ENRON PRESENTATION TO JOINT COMMITTEE ON TAXATION STAFF, JUNE 7, 2002

CONFIDENTIAL

ENRON CORP.
PRESENTATION TO THE JOINT COMMITTEE ON TAXATION

WASHINGTON, DC
June 7, 2002

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I. INTRODUCTION AND OVERVIEW

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A. Scope

1. Broad overview of Enron's tax history.
2. Framework that may assist the Senate Finance Committee (SFC) and Joint Committee on Taxation (JCT) in their review.
   - (a) This presentation covers a substantial amount of information relating to Enron's tax history; however, it does not cover all activities, transactions, and issues that may be of interest to SFC and JCT.
   - (b) In addition, this presentation does not cover all issues raised by the Internal Revenue Service (IRS) during its previous and current examinations of the Company.
3. Enron Corp. Tax Department representatives have varying degrees of knowledge regarding the particular topics to be discussed.

B. <u>Decentralized Business Structure</u>

1. Enron Corp. (ENE) - primarily a holding company.
2. Pipeline Group (ETS) – domestic pipeline system; transportation services; wholly-owned, minority, and MLP investments.
3. EOG Resources (EOGR, fka EOG) – exploration and production; was tax consolidated with ENE until December 1995; current ownership approximately 10%.
4. Enron North America (ENA, aka EWS, fka ECT) – commenced late 1980s; physical/financial commodity dealer; primarily natural gas and electricity; U.S. and Canada; online trading platform introduced 1999; hard asset investments (<u>e.g.</u>, domestic power plants); financings; merchant investments.
5. International infrastructure (EGAS, fka EI, fka EDC) – commenced early 1990s; foreign power plants and pipelines; greenfield, privatizations and acquisitions.
6. Enron Europe (Europe) – commenced mid-1990s; commodity dealer in UK and Continental Europe; primarily natural gas and electricity; some power plant and pipeline development.

7. Enron Energy Services (EES) – commenced mid-1996; natural gas and electricity dealer serving commercial end-users in deregulated markets; bundled energy outsourcing; energy efficiency programs; facilities management; energy related construction and services projects; minority owner of residential energy service provider (TNPC).

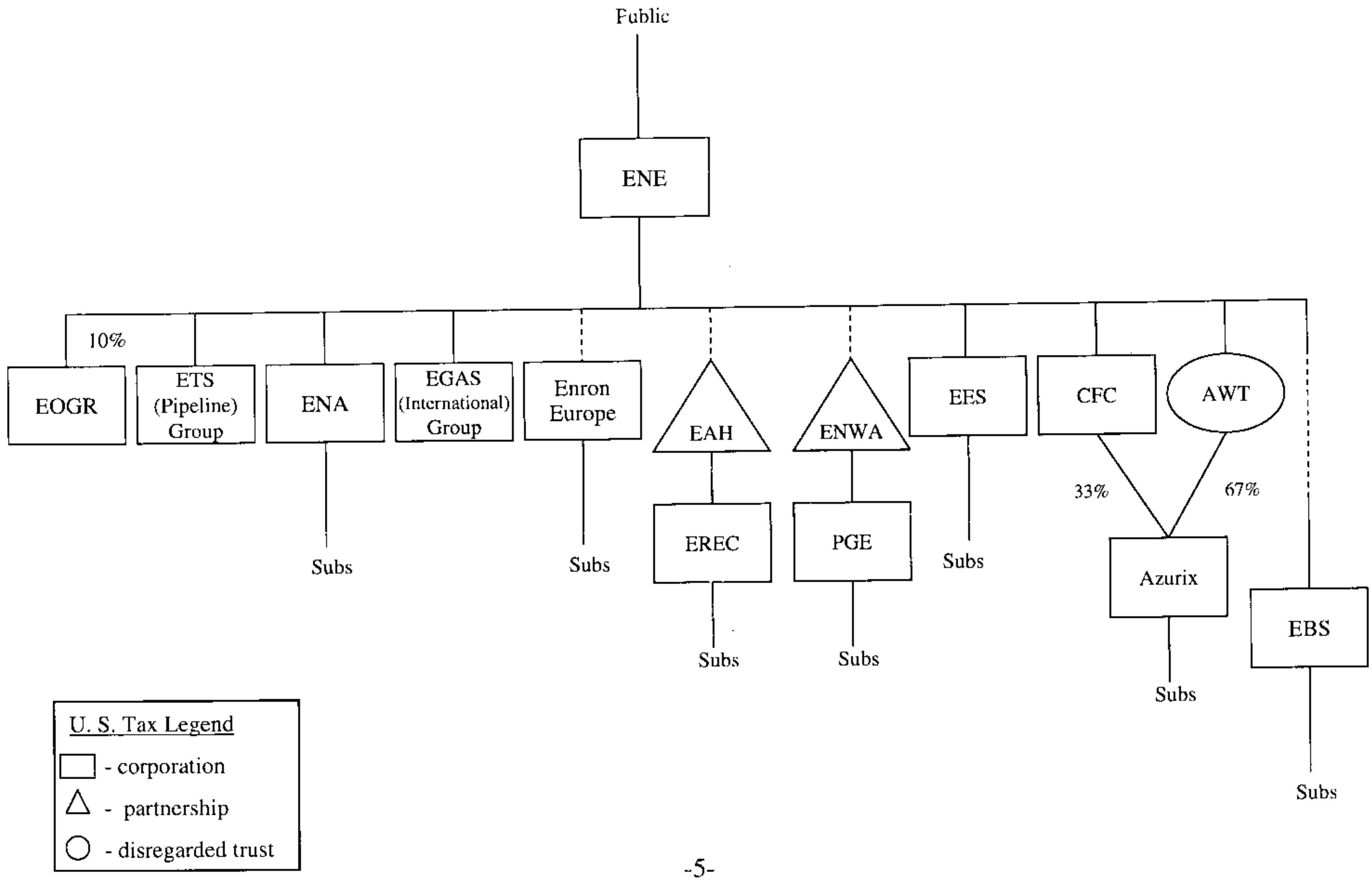
8. Enron Renewable Energy (EREC or Wind, fka Zond) – acquired early 1997; wind farm developments; turbine manufacturing; substantially all of its assets recently sold to General Electric.

9. Portland General Electric (PGE) – acquired July 1997; regulated electric utility in Portland.

10. Azurix – formed August 1998; principal asset is Wessex Water, a regulated water company in the U.K.; sale of Wessex Water recently announced.

11. Enron Broadband Services (EBS) – commenced mid-1999; bandwidth trading; telecom investments.

Simplified Structure – November 2001



C. <u>Tax Department Organization</u>

1. Decentralized Business Unit organization with separate tax departments within a larger tax department headed by the General Tax Counsel.

2. Each Business Unit had a Planning and a Reporting & Analysis (R&A) team.

3. Planning interfaced with Commercial teams on deal development.

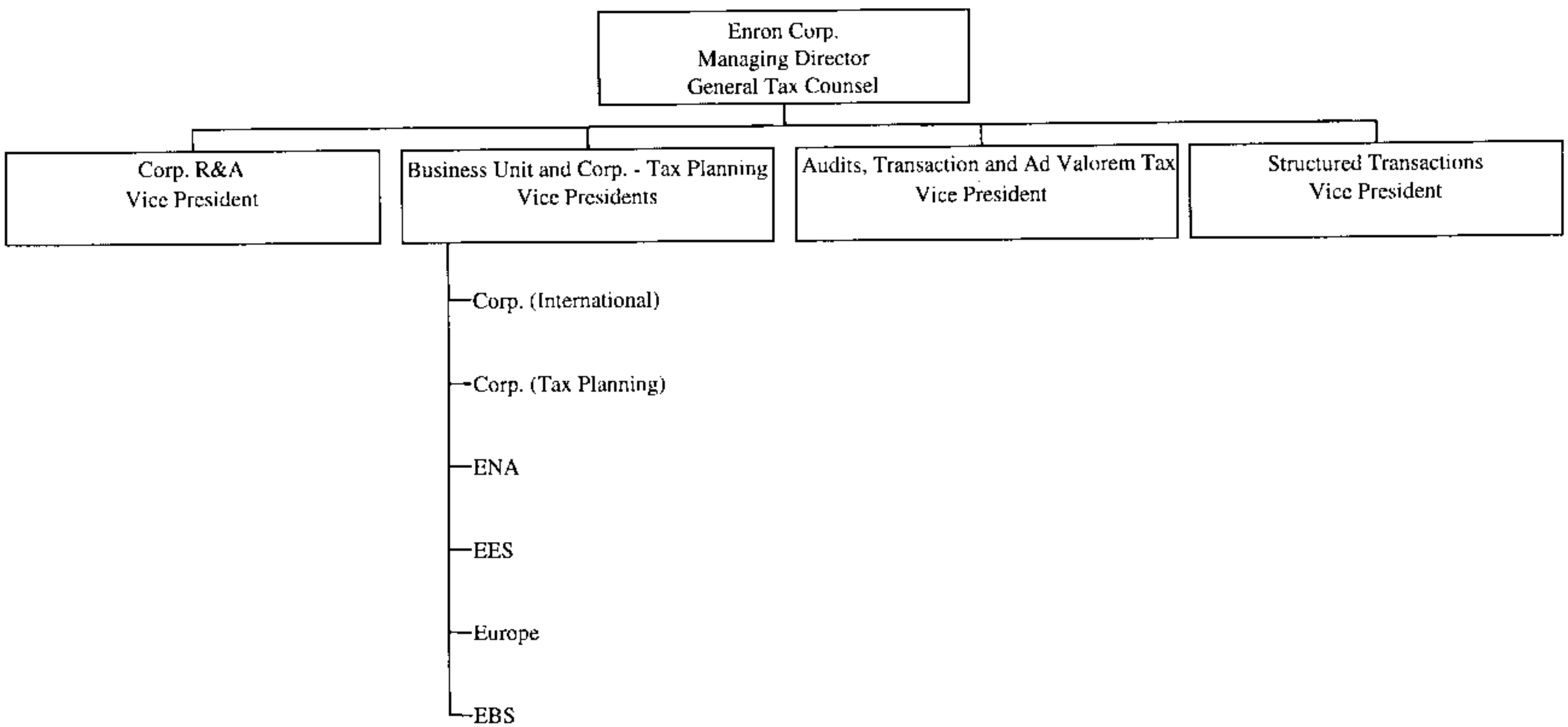
4. R&A interfaced with Tax Planning and Accounting on jurisdictional compliance and financial reporting.

5. Department-wide functions existed within the Corporate group, including:

- **(a) Consolidated Audit function for federal and state income taxes;**
- **(b) Transaction Tax function responsible for sales and use and property taxes; and**
- **(c) Systems.**

6. Structured Transaction Group identified and implemented tax-advantaged financings and other structured transactions or investments.

TAX DEPARTMENT ORGANIZATION
As of January 1, 2001



Enron Corp. Tax Department
Summary Headcount Analysis

Function	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
Managing Director/General Tax Counsel	1	1	1	1	1	1	1
Planning	13	18	24	33	37	27	8
Reporting & Analysis	31	46	61	69	80	81	50
Tax Systems	0	1	3	4	9	5	4
Structured Transactions	1	1	2	12	17	9	6
Audits	6	6	7	8	9	5	10
Sales and Use Tax	5	5	8	14	19	20	15
Ad Valorem Tax	9	8	8	9	9	6	3
Administrative	11	11	12	17	29	17	13
Azurix	--	--	2	4	2	--	--
PGE - Portland	--	9	9	7	7	7	7
London	6	10	12	20	34	5	--
	83	116	149	198	253	183	117

*U. S. TAX RETURN STATISTICS **

	1997	1998	1999	2000
Federal:				
Total Number of Returns Prepared for Enron Consolidated Tax Return	274	333	502	713
Total Number of Returns Prepared for Entities filed outside of the Enron Consolidated Tax Return * *	58	164	178	190
Total Number of Entities/Branches included in Foreign Information Returns	628	842	1,048	1,485
Total Number of Entities/Branches included in Partnership Returns	42	66	94	98
Total Federal Returns	**1,002**	**1,405**	**1,822**	**2,486**
Number of Unitary Returns	22	33	24	22
Number of Non-Unitary Returns	600	800	1,000	1,400
Total State Returns	**622**	**833**	**1,024**	**1,422**
Total Federal and State Income/Franchise Tax Returns	**1,624**	**2,238**	**2,846**	**3,908**

* *Includes "pro-forma" returns for check-the-box, accounting, and legal branches.*

* * *Approximately 15-20 separate company or consolidated returns.*

Enron Corp. and Subsidiaries
Estimated External U. S. Tax Advisor Fees
for Years 1996 through 2001

	1996	1997	1998	1999	2000	2001
General Tax Advice	1,400,000	1,800,000	2,200,000	3,900,000	4,500,000	2,400,000
Structured Transactions	100,000	2,000,000	2,000,000	10,000,000	10,000,000	- 0 -

Notes:

1. General Tax Advice includes tax return preparation, transfer pricing documentation, state tax issues, tax audit support, and federal tax consulting.
2. Structured Transactions also incurred significant placement fees for raising capital.

II. TAX SUMMARY

A. <u>Significant Pre-1996 Tax Items</u>

1. **Take-or-Pay on Gas Purchase Contracts**
   - (a) Enron paid approximately $900 million on Take-or-Pay contracts from 1986-1995.
   - (b) Approximately $175 million was capitalized and amortized over the life of contracts.
2. **Section 29 Credits**
   - (a) Enron claimed approximately $150 million of Section 29 (Tight Sands) credits for years 1991-1995.
3. **Mark-to-Market (MTM) Accounting**
   - (a) Enron adopted MTM accounting for financial reporting purposes in 1992 for its trading operations.
   - (b) Tax reported on an accrual basis.
4. **Teesside**
   - (a) First power plant Enron built outside of the U.S.
   - (b) Began operating in 1993.
   - (c) Constructed under turn-key contract by Enron Power Construction Limited (U. K.).
5. **MIPS – <u>See</u> Section IV. F. 1.**

6. Enron Management, Inc. (Project Tanya)

(a) This company assumed and managed Enron's deferred compensation and post-retirement benefit obligations (i.e., FAS 106 liabilities).

(b) Common and preferred stock initially held by Enron Corp. and preferred stock subsequently sold to two employees.

(c) Preferred stock sale resulted in the recognition of a capital loss of approximately $188 million on Enron Corp.'s 1995 consolidated tax return.

(d) The capital loss was examined and allowed by the IRS in its audit of Enron's 1995 consolidated tax return. The IRS has proposed adjustments to disallow deductions for the deferred compensation and post-retirement benefit payments for post-1995 tax years.

B. Post-1995 Tax Position

1.

Enron Corp. Consolidated Tax Return
Summary of TI, AMTI and Tax Liabilities
For the Taxable Years 1996 to 2001 (As filed or Amended)

	1996	*1997*	*1998*	*1999*	*2000*	*2001* (Estimated)
Ordinary Income<Loss>	(399,359,014)	(580,847,967)	(813,454,028)	(1,844,706,362)	(3,022,694,974)	(3,296,576,000)
Capital Gain <Loss>	89,127,806	77,310,084	60,671,198	386,285,429	6,122,751,118	(4,044,143,000)
Taxable Income <Loss> Before NOL	(310,231,208)	(503,537,883)	(752,782,830)	(1,458,420,933)	3,100,056,144	(7,340,719,000)
Net Operating Loss C/F Deduction	0	0	0	0	(3,039,243,513)	0
Regular Taxable Income <Loss>	(310,231,208)	(503,537,883)	(752,782,830)	(1,458,420,933)	60,812,631	(7,340,719,000)
AMT Adjustments including NOL Limit	46,050,745	(2,139,894)	47,009,820	78,882,457	255,041,692	50,000,000
AMT Income <Loss>	(264,180,463)	(505,677,777)	(705,773,010)	(1,379,538,476)	315,854,323	(7,290,719,000)
Tax Liabilities (Refunds)	0	0	0	0	63,170,865	(63,170,865)

<u>NOTES</u>:
1. A refund claim is expected to be filed for the taxes paid in 2000.
2. Projected NOL carryforward to 2002 is approximately \$6.3 billion.
3. Projected capital loss carryforward to 2002 is approximately \$1 billion.

2. Chiricahua Partnerships (Project NOLy)

(a) Objective – accelerate taxable income in 2000 to utilize all NOL and credit carryovers so that the 1996-2000 tax audit could be settled.

(b) Effect on 2000 taxable income – $5.556 billion capital gain recognized due to §1259.

(c) NOLy structure unwound in December 2001.

- ENE and ENA filed for Chapter 11 on December 2, 2001.
- Unwind triggered a $5.556 billion capital loss resulting in a carryback claim to 2000.
- The carryback is expected to free-up approximately $3 billion of tax losses that would carry forward to 2002.

(d) The IRS is in the process of reviewing this transaction.

3. Enron Corp. & Consolidated Financial Statement Subsidiaries

Approximate U. S. Federal Tax Liability

For the Years Ended 1996 thru 2000

	1996	1997	1998	1999	2000
Enron Consolidated Return	-	-	-	-	63,000,000
EOG Consolidated Return*	10,000,000	10,000,000	8,000,000	9,000,000	-
Other Returns	9,000,000	24,000,000	24,000,000	46,000,000	68,000,000
Total Federal Tax Liabilities	**19,000,000**	**34,000,000**	**32,000,000**	**55,000,000**	**131,000,000**

* Enron's ownership of EOG from January 1996 to August 1999 ranged from 53% to 79%. Thus, EOG was included in Enron's consolidated financial statements for this period, but not in Enron's consolidated tax return.

4. Anticipated §6405 Refund Claims

(a) Enron Corp. Consolidated – Approximately $63 million.

(b) Organizational Partners, Inc. (Project Teresa) – Approximately $107 million.

(c) Oneida Leasing, Inc. (Project Tomas) – Approximately $13 million.

(d) Enron Export Sales Ltd. (FSC) – Approximately $2.5 million.

(e) Enron Equity Corp. – Approximately $30 million.

III. TAX ACCOUNTING – BOOK/TAX DIFFERENCES (1996-2000)

III. TAX ACCOUNTING – BOOK/TAX DIFFERENCES (1996-2000)

A. Overview

1. See following Schedule for a high-level reconciliation of consolidated financial statement net income to taxable income <loss> per the Enron Corp. consolidated tax return. Comparing consolidated financial statement income to Enron Corp.'s consolidated taxable income <loss> is largely an "apples-to-oranges" comparison because many entities are consolidated for financial statement purposes that are not included in the Enron Corp. consolidated tax return.

2. Major book-tax differences for the Enron Corp. consolidated tax group and related entities for 1996-2000 are discussed in the remainder of Section III.

