IV. PROJECT COCHISE

Project Cochise

Deal Basics

Business Purpose – To acquire a diversified portfolio of financial instruments (REMIC interests and equipment leases) with an enhanced earnings profile

Primary Entities – Enron Corp. (bankruptcy filer); Maliseet Properties, Inc.; ECT Investments Holding Corp.

Date Closed – January 1999

Principal Assets – Current assets include REMIC regular & residual interests; $9 million in bank demand deposits (i.e. cash). Formation assets also included a portfolio of airplane leases and commercial paper.

Transaction Size – Approximately $65 million in assets acquired; anticipated earnings of up to $140 million

Net Income Impact – Earnings of approximately $105 million have been recorded through the 3rd quarter of 2001.

Primary Tax Return Effect – Through 2000, the structure generated tax deductions reported in Enron's consolidated return of approximately $1 million. 2001 return not yet filed.

Current Status – Not in default. Solvent. Needs careful attention to maintain REIT status. Various legal issues need to be addressed.

Counterparties

Counterparty – Deutsche Bank (through BT Green, Inc. and BT Ever, Inc.); 99 independent and 6 former and current Enron officers and directors are REIT investors.

Size of Investment – BT Green holds the entire $1.2 million common stock interest; also has a $2 million receivable balance due from Maliseet. A current liquidation could result in a substantial windfall to this investor.

Litigation Status – None currently

Control Rights – BT holds all of the common stock and has controlling vote over certain events including bankruptcy, amendment of charter, liquidation, recapitizations, etc.

Indemnities – Various

Advisory History

Principal Advisors

- King & Spalding – Tax, corporate and REIT counsel
- McKee Nelson – Tax, corporate and REIT counsel
- Potter Anderson – Special Delaware counsel

Primary Opinions

- Formation & operation of Maliseet including exemption from tax-shelter registration analysis (Tax)
- REIT Qualification (Tax)
- SAS 50 Letters issued by Arthur Andersen to Banker's Trust
- Delaware Law Opinion – Potter, Anderson
- Tax basis study on REMIC residual interests – K&S

Confidentiality Agreement – No

Widely Marketed Deal – No

Financial Model and Deal Memo – Completed on transaction

Current Counsel – None (DB has requested hiring of external counsel)

For Tax Department Management Use Only

Cochise

. Lay, Chairman
. Belfer
Blake, Jr.
. Chan
Duncan
Foy
.. Gramm
. Harrison

✓ R. K. Jaedicke
✓ C. A. LeMaistre
✓ J. J. Meyer
✓ J. K. Skilling
✓ J. A. Urquhart
✓ J. Wakeham
C. E. Walker
✓ H. S. Winokur, Jr.

AGENDA
MEETING OF THE BOARD OF DIRECTORS
ENRON CORP.

8:00 A.M., February 8, 1999
The Four Seasons Hotel, Ballroom B
London, United Kingdom

ECUTIVE SESSION:

Approve minutes of meetings of the Board of Directors held on December 8, 1998 – Mr. Lay.

Report on Executive Committee meeting held on December 18, 1998 -- Mr. Duncan.

Report on Compensation and Management Development Committee meetings held on January 25, 1999, and February 7, 1999 -- Dr. LeMaistre.

(a) Approve Amendment to 1991 Enron Corp. Stock Plan to delete members of the Board of Directors from grants of restricted stock or stock options for inclusion in the proxy for the 1999 Annual Shareholders Meeting.

(b) Approve 1999 Annual Incentive Plan for inclusion in the proxy for 1999 Annual Shareholders Meeting.

NOTE: 1998 Performance Review is included for information only.

Report on Finance Committee Meeting held on February 7, 1999 – Mr. Winokur.

(a) Approve amendment to existing debt authority.–

(b) Approve amendment to Guaranty Policy.

(c) Approve Dabhol Power Corp. Phase II Equity.

(d) Approve Dabhol Power Corp. Phase II LNG Ship Financing.

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MINUTES
MEETING OF THE BOARD OF DIRECTORS
ENRON CORP.
February 8, 1999

Minutes of a meeting of the Board of Directors of Enron Corp. ("Company"), held pursuant to due notice beginning at 8:00 a.m., G.M.T., on February 8, 1999, at the Four Seasons Hotel in London, England.

The following Directors were present, constituting a quorum:

Mr. Kenneth L. Lay, Chairman
Mr. Robert A. Belfer
Mr. Norman P. Blake, Jr.
Mr. Ronnie C. Chan
Mr. John H. Duncan
Mr. Joe H. Foy
Dr. Wendy L. Gramm
Mr. Ken L. Harrison
Dr. Robert K. Jaedicke
Dr. Charles A. LeMaistre
Mr. Jerome J. Meyer
Mr. Jeffrey K. Skilling
Mr. John A. Urquhart
Lord John Wakeham
Mr. Herbert S. Winokur, Jr.

Director Charls E. Walker was absent from the meeting. Director Chan joined the meeting in progress as noted below. The meeting was begun in executive session, during which only Mr. James V. Derrick, Jr. and Ms. Peggy B. Menchaca were in attendance.

The Chairman, Mr. Lay, presided at the meeting, and the Secretary, Ms. Menchaca, recorded the proceedings.

Mr. Lay called the meeting to order and stated that minutes of a meeting of the Board held on December 8, 1998, had been distributed to the Directors and were included in the meeting material. He called for additions, corrections, or comments. There being none, upon motion duly made by Mr. Blake, seconded by Mr. Foy, and carried, the minutes of the meeting held on December 8, 1998, were approved as distributed.

Mr. Duncan reported on a meeting of the Executive Committee of the Board of Directors held on December 18, 1998. He stated that at the December 18, 1998, meeting, the Executive Committee approved (i) an Azurix project to acquire a 35% interest in Empresa de Obras Sanitarias de Valparaiso S.A., a water and sewerage treatment company located near Valparaiso and Vina del Mar, Chile, (ii) a corporate transaction designed to assist in diversifying the Company's equity and debt investments, and (iii) a financing structure enabling the Company to obtain financing from independent investors at a lower cost of funds, and that the Executive

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Committee had also recommended corporate officer elections. He noted that minutes of the meeting were included in the meeting material, and he moved the acceptance of the report and approval of the minutes of the meeting. Mr. Duncan's motion was duly seconded by Mr. Harrison and carried, and the report of the Executive Committee meeting of December 18, 1998, was accepted, and the minutes of such meeting were approved.

Dr. LeMaistre reported on meetings of the Compensation and Management Development Committee held on January 25, 1999, and February 7, 1999. He stated that at the January 25, 1999, meeting, the Committee approved the annual incentive payouts, and he noted that a copy of the 1998 Performance Review, which was relied upon by the Committee in making its decisions with regard to incentive payouts relative to 1998 performance, was included in the meeting material.

Dr. LeMaistre stated that at the Compensation and Management Development Committee meeting held on February 7, 1999, the Committee (i) approved the "Report from the Compensation and Management Development Committee Regarding Executive Compensation" that would be included in the proxy statement for the 1999 Annual Meeting of Shareholders, and (ii) approved for recommendation to the Board amendments to the Enron Corp. 1991 Stock Plan (As Amended and Restated Effective May 6, 1997) (the 1991 Plan) and the Company's Annual Incentive Plan (the "AIP") relating to the need for additional shares, increased flexibility, and to ensure regulatory compliance. He reviewed the rationale for specific changes to each plan and noted that both plans would also be submitted to the shareholders of the Company for consideration at its 1999 Annual Meeting of Shareholders. Dr. LeMaistre moved approval of the amendments to the 1991 Plan and the AIP, his motion was duly seconded and carried, and the following resolutions were approved:

Amendment to Enron Corp. 1991 Stock Plan (As Amended and Restated Effective May 6, 1997)

WHEREAS, Enron Corp. (the "Company") and the shareholders of the Company heretofore approved and adopted the Enron Corp. 1991 Stock Plan (As Amended and Restated Effective May 6, 1997) (the "1991 Plan"); and

WHEREAS, the Company desires to amend the Plan:

NOW THEREFORE, IT IS RESOLVED, that the proper officers of the Company be, and they hereby are, authorized and directed to prepare an amendment to the 1991 Plan incorporating the form of amendment presented at this meeting with up to an additional ten million shares of Enron Corp. common stock authorized for granting awards under the 1991 Plan, or such lesser number of shares as such officers in their discretion may determine advisable for obtaining shareholder approval, and to present such 1991 Plan amendment for approval by the shareholders of the Company at their annual meeting in May, 1999;

Agenda Item 3
(Suggested Form of Resolutions)

