Enron

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Spring, 2002

Class 3: Understanding Enron's Transactions I

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Overview of Securitization

In a standard securitization, a new entity is created, a "special purpose vehicle" (SPV). Assets such as accounts receivable of an operating entity will be sold to the SPV in exchange for cash. The SPV will raise that cash by selling its own securities in public markets. The SPV will not be an operating entity, and will operate only as a conduit for translating its assets—the receivables—into cash to pay off the securities that it has issued. The SPV is designed to be "bankruptcy-remote" meaning, at a minimum, that it will not go into bankruptcy if the operating company that sold the receivables itself files a bankruptcy petition. Bankruptcy-remoteness can be created by making the SPV an entity of the sort that is not eligible for bankruptcy, see BC 109, or by controlling the decision-making ability of the entity, such as by requiring unanimous consent of the board of directors for a filing and by having an independent director.

You should be asking two questions: first, why do market participants value bankruptcy-remoteness?; and second, even if they find it privately useful, is it socially beneficial? As to the former, contrast the position of a standard secured creditor with that of the SPV. To be clear on what that means, assume that we got cash to the operating entity—this is the point of the securitization after all—by having the SPV lend money to the operating entity, secured by a first position on the receivables that would otherwise have been sold. The SPV again raises that cash by issuing securities. If the operating company filed under Chapter 11 of the Bankruptcy Code, the receivables would be property of the estate under BC 541, and would be "cash collateral" under BC 363. The debtor-in-possession—that is, the debtor after it files for Chapter 11 and retains control over its business under court supervision—will be able to use that collateral to operate its business if it can persuade the bankruptcy court that it can adequately protect the interests of the secured creditor. See BC 361, BC 363. There is no assurance that the secured creditor will receive interest in the bankruptcy proceeding, see BC 506, and it may get paid many years later under terms quite different from those originally negotiated. BC 1129.

In contrast, if the receivables are sold—and here we mean *really* sold, whatever that turns out to mean—in a transaction that does not have the taint of a fraudulent conveyance, we will respect this sale and the sold assets will not be involved in the bankruptcy of the operating company. That means that the debtor cannot use the receivables in the bankruptcy, and the SPV will not be subject to the treatment just-described for a secured creditor. This should make it clear why many potential investors want the protection of a bankruptcy-remote SPV.

How should society evaluate this transaction? Look first at the time of bankruptcy and then at the time of the transaction itself. Suppose, for example, that Debtor sold, for cash, a single share of Microsoft stock at the prevailing market price, and then filed for bankruptcy. This is the quintessential arms-length transaction, and there is no reason to think that we should overturn it after Debtor files for bankruptcy. Debtor has the cash in hand, and the estate has just swapped one asset for another. We should worry if a debtor sells property for less than it is worth, but we have fraudulent conveyance doctrines under state law and BC 548 to deal with these cases. Proper sales shouldn't trouble us then.

Suppose that Debtor blows the cash from the stock sale on losing lottery tickets right before filing for bankruptcy. Should we now question the sale itself? We shouldn't. It is true that Debtor could not have used the Microsoft share to buy the tickets directly, and that the conversion of that share to cash helped Debtor undertake its desperate scheme to restore solvency. But we usually do not impose on purchasers the burden of seeing how the proceeds of the sale will be used; creditors should play that role.

Is a securitization transaction any different from any other pre-bankruptcy fair-market sale? All of these transactions will have the consequence of removing assets from the bankruptcy estate. Debtors flush with cash rarely file for bankruptcy, so we can be confident that the debtor will have dissipated the cash received for the receivables, just as occurred in the lottery example. This will make it more difficult for the debtor to reorganize, as it will have fewer liquid assets, such as receivables to work with. It is possible that the debtor will not fully internalize the costs to creditors of exacerbating the liquidity crisis that the debtor will face, but these are marginal effects to be sure.

Try a different angle on this. There is an academic literature that emphasizes that securitization may have the consequence of creating judgment-proof entities. See Lynn M. LoPucki, The Death of Liability, 106 Yale L.J. 1, 28-29 (1996); Lois R. Lupica, Asset Securitization: The Unsecured Creditor's Perspective, 76 Tex. L. Rev 595 (1998). This debate is ongoing and is far from unanimous. See James J. White, Corporate Judgment Proofing: A Response to Lynn LoPucki's The Death of Liability, 107 Yale L.J. 1363 (1998), and the further response by Lynn M. LoPucki, Virtual Judgment Proofing: A Rejoinder, 107 Yale L.J. 1413 (1998).

What are the benefits of securitization? Many believe that securitization is socially useful in that it may reduce the cost of obtaining cash by making it easier for our certain borrowers to access public markets. See, e.g., Steven L. Schwarcz, Structured Finance: A Guide to the Principles of Asset Securitization (PLI, 2nd ed., 1993). Lowering transaction costs is generally something we want, and securitization may enable borrowers to exit thin markets and substitute into thicker, public markets.

In re LTV Steel Co., 274 B.R. 278 (Bankr. N.D. Oh. 2001)

WILLIAM T. BODOH, Bankruptcy Judge: This cause is before the Court on the emergency motion of Abbey National Treasury Services PLC ("Abbey National") for modification of an interim order entered by the Court on December 29, 2000. That order permitted LTV Steel Company, Inc., Debtor and Debtor-in-Possession in these jointly administered proceedings ("Debtor"), to use cash assets that are claimed to be cash collateral in which Abbey National has an interest. A hearing was held on this matter on January 18, 2001. Richard M. Cieri, Esq. and Bruce Bennett, Esq. appeared on behalf of Debtor. Thomas D. Lambros, Esq., David Spears, Esq. and Lindsee P. Granfield, Esq. appeared on behalf of Abbey National. This is a core proceeding over which the Court has jurisdiction pursuant to 28 U.S.C. § 157(b)(2)(M) and (O). The following constitutes the Court's findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 7052.

DISCUSSION

A. Facts

Debtor is one of the largest manufacturers of wholly-integrated steel products in the United States. Debtor mainly produces flat rolled steel products, hot and cold rolled sheet metal, mechanical and structural tubular products, and bimetallic wire. Debtor currently employs approximately 17,500 people in various capacities, and Debtor is also responsible for providing medical coverage and other benefits to approximately 100,000 retirees and their dependents. Debtor and 48 of its subsidiaries filed voluntary petitions for relief under Chapter 11 of Title 11, United States Code, on December 29, 2000. These cases are jointly administered.

This is not the first occasion on which Debtor has filed for relief under the Bankruptcy Code. Debtor previously filed a voluntary Chapter 11 petition in the Bankruptcy Court for the Southern District of New York on July 17, 1986. Debtor successfully emerged from Chapter 11 on June 28, 1993. Indeed, the current controversy stems from a series of financial transactions that Debtor executed after its previous reorganization. The transactions in question are known as asset-backed securitization or structured financing ("ABS"), and are generally designed to permit a debtor to borrow funds at a reduced cost in exchange for a lender securing the loan with assets that are transferred from the borrower to another entity. By structuring the transactions in this manner, the lender hopes to ensure that its collateral will be excluded from the borrower's bankruptcy estate in the event that the borrower files a bankruptcy petition.

Abbey National is a large financial institution located in the United Kingdom. Debtor and Abbey National entered into an ABS transaction in October 1994. To effectuate this agreement, Debtor created a wholly-owned subsidiary known as LTV Sales Finance Co. ("Sales Finance"). Debtor then entered into an agreement with Sales Finance which purports to sell all of Debtor's right and interest in its accounts receivables ("receivables") to Sales Finance on a continuing basis. Abbey National then agreed to loan Two Hundred Seventy Million Dollars ($270,000,000.00) to Sales Finance in exchange for Sales Finance granting Abbey National a security interest in the receivables. On the date Debtor's petition was filed, Chase Manhattan Bank ("Chase Manhattan") was Abbey National's agent for this credit facility.

In 1998, Debtor entered into another ABS financing arrangement. To that end, Debtor created LTV Steel Products, LLC ("Steel Products"), another wholly-owned subsidiary. Debtor entered into an agreement with Steel Products which purports to sell all of Debtor's right, title and interest in its inventory to Steel Products on a continuing basis. Chase Manhattan and several other banking institutions then agreed to loan Thirty Million Dollars ($30,000,000.00) to Steel Products in exchange for a security interest in Steel Products' inventory. Abbey National is not involved in this ABS facility, and it had no interest in pre-petition inventory allegedly owned by Steel Products.

Neither Sales Finance nor Steel Products is a debtor in this proceeding. Nevertheless, Debtor filed a motion with the Court on December 29, 2000 seeking an interim order permitting it to use cash collateral. This cash collateral consisted of the receivables and inventory that are ostensibly owned by Sales Finance and Steel Products. Debtors stated to the Court that it would be forced to shut it doors and cease operations if it did not receive authorization to use this cash collateral. A hearing was held on Debtor's cash collateral motion on December 29, 2000 as part of the first day hearings.

Abbey National was not present at the cash collateral hearing. However, the Court notes that Abbey National had actual notice of the hearing, first, in the form of an e-mail sent by a Chase Manhattan employee to Abbey National on December 28, 2000, and second, in the form of a telephone call made from a Chase Manhattan employee to Abbey National on December 29, 2000. Furthermore, it is clear that Debtor had given advance notice of its intention to file for bankruptcy protection to Chase Manhattan, Abbey National's agent, in the week prior to December 29, 2000. Chase Manhattan was present at the December 29, 2000 hearing.

On December 29, 2000, Debtor and Chase Manhattan reached an agreement regarding an interim order permitting Debtor to use the cash collateral. Chase Manhattan did not formally consent to the entry of this order, as it could not secure Abbey National's consent to the form of the order, but Chase Manhattan did negotiate some of the terms of the order and did not raise an objection to its entry by the Court. The Court determined that entry of the interim order was necessary to permit Debtor to continue business operations, that the interests of Abbey National and all other creditors who had an interest in the cash collateral were adequately protected by the order, and that entry of the order was in the best interests of the estate and creditors of the estate. Accordingly, the Court entered the order tendered by Debtor, the relevant provisions of which are summarized below:

1. Recognition that there is a dispute between Debtor and the secured lenders of Sales Finance and Steel Products as to whether the transactions between Debtor and those entities were true sales or disguised financing vehicles;

2. An order requiring the secured lenders to turn over to Debtor the cash proceeds of the inventory and receivables which are to be used to provide working capital for Debtor;

3. Recognition that in the event the Court determines these transactions to be true sales, the secured lenders whose cash collateral was used will be entitled to administrative expense claims against the estate;

4. Adequate protection was provided to the secured lenders in the form of senior liens on the inventory and receivables and weekly interest payments to the lenders at pre-petition non-default rates.

It is this order that Abbey National seeks to modify. Specifically, Abbey National asks the Court to modify the interim cash collateral order nunc pro tunc to include the following provisions:

a. The Debtors shall transfer to Sales Finance all receivables created on or after December 29, 2000 and not previously sold to Sales Finance and that would have been sold to Sales Finance were it not for the occurrence of a Liquidation Event;

b. Steel Products would continue to purchase Inventory from the Inventory Sellers and Sales Finance would continue to purchase Receivables from the

Receivables Sellers, each on the same basis and on the same terms as existed prior to the Petition Date;

c. The respective Collection Accounts would be administered by the Collateral Agent in the same manner as was administered prior to the Petition Date. Therefore, notwithstanding the occurrence of any Termination Date, collection on account of the Receivables would not be required to be applied to principal payments or amortization payments (other than any payments required in connection with the maintenance by the borrowers of their respective borrowing bases);

d. Steel Products and the Collateral Agent under the Inventory Facility would continue to automatically release all liens against the Receivables purchased by Sales Finance from Steel Products;

e. All minimum borrowing base and collateral value requirements set forth in the Receivables Facility and the Inventory Facility will continue in full force and effect;

f. In all other respects, the Receivables Facility and the Inventory Facility will continue to operate as required after the occurrence of a Liquidation Event including without limitation, the reimbursement of all expenses of each Receivables Lender and Inventory Lender.

(Abbey National's Emergency Motion to Modify Interim Order at 14-16).

Abbey National argues that the interim cash collateral order should be modified because *** there is no basis for the Court to determine that the receivables which are Abbey National's collateral are property of Debtor's estate ***.

*** Abbey National's next argument is that the receivables which constitute its collateral are not property of Debtor's estate, and thus this Court lacked jurisdiction to enter the interim order. We shall construe this as an argument that the interim order is void pursuant to Rule 60(b)(4).

Section 541(a) of the Bankruptcy Code provides that upon the filing of a bankruptcy petition an estate is created consisting of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). The estate created by the filing of a Chapter 11 petition is very broad, and property may be included in Debtor's estate even if Debtor does not have a possessory interest in that property. United States v. Whiting Pools, Inc., 462 U.S. 198, 204, 205-06 (1983).

Abbey National contends that the interim order is flawed because, on its face, the transaction between Debtor and Sales Finance is characterized as a true sale. Therefore, Abbey National argues, since Debtor sold its interests in the receivables to Sales Finance, Debtor no longer has an interest in the receivables and they are not property of the estate. However, Abbey National has admitted to the Court, both in its pleadings and in oral argument, that the ultimate issue of whether Debtor actually sold the receivables to Sales Finance is a fact-intensive issue that cannot be resolved without extensive discovery and an evidentiary hearing.

We find Abbey National's argument for "emergency" relief to be not well taken for several reasons. First, Abbey National's position in this regard is circular: we cannot permit Debtor to use cash collateral because it is not property of the estate, but we cannot determine if it is property of the estate until we hold an evidentiary hearing. We fail to see how we can conclude that the receivables are not property of Debtor's estate until an evidentiary hearing on that issue has been held. Because the determination of this issue must await further discovery, we decline to grant Abbey National relief from the interim order.

Furthermore, there seems to be an element of sophistry to suggest that Debtor does not retain at least an equitable interest in the property that is subject to the interim order. Debtor's business requires it to purchase, melt, mold and cast various metal products. To suggest that Debtor lacks some ownership interest in products that it creates with its own labor, as well as the proceeds to be derived from that labor, is difficult to accept. Accordingly, the Court concludes that Debtor has at least some equitable interest in the inventory and receivables, and that this interest is property of the Debtor's estate. This equitable interest is sufficient to support the entry of the interim cash collateral order.

Finally, it is readily apparent that granting Abbey National relief from the interim cash collateral order would be highly inequitable. The Court is satisfied that the entry of the interim order was necessary to enable Debtor to keep its doors open and continue to meet its obligations to its employees, retirees, customers and creditors. Allowing Abbey National to modify the order would allow Abbey National to enforce its state law rights as a secured lender to look to the collateral in satisfaction of this debt. This circumstance would put an immediate end to Debtor's business, would put thousands of people out of work, would deprive 100,000 retirees of needed medical benefits, and would have more far reaching economic effects on the geographic areas where Debtor does business. However, maintaining the current status quo permits Debtor to remain in business while it searches for substitute financing, and adequately protects and preserves Abbey National's rights. The equities of this situation highly favor Debtor. As a result, the Court declines to exercise its discretion to modify the interim order pursuant to Rule 60(b)(4). ***

CONCLUSION

For the reasons stated above, the Court concludes that Abbey National's motion seeking to modify the Court's interim order permitting the use of cash collateral on December 29, 2000 is properly characterized as a motion seeking relief from judgment pursuant to Fed. R. Civ. P. 60(b). Furthermore, the Court finds that Abbey National has failed to establish that modification of the interim order is warranted. Accordingly, Abbey National's emergency motion is overruled.

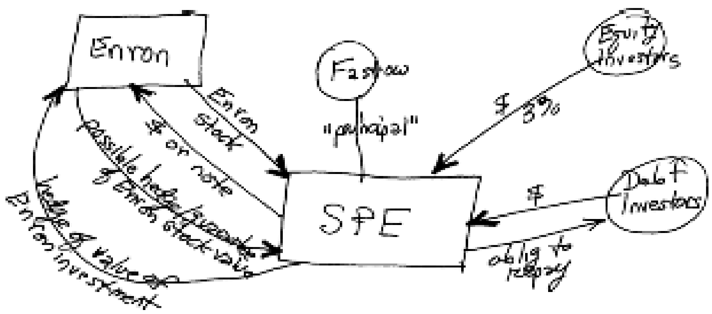
An appropriate order shall enter.