3. Similar book-tax differences existed for 2001.

Enron Corp & Subsidiaries
Reconciliation of Net Income per Annual Report to Taxable Income per Enron's Consolidated Tax Return
For the Calendar Years 1996 thru 2000
($ in Millions)

	1996	*1997*	*1998*	*1999*	*2000*
Net Income per Annual Report	**584**	**105**	**703**	**893**	**979**
Equity Earnings Adjustments	945	1,045	1,043	2,251	5,039
Other Net Consolidation Adjustments	(96)	(189)	(134)	(32)	(122)
Sub-Total	849	856	909	2,219	4,917
Net Book Income per Tax Return (Schedule M-1)	**1,433**	**961**	**1,612**	**3,112**	**5,896**
Book-to-Tax Adjustments:					
Federal Income Taxes	159	(35)	45	(128)	193
Net Partnership Adjustments	(107)	(122)	(109)	(338)	(481)
Net Mark-to-Market Adjustments	(118)	118	(333)	(906)	(537)
Section 1259 Income	0	0	0	0	5,566
Net Interest Adjustments	(2)	(24)	(3)	(12)	(149)
COLI Adjustment	(19)	(24)	(27)	(35)	(20)
Stock Option Deduction	(113)	(9)	(92)	(382)	(1,560)
Depreciation	(67)	(65)	(57)	(124)	(154)
Equity Earnings Reversal Per Tax Return	(1,183)	(1,023)	(1,688)	(2,868)	(5,516)
All other Book-to-Tax Differences	(293)	(281)	(101)	223	(137)
Taxable Income (Loss) per Enron's Consolidated Tax Return	**(310)**	**(504)**	**(753)**	**(1,458)**	**3,101**

B. Mark-to-Market – 1996-2000 Adjustment $1.8 billion decrease

1. **Financial statements used MTM accounting for commodity trading, merchant investments and specific components of bundled energy deals.**

2. **For income tax purposes, all Enron entities were accrual taxpayers through 2001. Accordingly, the unrealized MTM book income and expense was reversed and the realized income and expense was recorded for tax purposes. (Enron's commodity trading entities made MTM elections for tax purposes effective January 1, 2002.)**

3. **The yearly book increase in MTM originations generally exceeded the tax recognition of accrual income, causing the net book-tax difference to increase each year.**

C. Constructive Sale – 1996-2001 Adjustment net zero

1. **Project NOLy – Timing difference that originated in 2000 and reversed in 2001. See Section II. B. 2. This book-tax difference is labeled "Section 1259 Income" on the Schedule on p. 20.**

D. Stock Option Exercises – 1996-2000 Adjustment $2.1 billion decrease

1. **Stock options granted as a key component of employee compensation.**

2. **Significant share price increase from 1997 through 2000 (i.e., $20 per share to $90 per share) resulted in a significant amount of options exercised.**

3. **As options were exercised, a deduction was taken for tax purposes for the spread between the grant price of the option and the exercise price. The spread was taxable income to the employees and federal income and payroll taxes were withheld.**

4. **Neither the expense nor the tax benefit from the exercise of stock options flowed through book income. The tax benefit was recorded as a debit to Taxes Payable and a credit to Paid-in-Capital. This results in a significant book-tax adjustment each year.**

5. **Also book-tax timing differences created by restricted stock.**

E. **<u>Depreciation</u> – 1996-2000 Adjustment $466 million decrease**

1. **Significant investment in pipeline assets which have an extended book life.**

2. **Tax depreciation is significantly accelerated for almost all assets – usually no longer than 15 years.**

3. **The pipelines have continued to expand their asset presence and increase the depreciable base, continually refreshing the large depreciation deductions available in the early years of the asset life.**

F. **<u>Interest Expense</u> – 1996-2000 Adjustment $190 million decrease**

1. **Financing structures that were treated as other than debt for financial reporting were treated as debt for tax (<u>e.g.</u>, minority interest financings). The resulting interest expense created a book-tax difference.**

G. Corporate-Owned Life Insurance – 1996-2000 Adjustment $125 million decrease

1. **Life insurance policies are taken out on employees with company named as beneficiary.**
2. **Premium costs are not deductible for tax purposes; death benefits are not taxable income when received.**
3. **The net build-up of cash surrender value was recorded as book income.**
4. **Enron and its affiliates borrowed against the cash surrender value of certain of the policies. The interest paid on these loans was deductible for tax purposes (i.e., grandfathered pre-June 21, 1986 policies).**

H. Tax-Free Transactions

1. **PGE**

   (a) **Portland General Holdings merged into Enron Corp. in a tax-free "A" merger in July 1997. Portland General Electric became a subsidiary of Enron Corp.**

   (b) **Books used purchase accounting. Tax used carryover basis.**

   (c) **Book-tax differences are represented by depreciation and goodwill.**

2. **EOG**

   (a) **In August 1999, EOG transferred the ownership of EOGII to Enron in exchange for 62 million shares of EOG stock.**

   (b) **Transaction qualified as a tax-free §355 split-off.**

   (c) **For book purposes, a pre-tax gain of $454 million was reported.**

I. **<u>Securitizations</u> – 1996-2000 Adjustment $1.2 billion decrease**

1. **Business impetus to generate cash associated with MTM and fair value financial assets -- such as commodity contracts (<u>e.g.</u>, gas and power) and merchant equity interests (<u>e.g.</u>, venture capital-type investments).**

2. **Financial statement treatment as a sale under FAS 125/140; tax characterization and reporting as a borrowing based on general tax principles applied to the economics of the transaction.**

J. **<u>Partnerships</u>**

1. **Ordinary book-tax differences at the partnership level flowed-through to the partners.**

K. **<u>Foreign Income</u>**

1. **Books recorded equity and consolidated foreign affiliate income when earned; tax reported the income as dividends when actually or deemed received (<u>e.g.</u>, under Subpart F).**

2. **Significant Subpart F income was reported for tax on intercompany loans that were mostly eliminated on the consolidated financial statements.**

L. <u>Liability Management Transactions</u>

1. Enron Management, Inc. (Project Tanya) – <u>See</u> Section II. A. 6.

2. ECT Strategic Value Corp. (Project Valor)

   (a) **This company managed the credit and price risk on physical and financial commodity contracts with third parties.**

   (b) **Preferred voting stock issued to ECT in exchange for intercompany notes and unrelated party power and gas contracts.**

   (c) **Preferred stock subsequently sold to three employees of ECT resulting in a capital loss of $235 million on Enron Corp.'s 1996 consolidated tax return. This loss was not recognized for book purposes.**

   (d) **The IRS has proposed to disallow the capital loss on the preferred stock sale and losses from physical and financial commodity contracts and third party credit risks.**

M. <u>Carryover Tax Basis Transactions</u> – **1996-2001 Adjustment $110 million decrease**

1. ECT Investing Partners, L. P. (Project Steele)

   (a) **Corporate joint venture with a Bank. Bank contributed low-value, high-tax basis REMIC residual interests. Closed October 1997.**

(b) Through 2001, the Enron Corp. consolidated tax group has claimed approximately $110 million of deductions.

(c) The REMIC-related deductions are not expenses for book purposes.

2. Maliseet Properties, Inc. (Project Cochise)

(a) REIT joint venture with a Bank and individual investors. Bank contributed low-value, high-tax basis REMIC residual interests. Closed January 1999.

(b) Through 2001, the Enron Corp consolidated tax group has not claimed any material deductions from this structure.

(c) The REMIC-related deductions are not expenses for book purposes.

N. <u>Tax Basis Step-Up Transactions</u> – 1996-2001 Adjustment $60 million decrease

1. Seneca Leasing Partners, L.P. (Project Tomas)

(a) Partnership joint venture with a Bank. Upon formation in September 1998, an Enron affiliate contributed high-value, low-tax basis assets as well as other assets and liabilities. The partnership redeemed the Enron affiliate in late 2000.

(b) The Enron affiliate met the grandfather exception to the 1999 legislative change that enacted §732(f).

(c) Enron was not subject to tax on approximately $270 million of built-in gain.

2. ENA Asset Holdings, L. P. (Project Condor)

(a) Enron Corp. is a partner in Whitewing Associates, L. P. (Whitewing), a partnership with a third party investor group. An Enron affiliate contributed a high-value, low-tax basis asset to Whitewing. It was anticipated that Whitewing could redeem the Enron affiliate in the future in a manner that would step-up the tax basis of the affiliate's asset.

(b) No tax benefits have been (or will be) claimed by Enron from this transaction.

(c) No effect on the book basis of the affiliate's asset.

3. Enron Leasing Partners, L. P. (Project Teresa)

(a) Partnership leasing joint venture (JV) between a tax deconsolidated Enron affiliate and a Bank formed in March 1997. Due to redemptions of corporate stock held by the JV, increases to the Enron affiliate's outside tax basis in the JV exceeded taxable income allocated to the Enron affiliate. It was anticipated that the JV could later liquidate in a manner that would step-up the tax basis of certain assets. Book basis in the assets would not be adjusted.

(b) No incremental tax benefits have been (or will be) claimed by Enron or its affiliates from this transaction.

(c) The Enron affiliate paid approximately $107 million of separate company U. S. federal tax from 1997-2000. Refund claims will be filed due to NOL carrybacks from 2001 and 2002.

O. **Structured Financings** – 1996-2001 Adjustment $180 million decrease

1. Cherokee Finance VOF (Project Apache)

(a) An Enron foreign subsidiary raised $500 million of minority interest financing in May 1999. The funds raised were used to finance the factoring of Enron's third party account receivables.

(b) Book income earned by the foreign subsidiary was not subject to U. S. federal tax.

(c) Project Gladiator – Similar structure, but never implemented.

2. Enron Finance Partners, LLC (Project Tammy I)

(a) Various Enron entities contributed appreciated assets subject to debt to a partnership. The partnership raised $500 million of minority interest financing in November 2000. It was anticipated that the partnership could redeem one of the Enron partners in a manner that would step-up the tax basis of an asset. Book basis in the asset would not be adjusted.

(b) No incremental tax benefits have been (or will be) claimed by Enron from this transaction.

(c) Enron Northwest Finance, LLC (Project Tammy II) – was intended to be a similar structure, but was never fully implemented. Accordingly, no tax benefits have been (or will be) realized by Enron.

3. Enron Valkyrie, LLC (Project Valhalla)

   (a) An Enron affiliate served as the counterparty for a financing done by a foreign Bank.

   (b) Closed in May 2000. Net annual fee income of $20 million recognized by Enron for book and tax (<u>i.e.</u>, no book-tax difference).

4. Wiltshire Financial Asset Company, LLC (Project Renegade)

   (a) An entity that is consolidated with Enron for book purposes effectively raised net $8 million of low-cost FASIT debt in December 1998. Enron also earned a $1 million fee.

   (b) No book-tax differences.

IV. FINANCINGS

IV. FINANCINGS

A. Public Debt

1. Commercial Paper
2. $4 - $6 billion "plain vanilla" bonds
3. $1.25 billion zero coupon convertible notes (February 2001)
4. Two issuances of ACES:
   - (a) 1995, 6.25%, $217 million proceeds, extinguished December 1998 with 10.5 million shares of EOG common stock; and
   - (b) 1999, 7%, $255 million proceeds, exchangeable for 11.5 million shares of EOGR common stock, due July 31, 2002.
   - (c) Tax characterization is forward contract secured by a cash deposit.
5. Also "plain vanilla" bonds of subsidiaries – NNG, PGE, Azurix

B. Revolver

1. Two separate facilities: A $1.75 billion 364-day Revolving Credit Agreement and a $1.25 billion 5-year Revolving Credit Agreement
2. Wide syndication among over 100 banks; Citibank and JP Morgan Chase served as co-agents.
3. Never drawn until October 2001; previously, Enron accessed the Commercial Paper market.

C. Prepays

1. **Historically entered into by Enron as a means to generate cash flow; approximately $3.7 billion in prepayments from 1993 through 2001; structured both as commodity (i.e., physical) and financial prepays.**

2. **For financial statement purposes, the prepayment is reported as part of the Company's price risk management liability (PRM) and not as debt.**

   (a) **PRM reports instruments utilized in connection with trading activities measured on a MTM basis.**

   (b) **Cash reported as from operations, not from borrowings.**

3. **Special tax rules relating to prepayments for "inventoriable" goods (e.g., gas, power, oil) provide that such prepayments must be included in the recipient's income no later than the second taxable year following the receipt of a "substantial advance payment".** ***Treas. Reg. § 1.451-5(b)(ii)*** **and** ***(c).***

   (a) **The Regulations also provide that the taxpayer must match the gross income received with the associated estimated cost of goods sold.**

   (b) **End result is that the net prepayment amount is subject to tax in the second year following receipt.**

4. **Prepayments merely requiring Enron to pay a specified amount of money based on a notional principal amount of an indexed commodity were reported as borrowings for federal income tax purposes.**

D. <u>Securitizations</u>

1. Enron implemented numerous FAS 125/140 securitizations to fund assets off-balance sheet.

2. The Hawaii 125-0 Trust structure is typical of Enron's securitizations.

(a) Assets are securitized through a special purpose Delaware business trust in accordance with FAS 125/140.

(b) Two companion trusts: Hawaii I 125-0 Trust and Hawaii II 125-0 Trust:

- **Hawaii I: $171 million 364-day facility; and**
- **Hawaii II: $385 million 2-year facility.**

(c) The securitizations are reported as sales for financial statement purposes.

(d) Tax characterization is as a secured borrowing as generally determined by existence of following factors:

- **Commercial banks generally served as lenders;**
- **Sponsor (<u>i.e.</u>, the asset owner) effectively pledged the underlying asset as collateral;**
- **Enron Corp. guaranteed 97% of the debt, typically through a total return;**

- Sponsor obligated to repay proceeds and receive back asset typically through pre-maturity unwind or auction process; and
- Holders of the 3% Certificates viewed as lenders for tax because (i) no potential to realize more than their principal and accrued yield, (ii) generally same parties held both Notes and Certificates, and (iii) existence of over-collateralization.

E. **Off-Balance Sheet Debt**

1. Book consolidation generally required if Enron held more than 50% of vote or 80% of value of an entity.

2. Tax characterization of the structures determined using general tax principles.

3. Domestic off-balance sheet projects:

   (a) Typically structured as a partnership for tax; and

   (b) Partnership interest expense flows through to partners based on sharing ratios.

   (c) The more significant domestic off-balance sheet structures are discussed in items 4 – 7 below.

4. JEDI I: Limited partnership between Enron-affiliate and third party investor, ChewCo. Primary assets held were 12 million shares of Enron Corp. stock and equity interests in Mariner Energy, Inc., Hanover Compressor, and CGAS, Inc.

(a) JEDI I originally reported as an unconsolidated affiliate for financial statement purposes, and thereby removed from Enron's balance sheet the invested assets and associated debt; entity was subsequently consolidated in 2001 retroactive to 1997.

(b) For tax purposes, Enron reported its pro rata share of income and losses.

5. JEDI II: Limited partnership between an Enron affiliate and CalPERS.

(a) Not consolidated for financial statement purposes.

(b) For tax purposes, Enron reported its pro rata share of income and losses.

6. Whitewing: A limited partnership owned by Enron Corp. and the Osprey investor group. Osprey contributed $2.4 billion cash, which generally was used to purchase Enron debt securities and other assets.

(a) Osprey owned by small group of insurance and trust companies.

(b) A Share Settlement Agreement allowed the Osprey investors to benefit from additional Enron stock as collateral.

(c) Whitewing not consolidated for financial statement purposes.

(d) **For tax purposes, the sale by Enron of its assets to Whitewing treated as a realization event. Further, Enron reported its pro rata share of taxable income and loss. The yield paid to the Osprey investors flowed through as a tax deduction to Enron.**

7. **Atlantic Water Trust, Marlin Water Trust, and Preferred Voting Trust (Project Marlin): Finance structure that owns approximately 67% of Azurix Corp., a U.S. multinational water company with its primary subsidiary being the Wessex Water Company.**

(a) **Azurix was not consolidated with Enron for financial reporting purposes.**

(b) **The Marlin structure was treated as a financing for tax, with Enron Corp. as the borrower.**

8. **Foreign off-balance sheet projects – <u>See</u> Section VI. D. 1.**

F. <u>Minority Interest Financings</u>

1. **MIPS**

(a) **$214 million issuance in 1993. $75 million issuance in 1994.**

(b) **Public holders invested in a partnership that loaned funds to Enron.**

(c) **GAAP balance sheet accounting was originally "Preferred Stock of Subsidiary Company." GAAP was modified in 1995 to "Company – Obligated Preferred Securities of Subsidiaries."**

(d) Rating agencies give some equity credit.

(e) IRS challenged interest deductions in 1995. The IRS conceded the issue after docketed with the Tax Court.

2. TOPrS

(a) Three separate issuances from 1995–1997. Total principal of $550 million.

(b) The public holders held their partnership interests through a grantor trust. Otherwise, very similar to MIPS.

(c) Issue Forms 1099 instead of Schedules K-1.

3. Sundance Assets, L. P. (Project Rawhide)

(a) $750 million over-collateralized financing executed December 1998.

(b) Book accounting as "Minority Interest".

(c) For tax purposes, the return paid to the third party lenders was a §707(c) guaranteed payment.

4. Other – <u>See</u> Sections III. O. 1. and III. O. 2.

V. LJM TRANSACTIONS

V. LJM TRANSACTIONS

A. Overview

1. Transactions engaged in by Enron with LJM are reported in a variety of ways for financial statement purposes, including as sales and unconsolidated joint ventures.

2. For tax, the underlying transactions were characterized based on general tax principles.

   (a) Transactions treated as tax sales included the sale of cable fiber and interests in international assets such as the Cuiaba (Brazil) pipeline and the Nowa Sarzyna (Poland) power plant.

   (b) Transactions treated as financings for tax purposes included the hedging transactions engaged in by the Raptor structures.

B. Rhythms Stock Hedge

1. Enron owned approximately 5.3 million shares of Rhythms Netconnections, a highly volatile telecom stock.

2. Enron Corp. sold restricted Enron shares to LJM L. P. in exchange for a note receivable and various options tied to Rhythms stock.