WHEREAS, it is in the Company's best interest for the Company to set up a structure involving several affiliates of the Company to participate, directly or indirectly, in various investing activities and in a corporation formed for the purpose of investing in certain securities and other assets in the range and in the approximate amounts presented to the Executive Committee (the "***Transaction***"); and

WHEREAS, the Company authorized the retention of Bankers Trust Company to assist the Company in setting up such a structure, to be an interest holder in conjunction with the Transaction and to invest in the Transaction and/or the entities participating in the Transaction, all as deemed appropriate by officers or representatives of the Company;

NOW, THEREFORE, BE IT RESOLVED, that the Company authorize and set up the structure contemplated in connection with the Transaction as described to the Executive Committee with such modifications as may be approved by officers of the Company, including without limitation contributions to capital, if any, transfers of assets, guarantees and indemnifications, creation of entities, if any, and issuance of notes, all of the foregoing subject to the finalizing of contractual arrangements deemed necessary and appropriate to the Transaction and meeting the final approval of officers or representatives of the Company acting on the advice of counsel, which shall be conclusively evidenced by their signatures on documents intended to be final documents;

RESOLVED FURTHER, that the Transaction in form acceptable to the officers and representatives of the Company acting on the advice of counsel be, and hereby is, approved;

RESOLVED FURTHER, that the Company approves the purchase by it or one of its affiliates of mortgages and certain leased assets from Bankers Trust Company or an affiliate thereof in connection with the Transaction;

RESOLVED FURTHER, that the Company is authorized to guarantee payments and performances and to provide indemnities with respect to the Transaction as deemed appropriate by any officer of the Company (conclusively evidenced by the signature of such officer on related documents), and the Company also approves such action on the part of its affiliates;

RESOLVED FURTHER, that the Company and/or its affiliates pay such attorneys fees and adviser fees as they deem appropriate, in the range and approximate amounts presented to the Executive Committee;

RESOLVED FURTHER, that the Chairman and Chief Executive Officer, the President and Chief Operating Officer, the Senior Vice President and Chief Financial Officer, the Senior Vice President, Chief Accounting, Information and Administrative Officer, the Senior Vice President, Finance and Treasurer, or any Vice President of the Company be, and each of them hereby is, authorized and empowered on behalf of the Company to take such actions necessary or appropriate to effectuate the intent of these resolutions;

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RESOLVED FURTHER, that all actions heretofore taken by any officer or representative of the Company related to or in connection with the Transaction and the matters described in these resolutions, including without limitation the execution and delivery of any related documents or instruments, are hereby adopted, ratified, confirmed, and approved in all respects; and

RESOLVED FURTHER, that the proper officers of the Company and its counsel be, and each of them hereby is, authorized, empowered, and directed (any one of them acting alone) to take any and all such further action, to amend, execute, and deliver all such further instruments and documents, for and in the name and on behalf of the Company, under its corporate seal or otherwise, and to pay all such expenses as in their discretion appear to be necessary, proper, or advisable to carry into effect the purposes and intentions of this and each of the foregoing resolutions.

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Brian J. McGuire
Vice President
Bankers Trust Company

January 28, 1999

Mr. Richard A. Causey
Senior Vice President and
Chief Accounting and Information Officer
Enron Corp.
P.O. Box 1188
Houston, Texas 77251

Dear Mr. Causey:

This letter is to confirm that Enron Corp. (the "***Company***") has engaged Bankers Trust Company ("***Bankers Trust***") as its exclusive financial advisor in connection with (a) the direct investment in various leased property (the "**Leased Assets**") and (b) a real estate investment trust (the "**REIT**") which will acquire and manage financial assets including real estate mortgage backed securities (the "**Mortgage Securities**") and residual interests (the "**REMIC Residuals**") in real estate mortgage investment conduits (the "**Transaction**").

The Transaction will be structured substantially as described during recent conversations between representatives of the Company and representatives of Bankers Trust, and otherwise as agreed to between the Company and Bankers Trust. An affiliate of Bankers Trust will transfer leased property to an Enron affiliate in exchange for cash of equal value. Bankers Trust will contribute various REMIC Residuals and Mortgage Securities to the REIT and will in return receive common stock and debt securities of the REIT. Affiliates of the Company will contribute Mortgage Securities to the REIT and will in return receive preferred stock of the REIT.

Upon the terms and subject to the conditions set forth below (the "***Agreement***"), Bankers Trust is retained as exclusive financial advisor to the Company and any of its applicable affiliates with respect to structuring the Transaction.

1. **Services.** At the request of the Company, Bankers Trust will use its best efforts to perform the following services in connection with the Transaction:

    a) advise and assist in designing an appropriate structure for the proposed Transaction;

    b) assist in the preparation of financial analysis and computer modeling with respect to the Transaction to the extent requested by the Company, it being understood that all results of the use of such model shall be the sole responsibility of the Company;

130 Liberty Street, MS 2344
Mailing Address:
P.O. Box 318
Church Street Station
New York, NY 10008
Telephone: 212 250-1011
Facsimile: 212 669-1793

c) work with legal counsel, accountants and other relevant parties to document and close the Transaction;

d) provide future investment advisory services with respect to investments of the REIT, including acquisitions and dispositions of the REIT's assets, as requested by the Company or as deemed necessary by Bankers Trust (in its sole discretion);

e) provide assistance, as necessary, to have the record ownership of the REMIC Residuals transferred on the records of the respective trustees from that of Bankers Trust to that of the REIT; and

f) perform such other investment banking and financial advisory services related to or arising out of the services described in this paragraph 1, as Bankers Trust and the Company may from time to time agree.

2. **Compensation.** In consideration of the services rendered by Bankers Trust, the Company agrees to pay, or cause to be paid, to Bankers Trust a cash fee, in the aggregate amount of $15,000,000, subject to any reduction pursuant to the terms hereof. The preceding sentence notwithstanding, (a) Bankers Trust will be paid $5,250,000 on September 1, 1999 and an additional $750,000 on each March 1, June 1, September 1 and December 1 of the years 1999 through and including 2002, beginning December 1, 1999 and ending December 1, 2002; and (b) if a change in law or accounting rule (or the enacted effective date thereof) prior to December 1, 2002 materially reduces the Company's expected accounting reporting treatment of the Transaction under GAAP (as hereinafter defined), the portion of such fee which has not been paid to Bankers Trust at such time will be forfeited by Bankers Trust. Because the predominant purpose of the Transaction is to generate financial accounting benefits, if a Change in Law Event (as such term is used in the operative documents) or a change in accounting rule (or the enacted effective date thereof) occurs prior to December 31, 2003, that materially reduces the Company's expected financial accounting benefit (the "**Expected Benefit**") from the Transaction under GAAP, the fee payable to Bankers Trust will be reduced on a proportionate basis (comparing the actual recorded benefit to the Expected Benefit), provided that in no circumstances will Bankers Trust fee be less than $2 million.

For the purposes of this Agreement, (a) "**GAAP**" means generally accepted accounting principles in effect in the United States as in effect from time to time as applied to the REIT Transaction, and (b) the "**Closing**" is deemed to have occurred upon the transfer of the REMIC Residuals and the Mortgage Securities by Bankers Trust to the REIT and the acquisition by an Enron affiliate of the Leased Assets.

It is understood that the foregoing fee does not include fees for additional services including services provided to the Company or its affiliates under other engagement letters, and other services such as swaps, bridge financing, valuation services, commitment fees, and fees and expenses for other parties involved in the transaction (e.g., trustee fees and expenses).

