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From: Stephanie McGinnis [Stephanie McGinnis/HOU/ECT@It-Comp]
Sent: Thursday, August 31, 2000 7:04 AM
To: Mary Kay Moore
Cc: Rick L Carson
Subject: Lessons Learned

Rick Buy was very pleased with what you were able to do with our Lessons Learned presentations. We greatly appreciate your help in making this presentation a success!!!!

Below are the final versions which were given to Rick Buy (and the printed version to Jeff Skilling today).

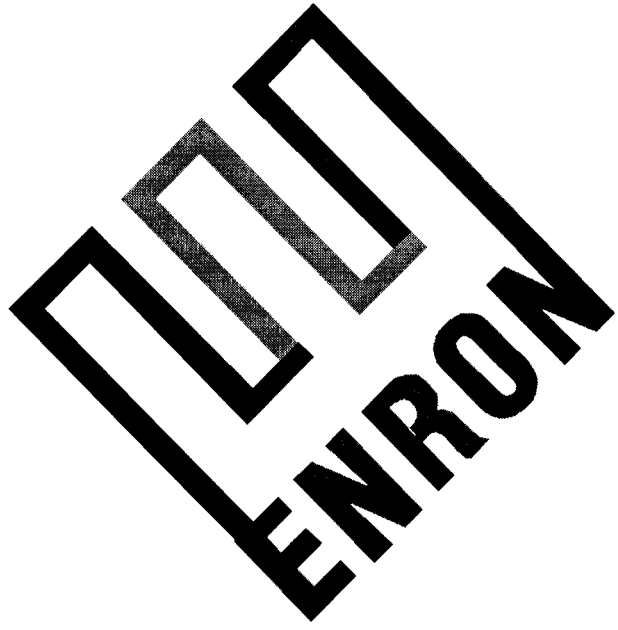
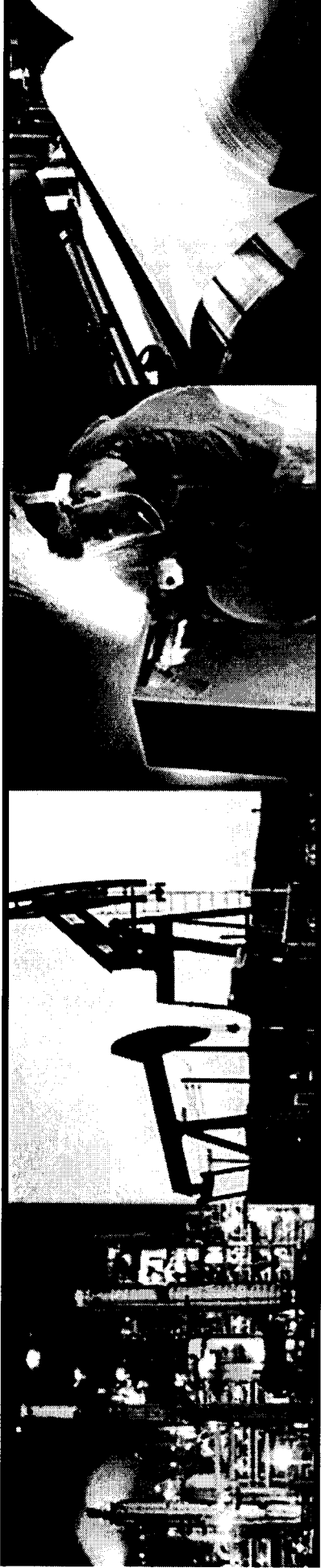


Lessons Learned
Animated MKM.p...



Lessons Learned
Handouts SKM.p...

