III. STRUCTURED FINANCING TRANSACTIONS

A. Background and Rationale

During the 1990s, Enron's rapid growth necessitated significant infusions of new capital. At tension with its capital requirements, however, was the need for Enron to maintain its credit rating, particularly as Enron's creditworthiness had a direct impact on its stock price. As a consequence of this circumstance, Enron raised nearly $10 billion through various structured financing transactions, including tiered preferred securities, investment unit securities, and commodity prepay transactions. The primary advantage to Enron from some of these transactions was its ability to raise capital without ostensibly incurring additional debt. Thus, such transactions enabled Enron to maintain its credit rating and, in turn, avoid the downward pressure on its market valuation that would likely result from additional leverage. In other transactions, the primary advantage to Enron was its ability to liquidate appreciated equity investments--and eliminate its risk of loss from future declines in the value of these investments--without actually disposing of the investments and incurring immediate recognition of gain for Federal income tax purposes.

In the case of the tiered preferred securities and investment unit securities, the favorable tax treatment accorded these transactions was a principal factor in Enron's decision to raise additional capital by issuing such securities. In the case of the commodity prepay transactions, Enron initially engaged in these transactions solely for tax purposes, but in later years used these transactions to manipulate its reported operating results. Throughout its participation in the commodity prepay transactions, Enron exercised a significant degree of selectivity in its tax treatment of these transactions, including the transactions that were carried out primarily for financial reporting purposes in later years.

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