ARTHUR ANDERSEN

To: The Files

From: Dave Duncan
Deb Cash
Patty Grutzmacher
Jennifer Stevenson

Date: December 31, 1999, as amended, October 12, 2001

Subject: LJMII Partnership Structure

Background

We were informed by a senior officer of Enron (CFO) that he saw a unique opportunity to match various capital providers wanting to diversify into sectors in which he had experience with needs Enron and other companies like Enron had for high degrees of third party equity capital. In effect, he wanted to form his own private equity fund similar to others he had observed in the market place which made sizable private investments and whose participants included sophisticated investors. He had explored this notion with other members of Enron's upper management who indicated a willingness for him to develop this idea. He further indicated that both he and they hoped that he could accomplish this and remain with the Company. While he and the Company planned to consider and address the obvious Corporate Governance and Fiduciary responsibility issues, we were asked by he and other members of Enron management to review the entity as it was developed to determine whether necessary features existed which would enable Enron to do transactions with the entity that would result in third party accounting recognition. Our deliberations with respect to such entity are described below.

Structure

On December 20, 1999, a private investment company, LJMII Co-Investment L.P. ("LJMII") was created for the purpose of acquiring or investing in primarily energy-related or communications-related businesses or activities.

LJMII was capitalized at formation with $55 million of equity and $63 million of debt capital. As indicated in the attached diagram (Diagram I), the equity holders are comprised of a senior officer of Enron (2% ownership and General Partner) and various third party investors (98% ownership). The composition of the 98% third party investor ownership, which were 51 entities in total, are as follows: Financial Institutions (37%), Pension Funds (22%), Independents (19%), Insurance Co. (10%), Other funds (8%) and Foundations (4%). A portion of the debt was provided by an entity that is wholly owned by a joint venture in which Enron is a co-owner, and the remaining debt was provided by a third party bank.

Since LJMII planned to transact at least initially with Enron, we determined that we should view LJMII as an Enron sponsored SPE. We informed Enron that, at some point, we might reconsider our view of LJMII as an SPE and that such reconsideration would be based on the number of third party transactions and the size of those transactions to the operations of the entity as a whole. Since we considered LJMII to be an SPE, we informed Enron and LJMII that we would subject LJMII to the capital and control tests set forth in EITF 90-15 and Topic D-14 before any transactions between the two entities could be given accounting recognition for Enron. Additionally, because of the significant senior officer involvement we needed to determine that 1) the senior officer did not control the partnership and 2) certain criteria existed to provide assurance that all transactions executed between Enron and LJMII involved the input of the outside investors to preclude the appearance of self dealing.

Date: December 31, 1999

Subject: LJMII Partnership Structure

Issues

1. Is the minimum SPE capitalization requirement met to support nonconsolidation?
2. Does the control structure support nonconsolidation of the entity for Enron Corp. as a result of the related party relationship?
3. What are the necessary disclosures?

Issue 1

EITF 90-15 requires SPE structures to be capitalized with at least 3% third party residual equity. As a result of the senior officer equity ownership (which we determined should not be given any credit when determining whether sufficient capital existed when evaluating potential transactions with Enron), we determined that the required amount of equity would need to be 3.02% as opposed to the normal 3% (to effectively discount for the proportionate share of the officer's ownership). The balance sheet of LJMII consists of $55 million of funded equity capital and $63 million of debt. Total funded third party equity of LJMII is $54 million, as indicated on the attached diagram. As this represented approximately 45% of the total capitalization, we determined that the SPE capital threshold was met with respect to any transaction LJMII may undertake directly with Enron.

We discussed this issue with Carl Bass and John Stewart of the Professional Standards Group, who concurred with our conclusions.