Thanks again!
Stephanie

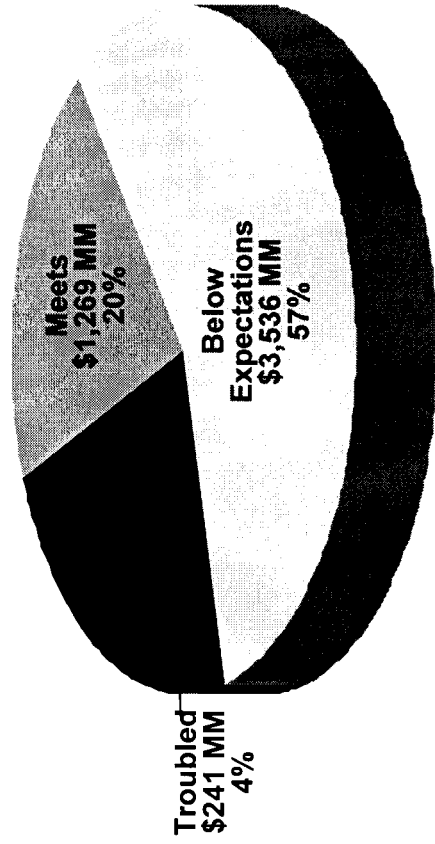


**Investment Portfolio
Lessons Learned
September 2000**

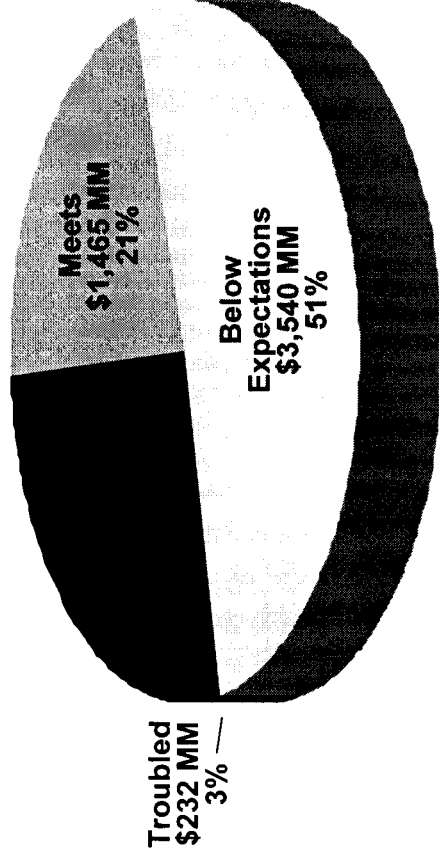
Investment Performance

Summary Statistics – Worldwide Equity Portfolio

Cost Basis \$6.2 Bn



Carrying Value \$6.9 Bn



CONCLUSIONS

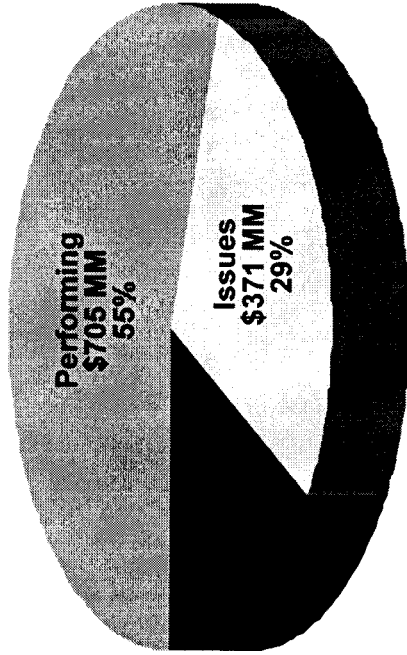
- ◆ 61% of originally expended capital is not meeting expectations.
- ◆ Enron has \$3.8 Bn of earnings exposure on assets performing below expectations.
- ◆ 78 out of 154 equity transactions are underperforming!



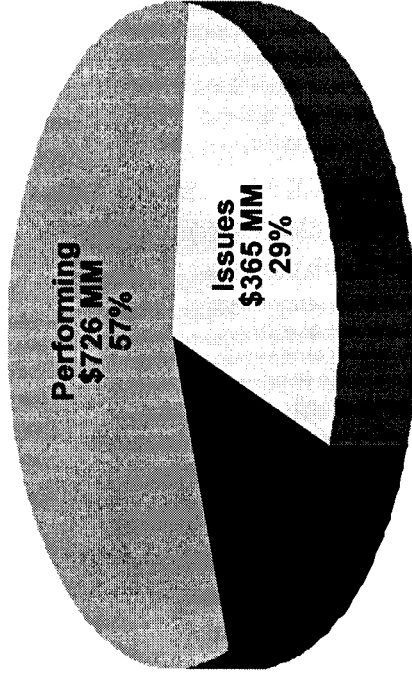
Investment Performance

Summary Statistics – Worldwide Debt Portfolio

Cost Basis \$1.3 Bn



Carrying Value \$1.3 Bn

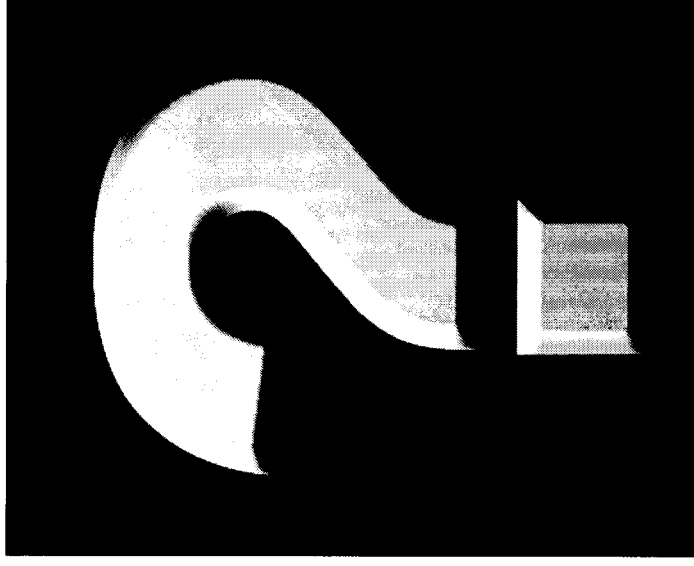


CONCLUSIONS

- ◆ 45% of originally expended debt capital is not performing or has issues.
- ◆ Enron has \$547 MM of earnings exposure on debt that is non-performing or has issues.
- ◆ 31 out of 65 debt transactions are non-performing or have issues!



