal support obtained by Bill Fox from Andy Fastow, Enron Corp's Chief Financial Officer. This facility has a one year termination date. However, the company expects to repay it in full by 3/31/01. If it is not repaid by 3/31/01, we will syndicate it.
4. To request approval for a new Clearing Limit of \$200 million for Enron Metals, Ltd. in London to facilitate early metals transaction payments.
5. To request approval to extend our \$38MM share of a 364 day revolving credit for Enron Funding Corp. from December 27, 2000 to March 28, 2001 to coincide with insurance policy termination dates contained in the structure. The obligations of Enron Funding Corp. are guaranteed by Enron Corp.
6. To request approval to extend and decrease our share from \$14.4MM to \$3.2MM in the Coal Monetization Facility for an additional 364 day period terminating on 12/31/01.
7. To request approval for a new derivatives trading line for Enroncredit.com in the amount of \$10MM to cover existing trades. London is negotiating SEDA. We are requesting a 90-day disclaimer.
8. To request approval to increase derivative trading lines for Enron North America Corp from \$82 MM to \$150MM to cover existing passive and active excesses and allow additional trades.
9. To request approval to increase SSB trading line for futures from \$25MM to \$50MM.

Total Exposure:



Enron Relationship:

S&P and Moody's rate Enron Corp as BBB+&Baa1, respectively and Enron has an internal risk rating of 4+. The revenue and RCRAP figures from Enron below include both Citibank and SSB:

| Year to Date Revenue (in millions) | | | | RORAP (bps) | | | |
|------------------------------------|---------|----------|----------|-------------|----------|----------|-----|
| | 9/30/00 | 12/31/00 | 12/31/00 | 9/30/00 | 12/31/00 | 12/31/00 | |
| \$38.5 | \$44.7 | \$19.2 | \$17.1 | 4,820 | 783 | 148 | 302 |

Total revenues for 2000 from Enron for Citibank and SSB combined are expected to exceed \$50 million. Citibank revenues in 2000 are expected to be \$41 million of the \$50 million.

Recommendation:

The three new transactions described above are strategic transactions for Enron. Given the breadth of our relationship with the company we have been told by Enron that it is important that we participate in these strategic initiatives. Each transaction has been structured to protect the bank as lender and yield a market return. In addition, we expect a significant amount of the incremental exposure (\$375MM) will be reduced by 3/31/00.

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CITI-SPSI 0128937

**ENERGY/POWER HOUSTON
ROUTING/TRANSMITTAL FORM**

CUSTOMER NAME: ENRON CORP.
 CA NUMBER/LEVEL: #1600/126771 INTERIM LEVEL 1/CPC/SM
 DATE APPROVAL NEEDED: DECEMBER 13, 2000
 PURPOSE: VARIOUS - SEE ATTACHED

| NAME/LOCATION | DATE SENT | DATE RETURNED |
|---|-----------------|---------------|
| TO: Please check individuals needed for approval | | |
| ORIGINATION - Please initial/date and forward to next level | | |
| Houston Analyst/Banker _____ | | |
| Lydia Junek, SCO <u>X</u> | <u>12/13/00</u> | |
| William Fox, SCO _____ | | |
| Tom Smit, Risk Mgr./Level 1 399P/3 <u>X</u> | | |
| Contact Executive <u>X</u> | | |
| CPC (Fernando Ynigo) <u>X</u> | | |
| LOAN STRUCTURING - Please initial/date and forward to next level | | |
| Houston Loan Structurer _____ | | |
| Steven Victoria 399P/11 _____ | | |
| John Byrne/2nd SSO _____ | | |
| PLEASE RETURN VIA UPS TO: Carol Rocney Citicorp North America, Inc. 1200 Smith Street/20th Floor Houston, TX 77002 Phone: 713-654-3590 Fax: 713-654-2349 | | |

