Nighthawk Restructuring Summary

Structure:

- Based on the Project Nighthawk structure already in place
- Contribution by Enron affiliate to Whitewing of $1B of leased assets in return for preferred partnership interest subordinate to Nighthawk's current interest
- Assets may be built-in gain (i.e., fully depreciated) property or full cost property, depending on what is available
- Effect of remedial allocations under partnership tax rules results in Enron affiliate's basis in the partnership climbing to $1B over the term of the transaction (or it would stay the same if full cost property is used), while Enron's basis in the partnership decreases to zero.
- When the leased assets are distributed at the end of the transaction (e.g., 15 to 20 years), the tax basis of the property will be stepped up to $1B, the amount of Enron affiliate's tax basis in its partnership interest in Whitewing. Section 732(b).
- Enron affiliate's tax basis will be used by Enron affiliate in the form of future depreciation or loss on the sale of the property.

Benefits:

- The increase in tax basis in Enron affiliate's interest in its partnership interest (and in the assets that will be distributed on liquidation) is approximately $1B that represents a future tax benefit of $350M.
- The tax liability of Enron and Enron affiliate from the transaction is approximately $310.7M (35% x [$1,367,760B less $480,000,000 DRD].
- Enron should, therefore, be able to create a deferred tax asset of $39.3M as a credit to income [$350M future tax benefit less the $310.7M tax payment].
- Change in law risk is mitigated with an unwind possible at any time with proportional benefit equal to time the structure is outstanding

Issues:

- Effect of restructuring and addition of the leased assets on current rating agency treatment?
  - Best answer is an enhanced rating or no effect.
  - What is the likelihood of a reduction (or maybe that isn't possible)?
- Additional leverage from addition of leased assets? Business issue.
- Business purpose
  - Potential (but fairly unlikely) agreement by guaranteed payment investor to reduce guaranteed return to which it is otherwise entitled
  - Potential to eliminate the expensive structured derivative contracts in the current structure if lease has a "hell or high water" provision causing the investor to hold a quasi-debt instrument.
  - Potential to leverage up structure with additional collateral?
  - Others? Business people can potentially help here.

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- Assumption of risk of enactment of Reg. section 1.337(d)-3 if assets are appreciated
  - Worst case scenario is immediate gain recognition
  - Acceptance of risk represents a judgment call for company.
  - Use of full cost property (as opposed to built-in gain/fully depreciated property) avoids risk but may not have such property.
  - Mitigants include current NOL posture. AMT? Capital gain management?
  - Not an active regulatory project. Not expected to be enacted because other provisions prevent the result the IRS sought to achieve.
- Other deals:
  - D&T has two deals ongoing, one for a pharmaceutical company and one for a "conservative" oil and gas company. One is a $500M transaction and one $1B transaction.
  - Only a handful planned
  - Not aware of anyone else with the technology although bits and pieces are in deals he has seen.
- Clinton Administration Fiscal 2000 Budget Proposals
  - Corporate tax shelter and partnership provisions
  - Bill Archer
  - Concern over how Treasury wields broad powers granted to it
- Effect on current structure
  - Reduces exposure to Notice 94-48
  - Potentially eliminates need for expensive derivatives in system – insurance contract backstopped by S&P put and underperformance put. [Is this cost incorporated into the guaranteed payment made by Whitewing each calendar quarter?]
  - [Nighthawk's right to liquidate the partnership in 3 ½ years is not a good fact. We believe Citibank won't penalize us too much but what about Harch Capital Management?]
  - [Management rights given to Nighthawk for purposes of deconsolidation may also pose a problem if Whitewing holds an operating asset]

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