*Why are 109 deals comprising 50% of
our investment portfolio not performing
according to expectations?*



Underperforming Deals

Major Factors

[Redacted]

Market Corroboration and Terms

Compensation/Incentives

[Redacted]

[Redacted]

Preparation for the "Worst Case"



Underperforming Deals

Major Factors

[Redacted]

Market Corroboration and Termination

Compensation/Incentives

[Redacted]

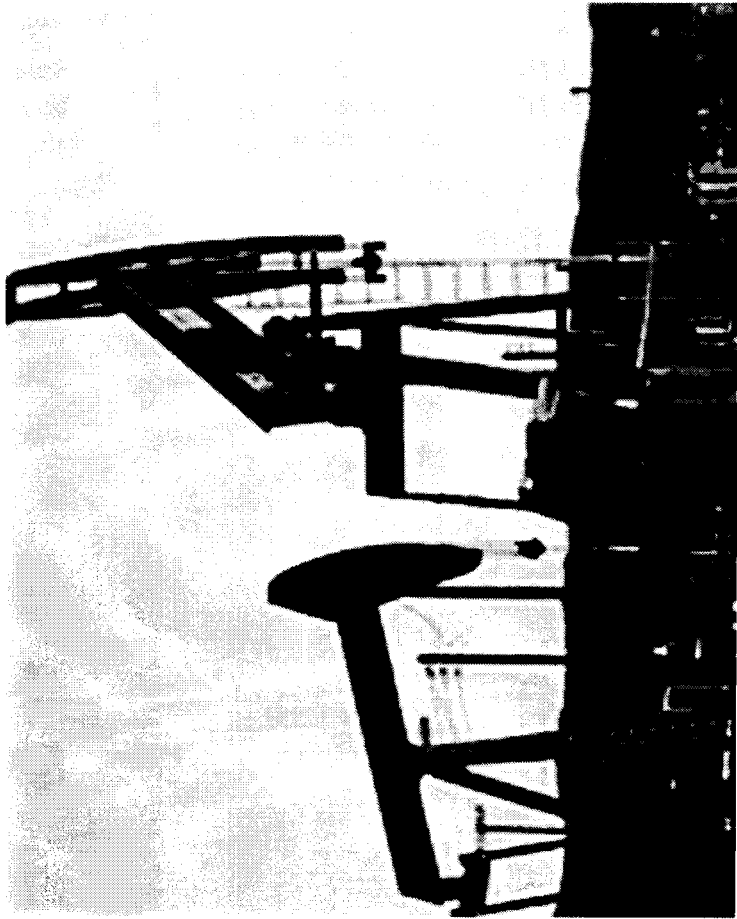
[Redacted]

Preparation for the "Worst Case"



Intense pressure to close deals driven by earnings considerations has motivated Enron to assume extraordinary investment risks or risks which have not been appropriately priced. RAC shares the responsibility for not adequately assessing and modeling transaction risks or increasing the capital price to reflect these risks.





Oil and gas drilling partnerships are examples of extremely high risk investments. Despite this, Enron has invested over \$380 million in 23 partnerships since 1994. Twelve of these partnerships have been complete failures with over \$75 million written off. Of the remaining eleven partnerships, seven are currently on the "Watch or Troubled Deal List."



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Underperforming Deals
Major Factors

[Redacted]

Market Corroboration and Terms

[Redacted]

[Redacted]

[Redacted]

Preparation for the "Worst Case"

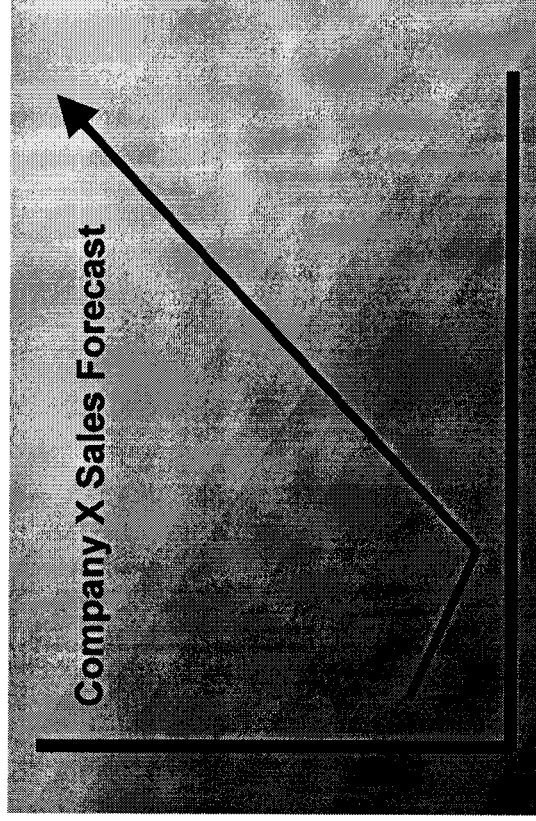


Market Corroboration and Terms

Investment assumptions have not been sufficiently validated by third party participation or use of current market input providing the ability to syndicate or, in the absence of syndication, that investment terms are comparable to those of similar transactions.

Market Corroboration and Terms

A study of a number of "troubled" investments where Enron did not have third party participation indicates that a major area where we may have differed from current market is in growth assumptions. Often our mezzanine debt was priced below market because we had received warrants, which were highly valued internally because of our aggressive growth assumptions. If third party participation had been applicable, it is likely that growth assumptions would have been more conservative.