3. **Indemnification**. The Company hereby agrees to indemnify and hold harmless Bankers Trust and its affiliates and their respective directors, officers, employees, agents and representatives (collectively, "***Indemnified Persons***") from and against all losses, claims, damages, liabilities, costs and expenses incurred by any of them (including fees and disbursements of legal counsel) which (i) arise out of or are based upon any untrue statement or alleged untrue statement of any material fact contained in any information provided by the Company in connection herewith or arise out of or are based upon any omission or alleged omission to state therein any material fact necessary to make the statements therein not misleading, or (ii) are otherwise related to or arise out of or in connection with the services contemplated hereby, and the Company will reimburse Bankers Trust and each other Indemnified Person for all expenses (including fees and disbursements of legal counsel) as they are incurred in connection with investigating, preparing or defending any such action or claim, whether or not in connection with pending or threatened litigation in which Bankers Trust or such other Indemnified Person is a party. The Company will not be responsible, however, for any losses, claims, damages, liabilities, costs or expenses of any Indemnified Person pursuant to clause (ii) in the preceding sentence to the extent they result primarily from the bad faith or recklessness of such Indemnified Person. The Company also agrees that neither Bankers Trust, nor any other Indemnified Person, shall have any liability to the Company for or in connection with the services contemplated hereby except for such liability for losses, claims, damages, liabilities, costs or expenses incurred by the Company to the extent they result primarily from Bankers Trust's bad faith or recklessness. If for any reason the foregoing indemnification is unavailable to an Indemnified Person or insufficient to hold any Indemnified Person harmless, then the Company shall contribute to the amount paid or payable by it and Bankers Trust as a result of such losses, claims, damages, liabilities, costs or expenses in such proportion as is appropriate to reflect the relative benefits received by the Company on one hand and Bankers Trust on the other hand, as well as any relevant equitable considerations. The amount paid or payable by a party as a result of losses, claims, damages, liabilities, costs or expenses shall be deemed to include any reasonable legal or other fees or expenses incurred in defending any action or claim. In no event shall the Company be liable to any Indemnified Person for any lost or prospective profits or any other special, punitive, exemplary, consequential, incidental or indirect losses or damages (in tort, contract or otherwise) under or in respect of this Agreement for any failure of performance related hereto howsoever caused, whether or not arising from the Company's sole, joint or concurrent negligence. The Indemnified Persons shall not be required to contribute in the aggregate any amount in excess of the amount of fees actually received by Bankers Trust hereunder.

4. **Company Approval.** The Company acknowledges that the Transaction has been approved by senior management personnel of the Company and by the Executive Committee of its Board of Directors.

5. **Additional Services.** If the Company requests Bankers Trust to perform services not contemplated by this Agreement, or if the terms and conditions of Bankers Trust's engagement

change, Bankers Trust's compensation therefor will be determined through negotiations conducted in good faith, and the terms of such engagement will be set forth in a separate written agreement between the Company and Bankers Trust. Nothing in this Agreement is intended to obligate or commit Bankers Trust or any of its affiliates to provide any services other than as set out herein.

6. **Affiliate Services.** In connection with the services to be provided hereunder, Bankers Trust may employ the services of its affiliates, including BT Alex. Brown Incorporated. Bankers Trust may share with any of its affiliates any non-public information related to the Company or the contemplated Transaction. The term "***affiliate***" as used herein shall have the meaning ascribed to such term in the rules and regulations promulgated under the Securities Exchange Act of 1934, as amended.

7. **Survival.** Bankers Trust's engagement hereunder may be terminated at any time by either Bankers Trust or the Company by prior written notice thereof to the other party, provided, that the indemnification provisions set out in Paragraph 3, the compensation provisions outlined in Paragraph 2, and the representations and warranties of the Company contained herein, shall remain operative and in full force and effect and shall survive such termination. The indemnity obligations of the Company hereunder and referred to herein shall be in addition to any liability the Company may otherwise have.

8. **Information.** The Company agrees to furnish Bankers Trust with such information as Bankers Trust reasonably requests in connection with its engagement hereunder. The Company recognizes and confirms that Bankers Trust (i) will be relying solely on such information and other information available from generally recognized public sources in performing the services contemplated hereunder, (ii) will not independently verify the accuracy or completeness of such information, (iii) does not assume responsibility for the accuracy or completeness thereof, and (iv) will make appropriate disclaimers consistent with the foregoing.

9. **Counterparts, Etc.** This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument. This Agreement constitutes the entire agreement between the parties hereto with respect to the subject matter hereof, supersedes all prior agreements and understandings, both written and oral, between the parties with respect to the subject matter hereof and cannot be amended or otherwise modified except in writing executed by the parties hereto. Bankers Trust may transfer or assign, in whole or from time to time in part, to one or more of its affiliates its rights and obligations hereunder, but no such transfer or assignment will relieve Bankers Trust of its obligations hereunder without the prior written consent of the Company. The provisions hereof shall inure to the benefit of and be binding upon the successors and assigns of the Company and Bankers Trust and their respective affiliates.

10. **Governing Law.** THIS AGREEMENT SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK WITHOUT REGARD TO THE CONFLICTS OF LAWS PROVISIONS THEREOF.

11. **Notices.** Notice given pursuant to any of the provisions of this Agreement shall be in writing and shall be mailed or delivered (a) to the Company, at its office at the address set forth above and (b) to Bankers Trust, at its offices at One Bankers Trust Plaza, 130 Liberty Street, New York, New York 10006, Attention: Mr. Brian McGuire.

12. **Bankers Trust Advice, Role, Etc.** No opinion or advice rendered by Bankers Trust, whether formal or informal, may be publicly disclosed nor may the Company refer to Bankers Trust's role in the contemplated Transaction without Bankers Trust's prior written consent. The Company confirms that it will rely on its own counsel, accountants and other similar expert advisors for legal, accounting, tax and other similar expert advice. Moreover, the Company understands and agrees that Bankers Trust makes no representation or warranty as to the tax or accounting consequences of the Transaction. The Company further agrees that neither Bankers Trust nor any of its directors, officers, employees, agents or representatives shall have any liability to the Company or its representatives resulting from their use of the form of structure to be used in the Transaction.

13. **No Rights In Shareholders, Etc.** The Company recognizes that Bankers Trust has been retained only by the Company, and that the Company's engagement of Bankers Trust is not deemed to be on behalf of and is not intended to confer rights upon any shareholder, owner or partner of the Company or any other person not a party hereto as against Bankers Trust or any of Bankers Trust's affiliates or the respective directors, officers, agents, employees or representatives of Bankers Trust or Bankers Trust's affiliates. Unless otherwise expressly agreed, no one other than the Company is authorized to rely upon the Company's engagement of Bankers Trust or any statements, advice, opinions or conduct by Bankers Trust.

If the Company is in agreement with the foregoing, please sign and return one copy of this letter which will thereupon constitute the agreement of the parties hereto with respect to the subject matter of this letter.

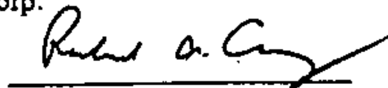
BANKERS TRUST COMPANY

By:

Brian J. McGuire
Vice-President

Agreed and Accepted:

Enron Corp.

By: 

Richard A. Causey
Senior Vice President

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ARTHUR ANDERSEN

Arthur Andersen LLP

1345 Avenue of the Americas
New York NY 10105-0032
Writer's Direct Dial
(212) 708 4930

MAY 26, 1999

Bankers Trust Company
One Bankers Trust Plaza
New York, NY 10006

Gentlemen:

We have been engaged to report on the appropriate application of United States generally accepted accounting principles to the hypothetical transaction described below. This report is being issued to Bankers Trust Company for assistance in evaluating accounting principles for the described hypothetical transaction. Our engagement has been conducted in accordance with standards established by the American Institute of Certified Public Accountants.

Hypothetical Transaction:

Note: Amounts and rates used in this description are for illustrative purposes only, and are not necessarily indicative of those in an actual transaction.

1. Co A, Co B and an unrelated group of investors will form a venture for the purpose of making investments in real estate related assets. The venture will be organized as a corporation for legal purposes, while it will be treated as a real estate investment trust (the "REIT") for Federal income tax purposes.

2. Four wholly-owned subsidiaries of Co A (collectively, the "Co A Subs") will each purchase a diversified portfolio of publicly-traded mortgage securities (the "Mortgages") for $11,262,500 in cash (for a total of $45,050,000 among all of the Co A Subs) directly from Co B. The Co A Subs will then contribute the Mortgages they purchased from Co B to the REIT in exchange for (1) $11,250,000 of Class A voting coupon preferred stock of REIT representing approximately 23.75% of the REIT's vote and 23.7187% of its value to each contributing subsidiary (for a total of approximately 95.000% of the vote and approximately 94.8749% of the value of the REIT held by the Co A Subs) and (2) $12,500 of Class B non-voting preferred stock of REIT representing approximately 0.0263% of the value of the REIT to each contributing subsidiary (for a total of approximately 0.1054% of the REIT's value held by the

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Co A Subs). In total, the Co A Subs will initially hold 100% of the outstanding Class A voting coupon preferred stock and 80% of the outstanding Class B non-voting coupon preferred stock for a combined total of 95.0000% of the vote and 94.9803% of the value of REIT. Since the Co A Subs are wholly-owned by Co A, all references herein to Co A means either Co A or the consolidated group including Co A and the Co A Subs.