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CITI-SPSI 0128938

Purpose: CA No. 2000/128771

1. To request Approval to extend Coal Monetization facility #146442 for an additional 364 day period with a decrease from \$14.423MM to \$6.159MM due to amortization. ✓
2. To request Approval of the Caymus Trust facilities (#205252 and #205253) in the total amount of \$250MM. ✓
3. To request Approval of our \$75MM hold position of the Turbo Park facilities (#205254 and #205255) with SSB's underwriting position of \$125MM. ✓
4. To request Approval to extend our \$38MM share of a 364 day R/C for Enron Funding Corp. from December 27, 2000 to March 29, 2001 to coincide with Insurance Policy Termination. Enron Corp. will guarantee Enron Funding Corp's obligations. ✓
5. To request Approval for a new \$200MM clearing limit for Enron Metal Limited (#204074) in London to facilitate early metals transaction payments. ✓
6. To request Approval to increase derivatives trading lines (#121827 and #179041) for Enron North America Corp. from \$82MM to \$150MM to cover existing passive/active excess and allow additional trades. ✓
7. To request Approval for a new derivatives trading line for Enroncredit.com (#204045) in the amount of \$10MM to cover existing trades. ISDA is being negotiated in London. Request 90 day deferral. ✓
8. To request Approval for our \$4MM share of a new \$8MM 7-year Revolving Commitment (#203722) for Garden State Paper Company, LLC. Chase Manhattan is co-lender. ✓
9. To request Approval for our \$20.5MM share of a new \$41MM 7-year Multi-Draw Term Facility (#203727) for Garden State Paper Company, LLC. Chase Manhattan is co-lender. ✓
10. To request Approval to increase SSB trading line (#188768) from \$25MM to \$50MM.

As of November 30, 2000 a total of \$134MM in notional credit derivatives has been sold with a net asset reduction of \$13.6MM.

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CITI-SPSI 0128939

Enron Corp.
Pre-Tax Earnings Analysis of SFAS 140's 1998-2001*
(\$MM)

| Origination Date | Deal Name | Gain/(Loss) 1998 | Gain/(Loss) 1999 | Gain/(Loss) 2000 | Gain/(Loss) 2001 Q1&Q2 | Gain/(Loss) 2001 Q3 | Grand Total |
|------------------|-----------------------|------------------|------------------|------------------|------------------------|---------------------|-------------|
| 2001 | Hanover | | | | | | - |
| 2001 | CGAS (H2) | | | | - | | - |
| 2001 | Tahiti 1 (H2) | | | | 30 | (30) | - |
| 2001 | Tahiti 2 (H2) | | | | 20 | (20) | - |
| 2001 | Service Co. | | | | | 19 | 19 |
| 2001 | EOTT | | | | | 10 | 10 |
| 2001 | ETOL III | | | | 40 (c) | | 40 |
| 2001 | Eli Lilly (H2) | | | | 33 | | 33 |
| 2000 | TNPC (H1) | | | 47 (a) | | (26) | 21 |
| 2000 | TNPC (H1) | | | 91 (b) | | (65) | 26 |
| 2000 | TNPC (H1) | | | 30 | | (21) | 9 |
| 2000 | RIVA (H2) | | | 37 | | | 37 |
| 2000 | EBSCS (H2) | | | 53 | 57 | (110) | - |
| 2000 | Avici | | | - | | (30) | (30) |
| 2000 | Cerberus | | | - | | | - |
| 2000 | Bacchus/Networks | | | 112 | | | 112 |
| 2000 | Iguana/Mariner/ECP | | | - | | | - |
| 2000 | Discovery/First World | | | - | | | - |
| 2000 | ETOL L,II | | | 104 (c) | 20 (c) | | 124 |
| 1999 | Sarlux 2 | | 38 | | | | 38 |
| 1999 | Trakya 2 | | 57 | | | | 57 |
| 1999 | Riverside 5 | | 2 | | | | 2 |
| 1999 | Ghost | | - | | | | - |
| 1999 | Piti Power Guam | | 14 | | | | 14 |
| 1999 | Alchemy | | 11 | | | | 11 |
| 1999 | Blackbird | | 8 | | | | 8 |
| 1999 | Sutton Bridge 2 | | 39 | | | | 39 |
| 1999 | Rock | | 27 | | | | 27 |
| 1998 | Sarlux/Trakya 1 | 200 | | | | | 200 |
| 1998 | Riverside 3 | 58 | | | | | 58 |
| 1998 | Riverside 4 | 28 | | | | | 28 |
| 1998 | Bammel Looper | 27 | 10 | | | | 37 |
| 1998 | Mid Texas | 40 | | | | | 40 |
| 1998 | American Coal | 5 | | | | | 5 |
| 1998 | Powder/Wind River | 28 | 32 | | | | 60 |
| 1998 | Churchill | 167 | | | | | 167 |
| 1998 | Northern Borders | 49 | | | | | 49 |
| Total 125/140 | | \$ 602 | \$ 238 | \$ 474 | \$ 200 | \$ (273) | 1,241 |
| Enron IBIT | | (d) \$ 1,582 | \$ 1,995 | \$ 2,482 | \$ 1,588 | \$ (633) (e) | |