Underperforming Deals

Major Factors

[Redacted]

Market Corroboration and Terms

Operational/Incentive

[Redacted]

[Redacted]

Preparation for the "Worst Case"

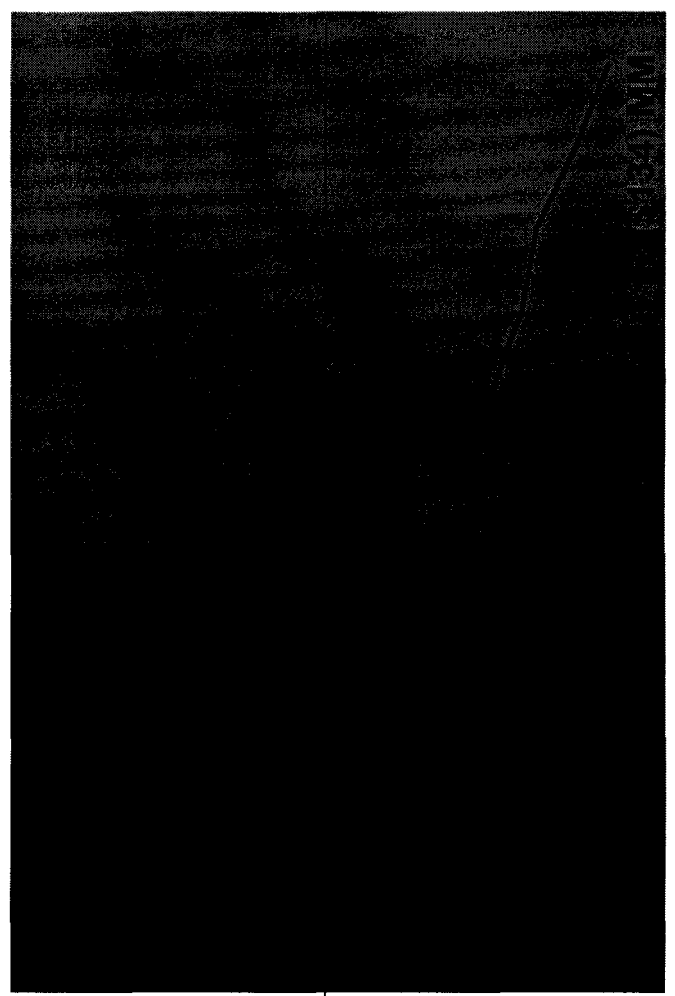


Immediate recognition of MTM earnings, assuming flawless execution, has not incentivized commercial personnel to aggressively manage deal execution through exit for value. Incentives to assure that actual performance meets projections have been inadequate.



Enron's MTM Income

The chart below shows the combined historical fair value marks through time of 30 transactions which have appeared as "Troubled" or "Loss" on the bi-weekly Watch List Report since its inception in January 1999. The fact that as much as \$113 million in MTM income was credited to these failed projects causes concerns that proper incentives for long term execution are absent from our current structure.



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Underperforming Deals
Major Factors

[Redacted]

[Redacted] Market Corroboration and Terms

[Redacted]

[Redacted]

[Redacted]

[Redacted] Preparation for the "Worst Case"



We have a dismal record of investment performance in start-up entities involving technology and construction risks due primarily to the significant inherent risks of start-up businesses, our counterparties' lack of management expertise, as well as passive execution oversight by Enron. These risks have been exacerbated by investments in industries where Enron had limited expertise, so pitfalls obvious to experienced investors were not avoided.



Construction of start-up steel mills and processing facilities is an area where Enron has invested over \$121 million despite our lack of expertise in the area.

To date, \$80 million has been lost and the remaining \$41 million is in serious jeopardy.



Underperforming Deals

Major Factors

[Redacted]

Market Corroboration and Term

[Redacted]

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Preparation for the "Worst Case"



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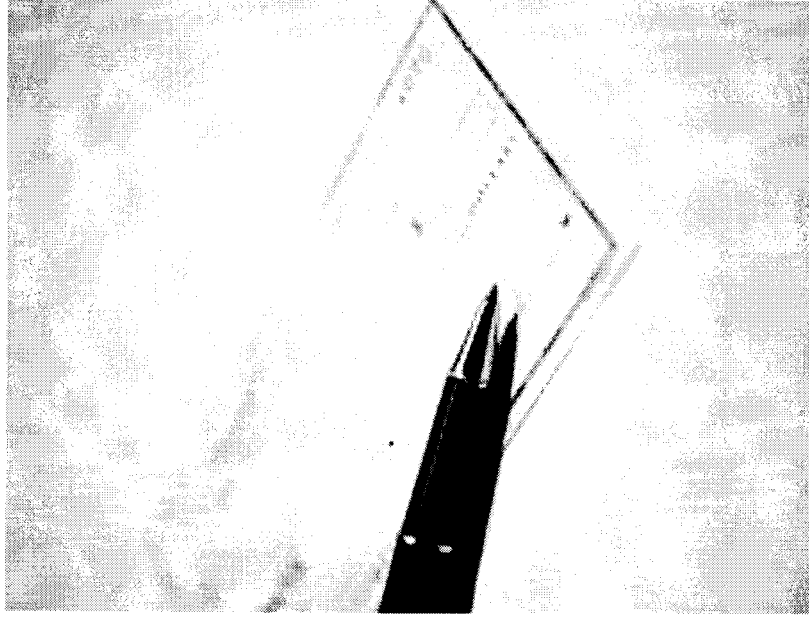
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Investees have been undercapitalized and have experienced liquidity crises in some instances due to our failure to insist on both third party financing and a source of “rainy day” liquidity before making our investment.



