Project Condor

Purchase of equity interest to increase Enron Corp's basis in Whitewing. Steven had envisioned that Enron would purchase the outside investor's (equity's) interest about 4-5 years into or mid-way through the life of the partnership. Enron Corp's basis has to be sufficient to absorb the cash distributions during the term of the partnership because cash distributions in excess of Enron's basis will give rise to capital gain. The problem is that buying the equity interest will cause a deconsolidation of the partnership. In response to this problem, Steven suggests that Enron could wait until just before it wants to take its cash out of the partnership [or even until the partnership is liquidated] before acquiring the investor interest.

For example, during the first 7 years or so, Enron Corp. would take its cash distributions until its basis is reduced to zero. From that point forward until the [pipeline assets] are distributed to Enron affiliate, the same money would be distributed to Enron by the partnership but only in the form of a loan. After the [pipeline assets] are distributed to Enron affiliate, the $30M in annual dividend income coming into the partnership would increase Enron Corp's basis sufficiently to allow the distribution of the current income. When the structure has been in place over the [15-20] year depreciable life of the [pipeline assets] and Whitewing is ready to be deconsolidated, Enron Corp. would purchase the outside investor's interest and [reduce the deficit in its book basis or capital account to bring it up to zero].

Enron's election not to use either the full or partial purchase option. Presumably, the new partnership agreement for Whitewing will also not contain a right on the part of Enron elect a full or partial purchase option. Steven, in fact, seemed to indicate that the partnership might operate in 5 year increments. This intuitively makes sense based on the time horizon of most lenders, but it complicates things.

Since the benefits of the transaction would be much reduced if the partnership were terminated only 5 years into the structure, Steven suggests that the partnership agreement provide for a doomsday scenario that would occur is the outside investor required the partnership's liquidation. In this case, the partnership agreement would provide that the partnership's assets could be distributed in kind to either the partners or to persons designated by the partners in accordance with their positive capital accounts. The partnership would have to accumulate cash sufficient to repay the investor [or obtain a loan from Enron?]. The partnership would then transfer the Enron common stock and [pipeline assets] subject to lease to a new partnership. Under Section 708(a), this new partnership would be considered a continuation of the old partnership [on the assumption that because of the introduction of Enron affiliate as a partner,

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the outside investor would no longer have an interest constituting 50% or more of the total interest in partnership capital and profits under section 708(b)(1)(B)].

Use of assets temporarily. The use of Whitewing as a entity to cycle assets in and out of is not a good idea because of the disguised sale rules. Steven seemed to agree that we should get the appropriate asset(s) into the structure at the same time we lever up Whitewing. I'm still not clear, I guess, on Ben's rationale here. He indicated that Jeff McMahon wants to sell some assets out of the Rawhide structure, and Ben wants to scale back the transaction because from his standpoint, it is not efficient to tie up assets of this value given the amount borrowed. That makes sense. What is still unclear to me is why moving them into this structure is a good idea unless they would serve as additional collateral and Ben doesn't seem to be treating them this way based on the put option he has designed. (See below for more on this issue)

Use of the current Enron building. [For federal income tax purposes, the Enron building is treated as owned by Enron Leasing Partners, LP. ("Leasing Partners"), a Delaware limited partnership of which a 97% LP interest is owned by Organizational Partner, Inc. or "OPI," a 1% GP interest is owned by Enron Property Management Corp., and a 2 LP interest is owned by an unrelated institutional investor. Leasing Partners received the rights (and assumed the obligations) under the lease from OPI as a partnership contribution in exchange for an LP interest.... Ben will want to know why he can't use the Enron building in Project Condor...]

Leverage as business purpose. If pipeline assets are contributed to Whitewing, we should get credit for them from a business perspective and to support leverage as our business purpose. Specifically, the put option should be reduced for the value of the assets. Steven wonders why we even need the put option at all. See below for more.

Put options. It is more awkward for the bank with the put agreements with Enron and Whitewing to also be the lender to Whitewing. We may be able to get there, but this is an awkward arrangement. What is the cost of the option versus the value of the tax deduction on the interest over the period of the debt that is being put at risk. ("Quick and dirty" example: $1B x 8% x 35% x 5 years = $140M)

Confirm with Ben that the reason he wants both banks to be the same is because the cost of the put is reduced when only one bank rather than two have Enron credit exposure. In terms of quantifying the cost of the put, confirm with Ben how far the first bank's credit exposure extends. For example, if Enron's stock is worth zero, is the first bank on the hook for the full $1.5B?

Steven asks why do we need the put option. The partnership agreement could provide that if the value of the underlying property has a value of less than $1B, Enron or Enron affiliate could be obligated to make capital improvements or sell the property. This would

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result in liquidation of the partnership, but in this case, we could lose the sought-after benefit any way. Why? The partnership rules require that the distribution of proceeds in liquidation be in accordance with the partners' capital accounts. If the value of the property has fallen below $1B but Enron affiliate's capital account still equals $1B, the partnership will have an obligation to distribute cash (or stock) to make up the difference.

General partnership anti-abuse rules.

Remedial allocation anti-abuse rules. In McKee's partnership treatise, the authors state that the choice of the remedial allocation method is subject to the anti-abuse rule of Reg. section 1.704-3(a)(10). [see legislative history also cited] Steven says, however, that our application of the remedial allocation method should not run afoul of the rule and, in fact, follows it to the letter. The rule provides that an allocation method (or combination of methods) is not reasonable if the contribution of property and the corresponding allocation of tax items with respect to the property are made with a view to shifting the tax consequences of built-in gain (or loss) among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability. In this case, the tax consequences are not being "shifted" but are instead being allocated to the partner whose contribution of property had the built-in gain.

Depreciation anti-churning rules. Bob Hermann has asked the question of whether the depreciation anti-churning rules apply. Essentially, Steven Klig hadn't focused on these rules and we both plan to study them further. My quick research thus far indicates that the MACRS and ACRS anti-abuse rules are intended to disallow a taxpayer from applying these accelerated accounting rules to property originally placed in service prior to the effective dates for these rules.

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