- (a) \$20M gain on initial securitization. \$26M income through TRS. Additional value monetized in 2000.
(b) \$25M gain on initial securitization. \$66M income through TRS. Additional value monetized in 2000.
(c) The MTM of the TRS in 4Q2000 of GBP 9M and GBP 10M in 2001 has not been reflected on this schedule.
(d) Income Before Interest, Minority Interests and Income Taxes
(e) Enron IBIT includes non-recurring items.
H1 = Hawaii 1
H2 = Hawaii 2
*All gains are represented net of any current period losses

Permanent Subcommittee on Investigations
EXHIBIT #367

ECu000072327

**Enron Consolidated
2002 PLAN
Equity & Other Strategic Investing Activities**
(Millions of Dollars)

| | 2002 Activities | | | | | | | | | | | | Total |
|--|-----------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|-------|--------|---------|
| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | |
| Equity & Other Strategic Investing Activities | | | | | | | | | | | | | |
| ETS Base Gas Buyback | (2.4) | (2.3) | (2.3) | (2.3) | (2.5) | (3.3) | (5.0) | (5.0) | (5.0) | (6.7) | - | - | (24.0) |
| ETS Operational Storage Adjustment | - | - | - | - | - | - | (1.6) | - | - | - | - | - | (17.0) |
| ETS Other | - | - | - | - | - | - | (1.6) | - | - | - | - | - | (1.6) |
| PGS Other | (1.5) | (1.5) | (1.5) | (1.5) | (1.5) | (1.5) | (1.6) | (1.6) | (1.6) | (1.5) | (1.5) | (1.5) | (18.4) |
| EGAS SK Corp | (10.0) | (3.9) | (3.9) | (3.9) | (3.9) | (3.9) | - | - | - | - | - | - | (40.0) |
| EGAS DPC | (0.7) | (0.9) | (0.9) | (0.9) | 1.3 | (0.5) | (0.7) | (0.6) | (0.6) | (0.4) | (0.4) | 12.0 | (24.4) |
| EGAS Other | - | - | - | - | - | - | - | - | - | - | - | - | 7.6 |
| EREC Installment Note Collections | - | - | 2.6 | - | 0.9 | 0.3 | - | - | - | - | 0.6 | 0.7 | 5.1 |
| EREC Other | - | - | - | - | - | - | - | - | - | - | - | - | - |
| EMA Other | - | - | - | - | - | - | - | - | - | - | - | - | - |
| EGM LNG - Jose Project | - | - | - | - | - | - | - | - | - | - | - | - | - |
| EGM LNG - Bahamas Project | - | - | - | - | - | (5.0) | - | - | - | - | - | (30.0) | (30.0) |
| EGM Coal Domestic - Unidentified Asset Acquis. | (2.9) | (2.9) | (2.9) | (2.9) | (2.9) | (2.9) | (2.9) | (2.9) | (2.9) | (2.9) | (2.9) | (2.9) | (35.0) |
| EGM LNG - Jose/Venezuela LNG Project | (0.3) | (0.7) | (2.7) | (2.7) | (2.7) | (2.7) | (1.7) | (0.4) | (0.4) | (0.4) | (0.4) | (0.4) | (15.5) |
| EGM LNG - Bahamas Land Acquisition | - | - | - | (8.0) | - | - | - | - | - | - | - | - | (8.0) |
| EGM Other | - | - | - | - | - | - | - | - | - | - | - | - | - |
| EIM Sundance - Stadacona | - | - | - | - | - | (13.8) | - | - | (14.9) | - | - | (7.2) | (35.9) |
| EIM Sundance - Garden State | - | - | (5.1) | - | - | (4.1) | - | - | (4.1) | - | - | (4.1) | (17.4) |
| EIM Other | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Other | (1.0) | (1.0) | (1.0) | (1.0) | (1.0) | (1.0) | (1.0) | (1.0) | (1.0) | (1.0) | (1.0) | (1.0) | (12.0) |
| Total | (22.7) | (13.2) | (17.6) | (21.8) | (14.2) | (38.9) | (14.3) | (11.6) | (35.6) | (13.2) | (5.6) | (34.4) | (243.0) |