Enron acquired a majority equity interest in a landfill gas company in 1999. It was recognized prior to deal closing that substantial external project financing was necessary for the Company to be viable. The acquisition was closed with the representation that a financing commitment was in place with a recognized financial institution. Apparently the financing "commitment" was much more tentative than originally represented and fell through soon after closing. Enron now having to provide "life support" working capital because we failed to ensure before making our investment that appropriate third party financing was in place!



Underperforming Deals

Major Factors

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Market Corroboration and Terms

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Preparation for the "Worst Case"



Preparation for the “Worst Case”

Because of Enron’s aggressive investment policies, “troubled deals” should be expected; we have inadequately planned for “troubled deals” in terms of our legal documentation, our monitoring procedures and ability to react to these transactions with a “quick response” team.



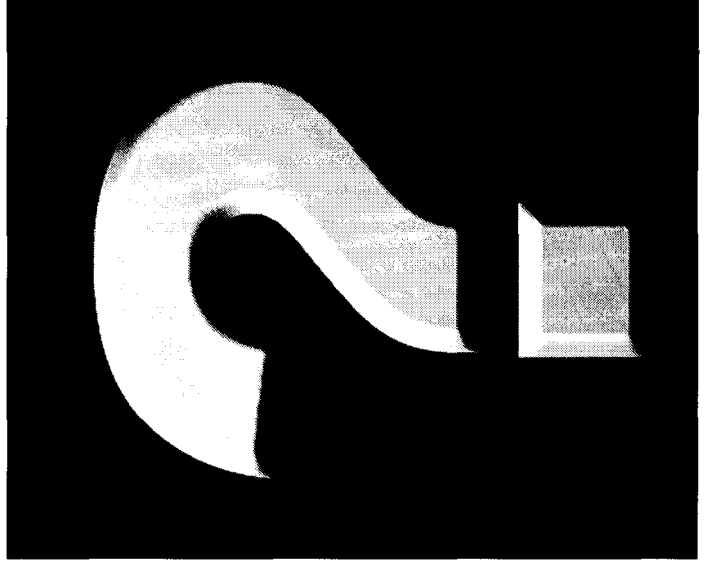
Preparation for the "Worst Case"

A study of a number of deals that have become "troubled" indicates that legal documentation providing Enron rights in a distress situation were never included or were negotiated away by dealmakers.

In one preferred stock investment, Enron reserved additional rights if the company failed a cash flow test. Unfortunately, "cash flow" was not adequately defined and the company was able to avoid our assertion of additional rights.



*How do we improve our investment
performance?*



Recommendations

Investment Performance Improvement

Recommendations

#5 - Investments in start-up entities will not be

approved without the following:

#1 - RAC Underwriting should meet with deal originators

#2 Deal Underwriting should meet with deal originators

#3 Deal Underwriting should meet with deal originators

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#5 Deal Underwriting should meet with deal originators

#6 Deal Underwriting should meet with deal originators

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#16 Deal Underwriting should meet with deal originators

#17 Deal Underwriting should meet with deal originators

- ◆ Deal "milestones" and established due dates to monitor the above



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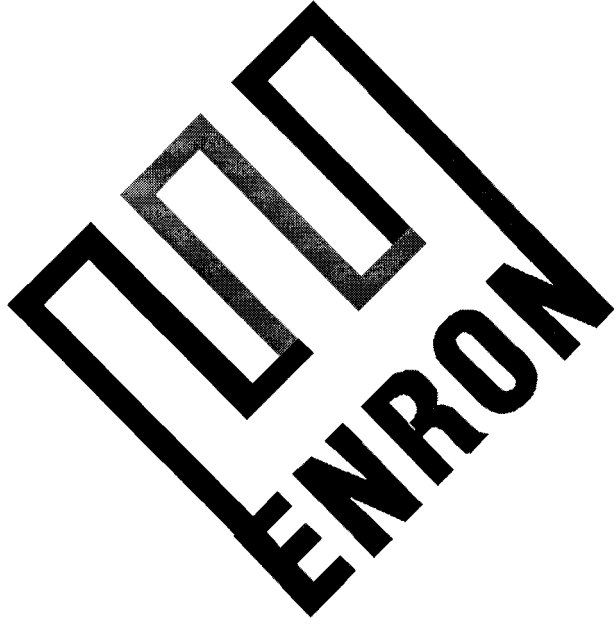
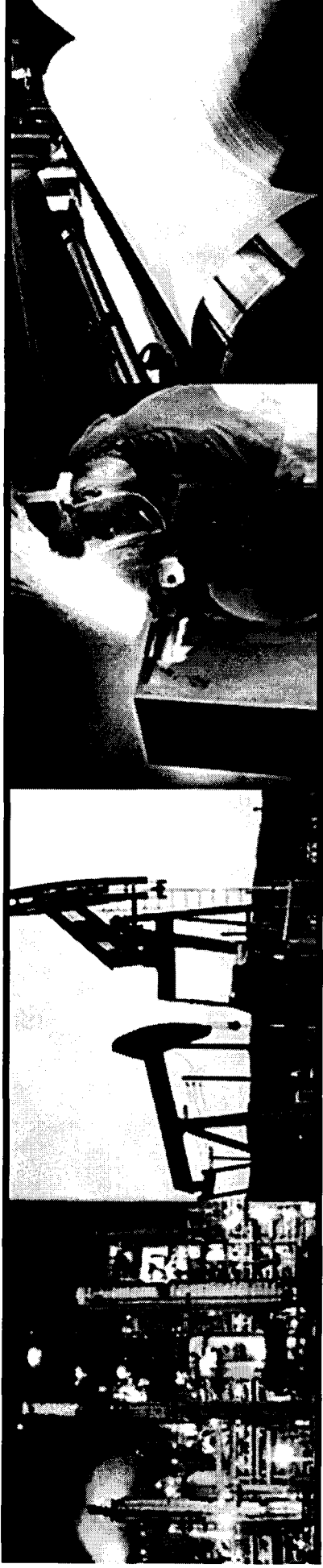
Summary