3. Rhythms stock price declined substantially. Accordingly, the options became "in-the-money" to Enron.

4. **Options settled after 9 months for a net $104 million book gain. LJM L. P. used the Enron Corp. restricted stock to settle the option.**

5. **Tax followed books and treated the option settlement as a realization event; no tax reporting change following the Form 8-K restatement.**

C. **Raptors**

1. **Structures and related transactions were entered into by Enron and certain affiliates with LJM2 and its affiliates for the purpose of hedging price volatility associated with a number of Enron merchant investments.**

   (a) **Enron accounted for the Raptor – LJM2 entities using the cost method. Accordingly, for book purposes Enron accounted for its derivative transactions with these entities as hedges.**

   (b) **LJM2 relied on unrealized gains in Enron stock (subject to restrictions) to absorb losses associated with these transactions.**

2. **For federal income tax purposes, however, the hedging activities were conducted between disregarded entities owned by Enron. Therefore, there was no tax effect to Enron from these activities. LJM2 was a lender for tax.**

VI. INTERNATIONAL OPERATIONS

VI. INTERNATIONAL OPERATIONS

A. Overview

1. The number of foreign entities is far fewer than reported in the media.
2. As of December 31, 2001:
   - (a) Approximately 1,300 foreign entities;
   - (b) Approximately 220 entities associated with active operations;
   - (c) Approximately 80% were inactive; and
   - (d) Fewer than 80 foreign entities are partnerships for U. S. tax.
3. Information for all foreign entities was provided annually according to U. S. tax reporting rules. For 2000:
   - (a) Approximately 680 Forms 5471 for CFCs;
   - (b) Approximately 60 Forms 8865 for CFPs; and
   - (c) The remaining entities were 10/50 companies, non-controlled foreign partnerships and other entities that do not require annual reporting.
4. Once formed, foreign entities typically were not dissolved due to non-tax considerations.

B. Infrastructure Projects

1. Infrastructure projects were Enron's first major expansion into international operations.
2. Business was initially focused on power plants, but later included gas pipelines and related energy projects.

3. **Where possible, projects were structured in a manner commonly used to defer U. S. tax on income earned and reinvested in foreign countries. See following Diagrams.**

(a) **Flow-through**

- **Active project income earned by Project Company partnership.**
- **Partnership distribution is not Subpart F income to Foreign HoldCo.**
- **Funds reinvested by Foreign HoldCo outside the U. S.**

(b) **High-tax**

- **Foreign HoldCo's gross E&P from Foreign OpCo dividend is reduced by E&P deduction for interest on bank debt incurred to acquire Foreign OpCo.**
- **Foreign HoldCo's taxes deemed paid (from Foreign OpCo dividend) divided by Foreign HoldCo's E&P >31.5% (i.e., U. S. tax rate 35% x 90%).**
- **Funds reinvested by Foreign HoldCo outside the U. S.**

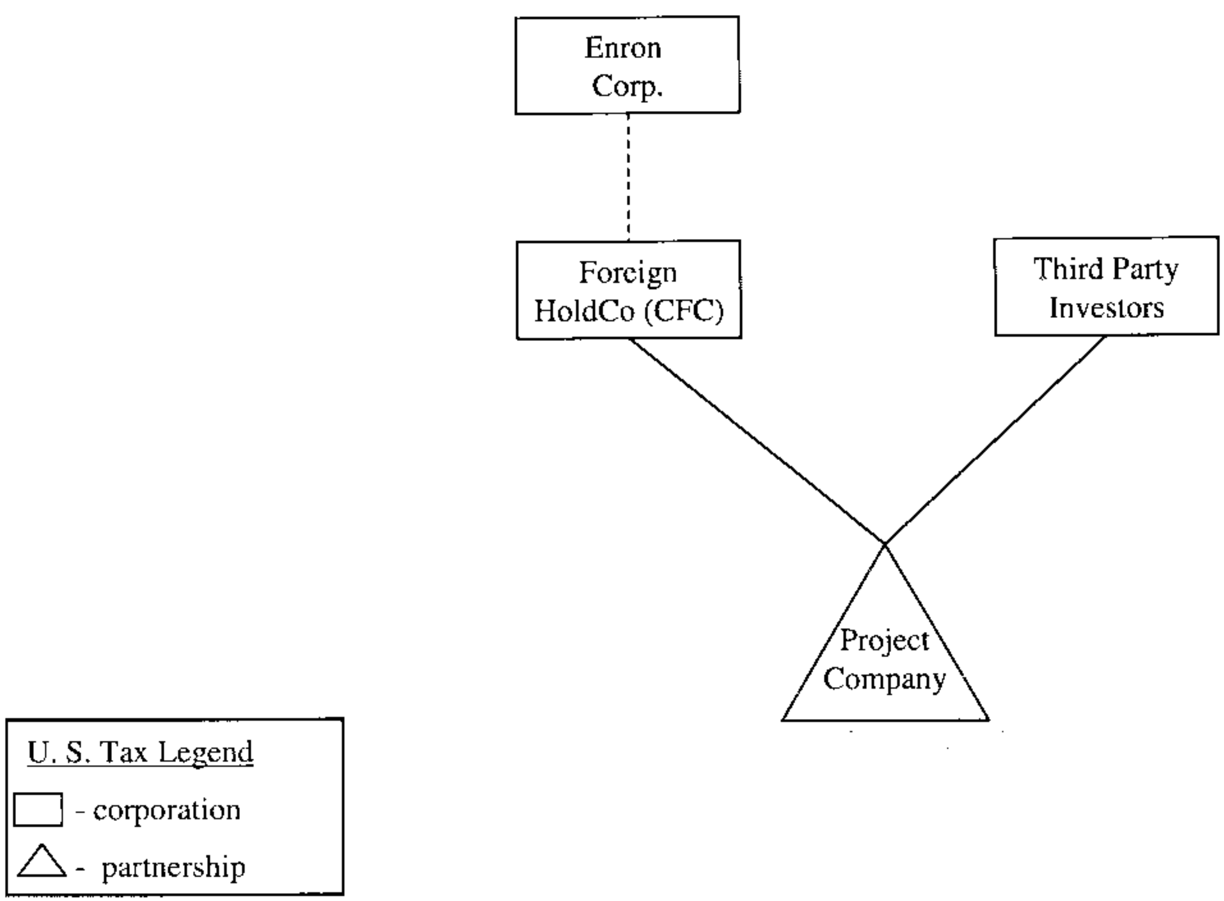
(c) **Same country**

- **Local Country HoldCo and Local Country OpCo are both CFCs incorporated in the same country.**
- **Dividend from Local Country OpCo to Local Country HoldCo meets same country exception.**
- **Funds reinvested by Local Country HoldCo outside the U. S.**

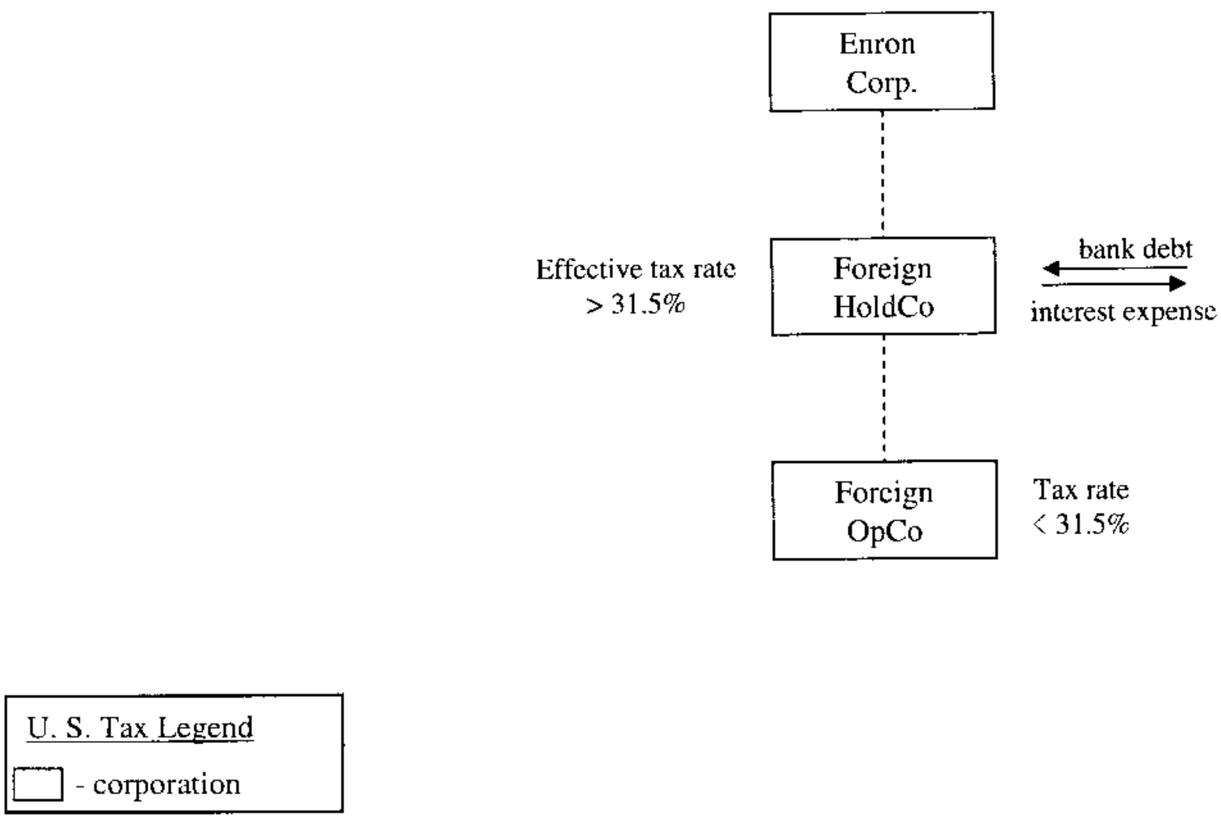
(d) Non-deferral

- **Foreign OpCo's E&P tax rate <31.5%.**
- **Foreign OpCo and Foreign HoldCo not incorporated in same country.**
- **Foreign OpCo is not a CFC.**
- **Dividend from Foreign OpCo to Foreign HoldCo is Subpart F FPHCI.**

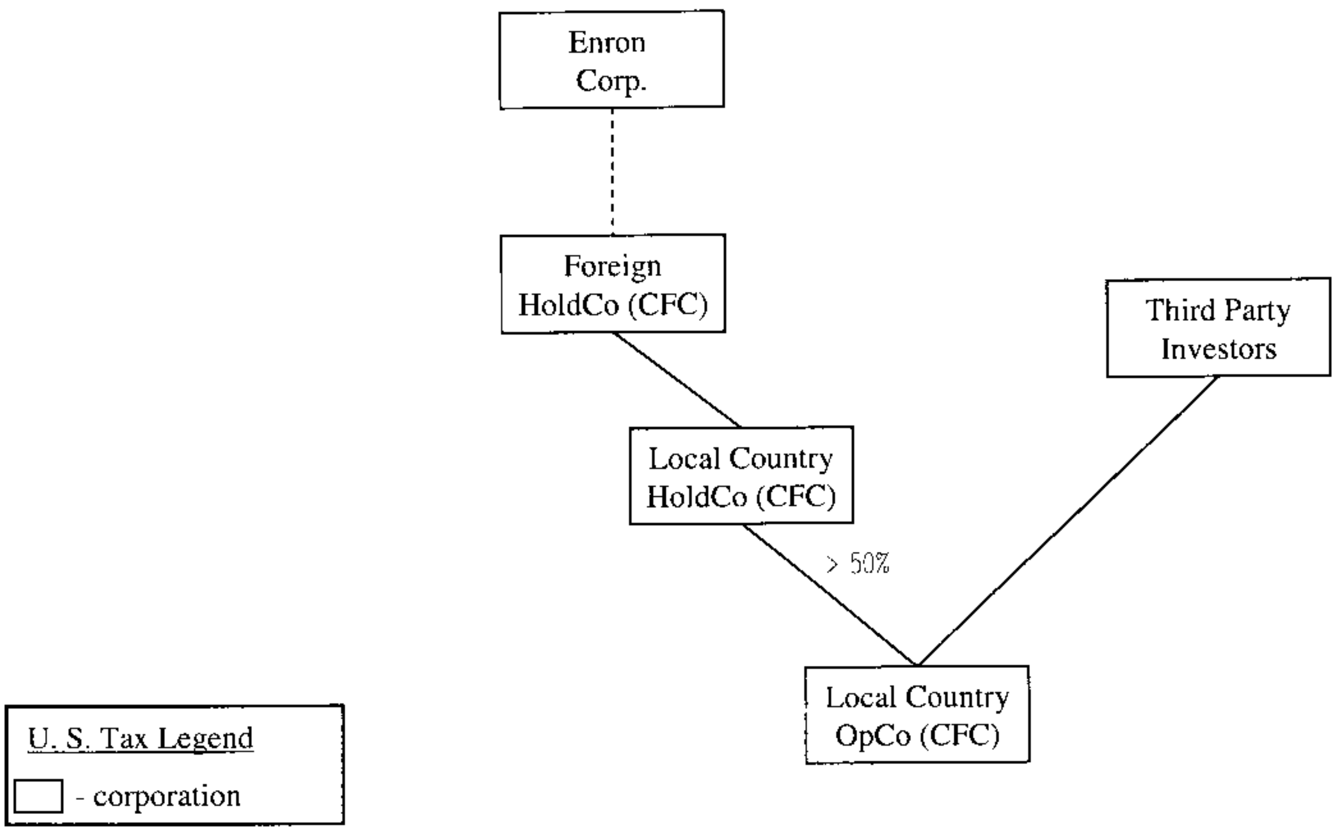
Typical Flow-Through Structure



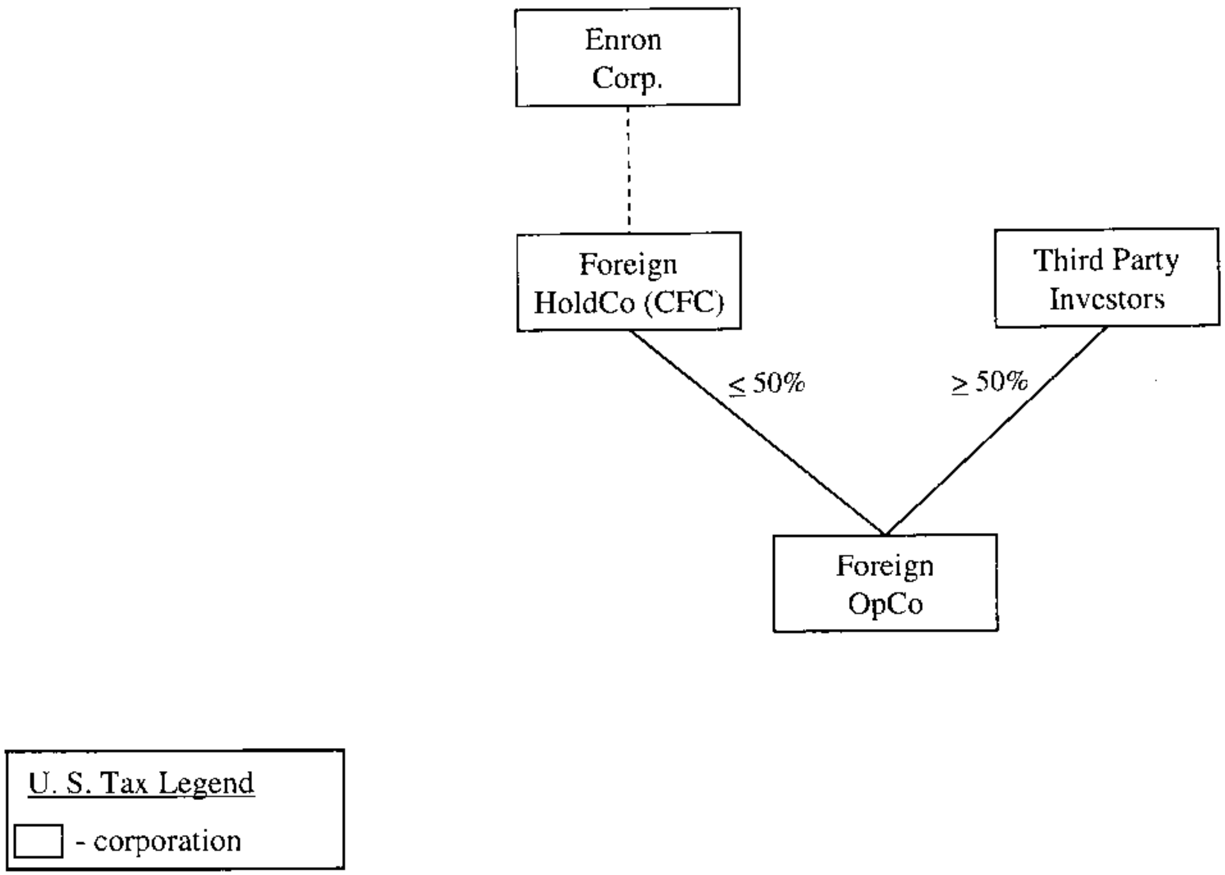
Typical High-Tax Structure



Typical Same Country Structure



Typical Non-Deferral Structure



4. **Costs related to development of projects were capitalized until project was sold, abandoned or otherwise disposed of (i.e., generally tax followed book).**

5. **See the following Table for a summary of the completed projects.**

Enron International Infrastructure Assets

Country	Project Name	Asset Type	Year Started	Year Operational	Year Disposed
Argentina	TGS	Pipeline	1992	1992	
Bolivia	Transredes	Pipeline	1997		
Brazil	CEG/CegRio	Gas LDC	1997		
Brazil	Copel	Stock Investment	1999		2001
Brazil	Cuiaba	Power Plant / Pipeline	1997	1999	
Brazil	Electrobolt	Power Plant	2000	2001	
Brazil	Elektro	Electricity LDC	1998	1998	
Brazil	Gaspart	Gas LDC	1997	1997	
Brazil-Bolivia	Brazil-to-Bolivia Pipeline	Pipeline	1994	1999	
China	Eclipse	Power Plant	1999	1999	
China	EnronChina	E&P	1997	1998	2001
China	Hainan	Power Plant	1994	1996	2001
Colombia	Centragas	Pipeline	1994	1996	
Colombia	Promigas	Pipeline	1996	1976	
Dominican Republic	Haina	Power Plant	1999		2000
Dominican Republic	SECLP	Power Plant	1993	1994	
Germany	Bitterfield	Power Plant	1993	1933	1999
Guam	Piti	Power Plant	1997	1999	
Guatemala	Puerto Quetzal	Power Plant	1992	1993	
India	Broadband Solutions	Data Center	1999	2000	2002
India	Dahbol	Power Plant	1993	1999	
India	EOGIL	E&P	1993	1994	2002
India	GAIL	Stock Investment	1999	N/A	
India	Greenfield Shipping	LNG Transporation	1999	2001	
Italy	Sarlux	Power Plant	1992	1999	
Jamaica	IGL	LPG Facility	1985		2002
Korea	SK-Enron	Gas Distr.	1999	1999	
Nicaragua	Corinto	Power Plant	1999	1999	
Nigeria	Nigeria Power Barge	Power Plant	1999	1999	2000
Palestine	Gaza	Power Plant	1999		
Panama	BLM	Power Plant	1998	1999	
Philipines	Batangas	Power Plant	1992	1993	
Philipines	Subic	Power Plant	1993	1994	
Poland	ENS	Power Plant	1996	2000	
Puerto Rico	EcoElectrica	Power Plant	1997	2000	
Puerto Rico	ProCaribe	LPG Facility	1986		
Puerto Rico	Progasco	LPG Facility			2001
Puerto Rico	San Juan Gas	Gas LDC	1985	1911	
Turkey	Trakya	Power Plant	1993	1999	
United Kingdom	Sutton Bridge	Power Plant	1997	1999	
United Kingdom	Teeside	Power Plant	1992	1993	
Venezuela	Accroven	Gas Processing	1998	2001	
Venezuela	Bachaquero	Gas Compression	1997	1998	2001
Venezuela	Madosa	Appliances			1998
Venezuela	Vengas (fka Ventane)	LPG Facility	1992		