3. A wholly-owned subsidiary of Co B ("Co B Sub"), operating through its London branch ("Co B Sub (London)") will contribute to the REIT a diversified portfolio of publicly traded mortgage securities (additional "Mortgages") with a fair market value of approximately $4,912,500 and a portfolio of REMIC Residual Interests (the "REMICs") with little or no economic value and a tax basis of approximately $70 million in exchange for (1) 100% of the common stock of REIT with a value of approximately $2,368,400 which represents approximately 5.0000% of the vote of REIT and approximately 4.9934% of the REIT's value, (2) a 20 year zero-coupon debt security of REIT (the "Original REIT Debt Security") with a value of approximately $2,531,600 and (3) $12,500 of Class B non-voting coupon preferred stock representing approximately 0.0263% of the value of REIT (the "Class B Stock"). Co B Sub (London) will transfer $12,500 of Class B non-voting coupon preferred stock to at least 99 qualified investors (the "Investors") in exchange for fair market value consideration.

4. A wholly owned subsidiary of Co A (Co A Sub 5) will make a $45 million cash purchase from a Co B subsidiary (Co B Sub2) of assets (such as leased aircraft) on long term lease to an unrelated lessee (the "Leased Assets").

5. Since all the assets of the REIT are being acquired from Co B and its affiliates, Co B Sub (London) and Co B Sub 2, the pools of assets can be viewed as an acquisition from one party. Accordingly, we will refer herein to the Mortgages acquired from Co B, the Leased Assets acquired from Co B Sub 2, and the Mortgages and REMICs contributed by Co B Sub (London) as the "Co B Assets".

6. At this point, absent consideration of any deferred tax assets or liabilities that may be appropriate, the REIT consists of the following (in millions):

REMIC Residual Interests	$0
Mortgages	$49,962,500
Total Assets	$49,962,500
Original Debt	$2,531,600
Equity-	
Class A Preferred	45,000,000

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Class B Preferred	62,500
Common Stock	2,368,400
Total Equity	47,430,900
Total Debt and Equity	$49,962,500

The corporate charter of the REIT will contain a provision which will allow any shareholder with a voting interest to force (a) a recapitalization (the "Recap") of Co B Sub (London)'s common stock interest and the Original REIT Debt Security into a debt security (the "Recap Debt") with equal fair market value at any time after five years and (b) a conversion of the Class A voting preferred stock into common stock. Economic Earnings on the REIT assets will be distributed annually in accordance with the economic ownership percentages of the various classes of stock.

Subsequently, Co A could (1) cause the REIT to dispose of some or all of the Mortgages and/or (2) cause Co A Sub 5 to sell some or all of the Leased Assets to an unrelated third party for cash of equal value. You have instructed us to assume that the REMIC Residual Interests will not be sold in any event. If such sale(s) occur, the sales proceeds would be reinvested in assets used in the respective seller(s) normal course of business. Any decision to make such sale(s) would be made subsequent to the acquisition of such assets by the REIT and/or Co A Sub 5 and would be based on prevailing market conditions at the time of the subsequent sale(s).

7. Should Co B Sub (London) exercise its right to effect the Recap and that right not be honored for any reason, Co B Sub (London) will not have creditor rights against the REIT or any of the parties in the transaction, including Co A.

8. The activities of the REIT will be limited by its charter to the ownership of real estate related assets (such as the Mortgages and REMIC Residuals). Those governance decisions which do need to be made, such as the reinvestment of the income or proceeds or maturing investments (within investment parameters defined in the charter) or appointment of investment managers to do so will be made solely by Co A as owner of the majority of the voting rights.

9. You have informed us that the following apply or will occur:

   a. Co A's initial tax basis in the REIT Class A and Class B preferred stock will be $45,050,000.

   b. The formation of the REIT and the contribution of assets to the REIT will be a tax-free exchange to the REIT and to Co B Sub (London). The REIT's acquisition of the assets will not result in an allocation of the purchase price directly to the assets themselves for

tax purposes; nor will there by any election to treat the acquisition as a purchase of assets for tax purposes.

c. The REIT will not be included in Co A's consolidated tax return during the period prior to the Recap or for any subsequent period in which it is treated as a REIT for tax purposes.

d. To the extent the REIT has taxable income in excess of actual cash income in any particular year, it is expected that the remaining taxable income each year will be deemed to be distributed to Co B Sub (London) as the common shareholder for income tax purposes who will be taxed thereon. To the extent of such distributions, the REIT will receive a tax deduction for such dividends and thus will eliminate its taxable income and, accordingly, have no tax due of its own.

e. Subsequent to the contributions to the REIT, the REMICs are expected to generate non-cash taxable income totaling approximately $330 million which will create additional tax basis in the REMICs within the REIT (thus the tax basis in the REMICS is expected to increase to approximately $400 million).

f. If Co B Sub (London) does not elect to require a Recap at the end of year five, it is the intention of Co A to do so. In either case, Co A would further intend, once Co B Sub (London)'s common stock interest in the REIT has been exchanged for Recap Debt, to implement a strategy to allow any deductions generated by the REIT to offset income taxable to a taxable entity other than one treated as a real estate investment trust for income tax purposes.

Accounting discussion:

You have asked that we address the accounting for this transaction in the consolidated financial statements of Co A. You have not asked us to consider the treatment of the transaction for tax purposes; accordingly, our discussion of the accounting for income taxes pursuant to Statement of Financial Accounting Standards ("SFAS") No. 109 – Accounting for Income Taxes, is in sole reliance upon your description of the tax consequences of the transaction.

Consolidation of the REIT –

The rules for consolidation of subsidiaries are set forth in Accounting Research Bulletin No. 51 and Statement No. 94 of the Financial Accounting Standards Board (FASB). These rules specify

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that a company should generally consolidate the accounts of an investee when it has a controlling financial interest in the investee. The usual condition for a controlling financial interest is ownership of a majority voting interest.

The Emerging Issues Task Force (the Task Force) of the FASB (in Issue 96-16) discussed the consolidation of an entity when the investor owns a majority of the voting stock but the minority shareholder or shareholders have certain approval or veto rights. The Task Force agreed that the assessment of whether rights of a minority shareholder should preclude an investor from consolidating when the investor has a majority voting interest in an investee is a matter of judgment that depends on facts and circumstances. The Task Force further agreed that the framework in which such facts and circumstances are judged should be based on whether the minority rights, individually or in the aggregate, provide for the minority shareholder(s) to effectively participate in significant decisions that would be expected to be made in the "ordinary course of business." This assessment of minority rights should be made at the time a majority voting interest is obtained and should be reassessed if there is a significant modification to the terms of the rights of the minority shareholder(s). The Task Force observed that all minority rights could be described as "protective" of the minority shareholder's investment in the investee, but that some minority rights also allow the minority shareholder(s) to participate in determining certain financial and operating decisions of the investee that are made in the ordinary course of business (subsequently referred to as "participating rights"). The Task Force agreed that minority rights that are only protective in nature (subsequently referred to as "protective rights") would not overcome the presumption in Statement 94 that the owner of a majority voting interest should consolidate its investee. The Task Force agreed that substantive minority rights that provide the minority shareholders with the right to effectively participate in significant decisions that would be expected to be related to the investee's ordinary course of business, although also protective of the minority shareholder's investment, should overcome the presumption in Statement 94 that the investor with a majority voting interest should consolidate its investee.

For these purposes, decisions made in the ordinary course of business are defined as decisions concerning matters of a type consistent with those normally expected to be addressed in directing and carrying out the entity's current business activities, regardless of whether the events or transactions that would necessitate such decisions are expected to occur in the near term. However, it must be at least reasonably possible that such events or transactions that would necessitate such decisions will occur. The ordinary course of business definition would not include self-dealing transactions with controlling shareholders.

The Task Force concluded that minority rights (whether granted by contract or by law) that would allow the minority shareholder(s) to participate in the following corporate actions should be considered participating rights and would create a presumption that the investor of a majority voting interest should not consolidate its investee:

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a. Selecting, terminating, and setting the compensation of management responsible for implementing the investee's policies and procedures

b. Establishing operating and capital decisions of the investee, including budgets in the ordinary course of business.