Essay: Some Thoughts on the Enron Bankruptcy [1]   Draft 3/29/02

Steven L. Schwarcz[2]

It now appears that Enron engaged in a range of manipulative accounting transactions, devoting much more energy to creative accounting than to making a profit to account for.[3] Its primary motivation was to maximize and accelerate financial statement asset values and profits,[4] and to avoid adding debt to its balance sheet which could have hurt Enron's credit rating and thereby damaged its credibility in the energy trading business.[5]

A common factor in this manipulation was the use of non-consolidated special purpose entities, or SPEs, to hedge certain Enron investments. In a typical transaction, for example, Enron would transfer its own stock to an SPE in exchange for a note or cash,[6] and also directly or indirectly guarantee the SPE's value.[7] The SPE, in turn, would hedge the value of a particular investment on Enron's balance sheet, using the transferred Enron stock as the principal source of payment.[8]



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[3] *Cf.* James Gordley, *Mere Brilliance: The Recruitment of Law Professors in the United States*, 41 AM. J. COMP. L. 367, 374 (1993) (in the context of criticizing the time away from research and writing spent by law professors in evaluating new appointments candidates, Prof. Gordley caustically observed, "No loyal and hardworking management bankrupts a company by putting more effort into accounting than into making profits to account for").

[4] Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp. [William C. Powers, Jr., Chair] 4, 68, 78, 97 (Feb. 1, 2002) (the "Powers Report"). As will be discussed, Enron maximized financial statement asset values by hedging against losses in value.

[5] Powers Report at 36.

[6] *See, e.g.,* Powers Report at 13.

[7] Powers Report at 36-37.

[8] *See, e.g.,* Powers Report at 13.

Because of its historically rising stock price, Enron apparently judged the risk that it would have to pay on its guarantees as remote. But undue reliance on historical price information is, of course, precisely what got Long Term Capital Management into trouble.[9]

When Enron's stock price subsequently fell, the SPE's value also fell, triggering the Enron guarantees, which guarantee payments in turn apparently further reduced Enron stock value, triggering additional guarantees.[10] Moreover, where the value of Enron's investment and Enron's stock price simultaneously fell, the SPE would lack sufficient assets to perform its hedge. This, and in some cases also the lack of sufficient SPE third-party equity,[11] forced an accounting consolidation of Enron and the SPE, bringing the SPE's debt onto Enron's balance sheet.[12]

The "Rhythms" transaction is illustrative. Enron transferred its own stock to an SPE in exchange for a note.[13] The SPE then hedged the risk that Enron's substantial investment in Rhythms NetConnections, an internet service provider, might decline.[14] When the price of the Rhythms stock and the Enron stock simultaneously declined, the SPE could not satisfy its hedging obligation.

These manipulations thrived because of a tangled web of conflicts of interest: senior Enron executives, most notably Andrew Fastow, served as the SPEs' principals, receiving such massive amounts of compensation and returns as to skew their loyalty in favor of the SPEs.[15] These and other senior Enron executives also seemed to have a somewhat casual approach

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[9] LTCM was engaged in making highly leveraged bets on the historical interest rate spread between risky bonds and US Treasury securities; but it lost these bets when, as a result of the implosion of Russia's financial markets, investors fled high-risk investments for the safety of US Treasurys. [•cite]

[10] *Cf.* Powers Report at 125 (noting that Enron unwound the Raptor transactions because, under its guaranties, it would have to "deliver so many shares of its stock to the Raptors that its reported earnings per share would be diluted significantly").

[11] *See* Powers Report at 41-42, 49-50, 52 (observing that the financing structure Enron created for the Chewco SPE was at least 50% short of the required third-party equity need for non-consolidation because a portion of such equity was protected by reserve accounts funded by Enron; and expressing uncertainty whether this "failure to qualify for non-consolidation resulted from bad judgment or negligence, or whether it was caused by Enron employees putting their own economic or personal interests ahead of their obligations to Enron"). *See also* Powers Report at 83-84 (noting that the Andersen accounting firm admitted that it made an error in computing the outside equity of the SPE in the Rhythms transaction).

[12] In some cases, such as the Raptor transactions, Enron itself decided to unwind the SPE structures (thereby triggering the consolidation) in order to avoid diluting its stock. Powers Report at 125.

[13] Powers Report at 77, 79.

[14] Powers Report at 78, 80.

[15] Powers Report at 41, 60, 77, 102. These Enron executives also may have received financial windfalls in connection with the termination of SPEs. *Id.* at 60-61. For example, the unwinding of the Rhythms transaction (with respect to which "Enron did not seek or obtain a fairness opinion") "resulted in a huge windfall" to that SPE, and thus to the Enron executives associated with it. *Id.* at 89.

towards compliance with Enron's Code of Conduct. The required Board approval of these types of conflicts[16] was rarely obtained or even sought.[17]

These abuses have given rise to a host of troublesome and confusing issues. The central accounting issue, for example, is whether the incestuous hedging substantively transferred economic risk. The answer isn't black and white, as the Powers Report sometimes appears to suggest.[18] Enron's attempt to use the "embedded" value of its own stock, increases in which could not be reflected on its balance sheet under generally accepted accounting principles, is ingenious because the stock *does* create real value for the hedging entities. Indeed, Enron even obtained independent fairness opinions on at least some of these transactions.[19] In perspective, therefore, Enron and its accountants were making exquisitely fine judgment calls – shades of grey that, for accounting, must be rendered as black or white.[20] Although Enron, in retrospect, may have misjudged, the culpability of its actions must be assessed ex ante, not ex post.

Certainly Enron can, and as we learn more will continue to, teach us many lessons. Because humans are fallible, mistakes are inevitable; and conflicts of interest make them more likely, especially where there are judgment calls. In this context, Enron illustrates that even extensive controls cannot always moderate the effect of these conflicts.[21] Indeed, the Powers

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[16] Enron's Code of Conduct provided, in relevant part, that no officer or employee should "[o]wn an interest in or participate, directly or indirectly, in the profits of any other entity which does business with … the Company, unless such ownership has been previously disclosed in writing to the Chairman of the Board and Chief Executive Officer of Enron Corp. and such officer has determined that such interest or participation does not adversely affect the best interests of the Company." Powers Report at 44 n. 8.

[17] Neither Fastow nor other participating Enron employees appeared to seek or obtain Board permission for the conflict in the Chewco transaction, for example. Powers Report at 41. However Fastow did obtain appropriate permission for his participation as general partner in the LJM SPEs, based on the understanding that transactions between Enron and those SPEs be subject to approval by Enron's Chief Accounting Officer and Chief Risk Officer and also be annually reviewed by Enron's Audit and Compliance Committee . *Id.* at 68-69, 71, 154. These controls, however, if implemented, "did not accomplish their intended purpose." *Id.* at 150.

[18] Although the Powers Report states, at 14, that these "'hedging' transactions did not involve substantive transfers of economic risk" and, later at 129, that "[p]roper financial accounting does not permit" such hedges," it perhaps inconsistently observes at 83 that such hedges merely raise "substantial accounting questions."

[19] *See, e.g.,* Powers Report at 79, 81, referring to PriceWaterhouseCoopers fairness opinion (regarding exchange of the Enron shares for the SPE-put and note) on the Rhythms transaction.

[20] For example, a central question was whether Fastow's position as general partner of the SPEs constituted, for accounting purposes, sufficient "control" by Enron to require the SPEs to be consolidated with Enron, even though the SPE partnership agreements permitted the limited partners to remove Fastow as general partner. The Powers Report admits, in these circumstances, that "the criteria for determining control with respect to general partners are subjective [and that there are] substantial questions whether Fastow was in effective control." Powers Report at 75-76.

[21] As discussed, *supra* note XX, Enron's controls failed completely.

Report notes that "a conflict … that could be managed only through so many controls and procedures should not have been approved in the first place,[22] later explaining that

> perhaps the most basic reason that controls failed was structural. Most of the controls were based on a model in which Enron's business units were in full command of transactions and had the time *and* motivation to find the highest price for assets they were selling. In some cases, transactions were consistent with this model, but in many of the transactions the assumptions underlying this model did not apply.[23]

These concerns over conflicts have not been limited to Enron; they arguably extend to its accountants, whose auditing judgments allegedly were biased by their lucrative consulting business with Enron.[24] It is therefore a very positive step that accounting firms are now, in response to Enron, beginning to separate their consulting from their auditing businesses.[25] Another lesson is the importance of taking corporate codes of conduct seriously and thinking through their implementation.

Other lessons are less obvious. For example, accounting standards originated at a time when manufacturing was the corporate paradigm, but financial services is increasingly the paradigm. Although the Financial Accounting Standards Board, which promulgates these standards, has attempted to keep up,[26] there certainly should be a critical re-examination of standards from this new perspective.

Enron's potential abuse of SPEs also raises fundamental questions about the legitimacy of the trillions of dollars of non-Enron structured finance transactions, of which securitization transactions[27] constitute the bulk.[28] What, if anything, differentiates Enron's abuse from these other transactions? This inquiry is important because the absence of meaningful differences would call all these transactions into question.[29] On the other hand, the presence of meaningful

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[22] Powers Report at 156.

[23] Powers Report at 171.

[24] [•cite]

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[26] [•Cite to materials from FASB's website, www.FASB.org.]

[27] For an introduction to these transactions, *see* Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STANFORD J. L. BUS. & FIN. 133 (1994); for a more complete analysis, *see* STEVEN L. SCHWARCZ, STRUCTURED FINANCE, A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION (3d. ed. 2002) (hereinafter "STRUCTURED FINANCE").

[28] *See, e.g.,* Diana B. Henriques, *The Brick Stood Up Before. But Now?*, N.Y. TIMES, Mar. 10, 2002, at B_ (referring to SPEs used in securitization transactions as "the most common special-purpose entities"). *See also* STRUCTURED FINANCE § 1:1, at 1-2 n, 2 (discussing the relationship between structured finance and securitization).

[29] *See* Henriques, *The Brick Stood Up Before. But Now?, supra* note XX: "The same financial tools used to create asset-backed securities were also used to construct the elaborately camouflaged and booby-trapped partnerships that have been blamed for Enron's collapse. … Consequently, whatever courts, regulators, lawmakers, accountants and investors decide about the permissible uses of special-purpose entities could have far-reaching and unintended consequences

differences may inform regulatory schemes, perhaps providing a basis to distinguish structured finance transactions that should be allowed from those that should be restricted.

Securitization is normally a way for a company to obtain lower-cost-financing through disintermediation, or removal of intermediaries such as bank lenders between the company and the ultimate source of funds, the capital markets.[30] This avoids the mark-up charged by a middleman of funds, and also enables the company to raise funds cheaply based on an allocation of risks that are assessed by parties having the most expertise.[31] This is markedly different from Enron's mere balance-sheet manipulation.

To the limited extent securitization is done solely for off-balance sheet purposes, it superficially looks more like Enron. But even then there are at least two critical differences.[32] In Enron, the structured transactions had dubious economic value given the high risk that Enron's stock price and asset values could both fall (as they did). But in securitization deals, the financial assets – in the form of receivables – are selected precisely because of their reliable valuation.[33]

The second, and even more basic, difference arises from the effect on disclosure of the conflicts of interest that pervaded Enron's SPE structures. Although the existence

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for Wall Street's highly profitable structured-finance business. And that, in turn, will affect the companies that rely on structured finance to solve legitimate credit and cash-flow problems."

[30] The capital markets are "markets where capital funds—debt and equity—are traded. Included are private placement sources of debt and equity as well as organized markets and exchanges." JOHN DOWNES & JORDAN GOODMAN, DICTIONARY OF FINANCE AND INVESTMENT TERMS 59 (3d ed. 1991). For an introduction to how the disintermediation is implemented, *see* STRUCTURED FINANCE § 1:1.

[31] *Cf.* STRUCTURED FINANCE Appendix A: Is Securitization a Zero-Sum Game? (explaining the economic rationale for securitization).

[32] Arguably, there is also a third difference: that securitization deals, unlike the transactions in Enron, shift actual risk from the company originating the deal to third-party investors. *See* Henriques, *The Brick Stood Up Before. But Now?, supra* note XX (quoting law firm partner David Eisenberg that "securitization is about transferring risk to others – and Enron only appeared to be doing that, when in reality they were retaining the risk themselves"). This distinction, however, is somewhat debatable: although securitization deals do shift some risk, they always require the company originating the deal to retain sufficient first-loss risk on the transferred assets, usually in the form of "overcollateralization," to minimize the investor risk to an investment grade level. *See, e.g.,* Schwarcz, *The Alchemy of Asset Securitization, supra* note XX, at 141 (observing that "'overcollateralization' is needed to assure investors … that they will not suffer losses from delayed collections or defaults" on those assets). I am not suggesting there is anything misleading or inappropriate about the company retaining first-loss risk – it logically follows from the asymmetric information between the company (whose assets are being transferred) and investors – merely that it minimizes the significance of this third difference.

[33] STRUCTURED FINANCE § 2:1, at 2-1 ("[a]n essential element of securitization is that the receivables being sold consist of a payment stream as to which there is a reasonable predictability of payment").

of the SPEs was generally disclosed to Enron's investors,[34] the disclosure was ultimately inadequate.[35] This inadequacy itself may have two explanations, both relating to conflicts of interest. Under one explanation, the disclosure was intentionally minimized[36] in order to avoid disclosing the extent to which Fastow and other top Enron executives were enriching themselves by engaging in non-arm's length deals (through SPEs) detrimental to Enron.[37] To this extent, Enron simply represents fraud.

There is, however, another possible explanation that is more fundamental and also goes to the heart of Enron's governance: Enron's structured finance transactions were so highly complex that disclosure is *necessarily imperfect* – either oversimplifying the transactions, or providing detail and sophistication beyond the level of an ordinary investor in Enron's securities. Enron's investors therefore must, to some extent, rely on the business judgment of Enron's management in setting up these structures for Enron's benefit. The catch, however, was that such reliance failed because of the conflict; and indeed there is evidence that Fastow and the other conflicted Enron executives were either overruling or intimidating employees under them that felt the transactions were detrimental to Enron.[38]

This latter explanation may well raise broader issues for structured finance. Although securitization and other legitimate structured finance deals can be disclosed with sufficient depth and detail to adequately inform a sophisticated investor in the *SPE's securities*, such disclosure may sometimes go over the head of an ordinary investor in, for example, *equity securities of the company originating* the structured finance transaction; whereas a lower level of disclosure is likely to oversimplify the transaction. In these cases, ordinary investors must, to some extent, rely on the business judgment of the company's management in setting up the structured financing transactions for the

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[34] *See* Powers Report at 200-01: "[W]hile it has been widely reported that the related-party transactions connected to Fastow involved 'secret' partnerships and other SPEs, we believe that is not generally the case. … [T]he fact remains that the LJM partnerships, the Raptor entities, and transactions between Enron and those entities all were disclosed to some extent in Enron's public filings."

[35] *See* Powers Report at 197, contending that notwithstanding disclosures of the *existence* of the SPEs to Enron's investors, such disclosures "failed to achieve a fundamental objective: they did not communicate thes essence of the transactions in a sufficiently clear fashion to enable a reader of [Enron's] financial statements to understand what was going on." *Accord id.* at 17, 192.

[36] *See* Powers Report at 201, that notwithstanding disclosures of the *existence* of the SPEs to Enron's investors, the description of the transactions between the SPEs and Enron was minimized. As a result, such disclosures "failed to achieve a fundamental objective: they did not communicate thes essence of the transactions in a sufficiently clear fashion to enable a reader of [Enron's] financial statements to understand what was going on." *Id.* at 197; *accord id.* at 17, 192.

