MEMORANDUM

TO: Enron general file (re: Accounting Issues)

FROM: Max Hendrick, III

DATE: October 22, 2001

RE: Telephone Interview with Jeffrey McMahon on October 18, 2001

On October 18, 2001, Joe Dilg and the author interviewed Jeffrey McMahon ("McMahon") by telephone. McMahon had previously been interviewed in connection with the investigation into the allegations contained in an anonymous letter and supplemental materials authored by Sherron Watkins. The supplemental interview was occasioned because of information relayed by Steve Kean ("Kean") to the effect that McMahon had made several statements regarding the LJM transactions that seemed inconsistent with statements he had previously made in his interview. The focus of the supplemental telephone interview was to clarify those points on which there was potential inconsistency.

Leaving the Office of Treasurer under Duress

McMahon initially stated that his comments to Kean were made immediately after learning Enron had been sued in a derivative lawsuit regarding the LJM transactions. He wanted Kean to know that there were certain areas of concern that would, no doubt, come under scrutiny as a result of the lawsuit or further legal or SEC inquiry.

By way of history, McMahon stated that he had approached Andy Fastow ("Fastow") many times about how the LJM issue was being treated. Fastow was wearing two hats but still in charge of and superior to people negotiating for Enron. Employees subordinate to Fastow were charged with responsibility for working on LJM matters; Enron and LJM were operating out of the same space. Reference to Fastow's ownership in LJM was used as a subtle stick in negotiations against Enron. All of these factors (previously discussed in the initial interview) contributed to McMahon's view that there was a conflict of interest.

Fastow never addressed these problems, whereupon McMahon felt compelled to discuss the issues with Jeffrey Skilling ("Skilling"), Enron's then President and Chief Operations Officer. McMahon advised Skilling that there were major conflicts of interest, but that those conflicts could be resolved. The people involved in the LJM conflicts were not responding well, and it was a stressful situation. McMahon did not present an ultimatum to Skilling (he volunteered that presenting ultimatums was not the way one could deal successfully with Skilling). He simply presented the fact that he could not compromise his position in light of the existing conflict of interest. Either some changes had to be made to resolve the conflict of interest or Skilling needed to find McMahon a new position. Several weeks later Skilling encouraged McMahon to take the job with Enron Networks, but Skilling did not link this to the conflict of interest with LJM.

McMahon believes that there are lots of people who know about his position and complaints about the conflict of interest. There may be a general perception that McMahon was "forced out" of the Treasurer's position as a result of this, and McMahon thought that Kean should be aware of this potential problem.

Pressure on Enron's Bankers to Invest in LJM

McMahon believes that a lot of the adverse publicity may be coming from bankers who believe they were pressured to invest in LJM. Several bankers came to McMahon and inquired whether an investment in LJM gets them an inside position for Enron business. McMahon consistently responded, "Not as far as I'm concerned." At later points in time, at least two bankers came to McMahon and said that they were promised business in turn for their investment in LJM.

McMahon recounted that First Union Bank's Paul Riddle called and complained about not getting a bond deal. He stated that he was promised the next bond deal for investing in LJM. McMahon's response was to the effect, "Not by me, you're talking to the wrong guy."

Merrill Lynch (no name given) commented, not by way of sour grapes, but simply as fact that it was felt linkage existed between investment in LJM and Enron business.

Deutsche Bank did not invest in LJM, but thought there was a linkage and felt it was improper.

Chase Bank felt there was a linkage between an investment in LJM and Enron business.

McMahon made clear that he had no first-hand knowledge – he was not present when any pressure was put on a bank to invest in LJM. He is concerned, however, how other Enron officers may have to testify on this subject. McMahon identified the following Enron employees as having had discussions with banks and who can comment more directly on the possibility of pressure being put on them to invest in LJM: Ben Glisan, Tim Despain, _____ Brown, Ray Bowen and Kelly Boots.

After he left the Treasurer position, McMahon never saw anything fishy about the way bank business was given out, but he was totally out of the loop. While he was Treasurer, he never saw anything about giving business to banks that he thought was improper or he would have "pulled the red chain."

Buy-out of Michael Koppers' Equity in JEDI-1

McMahon recounted that when Calpers was bought out as an equity owner in JEDI-1, Michael Koppers ("Koppers"), an Enron employee who worked for Fastow, was used as a replacement equity owner. The JEDI-1 structure was administrative burdensome and McMahon thought the equity (then owned by Koppers) should be bought out. He understood that Koppers had invested approximately $100,000 a year before. He discussed the possible buy-out with Fastow and felt Koppers could easily be bought out at a modest profit. Fastow said that he would handle the negotiations with Koppers.

There was actually a formula built into the JEDI investment whereby Enron could effect the buy-out. Going by the formula, Koppers would be entitled to approximately $22 million. McMahon felt like Koppers should not even get $1 million. As McMahon understands it, Koppers was to get $10-12 million as a result of the final negotiations. McMahon's discussions with Fastow on this subject were in January-February of 2000, shortly before he left as Treasurer. He thinks the deal did not close until early 2001.

McMahon's concern about this buy-out of Koppers in JEDI-1 was based on rumors that Koppers used the money from JEDI-1 to buy out Fastow's position in LJM. Many people assume that this was the case, but McMahon again has no personal knowledge. He thinks the same financial executives named above plus Kevin Howard would either have knowledge or a view of this situation.

Pressure on Enron Representatives Negotiating with LJM

McMahon believes that the lawsuits and related inquiries are going to look for all leakage out of Enron to LJM. People who negotiated for Enron against LJM will probably testify that they felt pressure. One example, which he gave in his prior interview, was Doug McDonald negotiating on behalf of Enron against Koppers. McMahon was at home, received a call from Fastow, who complained about McDonald negotiating too hard. As it turned out, Fastow had the facts wrong and ultimately backed off.

McMahon has no personal knowledge of deals that were against Enron's interest or well-being, but he is concerned about this subject. He gave the following names of individuals and situations that indicate that they may be the source of information unfavorable to Enron's position in this regard:

Kevin Howard – a good person to talk to about pressure exerted on Enron professionals negotiating against LJM;
Ray Bowen – another guy who got chewed out for negative comments about the LJM situation;
Cliff Baxter – frequently in Skilling's office complaining about LJM and Fastow's conflict of interest;

Ken Rice – same story;
Paul Chivens – an ex-Enron London guy now with Credit Agricole in Paris: and
Mike Jakgbic – hired by McMahon to set up a private equity fund. McMahon wanted a friendly source of capital to do deals. By the time Jakgbic arrived for work, Fastow had set up LJM, which was exactly the same concept. Jakgbic felt that Fastow stole his concept. He is now the relationship person for Enron with Deutsche Bank.

As a final note, McMahon stated that the Bloomberg release has lots of information concerning the derivative lawsuit filed against Enron.

MHIII

c: Joseph C. Dilg

Houston 690086.1

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MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 7, 2001

RE: Interview with Jeffrey McMahon, August 30, 2001

On Thursday, August 30, 2001, Joe Dilg and the author interviewed Jeffrey McMahon ("McMahon"), President and Chief Executive Officer of Enron Industrial Markets ("EIM"), to obtain information relevant to an employee's inquiry regarding the propriety of the Raptor and Condor/Whitewing structures.

McMahon was in Enron's London office as Chief Financial Officer of Enron Europe until mid-1998. From mid-1998 until March 2000, McMahon was Treasurer of Enron Corp., reporting to Andy Fastow ("Fastow"), Enron's Chief Financial Officer. In March 2000, McMahon moved to a business position with Enron Networks which later evolved into EIM.

When McMahon came on as Treasurer in mid-1998, the NightHawk structure, a predecessor to Condor/Whitewing was already in place. Condor/Whitewing was set up after he came, as a structured finance project and was managed by Michael Kopper ("Kopper"), who reported directly to Fastow. Although McMahon had no direct responsibility for or involvement in Condor/Whitewing, he understood it was set up as a temporary holding facility for assets Enron wanted to sell. Condor/Whitewing was capitalized, bought assets that Enron wanted to sell; then Condor/Whitewing would sell off the assets either individually or in packages as time and circumstances allowed.

Both LJM1 and LJM2 were set up during McMahon's tenure as Treasurer, but he was not familiar with the exact structure. He knew that Fastow would be the general partner of the entity. Although he tried to find out who the investors were, and felt he should know about them because his job was dealing with banks with whom Enron transacts business, he was never told who the investors were. LJM was likewise handled as a special project by Kopper. The Raptor vehicles came along after McMahon left as Treasurer, although he understood that Raptor was a vehicle established so that Enron could protect the value of certain of its merchant assets.

McMahon does not recall reasons being given for the secrecy or confidentiality of LJM, although it was perhaps because he never asked. The widely held perception was that LJM presented an inherent conflict. McMahon was vocal with Fastow and Skilling on this point. His issue was not with the fairness or valuation of transactions that were placed in LJM but rather the potential conflict of interest.

McMahon explained that the conflict arose because employees under his supervision negotiated on Enron's behalf with other Enron employees representing LJM on the value of assets to be sold. Enron employees he supervised were instructed to get the best deal for Enron; he assumes that those acting for LJM were similarly instructed to get the best deal for LJM. The perception to employees he supervised was that when Fastow got involved, the guys negotiating for Enron might shrink from their expected vigorous negotiations. Fastow, after all, had the final say on their evaluations for salary and bonus purposes.

McMahon and Fastow went round and round on this issue. McMahon thought there was a conflict and thought it needed to be fixed. He proposed several options that would avoid or lessen the conflict:

(1) Fastow could resign from LJM (McMahon did not view this as a realistic alternative because he did not think Fastow would voluntarily resign);

(2) Fastow could remove himself from the evaluation process for salaries and bonuses of those Enron employees other than McMahon representing Enron in negotiations with LJM (*i.e.*, let McMahon deal with the conflict);

(3) Enron and LJM could be separated by (a) eliminating dual employees and (b) establishing separate office space for LJM.

Fastow never acted to implement any of these options (to which McMahon attributes no bad motive or intent), so he discussed the conflict with Jeffrey Skilling ("Skilling") to the effect that the conflict needs to be fixed or McMahon should be moved. This discussion took place in the February-March 2000 time frame and Skilling said that he would look into it.