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- **Assess and price risks more realistically**
- **Devote additional resources to deal
monitoring and execution**

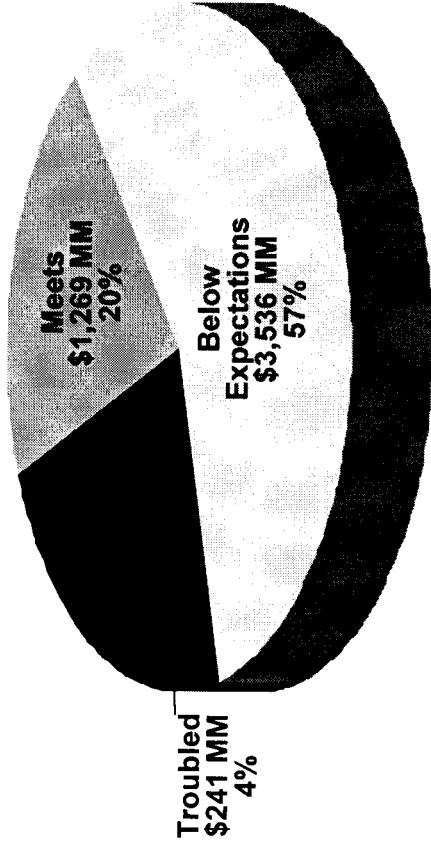


**Investment Portfolio
Lessons Learned
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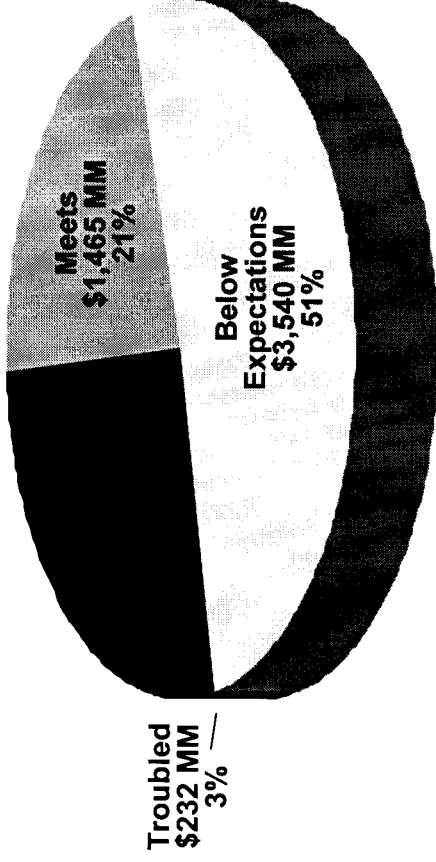
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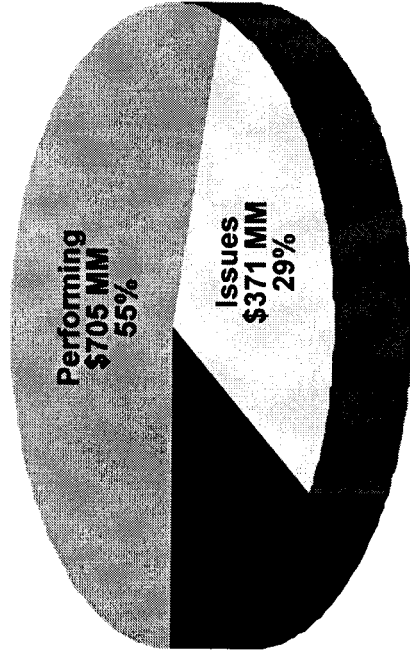
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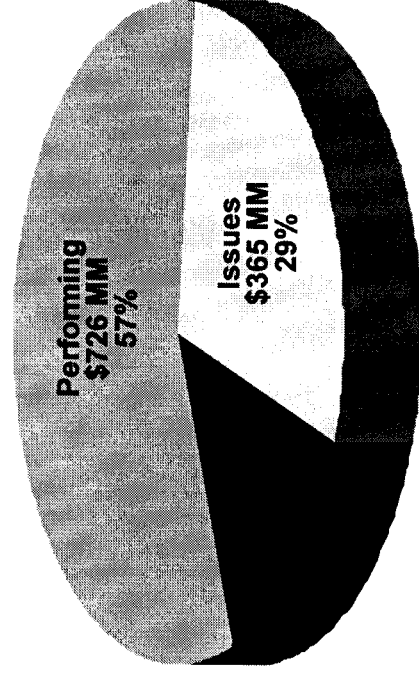
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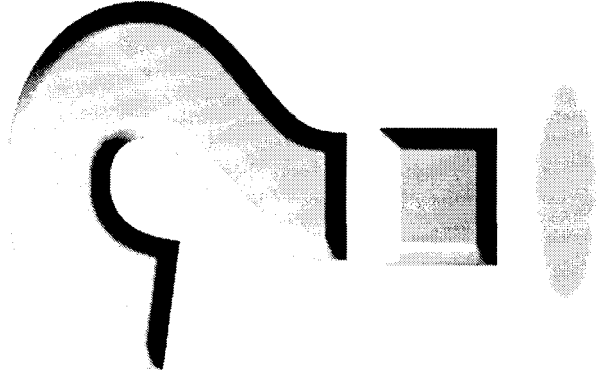
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Underperforming Deals