[37] *See supra* notes XX-XX and accompanying text (describing enrichment of these executives).

[38] Powers Report at 18, 21, 144, 166-67 (discussing allegations that Enron-CFO Fastow, on behalf of the LJM-SPEs, pressured Enron personnel to give favorable terms to such SPEs, even though such terms are not in the best interests of Enron shareholders).

company's benefit.[39] This reliance requires that management be free of material conflicts of interest stemming from structured financing transactions.[40]

In securitization transactions, management would indeed be expected to be free of material conflicts. These transactions typically involve two SPEs,[41] of which the first is wholly-owned by the company originating the deal[42] and managed by directors – who may include employees of the company originating the transaction.[43] In my experience, these directors receive compensation of $5-15,000 per year, hardly a material sum relative to corporate salaries. Even the Powers Report recognizes that it was the magnitude of the conflict that was most problematic in the Enron structured finance transactions.[44] The second SPE in a securitization transaction (which issues securities to capital market investors) is typically owned and managed completely independently of the company originating the deal,[45] so conflicts again should not arise.

These distinctions are important because they show that, to the extent Enron is a catalyst for the regulatory examination of structured financing transactions, the focus should be on preventing the material conflicts of interest that allowed, and indeed encouraged, the Enron abuses to thrive.[46]

Ultimately, however, perhaps the greatest danger of the Enron debacle is our possible overreaction – and consequent over-regulation. It's human nature to overreact to dramatic events, like air crashes or, in this case, a landmark bankruptcy. Enron does not, however, represent a systemic problem; the existence of fraud and bad judgment should not, in and of itself, be a basis to change the legal, financial, and accounting infrastructure of business that has – Enron aside – served us so well. Excessive safeguards can stifle business innovation. To remain competitive in a global economy, we must favor flexibility over rigidity, innovation over consistency – even at the risk of another Enron.

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[39] *But cf.* Henriques, *The Brick Stood Up Before. But Now?, supra* note XX, which quotes Prof. Ronald Gilson as emphasizing disclosure: "Companies that want to use complicated structured-financing techniques should be prepared to explain them completely [and] in plain English…." I am questioning, however, whether such disclosure is always practical, and am arguing that, even in cases where it is not, investors should be able to rely on the judgment of management so long as the structured financing creates no material management-conflicts of interest.

[40] [•examine how this ties to the business judgment rule and its conflict protocols]

[41] *See* STRUCTURED FINANCE § 3:2.2 (describing the so-called FINCO, or two-tier structure).

[42] *Id.* at 3-14

[43] *Id.* at 3-3.

[44] Powers Report at 148.

[45] *Id.* at 3-15.

[46] Indeed, the Powers Report itself concludes, at 9, that the arrangement under which Fastow participated in the Enron SPEs notwithstanding the conflict of interest was "fundamentally flawed."

107TH CONGRESS
1ST SESSION

S. 420

AN ACT

To amend title 11, United States Code, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Bankruptcy Reform Act of 2001".

clearing organization or contract market or in a resolution of the governing board thereof, and a right, whether or not in writing, arising under common law, under law merchant, or by reason of normal business practice.''.

SEC. 912. ASSET-BACKED SECURITIZATIONS.

Section 541 of title 11, United States Code, is amended—

(1) in subsection (b), by inserting after paragraph (7), as added by this Act, the following:

''(8) any eligible asset (or proceeds thereof), to the extent that such eligible asset was transferred by the debtor, before the date of commencement of the case, to an eligible entity in connection with an asset-backed securitization, except to the extent such asset (or proceeds or value thereof) may be recovered by the trustee under section 550 by virtue of avoidance under section 548(a);''; and

(2) by adding at the end the following new subsection:

''(f) For purposes of this section—

''(1) the term 'asset-backed securitization' means a transaction in which eligible assets transferred to an eligible entity are used as the source of payment on securities, including, without limitation, all securities issued by governmental units, at least one class or tranche of which was rated investment grade by one or more nationally recognized securities rating organizations, when the securities were initially issued by an issuer;

“(2) the term ‘eligible asset’ means—

“(A) financial assets (including interests therein and proceeds thereof), either fixed or revolving, whether or not the same are in existence as of the date of the transfer, including residential and commercial mortgage loans, consumer receivables, trade receivables, assets of governmental units, including payment obligations relating to taxes, receipts, fines, tickets, and other sources of revenue, and lease receivables, that, by their terms, convert into cash within a finite time period, plus any residual interest in property subject to receivables included in such financial assets plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders;

“(B) cash; and

"(C) securities, including without limitation, all securities issued by governmental units;

"(3) the term 'eligible entity' means—

"(A) an issuer; or

"(B) a trust, corporation, partnership, governmental unit, limited liability company (including a single member limited liability company), or other entity engaged exclusively in the business of acquiring and transferring eligible assets directly or indirectly to an issuer and taking actions ancillary thereto;

"(4) the term 'issuer' means a trust, corporation, partnership, governmental unit, limited liability company (including a single member limited liability company), or other entity engaged exclusively in the business of acquiring and holding eligible assets, issuing securities backed by eligible assets, and taking actions ancillary thereto; and

"(5) the term 'transferred' means the debtor, under a written agreement, represented and warranted that eligible assets were sold, contributed, or otherwise conveyed with the intention of removing them from the estate of the debtor pursuant to subsection (b)(8) (whether or not reference is made to this title or any section hereof), irrespective and without limitation of—

"(A) whether the debtor directly or indirectly obtained or held an interest in the issuer or in any securities issued by the issuer;

"(B) whether the debtor had an obligation to repurchase or to service or supervise the servicing of all or any portion of such eligible assets; or

"(C) the characterization of such sale, contribution, or other conveyance for tax, accounting, regulatory reporting, or other purposes.".

SEC. 913. EFFECTIVE DATE; APPLICATION OF AMENDMENTS.

(a) EFFECTIVE DATE.—This title shall take effect on the date of enactment of this Act.

(b) APPLICATION OF AMENDMENTS.—The amendments made by this title shall apply with respect to cases commenced or appointments made under any Federal or State law on or after the date of enactment of this Act, but shall not apply with respect to cases commenced or appointments made under any Federal or State law before the date of enactment of this Act.

(c) EFFECTIVE DATE.—The final regulations promulgated under subsection (a) shall take effect on the date of publication of the final regulations.

Passed the Senate March 15, 2001.

Attest:

Secretary.

January 28, 2002

Senator Patrick Leahy
433 Russell Senate Office Bldg.
United States Senate
Washington, DC 20510

Congressman F. James Sensenbrenner
2332 Rayburn House Office Building
Washington, D.C. 20515-4909

Dear Chairman Leahy and Chairman Sensenbrenner:

We are law professors who teach in the area of bankruptcy, commercial and related business law. We write to you as the Chairmen of the Senate Delegation and the House of Representatives Delegation to the Conference Committee on S. 420/H.R. 333. We call your attention to § 912 of both bills. This section is intended to facilitate securitization of certain financial assets. It would accomplish that goal, but at potentially significant cost to the financial transparency required for efficient functioning of securities markets and for effective investor protection. In short, § 912 will be good for the securitization industry specifically, but bad for securities markets generally. We urge you to oppose it.

Section 912 provides a bankruptcy safe harbor for asset sales to securitization vehicles, regardless of whether the so-called buyer retains recourse against the seller. For reasons discussed below, this will make it easier for corporations to move debt off their balance sheets and to create secret liens. Section 912 will allow corporations to disguise borrowing transactions, secured by receivables, as sales of assets, to the detriment of both creditors and equity investors.

Under current law, the Securities and Exchange Commission, public accountants and judges enforce the accurate depiction of transactions as secured loans or as sales. The *Enron* case makes it clear that this line can be manipulated, even under current law. Far from remedying the existing problem, § 912 will prohibit judicial policing of the sale/secured loan distinction in securitization transactions, and will knock one leg out from under a three-legged stool that is already wobbling. As such, § 912 will make it more difficult for investors to accurately assess the riskiness of investments in companies that securitize assets.

Securitization Described:

Under current law (even after the Bankruptcy Court decision in the *LTV* case)[1] the securitization market continues to boom. The structure of a securitization is simple. Instead of entering into a secured financing, a company that wishes to raise money (the "Originator"), sells assets to a separate entity, or special purpose vehicle ("SPV"), that exists solely for the purpose of buying assets from the Originator and issuing securities backed by those assets (known as "asset-backed securities" or "ABS"). The assets conveyed can take many forms: they may be mortgage loans, credit card receivables, lease receivables, or the accounts receivable of the Originator (collectively, the "Assets"). The principal attraction of securitization derives from the fact that the Originator can raise money more economically by securitizing the Assets than it can by borrowing against them. This cost advantage derives from two distinct characteristics of securitization. Securitization enhances the liquidity of asset-backed securities, by making them available in smaller denominations to non-specialized investors. This benefit does not come without costs, however. Because securitizations are structured as sales rather than loans, the

Assets, once sold, are removed from the potential bankruptcy estate of the Originator. This can, depending on the adequacy of consideration and how the proceeds are used, shift risk from investors in the securitized assets to the other creditors and equity owners of the Originator. This effect is well described in the separate letter previously submitted by Professors Janger, Lawless, Lopucki, Lupica, Warren, Westbrook and others, dated January 23, 2002, with which we agree.

Section 912 is troubling, however, even if one is not troubled by securitization generally. Section 912, if enacted, will allow the Originator to accomplish this risk alteration in secret. Section 912 will thus make the Originator's finances in general, and many of its financing transactions, less transparent, thereby undercutting the effectiveness of the financial disclosure laws so necessary to the smooth functioning of securities markets.

True Sales, Disguised Loans, Unperfected Security Interests and Financial Transparency

As the recent *Enron* debacle makes clear, a sale of Assets to an SPV can be used to move debt off the Originator's balance sheet. Under current accounting rules, so long as a small portion of the SPV's capitalization derives from sources unrelated to the Originator, the debt of the SPV is not treated as debt of the Originator. Similarly, because the sale of Assets to the SPV is booked as a sale, rather than a loan, no debt appears on the Originator's balance sheet either. In *Enron*, the concealment of business risks in two off-balance sheet special purpose entities caused a publicly traded company to fool its auditors and misstate shareholder equity by $1.2 billion.

Under current law, this pernicious effect of securitization is held in partial check by the centuries old distinction between "true sales" and "disguised secured loans," often known as "sales intended as security." To obtain the financial benefits of ownership, the purchaser must also accept the risks of ownership. Many securitizations, however, are sales in name only. They are structured so that the SPV gains all of the benefits of ownership but bears none of the risk. A common feature of securitization deals is that the SPV will have a "put" option with regard to the purchased Assets. If the value of the Assets falls below an agreed price, the Originator must buy them back for that price. Such a transaction is nothing more than a "disguised loan." Notwithstanding the "sale" of the Assets, the Originator retains the risks of ownership. Under current law, the disguised loan is recognized for what it is, and treated as a secured loan. Securitizations which are, in truth, disguised loans are not given effect.

Section 912 would do away with this crucial distinction between sales and disguised secured loans. Eliminating this distinction will allow the Originator to both retain undisclosed risk relating to assets that it has apparently sold, and to create enforceable secret liens on assets that it would, by all outward appearances, still own.

- First, § 912 makes it absolutely clear that a "sale" can be subject to a "put" option that leaves the risks of ownership on the Originator, and the "sale" will be treated as a "true sale" – regardless of whether it would be treated as such under applicable state law (including Article 9 of the Uniform Commercial Code), accounting rules, disclosure rules, or by the IRS. Thus, § 912 will allow Originators to sell Assets, but retain undisclosed risks of ownership.

- Second, and as if this were not enough, § 912 also allows the Originator to retain assets on its balance sheet, while conveying away all the benefits of ownership. In order to be treated as a sale, there need only be a private written agreement with the SPV ("eligible entity" in the language of § 912), saying that the assets are *intended* to be removed from the Originator's bankruptcy estate. Under current state law, this "agreement" would create a secret lien that would be treated as an unperfected security interest and be invalidated in bankruptcy. Because § 912 treats such a transaction as a sale, and also cuts off the power of the Originator's bankruptcy trustee to avoid unperfected security interests under 11 U.S.C. §544, such an "agreement" would, be even better than a perfected security interest or properly perfected sale of financial assets; it would not only remove the Asset from the Originator's bankruptcy estate entirely, it would do so in secret.

These are just a few of the ways in which § 912 will make the finances of public companies less transparent.

Rating of Securities Issued by the SPV Does Not Protect Investors in the Originator

Section 912 confers its extraordinary favors only upon transactions where one tranche of the securities issued by the SPV are rated by private rating agencies (to which the bill refers by the term used in the Securities and Exchange Commission's regulations, "nationally recognized statistical rating organizations," or "NRSROs") as investment grade. There are two reasons why rating agency scrutiny does not solve the transparency problem created by §912.

- First, rating agencies, charged with rating the asset backed securities, do not ask the same questions as an attorney or judge, charged with evaluating whether a transaction is a loan or a sale. Rating agencies look only at the finances of the SPV, and whether the Assets conveyed to the SPV, together with other credit enhancements included in the securitization, are sufficient to merit a particular rating. By contrast, the issue of whether an asset transfer is a sale or a collateral transfer in connection with a secured loan has a huge impact on the finances of the Originator. The resolution of this issue requires the answer to a number of questions. Is securitization being used to hide liabilities that should be carried on the books of the Originator as debt? Is the securitization being used to shift assets away from the Originator? Is the securitization being used to manipulate financial ratios? Legal opinion writers and judges must look at the substance of the transaction and its effect on the finances of the Originator to determine the nature of the asset transfer. The benefits of this scrutiny redound to the creditors of and investors in the Originator. Rating agency scrutiny of the asset backed securities, by contrast, does nothing to encourage transparent reporting of the finances of the Originator.

- Second, the rating agencies, unlike judges, are unaccountable. Rating agencies have virtually no responsibility to anyone but their shareholders and their clients. The SEC recognizes particular rating agencies as being NRSROs, but a rating agency that has been so recognized is not thereafter subject to material oversight. When sued by investors who assert that they were misled by faulty ratings, rating agencies have successfully invoked First Amendment and asserted that they are mere publishers of opinion. Yet rating agencies are subject to a fundamental conflict of interest. They receive their compensation from the issuers of the rated securities, not from the investors who rely on the ratings they issue. Moreover, the NRSROs are virtually immune from market discipline, consisting of only four entities, of which two (Moody's and Standard & Poor's) dominate the market. Barriers to entry by competitors have proven insurmountable since the NRSRO concept was added to the SEC's regulations in 1973.

Concerns have often been voiced in Congress, in the financial community and among academics that rating agencies are too powerful and too unaccountable. Section 912, far from checking that power, enhances it.

Conclusion

In conclusion, it is risk concealment, not just risk reallocation that makes §912 particularly dangerous, and which benefits the securitization industry at the expense of the securities markets. The sale/secured loan distinction encourages Originators to disclose the true nature of their financing transactions. Proper disclosure of risks encourages investor confidence in the securities markets. By contrast, a statute that allows companies to misdescribe what they own and what they owe increases the risk of more *Enron* like scandals, and poses a danger to investor confidence generally.

If we can help in any way, please feel free to call on us.

Yours truly,

Edward J. Janger
Associate Professor
Brooklyn Law School

Kenneth C. Kettering
Associate Professor
New York Law School

Jonathan Lipson
Assistant Professor University of Baltimore School of Law

Lois R. Lupica
Professor of Law
University of Maine School of Law

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[1]In that case, a Bankruptcy Court allowed a debtor to use securitized assets during the early stages of a Chapter 11 case. *See* LTV Steel Co., Inc. 2001 Bankr. LEXIS 131 (2001).

CONFIDENTIAL

PRIVATE PLACEMENT MEMORANDUM

LJM2 Co-Investment, L.P.

Merrill Lynch & Co.