C. Commodity Trading

1. **Large operations in Western Europe with smaller operations in South America and Australia.**

2. **Mostly Energy-Related Commodities:**

   (a) **natural gas;**

   (b) **electricity;**

   (c) **coal;**

   (d) **oil;**

   (e) **metals (mid-1999); and**

   (f) **both physical and financial in most commodities.**

3. **Potential Subpart F Application:**

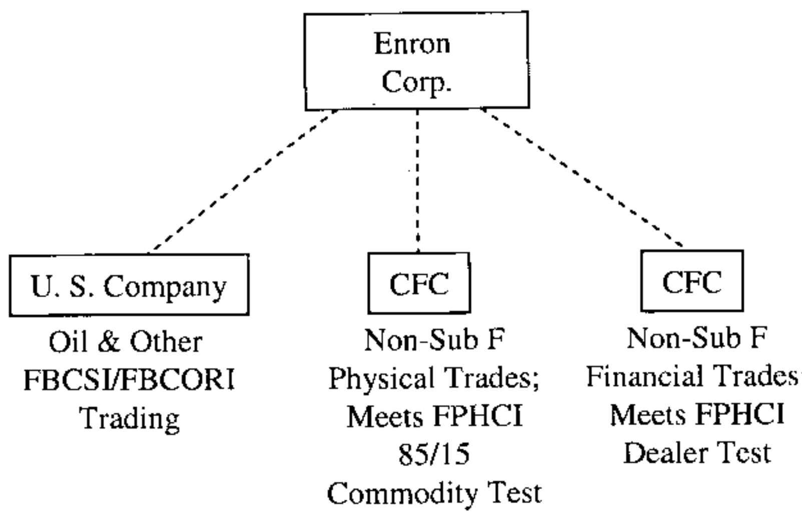
   (a) **Foreign Personal Holding Company Income (FPHCI);**

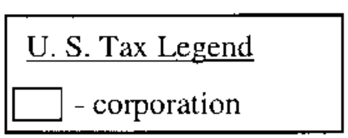
   (b) **Foreign Base Company Sales Income (FBCSI); and**

   (c) **Foreign Base Company Oil-Related Income (FBCORI).**

   (d) **See following Diagram for typical structure.**

Commodity Trading – Simplified Structure





D. Financings

1. **Most infrastructure projects had debt at the project company level.**
   - (a) **Few project companies were book consolidated so debt (and related asset) was not on Enron's financial statements.**
   - (b) **Foreign entities not in U. S. consolidated tax return, so no U. S. deduction for interest expense.**
   - (c) **Financings were routine project-finance in accordance with industry terms and practices.**
   - (d) **No "double-dip" structures.**
2. Financing hubs
   - (a) **Earnings from foreign projects were loaned to foreign affiliates through wholly-owned cash management companies.**
   - (b) **Followed typical practices to re-invest foreign income to defer book and cash tax.**
   - (c) **Interest income on intercompany loans was Subpart F income unless an exception was met.**
3. Compagnie Papiers Stadacona (Project Slapshot)
   - (a) **A Canadian subsidiary raised a $375 million net loan from commercial bank to finance the acquisition of Canadian paper mill in 2001.**
   - (b) **Provided Canadian tax benefits to wholly-owned Canadian subsidiaries (controlled foreign corporations); no U. S. tax effect.**

E. <u>Other</u>

1. **In addition to core trading and infrastructure businesses:**
   - (a) **Bottled gas businesses in Puerto Rico, Jamaica and Venezuela, and**
   - (b) **Wind turbine manufacturing in Germany**
2. **Enron did not make material use of techniques described in Notices 98-11 and 98-35.**
3. **Transfer Pricing**
   - (a) **Enron's business did not involve extensive cross-border transactions between related parties.**
   - (b) **Foreign use of trademarks and commodity trading systems was covered under qualified cost-sharing agreements.**
   - (c) **Enron recently received a copy of an IRS National Office FSA to the IRS audit team concerning related-party services associated with a foreign infrastructure project.**
   - (d) **Section 6662(e) documentation was prepared and provided to IRS examiners.**
4. **The Enron Corp. consolidated tax group had a significant overall foreign loss. Thus, actual or deemed foreign dividends to the Enron consolidated tax group resulted in double tax.**

VII. REGISTERED TAX SHELTERS AND LISTED TRANSACTIONS

VII. REGISTERED TAX SHELTERS AND LISTED TRANSACTIONS

A. § 6111(c) Tax Shelters

1. Renewable Energy Partnerships

   (a) Wind power limited partnerships formed in 1984 allowed participants to invest in renewable or "Green" energy wind farms located in California.

   (b) Enron Wind's ownership percentage in partnerships is minimal (.5%-1%).

2. Master Limited Partnerships (MLP)

   (a) Energy-related publicly traded partnerships (NYSE) syndicated prior to 1995. Commercial activity of the partnerships is the transportation and marketing of natural gas, gas liquids, crude oil, and crude oil products.

   - Enron Liquids Pipeline L.P. (1992)
   - Northern Border Partners, L.P. (1993)
   - EOTT Energy L.P. (1994)

   (b) MLP prospectus informed investors of intent to register as a tax shelter.

3. Enron Leasing Partners, L. P. (Project Teresa) – See Section III. N. 3.

B. <u>§ 6111(d) Tax Shelters and Listed Transactions</u>

1. No § 6111(d) tax shelters.

2. The only Enron transactions described as "listed transactions" in Notice 2001-51 are two transactions undertaken in 1995 and 1996 (<u>i.e.</u>, Projects Tanya and Valor).

XIII. EFFECTIVE TAX RATE

XIII. EFFECTIVE TAX RATE

A. Enron's 1998 – 2000 financial statement effective tax rate (ETR) reconciliation was as follows:

	1998	1999	2000
Statutory federal income tax provision	35.0 %	35.0 %	35.0 %
Net state income taxes	1.7	1.8	2.5
Foreign tax rate differential	0.8	(7.0)	(2.4)
Equity earnings	(4.3)	(10.1)	5.3
Basis and stock sale differences	(14.2)	(10.8)	(11.9)
Goodwill amortization	2.0	1.6	1.6
Audit settlement related to Monthly Income Preferred Shares	-	(1.8)	-
Other	(1.0)	0.5	0.6
	20.0 %	9.2 %	30.7 %

See footnote 5 to Enron's 2000 Annual Report.

B. Typical ETR reconciliation items – state taxes, foreign tax rate differential, equity earnings, goodwill, meals and entertainment, etc.

C. Tax benefit of non-qualified stock option deductions does not affect the ETR or book income

D. Impact of "structured transactions" on the ETR

1. The 1995 – 2001 impact on book income of "structured transactions" was approximately $933 million. This would translate to approximately $2,666 million of current and future deductions or income not subject to U. S. federal income tax.

2. **The cumulative tax return effect through 2001 of these transactions is as follows:**

   (a) **4 transactions – Approximately $770 million of deductions or income not subject to U. S. federal income tax.**

   (b) **3 transactions – Approximately $230 million of U. S. federal taxable income.**

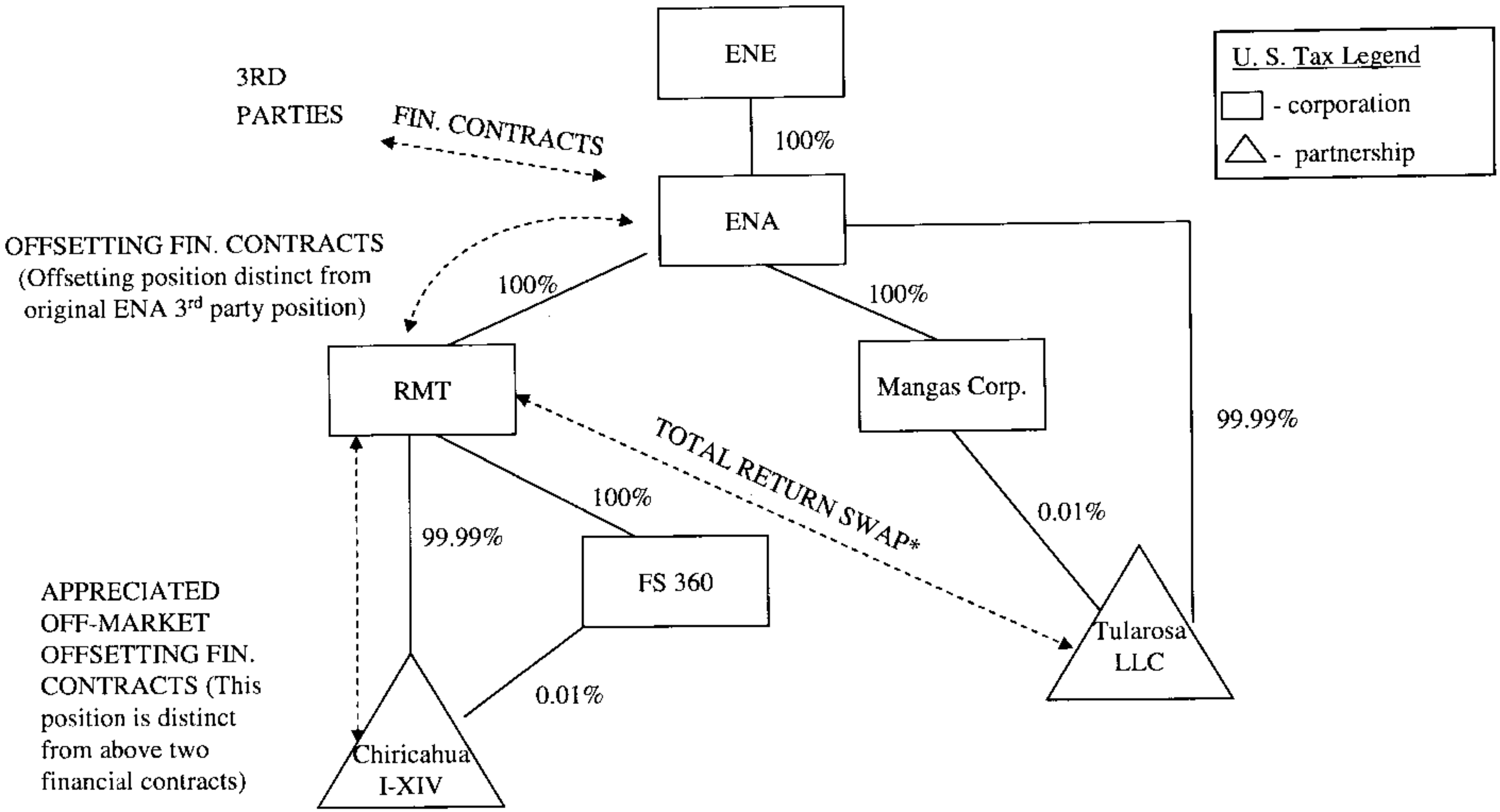
   (c) **4 transactions – No tax return impact.**

   (d) **Net combined tax return effect through 2001 – approximately $540 million of deductions or income not subject to U. S. federal income tax.**

APPENDIX

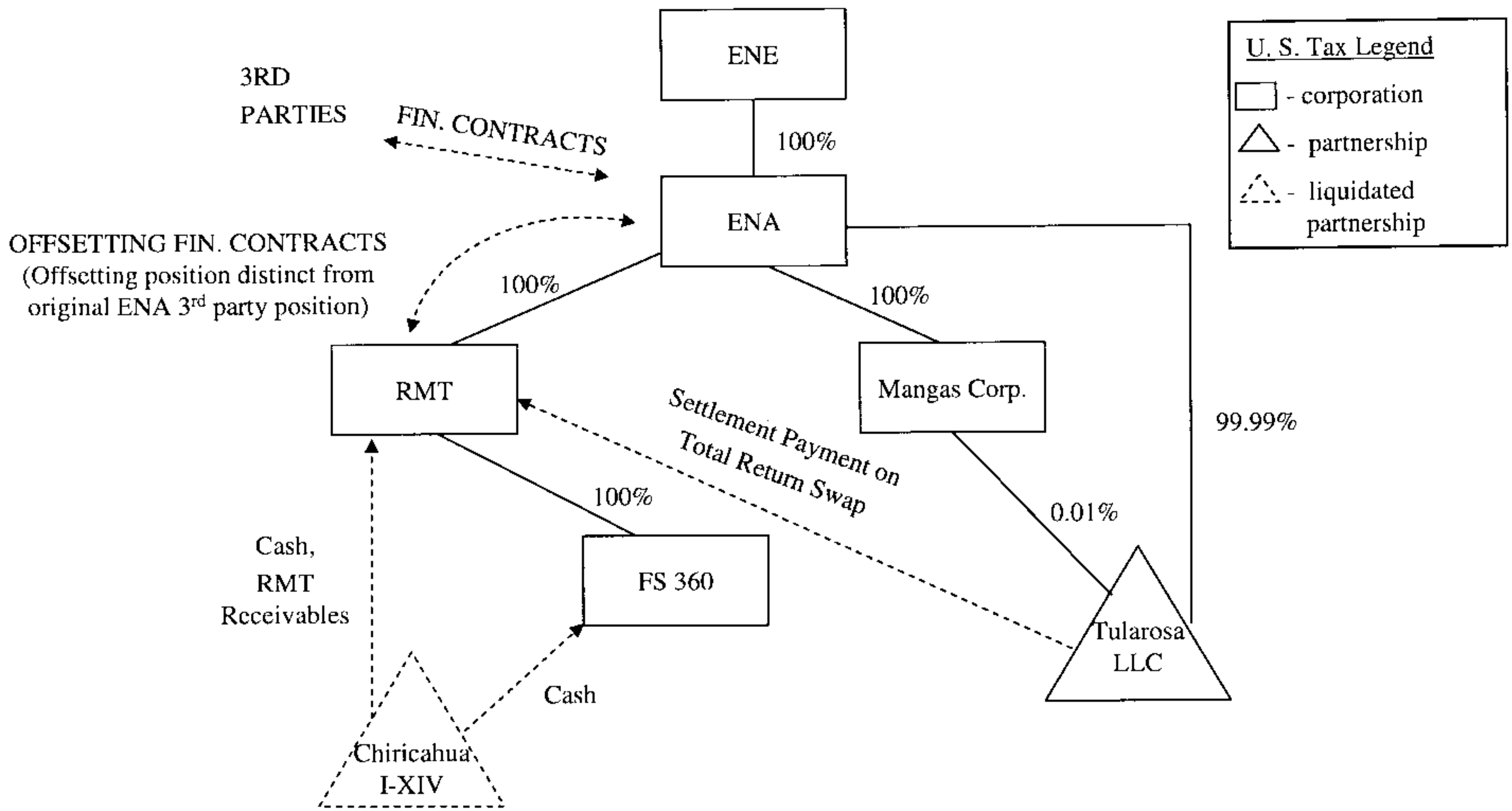
Confidential

Project NOLy – December 2000



*Total return swap contract whereby Tularosa LLC agrees to pay RMT $5.556 billion in return for RMT's obligation to pay to Tularosa LLC all returns related to RMT's interest in Chiricahua LLC. Net cash settlement of difference between (i) FMV of Chiricahua interest at settlement date + distributions on such interest, and (ii) $5.556 billion fixed payment.

