

**UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK**

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**IN RE:**

**Chapter 11**

**ENRON CORP., ET AL.,**

**Case No.: 01-16034 (AJG)**

**Debtors.**

**Jointly Administered**

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**INTERIM CASH MANAGEMENT REPORT OF HARRISON J. GOLDIN,  
THE COURT-APPOINTED EXAMINER IN THE  
ENRON NORTH AMERICA CORP. BANKRUPTCY PROCEEDING**

**APRIL 9, 2002**

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## **EXECUTIVE SUMMARY**

By Orders dated February 21, 2002 (the “February 21 Order”) and March 6, 2002 (the “March 6 Order”), the United States Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”) appointed an Examiner in the Chapter 11 case of Enron Corp. *et al.* (individually and collectively, the “Debtor” or the “Debtors”), pursuant to section 1106(b) of the United States Code, 11 U.S.C. §§ 101 *et seq.* (the “Bankruptcy Code”), to investigate and file an interim report (the “Interim Report”) by April 9, 2002 on, *inter alia*, (i) the cash and cash equivalent assets of Enron North America Corp. (“ENA”),<sup>1</sup> (ii) matters relating to intercompany transfers between ENA and its parent, Enron Corp. (“Enron”),<sup>2</sup> and (iii) the allocation of certain overhead expenses to ENA. Prior to Enron’s and ENA’s bankruptcy filings on December 2, 2001, ENA revenues, like those of other Enron subsidiaries, were transferred or “swept” on a daily basis from ENA bank accounts into an Enron concentration account. Subsequent to the bankruptcy filings, pursuant to an Order of the Bankruptcy Court, Enron continued using its pre-petition centralized cash management system (the “Centralized Cash Management System”) to sweep ENA’s and other Enron subsidiaries’ revenues into an Enron concentration account.

On February 25, 2002, after objections by certain ENA creditors, the Bankruptcy Court entered an Order (the “Amended Cash Management Order”) that, while allowing Enron to continue using the Centralized Cash Management System, imposed important conditions, including, but not limited to, a 30-day prohibition (since extended until May 9, 2002) on cash

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<sup>1</sup> Unless otherwise noted, references to “ENA” in this Interim Report cover ENA and its direct and indirect Debtor subsidiaries collectively, but not ENA’s non-Debtor subsidiaries. References to ENA individually are “ENA Corp.”

<sup>2</sup> Unless otherwise noted, references to “Enron” in this Interim Report refer to Enron individually and *not* its direct and indirect subsidiaries.

sweeps from ENA to Enron and a grant of adequate protection for intercompany transfers in the form of superpriority Junior Reimbursement Claims and Junior Liens (each as hereinafter defined).

The Bankruptcy Court specifically directed the Examiner, *inter alia*, to determine in connection with “ENA’s continued participation in the Cash Management System” whether (i) sufficient assets exist subject to the Junior Liens for repayment of the ENA intercompany transfers that have been or may be made to other Debtors and (ii) to recommend an allocation of “certain overhead costs to ENA.” In addition, the Examiner was given a continuing oversight duty and directed to (i) file weekly reports with the Bankruptcy Court listing all deposits and disbursements made into and out of the “Consolidation Account” (the “Weekly Reports”),<sup>3</sup> (ii) file monthly reports regarding the status of ENA’s gross and net collections, expenditures and assets and liabilities (the “Monthly Reports”), (iii) participate in all meetings of the Enron Cash Management Committee and Risk Assessment Committee,<sup>4</sup> which are responsible, *inter alia*, for the review and approval of ENA expenditures and (iv) report immediately to the Bankruptcy Court any “improper” ENA expenditures.

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<sup>3</sup> The March 6 Order, which did not specifically define the “Consolidation Account,” referred to a definition in the Amended Cash Management Order. However, the Amended Cash Management Order did not define “Consolidation Account” either. With the term not otherwise defined, the Examiner has interpreted it to mean the “ENA Concentration Account,” defined herein as the account into which the cash of ENA is swept and consolidated. Unless the Examiner is otherwise instructed by the Bankruptcy Court, the Weekly Report, therefore, will not include information specifically relevant to the “Enron Concentration Account,” defined herein as the account into which cash of Enron and its non-ENA direct and indirect Debtor subsidiaries is swept and consolidated.

<sup>4</sup> The Debtors have informed the Examiner that the “Risk Assessment Committee” is, in fact, the Bankruptcy Transaction Review Committee (the “BTRC”).

In the 20 business days available for preparation of this Interim Report the Examiner has been able to reach certain conclusions regarding the important issues raised in the February 21 Order and the March 6 Order.

*First*, it is highly likely that more than sufficient assets exist subject to the Junior Liens for repayment of ENA post-petition transfers to Enron. The Examiner has confirmed that there have been no ENA transfers to Enron since February 25, 2002, the effective date of the Amended Cash Management Order. As of the date of this Interim Report, post-petition transfers from ENA to Enron (after deducting the amount of any such transfers returned to ENA by Enron) total approximately \$481 million. (An important caveat is that the total amount Enron is obligated to repay is less; for it must be reduced by (i) ENA post-petition payroll expenses previously paid by Enron for the period since the bankruptcy filing and (ii) ENA's share of corporate overhead expenses.) As discussed below, the Examiner estimates that Enron assets have a value substantially in excess of that amount. Nonetheless, while the Examiner believes Enron has sufficient assets ultimately to repay the ENA post-petition transfers, he has not had sufficient opportunity to analyze the liquidity needs of Enron in order to make a reasonable calculation as to when such repayment should occur in the context of the overall Enron bankruptcy cases.

*Second*, based on Enron's near term projected expenditures, it appears to have sufficient cash on hand to fund Enron operations for at least 90 more days (and perhaps much longer) without having to resort to the proceeds of the sale of its assets or to any additional cash sweeps from ENA. Moreover, as of March 22, 2002, ENA Corp. had approximately \$176 million in the ENA Concentration Account. The Examiner estimates that ENA will also have sufficient cash on hand for at least the next 90 days (and probably much longer) to meet its operating costs (the

Examiner, as required by the February 21 Order and March 6 Order, will continue to monitor and report on ENA's cash needs and will make further recommendations, as may be appropriate, respecting modifications to the Amended Cash Management Order).

*Third*, the Junior Liens and Junior Reimbursement Claims, together with the Cash Management Committee and BTRC procedures (augmented by appropriate modifications as discussed below and the Examiner's continued oversight role on the Cash Management Committee and BTRC, close monitoring of ENA expenditures and compilation of the required Weekly and Monthly Reports), afford adequate legal and supervisory protection for ultimate repayment of the Junior Liens.

*Fourth*, although in directing the Examiner in the March 6 Order to report immediately to the Bankruptcy Court any "improper" ENA expenditures the Bankruptcy Court did not prescribe a standard of review, the standard the Examiner has utilized is whether such expenditures are calculated to preserve or enhance the value of the ENA estate within a reasonable timeframe. Utilizing this standard, the Examiner has to date found no improper expenditures of ENA funds.

