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Memorandum

Date: January 22, 2002

To: McCullough Research Clients

From: Robert McCullough

Subject: Understanding Whitewing

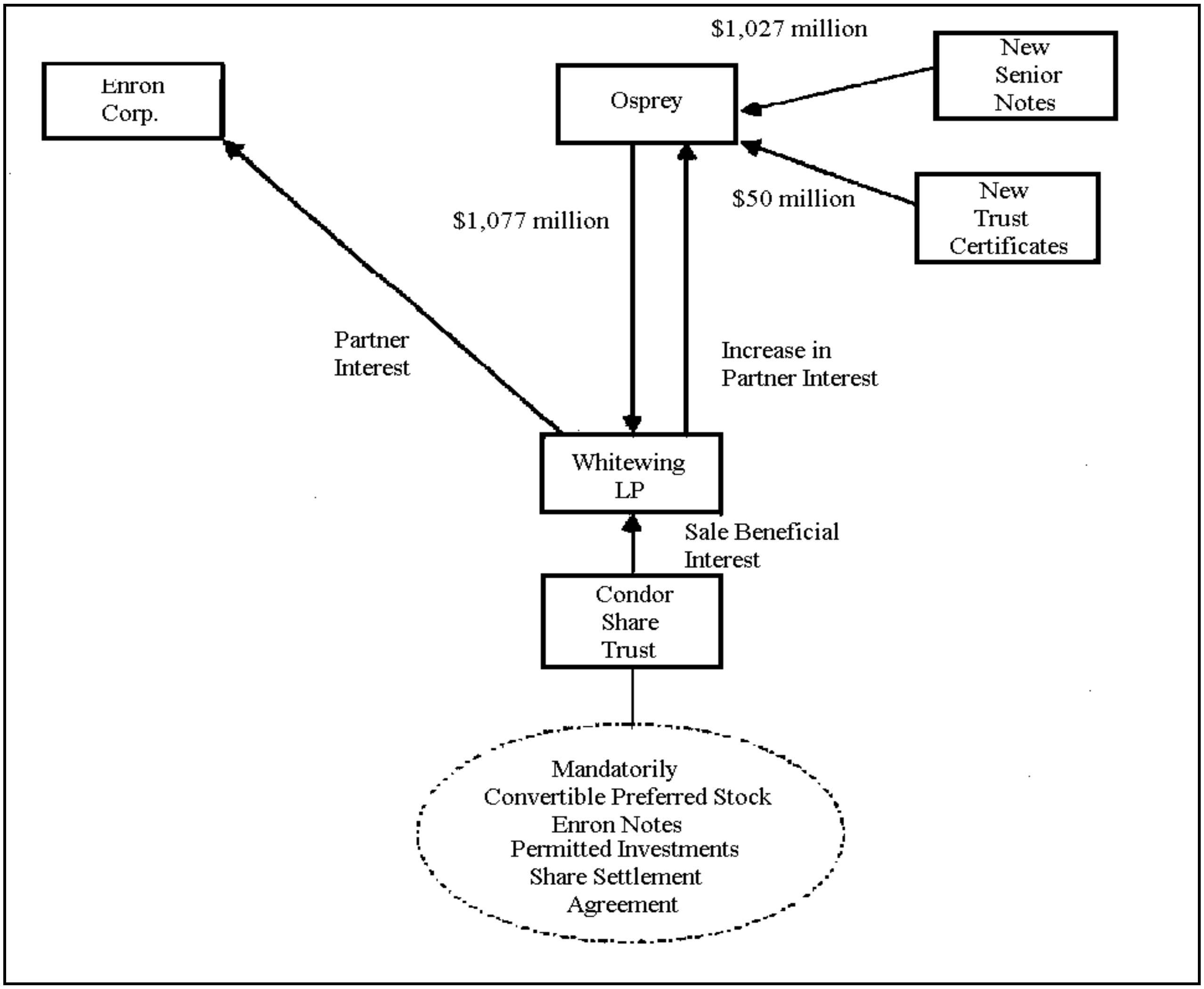
The Whitewing Dove is a bird native to Texas. Not surprisingly, Whitewing is also a member of the flock of special purpose entities used as financing vehicles by Enron. Whitewing, based on Enron's financial statements, was a vehicle that allowed Enron to realize cash from investments made by third parties without formally selling a variety of assets. The single largest asset in Whitewing was a guarantee made by Enron that it would cover approximately $2.4 billion dollars in risk to the third party lenders. Overall, it appears that Whitewing was a gamble which allowed Enron to offset anticipated future stock appreciation against assets that may have been unable to realize their book value in the open market.

Whitewing was formed in December 1997.[1] The original capitalization was $579 million from Enron and $500 million from Osprey. The proceeds were invested in 250,000 shares of Enron Series A

[1] Minority interests include Jacare beginning January 1, 1999, majority-owned limited partnerships since their formation in December 1998 and July 1999, Whitewing from its formation in December 1997 until its deconsolidation in March 1999, EOG until the exchange and sale of Enron's interests in August 1999 and Enron Global Power & Pipelines L.L.C. until Enron acquired the minority interest in November 1997 (see Notes 2, 8 and 9 to the Consolidated Financial Statements). 1999 Enron 10K.