Project NOLy Unwind – December 2001



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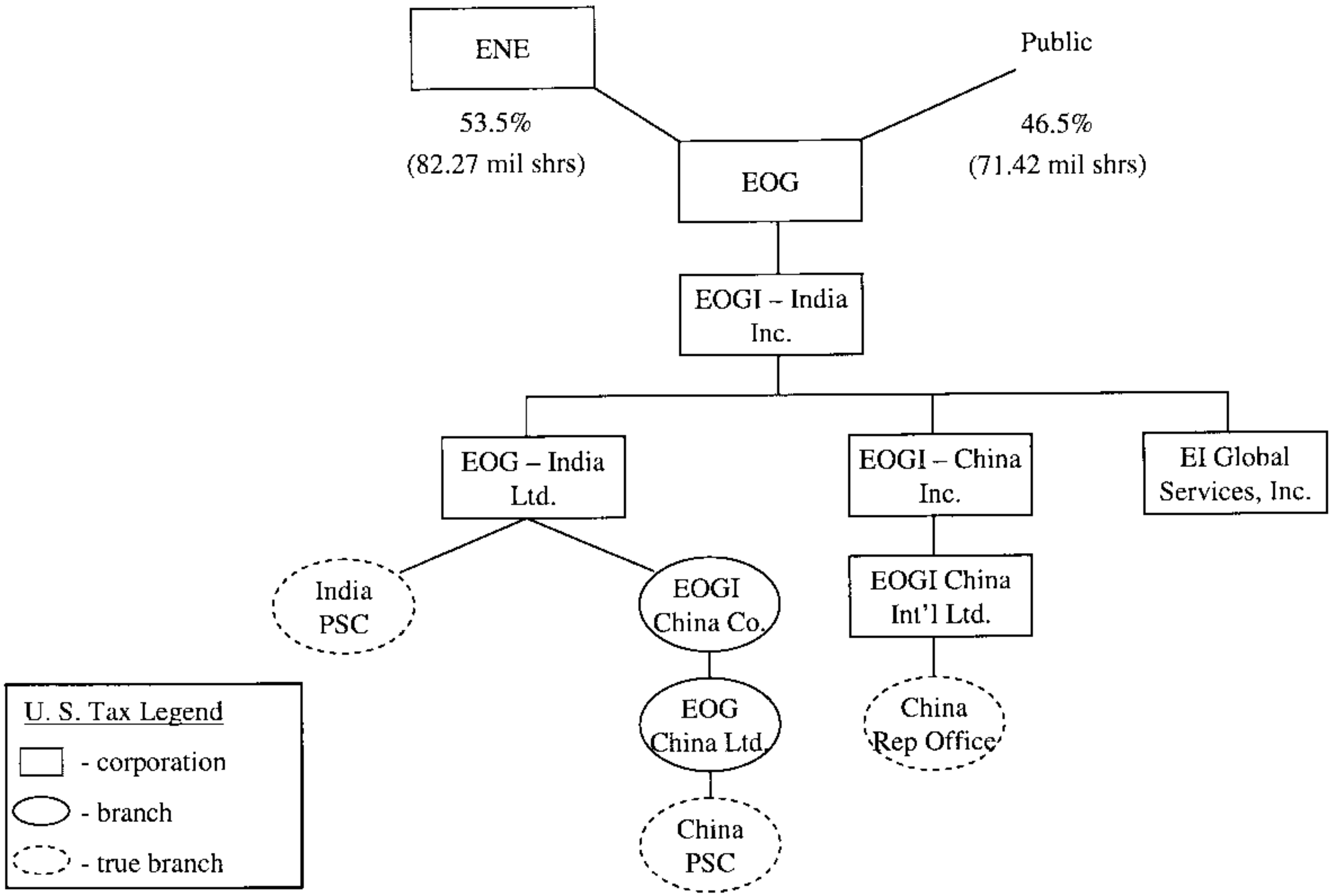
EOG Split-off
U. S. Tax Structure Immediately before the Share Exchange Closing



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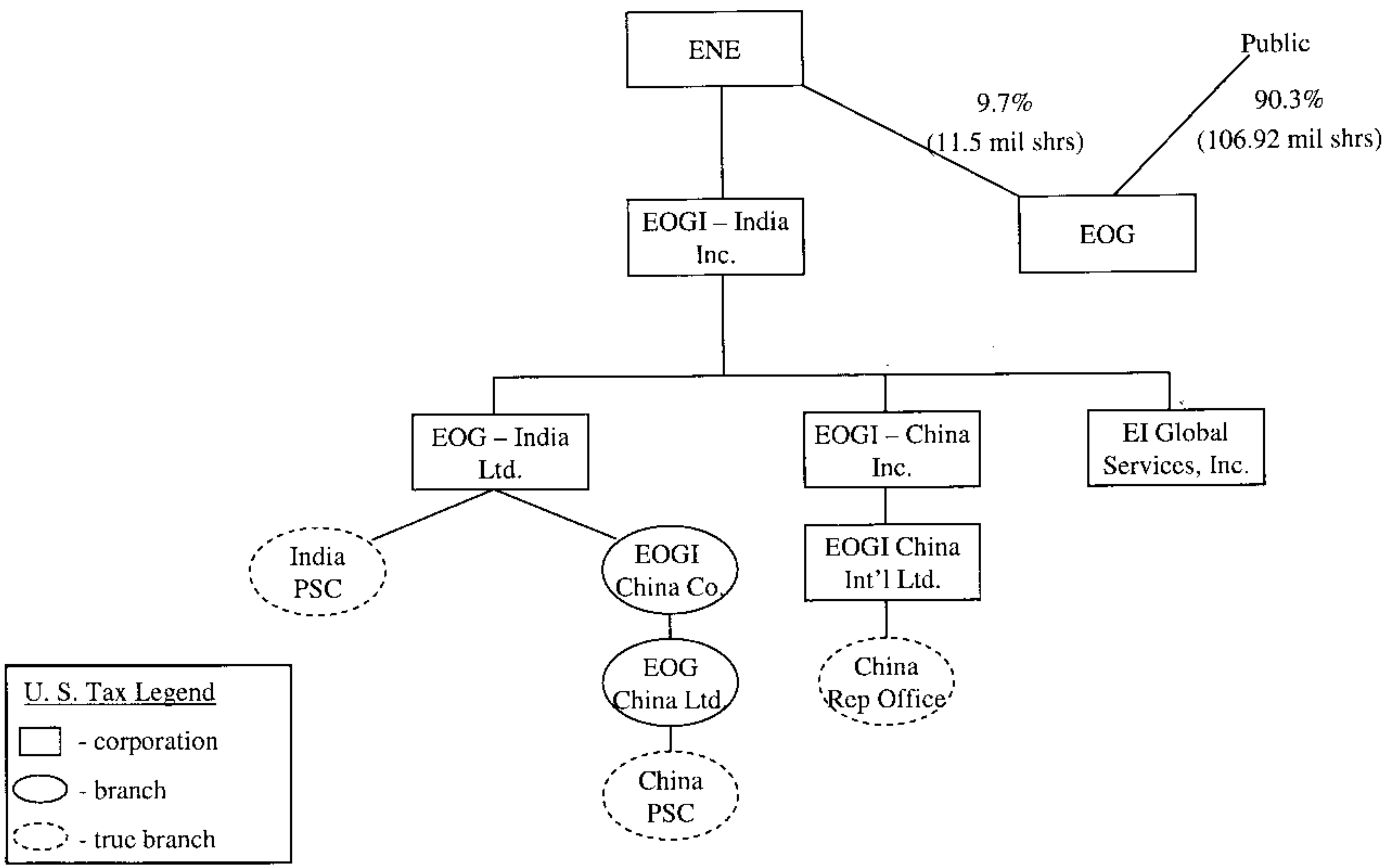
EOG Split-off
U. S. Tax Structure after the Share Exchange and EOG Stock Offering



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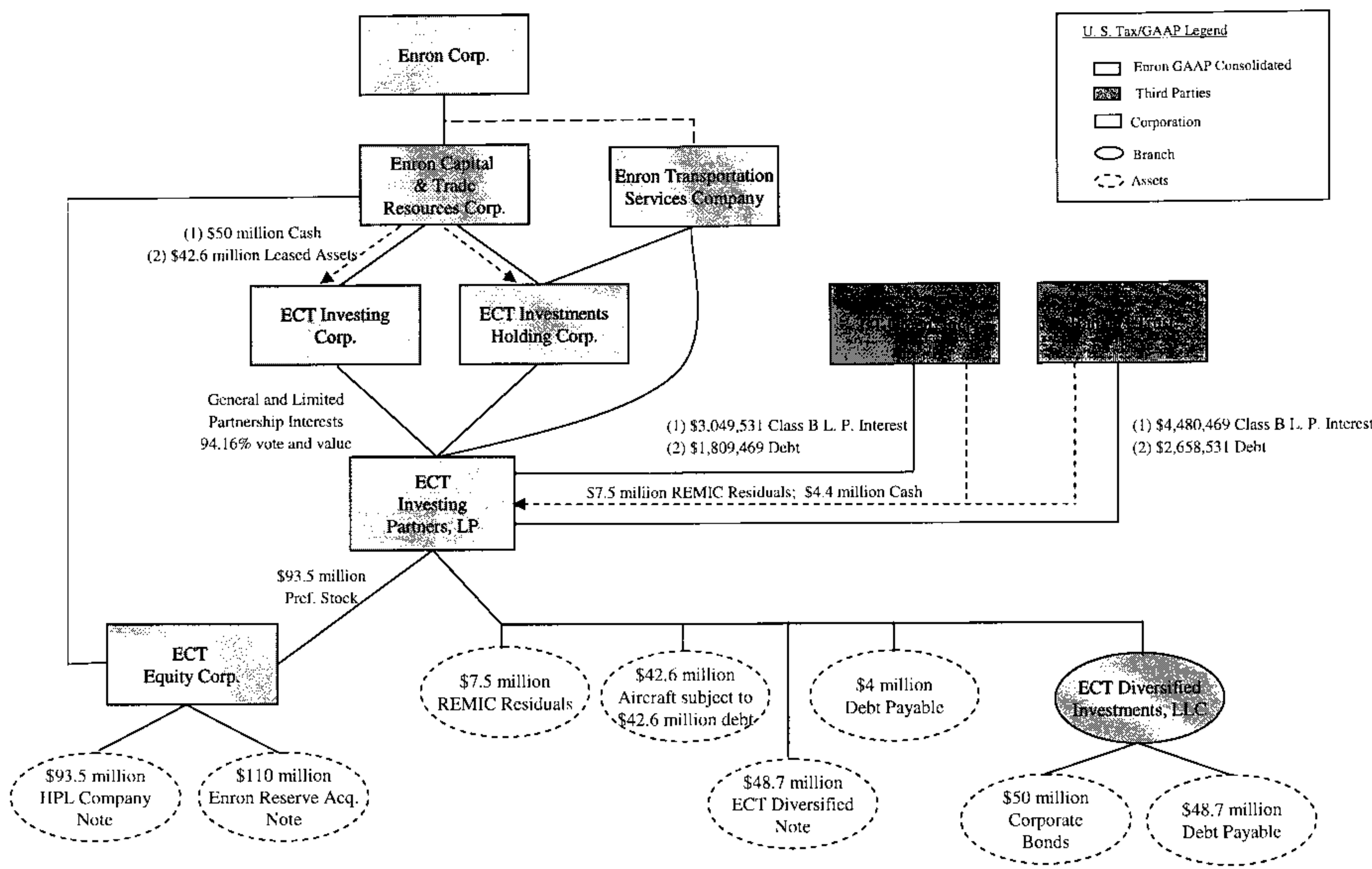
Project Steele
Structure as of October 31, 1997



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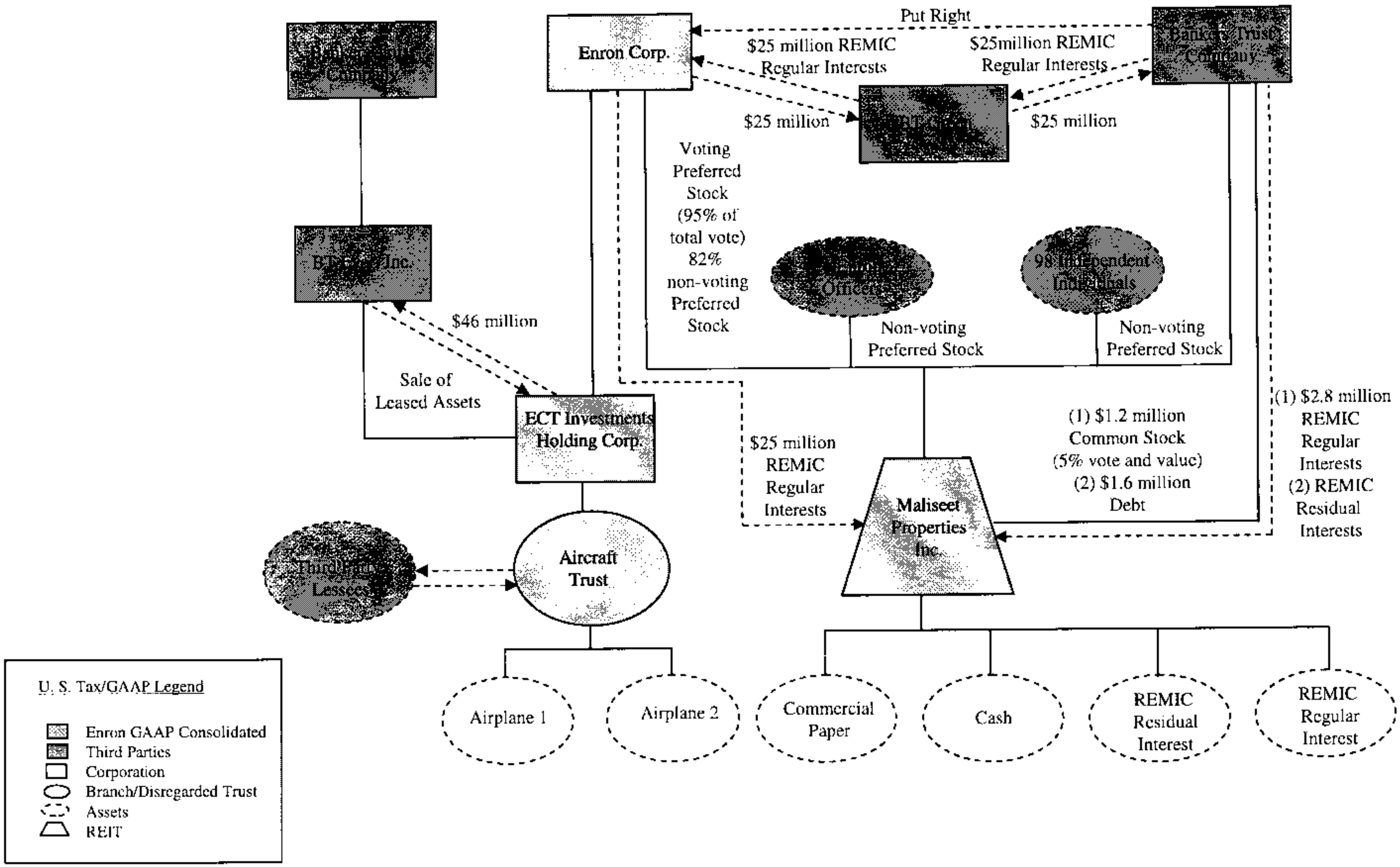
Project Cochise
Structure as of January 1999



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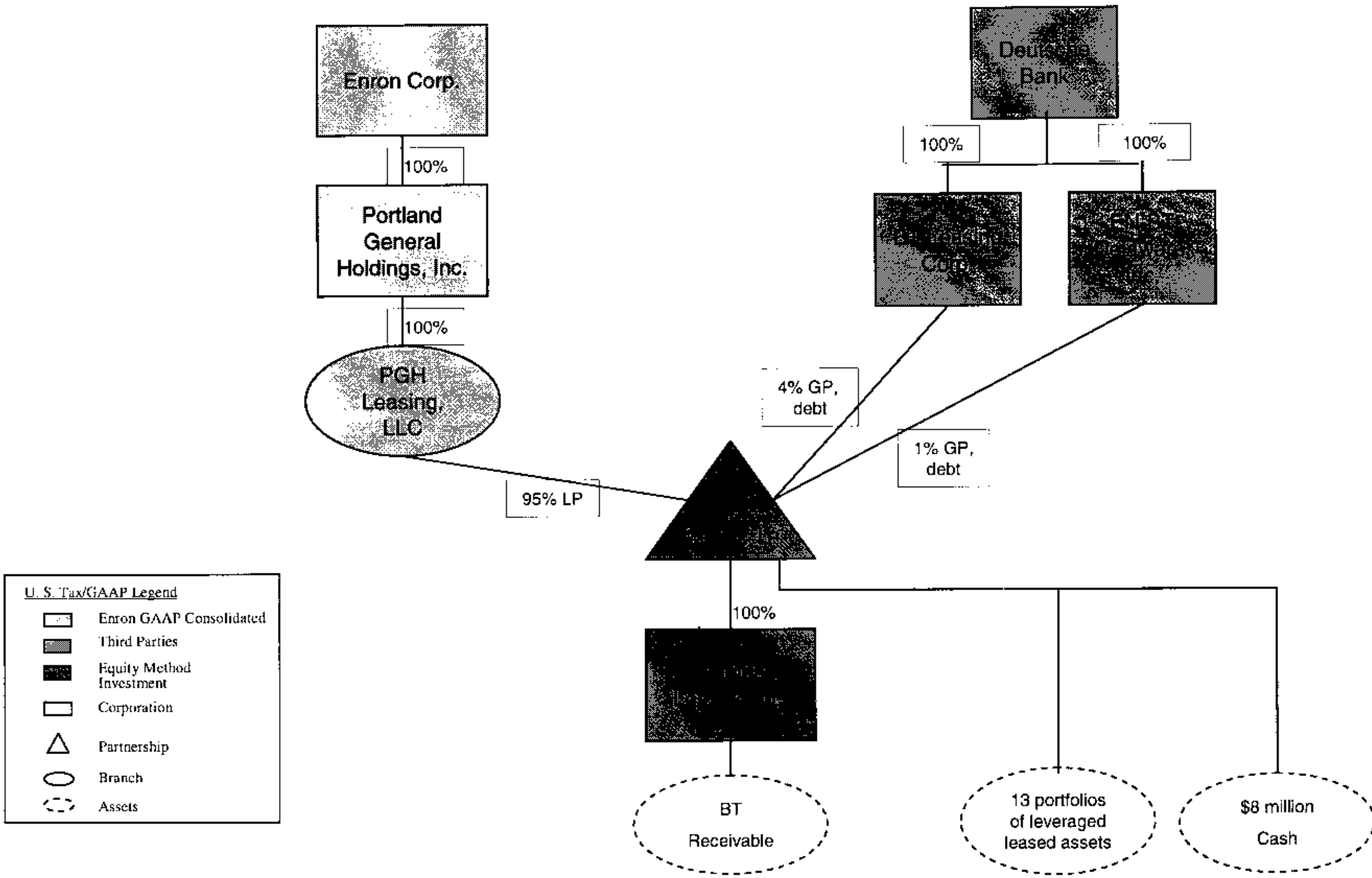
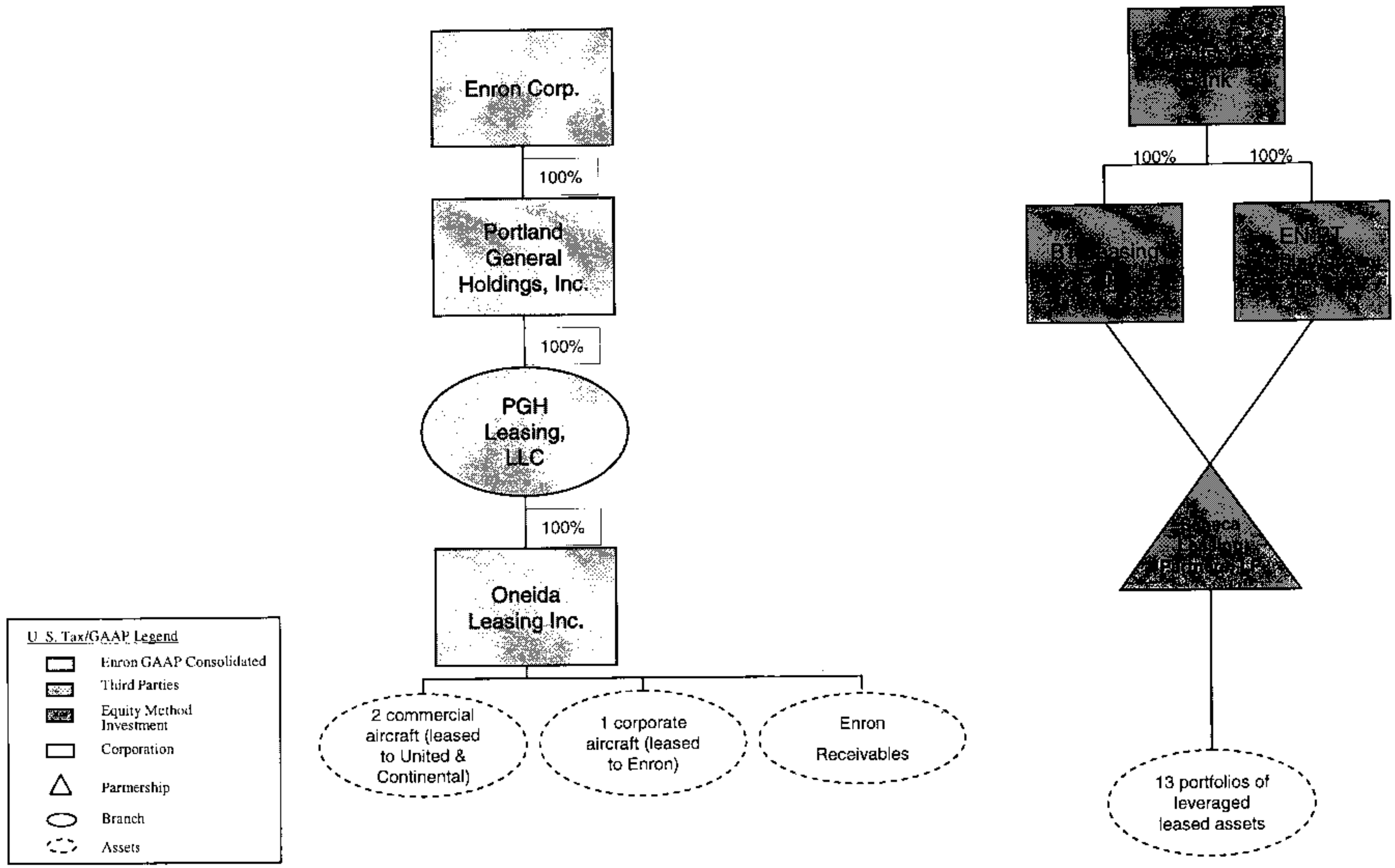
Project Tomas
Structure as of September 30, 1998