Issue 2

Topic D-14 states that the SEC staff believes that for nonconsolidation by the sponsor to be appropriate, the majority owner of the SPE must be an independent third party who has made a substantive capital investment in the SPE, has control of the SPE and has substantive risks and rewards of ownership of the assets of the SPE. The $54 million of LJMII equity that was contributed by third party investors represents a substantive capital investment. As indicated, a senior officer of Enron serves as the GP of LJMII and is therefore in control of day-to-day operations of the partnership. To overcome the presumption of control by the GP (and by association, Enron) for purposes of consolidation, we noted that the Partnership Agreement included the provision that the GP can be removed without cause with the recommendation of two-thirds of the AC and a vote of Limited Partners (LP) that represents 75% of the total LP interests. With respect to the inclusion of criteria to ensure LP involvement in transactions with Enron, we noted that an Advisory Committee ("AC") existed with specific duties outlined in the partnership agreement. These duties included, among other things, reviewing and approving all transactions between LJMII and Enron or any of its subsidiaries above certain thresholds. We determined that transactions below the thresholds would probably not be material to Enron, but we informed management we would have to review such situations on a case-by-case basis. We noted that, the AC consists of representatives of the limited partners, all of whom we noted were independent from Enron (2 pension fund representatives, 4 financial institution members, 1 independent and 1 insurance company). Although we noted that the AC members are appointed by the GP, we noted that all other LP had the right to remove any AC member without cause with the consent of 75% of the LP's. We concluded that these provisions were sufficient to overcome the presumption that the GP (and by association Enron) controls and that nonconsolidation of LJMII is therefore appropriate. We informed the client that, while the removal of the GP without cause feature generally was sufficient to overcome a presumption of control by the GP, an important consideration was the reasonableness of the ability of the LP's to do so. We noted that the existing feature (two-thirds of AC and 75% of the LP's) was at the very upper limit of what may be acceptable. We

Date: December 31, 1999

Subject: LJMII Partnership Structure

encouraged them to request LJMII to lower these thresholds before any material transactions were consummated.

Issue 3

Since the GP of LJMII is a related party, as transactions are entered into with Enron or its affiliates, certain disclosures will be required. We informed the client that the existence of LJMII will need to be disclosed, including the related party that serves as the GP of the partnership, as well as the purpose of the entity. The nature of transactions executed with Enron and Enron affiliates must also be disclosed as well as any associated gains or losses. We will review the filings and other issuances of financial statements to ensure all appropriate disclosure requirements are met.

Conclusion

We concurred with Enron that the necessary capitalization and control features had been met for nonconsolidation of LJMII and that recognition could be given to transactions with LJMII as a third party.

We informed management that this conclusion would need to be reviewed as transactions occurred and that we would need to address the audit evidence we would require (particularly with respect to the valuation of transactions between the two entities) on a case-by-case basis as they occurred.

We discussed the formation of this entity and our conclusions with Mike Odom, Practice Director, Bill Swanson, ABA Head, and Mike Lowther, concurring partner, concurred with our conclusions.

Additional Note

In addition to the technical accounting issues, we also considered Enron corporate governance issues related to these transactions. We discussed with Enron management (other than the senior officer involved) their planned activities to ensure such issues had been considered. We determined that Enron was receiving advice from internal and external counsel regarding the acceptability of the transactions and planned to disclose the formation of the entity and any contemplated transactions between the entity and Enron with the Finance Committee of the Board of Directors of Enron prior to their completion. In connection with our procedures, we confirmed that all of the above occurred. We also ensured that the Audit Committee was made aware of the entity and related transactions.

Memo

ANDERSEN

To	The Files
From	Dave Duncan Deb Cash Patty Grutzmacher Jennifer Stevenson
Date	March 28, 2000, as amended, October 12, 2001
Subject	Raptor Transaction

Purpose

The creation of a vehicle used to hedge Enron's exposure related to equity investments (accounted for under either fair value or accrual accounting).

Transaction Structure

Under the transaction structure shown in the attached diagram (Exhibit I), Enron, Harrier LLC (Harrier), a wholly-owned subsidiary of Enron, and Talon LLC (Talon) executed a series of agreements that result in Harrier acquiring the right to execute equity swap transactions up to a notional amount of $1 billion, or purchase put options through the conversion of a $400 million note receivable from Talon LLC into option premiums. Talon is an SPE that is capitalized by LJMII, a third party equity holder, who serves as the managing equity holder of Talon, and Enron Corp. who has a preferred LP interest. LJMII is a related party entity (See LJMII memo in 4th quarter file for an explanation of the relationship).

In the structure, Talon receives the following from Harrier:

1. A $50 million interest bearing note receivable, payable quarterly @ 7%;
2. 3,739,175 shares of Enron common stock which is restricted from sale for 3 years;
3. A contingent right to 3,876,755 of Enron common stock which could be delivered to Talon during 2003, subject to certain conditions being met (the "contingent forward") and which would be restricted from sale until 2005.;
4. A premium of $41million for writing an Enron common stock share settled put option on 7,171,418 shares at a strike price of $57.50/share, which expires 6 months from the closing date; and
5. A nominal net capital contribution of $1,000 from Enron for its preferred LP interest.

The value of the Enron shares, given the restrictions, has been determined to be approximately $350 million, as compared to the current value of a similar number of unrestricted Enron shares in the public market, which would be approximately $536 million.