Junior Convertible Preferred Stock (Series A Preferred Stock.)[2,3]

The Osprey Trust Offering includes the following flow chart showing the relationship between Osprey, Whitewing, and Condor:[4]



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[2]In 1997, Enron and a third-party investor contributed approximately $579 million and $500 million, respectively, for interests in Whitewing. Whitewing purchased 250,000 shares of Enron Series A Junior Convertible Preferred Stock (Series A Preferred Stock) from Enron. 1999 Annual Report, page 53.

[3]Enron and Osprey, through a series of transactions (the "Original Osprey Transactions"), invested in Whitewing LP, a vehicle designed to acquire, hold and sell Permitted Partnership Investments, including designated Assets, from time to time. 9/28/2000 Osprey Trust Offering Memorandum.

[4]Osprey Trust Offering Memorandum 9/28/2000, page 4.

The Osprey Trust is owned by a variety of different financial entities from Traveler's to Vanguard.

In March 1999, control was shared equally between Enron and Osprey resulting in the removal of Whitewing from Enron's consolidated financial statements.[5]

In September 1999, Enron exchanged all outstanding shares of Enron Series A Preferred Stock held by Whitewing for 250,000 shares of Enron Mandatorily Convertible Junior Preferred Stock. Each share of Series B Preferred Stock is mandatorily convertible into 200 shares of Enron common stock on January 14, 2003. In addition, Enron entered into a Share Settlement Agreement under which Enron would deliver additional shares of common stock or Series B Preferred Stock to Whitewing for the amount that the market price of the common stock is less than $28 per share. Additional net outside capital of $922 million was received by Whitewing.[6]

The product of the preferred stock, 250,000, and the conversion rate, 200 shares of common for one of preferred, times the guaranteed value, $28.00, is a promise of Enron's part to pay $1.4 billion on the liquidation date of the trust. At this point, Whitewing was simply a financial gamble where the owners of the partnership were guaranteed a minimum value for their stock, but could profit if the stock was above $28.00 a share. Enron's accounting on liquidation hasn't been made clear. As a general rule, companies are not allowed to speculate in their own stock, so Enron would have been forced to make a balance sheet consolidation of the profits if the stock was above the set value on January 14, 2003. Enron faced a financial risk if their stock was below $28.00. It appear that Enron's guarantee also extended to a shortfall in the value of the all assets at Whitewing backing $2.4 billion debt at Osprey.[7]

The 3rd Quarter 2001 Enron 10Q identifies Whitewing assets as having a book value of $4.7 billion

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[5]In March 1999, Whitewing was amended to allow, among other things, control to be shared equally between Enron and the third-party investor. Consequently, Whitewing was deconsolidated by Enron, resulting in an increase in Enron's investment in unconsolidated equity affiliates of approximately $500 million, an increase in preferred stock of $1.0 billion and a decrease in minority interests of $500 million. 1999 Enron 10K.

[6]In September 1999, Enron entered into a series of transactions that resulted in the exchange of all outstanding shares of Enron Series A Preferred Stock held by Whitewing for 250,000 shares of Enron Mandatorily Convertible Junior Preferred Stock, Series B (Series B Preferred Stock) with a liquidation value of $1,000 million. Each share of Series B Preferred Stock is mandatorily convertible into 200 shares of Enron common stock on January 14, 2003 or earlier upon the occurrence of certain events (together, the Settlement Date). In addition, Enron entered into a Share Settlement Agreement under which Enron could be obligated, at the Settlement Date, to deliver additional shares of common stock or Series B Preferred Stock to Whitewing for the amount that the market price of the converted Enron common shares is less than $28 per share. As a part of the restructuring of Whitewing, additional net outside capital of $922 million was received by Whitewing. 1999 3rd Quarter 10Q.

[7]On 11/15/2001 Enron made a 425 filing that included the transcript of a conference call to investors. The obligation is referred as a "top up" obligation that makes the Osprey investors whole for a total of $2.4 billion.

including $1.3 billion in projects in Europe and South America and a distribution company in Brazil.[8] In addition, it holds $600 billion in demand notes, $600 million in merchant investments, and $100 million in other assets.[9] The 10Q also sets the economic value of Enron's guarantee at $2.1 billion.

The net value required from Enron of $1 billion would seem to reflect a stock valuation of $22 per share – a lower value than the share price on that date. The 10Q goes on to add $600 million dollars of exposure as of November16th, when the share price had fallen to $10. This would appear to match the values well – $2.1 billion of guarantees by Enron would break into stock issuance worth $500 million and a transfer from Enron of $1.5 billion.

