II. PROJECT TANYA

AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

ARTHUR ANDERSEN
Arthur Andersen & Co.

To: Robert J. Hermann, Enron Corp.

From: Robert P. Palmquist, Houston

Date: October 27, 1995

Subject: Enron Capital Loss

1. Attached are preliminary steps to implement.

2. We are doing preliminary feasibility study of reviewing particular items:

	(in millions)
Deferred Compensation	$60
SERP	20
FAS 106	120
Targeted Loss	$200

3. Items considered but on hold:

   Pension plans
   Stock options

4. Biggest issue to be resolved -- business purpose for Newco's managing these items.

5. AA fees

Feasibility review	$75,000 - $100,000
Implementation	$100,000 - $200,000

MLP\\[illegible]

EC2 000037798

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:MSR:HOU:TL-N-TL-N-3895-98
JRBalboni

date: AUG 16 1999

to: Chief, Quality Measurement Staff, Houston District

from: District Counsel, Houston District, Houston

subject: **Review of Proposed Notice of Deficiency**
Taxpayer: Enron Corporation and Subsidiaries
EIN: 47-0255140
Years: 1995

We have reviewed the above-stated notice of deficiency and agree to the issuance of the notice with the following changes. We have previously returned to your office the proposed explanation paragraphs with certain changes. The recommended changes need to be made in accordance with the corrections we made on the explanation paragraph pages before the notice is sent to the taxpayer.

We cannot approve the adjustment titled "Sale of Enron Management, Inc. Stock" (adjustment h. under Enron Corporation). That proposed adjustment is a determination that Enron should not be allowed a long term capital loss on the sale of Enron Management, Inc. preferred stock in the amount of $188,515,109. The primary posisition for making the adjustment is that there was no economic substance to the transaction. However, after discussing the issue with the Corporate Division of Chief Counsel, we determined that our case was covered by the recently issued Field Service Advice 199905008, which advised against applying the lack of economic substance argument. Accordingly, the National Office will not support our proposed primary position. We also discussed our alternative position, lack of business purpose, with the Corporate Division. The Division reviewed our alternative position, which we prepared after we were informed that the primary position was not approved. They will not support our alternative position either. They determined we do not have sufficient facts to support a disallowance of the deduction based on the the economic substance arguement. Therefore, we approve the issuance of the notice only if the Enron Management, Inc. adjustment in the amount of

5

$188,515,109, is not included.

If you have any questions, please contact Janet R. Balboni at 281-721-7307.

BERNARD B. NELSON
District Counsel

By: Janet R. Balboni
JANET R. BALBONI
Attorney

Enron Corporation
Project Tanya
To Do List
November 9, 1995

Action Step	Responsibility	Target Date
1. Prepare list of available subsidiaries • Equity of $500,000 to $5,000,000 • Preferably 1st tier subs • AA LLP to address issues involving the potential use of a 2nd tier subsidiary and or a subsidiary with minimal existing equity (i.e. $1,000)	Enron Tax AA	Mon. 11/13
2. Draft documents/discuss project with attorney • Select Enron corporate attorney to assist with project • Amend Newco's Articles of Incorporation for name change and to provide for two classes of stock (a sample document has been provided). • Newco Board of Directors resolution providing for the <u>issuance</u> of stock in consideration for (1) the contribution of the note(s) receivable and (2) assumption of certain liabilities (a sample document has been provided). • Enron Board of Directors resolution providing for the <u>acquisition</u> of stock in consideration for (1) the contribution of note(s) receivable and (2) assumption of certain liabilities (a sample document has been provided). • Agreement for the assumption of liabilities. • Agreement(s) to convert intercompany receivables to notes receivable. • Tax sharing agreement (if necessary) • Consulting agreement/stock purchase agreement. • AA LLP to obtain sample additional sample documents (if available).	Enron Legal	Wed. 11/15 Fri. 11/10
3. Select existing liabilities to be transferred to Newco • Meet Monday afternoon (1:30) to discuss with HR and Towns Perrin. • Determine if assets related to the liabilities (i.e. COLI & VEBA) must reside in the same subsidiary as the liabilities. Review for possible delay in transferring the assets since they will not provide any tax benefit. • Deferred Compensation (pre 1994, excludes rabbi	Enron/AA	Tues. 11/14 Mon. 11/13

EC2 000037845

Action Step	Responsibility	Due Date
trust/COLI).		
• FAS 106 Post Retirement Benefits.		
• Active Medical Obligation (?).		
• Determine the fair market value of the liabilities to be assumed by Newco.		
• Consider provisions to "cap" Newco's exposure where the costs of satisfying the liabilities could increase substantially.		
• Any regulatory issues on the transfer of liabilities/VEBA funding?	Enron	
4. Identify existing intercompany accounts receivable to be converted to intercompany notes receivable.	Enron	Tues. 11/14
• Bob Butts will provide a list.		
• Accounts receivable must have tax basis.		
• Determine the required interest rate for the notes.		
• Determine the required face amount of the notes to yield the desired value of the second class of stock.		
5. Determine the potential buyer of Newco stock	Enron	Tues. 11/14
• Drives the type of stock to be issued.		
• Employee – voting participating preferred		
• Consultant – nonvoting class B common		
• Determine the terms of Newco's new class of stock.		
6. Develop a cashflow/accounting model for Newco	TBD	11/16
• Supports the value placed on the second class of stock		
• Payment of liabilities		
• Receipt of interest income		
• Payment of dividends (only if preferred stock is used)		
• Payment of administrative costs		
• Payment for (and assumption of) additional future obligations (if any)		
• Use of intercompany advances to meet cashflow needs		
• Future redemption of second class of stock		
• Book Basis Balance Sheet/Income Statement		
• Tax Basis Balance Sheet/Income Statement		
• Deferred Tax Treatment		
• AA LLP to obtain sample model (if available)		
7. Draft Tax Opinion	AA	
• Draft Opinion (based on generic factual assumptions)		11/14
• Develop business purpose	Enron/AA	11/14
• Finalize Tax Opinion (based on Newco's specific facts)		

EC2 000037846

Action Step	Responsibility	Due Date
8. Resolve financial accounting treatment • Send preliminary cashflow/accounting model to Dave Duncan and Bob Butts	AA Audit	11/17
9. After Newco has been formed and the second class of stock has been issued, begin negotiations with potential buyer(s). • Negotiate consulting agreement/stock purchase agreement with buyer. • Preferably agreement will not require audited financial statements for Newco. Instead, Newco's FMV can be supported with actuarial determinations of the value of the liabilities.	Enron	December