In addition, the Examiner has been developing a format and process for the mandated weekly and monthly reports. The initial Weekly Report for the week ending March 22, 2002 was issued on April 9, 2002 (a copy is attached as Exhibit "A") and the Examiner anticipates that the initial Monthly Report will be issued on or about May 1, 2002. The Examiner expects that the Monthly Reports will give the parties a snapshot of ENA's assets and liabilities, will provide a useful focus for the development of an ENA plan of reorganization and will constitute a basis for monitoring the ultimate realizable value of ENA's assets.

Since the Examiner's appointment, Enron and ENA personnel have cooperated with him fully. However, the time allotted for preparation of the Interim Report was simply not sufficient for a comprehensive analysis of all the issues covered by the February 21 Order and the March 6 Order. Specifically, the timeframe has not permitted the Examiner to complete the following tasks:

- The formulation of an appropriate allocation of certain overhead expenses to ENA; it requires a detailed and complex analysis of cost-accounting issues among a multiplicity of legal entities. The Debtors have reported that they are working on developing a methodology they believe will be fair to all constituencies. In the Examiner's view, given numerous intercompany issues, any methodology will have to be tested thoroughly and validated. The Examiner has not yet been given all the relevant information and documentation requisite to an appropriate analysis that will enable him to make a thoughtful recommendation to the Bankruptcy Court. The Examiner anticipates that he will be able to make such a recommendation within the next 60-90 days.
- While the labyrinthian organizational charts of Enron and ENA identify legally constituted subsidiaries of ENA, certain relationships between or among business units that may or may not have a discrete legal identity appear to create rights and/or cash flow implications which the Examiner has not yet had an opportunity to explore fully, *i.e.*, looking solely at ENA does not appear to provide a complete picture concerning all of ENA's economic benefits and/or interests. Hence, the Examiner cannot be certain at this point that he has identified all of ENA's cash activity. Accordingly, he is unable to state definitively that all ENA-related entities are not in some way supporting Enron entities. The Examiner will require additional time in order to formulate a definitive conclusion in this regard and to make an appropriate recommendation to the Bankruptcy Court.<sup>5</sup>
- The Examiner has not yet had an opportunity to analyze fully the relationship between ENA Corp. and its subsidiaries in order to ascertain whether the arrangements between or among them warrant adjustment. Certain ENA trade creditors have identified this issue for the Examiner as it relates to the Amended Cash Management Order and the Examiner expects to cover it in a subsequent report.

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<sup>5</sup> Although the Examiner has not yet completed his investigation of all cash flows that could be categorized as constituting beneficial interests of ENA, a preliminary review suggests that such cash flows will not be substantial.



- A valuation of ENA's substantial book of existing physical and financial contracts, better known as its "Trading Book" (hereinafter referred to as the "Trading Book"), depends on a number of critical variables pertaining to each contract, which include the state of the market on the dates contracts are terminated and the outcome of negotiations with counterparties on such matters as (i) the choice of a discount rate for calculating present value, (ii) an assessment of current and future commodity prices and (iii) contractual provisions covering such matters as netting arrangements. The Examiner has not had an opportunity within the timeframe provided to conduct such a detailed and important review.

In light of the foregoing, the Examiner recommends that for at least the next 90 days ENA continue to be excluded from the Centralized Cash Management System and that the Bankruptcy Court continue the conditions it has imposed regarding credit limits on intercompany transfers. Over the course of this 90-day period, in consultation with the relevant parties, the Examiner will review how and when the ENA intercompany transfers should be repaid and make a recommendation in that regard to the Bankruptcy Court. Relevant issues in this connection include the timeframe in which Enron assets are likely to be monetized, the projected rate and amount of Enron's operating expenses, the extent of the DIP credit facility that is available to and accessed by Enron and its non-ENA subsidiaries and the magnitude and treatment of other Junior Liens relating to intercompany transfers to Enron from other non-ENA Debtors.

Part I of this Interim Report summarizes the proceedings in the Bankruptcy Court that led to the Examiner's appointment. Part II reviews the scope of the Examiner's duties and responsibilities and his activities in preparing the Interim Report. Part III outlines the Examiner's interim findings, summarizes the initial Weekly Report and describes briefly the forthcoming Monthly Report. Part IV presents the Examiner's recommendations.

## I.

### **BACKGROUND TO THE EXAMINER'S APPOINTMENT**

On December 2, 2001 (the “Petition Date”) Enron, ENA and certain of their subsidiaries and affiliates filed voluntary petitions in the Bankruptcy Court for reorganization under Chapter 11 of the Bankruptcy Code.<sup>6</sup> Pursuant to an Order of the Bankruptcy Court dated December 3, 2001, the Debtors’ bankruptcy cases were consolidated for administrative purposes only and are being administered jointly. Since December 3, 2001 certain other affiliates or subsidiaries of Enron have filed voluntary petitions for relief with the Bankruptcy Court; these cases have been administratively consolidated with those of the Debtors. Since filing their petitions for relief the Debtors have continued to manage and operate their businesses as debtors-in-possession pursuant to sections 1107 and 1108 of the Bankruptcy Code.

#### **A. Overview of Enron and ENA**

##### **1. Enron**

In its bankruptcy petition (the “Petition” or “Enron Petition”) Enron describes itself as “a holding company of subsidiaries engaged in wholesale merchant and commodity market businesses, the management of end-use retail customer energy services, the operation of gas transmission systems, and the worldwide management of energy assets and broadband services.” *See* Enron Petition, Exh. A, ¶ 3.

Enron also stated in the Petition that it had assets and liabilities in excess of \$24 billion and \$13 billion, respectively. In a footnote to the Petition Enron noted that the stated liabilities

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<sup>6</sup> Although the relevant aspects of these bankruptcy proceedings are well known to the Bankruptcy Court and most, if not all, parties in interest, the Examiner has determined that it is useful to provide in this Interim Report an objective summary of events leading up to and following the Examiner’s appointment.

did not include “off balance sheet and contingent obligations” likely relating to Special Purpose Vehicles (“SPV’s”) and its Trading Book. Enron estimated that it had over 1,000 creditors and that after paying administrative expenses it would have funds available for distribution to unsecured creditors. *See* Enron Petition, at 1.

On December 3, 2001 the Debtors filed a motion pursuant to Rule 1007 of the Federal Rules of Bankruptcy Procedure to extend until April 17, 2002 their time to file the required schedules of assets and liabilities, statements of financial affairs and schedules of executory contracts and unexpired leases. On the same day the motion was granted by the Bankruptcy Court. On March 15, 2002 the Debtors filed a motion for a further extension of time, until June 17, 2002, to file their schedules.<sup>7</sup> This most recent motion for an extension is scheduled for a hearing on April 11, 2002.

## **2. ENA**

According to ENA Corp.’s bankruptcy petition (the “ENA Petition”), Enron “directly or indirectly owns, controls, or holds, with power to vote,” 100% of the voting securities of ENA Corp. *See* ENA Petition, Exh. A, at ¶ 4. ENA’s business includes the trading of such commodities as electric power and natural gas and the development of power projects. *See* ENA Petition, at 1. As of its Petition Date, ENA Corp. reported total assets of over \$13.7 billion and total debt of over \$8.8 billion, although total debt did “not reflect off-balance sheet and contingent obligations.” *See* ENA Petition, Exh. A, at ¶¶ 2(a) and (b) and n.1.

