# XI. MATERIALS RELATING TO PURCHASE AND RECONVEYANCE OF MR. LAY'S ANNUITY CONTRACTS

# Ken Lay Insurance Swap Analysis

**Scenario 1**

## Enron Purchases Policies and Awards back to Ken with Vesting vs Enron Stock Award

| | Ken's Policy | Linda's Policy | Policy Total | Enron Stock |
|---|---|---|---|---|
| **CURRENT SITUATION** | | | | |
| - Tax Basis | 5,000,000 | 5,000,000 | 10,000,000 | |
| - Current Market Value | 2,459,475 | 2,232,092 | 4,691,567 | |
| - Current Floor Value | 5,819,795 | 5,420,890 | 11,240,685 | |
| **EXCHANGE POLICY FOR CASH** | | | | |
| - Purchase Price / Current Fair Market Value | **5,000,000** | **5,000,000** | **10,000,000** | |
| ************************ | | | | |
| **AWARD BY ENRON** | | | | |
| - Value of Award | 5,000,000 | 5,000,000 | 10,000,000 | 10,000,000 |
| **VESTING** | | | | |
| - Assumed Value in 4.25 years (12/31/05) | 7,455,171 | 6,944,173 | 14,399,344 | 14,399,344 |

| **Enron Issues** | Policy Total | Enron Stock |
|---|---|---|
| Enron Tax Deduction on Benefit Payments (162m) | No | No |
| Dilution to Common Shares Outstanding | No | Yes |
| ENE Taxes on Build-up while ENE owns policy (like any other investment) | Yes | No |

| **Ken Lay Issues** | Policy Total | Enron Stock |
|---|---|---|
| Initial Liquidity for Insurance | Yes | No |
| Cash Flow at Vesting for Tax Liability | No | Yes |
| Cash Flow begins appr. 2007 or when annuity starts | Yes | No |
| Full Vesting at Earliest of 12/31/2005, Death, Retirement, Disability | Yes | Yes |

# Ken Lay Insurance Swap Analysis

**Scenario 2**

## Enron Purchases Policies and Awards back to Ken with Vesting vs Enron Stock Award

| | Ken's Policy | Linda's Policy | Policy Total | Enron Stock |
|---|---|---|---|---|
| **CURRENT SITUATION** | | | | |
| - Tax Basis | 5,000,000 | 5,000,000 | 10,000,000 | |
| - Current Market Value | 2,459,475 | 2,232,092 | 4,691,567 | |
| - Current Floor Value | 5,819,795 | 5,420,890 | 11,240,685 | |
| **EXCHANGE POLICY FOR CASH** | | | | |
| - Purchase Price / Current Fair Market Value | **2,459,475** | **2,232,092** | **4,691,567** | |
| ************************ | | | | |
| **AWARD BY ENRON** | | | | |
| - Value of Award | 2,459,475 | 2,232,092 | 4,691,567 | 4,691,567 |
| **VESTING** | | | | |
| - Assumed Value in 4.25 years (12/31/05) | 7,455,171 | 6,944,173 | 14,399,344 | 14,399,344 |

| **Enron Issues** | Policy Total | Enron Stock |
|---|---|---|
| Enron Tax Deduction on Benefit Payments (162m) | No | No |
| Dilution to Common Shares Outstanding | No | Yes |
| ENE Taxes on Build-up while ENE owns policy (like any other investment) | Yes | No |

| **Ken Lay Issues** | Policy Total | Enron Stock |
|---|---|---|
| Initial Liquidity for Insurance | Yes | No |
| Cash Flow at Vesting for Tax Liability | No | Yes |
| Cash Flow begins appr. 2007 or when annuity starts | Yes | No |
| Full Vesting at Earliest of 12/31/2005, Death, Retirement, Disability | Yes | Yes |

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Towers Perrin

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November 2, 2001

Dr. Charles A. LeMaistre
Chairman, Enron Compensation Committee
Enron Corp.
7 Bristol Green
San Antonio, TX 78209

Dear Dr. LeMaistre:

As you requested, Towers Perrin has prepared this letter based on our previous discussions with Mary Joyce prior to September 14, 2001, providing our observations regarding the Ken Lay insurance swap approved by Enron's Compensation Committee earlier this year.

**Background**

Towers Perrin understands that Ken Lay purchased annuities with a tax basis of $5 million for his wife Linda and himself (for a total tax basis value of $10 million). At the time when Enron's Board asked Ken to resume his duties as CEO following Jeff Skilling's departure, the Company began exploring ways to provide a reasonable retention incentive for Mr. Lay to encourage him to continue serving as CEO for the next 4.25 years.

Traditionally in the market, this type of retention handcuff is handled by issuing restricted stock to the executive. However, we understand that Mr. Lay has a very large current position in Enron stock and that he expressed an interest in having more liquidity in his personal portfolio. Consequently, as part of an attempt to give Mr. Lay the liquidity he desired and a simultaneous retention incentive, Enron's Compensation Committee agreed to the following:

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- Enron purchased the two annuities from Mr. Lay for $10 million in cash.
- The Board agreed to allow Mr. Lay to earn the annuities back over 4 years for continued service.
- The $10 million present value of the annuities is to be netted out against Mr. Lay's long-term incentive awards over the next 4 years ($2.5 million per year).

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*Towers Perrin*

As we understand this transaction, the initial $10 million cash payout to Mr. Lay for the annuities is equal in value (on net present value basis) to his cost for the annuities and is less than the current NPV floor value of the annuities ($11.2 million). Therefore, while there are cash flow consequences to the transaction (since Mr. Lay receives the cash now), the Company will receive greater value for this swap in the future than the $10 million payout made to Mr. Lay.

The feature of the swap which allows Mr. Lay to earn back the annuities over 4 years is similar to the way a restricted stock award would be structured. Thus, it should serve as an effective retention device, similar to restricted stock. However, since this portion of the insurance swap was done in lieu of restricted stock (which would be the more common vehicle used in the market), Towers Perrin recommends that this value be subtracted from future restricted stock/option awards that would otherwise be granted to Mr. Lay over then next 4 years (at a rate of $2.5 million per year).

Finally, Towers Perrin understands that one alternative to the structure described above was to simply provide a $5 million signing bonus to Mr. Lay and to allow him to also sell his annuity, but not his wife's annuity to the Company. Towers Perrin believes the structure of the original agreement is preferable to this alternative, since it provides a meaningful retention incentive.

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I hope this letter meets Enron's needs. Please call me with any questions.

Sincerely,

Chuck Ericks

CEE:mhm

cc: Ms. Mary Joyce
Mr. John Duncan

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