

**Andersen
ENERGY**

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cc: Michael C. Odom@ANDERSEN WO
Date: 05/03/2001 04:08 PM
From: David B. Duncan, Houston, 237 / 2518
Subject: Enron Practice Review Request

One of the requests of the internal practice review team for Enron last summer was to confirm PSG consultation on certain selected transactions. For a variety of reasons, but mainly my own lack of proactiveness, this step has not been completed and is necessary for the review team to accomplish final sign-off of their work.

John and I discussed this some months ago and decided an outline that could facilitate a brief discussion would probably be more efficient than slogging through a number of memos and the practice review team has concurred. Attached is such an outline.

I will have my assistant, Shannon Adlong, work to set up what I hope will be brief calls to accomplish this task over the next couple of days/weeks. The topics and the suggested participants are listed below. Obviously, if we can kill multiple topics in any one call or with the fewest participants, that would be preferable (for instance, it looks like we could hit all the topics with a call to Ben and another to Carl or John, although I certainly don't want to preclude anyone's participation). The primary Enron team participant (me or Deb) will lead the discussion to walk through the key decisions and, of course, we will want to respond to any questions from the review team.

Let me know of any suggestions or issues with this. Otherwise, thanks in advance for your help.

Transaction	Primary Enron	Primary PSG
Condor	Duncan	Ellis, Neuhausen
Nahanni	Cash	Neuhausen
EES Bundled K's Cash		Stewart, Petersen, Bass
LJM	Duncan, Cash	Stewart, Bass

(As Patty Grutzmacher seemed to be involved in all these deals, she will also participate on the calls.)



transactionmemosummar

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John E. Stewart

Transaction Name: Condor
Date:
Primary PSG Contact: Jeff Ellis
Other PSG Members Consulted: John Stewart and Ben Neuhausen
AA Individuals: Dave Duncan, Deb Cash, Patty Grutzmacher and Kate Agnew

Issue 1:

Should Enron consolidate White Wing?

Resolution:

Since,

- the third party investor had various significant participating rights,
 - the third party investor was capitalized with equity based on the capital-at-risk of White Wing as opposed to the capital-at-risk of Osprey and
 - White Wing met the majority of the joint venture attributes outlined in APB 18,
- we decided that White Wing was appropriately considered a joint venture. As such, the capital-at-risk in the venture structure should be subjected to the 80/20 test we often apply to ensure that both parties in a deconsolidated joint venture have enough capital-at-risk to support the shared control characteristics of the venture.

Also since,

- the venture was being structured by Enron,
 - the venture involved financial counterparties and significant financial assets, and
 - it was contemplated that the venture would do a substantial amount of business with Enron,
- we also determined that the venture should meet the 3rd party equity requirements of an SPE

In summary since,

- the third party investor had 1) significant participating rights, which included the ability to remove Enron as the Managing Member with or without cause and shared voting control,
 - Enron did not have > 80% of the capital-at-risk of the joint venture and
 - the 3rd party residual equity was calculated based on 3% of the capital-at-risk of the joint venture
- we decided that Enron should not consolidate White Wing.

Issue 2:

Should Osprey's total contribution of \$1.4 billion represent third party equity at risk in the 80/20 test?

Resolution:

As long as:

- The share settlement agreement was an asset of the joint venture,
- The share settlement agreement goes through the liquidation waterfall like all other joint venture assets,
- The partners had normal liquidation rights with no subjective acceleration and no attachment to any specific assets within White Wing (no direct collateralization),
- Indemnifications were only on negative capital (i.e., Enron cannot provide indemnifications on Osprey's initial investment)
- Any Enron indemnifications were for pre-existing conditions or were under normal operating agreements and
- Indemnifications on assets purchased from Enron by the venture go into an asset by asset risk/reward transfer test for purposes of determining if sale treatment was appropriate

then the total contribution made by Osprey should represent third party equity at risk in the 80/20 test.

Issue 3:

Can Enron recognize gains on the sale of assets to White Wing?

Resolution:

Gains/losses on sales to a joint venture with disproportionate sharing ratios were based on the "incremental hypothetical liquidation basis" (i.e., while White Wing was in the first payout where Enron received the first \$750 million of gain/loss, Enron will be required to defer 100% of all gains and recognize 100% of all losses on sales of assets to White Wing).

Transaction Name: Nahanni
Date: 4th Quarter '99
Primary PSG Contact: Ben Neuhausen
Other PSG Members Consulted: None
AA Individuals: Deb Cash and Patty Grutzmacher

Issue 1:

Can the exchange of Treasury Bills for the minority interest of the LP be considered a non-cash activity by Enron and only be disclosed in the footnotes (related literature SFAS No. 95 paragraph 32 and 70)?