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LJM2 CO-INVESTMENT, L.P.
$200,000,000
Limited Partnership Interests

This Private Placement Memorandum ("Memorandum") is being furnished to prospective investors on a confidential basis in order that such prospective investors may consider an investment in limited partner interests (the "Interests") in LJM2 Co-Investment, L.P., a Delaware limited partnership ("LJM2" or the "Partnership"), and may not be used for any other purpose. Each potential investor, by accepting delivery of this Memorandum, agrees not to make a photocopy or other copy or to divulge the contents hereof to any other person other than a legal, business, investment, or tax advisor in connection with obtaining the advice of such person with respect to this offering.

The Interests are being offered in a private placement to a limited number of accredited investors and will not be registered under the Securities Act of 1933, as amended (the "Securities Act"), or any state securities laws. Accordingly, unless a disposition is exempt from the registration requirements of such laws, the Interests must be held until the Partnership is liquidated. In addition, the transferability of the Interests will be restricted by the Amended and Restated Limited Partnership Agreement of the Partnership (the "Partnership Agreement").

This Memorandum is intended to present, among other things, a general outline of the objectives and structure of the Partnership. The Partnership Agreement, which specifies the rights and obligations of the partners, should be reviewed thoroughly by each prospective investor. The summary of certain provisions of the Partnership Agreement contained herein is necessarily incomplete and is qualified by reference to such Partnership Agreement. Copies of the Partnership Agreement and other relevant material will be made available to prospective investors upon request.

In making an investment decision, investors must rely on their own examination of the Partnership and the terms of the offering, including the merits and risks involved. Each prospective investor or its representative may request copies of such documents, ask questions, and obtain additional information reasonably necessary to verify the accuracy of the information contained in this Memorandum. Except as provided herein, no person has been authorized in connection with this offering to give any information or to make any representations other than as contained in this Memorandum.

The Interests have not been approved or disapproved by the Securities and Exchange Commission ("SEC") or any state securities commission, and neither the SEC nor any state securities commission has passed upon the accuracy or adequacy of this Memorandum. Any representation to the contrary is a criminal offense.

Merrill Lynch & Co.

Investment in the Interests described herein will involve significant risks, including those described in the section titled "Risk Factors" below. Investors should have the financial ability and willingness to accept the risks and lack of liquidity which are characteristic of the investment described herein.

Prospective investors are not to construe the contents of this Memorandum as legal, investment, business, or tax advice. Each investor should consult its own counsel, accountant, and other advisors as to legal, investment, business, tax, and related aspects of a purchase of the Interests offered hereby. The Partnership is not making any representations to any offeree or purchaser of the Interests regarding the legality of an investment therein by such offeree or purchaser under appropriate legal investment or similar laws.

The Partnership reserves the right to withdraw this offering of the Interests at any time and the Partnership and LJM2 Capital Partners, LLC, a Delaware limited liability company that is the general partner of the Partnership (the "General Partner"), reserve the right to reject any commitment to subscribe for the Interests in whole or in part and to allot to any prospective investor less than the full amount of the Interests sought by such investor. The General Partner and certain related persons may acquire for their own account a portion of the Interests.

This Memorandum does not constitute an offer to sell, or a solicitation of an offer to buy, any Interests in any jurisdiction where, or to or from any person to or from whom, such offer or solicitation is unlawful or not authorized.

None of Enron Corp., an Oregon corporation ("Enron"), and its subsidiaries has issued, or guaranteed any payments with respect to, the Interests, and none of Enron and its subsidiaries is responsible for the financial or other performance of the Partnership.

This Memorandum includes or incorporates by reference forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts included in this Memorandum, including, without limitation, statements regarding the Partnership's future financial position, business strategy, and plans and objectives, including the ability of the Partnership to participate in investment opportunities generated by Enron and its subsidiaries, are forward-looking statements. Important factors that could cause actual results to differ materially from those anticipated by the Partnership include the willingness of Enron to permit the Partnership to participate in investment opportunities generated by Enron and its subsidiaries, the success of the Partnership in identifying other investment opportunities, the ability of the Partnership to participate in such investments on terms acceptable to the Partnership, and the actual performance of the investments in which the Partnership participates. Although the Partnership believes its expectations are reasonable, it can give no assurance that its investment objectives will be achieved.

No person has been authorized to give any information or to make any representation concerning the Partnership or the offer of the Interests other than the information contained in this Memorandum, and, if given or made, such information or representation must not be relied upon as having been authorized by the Partnership, the General Partner, or Merrill Lynch & Co. The information contained in this Memorandum has been compiled as of October 13, 1999 (except as otherwise stated herein). Certain information presented herein about Enron has been compiled from publicly available sources. Enron has not prepared this Memorandum and Enron has not approved or endorsed the contents of this Memorandum. Neither the delivery of this Memorandum at any time, nor any sale hereunder, shall under any circumstances create an implication that the information contained herein is correct as of any time subsequent to such date, and none of the Partnership, the General Partner, and Merrill Lynch & Co. undertakes an obligation to update or revise the information contained in this Memorandum, whether as a result of new information, future events or otherwise. The information is from sources believed to be reliable, but none of the Partnership, Merrill Lynch & Co., and any other person has independently verified the information contained herein.

Merrill Lynch, Pierce, Fenner & Smith Incorporated has been engaged as placement agent in connection with the formation of the Partnership and may use its affiliates to assist in its placing activities. Reference in this Memorandum to "Merrill Lynch & Co." shall be deemed to include Merrill Lynch, Pierce, Fenner & Smith Incorporated and, where the context so permits, its affiliates that assist in its placing activities.

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I. EXECUTIVE SUMMARY

Introduction

LJM2 Co-Investment, L.P., a Delaware limited partnership ("LJM2" or the "Partnership"), is being organized by Andrew S. Fastow, Executive Vice President and Chief Financial Officer of Enron Corp., an Oregon corporation ("Enron"), to make privately negotiated equity and equity-related investments in energy- and communications-related businesses and assets. The Partnership expects that Enron will be the Partnership's primary source of investment opportunities and that the Partnership will (i) co-invest with Enron or its subsidiaries in new investments in, or acquisitions of, businesses and assets, and (ii) make investments in, or acquire an investment interest from Enron or its subsidiaries relating to, existing assets or businesses owned by Enron or its subsidiaries. It is expected that in connection with the foregoing investments, Enron will retain a significant economic or operating interest in the businesses or assets in which the Partnership invests. The Partnership may also from time to time make investments in businesses or assets where Enron has no involvement. This is the second such fund formed by Mr. Fastow targeted at investing primarily in companies owned or controlled by Enron. The Partnership's objective is to generate an annualized internal rate of return ("IRR") in excess of 30% to investors in the Partnership after payment of all Partnership fees and expenses and payment of the carried interest to the General Partner.

Enron, headquartered in Houston, Texas, is one of the largest sellers of natural gas and electricity in deregulated and privatized markets on three continents. Additionally, Enron is the largest provider of energy risk management services in the world and owns the largest natural gas pipeline system in the U.S. Enron is also constructing a 10,000 mile nationwide fiber-optic telecommunications network. Enron is frequently characterized as the agent of change in the rapidly deregulating and privatizing energy markets and has been named the "Most Innovative Company in the World" for four consecutive years by *Fortune*. Enron currently ranks among the Fortune 100 companies with annual revenues of over $30 billion. Importantly, Enron has made investments of over $7 billion in each of the last two years in a variety of energy-related businesses and currently owns merchant investments of over $10 billion. *See* - "Overview of Enron." Under Mr. Fastow's management, the Partnership expects to have the opportunity to co-invest with Enron in many of Enron's new investment activities and the opportunity to acquire existing Enron assets on a highly selective basis. This access to deal flow should provide the Partnership with unusually attractive investment opportunities.

The target size of the Partnership is $200 million. The General Partner reserves the right to accept additional commitments in excess of $200 million. The Partnership is expected to generate significant co-investment opportunities for investors in the Partnership because the Partnership will be limited to investing no more than 10% of its committed capital in any one company, and the General Partner expects many of the opportunities the Partnership pursues to require capital in excess of the amount the Partnership is able to provide under this diversification limitation. Co-investment amounts will not be subject to a carried interest.

The General Partner of the Partnership will be LJM2 Capital Partners, LLC, a Delaware limited liability company (the "General Partner"), an entity owned and controlled by one or more of the Principals (as defined below). The Partnership will be managed on a day-to-day basis by a team of three investment professionals who all currently have senior level finance positions with Enron: Andrew S. Fastow, Michael J. Kopper, and Ben Glisan, Jr. (collectively, the "Principals"). The Principals will continue their current responsibilities with Enron while managing the day-to-day operations of the Partnership. *See* – "Risk Factors – Dependence on Key Personnel" and "Conflicts of Interest – Dual Role of Principals."

Investment Opportunity

The Principals believe that LJM2 provides investors with an unusually attractive investment opportunity for the following reasons:

Access to Significant Proprietary Deal Flow. Enron has extensive deal origination capability that is derived from approximately 2,000 fully dedicated Enron-employed origination and monitoring professionals located around the world. The deal flow emanating from this origination infrastructure has resulted in Enron making over $7 billion of energy-related investments in each of the last two years and holding merchant investments of over $10 billion. As a result of Enron's in-house deal sourcing capability as well as its leading market position in most businesses in which it operates, Enron frequently has access to investment opportunities that are not available to other investors. The Partnership expects to benefit from having the opportunity to invest in Enron-generated investment opportunities that would not be available otherwise to outside investors.

Enron's Investment Record. Enron's record as a successful investor is reflected in returns it has generated for its shareholders as measured by the appreciation in its common stock, which, from January 1, 1990, through September 30, 1999, has increased 641% (price increase plus assumed re-investment of dividends), as compared to returns of 363% for the S&P 500 and 141% for the S&P Energy Index for the same period. Furthermore, Enron has successfully managed two institutionally funded private equity partnerships, Joint Energy Development Investments Limited Partnership ("JEDI I") and Joint Energy Development Investments II Limited Partnership ("JEDI II"), which have generated (or are estimated to generate, as the case may be) an IRR after payment of fees and expenses of the partnership and payment of a carried interest, if any, to the partnerships' general partners (each, a "Net IRR") of 23% and 194%, respectively, compared to targeted IRRs for the partnerships on invested capital before fees, expenses, and carried interest (a "Gross IRR") of 15% and 20%, respectively. The General Partner believes that a significant portion of this superior performance can be attributed to the quality of investment opportunities sourced by Enron. *See* – "Summary of Investment Experience."

Enron's Capabilities to Analyze and Structure Investments and Operate Assets. Over the years, Enron has developed a rigorous process of investment analysis, which employs approximately 130 professionals in varying disciplines such as engineering, research, credit, tax, legal, accounting, insurance, and risk analysis. As LJM2 expects that it primarily will be investing in assets in which Enron has an interest, it should benefit from Enron's expertise in all areas relating to the investment in and management of energy and communications assets, including the physical and financial risk management of energy assets and extensive operating capabilities in all aspects of the energy industry and certain aspects of the communications industry.

The Ability to Evaluate Investments with Full Knowledge of the Assets. Due to their active involvement in the investment activities of Enron, the Principals will be in an advantageous position to analyze potential investments for LJM2. The Principals, as senior financial officers of Enron, will typically be familiar with the investment opportunities LJM2 considers. The Principals believe that their access to Enron's information pertaining to potential investments will contribute to superior returns.

Speed and Knowledge Advantage of LJM2. LJM2 will be positioned to capitalize on Enron's need to rapidly access outside capital due to the Principals' familiarity with Enron's assets and their understanding of Enron's objectives, which should facilitate LJM2's ability to quickly execute transactions. This ability to act quickly is invaluable to Enron and should enhance the flow of opportunities for LJM2.

Investment and Financial Expertise of Principals. The Principals are a group of highly talented financial professionals with extensive experience originating and structuring complex transactions. This experience has given the Principals the ability to create innovative financial structures around investments, which should enhance returns to investors in LJM2. The Principals have been involved in managing JEDI I and JEDI II.

The Principals

The day-to-day activities of the Partnership will be managed by Messrs. Fastow, Kopper, and Glisan. Each of the Principals has spent a significant portion of his professional career in energy and communications investing, structured finance, and risk management (including substantial involvement in the organization, operation, and investment management of each of JEDI I and JEDI II), and, as a team, the Principals possess specific expertise necessary to maximize the Partnership's performance.

Andrew S. Fastow, Executive Vice President and Chief Financial Officer of Enron, has been the Chief Financial Officer of Enron since 1997; prior to that, he was a Managing Director and principal financial officer for Enron Capital & Trade Resources Corp. ("ECT"), Enron's principal merchant and investing subsidiary. In these capacities, he has been involved in structuring and managing many of Enron's investments. Mr. Fastow has been with Enron for nine years. Michael J. Kopper, Managing Director in Enron's Global Equity Markets Group, is responsible for Enron's Global Equity and Structured Finance businesses. He has been with Enron for five years. Ben Glisan, Jr., Vice President in Enron's Global Equity Markets Group, is primarily responsible for Enron's structured finance activity. Mr. Glisan has been with Enron for three years. Summary biographies of the Principals are included elsewhere in this Memorandum. *See* – "Management of the Partnership – Biographies of the Principals."

The Principals will remain employees of Enron and will devote such of their business time and attention as they deem reasonably necessary to manage the affairs of the Partnership, subject to their obligation to devote their business time and attention primarily to the discharge of their responsibilities as senior financial officers of Enron. The Partnership should also benefit indirectly from time spent by the Principals in evaluating and structuring investments for Enron, as many of these investments may become candidates for investment by the Partnership.

II. INVESTMENT STRATEGY

Investment Strategy

LJM2 believes that it will be uniquely positioned to capitalize on Enron's need for outside capital due to the Principals' familiarity with Enron's assets and their understanding of Enron's objectives and LJM2's ability to quickly execute transactions. This ability to act quickly is valuable to Enron and should result in a steady flow of opportunities for the Partnership to make investments at attractive prices. In order to fully capitalize on its advantages, LJM2 will seek to implement the following investment strategy:

> *Invest with Enron.* LJM2 expects that Enron will be LJM2's primary source of investment opportunities and that LJM2 will (i) co-invest with Enron or its subsidiaries in new investments in, or acquisitions of, businesses and assets, and (ii) make investments in, or acquire an investment interest from Enron or its subsidiaries relating to, existing assets or businesses owned by Enron or its subsidiaries. LJM2 may, however, make investments in businesses or assets where Enron has no involvement.
>
> *Invest in Assets and Businesses Where the Seller Retains an Ongoing Economic Interest.* LJM2 will typically require that the seller (expected to be Enron in most cases) retain a significant ongoing economic or operating interest in the assets. By requiring Enron to retain a significant economic or operating interest in its deals, LJM2 should ensure that it will have access to the significant resources of Enron in order to manage assets on an ongoing basis.
>
> *Capitalize on Financial Expertise.* Once a target investment has been identified, the Principals will seek to enhance the risk/return profile of such investment through the use of innovative transaction structures and will implement rigorous risk management techniques in order to seek to protect investments from downside risk.

LJM2 will typically seek to exit transactions either by negotiating co-sale rights or by securitizing and placing investments into the capital markets. LJM2 will typically have no hold restrictions and may also individually re-market an investment to industry and financial investors.

Rationale for Enron Providing Investment Opportunities to LJM2

Enron has been active in making investments over the past seven years. It is notable that, as of June 30, 1999, Enron had $34 billion of assets on its balance sheet, but was owner or manager of assets in excess of $51 billion (the difference between these numbers represents the amount of assets financed off-balance sheet, often through co-investment partnerships or joint ventures). When Enron acquires an investment, it may decide to reduce its operating and financial risk by selling a portion of its investment to co-investors; in many cases, it seeks to maintain an active or controlling role in the underlying investment.