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12/20/02 4:20 PM

EC:000072330

Fishtail (1362)

| | | Opening Balance 12/20/2000 | Entries 12/31/2000 | Ending Balance 12/31/2000 |
|-----------------------------------|---------|-------------------------------|-----------------------|------------------------------|
| Fishtail LLC CINY | | - | - | - |
| Notes Receivable - 3rd Party | 364 | 8,024,061.00 | - | 8,024,061.00 |
| Notes Receivable - 3rd Party | 54N | - | 7,713,110.00 | 7,713,110.00 |
| Notes Receivable - 3rd Party | 967 | - | 1,407,065.00 | 1,407,065.00 |
| A/R | | 1,000.00 | - | 1,000.00 |
| A/R-Trade | | 5,016,438.00 | (893,506.00) | 4,122,932.00 |
| Inventory | PCDUMMY | 13,406,400.00 | 7,951,536.00 | 21,357,936.00 |
| Price Risk Management Assets | | 87,548,671.00 | (20,645,346.00) | 66,903,325.00 |
| Goodwill | | 114,571,521.00 | - | 114,571,521.00 |
| A/P-Trade | | (20,543,030.00) | 5,874,206.00 | (14,668,824.00) |
| Additional PIC | 364 | (200,001,000.00) | 200,000,000.00 | (1,000.00) |
| Additional PIC | 1355 | - | (200,000,000.00) | (200,000,000.00) |
| Additional PIC | 1370 | (8,024,061.00) | - | (8,024,061.00) |
| Unrealized MTM Revenue | | - | 20,645,346.00 | 20,645,346.00 |
| Financial Settlements - 3rd Party | | - | (22,052,411.00) | (22,052,411.00) |
| | | - | - | - |
| Earnings Before Interest & Taxes | | - | (1,407,065) | (1,407,065) |

| Final Sundance Numbers | | |
|-------------------------------------|-------------|--------|
| Langtry Total | 188,500,000 | 20.11% |
| ENE Total | 748,900,000 | 79.89% |
| | | |
| Langtry Initial Contribution | 28,500,000 | 3.04% |
| Langtry Commitment | 160,000,000 | |
| ENE Total Contribution (je cushion) | 748,900,000 | |
| | | |
| Garden State | 60,000,000 | |
| Stadacona | 375,000,000 | |
| SATCO | 13,900,000 | |
| Fishtail | 210,000,000 | |
| Liquidity Facility | 25,000,000 | |
| Add'l Capital Commitment | 65,000,000 | |
| | 748,900,000 | |
| | 660,000,000 | |
| | 88,900,000 | |

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December 10, 2002

VIA HAND DELIVERY

Mr. Robert L. Roach
Counsel
Permanent Subcommittee on Investigations
Senate Committee on Governmental Affairs
199 Russell Senate Office Building
Washington, DC 20510

Re: Enron Corp.

Dear Mr. Roach:

Enclosed please find a response prepared by Enron Corp. (the "Company") to the request of the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs dated December 2, 2002. For your reference, the response is Bates-stamped EC2 000047195 through EC2 000047196.

With this production, the Company does not intend to provide a general waiver of the attorney-client, attorney work product or other applicable privileges, and does not waive those privileges as to other documents not produced here.

Sincerely,



Armando Gomez

Permanent Subcommittee on Investigations
EXHIBIT #368

Response to Permanent Subcommittee on Investigations
 Letter of December 2, 2002
 Slapshot financing transaction

(1) **What is the status of the loans, assets and entities involved in the Slapshot transaction?** See following tables for status of the loans and entities involved in the Slapshot transaction. Note that certain entities involved in the transaction are owned and controlled by unrelated parties and, therefore, no information regarding the status of those entities or any loans to such entities is provided below. The primary assets involved in the Slapshot transaction were the Canadian paper and pulp mill assets owned by Compagnie Papiers Stadacona ("CPS"). These assets are still owned and operated by CPS.