The Task Force considered the above listing to be illustrative of participating rights, not necessarily all inclusive. The Task Force agreed that the following factors should be considered in evaluating whether minority rights that appear to be participating are substantive rights; that is, these factors provide for effective participation in decisions related to the investee's ordinary course of business:

a. As the disparity between the ownership interest of majority and minority shareholders increases, minority shareholders' rights are presumptively more likely to be protective rights and should raise the level of skepticism about the substance of the right.

b. The corporate governance arrangements need to be considered to determine at what level decisions are made. In all situations, any matters that can be put to a vote of the shareholders must be considered to determine if other investors, individually or in the aggregate, have participating rights by virtue of their ability to vote on matters submitted to a shareholder vote.

c. Relationships between the majority and minority shareholders (other than investment in the common investee) that are of a related party nature, should be considered in determining if the minority shareholder's participating rights are substantive.

d. Certain minority rights may deal with operating or capital decisions that are not significant to the ordinary course of business of the investee and thus may not convey participating rights to the minority interest.

e. Certain minority rights may provide for the minority shareholder to participate in significant decisions that would be expected to be made in certain business activities in the "ordinary course of business"; however, the Task Force concluded that the existence of such a minority right should not overcome the presumption that the majority should consolidate if it is remote that the event or transaction that requires minority approval will occur.

f. An owner of a majority voting interest who has a contractual right to buy out the minority shareholder's (s') interest in the investee for fair value or less should consider the feasibility of exercising that contractual right when determining if the minority shareholder's (s') participating rights are substantive.

Inasmuch as Co A is the sole owner of the Class A preferred, and as such has 95% of the voting interest in the REIT, Co A will have voting control. Though the REIT's charter will include certain limits on its activities, so long as Co A has the unilateral ability to determine REIT actions, including management of the REIT's assets or selection of the manager thereof, or disposition of some or all of the Mortgages, without having to submit to "participating rights" held by Co B, Co A should consolidate the financial statements of the REIT with its own.

The FASB has issued an Exposure Draft (the Consolidation ED) that could significantly revise the accounting rules for consolidated financial statements. As presently proposed, we do not believe that the Consolidation ED would change our conclusions regarding the consolidation of The REIT.

Accounting By Co A For Co B Sub (London) and the Investors' Interest in the REIT

Equity interests in consolidated entities not owned by the parent company are normally reflected as minority interests. If, however, the holders of such interests obtain rights that are creditor rights or are identical to creditor rights against the issuing entity (or the parent company, possibly due to the presence of a guarantee) in the event of nonpayment of dividends or in liquidation, they should generally be classified as debt. Since the REIT will be consolidated by Co A, the common stock of the REIT issued to Co B Sub (London) needs to be examined under these principles. You have informed us that neither the Class B preferred nor the common shares have any rights that could collectively be classified as creditor rights. Though Co B Sub (London) as the common equity holder may have the right under certain circumstances to assume control of the REIT (i.e., the failure to honor a request for a Recap) and direct it to liquidate assets, it has no direct creditor rights against the REIT or against Co A with respect to its common equity interests unless and until they effect a Recap. Accordingly, its investment should be accounted for as minority interest in Co A's consolidated balance sheet, a classification which falls between liabilities and stockholders' equity. This accounting would also apply to the accounting for the Investor's equity interest in Co A' s consolidated financial statements.

Regulation S-X issued by the Securities and Exchange Commission ("SEC") specifies that preferred stock which either is automatically redeemable by its terms or otherwise may be redeemed outside of the control of the issuing company should be reflected as redeemable

equity which is to be classified outside of stockholders' equity and is not to be included in a subtotal with stockholders' equity. The staff of the SEC and practice has generally extended this concept to any form of equity that may be redeemed outside of the control of management. In our view, since Co B has the ability to unilaterally convert its equity in REIT to debt, this equity should be reflected as redeemable equity in The REIT's financial statements.

The Financial Accounting Standards Board (FASB) has added a project to its agenda on distinguishing debt instruments from equity. While no firm positions on this project have been reached, the FASB has developed a working framework for determining the proper classification of financial instruments that appear to have both liability and equity attributes. Under that framework, individual obligations and certain types of options that are embodied in a financial instrument would be separated and initially classified based on certain characteristics of the component. A component that embodies an obligation that requires the issuer to transfer assets would be a liability. An obligation that requires or permits the issuer to satisfy the obligation by issuing its own equity shares would be classified as equity only if the fair value of the component is indexed to the fair value of the issuer's own equity shares. If the fair value of the component that obligates the entity to issue its own stock is indexed to something other than the issuer's own equity shares, it would be classified as a liability.

There is no way to know when or if this project may result in proposed changes to existing rules or practices relative to equity securities that may be put to the issuer or otherwise redeemed outside of the issuer's control or, if such changes are proposed, what the final rules may require.

The Original REIT Debt Security represents debt of The REIT and, hence, would be reflected as debt in Co A's consolidated financial statements.

Accounting for the acquisition of the Co B assets by Co A

Inasmuch as Co A will consolidate the REIT, it will need to account for the acquisition of the Co B Assets in its consolidated financial statements as well as the acquisition of the Leased Assets from Co B Sub 2. Since these acquisitions are being made by entities in the Co A consolidated group from entities in the Co B consolidated group, under a structured purchase, they should be aggregated as the same purchase transaction. It is unclear whether these acquisitions would constitute a business combination under US GAAP. Accounting Principles Board Opinion ("APB") No. 16 – *Business Combinations* states that "A business combination occurs when a corporation and one or more incorporated or unincorporated businesses are brought together into one accounting entity". Since APB 16 provides no further guidance as to what constitutes a "business", we would look to Regulation S-X which states, in Rule 11-01(d):

"For purposes of this rule, the term business should be evaluated in light of the facts and circumstances involved and whether there is sufficient continuity of the acquired entity's operations prior to and after transactions so that disclosure of prior financial information is material to an understanding of future operations. A presumption exists that a separate entity, a subsidiary, or a division is a business. Among the facts and circumstances which should be considered in evaluating whether an acquisition of a lesser component of an entity constitutes a business are the following:

Physical facilities,
Employee base,
Market distribution system,
Sales force,
Customer base,
Operating rights,
Production techniques, or
Trade names."

The determination of whether the acquisition of the Co B Assets is a business combination thus depends on whether the Co B Assets are considered a "business" which in turn depends on the significance of the operations relative to the nonoperating assets. No guidance exists in the accounting literature and we are unable to provide any "rule of thumb" for this facts and circumstances judgmental decision. In this letter, we will discuss the accounting in both the case where the acquisition is considered a business combination as well as when it is not.

Accounting For Transfers of Financial Assets

SFAS 125 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. Those standards are based on an approach that focuses on control over the transferred assets. Under that approach, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished. SFAS 125 provides standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings.

Under SFAS 125, a transfer of financial assets, in which the transferor surrenders control over those assets, is accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. The transferor has surrendered control over transferred assets if and only if all of the following conditions are met:

a. The transferred assets have been isolated from the transferor -- put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. This would require that the Co B Assets transferred to the REIT be beyond the reach of the creditors of Co B Sub (London) or Co B should one or both become insolvent (i.e. the creditors could get the stock and debt representing Co B's investment in REIT but could not reach into REIT).

b. Either (1) each transferee obtains the right -- free of conditions that constrain it from taking advantage of that right -- to pledge or exchange the transferred assets or (2) the transferee is a qualifying special-purpose entity and the holders of beneficial interests in that entity have the right -- free of conditions that constrain them from taking advantage of that right -- to pledge or exchange those interests. This would be met in the transaction discussed herein unless the terms limiting Co A's ability to exercise free and uninhibited control were so limiting as to violate this requirement. So long as Co A has the right to pledge any or all of the Co B Assets (and has the right to add leverage), we believe that this criterion is met.

c. The transferor does not maintain effective control over the transferred assets through (1) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity or (2) an agreement that entitles the transferor to repurchase or redeem transferred assets that are not readily obtainable. As to Co B and subsidiaries, this requirement would be met.

You have instructed us to assume that the SFAS 125 requirements set forth above will be met relative to Co B's transfer of assets and that, hence, Co B would reflect these assets as sold for accounting purposes and The REIT (and Co A Sub 5, if the Leased Assets are deemed to be financial assets) would reflect them as its assets. If this were not the case, the transfer of the Co B Assets would be accounted for, by REIT (and, if applicable by Co A Sub 5), as a collateralized loan to Co B.

Recording of deferred tax assets/liabilities related to REIT assets/liabilities

Accounting for income taxes is governed by SFAS No. 109. That Statement provides that, among other things, assets and liabilities which are recorded at different amounts for financial reporting purposes than for income tax purposes create basis differences for which a deferred tax asset or liability might be required. In this transaction, the REMICs, with fair value at or close to $0 and an initial tax basis of $70 million, give rise to such a basis difference. In addition, $330 million of non-cash taxable income to be generated in future years will create an additional difference.