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<sup>7</sup> At least one ENA trade creditor has objected to the Debtors’ motion for an extension of their time to file schedules on the grounds that, among others, ENA should be moving more quickly towards formulating a plan of reorganization and extending the Debtors’ time to file the schedules would impede ENA’s ability to do so.

**B. Relevant Proceedings In the Bankruptcy Court**

**1. The DIP Financing**

On December 3, 2001 Enron and ENA Corp., as Borrowers, their respective subsidiaries, as Guarantors and Citicorp, USA ("Citicorp") and JPMorgan Chase Bank ("Chase"), as Lenders (Citicorp and Chase, collectively, the "DIP Lenders") entered into a Revolving Credit and Guaranty Agreement (the "Credit Agreement") providing up to \$1.5 billion in debtor-in-possession financing. The DIP Lenders agreed to make a "Tranche A loan" to Enron in the amount of up to \$1.5 billion to be used for loans or letters of credit and to fund administrative and operating expenses. The DIP Lenders also agreed to lend ENA Corp. a "Tranche B loan" in an amount to be negotiated and to be used "for the purposes agreed to by the Tranche B Lenders."

The DIP financing was to be secured by (i) a superpriority claim pursuant to section 364(c)(1) of the Bankruptcy Code, (ii) a perfected and first priority lien on all unencumbered assets pursuant to section 364(c)(2) of the Bankruptcy Code and (iii) a junior lien on all assets subject to valid and perfected liens pursuant to section 364(c)(3) of the Bankruptcy Code. *See* Credit Agreement, at ¶ 2.23.<sup>8</sup> Repayment of amounts owed under the Credit Agreement was jointly and severally guaranteed by the Guarantors.

On December 3, 2001 the Debtors moved for an Interim Order approving the borrowing of up to \$250 million under the Credit Agreement and setting a date for a hearing regarding "Final Approval of the Credit Agreement" (the "Financing Motion"). On the same day, the

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<sup>8</sup> These liens were subject to a "carve-out" for court costs, United States Trustee fees and up to \$12.5 million in fees for professionals retained by the Borrowers, Guarantors or any Committees and/or for expenses incurred by any Committee member(s). *See* Credit Agreement, at ¶ 1.01.

Bankruptcy Court issued an Interim Order authorizing Enron to borrow up to \$250 million under the Credit Agreement (the "Interim Order"). As of the date of this Interim Report, the Bankruptcy Court has not held a final hearing on the Financing Motion<sup>9</sup> and none of the \$250 million authorized borrowing under the Credit Agreement has been drawn down by the Debtors.

The Examiner has been informed recently by the Debtors that Enron as the borrower and each of Enron's direct and indirect Debtor subsidiaries as guarantors (the "Amended DIP Guarantors") are negotiating an amended and restated DIP credit facility (the "Amended DIP Facility") with the DIP Lenders. The Amended DIP Facility is to be limited to \$250 million, used only to support the issuance of letters of credit ("L/Cs") and to be fully cash collateralized by the individual Debtor or non-Debtor entity requesting an L/C.

On the closing date of the Amended DIP Facility Enron's collateral account must have \$25 million in cash and Enron must always have 110% of cash collateral coverage for any L/C exposure. The Amended DIP Facility requires that Enron and the Amended DIP Guarantors maintain at all times at least \$75 million in aggregate cash in accounts other than collateral accounts.<sup>10</sup>

As of the date of this Interim Report the Debtors have not sought Bankruptcy Court approval of the Amended DIP Facility. Assuming the Amended DIP Facility is approved, the

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<sup>9</sup> On March 1, 2002, citing its appointment of an ENA Examiner, the Bankruptcy Court entered an Order adjourning the final hearing on the Financing Motion pending the filing of the ENA Examiner's report, at which time, it indicated, the hearing would be rescheduled. *See* Order Adjourning the Post-Petition Financing Hearing, dated March 1, 2002, at 2.

<sup>10</sup> Under the Amended DIP Facility Enron will no longer be required to deposit asset sale proceeds into a collateral account. Also, the carve-out amount will be reduced from \$12.5 million to \$2.5 million.

Examiner's ability to assess whether ENA's Junior Liens can be repaid will have been facilitated because, *inter alia*, (a) the amount of the potential liens senior to ENA's Junior Liens will have been reduced from \$1.5 billion to approximately \$275 million, (b) the new senior lien will be fully cash collateralized, thereby freeing up Enron's other cash and substantial non-cash assets to repay ENA and (c) the proceeds of asset sales will be able to be utilized, if necessary, to repay ENA and will not be required to be deposited with the DIP Lenders.<sup>11</sup>

The Examiner's recommendations in this Interim Report are premised in part on the assumption that the Amended DIP Facility in substantially the form presented to him will ultimately be approved by the Bankruptcy Court.

**2.     The Order Authorizing Continued Use of Enron's  
Pre-Petition Centralized Cash Management System**

On December 3, 2001, the same day the Debtors sought the Interim Order, the Debtors also sought an order authorizing the continued use of the Centralized Cash Management System. In their motion papers and at a Bankruptcy Court hearing on February 8, 2002 the Debtors described the pre-Petition Centralized Cash Management System as follows: "Collection" accounts were set up for substantially all of Enron's subsidiaries. These accounts collected the cash receipts of the various subsidiaries.<sup>12</sup> Appropriate lockboxes were established for check collections. Funds in these individual collection accounts and lockboxes were transferred daily to an Enron concentration account maintained first at Bank of America and later at Chase and

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<sup>11</sup> The Examiner has not yet analyzed the extent to which ENA may need L/Cs to support the Trading Book.

<sup>12</sup> On the Petition Date Enron stopped sweeping cash from its non-Debtor subsidiaries.

then to an account at Citibank.<sup>13</sup> Funds swept into the Enron concentration account from each individual subsidiary (including ENA) were booked as an account payable due from Enron to that subsidiary.

Payroll, as well as such corporate overhead expenses as rent, insurance, expenses relating to computer systems and expenditures for servicing corporate debt, were paid from the Citibank account. Each subsidiary's allocated share of overhead was booked as an account receivable due Enron from that subsidiary.<sup>14</sup> Based upon their cash needs for daily operations and other expenses (other than payroll and corporate overhead), subsidiaries would make requests to Enron for disbursements. When a subsidiary's request for a disbursement was approved, funds from the Citibank account would be transferred to the subsidiary's account. Each such transfer was booked as an account receivable due Enron from the subsidiary (or used to reduce any account receivable due the subsidiary from Enron). *See, inter alia*, Motion of the Debtors for Order Authorizing Continued Use of Existing Bank Accounts, Cash Management System and Business Forms, at ¶¶ 10-12 and Exh. A thereto; Transcript of the February 8, 2002 hearing, at 32-35, 39-46, 49-54.