Harrier receives the following from Talon:
1. A $400 million note receivable that is convertible into option premiums, subject to Talon approval;
2. The ability to enter into derivatives, subject to Talon's approval, with a cumulative notional amount of $1 billion;
3. A non-voting preferred limited liability company interest in Talon; and
4. A put option on Enron common stock whereby Enron has the obligation to deliver Enron shares to Talon for settlement below a stock price of $57.50.

The obligations under this transaction will terminate upon the earliest occurrence of one of the following: (1)April 18, 2005, (2)the date either Talon or Harrier wish to terminate the agreement provided the proper notice is given, and (3)a default event, as defined in the various transaction documents. Termination of this agreement by one of the above circumstances only terminates Harrier's right and Talon's obligation to execute additional derivatives. Previously executed derivatives will remain in effect and do not automatically terminate without mutual consent of the parties.

Issues
1. Does the structure of Talon meet the minimum control requirements of a special purpose entity that supports non-consolidation by Enron? What are the initial and ongoing capitalization requirements of the SPE?
2. How should Enron account for its preferred limited liability company interest in Talon?
3. How should Enron account for the purchased share-settled put option?
4. What is the proper accounting for the contingent forward sales contract?
5. How will the value of the derivative transactions be substantiated?
6. What is the impact of Talon's credit worthiness on the value of the derivative instruments to Harrier?
7. What are the required disclosures in the Enron Corp. financial statements as a result of the transaction?

Issue 1
The sponsor of the Talon SPE is Harrier. As mentioned, the SPE was capitalized by an independent third party member, LJMII, who infused $30 million of equity as its initial capital investment that will be at risk during the term of the structure. Harrier, who also made a $1,000 capital investment, serves as the other member of the SPE. In analyzing whether non-consolidation is appropriate, specific control criteria must be met, and the initial and ongoing capital investment must be 3% of the total assets of the SPE.

Control Requirements
Based on Topic D-14, "Transactions Involving Special-Purpose Entities," the SEC staff believes that for non-consolidation recognition by the sponsor to be appropriate, the majority owner of the SPE must be an

independent third party who has made a substantive capital investment in the SPE, has control of the SPE and has substantive risks and rewards of ownership of the assets of the SPE.

LJMII serves as the managing member of the SPE. Harrier has no involvement in the management or operations of the entity. Therefore the control requirements are met.

Capital Requirements
The typical capital requirement of an SPE is 3% residual equity at risk of the total assets of the entity in question. In considering this requirement as it relates to Talon, we considered the following:

1. The required equity capital was coming from LJMII, an investment partnership we knew to 1) include an Enron employee among its capital participants and 2) have debt in its overall capital structure. Accordingly, we needed to determine that the capital we were considering in our test was not attributable to the Enron employee (we had previously determined that we would not consider such capital as "qualifying" equity capital as it related to structured transactions with Enron) or borrowed capital (which does not qualify in any instance). We reviewed LJMII's balance sheet to confirm it had sufficient equity capital to finance its contribution to Talon exclusive of its debt capital and the Enron employee capital. We determined this to be the case and concluded that all of the LJMII contribution could be considered for purposes of the required capital test. We grossed-up the required capital amount to effectively discount the Enron employee's proportionate share of LJM II capital.

   We discussed this issue with John Stewart of the Professional Standards Group who concurred with our conclusions.

2. As a part of the transaction origination, we noted that organizational expenses were being paid by Harrier directly to applicable third party vendors on behalf of Talon. Because these expenses are incurred by the SPE, but paid by Enron, we determined that they should be included in the 3% capital requirement analysis consistent with how we have seen this situation addressed in other SPE situations in practice.

3. It was contemplated that Talon would be entering into derivative transactions which might include swaps. Typically swaps done "at-the-money" have little to zero asset value at origination. We noted that using zero as the asset value for purposes of determining the minimum required amount of capital for these type instruments may not be reasonable, particularly as the instruments notional amount (maximum potential for loss) increased. We informed the company that we believed the minimum should be calculated on the notional amount (maximum potential for loss) of any such instruments and that we would follow that principle in applying the test.

   We discussed this issue with John Stewart, Professional Standards Group, who concurred with our conclusions.

Although the option to redesignate earnings of the entity to capital at risk (see Redesignation memo dated March 28, 2000) is available, the terms of this transaction structure does not meet criteria 4; therefore, redesignation is not available. Therefore, as the maximum exposure of the entity changes (i.e. through leveraging Talon or increasing the notional capacity of derivatives), LJMII will be required to provide additional equity to capitalize the entity.

We discussed all the above matters in Issue I with Carl Bass of the Professional Standards Group who concurred with our conclusions.