The pace of sales of investments by Enron to co-investors has increased recently for three reasons. First, Enron's investment opportunities continue to accelerate. The global energy markets in which Enron is a leading participant exceed $1 trillion per year in revenues. The natural gas and electricity industries are among the most capital-intensive industries in the world. Enron, as one of the leaders in these industries on three continents, must invest significant amounts of capital in order to retain and enhance its leadership position. Enron has also recently entered the communications business, which has significant investment opportunities as well.

Second, Enron's growth capital is derived from the sale or partial sale of investments. To capitalize on its unique growth (as evidenced by its more than $10 billion in merchant investments and its ability to invest $7 billion a year for the past two years), Enron must have significant capital resources. Although investments in the natural gas, electricity, and communications industries may have very attractive rates of return, such investments often do not generate cash flow or earnings in the first several years. Lack of cash flow may restrict a company's ability to finance the investment with debt, and lack of current earnings may restrict a company's ability to issue public equity. By bringing in co-investors or by disposing of portions of investments, Enron can finance substantial growth and make investments while maintaining its investment grade credit rating, meeting current earnings expectations, and retaining desired financial and operating involvement in its investments.

Third, in addition to the equity return earned on its investments, a significant portion of Enron's earnings is derived from fees garnered from the physical marketing of commodities, price risk management (related to those commodities), and asset development and management. Notwithstanding that the initial investment is still generating significant returns, in order to invest in new, additional fee-generating assets, Enron may sell down investments.

As a result of Enron's substantial investment opportunities and because of its need to optimize its financial flexibility, the Principals expect that Enron will continue to seek co-investors or to dispose of portions of investments. The Partnership's strategy will be to capitalize on Enron's needs by being a value-added investor for Enron through the Partnership's ability to invest quickly and its ability to structure deals that match Enron's objectives.

Profiles of Selected Example Investments

Described below are three transactions that Enron either has completed or is in the process of completing and that are representative of the types of investments in which LJM2 might participate:

East Coast Power LLC – Co-investment with Enron. In February 1999, JEDI II (whose partners are Enron (or a subsidiary thereof) and California Public Employee Retirement System ("CalPERS")) formed East Coast Power LLC ("East Coast Power") in order to acquire assets from Cogen Technologies Group for a total of $1.5 billion. East Coast Power indirectly owns equity interests in three combined-cycle natural gas co-generation power plants in New Jersey. Each plant sells electricity to investor-owned utilities in New York or New Jersey pursuant to long-term power purchase agreements. The facilities have a combined nameplate capacity of 1,037 megawatts of electrical power production. By securitizing the power purchase agreements, Enron was able to reduce the equity capital required to finance the acquisition from 30% to 9% of total capitalization. This generated base case equity returns in excess of 20% compared to similar projects that typically generate returns in the low teens. In July 1999, JEDI II sold approximately 50% of its ownership interest in East Coast Power to a third party, generating a Gross IRR of 5048% for the portion of the investment sold. Messrs. Fastow and Kopper were involved in the structuring of this transaction.

Project Margaux - Investment in Existing Enron Assets. Enron is currently working on Project Margaux, a new structured finance transaction that monetizes the dividend streams of five European assets developed or acquired by Enron over the past 10 years. In this transaction, Margaux Holdings, a newly formed entity, is expected to acquire indirect equity interests in the five European assets from Enron. Project Margaux would be capitalized with approximately $525 million of high yield debt or bank debt and approximately $50 million of equity. Repayments of the high yield issuance or bank facility and a return to the equity investors will come from the distributions made by the individual projects to their equity owners.

Enron Energy Services - Investment in an Existing Enron Business. In 1997, Enron created a new business unit named Enron Energy Services ("EES"). Unlike Enron's existing businesses, which were selling energy products and services at the wholesale level, EES was developing a business model to sell products "around" the utility and directly to various end-users. While this market had been open previously on a limited basis, new legislation at the state levels was pending that would open much of the $300 billion market to competition. Mr. Fastow helped Enron obtain investments in EES by two pension funds totaling $165 million in exchange for 8.7% of the equity of EES. Based on these investments, the implied market value of EES at the time of the investment was $1.9 billion. Equity research analysts currently estimate the value of EES to be between $4 billion and $10 billion, which would generate an estimated Gross IRR of between 77% and 229% if the investors were to liquidate the investment at year-end 1999.

Dual Role Advantages

Mr. Fastow will continue to hold the titles and responsibilities of Executive Vice President and Chief Financial Officer of Enron, and Messrs. Kopper and Glisan will continue to serve as senior financial officers of Enron, while acting as the owners and managers of the General Partner. As a result, investors in the Partnership should benefit from Mr. Fastow's and the other Principals' dual roles which will facilitate the Partnership's access to Enron deal flow. The Principals' dual roles in managing the Partnership while remaining employed as senior financial officers of Enron, however, raise certain conflicts of interest that could affect the Partnership. *See* - "Conflicts of Interest."

III. INVESTMENT HIGHLIGHTS

The Principals believe that the Partnership represents an attractive investment opportunity for the following reasons:

Access to Significant Proprietary Deal Flow

Enron has extensive deal origination capability that is derived from approximately 2,000 fully dedicated Enron-employed origination and monitoring professionals located around the world. The deal flow emanating from this origination infrastructure has resulted in Enron making over $7 billion of energy-related investments in each of the last two years and holding merchant investments of over $10 billion.

Enron's leadership position in the markets in which it competes also creates proprietary investment opportunities for Enron. The global energy markets in which Enron is a leading participant exceed $1 trillion per year in revenues. The forces of deregulation and privatization are driving the restructuring of this enormous industry. As gas and electricity markets have opened up in the U.S. and internationally, Enron has consistently been or has become a market leader. In most deregulated markets in which it operates, Enron sells more gas and electricity than any of its competitors, including the incumbent utilities. This market leader position has led to unique and proprietary investment opportunities for Enron. Enron has recently entered the communications business, which has significant investment opportunities as well.

As a result of Enron's in-house deal sourcing capability as well as its leading market position in most businesses in which it operates, Enron frequently has access to investment opportunities that are not available to other investors. The Partnership expects to benefit from having the opportunity to invest in Enron-generated investment opportunities that would not be available otherwise to outside investors.

Enron's Investment Record

Enron's record as a successful investor is reflected in returns it has generated for its shareholders as measured by the appreciation in its common stock, which, from January 1, 1990, through September 30, 1999, has increased 641% (price increase plus assumed re-investment of dividends), as compared to returns of 363% for the S&P 500 and 141% for the S&P Energy Index for the same period. Furthermore, Enron has successfully managed two institutionally funded private equity partnerships, JEDI I and JEDI II, which have generated (or are estimated to generate, as the case may be) Net IRRs to outside investors of 23% and 194%, respectively, compared to targeted Gross IRRs of 15% and 20%, respectively. *See* – "Summary of Investment Experience."

Enron's Capabilities to Analyze and Structure Investments and Operate Assets

A key element of Enron's ability to create value has been its ability to structure and implement complex transactions. Over the years, Enron has developed a rigorous process of investment analysis, which employs approximately 130 professionals in varying disciplines such as engineering, research, credit, tax, legal, accounting, insurance, and risk analysis. This creative approach to structuring many of its investments has enabled Enron to mitigate downside risk, provide opportunities for early return of capital, enhance its returns, and provide additional upside opportunity. The Principals have been the key architects of many of these innovative structures and will employ such structures, where appropriate, for the benefit of investments made by LJM2. Since LJM2 expects that it primarily will be investing in assets in which Enron has an interest, it should benefit from Enron's expertise in all areas relating to the investment in and management of energy and communications assets, including the physical and financial risk management of energy assets and extensive operating capabilities in all aspects of the energy industry and certain aspects of the communications industry.

The Ability to Evaluate Investments with Full Knowledge of the Assets

Due to their active involvement in the investment activities of Enron, the Principals will be in an advantageous position to analyze potential investments for LJM2. The Principals, as senior financial officers of Enron, will typically be familiar with the investment opportunities the Partnership considers. The Principals believe that their access to Enron's information pertaining to potential investments will contribute to superior returns.

Speed and Knowledge Advantage of LJM2

LJM2 will be positioned to capitalize on Enron's need to rapidly access outside capital due to the Principals' familiarity with Enron's assets and their understanding of Enron's objectives. The Principals' positions at Enron should enable them to recognize investment opportunities early, to make decisions quickly, and to structure investments to meet LJM2's and Enron's objectives. This ability to act quickly is invaluable to Enron and should enhance the flow of opportunities for the Partnership.

Investment and Financial Expertise of Principals

The Principals are a group of highly talented financial professionals with extensive experience in originating and structuring complex transactions. This experience has given the Principals the ability to create innovative financial structures around investments, which should enhance returns to investors in LJM2. The Principals have been involved in managing both JEDI I and JEDI II.

IV. SUMMARY OF INVESTMENT EXPERIENCE

The Principals have extensive experience in originating, structuring, and executing complex transactions, and each has had extensive involvement in the organization, investment activity, and operations of JEDI I and JEDI II. The Principals believe that the performance information regarding JEDI I and JEDI II presented below will be useful to investors considering an investment in LJM2 because of the Principals' involvement in JEDI I's and JEDI II's investment activity, and because the investments made by those partnerships are indicative of some of the types of investment opportunities that will be available to LJM2. Prospective investors should note that past performance is not necessarily indicative of future results, and there can be no assurance that LJM2 will achieve comparable results. Prospective investors should also note that there are material differences between LJM2 and each of JEDI I and JEDI II, including overlapping but different investment mandates (JEDI I and JEDI II target co-investment with Enron in new energy investments, but cannot purchase existing investments from Enron) and different profit-sharing arrangements among the partners, which should be considered when evaluating the investment performance information presented below.

JEDI I was formed in 1993 with $500 million of capital commitments. Enron and CalPERS each contributed $250 million to JEDI I. Enron Capital Management, L.P., an affiliate of Enron, is the general partner of JEDI I. The investment guidelines for JEDI I were to achieve a Gross IRR of 15% by investing in new investments (primarily natural gas-related) made by Enron in the debt, equity-linked, and equity securities of energy companies located in the U.S. Using a combination of contributed capital, debt financing, and reinvestment of investment proceeds, JEDI I invested $2.1 billion in 63 separate transactions. Upon a sale of its interest in JEDI I in 1997, CalPERS realized $383 million on its $250 million of contributed capital, generating a Net IRR to CalPERS of 23%.

JEDI II was formed in 1997 with $1 billion of capital commitments. Enron and CalPERS each committed $500 million to JEDI II. Enron Capital Management II Limited Partnership, an affiliate of Enron, is the general partner of JEDI II. The investment guidelines for JEDI II are to achieve a Gross IRR of 20% by investing in new investments (energy-related) made by Enron in debt, equity-linked, and equity securities of energy companies located in the U.S. and internationally. Using a combination of contributed capital, debt financing, and reinvestment of investment proceeds, JEDI II has invested $810 million in 31 separate transactions to date. As of June 30, 1999, the partners of JEDI II had made capital contributions to JEDI II of $237.5 million. The Principals estimate that, if JEDI II's unrealized investments had been liquidated for their then fair value and JEDI II had been liquidated as of June 30, 1999, the unrealized value of CalPERS' $118.8 million of contributed capital would have been $214.7 million, generating a Net IRR to CalPERS of 194%.

The estimated value of JEDI II's investments is determined in accordance with the fair value accounting methodology. Generally, an investment's "fair value" is an estimate, based on a variety of factors, of the amount that may be realized currently upon an orderly disposition of such investment; under the fair value accounting methodology, the carrying value of investments is periodically increased or decreased to reflect changes in their fair value, even where no realization event has occurred. For publicly traded securities, fair value is based upon quoted market prices; for securities that are not publicly traded, fair value is determined based on other relevant factors, including dealer price quotations, price activity for comparable instruments, and valuation pricing models. "Fair value" is only an estimate of current value for an unrealized investment. The actual realized return on all unrealized investments will depend on the value of the investments at the time of disposition, any related transaction costs, and the manner of disposition. Accordingly, the actual realized returns on all unrealized investments may differ materially for the values indicated herein.

Summary of Investment Experience[a]
($ in millions, as of June 30, 1999)

Partnership	Year Established	Contributed Capital	Value: Realized	Value: Estimated Unrealized[b]	Value: Total	Net IRR[c]
JEDI I	1993	$250.0	$383.0	$0.0	$383.0	23%
JEDI II	1997	118.8	0.0	214.7	214.7	194%

[a]This table presents investment performance information for the outside investor in each of JEDI I and JEDI II. The amounts shown under the headings "Contributed Capital," "Realized," "Estimated Unrealized," "Total," and "Net IRR" represent the performance investment for such outside investor.

[b]Unrealized values are accounted for under the fair value accounting methodology. Generally, an investment's "fair value" is an estimate, based on a variety of factors, of the amount that may be realized currently upon an orderly disposition of such investment; under the fair value accounting methodology, the carrying value of investments is periodically increased or decreased to reflect changes in their fair value, even where no realization event has occurred. For publicly traded securities, fair value is based upon quoted market prices. For securities that are not publicly traded, fair value is determined based on other relevant factors, including dealer price quotations, price activity for comparable instruments, and valuation pricing models.

[c]The fees, expenses, and carried interests of JEDI I and JEDI II are different from the proposed terms of the Partnership.

V. MANAGEMENT OF THE PARTNERSHIP

Overview

The General Partner of the Partnership is LJM2 Capital Partners, LLC, a Delaware limited liability company owned by one or more of the Principals. The manager of the Partnership is LJM2 Capital Management, L.P., a Delaware limited partnership ("Manager"), and as such will manage the day-to-day affairs of the Partnership. The Manager is owned, directly and indirectly, by the Principals. Each of the Principals is and will remain an employee of Enron. Enron's Office of the Chairman has waived certain provisions of Enron's employee code of conduct to permit the Principals to form and operate the Partnership, and Enron's Board of Directors has ratified that waiver as it applies to Mr. Fastow. The Principals will devote such of their business time and attention as they deem reasonably necessary to manage the affairs of the Partnership, subject to their obligation to devote their business time and attention primarily to the discharge of their responsibilities as senior financial officers of Enron. The Partnership should also benefit indirectly from time spent by the Principals in evaluating and structuring investments for Enron, as many of these investments may become candidates for investment by the Partnership. The Principals also have plans to hire additional personnel to provide support services to the Partnership. Furthermore, the Manager will enter into a support services agreement with Enron, pursuant to which the Manager will receive and pay for certain support services from Enron. *See* – "Risk Factors – Dependence on Key Personnel."

Conflict of Interest

One of the most challenging due diligence issues for the Partnership is the potential for a conflict as a result of the Principals' dual positions as Enron employees and Principals of the Partnership. *See* – "Risk Factors – Dependence on Key Personnel" and "Conflicts of Interest – Dual Role of Principals." Several steps have been taken to assure that the conflict-of-interest issue is fully vetted and appropriate procedures are put in place to allow for operation of the Partnership in situations where conflicts arise. The Partnership will establish an Advisory Committee (as defined below) to provide for an independent review of decisions made by the General Partner in a situation where the General Partner believes a conflict of interest exists. In addition, Richard Causey, Executive Vice President and Chief Accounting Officer of Enron, will, in behalf of Enron, monitor and mediate conflict-of-interest issues between Enron and the Partnership.

Biographies of the Principals

The following are professional biographies of the Principals. Each of the Principals has spent a significant portion of his professional career in energy and communications investing, structured finance, and risk management, and, as a team, the Principals possess the specific expertise necessary to maximize the Partnership's performance.

Andrew S. Fastow

Andrew S. (Andy) Fastow, 37, is Executive Vice President and Chief Financial Officer of Enron, and, as such, is responsible for Enron's finance and treasury activity. Previously, Mr. Fastow was a Managing Director with ECT. He joined ECT in 1990 to develop the company's funding business and to obtain and manage the debt and equity capital required for ECT's third-party finance business as well as for ECT's physical and financial acquisitions and investments. During 1996, Mr. Fastow led the development of Enron's retail energy business. Mr. Fastow was named CFO of Enron in 1997 and Executive Vice President of Enron in 1999.