Major Factors

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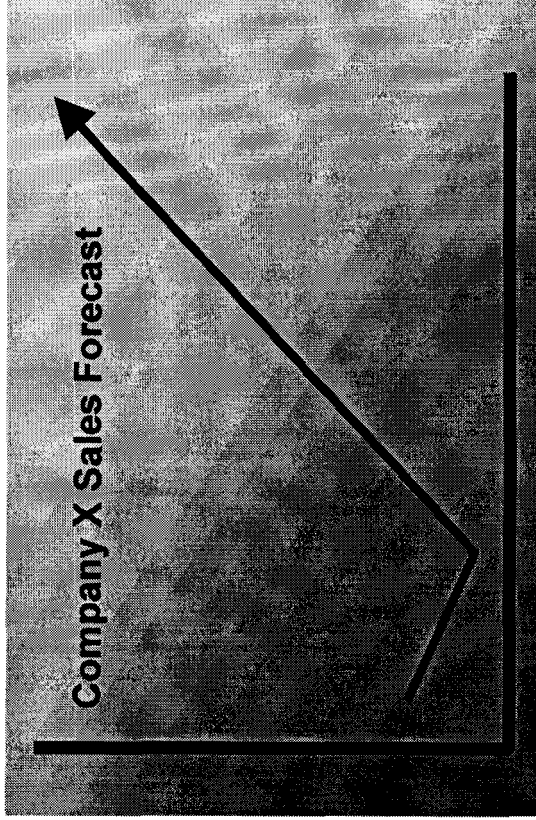


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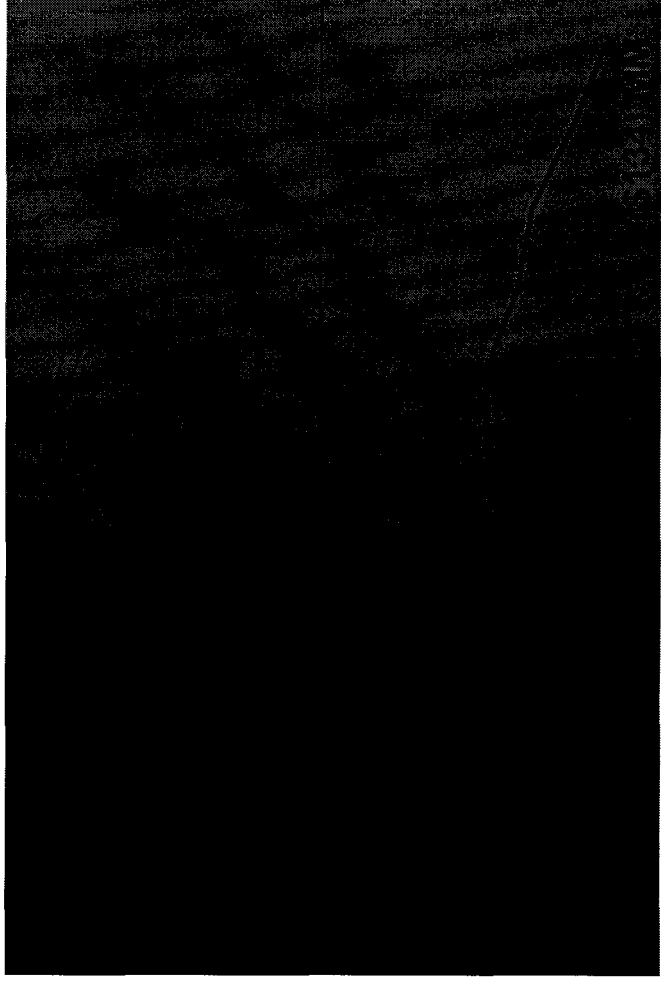


***Immediate recognition of MTM earnings, assuming
flawless execution, has not incentivized commercial
personnel to aggressively manage deal execution through
exit for value. Incentives to assure that actual
performance meets projections have been inadequate.***



Investigation Report

The chart below shows the combined historical fair value marks through time of 30 transactions which have appeared as "Troubled" or "Loss" on the bi-weekly Watch List Report since its inception in January 1999. The fact that as much as \$113 million in MTM income was credited to these failed projects causes concerns that proper incentives for long term execution are absent from our current structure.