A- 7

Project Tomas
Structure as of December 31, 2001



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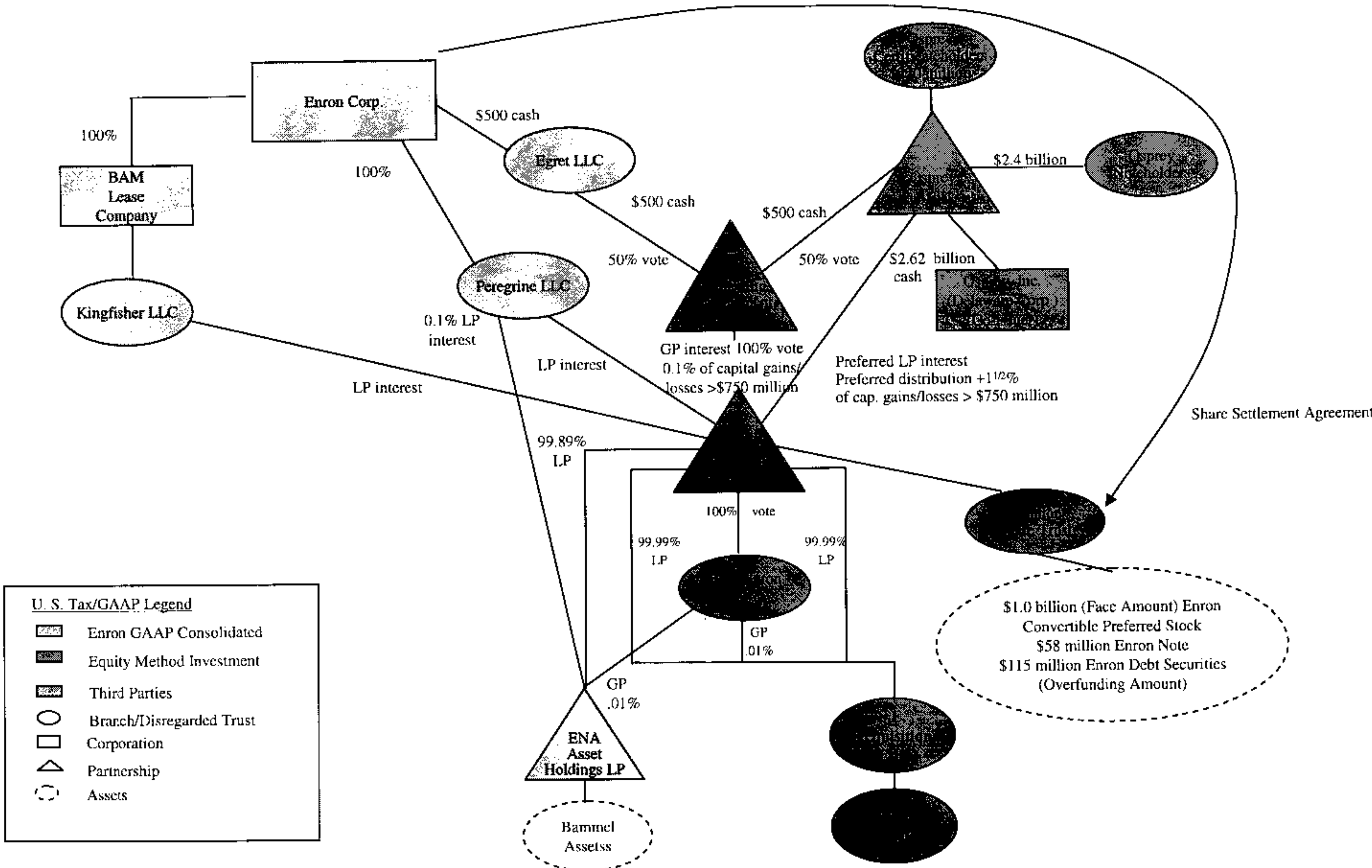
Project Condor
Structure as of December 31, 2001



A- 9

Project Teresa
Structure as of December 2001

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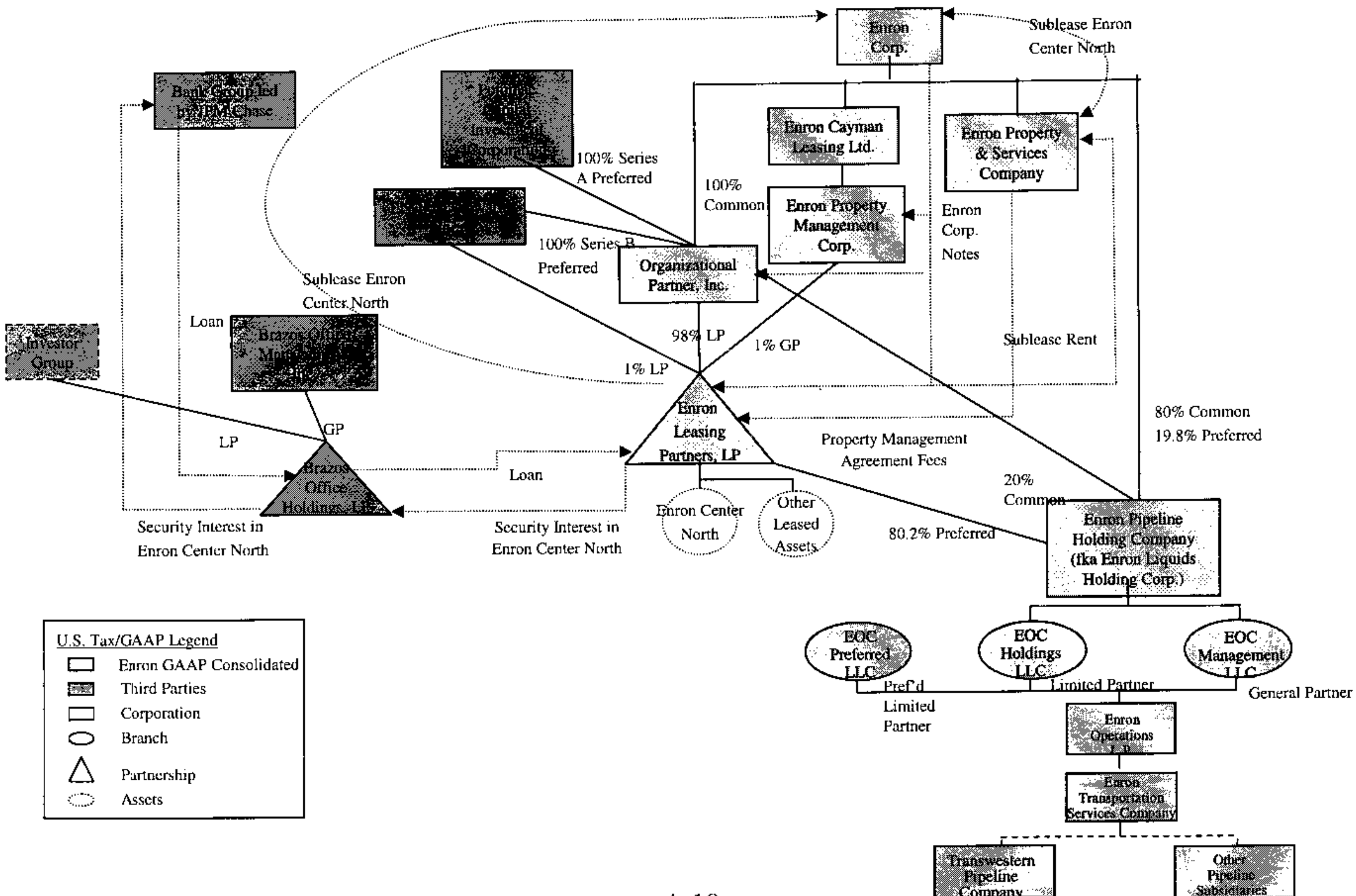

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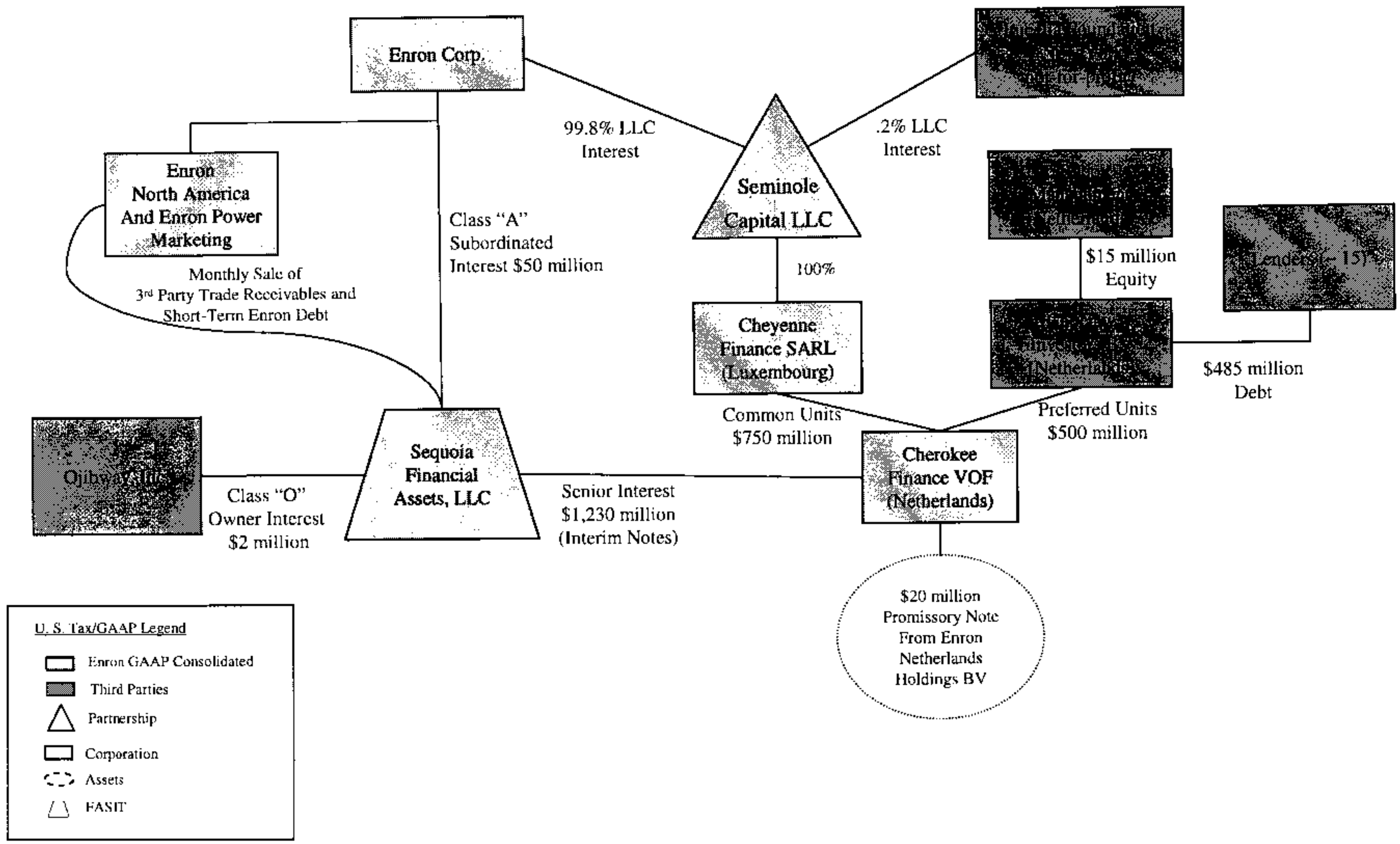
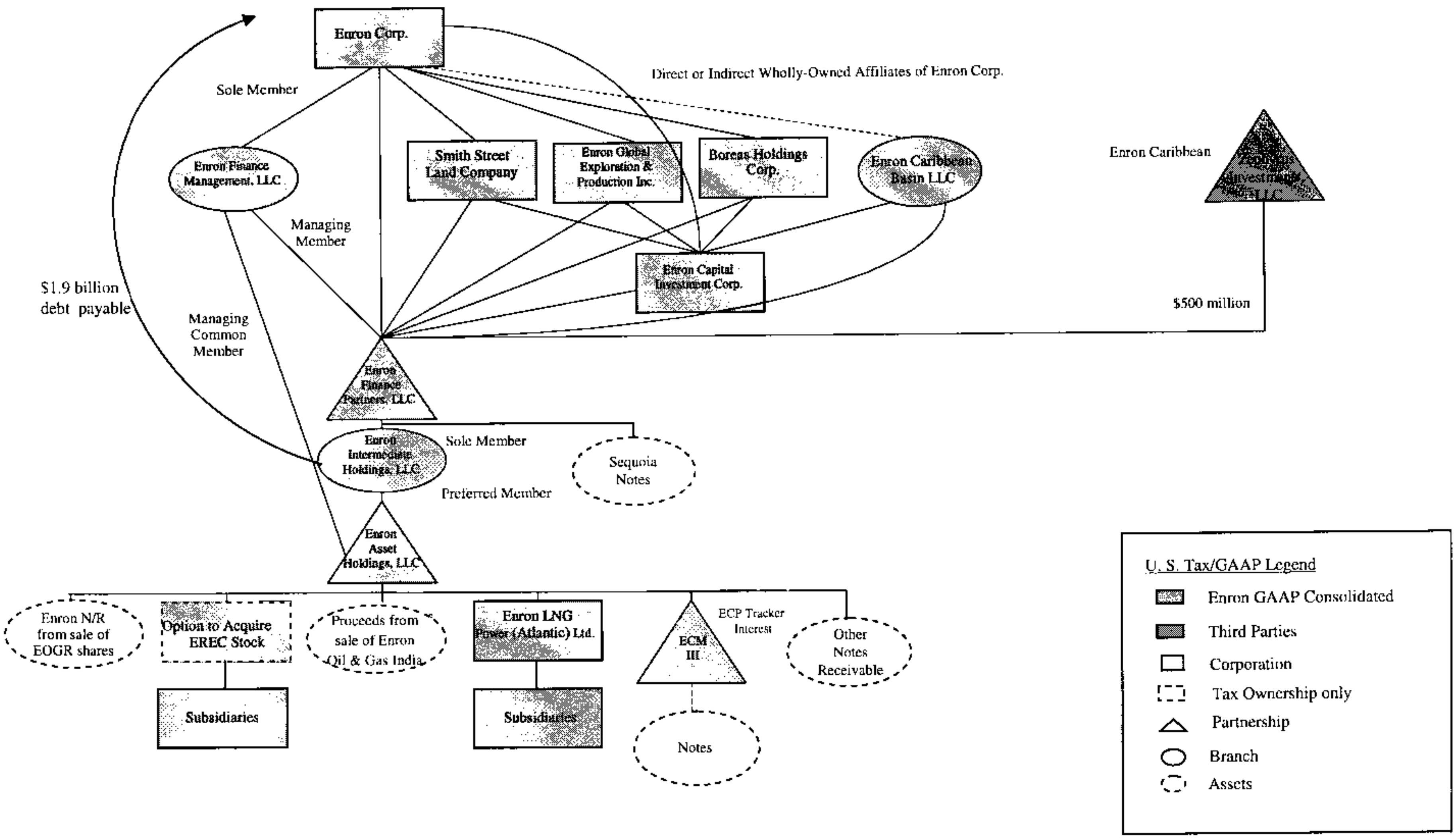
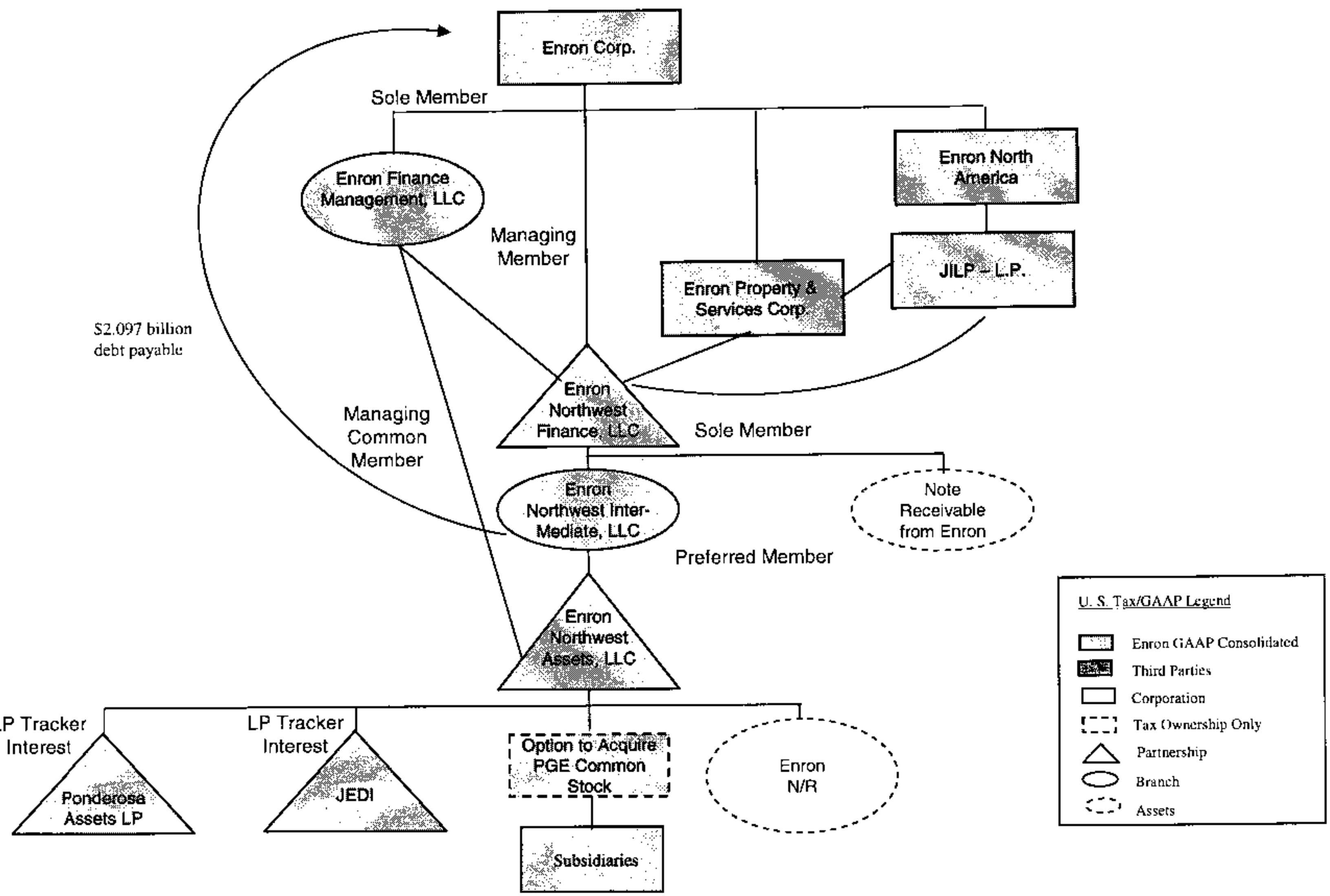
Project Apache
Structure as of May 28, 1999