Resolution:

Yes, as long as the Treasury Bills have a maturity longer than 90 days, the transaction would be non-cash and only require footnote disclosure.

Issue 2:

Can Treasury Bills be considered Merchant Investments?

Resolution:

Yes, the Treasury Bills can be considered Merchant Investments; however, Enron's Merchant Activities footnote should be changed to include government securities in the description of Merchant Investments.

Issue 3:

Does the issuance of minority interest require MIPS treatment?

Resolution:

No, because the minority interest holder's return was not fixed or guaranteed.

Transaction Name: EES Bundled Contracts
Date: October 27, 1999
Primary PSG Contact: John Stewart
Other PSG Members Consulted: Rick Petersen and Carl Bass
AA Individuals: Deb Cash and Michael Patrick

Issue 1:

How should EES account for its energy trading activities when bundled with other services in one contract?

Resolution:

Bifurcate the components and account for using applicable guidelines (e.g. SOP 97-2, SOP 81-1, SFAS 133, SFAS 13, EITF 98-10, SFAS 125)

Issue 2:

How should EES separate the different service components of the contract if bifurcation is appropriate?

Resolution:

- Allocate revenue to non-trading activities based on objective verifiable evidence of fair value
- Remainder of revenue allocated to trading (which bears any "discount")

Issue 3:

How should EES account for subsequent changes in the estimated or actual volumes to be delivered under the bundled contract?

Resolution:

Captured in trading activity and MTM.

Issue 4:

How should EES account for subsequent changes in the cost of energy asset management projects?

Resolution:

Recognized as income or loss as the project was performed (i.e. accrual)

Transaction Name: LJMI
Date: 2nd Qtr '99
Primary PSG Contact:
Other PSG Participants:
AA Individuals: Dave Duncan
Patty Grutzmacher

Issue 1

Is LJM an SPE?

Resolution

Since,

- The managing member was an Enron related party who was a senior officer of Enron and
- LJM's near-term objectives as far as we could observe, included investing in mainly Enron related assets then LJM should be considered an SPE and reviewed for appropriate capitalization and control criteria as such.

Issue 2

Was the minimum capitalization and control requirements met in LJM to support deconsolidation by Enron?

Resolution

Yes, LJM was capitalized with 19% third party equity (excluding the Managing Members capital) which exceeded the required 3%. The managing member does not control LJM because the Limited Partners had various participating rights in investment decisions including the direct approval of any transactions contemplated with Enron (AALLP audited the LP's approval of the one and only transaction done by LJMI before it was liquidated).

Issue 3

Was the transaction between Enron and LJM arms length?

Resolution

Due to the relationship the General Partner of LJM has with Enron, AALLP requested an independent fairness opinion on each transaction executed between LJM and Enron that cannot be objectively valued otherwise. Also, all transactions with LJM would require related party disclosure as long as the CFO relationship exists.

Transaction Name: LJMII
Date: 4th Quarter 99
Primary PSG Contact: Carl Bass
Other PSG Participants: John Stewart
AA Individuals: Dave Duncan, Deb Cash, Patty Grutzmacher, Jennifer Stevenson

Issue 1

Was the minimum capitalization and control requirements met in LJMII to support deconsolidation by Enron?

Resolution

Yes, LJMII was capitalized with 46% (\$54 million/\$118 million) third party equity (which excludes equity of the Managing Member) which exceeded the required 3%.

The Managing Member did not control LJMII because the following provisions in the LJMII partnership agreement were considered sufficient to overcome the presumption that the Enron related party, who was the Managing Member, controls:

- Although the General Partner had full control over the business and affairs of LJMII, an Advisory Committee ("AC"), which was solely appointed by the GP, had specific duties outlined in the partnership agreement, such as periodic reviews of asset valuations
- The senior officer was required to promptly provide information to the AC members relating to any transaction between LJMII and Enron or any of its subsidiaries.
- The GP of LJMII may be removed without cause with the recommendation of two-thirds of the AC and a vote of Limited Partners that represents 75% of the total LP interests (subsequently amended to require the majority of the AC and 2/3 of the total LP interests).
- With the consent of the majority, the LPs have the right to remove any AC member without cause.
- The LP's have various participating rights (i.e., acquisitions above a specified threshold).

Because of the above criteria, we believe that nonconsolidation of LJMII is appropriate.