Coincidentally, McMahon was being recruited by Greg Whalley to join Enron Networks in a business position. While in the process of making his decision on this possible move, Skilling encouraged him to take the new job, emphasizing that it was Enron's core business and his talents were needed. McMahon did so and commented that it was the best move he ever made. Enron Networks ultimately developed into EIM.

McMahon is confident that the conflict issue, as he viewed it, was brought to the attention of Skilling because he discussed it with him personally. He doubts that Ken Lay was aware of this specific conflict that was his concern.

Although McMahon said he was unaware of Fastow intervening directly in the negotiations between Enron and LJM, he cited one situation in which Doug McDowell ("McDowell") was negotiating from Enron's standpoint with Kopper on a deal near year-end 1999. Fastow called McMahon at home and complained that McDowell was negotiating too hard and that they should get the deal done. As it turned out, there was a communications problem and Fastow did not have the right information about the deal terms. The deal was later consummated in favor of the points being argued by McDowell. McMahon has no examples of a deal having been struck that was unfair to Enron. His concern was that the Enron guys may not be negotiating the same way they would have with a truly independent third party.

McMahon stated that the approval procedure was put in place after he left as Treasurer. He believes that this was started as a result of one of his complaints. He was aware that Rick Buy, Risk Management Manager, and Rick Causey, Chief Accounting Officer, are part of the approval process. He noted that Rick Buy would be an interesting person to talk to, because he believes that the approval procedure shifted the conflicts issue from the Treasurer to Buy.

McMahon emphasized he had no problem with Fastow's motive or intent in the LJM vehicle. His issue was the inherent conflict in appearance only. The impact of this conflict was on the junior people negotiating for Enron under those circumstances.

McMahon commented that a lot of transactions that were done with LJM were highly beneficial to Enron. Without this form of friendly equity vehicle, a lot of these deals would not have gotten done.

Since becoming CEO of EIM, McMahon has had no dealings with LJM or the Raptor vehicles. Those vehicles were used to monetize assets or protect the value of assets and EIM has no assets that require those services.

McMahon also pointed out that the anonymous letter addressed accounting issues, and that accounting issues have never been the subject of his concern. He was not involved with and is not competent in those areas of accounting issues and is further confident that Causey and Arthur Andersen & Co. make sure that things are done properly.

McMahon viewed the individual who wrote the anonymous letter to have a concern about how the structure/transactions with LJM would stand up to public scrutiny. He personally thinks not very well, although he is confident that everything was done in a technically correct way.

If the conflict issues were cured, McMahon believes it was good to have a friendly equity investor available. Fastow simply did not need to be the general partner.

As Treasurer, McMahon received inquiries from bankers about whether continued banking relationships with Enron were dependent on investing in LJM. McMahon believes that Fastow solicited the ten or so key banks with which Enron did business to be investors in LJM, and McMahon heard from at least half of them. This possibly presented another area of conflict. Fastow had the final say on bank selections; some he picked alone on special projects, but most requests would be originated by the Treasurer. McMahon consistently informed the banks that there was no linkage between Enron banking business and investments in LJM.

McMahon agrees that the anonymous letter raises no new information. As he walks through the letter, he cannot believe that the accounting is not absolutely perfect. It has been carefully reviewed.

During the course of the interview, McMahon indicated that the person who wrote the anonymous letter came to visit him directly, so he is aware of the person's identity. He believes some information she provided may have overstated or misstated the nature of his concerns, as his concerns were not related to accounting issues.

c: Joseph C. Dilg

Houston 644816.1

MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 18, 2001

RE: Interview with Sherron Watkins, September 10, 2001

On Monday, September 10, 2001, Joe Dilg and the author interviewed Sherron Watkins ("Watkins") to obtain information relevant to the inquiries contained in her anonymous letter to Ken Lay regarding the propriety of the Condor/Whitewing and Raptor structures. The interview was somewhat disjointed because it was felt better to let Watkins discuss issues she wanted to address initially before questioning in any particular areas. As a result, the following memorandum, which attempts to track the general flow of discussion, is repetitious in certain areas.

By way of her personal employment background, Watkins advised that she spent eight years with Arthur Andersen L.L.P. ("AA"), five in the audit department in Houston (auditing primarily energy clients) and three in the New York office in litigation support. She then spent three years with MG Trade Finance in New York City before returning to Houston and joining Enron Corp. ("Enron") in October, 1993. She took a job working for Andy Fastow ("Fastow") (apparently in the corporate finance area) and was a manager for the JEDI, Cactus and related projects. During the three year period in that position, she reported variously to Fastow and/or Rick Causey. Over the next 3-4 years, Watkins apparently had several different positions with Enron's materials and metals operations and Enron International. She joined Enron Broadband in early 2000 but left in the spring of 2001 as a result of the downsize movement. In the spring of 2001, she was considering positions in corporate relations or again working for Fastow. She took the position working for Fastow, and in June, 2001, commenced a project of listing and gathering information on assets Enron may want to consider selling off. Watkins current business card indicates she is Vice President, Corporate Development.

Watkins stated that her concern about the Condor and Raptor vehicles arose during the process of her listing of various assets that Enron may want to consider selling. She noted the following particular assets sold to Raptor on which a theoretical gain or revenues were reflected: NewPower Co., AVICI, and Hanover. She notes that these assets are all hedged in an investment vehicle in which LJM is an equity participant, but LJM has pulled out approximately $39 million, constituting more than its equity contribution. The Raptor entities owe Enron approximately $700 million, but those entities have no ability to pay Enron back and LJM has no obligation to put up additional equity.

Watkins understands that, because of value appreciation in Enron stock held in another entity, it was used to support these Raptor investments with LJM. She noted a progressive aggressiveness in Enron's accounting practices, beginning in 1996 when Enron began its mark to market evaluation. At first these were less aggressive, but by 1998-1999, Enron began pushing the edge.

Watkins' concern is that the Raptor transactions look bad. Each of the aforementioned three investments were pegged at their peak. No truly independent third party would have bought these assets at their then market value. Although Raptor provided a vehicle for Enron to hedge against declines in those values, Raptor couldn't hedge. Watkins' point is that in the Raptor transactions you can't find an equity or debt investor who will ultimately have to pay Enron back. Watkins commented that the initial bad appearance got even worse. Both the Enron stock values and the asset value of the assets in Raptor went down. In the first quarter of 2001, the Raptor vehicles had to be enhanced to avoid a write-down. In looking at the overall value of the credit, the Raptor vehicles simply had to be enhanced.

Watkins likewise commented on the inherent conflict of interest of Fastow being the managing partner of LJM. In fact, Jeff McMahon ("McMahon") told Jeff Skilling ("Skilling") of five options that were needed to fix the conflict in order for McMahon to stay on as Treasurer of Enron. Three days later, without addressing the five points, Skilling offered McMahon a position in Enron Networks, a new start-up business. She thinks it is highly unusual for a person to go from Treasurer to the business head of a start-up business. She viewed this as coercion and intimidation.

Watkins stated that she was upset by the situation she found in the Condor and Raptor structures. She decided to leave the company and thought she would tell Skilling all that she had found wrong on her last day of work. But Skilling announced his resignation and departed immediately. Accordingly, she put her concerns in the anonymous letter in advance of the Enron employee meeting to express her concerns to Ken Lay.

Another aspect of the inherent conflict in interest, according to Watkins, was Fastow in effect blackmailing banks to become investors in LJM. She stated that she had friends/acquaintances who worked for Chase, Bank of America and CreditSuisse First Boston who had told her as much during cocktail conversations.

Watkins stated that she had studied the Waste Management accounting problems. Waste Management had depreciated a landfill on a more aggressive schedule than was permitted by the SEC. In that context – which did not seem so bad to her – Waste Management executives and board of directors were removed; they were required to return bonuses and the company had to pay tremendous fines. She viewed Enron's actions as being much more horrific.

Watkins pointed out that Rick Buy's group, which was responsible for assuring the Raptor entities were creditworthy, put together various information which was shared with her. Rick Buy and his group did not get involved in accounting issues and from their standpoint, all they could do was push on the creditworthiness issue. She views some of the materials out of Rick Buy's group to be "smoking guns" if ever they fell into the hands of the wrong parties.

Watkins also identified Enron's activities in Entertainment on Demand, a FAS125 transaction, a total return swap with a bank, as a transaction that will come back to haunt Enron.

On several occasions Watkins mentioned that she felt Enron had no choice but to restate its financial statements and take its lumps. Skilling's departure has brought additional attention to Enron and its accounting practices, and she feels that the Condor and Raptor transactions will become public knowledge . Watkins has no information, however, that there was any causal relationship between these vehicles and Skilling's departure.

Watkins feels that efforts to enhance the Raptor vehicles again on Ken Lay's watch would come back to haunt him. She is concerned about this because of her understanding of a $250 million fix that will need to be made during the third quarter of 2001. Potential publicity may come from 100-200 employees who have been "redeployed" from Enron. She believes there is a risk of these employees providing information to journalists, analysts and authorities.

To reiterate her point that the Raptor transaction does not look good, she expressed concern about what a good plaintiff's lawyer could do with the facts of locking in of asset values at their highest point, expert witness testimony that this value is unrealistic and no one would pay that much, a loss of $700 million which no one has to pay and which Enron shareholders will have to absorb through dilution of their shares. Watkins stated that if the Raptor transactions are not arms length transactions, they have to be accounted for differently. She also points out that on a disclosure issue, Wall Street Journal articles and others are already writing stories about Enron's unclear financials.

Watkins admitted that she had not seen the legal documents on the Raptor transaction. She does not know how the deals were negotiated as to value for the AVICI, Hanover and NewPower assets. Her point, nevertheless, is that in hindsight, it looks bad.