Prior to the bankruptcy filings, requests for disbursements by subsidiaries were reviewed by, among others, business unit management and accounts payable personnel. Since the

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<sup>13</sup> In their December 3, 2001 motion seeking approval of their continued use of the existing Centralized Cash Management System, the Debtors noted that the Bank of America accounts were being replaced by accounts at Chase. This change of banks apparently related to the fact that Bank of America, an Enron creditor, effectuated a substantial setoff against the funds maintained in Enron's bank accounts.

<sup>14</sup> Enron's pre-Petition method for allocating overhead was not always complete or consistent. For example, pre-Petition, Enron allocated corporate costs only partially to business units.

bankruptcy filings, requests for disbursements have been reviewed by the Cash Management Committee and the BTRC.

By Order dated December 3, 2001 (the "Initial Cash Management Order") the Bankruptcy Court, *inter alia*, granted the Debtors authority to continue using the pre-Petition Centralized Cash Management System. Hence, the cash receipts of Debtor subsidiaries (including ENA) continued to be swept up to Enron (until February 25, 2002).

### **3. The UBS Sale**

Soon after the bankruptcy filings the Debtors began negotiating the sale of ENA's "Wholesale Trading Business," which included marketing, selling and market making in energy commodities and related risk management and financial services. The Wholesale Trading Business was described as a very valuable Enron asset, assertedly generating \$2 billion - \$3 billion of profits during the year preceding the bankruptcy. *See* Joinder of the Ad Hoc Committee in the Motion of Various Trading Creditors to Except Enron North America from the Centralized Cash Management System, at 2; Transcript of the January 18, 2002 hearing, at 12.

On December 14, 2001 the Debtors sought Bankruptcy Court approval for bidding procedures for the sale of the Wholesale Trading Business and a hearing date to consider terms of a proposed sale. As described in the Debtors' motion, the proposed transaction contemplated that ENA would contribute assets to a new entity called The New Energy Trading Company ("Netco"). Netco would, in turn, be 51% owned by the potential purchaser and 49% owned by ENA. The Trading Book would not be contributed to the joint venture. *See* Debtors' Motion for an Order Approving Agreements for the Sale of Assets of a Portion of Enron's Wholesale Trading Business, at ¶¶ 17.



On January 14, 2002 the Debtors announced that UBS Warburg AG ("UBS") was the highest bidder for the Wholesale Trading Business and disclosed the terms of the sale to UBS. ENA would receive no up-front consideration, but would be entitled to 33% (rather than 49%) of the new entity's prospective profits. *See* Transcript of the January 18, 2002 hearing, at 15-17; Enron's February 8, 2002 8-K filing.<sup>15</sup> These profits would be paid to or escrowed for the benefit of the DIP Lenders and ultimately the ENA estate. *See* Order Approving the Terms and Conditions of Agreements for the License and Related Transactions in Respect to Enron's Wholesale Trading Business, at ¶ 6.

On January 18, 2002 the Bankruptcy Court held a hearing on the Debtors' motion for approval of the UBS sale. The Blackstone Group L.P. ("Blackstone"), the Debtors' financial advisor, estimated that with the benefit of UBS's financial backing the Wholesale Trading Business could, in the future, earn aggregate profits in a range of \$40 million to \$2 billion. *See* Transcript of the January 18, 2002 hearing, at 17-20, 22-24.

The transaction was opposed by the Ad Hoc Committee of Energy Merchants (the "Ad Hoc Committee"), comprising counterparties to numerous energy and financial contracts in the

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<sup>15</sup> Specifically, ENA would receive a "Royalty" in the form of 33% of the "net profits" earned by Netco. Net profits would be calculated after first deducting (i) relevant business costs, defined as premises costs, legal, audit and other professional fees and expenses, personnel costs and all other costs of operating the business and (ii) overhead costs calculated at a set amount of \$25 million. In addition, UBS would be entitled to deduct up to \$20 million from the royalty payment for any amounts UBS expended in setting up the infrastructure for the new trading business, licensing proprietary technology from third parties and establishing a disaster recovery facility and system for the new business. *See* Comprehensive License Agreement among Enron, ENA, Enron Net Works, LLC and UBS, at ¶¶ 5.1, 5.2, 5.11.

Trading Book and claiming to be owed at least \$600 million.<sup>16</sup> *Id.*, at 161. The Ad Hoc Committee argued that the proposed transaction was not beneficial to ENA because, among other reasons, (i) UBS was obligated to pay no money up-front for the Wholesale Trading Business, (ii) the profits to be earned were speculative and (iii) the Enron traders joining UBS had the ability, if not the incentive, to engage in “front running,” *i.e.*, using their knowledge of ENA’s trading positions in its various commodities and financial contracts to their own advantage and to the detriment of ENA. *See* Transcript of the January 18, 2002 hearing, at 98-109; Motion of the Ad Hoc Committee to Alter or Amend the January 22, 2002 Order Approving the Terms and Conditions for the License and Related Transactions in Respect to Enron’s Wholesale Trading Business, at ¶¶ 4, 12-14.

By Order dated January 22, 2002 the Bankruptcy Court approved the sale to UBS over the Ad Hoc Committee’s objections. *See* Order Approving the Terms and Conditions of Agreements for the License and Related Transactions in Respect to Enron’s Wholesale Trading Business. The UBS transaction closed on February 8, 2002. *See* Enron’s February 8, 2002 8-K filing.

**4. The Motion of the Trading Creditors to Except ENA From the Centralized Cash Management System**

On January 17, 2002 a group of energy trading companies, creditors of ENA pursuant to hedge, forward or similar contracts, moved to (i) except ENA from the Centralized Cash Management System and (ii) direct ENA to implement a new cash management system and

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<sup>16</sup> The Ad Hoc Committee consists of Aquila, Inc., Independent Producer Group, Mirant Americas Energy Marketing, L.P., PG & E National Energy Group, Powerex and Reliant Energy Services, Inc.

provide an accounting. The Ad Hoc Committee and others joined in the motion (collectively, the “Movants”).

The Movants contended that ENA’s cash flow was more than sufficient to meet the needs of its ongoing operations and that there was, therefore, no need for ENA to participate in the Centralized Cash Management System. Indeed, the Movants complained, ENA’s cash flow was being swept up to Enron and disbursed to other Debtor and non-Debtor subsidiaries, to the detriment of the ENA estate. *See Application of Various Trading Creditors in Support of Motion for Order Excepting Enron North America from Existing Centralized Cash Management System*, at ¶¶ 9, 12-15.