| Loan | Status |
|--|---|
| June 22, 2001 \$1.414 bn loan from Flagstaff Capital Corp. to Hansen Investments Co. | In November 2001 Flagstaff Capital Corp. exercised its right to offset its obligations under a separate forward purchase agreement to acquire preferred shares of Hansen Investments Co. in full satisfaction of Hansen's obligations under the loan. |
| June 22, 2001 \$1.414 bn loan from Hansen Investments Co. to Compagnie Papiers Stadacona | Outstanding; amended to non-interest bearing demand note in May 2002 |
| June 22, 2001 \$1.039 bn loan from Compagnie Papiers Stadacona to Enron Canada Power Corp. | Repaid in May 2002 |

| Entity | Status |
|-----------------------------|---|
| JPMorgan Chase | Unrelated party – not known |
| Flagstaff Capital Corp. | Unrelated party – not known |
| Hansen Investments Co. | In existence |
| Newman Investments Co. | In existence |
| Compagnie Papiers Stadacona | In existence |
| Enron Canada Power Corp. | In existence; winding up business |
| Enron Canada Corp. | In existence; winding up business |
| Enron Corp. | In existence; filed for voluntary relief under Chapter 11, US Bankruptcy Code on December 2, 2001 |

(2) **Have any Enron-related entities, including but not limited to CPS, ECC, ECPC, Hansen or Newman, claimed any tax benefits related to the Slapshot transaction?** No United States federal income tax deductions were claimed by Enron Corp. or any of its subsidiaries with respect to the Slapshot transaction. In addition, there were no tax-related benefits reported in the Enron Corp. and consolidated subsidiaries publicly issued financial statements filed with the SEC. Certain Canadian tax deductions were claimed as described in answer (3).

(3) If so, what entities claimed those benefits, in which country were they claimed, and how much in the way of tax benefits were claimed? See the following table for an itemization of gross interest deductions reported by the specified entities for Canadian tax purposes.

| Entity | Country Claimed | Deductions Claimed |
|-----------------------------|-----------------|---|
| Hansen Investments Co. | Canada | \$44.5 mn interest expense on loan from Flagstaff Capital Corp. |
| Compagnie Papiers Stadacona | Canada | \$44.6 mn interest expense on loan from Hansen Investments Co. |
| Enron Canada Power Corp. | Canada | \$35.8 mn interest expense on loan from Compagnie Papiers Stadacona |

(4) Do any Enron-related entities, including but not limited to CPS, ECC, ECPC, Hansen or Newman, plan to claim or anticipate claiming any future tax benefits related to the Slapshot transaction? No

(5) If so, what entities plan to claim or anticipate claiming those benefits, in which country do they plan to claim the benefits, and how much do they anticipate claiming? Not applicable; see answer to question (4).

William Manias
07/17/98 09:56 AM

Global Oil & Gas (713) 216-6386 Fax Number (713) 216-4227
To: Robert Traband/CHASE@CHASE
cc:
Subject: Prepay

..... Forwarded by William Manias/CHASE on 07/17/98 09:52 AM

 07/16/98 01:21:00

Commodity Derivatives (212) 834-4284 Fax Number: (212) 834-6084
To: William Manias/CHASE@CHASE
cc: Jeffrey W. Dellapina/CHASE@CHASE
Subject: Prepay

Bill,

 [prepaygeneric_0798.ppt](#) Here is a copy of the new prepay pitch. I have saved it as a 4.0 powerpoint file as I think this is the version you guys use in Texas.

Obviously this is p&c and not for distribution so only use for your own education.

Jeff will be back in on Friday, and you can speak with him directly regarding Coastal States.

regards,

HSC

FOIA Confidential Treatment
Requested by JPMC

Permanent Subcommittee on Investigations
EXHIBIT #369

SENATE
MAH - 02604

XYZ Corporation

Presentation of:

Prepaid, Forward Sale of Inventory

16 July 1998

Contents

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| II. Transaction Attributes | 4 |
| III. Indicative Terms & Conditions | 7 |
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| V. Documentation | 13 |

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Introduction

- Prepayment received for a forward sale of inventory: fixed quantity; specific delivery location(s)
- Alternative source of finance
- Balance sheet "friendly"
- Chase has arranged transactions totaling in excess of \$2 Billion

Transaction Attributes

- Alternative Source of Medium Term Finance
 - Transactions generally 3-5 years
 - Performance risk rather than payment risk
 - Syndication of xyx risk using non-traditional means
 - amortizing, syndicated performance LC
 - surety bonds

Transaction Attributes (cont'd)

- Attractive accounting impact by converting funded debt to “deferred revenue”, or long-term trade payable
- Competitive economics
 - Performance LCs draw 50% capital weighting (loans, stand-by LCs, payment guarantees are 100% weighted)
 - Insurance companies have been aggressive in other deals