Issue 2

Harrier's preferred interest in Talon gives Enron the right to receive earnings from the entity that exceed certain earnings thresholds of the LJMII member as stated in the Talon Partnership Agreement. We noted that this interest is only settlable in cash (i.e., Enron cannot take any Enron shares Talon may hold in settlement). We considered whether it should be viewed as a derivative instrument. However, based on the form of the investment and the definition of a derivative as stated in SFAS 133, the form of the instrument is an investment and therefore should not be accounted for as a derivative.

Based on Topic D-46, a limited partnership investment should be accounted for using the equity method unless the investor's interest "is so minor that the limited partner may have virtually no influence over partnership operating and financial policies." The SEC staff understands that practice generally has viewed investments of more than 3 to 5 percent to be more than minor. As indicated in the Issue 1 discussion, Harrier, Enron's wholly owned subsidiary, has an investment of less than 1% and no voting rights as a member. (See also memo dated December 31, 1999 regarding the powers of the Advisory Committee and LP's). Accordingly, we concluded that the investment should be accounted for under the cost method on the balance sheet of Enron Corp.

We also noted that the result of the structure could be that, through this investment or through its other transactions with Talon, Enron may generate a gain (or offset losses) with economic benefits from Talon that could include the effects of changes in value of its own stock. Important to our consideration of this potential was that 1) the stock was to be considered issued and outstanding and 2) Talon had effective ownership of the risk and rewards of the shares and 3) Enron had no rights to ultimate settlement of anything that may accrue to Enron in shares (Enron could only receive settlement in cash). We noted that, when evaluated as a whole, the structure had analogous characteristics to a derivative in Enron's own stock settlable only in cash. As the change in value of such derivatives is required to impact income, we concluded that this potential outcome as it related to Talon was acceptable.

We discussed this issue with Carl Bass of the Professional Standards Group who concurred with our conclusions.

Issue 3

Enron purchased an option for $41 million whereby Enron has the right to put 7,171,418 shares of Enron common stock to Talon at a strike price of $57.50, the settlement of which is in the form of Enron shares. The put option was executed at market and contains the normal termination provisions granted under an ISDA Swap Agreement. Based on EITF 96-13 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," contracts whose settlement is indexed to the company's own stock should follow specific accounting treatment based on the settlement method which could be share or cash settled. In March 2000, the EITF reached a consensus on EITF 00-7, "Application of Issue No. 96-13 to Equity Derivative Instruments That Contain Certain Provisions That Require Net Cash Settlement If Certain Events outside the Control of the Issuer Occur" which states that contracts that may require a cash payment by the issuer upon the occurrence of future events outside the control of the issuer cannot be accounted for as equity. Because this purchased put option is indexed to Enron's stock and is settled only in shares at Enron's option, we determined that this contract should be accounted for as an equity instrument. Accordingly, the cost of the option should be accounted for through equity as opposed to income. This treatment is also appropriate for the value of any shares indicated to be deliverable under the terms of the instrument as it is evaluated on a current market basis at each reporting date. In addition, any shares so indicated should be included in the EPS calculation for such period, assuming they are dilutive.

We discussed the EPS issue with Ben Neuhausen of the Professional Standards Group who concurred with our conclusions.

<u>Issue 4</u>

The shares under the contingent forward sales contract between Harrier and Talon are currently issued and outstanding for purposes of calculating EPS for Enron Corp. Through this structure, Harrier has the obligation to deliver approximately 3.8 million of these shares if the value of each share equals or exceeds $50.00. If the price of these shares is below $50.00, Talon bears the risk. As a result, AA's view is that these shares should be included in the number of issued and outstanding shares.

We discussed this issue with Ben Neuhausen of the Professional Standards Group who concurred with our conclusions.

<u>Issue 5</u>

At the close of the transaction, no derivative instruments were executed other than Enron's purchased put option which was priced at market. However, until the termination of the entity, Harrier has the right to execute equity swap and option positions with Talon, subject to Talon's approval. Because it will be important to ensure that all transactions are priced at fair value, we informed the company that we will likely request an independent third party appraisal or a fairness opinion on the value if it is not readily confirmable by us using available public or other third party information.

<u>Issue 6</u>

As the derivative instruments are valued, assets or liabilities will be recognized on the books of Talon and Harrier since these instruments will be carried at fair value. Consistent with the valuation of all derivatives, the value recognized by each party will be subject to the capacity of the other party to financially fulfill the obligation (i.e. creditworthiness). As a result, the credit ability of the other party will be factored into the value of the derivative. Therefore, as Harrier records an asset based on the value of the derivatives, its value will represent Talon's ability to pay. Talon's credit capacity is represented by the fair value of Talon's net assets. This includes the fair value of the Enron stock at the date of valuation. As a result, AA will review each quarter of Enron's calculation supporting the value of derivative instruments relative to Talon's credit capacity.