The Debtors argued in response that a separate cash management system for ENA was unnecessary because (i) under the Centralized Cash Management System intercompany transfers were being recorded, (ii) the administration of the cash flows of the recipient entities would be subject to specific budgets and business plans and (iii) more generally, the Debtors would work to ensure that any entity receiving intercompany funds had adequate assets to repay such funds. *See Debtors’ Objections To Motion Of Various Trading Creditors For Order Excepting Enron North America from Existing Cash Management System*, at ¶¶ 2-3, 18-20.<sup>17</sup>

In its response, the Official Committee of Unsecured Creditors (the “Official Creditors’ Committee”) said the Movants’ concerns could be addressed by (i) providing ENA with a superpriority administrative expense claim and junior lien (subordinate only to the lien of the

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<sup>17</sup> The DIP Lenders also filed a limited objection on the ground that modification of the existing Centralized Cash Management System would cause Enron to violate its Credit Agreement with the DIP Lenders. *See Limited Objection of Citicorp USA, Inc. and JP Morgan Chase Bank to the Motion of Various Trading Creditors Excepting Enron North America From Existing Cash Management System*, at ¶¶ 2-3.

DIP Lenders) in the amount of any such transfers, (ii) paying ENA interest on such transfers and (iii) keeping detailed and accurate records of any such transfers. The Official Creditors' Committee attached to its response a draft amended cash management order providing such protections. *See* Response of the Official Committee of Unsecured Creditors to Motion of Various Trading Creditors for Order Excepting Enron North America from Existing Cash Management System, at ¶¶ 8, 10 and Exh. A-2.

On February 8, 2002 the Bankruptcy Court heard the Movants' motion. The Movants proffered evidence that (i) \$700 million had been disbursed from the Enron concentration account between December 3, 2001 and January 3, 2002 (*see* Transcript of the February 8, 2002 hearing, at 100-103), (ii) during the 18 months following the bankruptcy filings (based on Enron's budget projection) cash sweeps to Enron would amount to \$3.6 billion, of which approximately \$3 billion would be swept from ENA (*see id.*, at 151-152), (iii) there was no firm assurance that any of the Debtor and non-Debtor entities that had received (or would receive) intercompany loans from cash swept up to Enron would be able to repay them (*see id.*, at 141-142) and (iv) in fact, a number of the non-Debtor entities that had received intercompany loans following the bankruptcy filings had subsequently filed for bankruptcy themselves, thereby making Enron a creditor of such entities and, in the event of a pre-petition repayment of any portion of such loans, a potential recipient of preferential transfers from such subsidiary estates (*see id.*, at 126). Moreover, the Movants noted, no representative of ENA sat on the Cash Management Committee, no representative of ENA sat on the BTRC<sup>18</sup> and no ENA

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<sup>18</sup> As described more fully below, the BTRC, comprising representatives from various departments of Enron, including Corporate Development, Tax and Legal, reviews and evaluates transactions (such as asset sales and non-ordinary course expenditures)

(continued...)

representative had participated in any meaningful way in the decision as to whether ENA funds should be swept up to Enron. *See id.*, at 177-179, 196.

Accordingly, the Movants argued, the protections proposed by the Official Creditors' Committee, including the superpriority status of claims based on intercompany transfers and detailed accounting of such intercompany transfers, were inadequate: there was no assurance that either the significant amounts Enron had transferred or would disburse as intercompany loans could ever be repaid or that the ENA transfers would be repaid.

In rejoinder, the Debtors proffered evidence that Enron anticipated generating over \$2 billion from the sale of assets that were unencumbered other than by the DIP financing. Specifically, the Debtors pointed to \$1.5 billion they anticipated receiving from the sale of Portland General Electric Company, \$350 million from the sale of Enron Oil and Gas India Ltd. and \$300 million from the sale of Enron Wind Corp. *See* Transcript of the February 8, 2002 hearing, at 294-295. Hence, they claimed, Enron would have sufficient funds to repay intercompany loans made by ENA. The Debtors also said that excepting ENA from the Centralized Cash Management System would be cumbersome and inconvenient. *See id.*, at 236-243, 307-308.

## **5. The Amended Cash Management Order**

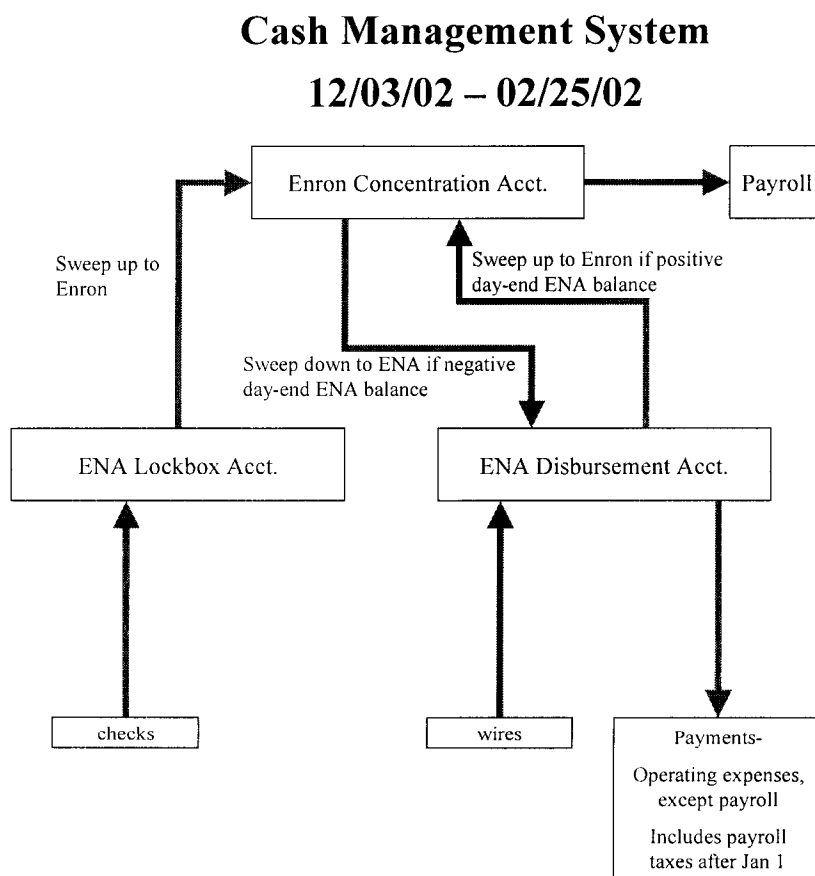
After considering these arguments, the Bankruptcy Court concluded (the "February 21 Decision") that amending the Initial Cash Management Order was in the best interest of the Debtors' estates. *See* Transcript of the February 21, 2002 hearing, at 34. Although the Bankruptcy Court, *inter alia*, authorized the Debtors to continue using the Centralized Cash

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<sup>18</sup> (...continued)  
proposed by Enron and/or its subsidiaries.