Making sense of the conference call comments on Osprey isn't quite as easy. Jeff McMahon says that:

> Let me just address Osprey briefly. The Osprey transaction relates to another financing where Osprey is an investor in a joint venture formed by Enron and outside institutional investors to acquire and own certain energy-related assets and other assets. Osprey was capitalized originally by issuing $2.4 billion of 144a debt and $220 million of equity. This is basically an asset-backed financing again with a top up obligation by Enron.
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> Now, the Osprey debt is supported by three things, 1) the assets within the vehicle, 2) Enron convertible preferred stock which converts into 50 million common shares of Enron and 3) a contingent obligation of Enron to issue additional shares if needed to satisfy the debt obligations if the assets and the preferred stock are insufficient to retire the 144a debt at maturity. So that's the structure of Osprey.
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> Now what's the current status of the financing. Well, if at maturity, the assets are valued using the 25% haircut to book value, this would result in an approximate $600 million incremental use of cash by Enron and a corresponding reduction in income and equity related to the top up obligation. Additionally, the liquidation of the vehicle would result in the retirement of the original $1 billion preferred stock issued to the

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[8]The primary assets are Elektro Eletricidade e Servicos, a Brazilian utility and major generating units like Trakya (Turkey) and Sarlux (Italy). Elektro has faced hydroelectric supply problems and exchange rate valuation adjustments.

[9]At November 16, 2001, Whitewing held assets with a book value of approximately $4.7 billion. This includes approximately $1.3 billion in energy related projects in Europe and South America, including European power plants, and an electric distribution company in Brazil, approximately $600 million of merchant investments, approximately $600 million in demand notes due from Enron and other assets of $100 million. The merchant portfolio includes both private and publicly traded entities and consists of oil and gas investments, power generation and energy investments and technology related and other investments. In addition, Whitewing holds Mandatorily Convertible Junior Preferred Stock, Series B, mentioned above, and a contingent obligation of Enron to issue additional shares, if needed, which together have a combined book value of approximately $2.1 billion. 3rd Quarter Enron 10Q.

vehicle at the origination which is currently on our balance sheet.[10]

It isn't clear whether the 25% haircut (value discount) is an average across a larger set of assets or specifically to Osprey.[11] The discussion above would indicate that Enron had valuation concerns for these assets.

Sherron Watkins comments concerning Condor, the entity that holds the non-Enron guarantee assets for Whitewing, indicates an $800 million liability in merchant asset sales from 1999. While we can identify the sales in 1979, we can't trace specific sales to the somewhat mysterious Whitewing balance sheet. We do know that such sales did take place and they have the correct scale in 1979.[12] From what little we do know, Whitewing (through Condor) acquired assets from Enron for cash which was, in turn, contributed by a series of financings through Osprey.

Where do we stand now?

Enron's stock contribution should logically be valued at zero, leaving Enron at risk for the entire guarantee. Enron's total guarantee should be $2.4 billion.[13] There clearly are inconsistencies. The 10Q uses a value of $2.1 billion. While we still do not have a clear statement of the value of the assets at Condor, the comments by Lay and McMahon would seem to indicate a $600 million valuation exposure.

The 3rd Quarter 10Q closes with a prediction of a $700 million dollar income statement impact of the

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[10] 11/14/2001 Investor Conference Call.

[11] The conference call returns to the issue of Osprey's valuation with the following exchange:

Anatol Feygin: Good morning everyone. Can you provide us with some color on the Osprey vehicle and what are the major assets behind there with Marlin? It's obviously pretty transparent with Wessex and the Mexican concession that remains. What are the big ticket items so to speak, in Osprey so that we can have some more color on where the 25% haircut is coming from?

Jeff McMahon: Yes, Anatol, what Osprey ended up having in there was several of their European electric power projects in - from - sorry, European power projects which include Trakya and Sarlux in Italy. And then there's some variety of North America merchant investments which are typically debt and equity instruments of energy companies.

Ken Lay: And Anatol, you probably know the two - the first items that Jeff mentioned are two large power plants, one in Turkey and one in Italy.

Anatol Feygin: Sure. No, at some point it held about 47% of your Brazilian investments or at least a portion of that. Is that still the case or...

Jeff McMahon: Yes, I think there's actually less than that. I think about 25%. That is still the case.

[12] 1999 Enron 10K, footnote 4.

[13] Proceeds of up to a required amount at least equal to approximately $2.43 billion from such remarketing or liquidation will be distributed by Whitewing LP to Osprey and Osprey will apply such proceeds to repay she -Senior Nosey in accordance with the Indenture. Osprey Trust Offering Memorandum 9/28/2000.

guarantee.[14] It is clear that Enron's guarantees are not included in the adjustments already made to Enron's books. The $700 million estimate appears to be low, considering that Enron's share of Whitewing had fallen to less than 33% in 2000 and the netting of guarantee against return of Enron's share of any guarantee would have been reduced.[15]

The investors in Osprey would also appear to be facing a substantial writedown since the guarantee – denominated in Enron stock – would appear to valueless. Enron had speculated that it would be selling the non-financial assets of Whitewing in the 3rd Quarter 10Q at an apparent 25% discount. In sum, total assets at Whitewing might be as low as $2 billion compared to the $4.7 billion book value.

[14] 3rd Quarter 2001 Enron 10Q, page 70.

[15] After giving effect to the New Osprey Transaction, Enron's interest in Whitewing LP will be approximately $1.t2 billion and Osprey's interest in Whitewing LP will be approximately $2.65 billion. Osprey Trust Offering Memorandum 9/28/2000, page 5.