On several occasions, Watkins pointed out possible sources of corroboration for her concern about Enron's accounting practices. She referenced an employee survey that was done in advance of the senior management retreat held September 6-7, 2001, which was summarized for Ken Lay's benefit and use by Cindy Olsen. Watkins heard two Enron employees – Jeff Donaghey, a managing director on the cultural committee, and Tim Detmiring, also a managing director – state, in effect, that questions regarding accounting issues were not reflected in that summary. Watkins did not know how many people commented on accounting issues, but felt that a legal assistant could plow through the surveys and make a determination. Watkins also identified people in Rick Buy's group as being sufficiently removed and knowledgeable about the accounting problems. These included Vince Kaminski, Rudi Zipter and Ding Yuan.

Insofar as the references in her anonymous letter to the unwinding in 2002-2003, Watkins stated her understanding that Condor has debt coming due in 2003, or otherwise has a time period by which Enron has to do something about that vehicle. Insofar as Raptor, she understands that the derivative contracts must be settled in 2002. At that point, something will have to be done to Enron's accounting.

When asked if she had specific instances in the Condor vehicles that the accounting was handled contrary to accounting rules or literature, Watkins' response was simply that the transaction would not play well in court. Although the asset was purportedly sold by Enron to Condor, Enron's business units are still managing the asset. Enron booked cash flow on the sale of the asset but is still running it. She acknowledged, however, that Condor was a cash flow and off-balance sheet tool, and not an earnings management tool.

Watkins points out that the mere fact that Fastow has sold his interest in LJM may help cure the inherent conflict of interest, but it does not cure the problem of dealing with a "friend of Enron." Dealing with any friend of Enron raises two issues:

- No one will do transactions of this kind unless they know that payment will be made by Enron stock or they will otherwise be made whole;

- The issue is not just valuation at the time; the ongoing value of assets placed in Raptor is an important factor.

Watkins' understanding of the first quarter of 2001 enhancement of Raptor with Enron stock was that it was done so Raptor's credit would not be restricted. Something had to be done to avoid credit write-downs. She thinks this looks bad from a possible "coverup" exposé, but she is not sure how the enhancement was accomplished. She thinks it is one thing to have the Raptor transactions in the first place, but worse to enhance Raptor with Enron stock after the Raptor asset value declines. In the third quarter she understands $250 million credit deficiency will exist in Raptor. She thinks there will be another effort to enhance Raptor but that Ken Lay will be making a mistake to do it.

The comments in Watkins' letter about executives selling Enron stock at high prices is not related to her concerns about the Condor and Raptor structures. It is just another bad circumstance that will not play well in court. She does not have any facts linking these stock sales to the Condor/Raptor transactions.

Watkins does not necessarily know how LJM got its money out of the Raptor transactions. In her letter, she referred to a cash fee but all she knows is that LJM has received distributions that more than repaid its initial investment in the Raptor transactions.

The $250 million third quarter problem is known to her through casual conversations. She has had a number of conversations with representatives of Enron Global Markets who have innocently told her the information about Raptor and the $250 million problem.

Watkins believes that AA has not been kept from information relating to the Condor/Raptor transactions. She thinks that AA has let the transactions go too far and that AA is as "guilty" as Enron. She also points out that Enron is AA's largest customer world wide.

Watkins thinks that taking assets placed in Raptor at the highest market value was merely a coincidence; she has no indication that there was any backdating to achieve high market value for these assets.

Watkins explained the evolution of the various papers she had made available to Ken Lay. She initially wrote the anonymous letter. She then advised Cindy Olsen that she was the letter writer and wished to speak to Ken Lay. She was provided a copy of Rick Causey's e-mail addressing one of her concerns. She thinks that it is far too simplistic to respond that the contingent shares are included in the calculation of fully diluted earnings per share. She then wrote additional explanations of her points, and finally made an outline of topics she wished to discuss with Ken Lay. The last item was prepared after her discussion with McMahon, who suggested she needed to be organized and use her 30 minutes with Ken Lay wisely if the objective was get Jim Derrick to look at the issue closer.

Questions about Enron's accounting practices are not limited to Condor and Raptor. Watkins knows that Jeff Donaghey thinks that the sale of the MTE plant to EOTT on a mark to market basis is questionable. He did not like the mark to market treatment.

Watkins stated she was trying to give Ken Lay the impression that she was not a voice in the wilderness and that other employees were very concerned about this issue. She believes that a review of the employee survey would support her position in this regard.

Watkins suggested that Cliff Baxter and Jeff Donaghey would be good additional people to talk to regarding her criticism of accounting practices in the Condor/Raptor vehicles.

Insofar as determining how valuation was determined in the Raptor transactions, Watkins identified Vince Kaminski as a good person to talk to. She does not know exactly how the valuation matters were negotiated.

Watkins pointed out that it would also be useful to look at what happens in 2002 and 2003. Enron can't write off its Raptor investment because it would admit that it was not dealing with a real entity in arm's length transactions. She thinks Enron has to restate its financials and take its lumps.

c: Joseph C. Dilg

Houston 652950.1

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MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: August 30, 2001

RE: Interview with Jordan H. Mintz, August 24, 2001

On Friday, August 24, 2001, Joe Dilg and the author interviewed Jordan H. Mintz ("Mintz"), Vice President and General Counsel of Enron Global Finance ("EGF") to obtain background information regarding the Raptor transactions and, more particularly, the entity known as "LJM." Mintz has been General Counsel of EGF for approximately one year. In that capacity, his boss is Andy Fastow ("Fastow"), Chairman of EGF and Chief Financial Officer of Enron Corp. ("Enron"). Mintz initially indicated that when he became General Counsel of EGF, he was concerned about LJM, not because of any impropriety, but because of the ugly cosmetics. LJM created morale problems among senior management within EGF because there was uncertainty as to the fairness of the compensation of those participating in LJM.

According to Mintz, the impetus for LJM was created by Enron's acquisition of Portland General Electric ("PGE"). Because that acquisition would make Enron a utility, Enron was forced to divest itself of several "Qualifying Facilities" under certain federal regulatory statutes. The idea was to find a "friend of Enron" which would get a return on its investment, which would look to Enron to make it whole, and which would be easy for Enron to work with in the event Enron wanted to reacquire the assets. The structure requires sufficient third party equity so that it will not be an Enron affiliate for financial accounting purposes. Arthur Andersen & Co. ("AA")'s view was that 3% of the equity must come from the non-affiliated party. Enron also conferred with AA on the issue of booking assets on a mark to market basis. According to Mintz, Enron was looking for a structure in which to place mark to market assets and assure that any loss on those assets would be deferred until their disposition.

According to Mintz, Fastow created a private investment company in which he acted as manager of the general partner and various banks participated as limited partners. These banks were the same as those who ordinarily did business with Enron. Fastow (or perhaps more properly LJM) would earn a management fee based on the total funds raised. For instance, if the funds raised amounted to $200 million, LJM would earn 1% in fees regardless of any activities. Under the structure, the limited partners would get the return of their investment and a 30% return on their investment. Within the initial LJM fund (which Mintz referred to as "LJM1," the full name of which is LJM Cayman, L.P.), there were two deals. One was RhythmsNet and another was an interest in Cuiba, a pipeline project in Argentina (Brazil?).

There was later formed an LJM2 (LJM2 Co-Investment L.P.), which Mintz described as a larger fund with limited partners possibly including Credit Suisse First Boston and CitiBanc. Mintz indicated that the creation of these funds involved private placement memoranda and disclosure information, and he agreed to collect and provide a package of materials that would include these items reflecting information provided to the limited partners of LJM.

According to Mintz, after the formation of LJM2, the entity took on a life of its own. From Enron's standpoint, the transactions with LJM were funded with Enron shares of common stock that had built up considerable market value. (Later in the interview, Mintz indicated that these shares primarily came available with the dismantling of JEDI into which Enron had previously contributed shares of its common stock. At least some of this stock, once it became available from the termination of the JEDI vehicle, was used to fund transactions with LJM.) According to Mintz, there was lots of history of the Enron-LJM relationship reflected by Enron board of director resolutions and presentations. Deal sheets were also developed that reflected negotiations and approvals at various stages by appropriate Enron and LJM representatives.

At one point, Mintz indicated that the LJM vehicle accomplished several things:

(1) generate funds with which to purchase assets from Enron;
(2) generate revenues to Enron;
(3) move Enron assets off balance sheet; and
(4) hedge assets (also characterized as a subset of (1) above).

LJM was a third party with whom Enron could close deals quickly and could work easily. Mintz believes that Jeff Skilling liked the vehicle for that reason and was glad to have it around without regard of the personal profit to LJM and Fastow. To the extent this structure was criticized because Enron shares of common stock were used as currency, those shares were always used in calculating Enron's earnings per share on a fully diluted basis (that is, Enron shares committed to transactions with LJM were included in the denominator in the calculation of Enron's earnings per share).

Mintz observed the awkwardness and disfunctionality that was brought about by the LJM structure. Some employees of EGF also had roles with LJM. LJM was operated out of Enron's office space, although it was separate space in a separate building. Employees working for LJM received their salaries from Enron, but their bonuses were paid by LJM. Enron analysts and associates were routinely rotated through LJM. Certain Enron employees were likewise profiting from LJM. For instance, on the RhythmsNet deal, Fastow implied that his personal profit was in the $10-15 million range. At some point, according to Mintz, Fastow carved out a piece of his interest in LJM and conveyed it to Michael Koppers, also an Enron employee. Finally, effective July 31, 2001, Koppers left Enron and Fastow either sold all of his interest in LJM to Koppers. There were only two transactions between Enron and LJM in the first half of July, 2001, and the sale of Fastow's interest to Koppers was structured so that Fastow would realize no income from LJM transactions with Enron during 2001. Under the sale transaction as currently structured, LJM will lease office space from Enron in Three Allen Center, but Koppers will retain an office in Enron's premises through September, 2001.

According to Mintz, the relationship between Enron and LJM was reviewed by both the audit committee and finance committee of Enron's board of directors. The review is done on a transaction by transaction basis and there was a discussion of (1) the deal, (2) the purposes, and (3) the benefits to Enron. Mintz does not believe this review process delved into the profits received by Fastow (or any other Enron employee) from LJM.

The deals between Enron and LJM, at the time they were entered into, were likewise signed off by appropriate business personnel, including representatives from legal (Mintz himself), Risk Management (Rick Buy), Enron Accounting (Rick Causey), among others. Although Mintz attempted to secure Skilling's signature to sign off on these deals, he was not able to accomplish this.