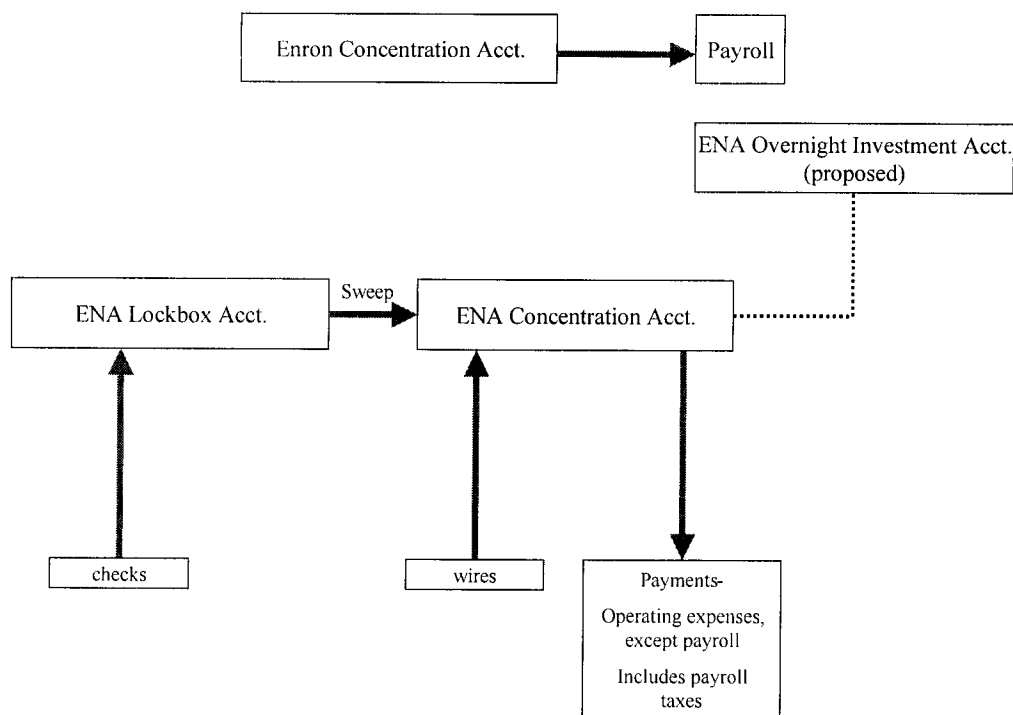
Management System, it imposed certain modifications thereto (*see id.*, at 34-35) and so provided in an Order amending the Centralized Cash Management System entered on February 25, 2002 (the Amended Cash Management Order).

The following chart illustrates how the Centralized Cash Management System operated from the Petition Date through and including February 25, 2002 as it related to Enron and ENA:



The following chart illustrates how the Centralized Cash Management System has operated from February 26, 2002 forward:<sup>19</sup>

### Cash Management System 02/26/02 – Present



The Amended Cash Management Order provides that, “[e]xcept as otherwise required by any applicable cash collateral or postpetition financing orders or the DIP Credit Agreement, the Debtors are authorized to continue to utilize the Centralized Cash Management System as described in the Initial Cash Management Motion.” Amended Cash Management Order, at ¶ 4.

<sup>19</sup> Annexed hereto as Exhibits “B” and “C” are charts which illustrate the flow of cash through ENA entities on a representative date prior to the entry of the Amended Cash Management Order and on a representative date after the entry of the Amended Cash Management Order. Exhibit “B” illustrates the flow of funds through ENA entities on January 15, 2002; Exhibit “C” illustrates the flow of funds through ENA entities on March 18, 2002.

Accordingly, the Debtors are “not required to establish separate accounts for cash collateral and/or tax payments” and are “specifically authorized to pay any costs or expenses associated with the maintenance of the Centralized Cash Management System.” *Id.* However, the Debtors’ continued use of the Centralized Cash Management System is expressly conditioned on the Debtors having “no more than \$250 million in outstanding DIP Obligations, subject to increase by a maximum amount of \$150 million at the final hearing on DIP financing.”<sup>20</sup> *Id.*

In addition, the Amended Cash Management Order grants certain forms of adequate protection to each Debtor that transferred property subsequent to the Petition Date (the “Adequately Protected Debtor”) to or for the benefit of any other Debtor (the “Beneficiary Debtor”). Amended Cash Management Order, at ¶ 5. Such adequate protection includes the granting of “Junior Reimbursement Claims” and “Junior Liens.” Junior Reimbursement Claims are defined as claims against the Beneficiary Debtor for the fair value of any property or benefit transferred. *Id.*, at ¶ 5(a). Such claims bear interest at the “Prevailing Rate”<sup>21</sup> and have priority over all other administrative expenses set forth in sections 503(b) and 507(b) of the Bankruptcy Code. *Id.* Junior Liens are defined as liens on all property of a Beneficiary Debtor’s estate that secures the Junior Reimbursement Claims. *Id.*

The Amended Cash Management Order provides that Junior Reimbursement Claims and Junior Liens are “junior, subject and subordinated only to the superpriority claims and liens

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<sup>20</sup> The Amended DIP Facility as proposed will satisfy this requirement.

<sup>21</sup> The “Prevailing Rate” is defined in the Amended Cash Management Order as “one-month LIBOR plus 250 basis points, measured on the first business day of any month in which such Junior Reimbursement Claim or Intercompany Loan is outstanding, attributed to the average outstanding balance for the whole month.” *See* Amended Cash Management Order, at ¶ 7.



granted to the Agents and the DIP Lenders in respect of the Debtors' DIP Obligations (as such terms are defined in the Interim DIP Financing Order), and to any claims against such Beneficiary Debtor that are expressly senior to, or carved out from, such claims of the Agents and DIP Lenders . . . .” Amended Cash Management Order, at ¶ 5(b)(i). However, an Adequately Protected Debtor is prohibited from exercising any right or remedy relating to the Junior Reimbursement Claims or the Junior Liens; such rights and remedies are reserved exclusively for the Agents for the DIP Lenders. *Id.*, at ¶¶ 5(b)(ii) and (iii). Upon the request of the Agents for the DIP Lenders, the Adequately Protected Debtor must release or terminate its Junior Liens to the extent the property subject to the Junior Liens is sold or otherwise disposed of by the Agents or other Debtors. *See id.*, at ¶ 5(b)(iii). If Debtors sell property that is subject to Junior Liens, the Junior Liens will attach to the proceeds of sale in the same order of priority. *See id.*, at ¶ 5(c). Unless otherwise ordered by the Bankruptcy Court, a Debtor is prohibited from transferring property to or for the benefit of another Debtor unless the aggregate fair value of the assets of the Beneficiary Debtor “exceeds the sum of (x) all outstanding DIP Obligations in excess of the amount of cash collateral being held in escrow by the DIP Agents, (y) all claims against the proposed Beneficiary Debtor that are expressly senior to, or carved out from, claims in respect of the DIP Obligations (excluding setoff rights whose exercise has not previously been authorized by the Court) and (z) all Junior Reimbursement Claims allowable against the proposed Beneficiary Debtor, immediately after such transfer.” *Id.*, at ¶ 5(d).