Project Tammy I
Structure as of December 2001

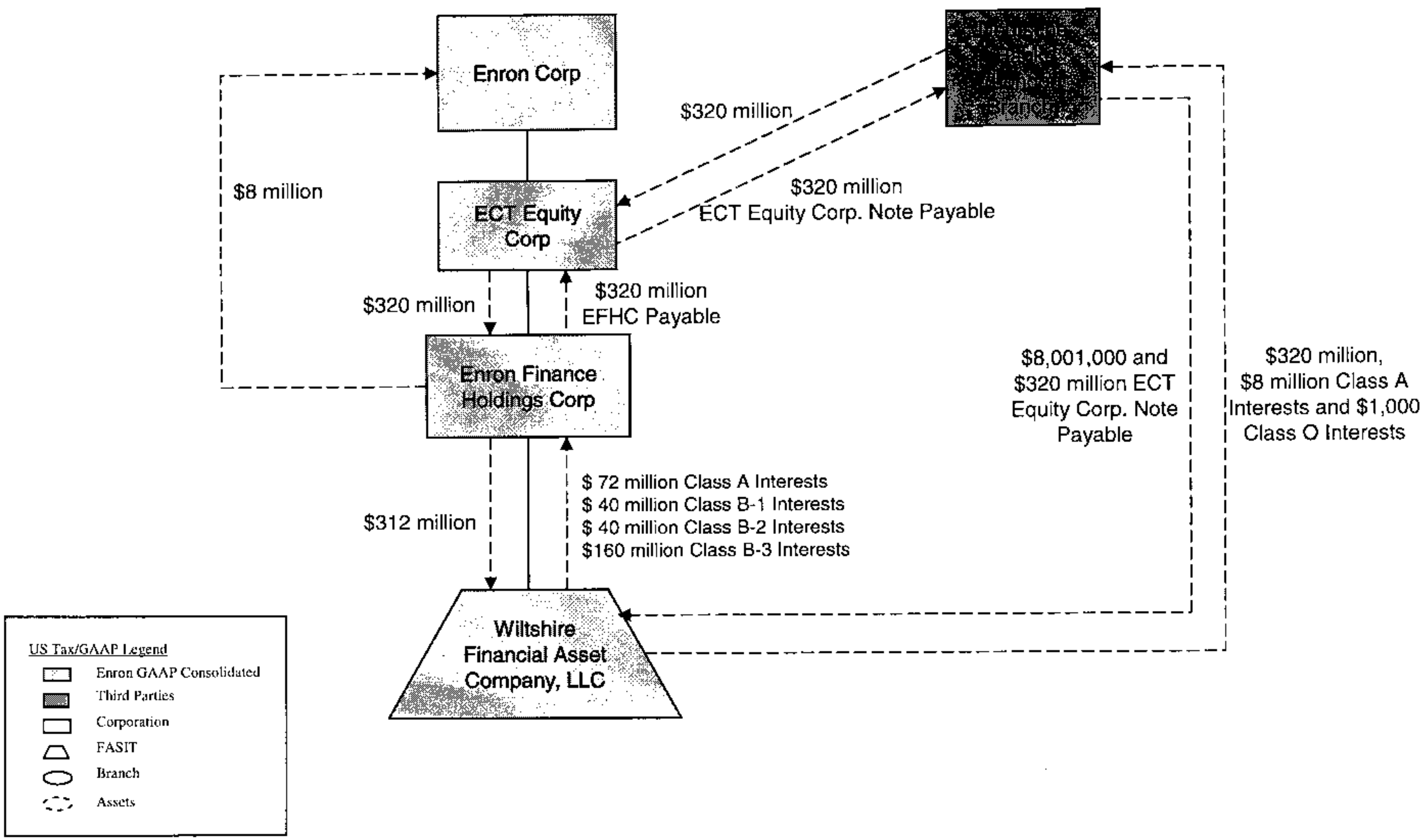


Project Tammy II
Structure as of December 2001

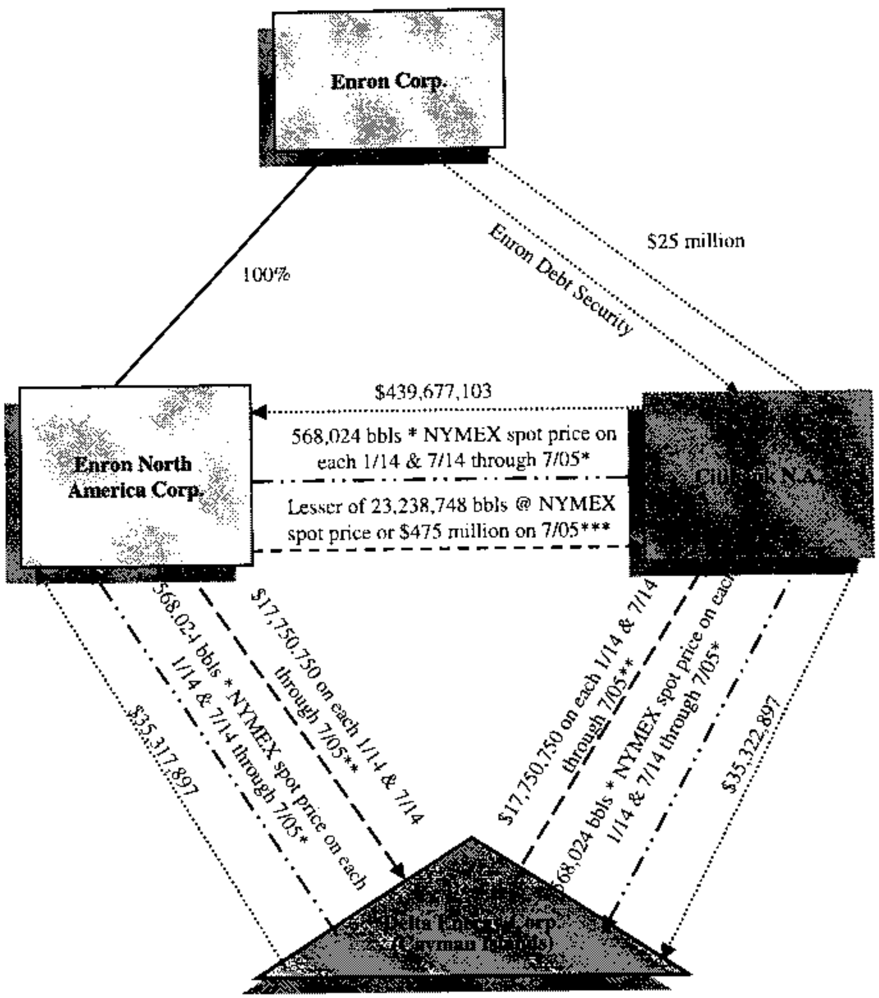


Project Renegade
Structure as of December 29, 1998

Confidential



ENA $475 Million Prepay Transaction
August 25, 2000
(Partial Diagram)



U.S. GAAP/Tax Legend

- Enron GAAP Consolidated
- Third Parties
- Corporation
- Partnership

Prepay Legend

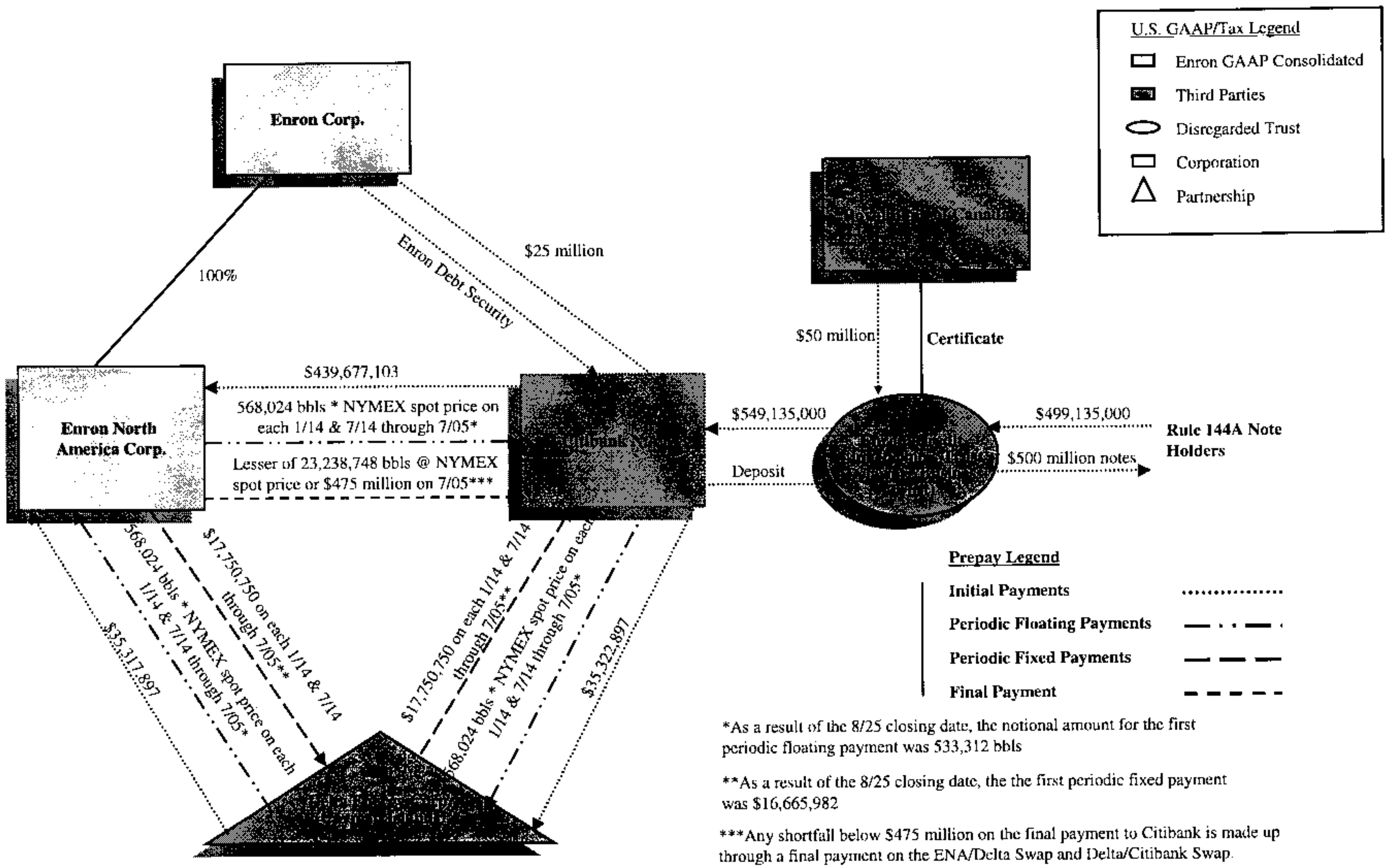
- **Initial Payments** ················
- **Periodic Floating Payments** — · · —
- **Periodic Fixed Payments** — — —
- **Final Payment** - - - - -

*As a result of the 8/25 closing date, the notional amount for the first periodic floating payment was 533,312 bbls

**As a result of the 8/25 closing date, the the first periodic fixed payment was $16,665,982

***Any shortfall below $475 million on the final payment to Citibank is made up through a final payment on the ENA/Delta Swap and Delta/Citibank Swap.

ENA $475 Million Prepay Transaction
August 25, 2000

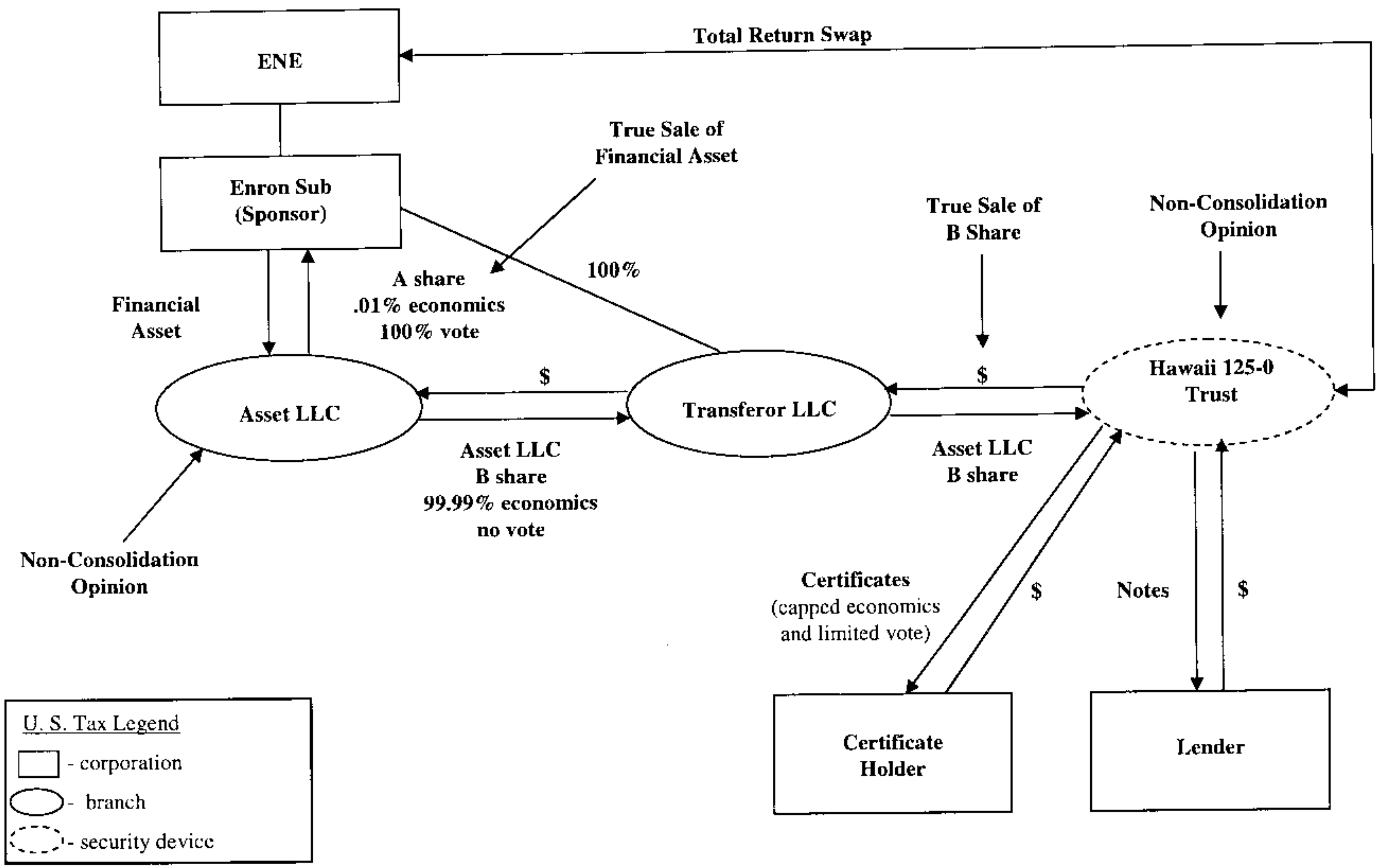


*As a result of the 8/25 closing date, the notional amount for the first periodic floating payment was 533,312 bbls