According to Mintz, AA would also review deals to assure appropriate accounting treatment. Primarily, AA was looking at the LJM side to make sure the deals had sufficient third party equity in the party. Mintz indicated that the deals were negotiated and reviewed from the LJM side as well, which used Kirkland & Ellis as its counsel and Coopers/Price Waterhouse as its accountants.

Mintz indicated that a third fund, LJM3, was in the works earlier this year, but the project did not go forward. Although Mintz did not so state, the scrapping of LJM3 was apparently done about the time it was determined that Fastow should divest himself of all ownership interest in LJM entities.

Possible Follow Up Activities

During the course of the interview described above, Mintz indicated he would provide a package of information relating to LJM which will include, at a minimum, private placement memorandum issued by LJM to its investing limited partners. If the package does not contain additional information, possible consideration should be given to requesting the following items for further background review:

(1) Resolutions and minutes of the board of directors of Enron Corp., and the audit committee and finance committee thereof, with respect to transactions between Enron and LJM (this has been provided);

(2) All written presentations to the Enron board of directors, audit committee or finance committee regarding LJM or transactions between Enron and LJM (this has been provided in part, but should be confirmed for completeness); and

(3) All "deal sheets" showing the nature and approval of transactions between Enron and LJM (this has not been provided).

c: Joseph C. Dilg

Houston 639760.1

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MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: August 30, 2001

RE: Interview with Andrew S. Fastow, August 27, 2001

On Monday, August 27, 2001, Joe Dilg and the author interviewed Andy Fastow ("Fastow"), Chief Financial Officer of Enron Corp. ("Enron") and Chairman of Enron Global Finance ("EGF") to obtain information relevant to an employee's inquiry regarding the propriety of the Raptor and Condor/Whitewing structures.

Fastow expressed some irritation with the implication of the employee's letter referring to the Condor/Whitewing and Raptor structures, because all transactions were reviewed with the Office of the Chairman. This is also true of NightHawk, a predecessor to Condor/Whitewing. These were all stock deals (*i.e.*, Enron stock was issued to support the transactions) which required approval of the full board of directors. The full board of directors also approved any restructuring of these transactions. In addition, Arthur Andersen & Co. ("AA") reviewed every transaction under the auspices of Rick Causey, Enron's Chief Accounting Officer. Standard procedure was to review each transaction from a technical basis, and AA's technical specialists (specialists in accounting rules) were involved in this process. AA likewise reviewed legal documents utilized in each transaction and commented to counsel. Vinson & Elkins ("V&E") also reviewed documents and made comments. Moreover, the transactions were disclosed. V&E and AA worked diligently on the necessary disclosure reports.

Fastow noted that the Condor/Whitewing and Raptor structures were similar in that they were supported by the issuance of Enron stock, but that Raptor was different in that in each of the four Raptor transactions, LJM provided the equity for the deal. Fastow recused himself from the Enron part of the equation and represented LJM in those transactions.

The board of directors' approval was of the initial structure of the vehicles (Condor/Whitewing and Raptor). The audit committee of the board of directors performed an annual review of all LJM transactions, including the Raptor transactions.

Fastow interpreted the employee's letter to have two primary implications:

(1) AA made a mistake when they determined that Enron could book earnings from Raptor; and

(2) There was not full disclosure of the issuance of Enron stock to support these transactions.

In Fastow's view, the employee is simply "second guessing" AA's determination as to the first implication and is factually wrong on the disclosure issue. Fastow believes that Enron's issuance of shares to support these transactions has been fully disclosed in its public filings.

Fastow pointed out the primary difference between the Condor/Whitewing structure and the Raptor vehicles is that no earnings are booked by Enron from the Condor/Whitewing vehicles. These vehicles were intended to accomplish two things:

(1) Move assets and related debt off Enron's balance sheet; and
(2) Record funds flow when assets are sold by Enron to Whitewing.

Because Whitewing is an affiliate of Enron, Enron cannot book earnings from it. LJM is not an affiliate of Enron; therefore, Enron can book earnings from the vehicles in which LJM provides the equity.

Fastow speculates that the employee who wrote the letter would argue something as follows:

- contingent Enron stock associated with Whitewing vehicle was pledged to the Raptor entities

- Enron entered into derivative transactions with Raptor running in Enron's favor

- because of the decline in value of the assets placed in the Raptor entities, Enron will have to issue more stock to support these transactions, which would ultimately be dilutive of the earnings per share of Enron stock.

In response, Fastow would argue that Enron had been able to avoid write-downs on its assets because of its transaction with Raptor. Assets are sold to Raptor, Enron gets the benefit of derivatives from Raptor, and Enron has the benefit of a buffer on its P&L statement. AA says that this situation works perfectly under the accounting rules. Although the structure may be in a gray area, it is fully approved by AA and is fully disclosed.

Fastow offered the following simplified example of how the Raptor vehicles work: LJM2, as a non-Enron affiliated entity, would invest $30 million in a Raptor entity. Enron committed to contribute stock (initially dedicated to Whitewing which had excess value) to Raptor in exchange for which Raptor would issue a promissory note payable to Enron. Enron also took back a special limited partnership interest in Raptor. Enron would then enter into a series of derivative transactions with Raptor to hedge against a decline in value of the assets.

For example, Enron might invest in an IPO. Assuming the IPO had a market value of $100 million, Enron would then put the asset to Raptor for $100 million and enter into derivative hedging transactions. If the asset declined in value, the value of the derivative would increase. This would be a wash on Enron's balance sheet.

There are a number of merchant banking investments that could be placed in a Raptor vehicle and a number of derivative transactions that could be made as hedges. An ongoing test was made to assure Raptor's credit-worthiness to support these transactions. At some point in time, the derivative transactions would have to settle.

Insofar as the equity in Raptor, there was a formula providing a return to LJM. (Fastow further stated that this formula was reviewed this board of directors, board committees and office of the chairman). If cash was left over in Raptor after settlement of the derivative transactions, LJM would get it. Fastow thinks this was a unique structure which was developed not by himself, but by Ben Gilsan, now Treasurer of Enron.

Assuming the value of all assets contributed to Raptor increased, the following scenario would occur:

- Enron wrote up the value of those assets on its balance sheet
- Enron would settle its derivative transaction by paying cash to Raptor
- Cash goes to LJM in payment of its fee pursuant to the formula
- All excess cash flows back to Enron through its special limited partnership interests

The "train wreck" under this structure (according to the employee who wrote the letter) would occur if all contingent stock had to be issued. Assuming that Enron would have to issue new stock to fulfill its obligation, it would dilute the earnings per share of Enron stock. The answer, according to Fastow, is that all contingent stock that might be needed to satisfy Enron's obligations to Raptor was included in the earnings per share calculation – thus, no dilution will occur.

Fastow stated that, on the one hand, he applauded the employee who wrote the letter because it takes fortitude to stand up and complain, even on an anonymous basis. He questions the employee's motives, however, because the person is smart enough to know that the structure and all transactions within the structure were reviewed by AA and found to be appropriate. [Fastow also stated his belief that this employee is acting in conjunction with a person who wants his job.]

When LJM was first brought up as an entity to provide equity in Raptor (or similar transactions), the primary issue discussed was the potential "Wall Street Journal risk" – *i.e.*, the bad cosmetics being aired publicly. LJM1 was created in June of 1999. It was put together to form a non-affiliated third party for Enron to enter into derivative transactions to hedge its investment in RhythmsNet stock. The Enron stock contributed to make LJM a credit-worthy counter party came from "UBS forwards" created several years earlier by Ed Segnor. Enron shares were issued to UBS and Enron entered into a contract to repurchase those shares in the future at a specified price. The shares held by UBS increased in value and after Enron repurchased them. the excess value was pledged to the RhythmsNet transaction.

LJM1 was capitalized by $1 million from Fastow and $7.5 million each from two separate banks. On its $20 million investment in RhythmsNet, Enron ultimately booked $400 million.

In returning to the "Wall Street Journal risk" that was discussed at the outset, Fastow was asked why the "friend of Enron" was not selected from some totally third party – a Goldman Sachs or other investment banker. According to Fastow, the reasons were (a) complexity, (b) speed of closing, and (c) confidentiality. By way of example, a bank typically wants to repackage and market products in which it invests, which would jeopardize confidentiality. New deals also came up quickly and banks could not move with the required speed.

The limited partners in LJM1 were two commercial/investment banks. The limited partners in LJM2 included banks, pension funds, insurance companies and high net worth individuals; a total of thirty different investors, none with relations to Enron. The LJM limited partnerships were marketed as unrestricted deals (*i.e.*, not limited to Enron transactions). All materials, including offering circulars, subscription agreements, etc. were reviewed by AA and V&E. AA made comments to LJM partnership agreement to assure that it was not an affiliated entity. LJM had its own attorneys (Kirkland & Ellis) and other limited partners had counsel which reviewed and commented on the LJM documents. The limited partners were also given extraordinary rights, including the power to remove Fastow as manager of LJM without cause. An advisory committee of limited partners was also established to review transactions.

LJM1 had very little equity ($16 million) and was set up specifically for the RhythmsNet deal. LJM1 actually did a second deal involving a portion of Enron's investment in the Cuiba Power Plant project in Brazil which enabled Enron to book future earnings on natural gas supply contract. Enron sold an $11 million dollar interest in the power plant, thereby dropping Enron's ownership to below 50%. This made the plant a deconsolidated asset and would permit Enron to value the gas supply contract on a mark to market basis. The future income under the gas contract could therefore be booked as revenue.

LJM2 was much larger fund which was closed in early December, 1999, and raised $349 million in equity, 1% from Fastow and the remainder from limited partners. By the end of 1999, seven different transactions occurred between Enron and LJM2. In total, LJM2 engaged in 24 transactions, three of which were non-Enron transactions, and four of which were Raptor structures.

