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December 11, 1997

Mr. David Maxey
Enron Corp.
1400 Smith Street
Houston, Texas 77251-1188

Dear Dave:

This letter further expands on our discussion regarding permanent gain deferral.

Basic Structure

The product is a technique through which a corporate partner may redeem its partnership interest while minimizing any potential tax consequences on the redemption. There are a number of variations of the technique and several implementation steps, depending on the particular facts. However, where a partnership currently exists, the implementation steps of the product are as follows:

1. The fair market value of the Enron's partnership interest is determined. Nonmarketable securities (or assets related to the business of the entity) in an amount equal to the fair market value of Enron's interest are purchased by the partnership.

2. The partnership transfers the nonmarketable securities to a corporation (newly formed or currently controlled by the partnership) in exchange for all of the stock of the corporation. § 351

3. Enron's entire partnership interest is redeemed by the partnership in exchange for the stock of the corporation controlled by the partnership. Enron becomes the parent of the corporation formerly controlled by the partnership (i.e., a subsidiary). § 732(b)

4. Enron later liquidates its subsidiary. The nonmarketable securities are distributed to the Enron. The tax basis of the nonmarketable securities is the fair market value of the Enron's former partnership interest (i.e., the purchase price cost basis of the securities). The nonmarketable securities are sold later to a third party. Effectively, Enron recognizes no gain or loss on the sale of its partnership interest. § 332

In the alternative, Enron holds appreciated property and may be able to use the product to permanently defer recognition of the current gain if it is willing to contribute the property to a

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partnership and wait the time period required. For example, forming a partnership with an affiliated entity may start the running of the seven-year clock until a "buyer" can be located.

There are several other variations of the technique that may better fit your particular fact situation and tolerance for risk.

What's the Benefit?

The benefits of the product are as follows:

(1) Partition of partnership activities. Provides Enron and its current partners with the ability to partition partnership assets in an economically efficient manner. Thus after the redemption, each party may devote its undivided attention to the particular segment of the partnership business in which it is most proficient.

(2) Resolution of partner disputes. The product provides a tax effective technique for Enron and its partners to resolve disputes. An opportunity for a tax-free redemption of unwanted partners is available.

(3) Stepped-up basis to remaining partners. Upon redemption of the partnership interest held by Enron, the partnership has the opportunity to make an election to increase the basis of its remaining assets so as to avoid the recognition of some of the gain inherent in the partnership's retained assets.

(4) Substantial tax savings to Enron on disposition. Without the technique, Enron upon selling its partnership interest or analyzing assets, would be subject to tax on the gain (at a potential maximum rate of 35 percent). With the technique, however, the entire gain is either eliminated or the tax is significantly minimized. The result is a substantial tax savings to the Enron.

(5) Gain deferral to noncorporate partners. The technique is available to noncorporate partners but gain deferral and not gain elimination is the goal.

(6) Basis step-up. A step-up of partnership assets to be sold is possible.

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__Inherent Risk__

As with other tax savings techniques, there is a potential risk that the Internal Revenue Service (IRS) may attempt to recast the transaction. For example, the IRS may seek to recast the transaction under the common law doctrines of business purpose, step transaction, and substance over form. Additionally, the IRS may argue that the product triggers the "avoidance or evasion of tax" provisions under I.R.C. § 269 or the Partnership Anti-Abuse Regulations. There is also a risk that Congress may change the law in this area as the technique was mentioned last April by the Joint Committee on Taxation as a possible target for legislative change. However, the inherent risk in the product will depend on your particular factual situation. At a minimum, we believe that substantial authority exist in support of the product. Because of the substantial benefits that the product provides, and the possibility of legislative action, you should be advised to utilize the technique now, as its shelf life may be limited.

I look forward to discussing this further with you.

Very truly yours,

ARTHUR ANDERSEN LLP

By

Robert P. Palmquist

MLP [illegible]

Copies to:
Greek Rice
Bob Hermann

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