Mr. Fastow has been responsible for the formation and operation of three private equity partnerships while at Enron. Currently, Mr. Fastow owns the general partner of LJM Cayman, L.P., a Cayman Islands excepted limited partnership ("LJM1"), an investment partnership with total capital commitments of $16 million. LJM1 was formed in 1999 with objectives that are substantially similar to those of LJM2.

Prior to joining ECT, Mr. Fastow served as senior director in Continental Bank's Asset Securitization Group in Chicago, where he structured short- and medium-term asset backed securities for commercial banks, leasing companies, and corporate clients.

Mr. Fastow received a B.A. in Economics and Chinese from Tufts University and an M.B.A. in Finance from Kellogg Graduate School of Management at Northwestern University.

Michael J. Kopper

Michael J. Kopper, 34, is a Managing Director in Enron's Global Equity Markets Group. He also manages the general partner of Chewco, an investment fund with approximately $400 million in capital commitments that was established in 1997 to purchase from Enron an interest in a defined pool of Enron assets. Prior to his current position, Mr. Kopper was a Managing Director in Enron Capital Management (in its Structured Finance Group) arranging financing for electric power projects, oil and gas producers, other supply-side customers, and end-users such as local distribution companies and co-generation facilities.

Before joining Enron, Mr. Kopper was employed by Toronto Dominion Bank from 1991 to 1994. There he specialized in negotiating and structuring project financings. His client focus was primarily non-regulated subsidiaries of electric utility companies, independent power producers, and natural gas pipeline companies. Mr. Kopper specialized in off-balance sheet project and structured financings relying on the interrelationship of cash flows as an economic basis for investment. These investments included natural gas pipelines, natural gas storage fields, and electric co-generation facilities.

From 1988 to 1991, Mr. Kopper was at Chemical Bank where he assisted marketing officers and transaction officers in documenting and closing a variety of financings across a broad spectrum of clients. At Chemical Bank, he focused on non-recourse facilities and project financings in the energy and utility sectors.

Mr. Kopper received his B.A. in economics from Duke University and completed his graduate work in accounting and finance at the London School of Economics.

Ben Glisan, Jr.

Ben Glisan, Jr., 33, is a Vice President in Enron's Global Equity Markets Group. Prior to his current position, Mr. Glisan worked at Enron Capital Management in its Structured Finance Group. Mr. Glisan has worked at Enron, or an affiliate thereof, for the past three years. Mr. Glisan's responsibilities include leading transaction teams that execute highly complex non-recourse or limited recourse joint venture and asset-based financings.

Before joining Enron, Mr. Glisan worked at Coopers & Lybrand and Arthur Andersen. His responsibilities included providing accounting and finance services principally to financial institutions as well as helping to develop financing transaction structures.

Mr. Glisan received his B.B.A. and his M.B.A. from the University of Texas at Austin.

VI. OVERVIEW OF ENRON

Enron is one of the world's leading international integrated natural gas and electricity companies. Enron's activities are conducted through its subsidiaries and affiliates, which are principally engaged in the transportation of natural gas through pipelines to markets throughout the U.S.; the generation and transmission of electricity to markets in the northwestern U.S.; the marketing of natural gas, electricity and other commodities, and related risk management and finance services worldwide; the development, construction, and operation of power plants, pipelines, and other energy-related assets worldwide; and the delivery of high bandwidth communication applications throughout the U.S. Enron has a proven track record of creating value in markets that are deregulating and privatizing in North America, Europe, and other areas worldwide.

Transportation and Distribution

Enron's transportation and distribution business is comprised of its North American interstate natural gas transportation systems and its electricity transmission and distribution operations in Oregon.

Interstate Transmission of Natural Gas. Included in Enron's domestic interstate natural gas pipeline operations are Northern Natural Gas Company ("Northern"), Transwestern Pipeline Company ("Transwestern"), and Florida Gas Transmission Company ("Florida Gas") (indirectly 50% owned by Enron). Northern, Transwestern, and Florida Gas are interstate pipelines and are subject to the regulatory jurisdiction of the Federal Energy Regulatory Commission. Each pipeline serves customers in a specific geographical area: Northern serves the upper Midwest, Transwestern serves principally the California market and pipeline interconnects on the east end of the Transwestern system, and Florida Gas serves the State of Florida. In addition, Enron holds an interest in Northern Border Partners, L.P., which owns a 70% interest in the Northern Border Pipeline system. One of Enron's subsidiaries operates the Northern Border Pipeline system, which transports gas from western Canada to delivery points in the midwestern United States.

Electricity Transmission and Distribution Operations. Enron conducts its electric utility operations through its wholly owned subsidiary, Portland General Electric Company ("Portland General"). Portland General is engaged in the generation, purchase, transmission, distribution, and sale of electricity in the State of Oregon. Portland General also sells energy to wholesale customers throughout the western U.S. Portland General's Oregon service area is approximately 3,170 square miles. At June 30, 1999, Portland General served approximately 711,000 customers.

Wholesale Energy Operations and Services

Enron's wholesale energy operations and services businesses operate in North America, Europe, and evolving energy markets in developing countries. These businesses provide integrated energy-related products and services to wholesale customers worldwide. Wholesale energy operations and services can be categorized into two business lines: (a) Commodity Sales and Services, and (b) Energy Assets and Investments.

Commodity Sales and Services. Enron's commodity sales and services operations include the purchase, sale, marketing, and delivery of natural gas, electricity, liquids, and other commodities; the restructuring of existing long-term contracts; and the management of Enron's commodity portfolios.

In addition, Enron provides risk management products and services to energy customers that hedge movements in price and location-based price differentials. Enron's risk management products and services are designed to provide stability to customers in markets impacted by commodity price volatility. Also included in this business is the management of certain operating assets that directly relate to this business, including domestic intrastate pipeline and storage facilities.

Energy Assets and Investments. In the energy assets and investments business, Enron manages and operates assets related to natural gas, electricity, and communications and offers financing alternatives to customers. Activities include developing, constructing, operating, and managing energy assets, including power plants and natural gas pipelines. Enron also provides capital to energy and communication customers seeking debt or equity financing.

Retail Energy Services

EES is a nationwide provider of energy outsource products to U.S. business customers. These services include sales of natural gas and electricity and energy management services directly to commercial and industrial customers as well as investments in related businesses. EES provides end-users with a broad range of energy products and services at competitive prices. These products and services include energy tariff and information management, demand-side services, and financial services.

Communications

Enron is building a long-haul fiber-optic network on strategic routes throughout the United States to create the nation's first Pure IPSM (Internet Protocol) backbone known as the Enron Intelligent Network (the "EIN"). The EIN, which is enabled with intelligent messaging software, enhances Enron's existing national fiber-optic network to bring to market a reliable, bandwidth-on-demand platform for delivering data and applications and streaming rich media to the desktop. Enron's strategy is based on a business model that offers immediate national reach while minimizing capital deployed through strategic alliances with industry technology leaders whose presence, customer access, market share, and content enable Enron to efficiently enter this new, emerging marketplace.

Available Information

Enron is subject to the informational requirements of the Securities and Exchange Act of 1934, as amended, and in accordance therewith files reports, proxy statements, and other information with the Securities and Exchange Commission ("SEC"). Such reports, proxy statements, and other information may be inspected and copied at the public reference facilities maintained by the SEC at 450 Fifth Street, NW, Room 1024, Washington, DC 20549, and at the following regional offices of the SEC: Midwest Regional Office, Citicorp Center, Suite 1400, 500 West Madison Street, Chicago, IL 60661-2511; and Northeast Regional Office, 7 World Trade Center, New York, NY 10048. Copies of such materials may also be obtained from the Public Reference Section of the SEC at 450 Fifth Street, NW, Room 1024, Washington, DC 20549, at prescribed rates or from the site maintained by the SEC on the World Wide Web at http://www.sec.gov. Enron's common stock is listed on the New York, Chicago, and Pacific Stock Exchanges. Reports, proxy statements, and other information concerning Enron may be inspected and copied at the respective offices of these exchanges at 20 Broad Street, New York, NY 10005; 120 South LaSalle Street, Chicago, IL 60603; and 301 Pine Street, San Francisco, CA 94014.

Certain of the information herein relating to Enron has been taken from reports filed by Enron with the SEC. The information regarding Enron herein is qualified by the other information in such reports, including information regarding forward-looking statements.

VII. SUMMARY OF PRINCIPAL TERMS

This Summary of Principal Terms is qualified by reference to the Partnership Agreement of the Partnership and the Subscription Agreement relating thereto (collectively, the "Agreements"). This Memorandum and forms of the Agreements should be reviewed carefully.

The Partnership:	LJM2 Co-Investment, L.P., a Delaware limited partnership (the "Partnership").
Investment Objective and Focus:	The objective of the Partnership is to achieve significant long-term capital appreciation through privately negotiated equity and equity-related investments ("Investments") in companies principally engaged in energy- or communications-related businesses. The Partnership expects that Enron will be the Partnership's primary source of investment opportunities and that the Partnership will (i) co-invest with Enron or its subsidiaries in new investments in, or acquisitions of, businesses and assets, and (ii) make investments in, or acquire an investment from Enron or its subsidiaries relating to, existing assets or businesses owned by Enron or its subsidiaries. It is expected that in connection with the foregoing Investments, Enron will retain a significant economic or operating interest in the business or assets in which the Partnership invests. The Partnership may also from time to time make Investments in businesses or assets where Enron has no involvement.
The General Partner:	LJM2 Capital Partners, LLC, a Delaware limited liability company (the "General Partner") owned by one or more of the Principals.
The Manager:	LJM2 Capital Management, L.P., a Delaware limited partnership (the "Manager") owned by the Principals.
The Principals:	Andrew S. Fastow, Michael J. Kopper, Ben Glisan, Jr.
Committed Capital:	The Partnership is targeting an aggregate of $200 million in capital commitments from prospective investors ("Limited Partners"), although the General Partner reserves the right to accept capital commitments in an aggregate amount less than or greater than $200 million. The minimum capital commitment for a Limited Partner in the Partnership will be $5 million; provided that the General Partner reserves the right to reduce the minimum capital commitment for selected investors.

Sponsor Commitment:

The General Partner will commit to invest, or cause the Manager or other affiliates to invest, a minimum of one percent (1%) of the Partnership's aggregate capital commitments in or alongside the Partnership (the "Sponsor Commitment"). The Sponsor Commitment may be increased (but not decreased) by up to $1 million annually.

Management of the Partnership:

The General Partner will manage the Partnership and will have sole discretionary authority with respect to Investments. The Manager will manage the day-to-day affairs of the Partnership in behalf of the General Partner.

Commitment Period:

All partners of the Partnership ("Partners") will be obligated to fund their capital commitments during the period (the "Commitment Period") commencing on the initial closing date and ending on the third anniversary of the final closing date, and thereafter, to the extent necessary, to: (i) cover expenses, liabilities, and obligations of the Partnership, including Management Fees; (ii) complete Investments by the Partnership in transactions which were in process as of (or contemplated by the terms of securities held by the Partnership prior to) the end of the Commitment Period; and (iii) effect additional Investments in companies in which the Partnership had an Investment as of the end of the Commitment Period (in an aggregate amount not to exceed 10% of the Partnership's capital commitments).

Term:

The Partnership will have a term of ten years from the date of the final closing of the Partnership, but may be extended at the discretion of the General Partner for up to a maximum of two additional one-year periods to facilitate an orderly liquidation of the Partnership's assets.

Initial and Subsequent Closings:

An initial closing of the Partnership will be held once the General Partner determines that a sufficient minimum amount of capital commitments has been obtained.

The General Partner has the right to accept additional capital commitments and to permit existing Limited Partners to increase their capital commitments to the Partnership in subsequent closings ("Subsequent Closings"). Such newly admitted Limited Partners (or Limited Partners increasing their capital commitments to the Partnership) will make contributions to the Partnership such that each Limited Partner (regardless of when such Limited Partner's capital commitment is made) will participate pro rata in all Investments and expenses of the Partnership in the manner provided below.

Subsequent Closings may occur up to 270 days after the initial closing of the Partnership. In the event that Limited Partners fund any portion of their capital commitments to the Partnership prior to the expiration of such 270-day period, each Limited Partner that makes capital commitments on closing dates subsequent to any such funding will pay (i) the amount of its capital commitment that would have been funded if such Limited Partner (and all other Limited Partners) had funded its capital commitment at the time of such funding, and (ii) interest on the amount set forth in clause (i) above from the date of each such funding at the prime rate plus 2%. Any amounts paid under clauses (i) and (ii) above shall be distributed as follows: (x) to the Manager in an amount equal to all Management Fees (as defined below) payable in respect of such Limited Partner's commitment retroactive to the initial closing date (together with any interest thereon at the prime rate plus 2% from the initial closing date), and (y) the remaining amount to the Partners that participated in prior closings ratably based on the amount and timing of their previous capital contributions to the Partnership.

Drawdowns; Reinvestment:

Each Partner's capital commitment will be payable when called by the General Partner to make Investments and to meet anticipated Partnership expenses and liabilities (including Management Fees). Any amounts returned to the Partners (i) as a distribution of Investment Proceeds (as defined below) prior to the second anniversary of the final closing date, (ii) in connection with the subsequent admission of additional Limited Partners (less any interest received with respect thereto), or (iii) as a return of capital contributions made in respect of an unconsummated Partnership Investment, may, in each case, be recalled and will be available for future investments.

If 25% or more of the Limited Partner commitments are from employee benefit plans or other funds subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), each Limited Partner will pay its pro rata share of each quarterly Management Fee and other Partnership expenses directly to the General Partner or the Manager, as appropriate, until the Partnership has qualified for the "venture capital operating company" exception to the Department of Labor plan asset regulations (i.e., until the Partnership has made its first qualifying investment), but for purposes of calculating when each Limited Partner has fulfilled its commitment and for purposes of calculating gains, losses, distributions, and sharing ratios, all amounts so paid, as well as any corresponding amounts payable by the General Partner to fulfill its commitment, will be treated as having been paid into the Partnership as a capital contribution by each Partner.

Co-Investment Opportunities:

Where possible and appropriate, the General Partner intends, but will be under no obligation, to provide an opportunity to the Limited Partners to co-invest alongside the Partnership.

Diversification:

Without the approval of a majority in interest of the Limited Partners, no more than 10% of the total capital commitments of the Partners may be invested in a single portfolio company.

Distributions:

Distributions of the net proceeds from disposition of Investments, as well as distributions of securities in kind, together with any dividends, interest, or other investment income (other than certain short-term investment income) received with respect to Investments (collectively, "Investment Proceeds"), generally will be made in the following order of priority:

(a) first, 100% to the Partners in proportion to funded commitments until the cumulative amount distributed equals (i) the aggregate funded capital commitments of the Partners, *and* (ii) a preferred return on amounts included in clause (i) at a rate of 8% per annum, compounded annually (the "Preferred Return");

(b) second, 100% to the General Partner until such time as the General Partner has received, pursuant to this paragraph (b), 20% of the sum of the distributed Preferred Return and distributions made pursuant to this paragraph (b); and

(c) third, (i) 80% to all Partners in proportion to funded commitments, and (ii) 20% to the General Partner in respect of its carried interest.

Prior to the second anniversary of the final closing date, the General Partner will have the right to elect to distribute, hold, or re-invest Investment Proceeds (and for purposes of clause (c) of the distribution provisions above, the General Partner's funded commitment will be deemed to include 20% of the realized gains upon Investments, the Investment Proceeds from which were re-invested in accordance with this sentence). After the second anniversary of the final closing date, the General Partner will distribute (i) the net proceeds from the sale or other disposition of Investments within 180 days of receipt by the Partnership, and (ii) dividends, interest, and other short-term investment income at least annually, each subject to the availability of cash after paying Partnership expenses and setting aside appropriate reserves by the General Partner for reasonably anticipated liabilities and obligations of the Partnership.

Prior to the termination of the Partnership, distributions will be in cash or marketable securities. Upon termination of the Partnership, distributions may also include restricted securities or other assets of the Partnership.