Fastow re-emphasized that the LJM vehicle was approved on several levels. First. LJM was set up with knowledge of the board of directors, its committees, and the office of the chairman. Second, on a transactional basis, Causey was designated to represent Enron. Causey negotiated and approved all transactions. Audit committees of the board of directors were to review all transactions with LJM on an annual basis, and have done so for two years. Scott Sefton. General Counsel of EGF, prepared Causey for the first review and Jordan Mintz, presently General Counsel of EGF. prepped Causey for the second review.

Insofar as the separateness of LJM and Enron, Fastow indicated that this took many different forms. Each employee of Enron who was also working for LJM was covered by a Services Agreement pursuant to which, in effect, LJM reimbursed Enron for the cost of that employee providing services to LJM. Michael Koppers, for instance, had his salary paid by Enron but his bonus was paid by LJM. For another employee, Cathy Lynn, LJM reimbursed Enron for her entire salary and bonus. LJM also had some employees who were not employed by Enron. The rationale for dual employees, according to Fastow, were two: (1) Enron employees could keep their benefits, such as stock options, insurance and the like; and (2) dual employees would be knowledgeable about Enron and work with Enron easily.

Fastow made several comments to indicate that the LJM-Enron relationship had adequate oversight and safeguards. Christina Mordant was General Counsel of EGF at the time LJM1 was formed and the RhythmsNet transaction occurred. Scott Sefton was General Counsel of EGF who prepared Causey for his first audit committee review and was further present when LJM2 was created and many of the transactions with LJM2 occurred. More recently, Jordan Mintz has been General Counsel of EGF for approximately a year and has participated in the oversight of transactions occurring during that time period as well as preparing Causey for his second presentation to the audit committee. Rick Causey has been the primary Enron officer scrutinizing transactions with LJM from the Enron standpoint.

Fastow also pointed out that Enron had no obligation to enter into any transactions with LJM. LJM was set up this way so that there would be no complaints that Enron was required to deal with LJM on any of the four Raptor entities or other transactions.

According to Fastow, the Condor/Whitewing structures have third party investors, some equity interests by Enron, but are subject to the special purpose accounting rules. These entities began in 1997 with NightHawk and then progressed into Condor/Whitewing and Ospray.

Fastow viewed the LJM-Enron relationship as good for LJM and great for Enron. He pointed out that LJM had, however, lost money on some of the transactions it had engaged in with Enron.

c: Joseph C. Dilg

Houston 641541.1

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MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 18, 2001

RE: Interview with Richard Causey, August 31, 2001

On Wednesday, August 31, 2001, Joe Dilg and the author interviewed Rick Causey ("Causey"), Executive Vice President and Chief Accounting Officer of Enron Corp. ("Enron"), to obtain information relevant to an employee's inquiry regarding the propriety of the Condor/Whitewing and Raptor structures.

Causey stated that he received the employee's anonymous letter from Jim Derrick. He made a brief response to the letter by e-mail and later visited with Ken Lay on this subject. Causey then launched into a narrative description of what he believed to be the relevant events, after which there were follow-up questions in specific areas.

According to Causey, years ago a minority interest financing structure was developed called NightHawk. Enron common stock was supplied to the structure. During that time period the stock appreciated in value, adding value to the NightHawk structure. This structure eventually led to Condor/Whitewing. The structure was carried forward, leveraging off the increased value in Enron stock. This created a larger equity base, together with outside equity, but was still supported by Enron stock. This structure permitted the management of off-balance sheet assets and cash flow.

Causey stated that the value of the Enron stock in the Whitewing structure kept going up. This led to the idea of putting the excess stock value in a Raptor vehicle (of which there were four) to take advantage of this equity. The structure was conceptualized by Ben Glisan. The structure was to use the equity shares – *i.e.*, Enron shares in the Whitewing structure that would be used to support the Raptor vehicles. The value in the Raptor vehicles was to cover losses on swaps.

The Enron stock then started dropping. Raptor may not have enough equity to pay its derivative obligations to Enron. In the first quarter of 2001, contingent shares were issued and Raptor gave back a note. Raptor is restricted from selling for a period of time so the shares were not sold, but the full value of those contingent shares was considered in calculating Enron's earnings per share. At the end of the day, this structure will do its job, but it may be in a more noisy fashion.

Raptor was created to withstand volatility. It was not created to withstand declining asset values of the magnitude that have been experienced.

Insofar as the impact of these transactions on Enron's earnings, the current target for earnings per share include all contingent share commitments. By reason of recent securities law rules, there is a maximum number of shares that can be delivered in these vehicles. These rules place practical limits on the number of shares that can be delivered that would begin to have an impact if Enron stock goes to $20 per share or below. Below this level, the consequences of this structure would hit Enron's income statement. All these consequences were known to Jeff Skilling and Ken Lay through discussions of this structure.

According to Causey, the logical windup of the situation would be for Enron to deliver shares to Raptor, Raptor to sell shares in the market, and cash to be paid to Enron in satisfaction of its derivative contract. According to Causey, there is not much use in keeping the Raptor structures in place. There are no more derivative trades that can be conducted with Raptor and those vehicles have reached their limits.

Causey pointed out that Raptor-3 did not involve Enron stock. It involved a hedge with NewPower stock. The NewPower stock price dropped significantly. The receivable hit a high point because of the derivative transaction, but the collateral shrunk. This transaction was not supported at all by Enron stock; however, there is now cross-collateralization of all Raptor structures.

Causey explained the Raptor vehicles and Arthur Andersen L.L.P.'s ("AA") role in approving the structure. LJM is a general partner in the Raptor vehicles; Enron is a special limited partner. AA never provided written approval as to the overall Raptor structure. Causey's approach is to include AA early and consult often on all projects. AA gets all documents and they walk down the path with Enron all the way. Ultimately, AA signs off with an audit opinion and reports to Enron's audit committee. The audit committee has definitely heard reports of hedging with Enron stock.

Causey states that AA has its own documentation of various Enron transactions. Dave Duncan is aware of the anonymous inquiry and went back and looked at the issues and advised Causey that he felt comfortable. AA used its Chicago-based technical group in passing on the Raptor structures. This is all done internally at AA.

Enron also has its own accounting documentation. The anonymous inquiry has made Causey more sensitive and he wants to look back at the documentation to see that it is in good shape.

Causey pointed out that an unfortunate error will require an adjustment to the third quarter statements. In the contingent fee/cross-collateralization transaction that occurred in the first quarter of 2001, the note taken by Enron was booked as a note receivable (an asset) and not a charge against equity. The note should have been booked as a charge against equity and this may have to be corrected in the third quarter statements. This amounts to approximately $800 million, and together with an expected $200 million in additional contingent share commitment that will be required in the third quarter, will amount to a $1 billion charge against equity. Causey characterizes this as a simple mistake that now requires correction.

Causey discussed the structural challenge in the Raptor transactions that required outside equity to be at risk. It was known that the Raptor structure would be used to hedge against volatile assets. A "put" on the Enron stock was negotiated with Raptor. The hope was that a put would result in equity being placed in Raptor. AA was well aware of this vehicle and the key issue was whether the third party money was really at risk. The negotiation of the put with LJM was the key factor in this structure.

There are other deals with LJM and business reps at Enron. These people would do the negotiations, then Rick Buy and Causey would review the deal.

Causey points out that there was always a review process in the LJM transactions with Enron. These transactions may not have been subject to independent evaluations, but he considered whether other transactions were considered, looked at the fairness of the transaction and the propriety of the accounting.

Generally, AA looked at any material dealing with LJM – AA needed to do so for purposes of disclosure. The amount of time spent by AA on deals depended on their complexity. AA was involved heavily in the Raptor transactions.

Deals would originate by the business unit looking for earnings opportunities and also monetizing assets to hit their cash flow targets. The decision to involve LJM on a deal was for speed and efficiency – some consideration was given to non-affiliate counterparties, but speed and efficiency normally sent the deal to LJM.

AA had the opportunity to look at and comment on LJM's structure – basically looking at the outside equity in LJM. Causey did not know if AA participated in comments to the partnership agreement, but it may have. AA said it was okay with the structure, but must have known that the structure would be considered unusual.

Causey noted that there were some caveats to a full board of directors approval. The review of the LJM transaction was done with the audit committee. Causey gave two such reports to the audit committee. The finance committee also got involved; he gave them a report at a year-end meeting. Causey identified the document entitled "Related Party Transactions – LJM 2000" as the document used to make a presentation to the audit committee.

According to Causey, Ken Lay and Jeff Skilling would normally be in the finance committee meetings because this was one of the company's most substantive business meetings. Lay and Skilling were possibly there when LJM transactions were reported. There are five meetings/presentations a year with the committee, and perhaps some special meetings.

The audit committee meeting involved a discussion of the structure of transactions with LJM and they were given a general status of the LJM activities.

Causey explained that the finance committee has approval authority at certain levels of expenditures – capital projects primarily, but not so much interested in the divestment of assets.

Dave Duncan was AA's engagement partner of the Enron account and works primarily with Causey. Depending on the deal and subject matter involved, specific AA partners would be assigned to work with the Enron business unit. If issues ever arose from that work, Causey and Duncan conferred to resolve them.

Causey commented that the Raptor presented a vehicle that permitted the booking of significant revenues. Some new accounting/securities rules came out after Raptor was formed which now diminish the value of the vehicle. The Raptor vehicles were used to hedge a group of volatile investments. Raptor 1 was the start. Raptor 2 and 4 were started because the Raptor 1 vehicle was not large enough. Raptor 3 was a special purpose vehicle in which the NewPower stock was used.

Causey stated that Whitewing is not a "revenue-generating vehicle." It was a structure for placing assets off balance sheet and generating cash flow.

In Whitewing, Enron stock in the vehicle is significant because they are share settleable derivatives. There will be some contingent obligation to deliver shares to satisfy these debts.

The contingent share commitment graph contained in the investor relations booklet reflects a dilution from the Whitewing and Raptor transactions, but it does not discuss those vehicles specifically.

The impact on a $20 per share price for Enron stock would cause losses to occur in income. Above the $20 floor, there is sufficient value in the vehicle.