We discussed this issue with John Stewart and Carl Bass of the Professional Standards Group who concurred with our conclusions.

Issue 7

The managing member of Talon is an Enron related party and derivative transactions are executed between a wholly owned Enron subsidiary, Harrier, and Talon. As a result, certain disclosures are required. A description of the structure, its purpose and the related party nature of the parties involved should be reflected in the footnotes to the financial statements submitted in 10-Q and 10-K filings. We will review these filings to ensure all appropriate disclosure requirements are met.

Conclusion

We discussed the features of the structure with Mike Odom, Practice Director and Mike Lowther, concurring partner, who concurred with our conclusions.

Memo

ARTHUR ANDERSEN

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To	The Files
From	Dave Duncan Deb Cash Jennifer Stevenson Patty Grutzmacher
Date	November 9, 2000, as amended, October 12, 2001
Subject	Raptor 3 Transaction

Background

During the third quarter Enron structured a transaction (Raptor 3) that effectively produces the same results as the Raptor I, II and IV transactions that were previously executed during the year. Although the structure of Raptor 3 is slightly different, it provides Enron with additional capacity to hedge its exposure to certain investments.

Transaction Structure

As detailed in the attached diagram (Exhibit I), EES created EES Warrant Trust (the "Trust") with Class A and Class B Member Interests. The Class A Member Interest represents 100% of the voting interest and .01% of the economic interest of the Trust and the Class B Member Interest represents 99.99% of the economic interest. EES transferred to the Trust 120,589 warrants, that are convertible into 24,117,800 million shares in common stock of The New Power Company ("TNPC"), in return for the Class A Interest. Pronghorn, a wholly owned subsidiary of EES, holds the B-interest in the Trust.

Pronghorn transferred the Class B Member Interest, which meets the criteria of a financial asset, to a third party, Porcupine LLP. Enron's basis in the underlying assets of the Class B Member Interest, which are warrants, was $-0- prior to the transfer. In return for the Class B Member Interest, Porcupine issued a $259 million note receivable (the "Note") to Pronghorn that is solely collateralized by the Class B Member Interest.

Porcupine LLC (Porcupine) is an SPE that is capitalized by LJMII, who serves as the managing member and Pronghorn, who has a preferred LP interest. LJMII is a related party entity (See LJMII memo in 4th quarter 1999 file for an explanation of the relationship). The capital contribution of $30 million made by LJMII was contributed from equity of the entity and represents 3% of Porcupine's maximum exposure. Therefore the initial capital requirement was met. (See Exhibit II for the initial 3% test.)

Under the transaction structure shown in Exhibit I, Enron, Pronghorn and Porcupine executed a series of agreements that result in the right for Pronghorn to execute equity price swap transactions. This structure could serve as a hedging vehicle of certain investments held by Enron entities.

In addition to the transfer of the Class B Member Interest, Porcupine received a $50 million interest bearing note receivable, payable quarterly @ 7%, and a capital contribution of $1,000 from Pronghorn. Coupled with the $259 million note receivable, Pronghorn received a non-voting preferred limited liability company interest in Porcupine, and a $50 million interest bearing note receivable, payable semi-annually @ 7% from Porcupine.

The obligations under this transaction structure will terminate upon the earliest occurrence of one of the following: (1)September 27, 2005, (2)the date either Pronghorn or Porcupine wish to terminate the agreement provided the proper notice is given, and (3)a default event, as defined in the various transaction documents. Termination of this agreement by one of the above circumstances only terminates Pronghorn's right and Porcupine's obligation to execute additional derivatives. Previously executed derivative transactions will remain in effect and do not automatically terminate upon termination of the structure.

Accounting Issues

The unique accounting issue with the Raptor 3 structure is the accounting for the transfer of the Class B Member Interest. Although the Class B Member Interest qualifies as a financial asset and all the criteria of paragraph 9 of SFAS 125 "Financial Assets and Liabilities: Sales, Transfers & Extinguishments" are met, sales treatment is not appropriate. Per paragraph 33-1 of the AA Interpretation of SFAS 125, because the Note "is solely collateralized by the Class B Member Interest without recourse to the third-party investor, then, in effect, the Note represents a beneficial interest in the transferred asset that precludes sale accounting pursuant to paragraph 9 to the extent of the beneficial interest retained." Thus, the Note is treated as a retained interest and the carrying value of the retained interest is $-0- although the fair value of the retained interest is valued at approximately $259 million.