The Amended Cash Management Order also limits the Debtors' ability to transfer property to non-Debtor affiliates. *See* Amended Cash Management Order, at ¶ 6. A Debtor can transfer property to or for the benefit of a non-Debtor affiliate only “if the aggregate fair value of

the assets of such non-debtor affiliate, immediately prior to such transfer, exceeds the aggregate liabilities of such non-debtor affiliate, immediately prior to such transfer, by at least 15%.” *Id.* If a Debtor transfers or had transferred property to a non-Debtor affiliate subsequent to the Petition Date, “with an aggregate fair value in excess of the aggregate fair value of property (including cash) or benefit received by the transferring Debtor from such non-debtor affiliate, the transferring Debtor shall be deemed to have made an intercompany loan to such non-debtor affiliate in the principal amount equal to the net fair value of property (including cash) or benefit transferred . . . (an ‘Intercompany Loan’).” *Id.* Unless the Bankruptcy Court orders otherwise, “aggregate Intercompany Loans by all Debtors outstanding at any time shall not exceed (x) \$30,000,000 to any individual non-debtor affiliate or (y) \$70,000,000 to all non-debtor affiliates, taken as a whole; provided, however, that the foregoing permitted maximum amounts shall be reduced to \$25,000,000 and \$50,000,000, respectively, on or before the 45th day after entry of this Order.”<sup>22</sup> *Id.* (emphasis in original).

The Amended Cash Management Order provides additional adequate protection for ENA. Specifically, for 30 days after entry of the Amended Cash Management Order “no transfers of cash of ENA shall be permitted to be made to any Debtor or non-debtor affiliate other than to pay for direct actual expenses of ENA, or a direct or indirect subsidiary of ENA, including, without limitation, payroll expenses, wholesale power purchases, and funds to support any letters of credit posted or to be posted for the direct benefit of ENA, or a direct or indirect subsidiary of

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<sup>22</sup> The 45<sup>th</sup> day after the entry of the Amended Cash Management Order is April 11, 2002. As of the date of this Interim Report, the Debtors are complying with these stated limits. As of March 22, 2002, aggregate loans and advances for payroll to non-Debtor affiliates total approximately \$21 million; the Examiner does not believe there have been any significant increases in this amount since that date.

ENA.” Amended Cash Management Order, at ¶ 10. ENA was also granted the following adequate protection:

- (i) As part of any Allocation Order (defined below), a limitation will be imposed on the maximum balance of net ENA post-Petition intercompany receivables from all other Debtors, taken as a whole;
- (ii) An ENA representative is added to the Debtors’ Cash Management Committee (referred to in the Amended Cash Management Order as the “cash approval committee”) and the BTRC (collectively, the “Committees”);
- (iii) The ENA representative is directed to consult with the Examiner on matters pertaining to ENA and reviewed by the Committees; and
- (iv) Within five business days after entry of the Amended Cash Management Order, ENA is directed to establish a separate cash concentration account in accordance with section 5.07 of the DIP Credit Agreement.<sup>23</sup>

*Id.*, at ¶ 10.

The Bankruptcy Court also imposed reporting requirements on each Debtor which continues to use the Centralized Cash Management System. Such Debtors are required to, *inter alia*, (i) keep a detailed accounting setting forth all intercompany transfers of property and benefits conferred and reflecting all Junior Reimbursement Claims, (ii) provide details and

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<sup>23</sup> Section 5.07 of the original DIP Credit Agreement states as follows:

*Maintenance of Concentration Account.* The Borrowers and the Guarantors shall, within 30 days after the Closing Date, and at all times thereafter, maintain with the Paying Agent an account or accounts (the “Concentration Account”) (a) to be used by the Borrowers and the Guarantors as their principal concentration accounts and (b) into which shall be swept or deposited, at the end of each Business Day, all cash of the Borrowers and the Guarantors and the full available balances in excess of an aggregate of \$100,000 in all of the operating and other bank accounts of the Borrowers and the Guarantors maintained at any institution other than the Paying Agent. (emphasis omitted)

summary information regarding cash disbursements, (iii) report weekly to the Official Creditors' Committee and the Agents for the DIP Lenders on a variety of topics, including, but not limited to, cash balances of each such Debtor, cash receipts and disbursements, use of any borrowings and valuations of assets and liabilities, (iv) provide balance sheets for each such Debtor and each non-Debtor affiliate that has an Intercompany Loan outstanding and (v) provide notice and copies of "any waivers or other modifications received or requested in respect of the DIP Credit Agreement as soon as practicable (but in no event later than one business day) thereafter." Amended Cash Management Order, at ¶ 12. The Amended Cash Management Order expressly states that the Examiner (as discussed below) is to receive copies of any reports generated pursuant to paragraph 12 of the Amended Cash Management Order. *Id.*

Lastly, the Bankruptcy Court directed that the Debtors consult with the Official Creditors' Committee in developing a formula for allocating shared overhead expenses among the Debtors and, if applicable, their non-Debtor affiliates, from and after the Petition Date. *See id.*, at ¶ 15. The Debtors were directed to file a motion seeking approval of such an allocation formula within 30 days of the entry of the Amended Cash Management Order (any order granting such approval being an "Allocation Order"). *See id.*

#### **6. The Termination of Sweeps From ENA**

On February 25, 2002, the date of entry of the Amended Cash Management Order, Enron stopped sweeping cash from ENA accounts. Moreover, as noted, the Amended Cash Management Order specifically prohibited Enron from sweeping up cash from ENA accounts for a period of 30 days following the entry of that Order -- or until March 27, 2002 (the "ENA Cash Freeze"). Pursuant to a Stipulation and Order of the Bankruptcy Court dated March 27, 2002

(the “March Order”), the ENA Cash Freeze was extended until 30 days after the date on which the Examiner is required to file the Interim Report -- or until May 9, 2002 (the “Cash Freeze Extension”).<sup>24</sup>

**7. The Appointment of the ENA Examiner**

In addition to modifying the Initial Cash Management Order, the Bankruptcy Court directed in its February 21 Decision that the Office of the United States Trustee appoint an Examiner in the ENA case. Under the February 21 Decision the Examiner is

to, among other things, prepare a report regarding the issues raised by the Movants as to the continued participation in the cash management system by Enron North America, including the terms and conditions of such participation; participate in both the Cash Approval [Cash Management] and Risk Assessment Committees [the BTRC]; [and] perform other tasks that may be agreed upon or recommended by the parties to these Motions and approved by the Court . . . .

*See* Transcript of the February 21, 2002 hearing, at 35.

By Application dated March 11, 2002, the United States Trustee moved for the appointment of the Examiner. By Order dated March 12, 2002, the Court approved the United States Trustee’s appointment of the Examiner. By two Orders, each dated March 27, 2002, the Bankruptcy Court approved the retention by the Examiner of (i) Goldin Associates, LLC as special consultant and financial advisor to the Examiner and (ii) Kaye Scholer LLP as counsel to the Examiner.

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<sup>24</sup> The Examiner was involved in the negotiations regarding the March Order and supported its entry. The March Order also extended Debtors’ time to move for an Allocation Order until May 9, 2002.