**As a result of the 8/25 closing date, the the first periodic fixed payment was $16,665,982

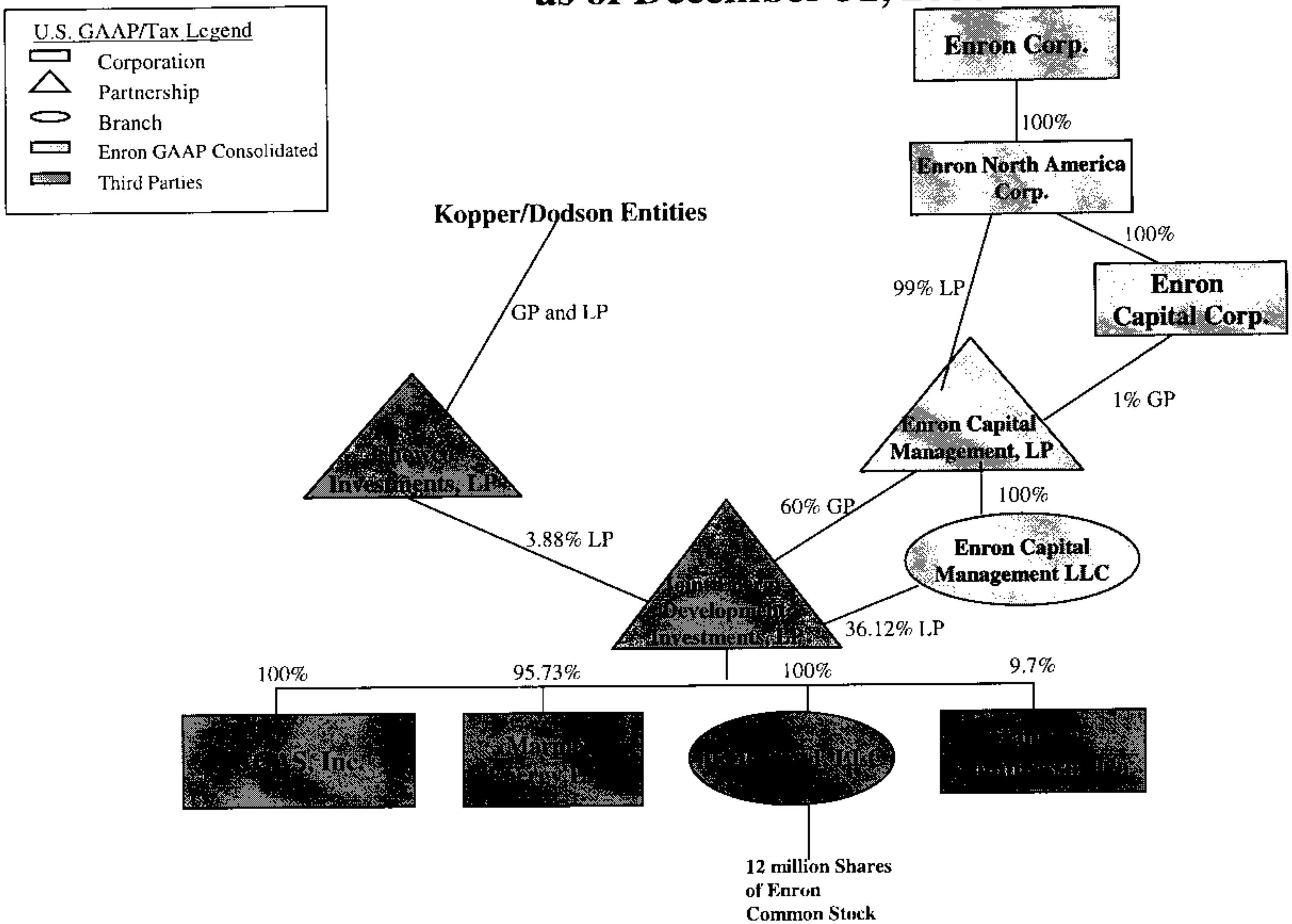
***Any shortfall below $475 million on the final payment to Citibank is made up through a final payment on the ENA/Delta Swap and Delta/Citibank Swap.

Hawaii 125-0 Structure Diagram



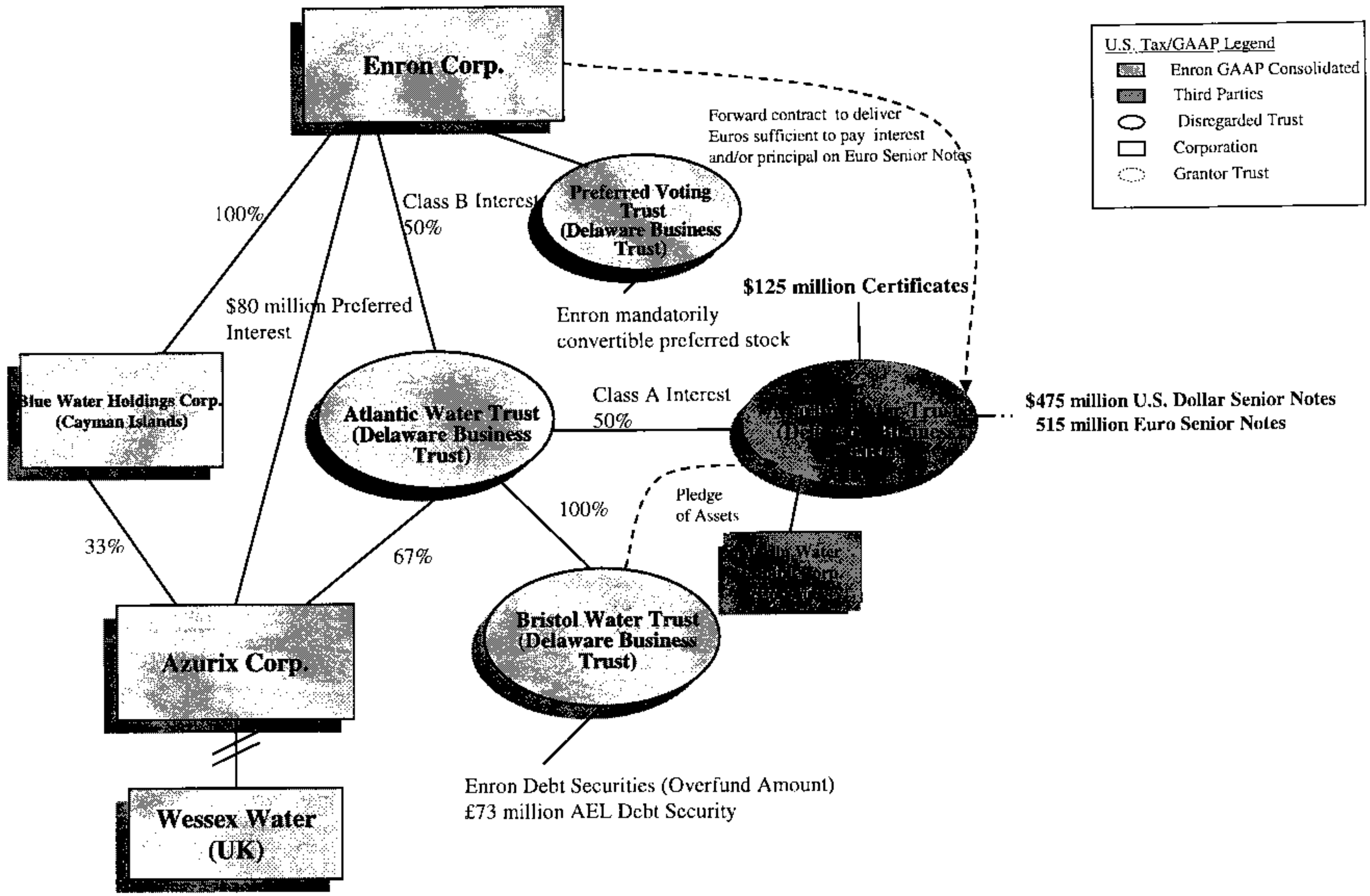
Confidential

JEDI I Ownership Structure as of December 31, 2000



Project Marlin
Structure as of December 31, 2001

Confidential



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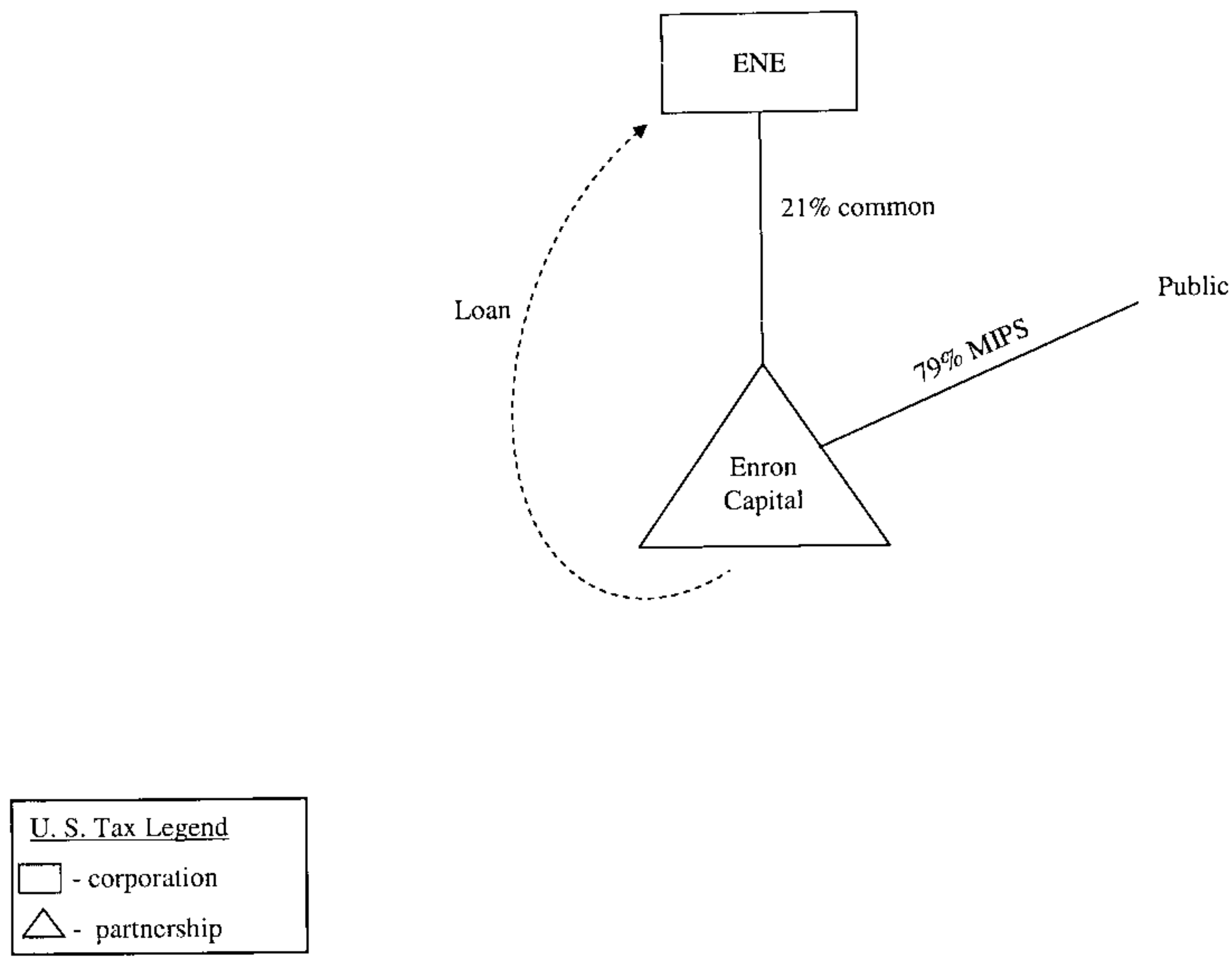
MIPS Financing



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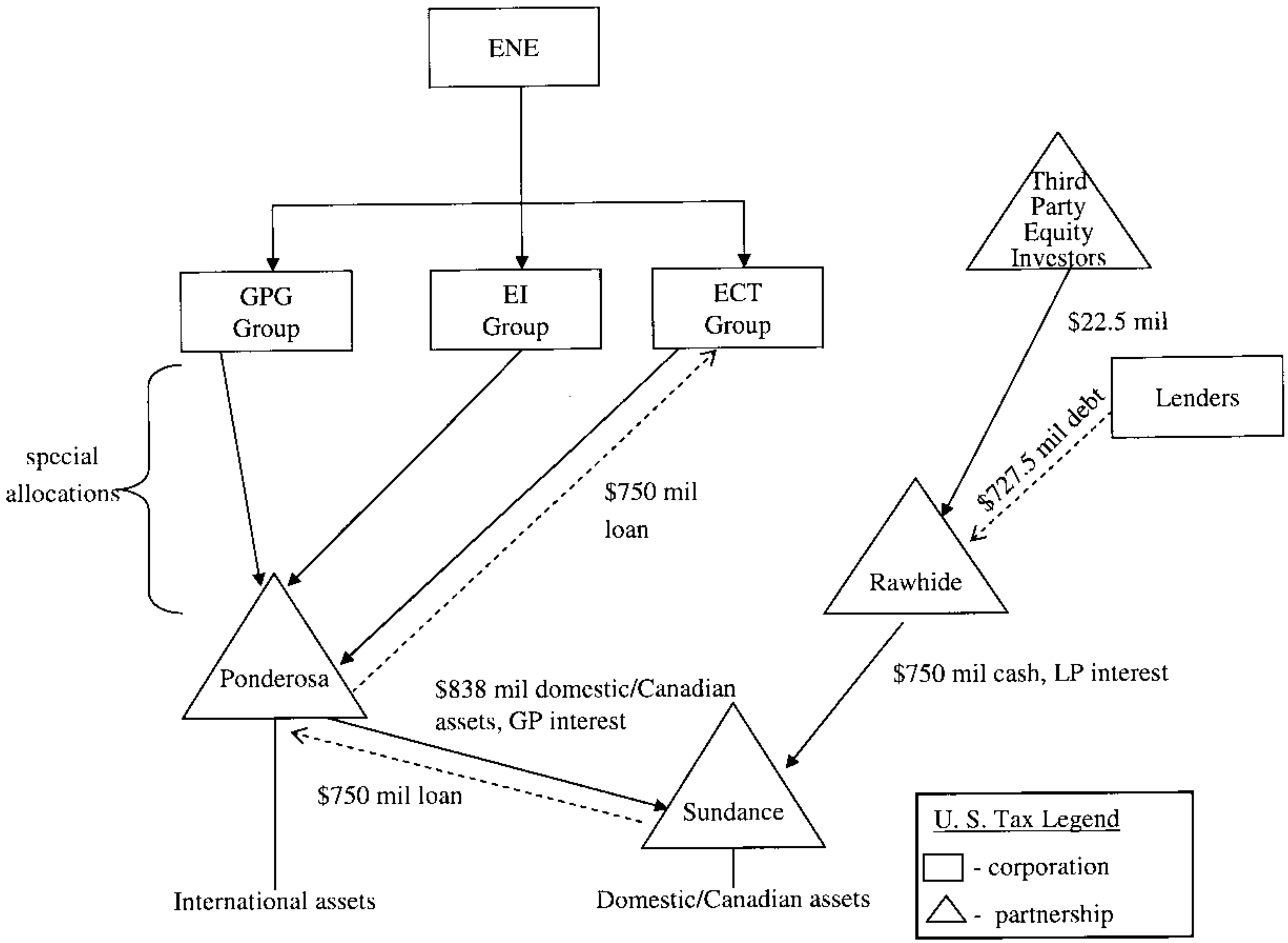
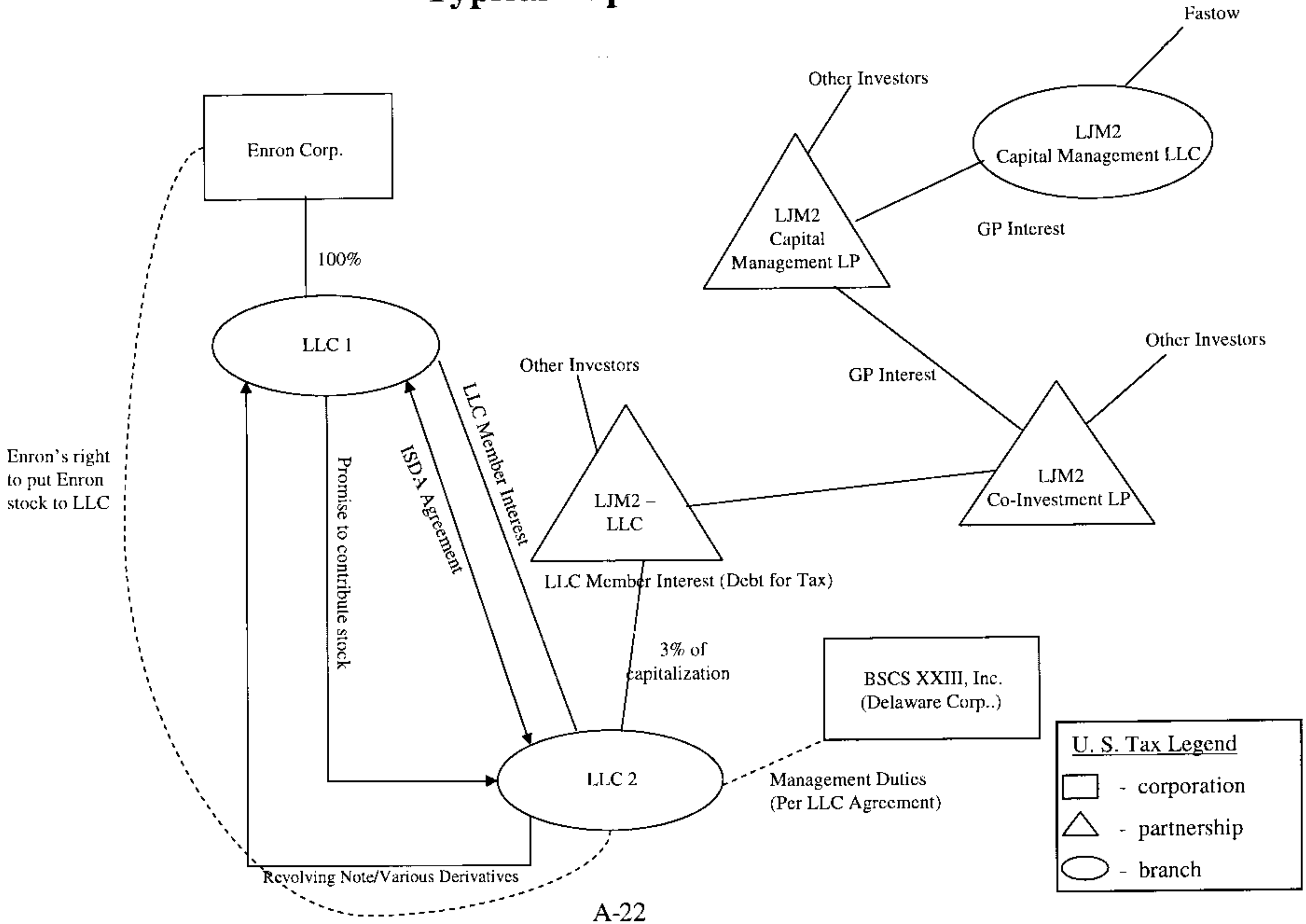
Project Rawhide Financing – December 1998



A-21

Confidential

Typical Raptor Structure



A-22