Other accounting issues related to this structure are identical to those within the other Raptor structures; therefore see the detailed discussion of accounting issues in the Raptor 1 memo.

Memo

ARTHUR ANDERSEN

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To The Files

From Dave Duncan
Deb Cash
Patty Grutzmacher
Jennifer Stevenson

Date December 28, 2000, as amended, October 12, 2001

Subject Raptor Structures Update

This memo provides an update on various transactions that have been executed within each of the Raptor structures since their inception. The detailed description of each Raptor structure may be found in the respective memos within the 2000 audit files.

Raptor 1

- The Enron share settled put that was to terminate in October 2000, was settled early on August 3, 2000, for a payment of $3.9 million (settled by an increase in the note receivable from Talon) by Talon to Enron based on the value of the unearned premium originally paid to Talon. Because the SPE, Talon, included the maximum exposure under the put in its 3% capital requirement test, the termination of this put created excess equity capital in the vehicle of approximately $412 million that can be utilized to execute derivative transactions. As a result of the early termination, the manager of Talon declared a distribution in the amount of $41 million in cash to be made by Talon to the LJMII member. This distribution was made in accordance with Section 5.1 of the Amended and Restated Limited Liability Company Agreement of Talon LLC, and satisfied the required return on the equity capital.

- On August 3, 2000, Talon sold a put option to Enron for a $36 million premium whereby Enron has the right to put certain of its equity investment price risks (related to those previously sold in the Merlin CLO Trust structure) to Talon up to $93 million (maximum payout). This put requires for payouts by Talon upon certain default events related to these investments. The maximum notional amount of this derivative reduced the available capacity of the entity by approximately $93 million, which represents the maximum payout by Talon under this put option.

- Equity price swaps and option transactions of approximately $730 million in notional value were executed to hedge the exposure of fair value investments of Enron North America and Enron Broadband Services. (See memo with details in the 3rd quarter ENA file.) Capacity is available as a result of the early termination of the share settled put option between Enron and Talon, as described above, to support these instruments.

- On October 30, 2000, an equity collar transaction was executed on the 7,615,930 shares of Enron common stock in the vehicle at a floor price of $81 and a cap price of $116.12. This collar locks in the value of the Enron common stock between this floor and cap, therefore limiting Talon's exposure to the volatility of the Enron stock. Enron's credit capacity test should reflect this transaction in assessing the value of Talon's assets.

Raptor 2

- The Enron share settled put that was to terminate in December 2000, was settled early on September 22, 2000, for a payment of $6.7 million by Timberwolf to Enron based on the value of the unearned premium originally paid to Timberwolf. Enron allowed Timberwolf to satisfy this payment obligation by increasing the payable amount of the note receivable from Timberwolf. Because the SPE, Timberwolf, included the maximum exposure under the put in its 3% capital requirement test, the termination of this put created excess equity capital in the vehicle of approximately $427 million that can be utilized to execute additional derivative transactions. As a result of the early termination, the manager of Timberwolf declared a distribution in the amount of $41 million in cash to be made by Timberwolf to the LJMII member. The distribution was made in accordance with Section 5.1 of the Amended and Restated Limited Liability Company Agreement of Timberwolf LLC, and satisfied the required return on the equity capital.

- On September 22, 2000, an equity swap transaction with a $460 million notional amount was executed to hedge Enron's exposure of three international investments that are accounted for under the equity method. These equity interests are in international local distribution companies that Enron management expects to sell to third parties. The notional amount of the derivatives closely approximates Enron's book value in these assets. As of September 30, 2000 and December 30, 2000, the equity swap derivative had a fair value of 0. To support these values at each quarter end, Enron obtained an independent fair value from CSFB that supports the total fair value and restriction discount that should be allocated due to the restrictive nature of these assets.

- On November 27, 2000, an equity collar transaction was executed on the 7,809,790 shares of Enron common stock in the vehicle at a floor price of $78.875 and a cap price of $111.8633. This collar locks in the value of the Enron common stock between this floor and cap, therefore limiting Timberwolf's exposure to the volatility of the Enron stock. Enron's credit capacity test should reflect this transaction in assessing the value of Timberwolf's assets.

- On December 28, 2000, an equity collar and swap transaction was executed to hedge ENA's exposure to one of its merchant investments. Because the combination of the transactions netted to a maximum exposure to the vehicle of approximately $53 million, that amount reduced the available capacity.