SFAS No. 109 provides that deferred taxes be provided only for basis differences which qualify as temporary differences, meaning those differences between the tax basis of an asset or liability and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the book carrying value of the asset or liability is recovered or settled, respectively. Further, deferred tax assets or liabilities are recorded only by the specific entity on whose books such differences reside (i.e., the REIT). In other words, if the REIT were a true tax "flow through" entity (i.e., not a taxpayer) such as a partnership, no deferred tax asset would be provided on the books of the REIT itself. In this case only the temporary differences which may exist on the unconsolidated books of Co A would be considered (such temporary differences are assumed to be nil since the tax basis of Co A's investment in the REIT of $45,050,000 equals its initial accounting basis).

You have informed us, however, that under the Federal Income Tax rules (FIT), a REIT is not a non-taxable flow-through entity, but rather an entity which receives a tax deduction for its dividends (deemed or actual) to its equity owners. While REIT remains a qualified REIT for FIT purposes, the reversal of the basis differences in the REMICS would not have tax consequences to the REIT because of the aforementioned tax deduction for distributions. The excess of tax basis over book value of the REMICs, however, could result in beneficial tax deductions to the extent such deductions are used to offset income which would be taxable to REIT at a time when it is neither a flow through entity nor an entity entitled to a tax deduction for dividends paid. Accordingly, we believe that a deferred tax asset should be recorded with respect to the book/tax basis difference related to the REMICs (totaling approximately $400 million) held by the REIT to the extent that such differences are expected to reverse and offset income which would otherwise be taxable to an entity that is neither a flow-through entity nor an entity entitled to a tax deduction for dividends paid. You have informed us that Co A and the REIT have a prudent and feasible strategy within their control and which they can exercise without incurring substantial cost to ensure this will be the case. Thus, Co A should be able to record a $28 million deferred tax asset for the initial basis difference in the REMICs upon their contribution to The REIT ($70 million basis difference times an assumed tax rate of 40%).

In addition, Co A could record an additional deferred tax asset in each future year (as the additional non-cash taxable income is generated on the REMICs) totaling approximately $132 million ($330 million of future taxable income at the assumed 40% effective rate). Accordingly, as taxable income is generated in future periods from the REMICs, Co A will recognize a deferred tax benefit and will record a corresponding deferred tax asset, subject to the realizability test (need for a valuation reserve) discussed below. For example, assuming the REMICs generate $50 million of non cash income in year one and assuming no need for a valuation reserve, then Co A would make the following journal entry (assuming 40% tax rate):

Dr Deferred tax asset $20 million
Cr Deferred tax expense $20 million

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Accounting if Deemed a Business Combination –

If Co A's acquisition of the Co B Assets were judged to constitute a business combination, APB No. 16 would apply, and the acquisition would be accounted for as a purchase. Inasmuch as the purchase price is not being allocated to the underlying assets and liabilities for tax purposes, deferred tax assets and liabilities must be recorded (or maintained) for any differences between their book basis (adjusted as necessary to fair values) and tax basis. Accordingly, the purchase accounting by Co A on a consolidated basis (assuming a 40% effective tax rate) would consist of:

Dr.	Leased Assets	45,000,000	
Dr.	REMIC Residual Interests	0	
Dr.	Mortgages	49,962,500	
Dr.	Deferred Tax Asset	28,000,000	
	Cr. Cash		90,050,000
	Cr. Original REIT Debt		2,531,600
	Cr. Minority Interest		2,380,900
	Cr. Negative Goodwill		28,000,000

APB 16 provides that neither current assets nor marketable securities (e.g. the Mortgages) are reduced to eliminate the negative goodwill. However, while APB No. 16 does not specifically prevent the reduction of non-marketable debt instruments such as the REMIC residuals, the SEC staff, in correspondence with banking regulators in 1990, indicated their belief that such loans should not be reduced. Though the staff has not, to our knowledge, addressed the issue with respect to other financial assets such as REMICs, we believe the principle to be sufficiently similar to reach the conclusion that such assets should also not be reduced by the negative goodwill (the REMIC residuals in any case are already carried at or close to zero).

If the Leased Assets were considered to be financial assets, their transfer would need to be considered under SFAS 125. They would be considered to be financial assets if they were classified as either direct financing leases or leveraged leases under SFAS 13, as amended (at least to the extent of the present value of minimum lease payments and possibly in total). If, however, the Leased Assets were classified as equipment subject to operating lease, the negative goodwill would be offset against these assets as follows:

Dr. Negative Goodwill	28,000,000	
Cr. Leased Assets		28,000,000

This results in the Leased Assets having a book basis of 17,000,000 and a tax basis of 45,000,000 and may require additions to the Deferred Tax Asset account and negative goodwill which is again netted against the Leased Asset balance. This leads to an iterative process with the following effect:

Dr. Deferred Tax Asset	18,000,000	
Cr. Leased Assets		17,000,000
Cr. Negative Goodwill		1,000,000

See the discussion of the Accounting for Leases in a Business Combination below.

Additionally, though the negative goodwill which has been created for accounting purposes has no tax basis, SFAS No. 109 specifically provides, in paragraph 30, that no deferred tax asset be recorded with respect to this difference. Accordingly, the amortization of the negative goodwill, which should be recorded over a reasonable life on a systematic and rational method (which in practice is generally on a straight-line basis) will increase income before taxes without a corresponding deferred tax expense being reflected.

Assuming that, at some subsequent date, Co A decides to have the REIT sell the Mortgages and to have CO A Sub 5 sell the Leased Assets, the entry to record the sales (assuming market prices do not change from the date of acquisition of these assets) would be as follows (again, assuming that the Leased Assets are not financial assets:

Cash	$94,962,500		
		Mortgages	$49,962,500
		Gain	45,000,000

Accounting If not Deemed a Business Combination –

If it were determined that the Co B Assets did not meet the definition of a business, the acquisition of these assets by Co A would not constitute a business combination, and APB No. 16 would not apply to the transaction. The Emerging Issues Task Force of the FASB (the Task Force), in Issue 98-11, discussed the *Accounting for Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combinations.* The Task Force reached a final consensus on May 20, 1999. The Task Force has decided that the tax effect of different book and tax bases in a single-asset acquisition should be recorded as an adjustment to the carrying amount of the purchased asset unless the asset is a financial asset. The consensus also included the following conclusions, among others:

1. The accounting for single-asset acquisitions when the single asset acquired is a financial asset should always be recognized at fair value.

2. The accounting (amortization and classification) for the additional credit that can arise when there is a deferred tax asset that is greater than the purchase price paid for the "non-tax asset" acquired should not be grossed for a "tax-on-tax" effect (i.e. although this credit has

no tax basis, no additional deferred tax would be recorded for this book/tax difference). The amortization of this balancing credit should go though the income tax provision line in the income statement. The amortization to income of the credit should be based on the timing of the actual cash reduction in income taxes as a result of using the acquired tax benefit.

3. The final consensus reached by the Task Force regarding Issue 98-11 should be applied prospectively.

As further discussed below, SFAS 109 specifies that deferred tax assets must be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. The valuation allowance should be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized. To the extent that the deferred tax asset recorded as part of the acquisition are offset by a valuation allowance the balancing credit would also be reduced or eliminated.

The resulting entries would be essentially the same as those described above, except that instead of negative goodwill there would be a balancing credit to be recognized though the income tax provision line in the income statement. The amortization to income of this credit would be based on the timing of the actual cash reduction in income taxes as a result of using the acquired tax benefit.

Assuming that, at some subsequent date, Co A decides to have the REIT sell the Mortgages and to have CO A Sub 5 sell the Leased Assets, the entry to record the sales (assuming market prices do not change from the date of acquisition of these assets) would be as follows:

Cash	$94,962,500		
		Mortgages	$49,962,500
		Gain	45,000,000

Need for a Valuation Allowance –

An additional issue is whether the deferred tax asset on the REIT's balance sheet will now require a valuation allowance since REIT will not be included in Co A's consolidated tax return for some period of time. Co A, for consolidated financial reporting purposes, may consider the effect of tax-planning strategies, which are described in paragraph 22 of FAS 109:

"In some circumstances, there are actions (including elections for tax purposes) that (a) are prudent and feasible, (b) an enterprise ordinarily might not take, but would take to prevent an

operating loss or tax credit carryforward from expiring unused, and (c) would result in realization of deferred tax assets. This Statement refers to those actions as tax-planning strategies. An enterprise shall consider tax-planning strategies in determining the amount of valuation allowance required. Significant expenses to implement a tax-planning strategy or any significant losses that would be recognized if that strategy were implemented (net of any recognizable tax benefits associated with those expenses or losses) shall be included in the valuation allowance."