Notwithstanding the foregoing, the General Partner may cause the Partnership to make distributions from time to time to the General Partner in amounts sufficient to permit the payment of the tax obligations of the General Partner and its members in respect of allocations of income related to the carried interest. The General Partner will endeavor to make annual aggregate distributions to the Limited Partners in an amount sufficient to permit payment of the Limited Partners' tax obligations in respect of their interests in the Partnership. Cash held by the Partnership prior to expenditure or distribution will be invested in short-term, high-grade instruments.

The amount of any taxes paid by or withheld from receipts of the Partnership allocable to a Partner from an Investment will be deemed to have been distributed to such Partner.

Allocation of Income, Expenses, Gains, and Losses:

Income, expenses, gains, and losses of the Partnership will generally be allocated among the Partners in a manner consistent with the distribution of proceeds described in "Distributions" above.

Management Fee:

During the Commitment Period, the Partnership will pay the Manager an annual management fee (the "Management Fee"), payable semi-annually in advance, equal to 2.0% of the aggregate commitments of Limited Partners. After the expiration of the Commitment Period, the Management Fee will equal 2.0% of an amount ("Capital Under Management") equal to the lesser of (i) the aggregate commitments of the Limited Partners and (ii) the aggregate amount invested by the Partnership in Investments. Capital Under Management will be calculated as of the beginning of each semi-annual period to which the Management Fee applies.

Operating Expenses:

The Manager will pay all ordinary operating expenses of the Partnership for salaries, rent, and similar expenses in connection with the investigation of investment and disposition opportunities for the Partnership and monitoring of the Partnership's Investments (to the extent not reimbursed by a portfolio company), except as set forth below under "Partnership Expenses."

Partnership Expenses:

The Partnership will pay or reimburse the General Partner, the Manager, and their respective affiliates for: (i) out-of-pocket expenses of the General Partner and Manager (including third-party fees and expenses) incurred in connection with unconsummated Investments; (ii) out-of-pocket expenses, including, but not limited to, all expenses incurred in connection with the origination, making, holding, monitoring, sale, or proposed sale of Investments (not otherwise paid in connection with the closing of the proposed origination or disposition), litigation or other extraordinary expenses, insurance, and indemnity expenses and expenses of liquidating the Partnership; and (iii) any other direct expenses incurred in connection with the Investments. The Partnership will also be responsible for all routine administrative expenses of the Partnership, including, but not limited to, the cost of the preparation of the annual audit, financial statements, and tax returns, expenses of the Advisory Committee, cash management expenses, and legal expenses.

Offering and Organizational Expenses:

The Partnership will bear all legal, accounting, and other offering and organizational expenses, including out-of-pocket expenses of the General Partner or the Manager incurred in connection with the formation of the Partnership. The Manager will bear the cost of placement agent fees charged in connection with the formation of the Partnership.

Transaction, Break-up, and Advisory Fees:	The General Partner and the Manager will not charge any transaction fees, break-up fees, advisory, monitoring, or similar fees in connection with actual or prospective Investments.
Other Investment Activities:	Without the approval of a majority in interest of Limited Partners, none of the General Partner, the Manager, and the Principals will commence investment activities for a Competing Fund (as defined below) in which such entity or person acts as sponsor or general partner until the earlier of (i) the termination of the Commitment Period or (ii) the date on which at least 70% of the total aggregate capital commitments of the Partnership have been taken down or committed. However, there will be no restrictions on the activities of the Principals in their capacities as employees of Enron, and these restrictions will not bind or otherwise obligate Enron. A "Competing Fund" means a pooled equity investment vehicle other than the Existing Funds (as defined below), the Partnership, and any Parallel Investment Vehicle (as defined below) which has investment objectives and strategies that are substantially similar to those of the Partnership and does not include any pooled equity investment vehicle managed, sponsored, or controlled by Enron or its subsidiaries or affiliates or any Parallel Investment Vehicle.
Allocation of Investment Opportunities:	The Principals currently are involved in the management of investment limited partnerships, including LJM1 and Chewco (the "Existing Funds"), that have investment objectives and strategies that are substantially similar to those of the Partnership. The General Partner expects that to the extent that both the Partnership and the Existing Funds would have capital available for investment in an opportunity, the Principals would cause the investment opportunity to be allocated to the Partnership and the Existing Funds in a manner determined to be fair and reasonable to both (taking into account the amount of available capital for each Partnership) consistent with prudent portfolio management and fiduciary concerns. Neither Enron nor any Existing Fund in which Enron has an interest has any obligation to offer investment opportunities to the Partnership, and the ability of Enron or any such Existing Fund to offer certain investments may be restricted by contractual obligations to third parties.

Advisory Committee:

An Advisory Committee, whose members will be selected representatives of the Limited Partners, will be established. The Advisory Committee will advise the General Partner and resolve issues involving conflicts of interest presented by the General Partner.

Parallel Investment Vehicles:

The General Partner may establish one or more additional entities or other similar arrangements (a "Parallel Investment Vehicle") prior to the expiration of the 270-day period following the initial closing to facilitate the ability of certain types of investors to invest in parallel with the Partnership. If formed, any Parallel Investment Vehicle will invest in each Investment on a pro rata basis (based on available capital) and on substantially the same terms and conditions as the Partnership.

Alternative Investment Structure:

If the General Partner determines in good faith that for legal, tax, regulatory, or other reasons it is in the best interests of the Partners that an Investment be made through an alternative investment structure, the General Partner may structure the making of all or any portion of such Investment outside of the Partnership by requiring the Partners to make such Investment through a limited partnership or other entity (other than the Partnership) that will invest on a parallel basis with or in lieu of the Partnership, as the case may be.

Exculpation and Indemnification:

None of the Principals, the General Partner, the Manager, their respective affiliates, and each of their respective officers, directors, members, managers, partners, employees, agents, and representatives (each, an "Indemnified Person") will be liable to the Partnership or to any Limited Partner for any act or omission by such Indemnified Person in connection with the conduct of the business of the Partnership, unless such act or omission constitutes such Indemnified Person's bad faith, gross negligence, or willful misconduct. The Partnership will indemnify each Indemnified Person from and against any losses, claims, liabilities, damages, and expenses (including legal fees and expenses, judgments, and amounts paid in settlement) incurred by such Indemnified Person in connection with the Partnership's activities, unless such losses, claims, liabilities, damages, or expenses result from such Indemnified Person's bad faith, gross negligence, or willful misconduct. The General Partner may require the Partners to return distributions made to each such Partner for the purpose of meeting such

Partner's pro rata share of the Partnership's indemnification obligations referred to above or to satisfy any other Partnership obligations (subject to certain limitations).

Limited Partner Withdrawal and Transfer:

Limited Partners generally may not withdraw from the Partnership. In addition, no Limited Partner may transfer or assign any of its interests, rights, or obligations with respect to its interest, except with the written consent of the General Partner, which written consent may be given or withheld in the General Partner's sole and absolute discretion. No such assignee, purchaser, or transferee of an interest may be admitted as a substitute Limited Partner without the written consent of the General Partner, which written consent may be given or withheld in its sole and absolute discretion. The General Partner may require a Limited Partner to withdraw from the Partnership under certain limited circumstances. Subject to certain conditions, the General Partner may (or may be required to) permit a Limited Partner to withdraw from the Partnership under certain limited circumstances.

ERISA Considerations:

The General Partner intends to cause the Partnership to qualify as a "venture capital operating company" under the Department of Labor plan asset regulations.

Tax Considerations:

An investment in the Partnership will have particular consequences for certain kinds of investors under the U.S. Federal income tax laws. The Partnership may engage in transactions that will cause tax-exempt Limited Partners to recognize "unrelated business taxable income" ("UBTI") within the meaning of Section 512 of the Internal Revenue Code of 1986, as amended (the "Code"), as a result of their investment in the Partnership, and the Partnership may engage in transactions that will cause foreign Limited Partners to recognize income treated as effectively connected with the conduct of a trade or business within the United States within the meaning of Section 864 of the Code as a result of their investment in the Partnership. Prospective investors should consult with their own tax advisors as to the consequences of making an investment in the Partnership. The General Partner intends to work with prospective investors to address their individual tax concerns.

Reporting:

The General Partner will send the Limited Partners withi[n] 120 days after the end of each fiscal year of the Partnershi[p] (or as soon thereafter as practicable in the event of delays in receiving information from portfolio companies) an audited annual financial report and tax information necessary for completion of each Limited Partner's U.S. Federal income tax return. The Partnership will also send its Limited Partners unaudited financial statements and other information within 60 days after the end of each quarter.

Auditors:	PricewaterhouseCoopers.
Legal Counsel:	Kirkland & Ellis.
Placement Agent:	Merrill Lynch & Co.

VIII. RISK FACTORS

Potential investors should be aware that an investment in the Partnership involves a high degree of risk. There can be no assurance that the Partnership's investment objectives will be achieved or that a Limited Partner will receive a return of its capital. The following considerations, among others, should be evaluated carefully before making an investment in the Partnership.

Dependence on Access to Enron Investment Opportunities

The Partnership's investment strategy is dependent upon the Partnership's access to investment opportunities from Enron. The Principals expect that Enron will continue for the foreseeable future to generate sufficient attractive investment opportunities to enable the Partnership to execute its investment strategy. Enron has no obligation to present investment opportunities to the Partnership, and no assurances can be given that Enron will continue to generate suitable investment opportunities or make such investment opportunities available to the Partnership. Changes in law, regulation, accounting principles, credit, capital or commodities markets, general or sector-specific economic conditions, or other changes may cause Enron to cease, or slow the rate of, its investment activities or to decrease its reliance on capital provided by co-investors or purchasers of investments from Enron. Enron may determine not to make investment opportunities available to the Partnership for any reason, including that the Principals, or certain of them, have ceased to be employees of Enron. The Principals may not be involved in all investments that Enron makes, and their involvement in some of Enron's investments may be limited. Enron will have no obligation to offer investment opportunities to the Partnership, and the ability of Enron to make investments available to the Partnership may be restricted by contractual obligations to third parties.

Highly Competitive Market for External Investment Opportunities

The activity of identifying, completing, and realizing private equity investments is highly competitive and involves a high degree of uncertainty. Although the Partnership expects to invest principally in companies and assets owned or controlled by Enron, the Partnership also may seek to invest in other external investment opportunities. In these situations, the Partnership will be competing with other private equity investment vehicles, as well as individuals, financial institutions, and other institutional investors.

Dependence on Key Personnel

The Limited Partners will be relying entirely upon the General Partner and the Manager to conduct and manage the affairs of the Partnership. The General Partner and the Manager depend upon the efforts and expertise of the Principals to enable them to render investment management services to the Partnership. The Principals are obligated to dedicate their business time and attention primarily to the discharge of their responsibilities as management employees of Enron. In addition, the Principals also dedicate a portion of their business time and attention to managing existing investment limited partnerships. Subject to the demands of these other responsibilities, the Principals will devote as much of their business time and attention as they deem to be reasonably necessary to manage the affairs of the Partnership. There can be no assurance that the Principals will continue to be employed by Enron throughout the life of the Partnership. As noted above, if the Partnership were to lose the services of the Principals, the Partnership could be adversely affected.

Limited Operating History

The Partnership, the General Partner, and the Manager will be newly formed entities, and none of the Partnership, the General Partner, and the Manager has an operating history of making private equity investments upon which prospective investors may base an evaluation of the likely performance of the Partnership.

Limited Sector Focus

The Partnership intends to concentrate on investments in energy- and communications-related businesses, and will be less diversified for industry risk than other, more broadly focused investment vehicles. As a result of the Partnership's sector focus, the effect on the Partnership of industry or general economic factors that have a greater impact upon the energy or communications sector than other industry sectors may be more pronounced than in more broadly focused investment vehicles.

Non-Control Investments

The Partnership expects to make Investments in portfolio companies over which Enron will acquire or retain ownership or control. The Partnership may not have the power, acting alone, to control a portfolio company's board of directors, management, or operations. In addition, the Partnership may not have the ability, acting alone, to cause a portfolio company to take, or refrain from taking, certain actions, or to cause a portfolio company to engage, or refrain from engaging, in material transactions, which conceivably could have an adverse effect on the Partnership's Investment, and the Partnership may not have the ability, acting alone, to control the timing of the liquidation of its Investment. In such Investments, the Partnership may be forced to rely on the fact that Enron will possess some or all of the foregoing control rights and that the interests of the Partnership and Enron will be sufficiently aligned such that Enron will exercise those rights in a manner that will protect the Partnership's Investment. Enron will have no obligation to align its interests with those of the Partnership.

Illiquid and Long-Term Investments

Although Investments may generate some current income, the return of capital and the realization of gains, if any, from an Investment generally will occur only upon the partial or complete disposition of such Investment. While an Investment may be sold at any time, frequently this will not occur for a number of years after the Investment is made. As noted above, in certain cases, the Partnership may be dependent upon Enron to create liquidity through a sale of, or other "exit" transaction involving, the portfolio company in which the Partnership holds an Investment. It is unlikely that there will be a public market for the securities held by the Partnership at the time of their acquisition. The Partnership generally will not be able to sell its securities publicly unless such sale is registered under applicable securities laws or unless an exemption from such registration requirements is available. In addition, in some cases, the Partnership may be prohibited by contract from selling certain securities for a period of time.

Non-U.S. Investments

The Partnership may invest in portfolio companies organized and operating outside of the U.S. Foreign securities involve certain risks not typically associated with investing in U.S. securities, including risks relating to: (i) currency exchange matters and costs associated with conversion of investment capital and income from one currency into another; (ii) differences between the U.S. and foreign securities markets, including potential price volatility in and relative illiquidity of some foreign securities markets and the absence of uniform accounting and financial reporting standards and disclosure requirements; (iii) certain economic and political risks, including potential restrictions on foreign investment and repatriation of capital and the risks of political, economic, or social instability; and (iv) the possible imposition of foreign taxes on income and gains recognized with respect to such securities.

Passive Investment in Interests

Limited Partners will be relying entirely on the General Partner and the Manager to conduct and manage the affairs of the Partnership. The Agreement will not permit the Limited Partners to engage in the active management and affairs of the Partnership. Because specific Investments of the Partnership have not yet been identified, the Limited Partners must rely on the ability of the General Partner to make appropriate Investments for the Partnership and to dispose of such Investments and of the Manager to manage such Investments.

No Market for Partnership Interests

The Interests have not been registered under the Securities Act, the securities laws of any state, or the securities laws of any other jurisdiction and, therefore, cannot be resold unless they are subsequently registered under the Securities Act and other applicable securities laws or exemptions from registration are available. It is not contemplated that registration of the Interests under the Securities Act or other securities laws will ever be effected. There is no public market for the Interests, and one is not expected to develop. A Limited Partner will not be permitted to assign its Interests, except by operation of law, without the prior written consent of the General Partner, which may be given or withheld in the General Partner's sole and absolute discretion. Except in extremely limited circumstances, voluntary withdrawals from the Partnership will not be permitted. Limited Partners must be prepared to bear the risks of owning Interests for an extended period of time.

Tax-Exempt Investors

The Partnership may engage in transactions that would generate UBTI. *See* – "Summary of Principal Terms – Tax Considerations" and "Certain Tax and Regulatory Considerations – Federal Income Tax Matters – *General*."

Foreign Investors

The Partnership may engage in transactions that will cause foreign Limited Partners to recognize income effectively connected with the conduct of a trade or business within the U.S. *See* – "Summary of Principal Terms – Tax Considerations" and "Certain Tax and Regulatory

Considerations - Federal Income Tax Matters - *Certain U.S. Tax Considerations for Foreign Investors.*"

IX. CONFLICTS OF INTEREST

Investors should be aware that there will be occasions where the General Partner and its affiliates may encounter potential conflicts of interest in connection with the Partnership's activities. The following discussion enumerates certain potential conflicts of interest which should be carefully evaluated before making an investment in the Partnership.