Raptor 3

- Three swap transactions were executed on October 22, 2000, to hedge Enron's exposure in several total return swaps relating to three series of trusts (McGarrett within the Hawaii 125-0 Trust structure (see the applicable memo in the EES file for a detailed description of the transaction and related accounting issues). The total return swaps expose Enron to the volatility of approximately 90,000 warrants that are convertible into 18,000,000 shares of common stock of The New Power Company ("TNPC"). Therefore these swaps within Raptor 3 were executed to mitigate Enron's exposure to the price volatility of TNPC stock. As a result of these swaps, Porcupine is now exposed to changes in the value of TNPC shares. The initial price at the date of execution of the swaps was $10.75 per share of common stock.

Raptor 4

- No transactions have been executed to date

As noted in our transaction memos, we review quarterly Enron's assessment of the adequacy of the credit capacity of each of the Raptor vehicles because Enron has various notes and derivatives with these entities. Consistent with the valuation of all notes and derivatives, the value recognized by each party is subject to the capacity of the other party to financially fulfill the obligation (i.e. creditworthiness). As a result, the creditworthiness of Raptor will be factored into the value of the derivative and in assessing the collectibility of the notes. Therefore, as Enron records an asset based on the value of the derivatives, its value may be impaired based on each entity's ability to pay.

To mitigate Enron's exposure to the potential decline in creditworthiness of each of the Raptor vehicles, Enron negotiated and executed an agreement with LJM, as equity holders in each of the Raptor vehicles, in December 2000. Under the agreement, the assets of each entity, Talon, Timberwolf, Porcupine and Bobcat, with the exception of the Promissory Note dated September 27, 2000, by Porcupine in favor of Pronghorn I LLC, were cross collateralized for the benefit of the creditors of each entity for a 45 day period. As consideration for this cross-collateral protection, Enron agreed to pay $50,000 to LJMII. Enron believed that this cross collateralization would allow them to benefit from the assets of each entity on an aggregate basis in assessing the credit capacity of the entities if the credit capacity test for any individual entity resulted in the need for an impairment at December 31, 2000. (However, since the individual entity credit capacity test did not yield the need for an impairment at year end, we agreed to revisit the appropriateness of the cross-collaterization in first quarter.)

During our deliberations on assessing the creditworthiness of the Raptor entities, we discussed with Carl Bass, Professional Standards Group, several options. Those options included (1) the cross collateralization for a 45 day period as described above, (2) cross collateralization for the entire term of these vehicles to be entered into after yearend but before the date of Enron's earnings release, and (3) conveying Enron's investment in certain Raptor entities to other Raptor entities to satisfy the credit worthiness test of an individual entity (in effect, an aggregation methodology). Carl Bass did not view Option 1 to be substantive because there was no true cross collaterization of the assets of the vehicle upon settlement only for a 45 day period. He did not view Option (3) to be substantive because the effect was to satisfy the creditworthiness of an entity that did not have credit capacity by using Enron owned assets, not the assets of that entity. Although he believed Option (2) achieved such cross collateralization upon settlement, the fact that that it would be entered into subsequent to December 31, 2000 was in fact a decision that the engagement team would have to assess with the Practice Director. We also discussed the practicality of Enron's position with Mike Odom, Practice Director, and Mike Lowther, Concurring Partner, who concurred with our conclusions that the client's position to view the assets of each entity on an aggregate basis in assessing credit capacity was acceptable given the latitude in SFAS 114.

Memo

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To	The Files
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Subject	Raptor Transaction Update

Transaction Structure

During the first quarter, Enron executed various transactions with Timberwolf and Bobcat, two entities that are primarily capitalized by related parties, (the "Entities"). (see Raptor memos in the applicable quarter files for detail explanation of structures). As described in the Raptor memo, a credit capacity test is calculated each quarter to ensure that assets recorded by Enron, due from the Entities are not impaired, and are realizable.

On March 26, 2001, 7,919393 and 4,080,607 shares of Enron common stock were sold to Timberwolf and Bobcat under a forward sales agreement in return for notes receivable of approximately $374.9 million and $193.2 million, respectively. These shares will not be delivered to the Entities until March 2005. Until that time, the right to purchase these shares cannot be assigned, pledged, hedged or transferred in any form to any party without the consent of Enron. Because of those restrictions, the aggregate notes receivable value of approximately $568.1 million represents the value on Enron's books at a discount of approximately 23%. The gross value of the stock under the forward sales agreement is approximately $737.8 million (based on a $61.48 price as of the effective date of 3/26/01) which represents the stock value included in the credit capacity test. In addition, equity collars were executed with Enron to hedge the value of the 12 million shares of Enron stock within the two Entities at a floor of $61.48 and a cap of $91.02.