Causey states that there were not many questions on these vehicles by equity analysts until the stock price fell precipitously; now, the news media has focused on the entities, but it is old news to the equity analysts. Causey states that there have been discussions about various risks involved in these vehicles. AA included these risks in its audit issues. Causey has discussed these risks with Skilling and Lay. Causey questions whether someone else might take a different view of these structures? Possibly, and that risk has long been known.

Causey commented that the anonymous employee who wrote the letter is correct that a decline in stock will require more shares to be delivered. These shares, however, are already being considered in calculating fully diluted earnings per share.

Causey identified Bob Butts, a senior accountant in Enron, and Rodney Feldun as additional Enron employees who might be knowledgeable about accounting and possibly valuation issues now under discussion.

According to Causey, there will be no hit to income as contemplated in the wind down of the Raptor scenario set forth in the letter from the anonymous employee. The impact would be on the capital portion of Enron's balance sheet (*i.e.*, a decline in equity).

c: Joseph C. Dilg
Houston 657378.1

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MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 14, 2001

RE: Interview with Rick Buy, September 5, 2001

On Wednesday, September 5, 2001, Joe Dilg and the author interviewed Rick Buy ("Buy"). Executive Vice President and Chief Risk Officer of Enron Corp. ("Enron"), to obtain information relevant to an employee's inquiry regarding the propriety of the Condor/Whitewing and Raptor structures.

Before joining Enron in 1994, Buy had ten years experience with Bankers Trust Company in the derivative finance area focused on the energy industry. He has held his current position for 3-4 years and is responsible for the Risk Assessment & Control Group ("RAC") which functions similar to a bank credit committee. This group reviews proposed transactions by Enron and affiliates for the soundness of assumptions, the reality of projections, and identification of underwriting risks. As a result of this analysis, his group will either recommend that a transaction be approved or not be approved.

Typically, Buy's group did not review the structured financing vehicles like Condor/Whitewing – those transactions are largely a repackaging of assets already in Enron, on which no new risks are being taken.

Buy gave examples of the normal type of transaction that his group would assess:

- the purchase of a pulp and paper company in Canada;
- acquisition of an oil and gas exploration company in West Texas; and
- various derivative transactions.

In assessing transactions of this type, the group would function much like a credit committee of a bank in that it would:

- identify the risks;
- assess the financing required and the ability for repayment; and
- assess profit potential.

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This would include a review of the financials to determine what the deal would look like based on various projections. This process would be documented in a Deal Approval Sheet ("DASH") which would present a summary of the transaction, its basic parameters, and the approval of a financial analyst and various supervisors. Andy Fastow's group would also look at and approve these transactions from the securitization standpoint.

In Enron's business, there arose a need for outside equity which led to the formation of LJM. Buy had no involvement in the structure of LJM but was involved in the governance issues and deals in which LJM was an investor. There had to be a process whereby deals with LJM would be assured to be in the best interest of Enron. This process was established from the outset of the Enron-LJM relationship.

Transaction approval for normal deals is detailed and specific. Andy Fastow is normally in the approval chain for those deals. Because of his ownership of LJM, Fastow had a conflict of interest in transactions in which LJM participated with Enron. The process therefore required that Buy and Causey sign off on all LJM deals. This process was in place from the outset and was presented to and approved by Enron's board of directors.

Buy regularly attends finance committee meetings of the board of directors and, in his view, there was lots of information presented about LJM and the finance committee signed off on LJM and the procedure that would be followed for the approval of deals done with LJM. This procedure was derived through discussions among Jeff Skilling, Fastow, Causey and himself (Rick Buy), and then submitted to the finance committee of the board.

Buy described a hypothetical non-Raptor transaction with LJM. A business group would originate the deal, LJM would buy an equity sliver, provide debt financing or the like, and approval would be sought. The review process by Buy's group would not be as rigorous as a normal transaction because the numbers and economics had already been run; this was just LJM taking a piece of the deal. Dave Gorde in the underwriting group would normally review transactions and the underlying detail and would pass on his recommendation to Buy.

According to Buy, Causey would also review the proposed transaction for a "smell test" of the commercial terms and would review the accounting.

Buy commented that the structure was beneficial to Fastow financially, but also beneficial to Enron and Causey to permit the generation of revenues to meet targets at the end of calendar quarters. It was a good vehicle but it needed to be managed carefully.

The deals done with LJM were relatively small – LJM would take a piece of a larger deal done by Enron. Speed of doing the deal with LJM was a key factor; the people knew the deal, the structure, and flexibility was very high. The approval process was not as tight on these deals as in the normal transaction approval process. There was not as great a concern with these deals because all knew it was highly structured.

Fastow's group would prepare the Enron Investment Summary form. It would be provided to Buy's group and the Deal Approval Sheet (DASH) would be prepared and executed.

The Raptor vehicles in which LJM participated were different because they involved derivative transactions. The credit capacity of the Raptor vehicles changed with the value of Enron stock and the value of the assets in the vehicle. Enron had contributed stock to some prior structured transaction; the stock appreciated in value and there was no good way for Enron to use this increased value in the prior vehicle. Accordingly, Enron shares were contributed to Raptor and Raptor could use the shares as its equity base. This vehicle could be used to hedge Enron's merchant banking assets. At this time, asset values were bouncing around like crazy. RhythmsNet was cited by Buy as an example.

According to Buy, Raptor provided a means to lock up an asset at a certain level. If the asset declined in value, it would eat up Enron equity, not Enron earnings. The problems with the vehicle arose when Buy's group conducted its check on the counter-party's credit worthiness. The equity base in the Raptor vehicles deteriorated to the point where the equity was negative. This posed a problem and Buy picked up the phone and called Skilling to discuss what to do about the structure so that Raptor would be a credit worthy counter-party. Skilling's solution was to wait for a while. Finally the situation got worse and in the third quarter of 2000, supplemental shares of Enron stock were dedicated that would assure credit worthiness of the Raptor vehicles, at least so long as Enron stock was traded above $20 per share.

Buy stated that his group received daily statements that would show the value of assets in the Raptor vehicles so that its credit worthiness could be traced. The $20 per share may be slightly tenuous if the asset value placed in the Raptor entities has declined. For instance, NewPower stock has gone down drastically, and some fix may need to be made in the Raptor entity which holds the NewPower stock.

The fix that was done in the second/third quarter of 2000 was the contingent share commitment/cross-collateralization among all Raptor vehicles. [This actually occurred in the first quarter of 2001.]

Buy stated that he (his group) did not spend a lot of time on valuing the Raptor assets. They mostly look at spreadsheets. He views the legal and accounting issues to be more significant than the valuation issue. He views the accounting as aggressive, but that is not his role. The accounting ramifications are under the control of Causey and AA.

Buy is not familiar with the unwind procedures for Raptor. He guesses that Raptor will be shored up with additional Enron stock. The Raptor vehicles need to be capitalized sufficiently to cover the credit exposure from the derivative contracts which fluctuate over time.

Buy stated he was not concerned about the Raptor structure -- he thinks it is a clever structure to put to work the excess value of Enron stock (held in a prior vehicle) and to minimize the volatility of the merchant bank assets conveyed to Raptor. He thinks Enron's accounting is aggressive, but not over the line.

Buy believes that valuation is a key factor, but not just today's valuation. It was not necessary for Raptor to be unwound, and those vehicles can be kept as long as they are credit worthy.

Buy commented that had Enron stock stayed high and the value of assets placed in Raptor not fallen sharply, there would be excess capacity in the Raptor vehicles. But these scenarios simply did not happen.

Buy sees no eminent "train wreck" arising from the Raptor vehicles, but he needs to check on the present value of NewPower stock. If the value of NewPower stock – held in one Raptor vehicle – becomes low enough, and the Enron stock has declined as well, that Raptor vehicle may be in an uncreditworthy position.

Buy concluded the interview by stating he will be available to address any follow up questions we might have.

c: Joseph C. Dilg

Houston 649549.1

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MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 7, 2001

RE: Interview with Mark E. Koenig and Paula H. Rieker, August 29, 2001

On Wednesday, August 29, 2001, Joe Dilg and the author interviewed Mark E. Koenig ("Koenig"), Executive Vice President Investor Relations, and Paula H. Rieker ("Rieker"), Managing Director of Investor Relations, to obtain information relevant to an employee's inquiry regarding the propriety of the Raptor and Condor/Whitewing structures. Also present during the interview was Rex Rogers, Assistant General Counsel of Enron Corp.

At the outset, Koenig and Rieker questioned the use of Condor and Raptor terms. They pointed out that those were simply internal code names within the Enron business groups, and the disclosures to investors were made with respect to Whitewing and LJM. Koenig likewise stated he was aware of the employee's anonymous letter but questioned why Investor Relations was being included in an investigation of the substance of that letter. It was explained that investors' perception of the Condor/Whitewing and Raptor structures may be useful to the investigation.

Koenig and Rieker recalled that investor questions first came to their attention after the initial disclosures in 1999 in the 10-Q that an Enron senior officer was the managing partner of LJM1, an entity with which Enron co-invested. The proxy materials for 2000 (covering the period through year-end 1999) disclosed that Andy Fastow ("Fastow"), Enron's Chief Financial Officer, was the Enron senior officer who was the managing partner of LJM. They indicated that several investors have spoken directly to Fastow for clarification.

Rieker indicated that there were earlier questions about the Whitewing structure. Whitewing is a securitization issue, but people thought it was a revenue management tool. According to Rieker, much of this confusion was caused by the hedge funds which were always attacking Enron.

Koenig and Rieker indicated they began getting inquiries about Whitewing when Enron's stock price went down. The investor/analyst's questions about Whitewing were directed at unfamiliar terms such as derivatives and required further explanation. Koenig responded that Ken Lay's comments about making Enron's financial reports more reader-friendly related to the management discussion and analysis portion of the financial statements. and not the related party disclosures.

Koenig and Rieker indicated that investor/analysts' inquiries over the past six months have turned largely to cash flow, not related party transactions.

In connection with Enron's second quarter results and the second quarter 10-Q, presentations were made regarding the dilutive effect of Enron's contingent share commitment. Because of this contingent share commitment, there was some dilutive effect in the second quarter of 2001. No questions were recalled about the potential dilutive effect that may occur in the third quarter of 2001. Investors are largely concerned about whether a company achieves its earnings per share target.