Dual Role of Principals

The Principals are employees of Enron and owe fiduciary duties to Enron and its subsidiaries; such fiduciary duties may from time to time conflict with fiduciary duties owed to the Partnership and its partners. Accordingly, the Principals, and entities controlled by the Principals, may take (or refrain from taking) such actions in behalf of the Partnership as the Principals in good faith determine to be necessary or appropriate in view of such conflicting duties. The Principals intend to consult regularly with the Advisory Committee regarding potential conflicts of interest regarding transactions with or involving Enron and its affiliates.

Transactions Involving Enron

To execute the Partnership's investment strategy (to capture investment opportunities generated by Enron), the Partnership will regularly evaluate, structure, negotiate, consummate, hold, manage, and liquidate Investments in companies in which Enron or its affiliates have an existing investment or which Enron or its affiliates control (including investments acquired directly from Enron or its affiliates). The evaluation (and valuation) of Investment opportunities and the negotiation of the price, terms, and conditions of an Investment will be conducted in behalf of the Partnership by the Principals acting in behalf of the General Partner.

Portfolio companies in which the Partnership invests may also engage in transactions with Enron or its affiliates, and profits derived by Enron or its affiliates from such transactions will not be shared with the Partnership.

In many cases, the Partnership will have a non-control Investment in a portfolio company controlled by Enron or its affiliates. The Partnership may invest in securities that are different from those held by Enron or may hold securities with a cost basis different from those held by Enron. Factors that influence Enron's or its affiliates' decision to exercise their rights in respect of their investment in such company (such as a decision to sell the company) may be more or less significant from the Partnership's perspective.

Carried Interest

The existence of the General Partner's carried interest could be viewed as an incentive for the General Partner to make riskier or more speculative investments in behalf of the Partnership than would be the case in the absence of this arrangement.

Diverse Limited Partner Group

The Limited Partners may have conflicting investment, tax, and other interests with respect to their investments in the Partnership. The conflicting interests of individual Limited Partners may relate to or arise from, among other things, the nature of Investments made by the Partnership, the structuring or the acquisition of Investments, and the timing of disposition of Investments. As a consequence, conflicts of interest may arise in connection with decisions made by the General Partner, including with respect to the nature or structuring of Investments, that may be more beneficial for one investor than for another investor, especially with respect to investors' individual tax situations. In selecting and structuring investments appropriate for the Partnership, the General Partner will consider the investment and tax objectives of the Partnership and its Partners as a whole, not the investment, tax, or other objectives of any Limited Partner of the Partnership individually.

X. CERTAIN TAX AND REGULATORY CONSIDERATIONS

Federal Income Tax Matters

General

The following discussion summarizes certain U.S. Federal income tax considerations generally applicable to a person considering the acquisition of an Interest. The discussion does not deal with all tax considerations that may be relevant to specific investors or classes of investors in light of their particular circumstances. In particular, the discussion does not address any considerations applicable to persons who acquire Interests in connection with the performance of services. Furthermore, no state, local, or foreign tax considerations are addressed. ALL PERSONS CONSIDERING AN INVESTMENT IN THE PARTNERSHIP ARE URGED TO CONSULT WITH THEIR OWN TAX ADVISORS AS TO THE SPECIFIC U.S. FEDERAL, STATE, LOCAL, AND FOREIGN TAX CONSEQUENCES TO THEM OF SUCH INVESTMENT.

The Partnership will receive an opinion from Kirkland & Ellis, counsel for the Partnership, that the Partnership will be classified for federal income tax purposes as a partnership rather than as an association taxable as a corporation under currently applicable tax laws. Opinions of counsel, however, are not binding on the Internal Revenue Service ("IRS") or the courts, and no ruling has been or will be requested from the IRS. No assurance can be given that the IRS will concur with such opinion or the tax consequences set forth below.

The Partnership will not pay federal income taxes, but each Partner will be required to report its distributive share (whether or not distributed) of the income, gains, losses, deductions, and credits of the Partnership (which may include the income and other tax items of any partnerships in which the Partnership invests). It is possible that the Partners could incur income tax liabilities without receiving from the Partnership sufficient distributions to defray such tax liabilities. For example, the Partners will be allocated Partnership income and gains for U.S. Federal income tax purposes even if funds from such Partnership income and gains are used by the Partnership to make Investments or to pay Partnership expenses and liabilities and are not distributed to such Partners (or are distributed but are then recalled by the Partnership for future Investments). The Partnership Agreement will provide that the General Partner may elect to re-invest rather than distribute (or distribute and recall for investment) Investment Proceeds prior to the second anniversary of the Partnership's final closing date. The Partnership's taxable year will be the calendar year, or such other year as required by the Code. Tax information will be distributed to each Partner annually.

The following discussion summarizes certain significant U.S. Federal income tax consequences to a prospective investor who (i) owns, directly or indirectly through another partnership, an Interest as a Limited Partner, (ii) is, with respect to the U.S., a citizen or resident individual, a domestic corporation or partnership, an estate the income of which is subject to U.S. Federal income taxation regardless of its source, or a trust for which a court in the U.S. is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all substantial decisions, as such terms are defined for U.S. Federal income tax purposes (a "U.S. Investor"), and (iii) is not tax-exempt.

Interest on any amount borrowed by a Limited Partner (other than a corporation) to purchase an Interest in the Partnership will generally be "investment interest," subject to a limitation on deductibility. In general, investment interest will be deductible only to the extent of the taxpayer's "net investment income." For this purpose "net investment income" will generally include net income from the Partnership and other income from property held for investment (other than property which generates passive activity income). However, long-term capital gain is excluded from the definition of net investment income unless the taxpayer makes a special election to treat such gain as ordinary income rather than long-term capital gain. Interest that is not deductible in the year incurred because of the investment interest limitation may be carried forward and deducted in a future year in which there is sufficient investment income.

The Agreement will contain provisions intended to comply substantially with IRS regulations describing partnership allocations that will be treated as having "substantial economic effect," and hence, the Partnership's allocation will be respected for tax purposes. However, those regulations are extremely complex, and there can be no assurance that the allocations of income, deduction, loss, and gain for tax purposes made pursuant to the Partnership Agreement will be respected by the IRS, if reviewed. Even if the IRS were to review the Partnership allocations and determine that they do not technically comply with such regulations, such allocations would be determined "in accordance with each partner's interest in the partnership (determined by taking into account all facts and circumstances)." The allocations under the Partnership Agreement should, in most cases, be substantially identical to each "partner's interest in the partnership."

Under Section 67 of the Code, a non-corporate taxpayer (including a shareholder of an S corporation) may deduct certain miscellaneous deductions (e.g., investment advisory fees, tax preparation fees, unreimbursed employee expenses, and subscriptions to professional journals) only to the extent such deductions exceed, in the aggregate, 2% of the taxpayer's adjusted gross income. Each Limited Partner's share of the Management Fee and other Partnership expenses probably will be treated as miscellaneous itemized deductions. Accordingly, a Limited Partner who is an individual generally will be permitted to deduct such expenses only to the extent that the sum of such expenses plus the individual's other miscellaneous itemized deductions exceed 2% of the individual's adjusted gross income. However, corporate Limited Partners (other than S corporations) and tax-exempt organizations are not affected by the 2% floor (unless, in the case of a tax-exempt organization, it is not a corporation and has unrelated business taxable income from the Partnership). Section 68 of the Code separately imposes limitations on the deductibility of itemized deductions by an individual whose adjusted gross income exceeds a specified amount (e.g., $126,600 for unmarried individuals, or married individuals filing jointly, for 1999, adjusted annually for inflation), which may also affect the ability of any Partner who is an individual to deduct his or her share of the Management Fee and other Partnership expenses. A Limited Partner who is an individual also generally will not be permitted to deduct his or her share of the Management Fee and other Partnership expenses for purposes of calculating such individual's alternative minimum tax liability.

Non-corporate investors (and certain closely held, personal service, and S corporations) are subject to the limitations on using losses from passive business activities to offset business income, salary income, and portfolio income (i.e., interest, dividends, capital gains from portfolio investments, royalties, etc.). The Partnership's distributive share of income or losses from a portfolio company which is a partnership or limited liability company engaged in business generally will be treated as passive activity income or losses. Accordingly, an investor will be subject to the passive activity loss limitations on the use of any such portfolio company losses, but any such portfolio company income may be offset by other passive losses (such as losses from limited partnership interests in tax shelters). Other partnership income generally will be treated as portfolio income. Therefore, an investor generally will not be able to use passive activity losses to offset such portfolio income from the Partnership.

Except as described in the following paragraph, a tax-exempt Limited Partner's distributive share of the Partnership's income should consist principally of income from dividends, interest, and capital gain from corporate stock and corporate securities – types of income which (subject to the discussion of debt-financing below) are expressly excluded UBTI.

However, the Partnership may invest in securities (including equity interests in partnerships and limited liability companies) that will generate UBTI ("UBTI Investments"). Each tax-exempt Limited Partner generally would be subject to U.S. Federal income tax on its share of any UBTI earned by the Partnership (and the receipt of UBTI could give rise to additional tax liability for certain limited categories of tax-exempt investors).

If a tax-exempt Limited Partner borrows any amount to fund its capital commitment, some or all of its distributive share of income from the Partnership could be UBTI, which could be taxable to such tax-exempt Limited Partner (and which could give rise to additional tax liability for certain limited categories of tax-exempt Limited Partners). Moreover, debt incurred either by the Partnership directly or in connection with a UBTI Investment could give rise to UBTI to a tax-exempt Limited Partner.

Certain U.S. Tax Considerations for Foreign Investors

Limited Partners that are not U.S. Investors and are not tax-exempt ("Foreign Investors") generally should not be subject to U.S. Federal income tax on gains from the sale of Investments. Notwithstanding the foregoing, a Foreign Investor's share of the net gain recognized upon disposition by the Partnership of a United States real property interest would be treated for Federal income tax purposes as if it were effectively connected with a U.S. trade or business. In general, the Partnership would be required to withhold tax from allocations to Foreign Investors of such net gain and each Foreign Investor would be required to report its share of such gain on a U.S. Federal income tax return. For this purpose, the term "United States real property interest" generally would include: (i) shares of stock in a U.S. corporation that does not have a publicly traded class of stock outstanding if 50% or more of the value of the corporation's assets at any point during the preceding five years consisted of interests in U.S. real property, and (ii) shares of stock in a U.S. corporation that does have a publicly traded class of stock outstanding where (A) the corporation satisfies the real property ownership test described in clause (i) above, and (B) the Partnership held (directly or pursuant to certain attribution rules) more than 5% of the outstanding stock of any publicly traded class of shares or held shares of non-publicly traded stock with a fair market value greater than that of 5% of the publicly traded class of the corporation's stock with the lowest fair market value. In addition, if the Partnership invests in partnerships or other persons that generate income that is treated as effectively connected with a U.S. trade or business (including gain recognized upon disposition of an United States real property interest), Limited Partners will be subject to U.S. Federal income tax, including withholding tax (and possibly the branch profits tax), on their share of such income and on their share of gain realized on the Partnership's disposition of its interest in such other partnership's (or other person's) assets attributable to such U.S. trade or business, and they will be required to file appropriate returns. Dividends paid by portfolio companies generally will, and interest paid by portfolio companies and capital gains upon realization of certain Investments may, in certain circumstances, be subject to withholding taxes, including U.S. withholding taxes, but such taxes may be reduced or eliminated by treaty.

THIS MEMORANDUM DOES NOT ADDRESS ALL UNITED STATES FEDERAL TAX CONSEQUENCES OF AN INVESTMENT IN THE PARTNERSHIP THAT MAY APPLY TO AN INVESTOR, AND IT DOES NOT ADDRESS ANY STATE, LOCAL, OR FOREIGN TAX CONSEQUENCES OF SUCH AN INVESTMENT. IN ADDITION, THE ABOVE DISCUSSION IS BASED ON CURRENT PROVISIONS OF THE CODE, TREASURY REGULATIONS, ADMINISTRATIVE RULINGS, AND JUDICIAL DECISIONS, AND NO ASSURANCE CAN BE GIVEN THAT FUTURE LEGISLATIVE, JUDICIAL, OR ADMINISTRATIVE ACTION WILL NOT AFFECT THE ACCURACY OF ANY STATEMENT IN THIS DISCUSSION, POSSIBLY WITH RETROACTIVE EFFECT. THE TAX CONSEQUENCES OF AN INVESTMENT IN THE PARTNERSHIP MAY VARY DEPENDING ON AN INVESTOR'S PARTICULAR CIRCUMSTANCES. FOR THE FOREGOING REASONS, EACH PROSPECTIVE INVESTOR IS ADVISED TO CONSULT ITS OWN TAX COUNSEL AS TO THE FEDERAL, STATE, LOCAL, AND FOREIGN TAX CONSEQUENCES OF AN INVESTMENT IN THE PARTNERSHIP.

Certain ERISA Considerations

The U.S. Department of Labor ("DOL") has issued regulations under ERISA, which generally provide that when an employee benefit plan invests in an entity such as the Partnership, the plan's assets include both the limited partnership interest and an undivided interest in each of the underlying assets of the Partnership, unless (i) the equity participation in the Partnership by benefit plan investors is not "significant" (defined as 25% of any class of the Partnership equity interests), (ii) the Partnership complies with the "venture capital operating company" ("VCOC") exception, or (iii) the Partnership qualifies for another exception under the DOL plan asset regulations. If the underlying assets of the Partnership were to be considered plan assets of the ERISA plan investor, the General Partner of the Partnership would be an ERISA fiduciary and the Partnership would be subject to undesirable ERISA requirements with which the Partnership generally cannot comply.

The Partnership will not limit investment by benefit plan investors, and it is therefore possible that investment by benefit investors will be "significant." However, the Partnership has been designed and is intended to be managed to comply with the VCOC exception. If it qualifies for the VCOC exception, the Partnership will not be subject to the ERISA fiduciary rules and the underlying assets of the Partnership will not be deemed "plan assets" of any ERISA plan investor. The Partnership will qualify if it (i) has direct contractual rights to substantially participate in or substantially influence the management of operating companies comprising at least 50% of its portfolio (measured by cost), and (ii) in the ordinary course of its business, actively exercises such management rights with respect to at least one of the operating companies in which it invests. An "operating company" is an entity engaged in the production or sale of a product or service, as distinguished from a re-investing entity.

The determination as to whether the fund qualifies as a VCOC is made when the Partnership makes its first long-term investment and thereafter on an ongoing basis. The Partnership must meet the 50% test at the time it makes its first long-term investment and on at least one day during each 90-day annual valuation period (generally beginning on the anniversary of the Partnership's first long-term investment) thereafter. The Partnership also would cease to qualify if it did not in the ordinary course of its business actually exercise its management rights with respect to at least one portfolio company each year. Special rules will apply to any wind-up of the Partnership when it enters into it "distribution period" as defined in the DOL regulations.

Prospective Limited Partners who are subject to the provisions of ERISA (such as pension funds or certain insurance company accounts) should consult with their counsel and advisors as to the provisions of ERISA applicable to an investment in the Partnership.

Certain Regulatory Matters

Investment Company Act of 1940, as amended (the "1940 Act")

The Partnership has not registered and does not plan to register under the 1940 Act in reliance on the exception provided in Section 3(c)(7) of the 1940 Act. As a condition to its admittance to the Partnership, each prospective Limited Partner will be required to represent to the Partnership and its General Partner that such prospective Limited Partner is a "qualified purchaser" within the meaning of Sections 2(a)(51) and 3(c)(7) of the 1940 Act and the regulations promulgated thereunder.

Securities Act

The offer and sale of the Interests will not be registered under the Securities Act in reliance upon the exemption from registration provided by Section 4(2) thereof and Regulation D promulgated thereunder. Each purchaser must be an "accredited investor" (as defined in Regulation D under the Securities Act) and will be required to represent, among other customary private placement representations, that it is acquiring its Interest in the Partnership for its own account for investment purposes only and not with a view to resale or distribution.

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