Additionally, Enron sold a contingent issuance that gives the Entities the right to receive up to 18 million shares of Enron common stock if certain conditions are not met under the existing forwards that were executed during 2000 with Talon, Timberwolf, and Bobcat, (the "SPEs).

The following waterfall describes the payout to each SPE under the previously executed Peregrine forward based on the Enron stock price:

SPE	Contingent share issuance	Contingency share price range
Raptor I	3,876,755	$48.55 - $52.63
Raptor II	7,809,790	$52.64 - $63.36
Raptor III	6,326,045	$63.37 - $75.89

If Enron stock does not exceed a certain price level as reflected in the above table, the newly executed contingent issuance will allow the SPEs to receive the shares that are not delivered under the Peregrine forwards in March 2003. If shares are due as a result of this contingent issuance they will also be delivered in March 2003. Similar to the above described 12 million shares, the rights under these contracts as well as the shares delivered are restricted from assignment, pledge, sale, or any form of transfer to a 3rd party without the consent of Enron.

In exchange for the issuance, Enron received an aggregate notes receivable amount of approximately $259.5 million. This amount reflects the fair value of the issuance of restricted sensus based on delivery in March 2003. The fair value of the issuance was determined based on a model created by Enron's Research Group.

In accordance with SFAS No. 114, Accounting by Creditors for Impairment of a Loan, (SFAS 114), "a creditor shall measure impairment based on 1) the present value of expected future cash flows discounted at the loan's effective interest rate, 2) the loan's observable market price or 3) the fair value of the collateral if the loan is collateral dependent." We believe that because the Raptor vehicles are highly leveraged and only enter into transactions with Enron that our impairment analysis should be assessed based on the "fair value of the collateral" or the fair value of the net assets held by Raptor.

SFAS No. 114 also states that "a creditor shall measure impairment based on the fair value of the collateral when the creditor determines that foreclosure is probable." Although the company does not believe foreclosure of the Raptor entities is probable at this time, the fair value of the collateral was appropriate for the analysis.

In assessing the credit worthiness of the Raptor entities we have used the screen price of the Enron stock at the date of valuation. We believe it is appropriate to use the current quoted price of Enron stock and not the fair value of the restricted stock at the date of valuation since the restrictions contractually expire in 2005 when the notes and derivatives are settled. That is Raptor will realize the full screen price at the time that the instruments are due and payable.

Enron and its entities (Harrier, Grizzly, Pronghorn and Roadrunner) entered into an assignment agreement with the Raptor entities (Talon, Timberwolf, Porcupine, and Bobcat) that allows each Enron entity to assign their individual rights to receive distributions from their cost method investments in the respective Raptor entities to another Raptor entity, to the extent that such entities have obligations due to an Enron entity that cannot be fully paid by the Raptor entity. In conjunction with this assignment, the termination dates of the Raptor vehicles were aligned to April 18, 2005. Enron considered this assignment in their credit capacity assessment of each Raptor entity. As a result, Enron assessed credit capacity on an aggregate basis allowing for excess asset values from one Raptor entity to absorb the excess liability values of another Raptor entity. Therefore, the impact on the credit capacity test is that credit capacity is assessed at an aggregate Raptor level. Although the client did not achieve true cross-collaterization with the assignment, we believe their assessment of credit capacity on an aggregate basis considering the cross-assignment was reasonable considering the latitude allowed under SFAS 114.

<u>Procedures</u>

The following procedures were performed to ensure proper accounting:

- Reviewed all transaction documents noting execution and agreement with discussed transaction terms.
- Performed an extensive review of the credit capacity models that are maintained by the client to understand the impact of the above transactions on the Entities' credit capacity. After review, the overall resulting loss was approximately $36 million.
- Discussed the valuation methodology of the contingent issuance transactions with Research Group personnel.
- Reviewed Research Group documentation describing the assumptions used in modeling the contingent issuance (see attached Exhibit I).
- Assessed the reasonableness of the Research Group's valuation methodology for the contingent issuance. (See documentation of procedures done by Andersen's quantitative team @ Exhibit II.)
- Reviewed third party documentation (Deutsche Bank) describing the reasonableness of the discount factor related to the Enron stock restrictions.
- Reviewed the equity collar contracts to ensure compliance with EITF No. 00-19, "Determination of Whether Share Settlement is within the control of the Issuer for Purposes of Applying EITF Issue No. 96-13," for verification of equity transaction accounting.

<u>Conclusion</u>

We discussed our conclusions with Mike Odom, Practice Director, and Mike Lowther, Concurring partner who concurred. We will continue to review and assess the credit capacity of the Entities on a quarterly basis.