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Transaction Attributes (cont'd)

- Attendant tax benefits
- “Off-the-shelf” documents for US crude oil- and natural gas-based transactions
- Chase’s working relationship with Mahonia Limited, a Jersey company active in commodity prepayments

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Terms and Conditions

Seller: xyx Corporation (or designated subsidiary)

Purchaser: Mahonia Limited (or The Chase Manhattan Bank)

Prepayment Amount: [approximately \$250,000,000]

Delivery Volume: pre-determined volume of hydrocarbons

Delivery Period: [5] years with a [] month grace period from closing

Delivery Sched: Either (i) ratable monthly over the period, (ii) tailored to specific requirements

7

FOIA Confidential Treatment
Requested by JPMC

SENATE
MAH - 02611

Terms and Conditions (cont'd)

- Delivery Locations:**
- For WTI, Cushing Oklahoma
 - For Natural Gas, various pipeline pooling locations in U.S., including:

| Pipeline | Points |
|---------------|----------------|
| Transco | Pooling points |
| TX Gas | Pooling points |
| Texas Eastern | Pooling points |
| Columbia Gulf | Pooling points |
| El Paso | Permian pool |
| Henry Hub | All pipes |

- other arrangements, including oil cargo settlements, as agreed between Mahonia and xyx

Terms and Conditions (cont'd)

Performance Risk Diversification:

Alternative (1)

Performance L/C: Amortizing L/C, syndicated by Chase, with an initial drawing amount equal to the natural gas delivery at closing

L/C Drawing: By Mahonia upon failure to deliver and make replacement payment

Alternative (2)

Surety Bond: Amortising surety bond issued by a number of acceptable insurance companies

Bond Drawing: By Mahonia upon failure to deliver and make replacement payment

Terms and Conditions (cont'd)

Economics:

Alternative (1)

Discount rate: Libor + [20] basis points
PL/C Fees: [25] basis points per annum on outstanding
Up front fees: [15] basis points

Alternative (2)

Discount rate: Libor + [20] basis points
Premium on Surety Bond: To be agreed with insurers
Up-front fees: [15] basis points

Terms and Conditions (cont'd)

Enhancements:

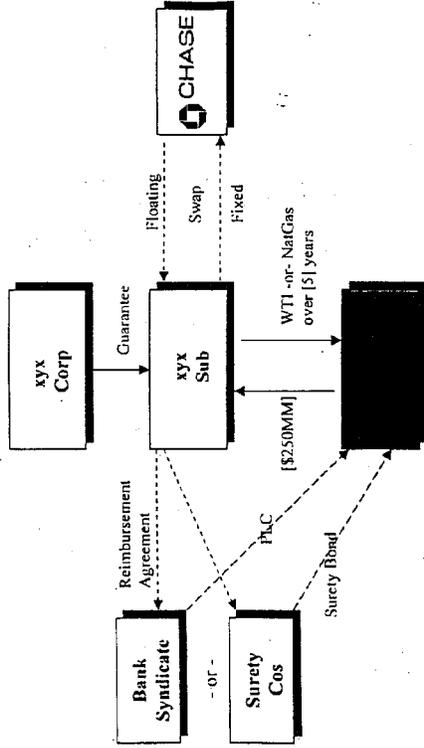
Chase can improve the economics for xyx as follows:

- Neutralize xyx's fixed price position (resulting from the forward sale) with a swap contract between Chase and xyx
- Reduce discount rates through embedded options
 - provide Mahonia option to call natural gas or crude oil
 - provide Mahonia a call on additional gas at a fixed price

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Summary Diagram



Documentation

- Commercial forward sale agreement
- Guarantee, if necessary
- Reimbursement agreement with banks or sureties
- [Financial swap confirmation]
- Standard enforceability opinions
- Estimated legal cost (excl xx counsel) \$25,000 *

* Having executed US oil & gas prepaids totaling \$2 billion, Chase can produce "shelf" documents.

Janet Caruso To: Lesley Daniels/Webster/CHASE
07/07/1999 03:52 PM cc:
Subject: Prepaid Forwards

Don David 06/21/99 05:27 PM

Global Markets & International 212-270-2249 Fax Number: 212-270-2296

To: Don M. Wilson/CHASE@CHASE, Fraser Partridge/CHASE@CHASE
cc: David Pflug/CHASE@CHASE, George Brash/CHASE@CHASE
Subject: DISGUISED LOANS

DON AND FRASER:

I HAVE ASKED DAVID PFLUG TO COORDINATE A TOP LEVEL REVIEW OF OUR DISGUISED LOANS, AND TO WORK ON DEVELOPING A POLICY THAT MEETS ALL OUR NEEDS, BOTH TECHNICAL AND STRATEGIC.