You have informed us that no valuation allowance would be necessary since Co A and the REIT have a planning strategy available which can be exercised at no significant cost which will provide sufficient taxable income is available to ensure the realization of the benefit of any tax deductions to be generated by the Co B Assets. As a result, we believe there is no need to provide a valuation allowance with respect to (1) the deferred tax asset relating to the book/tax basis difference in the REMIC residuals when the Co B Assets are acquired nor, (2) for the additional basis difference created in the REMIC residuals in future years.

Accounting For the Minority Interest After Inception –

On an ongoing basis, minority interest is generally accounted for by allocating to the minority its share of the income/loss of the entity in which it holds an ownership. However, a modification is appropriate in this case because of the presence of the Recap right and the likelihood of Co A exercising such right (in the event Co B Sub (London) does not exercise it first) to achieve the objectives discussed herein.

Therefore, the cash flows to Co B Sub (London) and Investors should be estimated, including the estimated exercise of the Recap right, as to timing and amount. Co B Sub (London) and Investors' original investment, classified as minority interest in the consolidated balance sheet as discussed above, should be accreted on a level-yield basis to such cash outflow amounts. Changes in estimates should be reflected each accounting period by a cumulative catch-up adjustment to the recorded minority interest balance. The accretion expense should be classified as minority interest expense in the consolidated income statement.

ACCOUNTING FOR LEASES IN A BUSINESS COMBINATION

In FASB Interpretation No. 21, "Accounting for Leases in a Business Combination," the FASB clarifies the application of SFAS No. 13 in business combinations. Specifically, FASB Interpretation No. 21 addresses the following questions:

a. Does the consummation of a business combination require the combined enterprise to treat leases of the combining companies as new leases to be classified according to the criteria set forth in SFAS No. 13, based on conditions as of the date of the combination?

b. If the consummation of a business combination does not require enterprises to treat leases of the combining companies as new leases as of the date of the combination, how should SFAS No. 13 be applied to the leases of the combined enterprise?

c. How do the requirements of APB Opinion No. 16, "Business Combinations," for assigning amounts to the assets acquired and liabilities assumed in a business combination that is accounted for by the purchase method affect the application of SFAS No. 13 by the combined enterprise to leases of the acquired company?

SFAS No. 13 requires that the classification of a lease be determined at the inception of the lease. Once that determination is made, the classification of the lease is not re-examined unless either (a) both parties to the lease agree to a revision that would have resulted in a different classification of the lease had the changed terms been in effect at the inception of the lease or (b) the lease is extended or renewed. In FASB Interpretation No. 21, the FASB views the substance of a business combination that is accounted for under the purchase method to be the purchase of the lessor or lessee's interest in an existing lease. The original lessee or lessor does not become a party to a new agreement; accordingly, there is no new agreement to be classified, and SFAS No. 13 does not permit reclassification of the existing lease unless the provisions of the lease are modified. The fact that the identity of one party to a lease may change in a business combination is not substantive. If the provisions of the lease are not changed, the modification does not represent a new agreement between the lessee and lessor, and the lease should not be reclassified.

Paragraph 88 of APB Opinion No. 16 provides "general guides for assigning amounts to the individual assets acquired and liabilities assumed, except goodwill," in a business combination that is accounted for by the purchase method. The guides in subparagraphs of paragraph 88 indicate the method of valuation to be used for various types of assets and liabilities. In a business combination that is accounted for by the purchase method, the acquiring enterprise should determine the amounts assigned to individual assets acquired and liabilities assumed (including assets and liabilities related to lease commitments and leased property) at the date of the combination consistent with the general guides for that type of asset or liability in paragraph 88 of APB Opinion No. 16. Subsequent to the recording of the amounts called for by APB Opinion No. 16, the leases should thereafter be accounted for in accordance with SFAS No. 13. FASB Interpretation No. 21 goes on to explain the application of this guidance to a leveraged lease by an enterprise that acquires a lessor. In practice, the guidance in FASB Interpretation No. 21 also has been used to value acquired lease portfolios as well as leases acquired as part of a purchase business combination.

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In addition to a business combination, we believe the provisions of paragraphs 40A through 40E of SFAS No. 13 apply to the acquisition of a lease (for example, an investment in an existing leveraged lease) or a portfolio of leases. When a lease or a portfolio of leases is acquired, or a target company owns only a portfolio of leases, some additional accounting issues arise. These are discussed below.

In our view, where the target company in a purchase business acquisition owns a portfolio of leases but does not have other assets or operations, it is inappropriate to have the APB Opinion No. 16, "Business Combinations," allocation result in goodwill because the acquirer has purchased only a lease portfolio. In this situation, the purchase price should be allocated based on the remaining estimated after-tax cash flows from the leases purchased. This will typically be the same basis used by the purchaser to price the transaction.

Except for leveraged leases, SFAS No. 109, "Accounting for Income Taxes," has amended APB Opinion No. 16 to eliminate "net of tax" valuation for acquired assets and liabilities. When the acquirer of leveraged leases is in a tax net operating loss carryforward position, we believe that the net operating losses and carryforwards should be included in the computation of cash flows used to allocate the purchase price to the leases because (a) such net operating losses probably were considered in the pricing of the transaction and (b) if "net of tax" values were assigned to the acquired leases, the resulting "goodwill" would need to be eliminated by reallocating the excess back to the leases.

Ongoing Need for Deferred Taxes –

A final issue relates to the need to provide a deferred tax liability for any difference in the tax basis vs. book basis of Co A's investment in the REIT which may arise. Paragraph 33 of SFAS No. 109 addresses basis differences related to a parent's investment in the stock of a subsidiary, as follows:

"Whether an excess of the amount for financial reporting over the tax basis of an investment in a more-than-50-percent owned domestic subsidiary is a taxable temporary difference must be assessed. It is not a taxable temporary difference if the tax law provides a means by which the reported amount of that investment can be recovered tax-free and the enterprise expects that it will ultimately use that means. For example, under current U.S. federal tax law:

An enterprise may elect to determine taxable gain or loss on liquidation of an 80-percent-or-more owned subsidiary by reference to the tax basis of the subsidiary's net assets rather than by reference to the parent company's tax basis for the stock of that subsidiary.

An enterprise may execute a statutory merger whereby a subsidiary is merged into the parent company, the minority shareholders receive stock of the parent, the subsidiary's stock is canceled, and no taxable gain or loss results if the continuity of ownership, continuity of business enterprise, and certain other requirements of the tax law are met.

Some elections for tax purposes are available only if the parent company owns a specified percentage of the subsidiary's stock. The parent company sometimes may own less than that specified percentage, and the price per share to acquire a minority interest may significantly exceed the per share equivalent of the amount reported as minority interest in the consolidated financial statements. In those circumstances, the excess of the amount for financial reporting over the tax basis of the parent's investment in the subsidiary is not a taxable temporary difference if settlement of the minority interest is expected to occur at the point in time when settlement would not result in a significant cost. That would occur, for example, toward the end of the life of the subsidiary, after it has recovered and settled most of its assets and liabilities, respectively. The fair value of the minority interest ordinarily will approximately equal its percentage of the subsidiary's net assets if those net assets consist primarily of cash."

In this regard, you have informed us that Co A has available to it a planning strategy which, without the incurring of substantial cost, would enable Co A to realize its investment in REIT but avoid recognition of future taxable income attributable to any excess of book carrying value of its investment in REIT over its corresponding tax basis in the stock of REIT. Accordingly, we believe there is no need to provide a deferred tax liability on any basis difference relating to Co A's investment in the stock of the REIT. Note that this conclusion relies on Co A's intention to complete such planning strategy. A plan to maintain the REIT's existence indefinitely, and therefore only postpone the tax liability on any basis difference even in perpetuity, would not eliminate the need for a deferred tax liability under SFAS No. 109.

Assurance of Sustaining Tax Positions –

The preceding discussion is predicated on assumptions about certain provisions of the Internal Revenue Code of 1986, as amended, the regulations thereunder, and other relevant authorities promulgated by the Internal Revenue Service and the courts applicable to the various aspects of the transaction. The recording of the financial statement benefits of the transaction is dependent on the proper interpretation and implementation of such authorities. All companies, in preparing their financial statements for presentation to their shareholders, have a responsibility to evaluate the possibility that positions they have taken on their tax returns may be subject to challenge.

In situations such as these, in which the ultimate realization of the economic and financial statement benefits is dependent upon certain positions that will be taken on current and future tax returns, we believe that the financial statement benefits should be recorded only if it is probable that the pertinent tax positions will be sustained. The term "probable", though discussed in SFAS No. 5 – Accounting for Contingencies, is not numerically defined therein or elsewhere in the authoritative accounting literature. It is clear that it requires a higher degree of likelihood than the "more likely than not" standard discussed in SFAS No. 109 (which represents a threshold of more than 50%).