Koenig and Rieker recalled no specific questions from investors/analysts on the portion of the 2001 proxy statement that addresses four structured entities in which LJM2 participated. Rieker points out that those are probably the Raptor vehicles which are referred to as "Entities" in the financial statements accompanying the various 10-Q reports. The only real noise that investors/analysts raised about LJM is the association of Andy Fastow as the managing partner in LJM.

Although neither Koenig nor Rieker are familiar with the details of the investments with LJM, Koenig was present in a finance committee meeting that reviewed the transactions in detail on a transaction by transaction basis.

According to Koenig and Rieker, investors want simplicity; because Enron's related party transactions are complex and not easily understood, they necessarily raise additional questions. However, they point out that this is not the only complexity inherent in Enron's business, and if there were no related party transactions, they would still have full employment explaining other complexities of Enron's business.

Koenig and Rieker reiterated that the contingent equity obligation is present; it is disclosed; and it is figured into Enron's earnings per share. Rieker referenced the 2001 second quarter analysts' conference where there was a presentation on the dilutive share number increasing from 860 million to 900 million during the preceding twelve months. Any dilutive effect of Enron's share commitment should be so small as to be immaterial, and, in any event, it already is included in the equation of Enron's earnings per share target.

Rieker stated that she believed investors understood that the value of the merchant investment portfolio within Enron (as well as every other merchant investment portfolio) has declined. This may have ramifications down the road, but investors/analysts' inquiries do not delve into this specifically.

At the close of the interview, Rieker supplied the presentation referenced earlier for the second quarter 2001, which was also posted on the Enron web site for a number of weeks. That presentation included a page entitled "Contingent Equity Commitments" which analyzed the components impacting share count of Enron stock 2001 versus 2000. The chart shows a dilution of Enron stock by an additional net 29 million shares issued and outstanding in the second quarter of 2001 over and above those existing in the second quarter of 2000. She indicated this was the dilution attributable to the contingent equity commitments to the Raptor and Whitewing vehicles.

c: Joseph C. Dilg

Houston 644504.1

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MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 7, 2001

RE: Interview with Greg Whalley, August 31, 2001

On Friday, August 31, 2001, Joe Dilg and the author interviewed by telephone Greg Whalley ("Whalley"), President and Chief Operating Officer of Enron Corp. to obtain information relevant to an employee's inquiry regarding the propriety of the Raptor and Condor/Whitewing structures. Whalley was in London and was not available for a personal interview.

Whalley stated that he had not seen the employee's anonymous letter, although he had heard about it and it took him some time to realize that he knew the author. He further indicated that he knew the author as Sharon Smith (apparently she does not go by the same name today). He does not know, however, why he was named as a person who might share the concerns stated in the letter.

In January or February of 2001, when Enron Wholesale was being put together, he asked a number of questions about the Raptor vehicle. Apparently, this came up when Enron North America employees suggested that he consider possible transactions with Raptor. Whalley sat down with Rick Causey, Chief Accounting Officer, and Ben Glisan, Treasurer, and got the basics of how the vehicle worked and how it was being managed. Once he got comfortable with how the situation was being managed and that Causey and Glisan had a handle on it, he backed off.

Whalley stated that he did not like the Raptor vehicle because of the short-sighted view of value that it fostered. That is, in negotiating a transaction with a third party, one's view of the value of that transaction may be affected because there is always the opportunity to turn around and place the asset in a Raptor-like vehicle and, while recognizing short term value, avoid the long term consequences of the initial trade.

The conflict of interest in dealing with LJM was disclosed and was apparent both within the Enron organization and to outside investors.

At various points during the conversation, Whalley questioned why an investigation was being conducted, that it seemed to be an issue of fact, and that it all hinges on whether the accounting structure used in Raptor was appropriate. If it was appropriate, there is no issue, but if it was not appropriate, there is an issue.

Whalley was likewise aware of the possible dilutive effect on Enron's earnings per share in the future if assets placed in the Raptor vehicles declined significantly in value. It was his impression in discussions with Causey and Glisan that there are several options to deal with this problem. He would not share the view of the author of the anonymous letter that these declines in value would lead to major problems in 2002 and 2003. He suggested that Causey and Glisan would be the logical persons to talk with about those options.

c: Joseph C. Dilg
Houston 644987.1

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MEMORANDUM

TO: Enron Corp. File

FROM: Max Hendrick, III

DATE: September 14, 2001

RE: Interview with David Duncan and Debra Cash, September 5, 2001

On Wednesday, September 5, 2001, Joe Dilg and the author interviewed David Duncan ("Duncan") and Debra Cash ("Cash"), both partners with Arthur Andersen L.L.C. ("AA") to obtain information relevant to an Enron employee's inquiry regarding the propriety of the Condor/Whitewing and Raptor structures. The accounting issues involved in these structures are very complex, and any technical aspects of accounting treatment discussed below should be confirmed for accuracy before being relied upon.

Duncan commenced the interview by stating that he had become aware of an Enron employee who had raised accounting issues regarding the Condor/Whitewing and Raptor structures. Upon internal AA advice, he then contacted Jim Derrick and was placed in touch with Rex Rogers to determine the nature of the inquiries raised by the employee. Duncan and Cash apparently knew the identity of the employee, although they did not reveal it. They further stated that the employee called one of their AA partners who was not assigned to the Enron account and attempted to discuss certain issues with him. That partner contacted Duncan and/or Cash and advised them of the inquiry. Duncan stated that his primary interest was to determine whether any new information had been brought forth by the employee's inquiry.

Duncan first addressed the Condor inquiry. Step 1 is to understand that Condor is a non-consolidated entity. In order to determine that, one looks to control. Condor is under shared control. The party who shares control with Enron has the ability to vote its interest as it sees fit, and also has the right to remove Enron from management. Once all factors are considered, including consultation with AA's technical people and practice staff, it was concluded that Condor qualified as an unconsolidated entity.

Once it is determined that Condor is an unconsolidated entity, the next inquiry is what happens upon a sale of assets to Condor. The first sub-question under this heading is: Is there a sale? The answer depends on what has been sold. If it is a financial instrument there is one set of accounting rules and, if it is a hard asset, there is another set of rules. AA reviewed each transaction on a case-by-case basis to determine from the type of asset whether there was a sale and whether there was a gain or loss upon the sale. No gains are realized from sales to an affiliated party such as Condor. If it is determined that a sale has occurred, the asset is moved from the seller's balance sheet to Condor's balance sheet. In accounting for cash flow, there are 3 possible categories:

- operations
- investments
- financing.

Placing revenues into one or the other of the above categories was a key decision. Duncan recalls that the vast majority of sales fell into the operating category. The issue in making that determination is the intent toward the asset at the time of its acquisition. Duncan stated that a textbook example is a large tract of real estate. If initially purchased to hold as an investment and later sold, the revenue would fall under the investment category. If purchased by a real estate developer to subdivide, develop and sell off the lots, the subsequent sales would be placed in the operating category. In Enron's case, the distinction was largely whether the asset was purchased as a merchant bank asset or a strategic asset. The sale of a merchant bank asset would generate operating cash flow.

AA has confirmed the transactions that have been conducted with Condor. AA audits Condor and has completed its year 2000 audit – *i.e.*, all transactions for 1999. The net impact of those transactions to Enron are set forth in a footnote to the financial statements in its annual report. Possible criticism of that footnote is that related parties and non-cash transactions are lumped together and not separated individually. Thus, it is difficult to tell which portion of those revenues relates directly to the Condor transactions.

A question arises whether an asset is a merchant investment or a merchant asset. Merchant investments are marked to fair market value; merchant assets are not. To be investments, they have to be in an investment company. Enron sometimes desires to move items from an asset to an investment category but once their character is declared, it is difficult to do so.

The inquiry of supporting Condor with Enron stock goes back to the initial capitalization with Enron stock. That stock increased in value while it was equity in Condor.

There is literature on (a) special purpose entities and (b) joint ventures. The former is subject to a strict set of rules, while the latter is very subjective. AA believes that Condor falls into the latter category because it is structured. Duncan also believes that the entity would comply with the emerging taskforce principles applicable to special purpose entities.

Duncan commented that the beauty of Condor was the fact that Enron's stock price went up after it was committed to the Condor vehicle. That gave Condor more capacity. Enron may have to do credit checks of Condor-owed obligations to Enron, but he does not think that has been a problem.

Duncan explained that Enron sold a "put" on Enron stock to Condor. The "put" is share settleable. Where there is debt to another that is supported by the debtor's stock, there is specific guidance in the accounting rules. If the instrument is cash settleable, it moves through income: if it is share settleable, it moves through equity. These shares are also included in the calculation of earnings per share. According to Duncan, this activity is disclosed in footnote 11 to Enron's Annual Report for Year 2000.

Turning to a discussion of the Raptor vehicles, Duncan commented that there was some analogy to Condor in that the Raptor vehicles are also supported by Enron stock. Enron approached AA about using a third party investor – *i.e.*, LJM – to be organized/managed by a senior officer of Enron. Duncan saw technical issues and corporate governance issues and wanted to make sure that approval for the transaction was obtained from the highest levels. As to a technical aspect, Raptor vehicles are one step removed from Condor – instead of an affiliate transaction, LJM would be a third party which would place equity in Raptor. To qualify, the LJM entity had to have unique control features not normally found in the partnerships. The limited partners had to have participatory involvement and the power to remove the Enron senior officer as manager without cause.

In determining whether investment in Raptor was made with third party equity, the contribution of Enron's senior officer to LJM had to be excluded. Further, none of the money contributed by the third parties could be borrowed. AA tested to assure that third party equity was in the transaction. AA viewed the Raptor entities as single purpose entities that had to be capitalized in accordance with specific SPF rules.

The Raptor vehicles were structured to achieve hedges against assets that had gone up in value. This was accomplished by a sale or pledge of the asset to the Raptor vehicle, and Enron getting a note back. Outside equity in the Raptor vehicle had to be three percent (3%). The Raptor vehicle needed to have credit capacity in its equity. Equity was supplied to the Raptor entity by a transaction whereby Enron would sell it stock. When the stock appreciated in value, the increase would increase Raptor's credit worthiness. The key feature was that Enron could settle in cash. The ultimate settlement of the derivative would give Enron cash, not shares – therefore, it would come into Enron as income.