THIS WOULD INCLUDE THINGS LIKE:

- O MIS ON HOW MUCH WE HAVE
- O SOMEHOW ENSURING CONSISTENT ACCOUNTING TREATMENT
- O SOMEHOW ENSURING MAXIMUM EFFORT AT OUR TRADITIONAL "LOANS ARE MADE FOR DISTRIBUTION" STRATEGY, DESPITE THE ODD FORM OF THESE LOANS.
- O ENSURING THAT WE UNDERSTAND THE SUBTLE RISKS ASSOCIATED WITH SOME TRANSACTIONS, INCLUDING "DOCUMENT RISK".

I WOULD EXPECT DAVID TO INVOLVE A FAIRLY LARGE NUMBER OF PEOPLE ON THIS, YOURSELVES INCLUDED.

THANK YOU IN ADVANCE FOR SUPPORTING THIS EFFORT.

DON

Don David 07/05/99 06:51

To: David Pflug/CHASE@CHASE
cc: Suzanne Hammett/CHASE@CHASE, Brian O'Neill@CHASE, Robert Fallon, Herb Aspbury/CHASE@CHASE, Don M. Wilson/CHASE, Fraser Partridge/CHASE
Subject: DISGUISED LOANS

DAVID

THIS TOPIC HAS COME UP IN A VARIETY OF WAYS RECENTLY, AND WAS A DISCUSSION ITEM AT BRIAN O'NEILL'S OFFSITE TODAY.

I THINK WE NEED TO MAKE AN OFFICIAL PROJECT OUT OF THIS. HERE IS HOW I SEE THE ISSUE:

WE ARE MAKING DISGUISED LOANS, USUALLY BURIED IN COMMODITIES OR EQUITIES DERIVATIVES (AND I'M SURE IN OTHER AREAS). WITH AFEW EXCEPTIONS, THEY ARE UNDERSTOOD TO BE DISGUISED LOANS AND APPROVED AS SUCH. BUT I AM QUEASY ABOUT THE PROCESS:

Permanent Subcommittee on Investigations
EXHIBIT #370

O IS THE PRICING RIGHT VS. THE LOAN MARKET, OR DOES IT UNDERPRICE VS. THE LOAN MARKET EVEN IF IT PRODUCES A GOOD SVA?
O IS THERE INTERNAL CAPITAL ARBITRAGE GOING ON?
O IS THE DOCUMENTATION UP TO LOAN STANDARDS, AS OPPOSED TO ISDA MASTER.
O AS A STRATEGY MATTER, IT CAN INDICATE PEOPLE FALLING BACK INTO THE HABIT OF MAKING LOANS TO MAKE LOANS (EVEN IF WELL-PRICED DUE TO STRUCTURING), AND WE DEFINITELY WANT TO END THAT BAD HABIT.
O IT ESCAPES ROUTINE TRANSPARENCY, AS THE LOAN IS BURIED IN THE TRADING BOOKS AND WHEN WE SAY "WE HAVE XXX LOANS TO COUNTRY YYY" IT IS NOT INCLUDED. WE NEED TO KEEP IT TRANSPARENT AND INCLUDE THEM.
O IT ESCAPES THE DISTRIBUTION DISCIPLINES AND PROCESS, I.E. IT JUST SITS ON THE BOOKS.

AS A POLICY MATTER, I THINK WE NEED A SMALL TASK FORCE TO NOT ELIMINATE DISGUISED LOANS BUT TO MAKE SURE THEY ARE DONE RIGHT, THAT THEY ARE TRANSPARENT AND DON'T DISAPPEAR FROM OUR RADAR SCREEN, AND THAT WE INCLUDE THEM IN THE DISTRIBUTION PROCESS OVER TIME.

PLEASE THINK ABOUT THIS AND LET'S TALK. I HAVE COPIED OTHER RELEVANT PARTIES SO THEY KNOW THIS IS GOING ON, AS SEVERAL WILL UNDOUBTEDLY GET INVOLVED, AND THEY CAN WEIGH IN WITH ANY THOUGHTS THEY HAVE AS WELL.

DON