The ultimate responsibility for the decision on the appropriate application of generally accepted accounting principles for an actual transaction rests with the preparers of financial statements, who should consult with their continuing accountants. Our judgment on the appropriate application of generally accepted accounting principles for the described hypothetical transaction is based solely on the facts provided to us as described above; should these facts and circumstances differ, our conclusion may change. We have not been asked to address and have not addressed any tax matters related to this transaction.

Our opinion is as of the date of this letter, and we do not assume an obligation to update this opinion for subsequent changes in relevant rules or practice.

Arthur Andersen LLP

EC2 000037367

portfolio limitations:
· term of mtgs around 5 yrs. - basis for amortizing pre-tax benefits
351(e) invest. company rules - mtg must be diversified

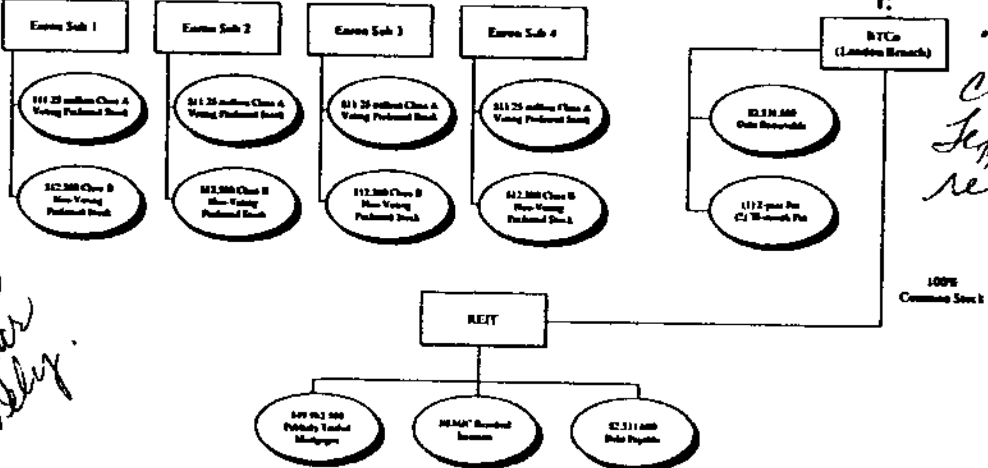
II. Transaction Structure

for each contributor to the REIT - issues of equal size accomplish this result

2. Transfer of Preferred Stock to Akin, Gump Partners

· found mtgs that meet these qualifications - fixed rate, callable - issues that need to be dealt w/ - sufficient cash flow to make payments on the preferred stock

· need to start conversations w/ Jeff Kinneman re the CMOs



recent Tony Edwards article - (on one count executives/officers of private REITs toward the 100 owner unit)

REIT 10 investor rule is tested in the 2nd yr. - 1st month of the following year effectivity.

alternatives to Akin Gump being considered - ees of Enron - holding by a benefit plan (w/ look through to beneficiaries)

- BTCo (London Branch) will transfer approximately $12,500 of Class B non-voting coupon preferred stock to Akin, Gump, Strauss, Hauer & Feld ("Akin, Gump") in satisfaction of legal services provided on matters unrelated to the REIT. Akin, Gump will distribute the Class B non-voting coupon preferred stock of the REIT to at least 99 partners of Akin, Gump.

— look @ grandfather rule in Admin. proposal — Private REIT issue — complete mechanics before Labor Day - before legis extenders

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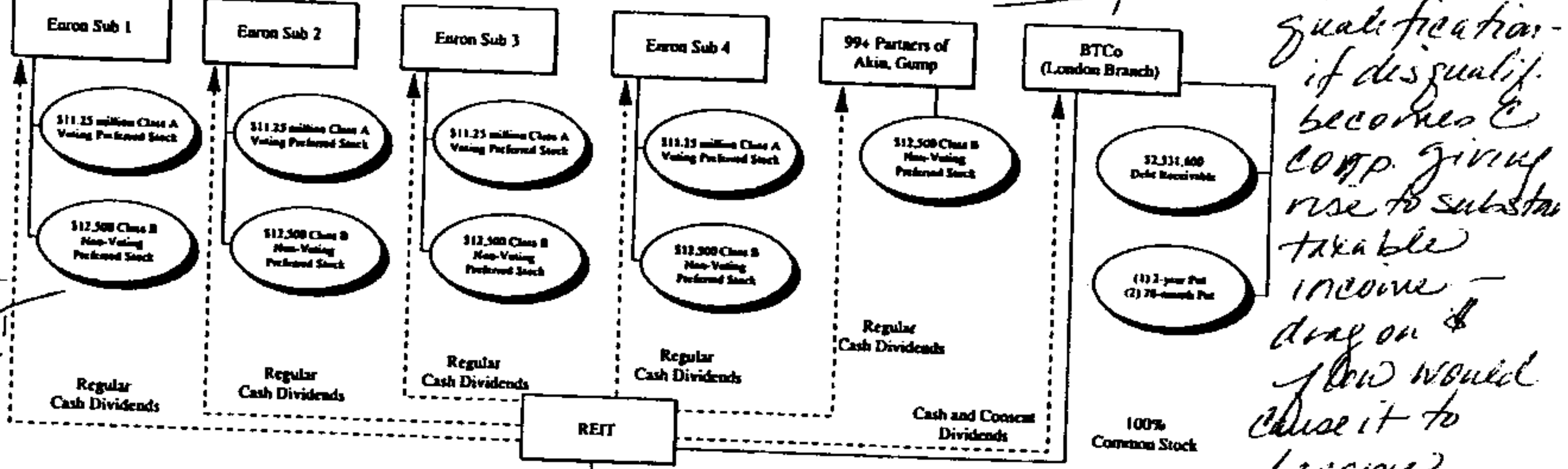
II. Transaction Structure

3. Dividends During Subsequent Years



- During subsequent years of operation, the REIT will make the required coupon payments on the voting and non-voting preferred stock. In addition, the REIT will distribute any remaining taxable income through cash and consent dividends to BTCo (London Branch) as the holder of the common stock.

Transaction Structure

Recapitalization

Enron
Directors
ECT Investments Holding Corp
Leased Assets
98 Investors
BTCo (London Branch)
New Debt Security
(1) 2-year Put
(2) 78-month Put
Common Stock
Class A Voting Preferred Stock
Class B Non-Voting Preferred Stock
Cash
Cash
Class B Non-Voting Preferred Stock
Cash
Maliseet
New Debt Security
Class B Non-Voting Preferred Stock
(1) Common Stock
(2) Original Debt Security
Mortgage Securities
REMIC Residual Interests
New Debt Payable to BTCo (LB)

- After at least 5 years, pursuant to the terms of the corporate documents governing Maliseet, either Enron or BTCo may force a recapitalization of Maliseet.
- As part of a recapitalization, Maliseet would redeem the Class B non-voting preferred stock.

EC2 000037446

I. Executive Summary

- This technique (the "Transaction") utilizes the rules of FAS 109 which ignore the time value of money concept and require the recording of deferred tax assets based on gross, undiscounted amounts. In the Transaction, Enron Corp. ("Enron") is able to record deferred tax assets at gross amounts well in excess of their present value. A portion of the deferred tax asset is recorded upon execution of the Transaction and effectively creates a bargain purchase for Enron. Moreover, the purchase accounting rules of APB 16 cause Enron to reduce the book basis of other assets acquired by Enron. The Transaction is structured in a manner which allows the benefit of the bargain purchase to be recognized into pre-tax income over a relatively short time frame. The remaining deferred tax asset is recorded over the next several years with a corresponding benefit directly to Enron's income tax provision.

- Specifically, the effect of the Transaction is to create pre-tax accounting income of approximately $75 million through the reduction of book basis of acquired assets and the amortization of a deferred credit, as well as approximately $79 million of earnings in the tax provision of the income statement, for a total of approximately $154 million of after-tax earnings. The net result is the generation of annual pre-tax accounting earnings of between $2-18 million per year from 1999-2003 and after-tax accounting earnings of between $15-36 million per year from 1999-2003.

- The Transaction will create tax losses of approximately $400 million during years 2006-2025. After allowance for fees and expenses, the Transaction will generate cash flows with a net present value at 7% of $100.7 million pre-tax and $63.5 million after-tax and a net present value at 10% of $59.9 million pre-tax and $37.7 million after-tax. The internal rate of return of the Transaction is 25.72% pre-tax and 16.20% after-tax.

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