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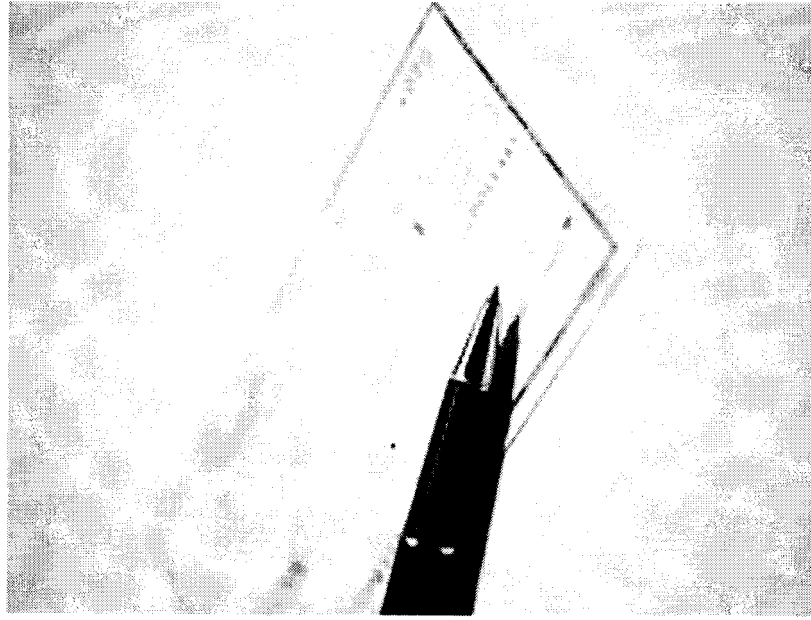
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Preparation for the “Worst Case”

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“troubled deals” should be expected; we have inadequately planned for “troubled deals” in terms of our legal documentation, our monitoring procedures and ability to react to these transactions with a “quick response” team.

Preparation for the “Worst Case”

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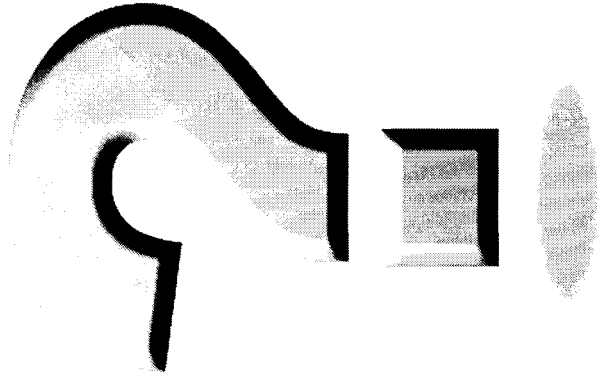
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*How do we improve our investment
performance?*



Recommendations

● ●
Investment Performance Improvement
Recommendations

**#1 - RAC Underwriting should meet with deal originators
and portfolio managers to reach agreement on risks
previously underestimated based on our “lessons
learned” such as drilling, exploratory, construction, start-
up, counterparty management and other execution risks.**

● ●

Investment Performance Improvement Recommendations

#2 – Segregate commercial responsibilities into two groups. One should be responsible for transaction origination and the other for transaction execution and asset management. There should be a definitive transfer of the asset to the Execution group at closing.

● ●
Investment Performance Improvement
Recommendations

#3 - Compensation based on MTM earnings on transactions should be shared between Origination and Execution functions with Execution personnel not earning their compensation until the transaction is successfully performing.



Investment Performance Improvement

Recommendations

**#4 - Deals must be developed using current market terms
or third party participation to corroborate pricing and
provide the ability to syndicate or maximize the
probability of a successful exit.**

Investment Performance Improvement Recommendations

#5 - Investments in start-up entities will not be approved without the following:

- *Independent consultant / engineering reports prepared for Enron, not another entity, if Enron lacks internal expertise*
- *Detailed plans for design, construction, and commissioning of new asset*
- *Assessment of the capabilities of management and staff with a plan to correct deficiencies*
- *Detailed cash flow budget and liquidity plan in the event of project delay or cost overruns*
- *Deal "milestones" and established due dates to monitor the above*



Investment Performance Improvement

Recommendations

#6 - Initiation of an independent legal review of transaction documents (in addition to the deal attorney) to ensure that

Enron is not assuming undue legal risks and has maximized its rights in the event of a distress situation.



Summary

If Enron is to be successful in its investing activities it must:

- **Assess and price risks more realistically**
- **Devote additional resources to deal
monitoring and execution**