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Memorandum

Date: May 5, 2002
To: McCullough Research Clients
From: Robert McCullough
Subject: Enron's Workout Plan

On Friday, Enron's new management proposed launching a lifeboat from the stricken liner. Not surprisingly, paying passengers were the first to board – Portland General Electric, and Enron's two pipelines. Several stowaways are also in the lifeboat – Elektro and Northern Border Partners.

OpCo may well face considerable controversy – especially since the inclusion of LJM2 occluded assets may well generate a considerable windfall for this unpopular partnership. Sale of PGE under Section 363 would also apparently extinguish whatever claims Portland General employees might have for their lost 401k savings.

The basic mechanism is a Section 363 sale of substantially all of the property. This is a standard tool in bankruptcies that allows the trustee to dispose of assets. The transaction is subject to approval of the bankruptcy court. Since the sale extinguishes the claims of the creditors, they may object. Most importantly, given the nature of the largest single asset, is the prohibition in Section 363(f)(1) concerning non-bankruptcy law. Thus the creation of OpCo will require the approval of the Oregon Public Utility Commission.

The assets chosen for OpCo clearly support the sense that Enron's "network" business plan was empty of value. Portland General and the two pipelines only provided five percent of Enron's total revenues. No mention is made of Enron Online – theoretically, the worlds largest web site – or any of the other doubtful assets like broadband.

Enron clearly believes that OpCo is a work in process:

The bankruptcy court process in which OpCo will be formed will allow for higher and better bids. OpCo itself will be the stalking horse in an auction process that ensures the market the opportunity to create the highest value for the creditors of the Estate. The market can bid for all or specified segments of OpCo in a transparent auction process. Any qualifying topping offers will be considered.¹

The assets outside of PGE, Transwestern, and Florida Gas are a hodgepodge of questionable investments. Some, like the Northern Border Pipeline, have a relatively small Enron ownership.²

The oddest assets are the transfer of the Brazilian assets. Enron had actively pursued the Brazilian market. Cuiaba, of course, has become famous for the mark-to-market manipulations cited in the Powers Report. Elektro, Enron's distribution utility in Brazil, is also deeply troubled:

- a. The Brazilian Real has fallen to 50% of the value it held when these purchases and investments were made
- b. Elektro has faced operating problems due to drought
- c. Elektro has faced criticism on its accounting by the Brazilian government
- d. The Brazilian government is contemplating reversing deregulation.

Page 39 of the OpCo Business Plan has a serious warning on the viability of the Brazilian assets:

¹OpCo Business Plan, page 4.

²Enron's share of this pipeline directly is cited at 7.7%, but this includes ownership through Sundance. Sundance is one of the mysterious partnerships with a large ownership share by LJM2.

Certain of the assets included in OpCo's historical and projected financial statements are wholly or partially held through existing structured finance vehicles. Historical and projected pro forma financial estimates assume that these assets are not encumbered in structured finance vehicles. The unwind and resolution of these structures may affect the financial results presented. The following lists the assets currently in structured finance vehicles that are assumed to be included in OpCo's financial results:

- CGAS Inc.
- Centragas
- ECP Trutta Swap
- Eletrobolt
- Mariner Exploration, inclusive of certain debt held by structured vehicles, which was assumed to be restructured to a lower interest coupon.
- Northern Border Partners (certain L.P. Interests)

OpCo Business Plan, page 25.

Due to restrictions on the Enron Estate in the bankruptcy process, management in some cases may not be able to control whether such indebtedness is demanded to be paid when due (particularly because the most significant indebtedness is owed to entities that may be subject to receiverships and/or liquidations in foreign jurisdictions). If such intercompany or other indebtedness comes due in whole, it could render certain businesses – most significantly Cuiabá EPE, Elektro, GasMat and Eletrobolt – insolvent. Such insolvency - either as a result of the intercompany notes or otherwise – could result in a revocation of the applicable project’s concession, which would in turn trigger scrutiny by the respective regulatory bodies of the authorizations granted to Enron’s remaining businesses to operate one or more of these Brazilian projects.

The assets held in Whitewing and Sundance are subject to numerous restrictions. The transfer of Elektro, one of the assets held in Whitewing, opens up the question whether Osprey, Whitewing’s other owner, is, itself, bankrupt. Since Osprey raised billions to purchase their share in Whitewing, transfer of this asset will face careful scrutiny by a new set of creditors.

Sundance has long been identified as the major remaining asset within LJM2. A number of the assets identified on page 16 have highly questionable ownership structures.

The pro forma on page 30 is clearly speculative. While analysis of these figures will require additional data, one thing leaps from the page. OpCo clearly counts on the Oregon PUC not requiring rate reductions in 2003. While the cost of electricity falls 10% in 2003, revenues stay constant.