Enron sold the Raptor entity shares with restrictions. In order to value the shares, a fairness opinion was obtained from Price-Waterhouse on the first Raptor-like transaction, and the basic format was used by analogy in subsequent transactions. It was concluded that the impairment test should lead to full market value being assigned to the Enron shares. This gave the Raptor vehicles capacity to do transactions with Enron. Had Enron stock gone up in value, it would have provided credit coverage for any decrease in the asset value. As time passed, the Raptor entity may elect to hedge its exposure. It purchased a derivative to hedge on the stock. This was a share settleable hedge. The impact was on equity, not income. When settleable, the payment by Enron in stock would not affect the income statement.

A number of scenarios can be envisioned depending on whether the stock and assets go up or down in value. If both stock and assets go up, the Raptor entity can settle with Enron and Enron can show income. If the stock goes up but assets go down, the entity can still settle and Enron will show income. If both stock and assets go down, Enron can settle with the impact being in its equity, not income position.

Duncan states that all of this is disclosed; nothing is left out that needed to be included in AA's audit opinion.

The key feature in Raptor transactions is the hedging activity. The man on the street may look at the share settleable hedge and question how it will work.

During the interview, Duncan raised the question of whether it would be appropriate for AA to visit with the Enron employee who made the inquiries. The point was made that the employee's inquiries might better be satisfied if she sat down with AA and received an explanation. From AA's standpoint, it simply wants to assure that there are no new facts raised by the employee.

Duncan explained that when the Raptor vehicles were originated, Enron sold a put that could be exercised by Raptor. After 60-90 days passed, and Enron stock had appreciated, the put would be settled by cash payment to the Raptor entity. Upon settlement, Raptor would distribute money to its equity investors. Once the distribution was made, the investors had amounts returned equal to their investment plus profit. Yet, technically, their investment had been properly made. The question is whether there is a valid business reason for the "put" transaction and AA relies on Enron's representation that a good business reason exists. Although this accounting treatment may look facially questionable, it satisfies the technical requirements.

Procedurally, AA reports to Enron's credit committee five times a year. The Condor and Raptor transactions have been discussed with them. The detail is not high, but information is available. There are not a lot of questions by the audit committee. A list of transactions entered into since the last meeting is generally discussed and approval is received for those transactions.

The audit committee is presented with a booklet of information for its review before or at each meeting. The booklet of the audit and compliance committee meeting held February 12, 2001, was examined as a sample. The booklet in similar form is presented for each meeting.

According to Duncan, Enron has never failed to follow AA's recommendation on technical and accounting matters. AA does not audit LJM, but had discussions with Fastow about whether they should or wanted to audit LJM.

AA pointed out the need for better documentation and analysis of transactions involving LJM. At some point in time, Enron adopted a Deal Approval checklist for these transactions.

Duncan, Cash and two other AA partners are full time on the Enron account. They have lots of discussions about lots of issues with Enron. AA has discussions internally on Enron issues, both from the practical standpoint and from a technical side. The structured transaction such as Condor and Raptor issues are discussed thoroughly with these internal groups.

c: Joseph C. Dilg

Houston 651256.1

DRAFT: October 23, 2001 (2:45PM)
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MEMORANDUM

TO: Enron general file (re: Accounting Issues)

FROM: Max Hendrick, III

DATE: October 22, 2001

RE: Telephone Interview with Jeffrey McMahon on October 18, 2001

On October 18, 2001, Joe Dilg and the author interviewed Jeffrey McMahon ("McMahon")by telephone. McMahon had previously been interviewed in connection with the investigation into the allegations contained in an anonymous letter and supplemental materials authored by Sherron Watkins. The supplemental interview was occasioned because of information relayed by Steve Kean ("Kean") to the effect that McMahon had made several statements regarding the LJM transactions that seemed inconsistent with statements he had previously made in his interview. The focus of the supplemental telephone interview was to clarify those points on which there was potential inconsistency.

Leaving the Office of Treasurer under Duress

McMahon initially stated that his comments to Kean were made immediately after learning Enron had been sued in a derivative lawsuit regarding the LJM transactions. He wanted Kean to know that there were certain areas of concern that would, no doubt, come under scrutiny as a result of the lawsuit or further legal or SEC inquiry.

By way of history, McMahon stated that he had approached Andy Fastow ("Fastow") many times about how the LJM issue was being treated. Fastow was wearing two hats but still in charge of and superior to people negotiating for Enron. Employees subordinate to Fastow were charged with responsibility for working on LJM matters; Enron and LJM were operating out of the same space. Reference to Fastow's ownership in LJM was used as a subtle stick in negotiations against Enron. All of these factors (previously discussed in the initial interview) contributed to McMahon's view that there was a conflict of interest.

Fastow never addressed these problems, whereupon McMahon felt compelled to discuss the issues with Jeffrey Skilling ("Skilling"), Enron's then President and Chief Operations Officer. McMahon advised Skilling that there were major conflicts of interest, but that those conflicts could be resolved. The people involved in the LJM conflicts were not responding well, and it was a stressful situation. McMahon did not present an ultimatum to Skilling (he volunteered that presenting ultimatums was not the way one could deal successfully with Skilling). He simply presented the fact that he could not compromise his position in light of the existing conflict of interest. Either some changes had to be made to resolve the conflict of interest or Skilling needed to find McMahon a new position. Several weeks later Skilling encouraged McMahon to take the job with Enron Networks, but Skilling did not link this to the conflict of interest with LJM.

McMahon believes that there are lots of people who know about his position and complaints about the conflict of interest. There may be a general perception that McMahon was "forced out" of the Treasurer's position as a result of this, and McMahon thought that Kean should be aware of this potential problem.

Pressure on Enron's Bankers to Invest in LJM

McMahon believes that a lot of the adverse publicity may be coming from bankers who believe they were pressured to invest in LJM. Several bankers came to McMahon and inquired whether an investment in LJM gets them an inside position for Enron business. McMahon consistently responded, "Not as far as I'm concerned." At later points in time, at least two bankers came to McMahon and said that they were promised business in turn for their investment in LJM.

McMahon recounted that First Union Bank's Paul Riddle called and complained about not getting a bond deal. He stated that he was promised the next bond deal for investing in LJM. McMahon's response was to the effect, "Not by me, you're talking to the wrong guy."

Merrill Lynch (no name given) commented, not by way of sour grapes, but simply as fact that it was felt linkage existed between investment in LJM and Enron business.

Deutsche Bank did not invest in LJM, but thought there was a linkage and felt it was improper.

Chase Bank felt there was a linkage between an investment in LJM and Enron business.

McMahon made clear that he had no first-hand knowledge – he was not present when any pressure was put on a bank to invest in LJM. He is concerned, however, how other Enron officers may have to testify on this subject. McMahon identified the following Enron employees as having had discussions with banks and who can comment more directly on the possibility of pressure being put on them to invest in LJM: Ben Glisan, Tim Despain, _____ Brown, Ray Bowen and Kelly Boots.

After he left the Treasurer position, McMahon never saw anything fishy about the way bank business was given out, but he was totally out of the loop. While he was Treasurer, he never saw anything about giving business to banks that he thought was improper or he would have "pulled the red chain."

Buy-out of Michael Koppers' Equity in JEDI-1

McMahon recounted that when Calpers was bought out as an equity owner in JEDI-1, Michael Koppers ("Koppers"), an Enron employee who worked for Fastow, was used as a replacement equity owner. The JEDI-1 structure was administrative burdensome and McMahon thought the equity (then owned by Koppers) should be bought out. He understood that Koppers had invested approximately $100,000 a year before. He discussed the possible buy-out with Fastow and felt Koppers could easily be bought out at a modest profit. Fastow said that he would handle the negotiations with Koppers.

There was actually a formula built into the JEDI investment whereby Enron could effect the buy-out. Going by the formula, Koppers would be entitled to approximately $22 million. McMahon felt like Koppers should not even get $1 million. As McMahon understands it, Koppers was to get $10-12 million as a result of the final negotiations. McMahon's discussions with Fastow on this subject were in January-February of 2000, shortly before he left as Treasurer. He thinks the deal did not close until early 2001.

McMahon's concern about this buy-out of Koppers in JEDI-1 was based on rumors that Koppers used the money from JEDI-1 to buy out Fastow's position in LJM. Many people assume that this was the case, but McMahon again has no personal knowledge. He thinks the same financial executives named above plus Kevin Howard would either have knowledge or a view of this situation.

Pressure on Enron Representatives Negotiating with LJM

McMahon believes that the lawsuits and related inquiries are going to look for all leakage out of Enron to LJM. People who negotiated for Enron against LJM will probably testify that they felt pressure. One example, which he gave in his prior interview, was Doug McDonald negotiating on behalf of Enron against Koppers. McMahon was at home, received a call from Fastow, who complained about McDonald negotiating too hard. As it turned out, Fastow had the facts wrong and ultimately backed off.

McMahon has no personal knowledge of deals that were against Enron's interest or well-being, but he is concerned about this subject. He gave the following names of individuals and situations that indicate that they may be the source of information unfavorable to Enron's position in this regard:

Kevin Howard – a good person to talk to about pressure exerted on Enron professionals negotiating against LJM;
Ray Bowen – another guy who got chewed out for negative comments about the LJM situation;
Cliff Baxter – frequently in Skilling's office complaining about LJM and Fastow's conflict of interest;

Ken Rice – same story;
Paul Chivens – an ex-Enron London guy now with Credit Agricole in Paris; and
Mike Jakgbic – hired by McMahon to set up a private equity fund. McMahon wanted a friendly source of capital to do deals. By the time Jakgbic arrived for work, Fastow had set up LJM, which was exactly the same concept. Jakgbic felt that Fastow stole his concept. He is now the relationship person for Enron with Deutsche Bank.

As a final note, McMahon stated that the Bloomberg release has lots of information concerning the derivative lawsuit filed against Enron.

MHIII

c: Joseph C. Dilg

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