## II.

### THE EXAMINER'S INVESTIGATION

#### **A. The Duties of the Examiner as Set Forth By the Bankruptcy Court**

Subsequent to the entry of the February 21 Order, in the March 6 Order the Bankruptcy Court further defined the Examiner's duties.<sup>25</sup> Pursuant to the March 6 Order the Examiner

shall have the duties, powers and responsibilities of an examiner under section 1106(b) of the Bankruptcy Code provided, however, that consistent with the Court's February 21, 2002 Order, the scope of the ENA Examiner's duties, unless expanded or limited by further order of this Court, shall be limited to the preparation of a report, including a recommendation (the "Cash Management Report"), regarding the issues concerning (i) ENA's continued participation in the Enron centralized cash management system, (this analysis would include, without limitation, whether and to what extent assets exist subject to the Junior Lien, as that term is defined on the Amended Cash Management Order, for repayment of ENA cash advances made and/or to be made to other Debtors under the Amended Cash Management Order) and (ii) the allocation of certain overhead costs to ENA, including, but not limited to, any allocation for the use of any intellectual property . . . .

March 6 Order, at p. 2.

The March 6 Order provides further that the Cash Management Report is due within 20 business days of the date of the appointment of the Examiner -- or by April 9, 2002. *Id.*, at p. 5. In addition to preparing the Cash Management Report, the Examiner is also (i) to be given notice of, and participate in, all meetings of the Cash Management Committee and the BTRC (*id.*, at p. 3), (ii) directed to "immediately report to th[e] Court any expenditure that [he] deems to be improper" (*id.*), (iii) directed to file with the Court weekly a "list of all deposits and

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<sup>25</sup> The March 6 Order is entitled "Order Defining Duties of Examiner to be Appointed Pursuant to February 21, 2002 Order Directing Appointment of an Examiner in Enron North America."

disbursements made into and out of the Consolidation Account, as that term is defined in the Amended Cash Management Order . . . ” (*id.*) and (iv) directed to file a monthly report “regarding the status of ENA Cash [as defined in the March 6 Order], including gross and net collections and expenditures and the status of ENA assets and liabilities . . . .” (*id.*, at p. 5).<sup>26</sup>

The March 6 Order also provides (i) that the Debtors and their professionals and the Official Creditors’ Committee and its professionals are to “cooperate fully with the ENA Examiner” and to provide him with “all documents and information that [he] deems relevant to discharge his duties under this Order, or as such duties . . . may be expanded or limited by this Court . . . .” (*id.*, at p. 4) and (ii) that the Examiner is a “party in interest” and is permitted to appear and be heard at all hearings on matters within the scope of his duties (*id.*). Lastly, the March 6 Order provides that the Court may *sua sponte* expand or limit the duties of the Examiner. *Id.*, at p. 6.

#### **B. The Scope of the Examiner’s Investigation**

As noted, the March 6 Order requires the Examiner to address a series of inter-related issues and make recommendations to the Bankruptcy Court regarding various significant matters relating to these bankruptcy proceedings. For example, the Examiner must determine whether ENA should continue to participate in the Centralized Cash Management System. Such a determination requires an analysis of a number of issues, including, but not limited to, (i) the

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<sup>26</sup> “ENA Cash” or “cash of ENA” is defined in the March 6 Order as “all cash, and cash equivalent assets, ever belonging to ENA, or arguably ever belonging to ENA, proceeds of the sale of assets belonging to ENA, and advances from direct and indirect subsidiaries and affiliates of ENA, including entities in which ENA has an equity interest, and shall specifically include, without limitation, the proceeds of ENA Cash as the same may have been or may be advanced, from time to time, to Enron Corp. or to other Enron Corp. direct and indirect subsidiaries and affiliates . . . .” March 6 Order, at pp. 5-6.

amount of cash swept up from ENA under the Centralized Cash Management System, (ii) the amount of the intercompany receivable due to ENA based upon such cash sweeps, giving consideration to amounts paid back to ENA by Enron and appropriate allocation of overhead charges to ENA by Enron, (iii) what assets exist subject to the Junior Liens, (iv) the value of such assets and the anticipated timing of the monetization of such assets and (v) the adequacy of the credit limits imposed by Enron on intercompany transfers to Debtor and non-Debtor entities to ensure that such intercompany transfers are repaid. A careful analysis of these issues is also central to the Examiner's assessment of whether the swept amounts will be repaid and, if so, when.

As noted, too, the March 6 Order requires the Examiner to perform an ongoing oversight function respecting the ENA estate by participating in meetings of the Cash Management Committee and the BTRC, identifying and reporting any improper expenditures, filing weekly lists of all deposits and disbursements made into and out of the ENA Concentration Account and filing monthly reports regarding the status of ENA Cash, assets and liabilities. To participate meaningfully in such Committee meetings, identify any improper expenditures, accurately quantify and describe ENA Cash, non-cash assets and liabilities and fulfill his reporting obligations, the Examiner must understand fully the nature and value of ENA's assets and liabilities, including the Trading Book, and its business more generally.

Furthermore, the March 6 Order requires that the Examiner report on "the allocation of certain overhead costs to ENA, including, but not limited to, any allocation for the use of any intellectual property . . . ." To perform this task, the Examiner must consider and evaluate a number of overhead allocation methodologies, both those proposed by the Debtors and their



consultants and potentially other methodologies. Thereupon, the Examiner will be able to make an informed determination respecting the appropriate allocation of overhead to ENA, as well as to calculate the net intercompany receivable due ENA, discussed further below.

**C. The Examiner's Activities Since His Appointment**

The Examiner's investigation commenced on March 13, 2002, immediately after the entry the preceding evening of the Order appointing Harrison J. Goldin Examiner in Enron North America, and has continued non-stop through the date of this report. The investigation has been conducted by Mr. Goldin, assisted by four consultants from Goldin Associates, LLC and attorneys from Kaye Scholer LLP.

The investigation has had a number of components. First, the Examiner himself has spent no fewer than all or part of ten days at Enron headquarters in Houston meeting with numerous officers and employees of Enron and ENA and examining documents and other materials. The Examiner and/or his representatives reviewed with these Enron and ENA officers and employees a number of topics in depth, including, but not limited to, the structure and function of the Centralized Cash Management System (i) prior to the bankruptcy, (ii) from the Petition Date until the entry of the Amended Cash Management Order on February 25, 2002 and (iii) after the entry of the Amended Cash Management Order. The Examiner and his representatives also reviewed Enron's efforts to comply with the Amended Cash Management Order, the present and projected cash inflows and outflows of Enron and ENA, actual and anticipated intercompany transfers, Enron's primary assets and any prospective or actual sales of such assets, the Trading Book, ENA non-trading assets, the organization and structure of ENA,

both as a formal matter and in terms of the actual flow of economic benefits and the status of Enron's effort to develop an overhead allocation.

Second, the Examiner and/or his representatives have met with PricewaterhouseCoopers ("PwC"), the Debtors' financial consultants, Zolfo Cooper, LLC ("Zolfo Cooper"), the Debtors' turnaround and restructuring consultants, and Ernst & Young Corporate Finance LLC ("E&YCF"), the Official Creditors' Committee's financial consultants. The Examiner reviewed with these consultants such topics as Enron's and ENA's financial condition and cash balances, present and projected cash flows, allocation of overhead, planned and prospective transactions relating to Enron and ENA assets, the status of reports required in the Amended Cash Management Order, the source information utilized to develop information reports and the treasury and accounting systems.

Third, since March 15, 2002 the Examiner and/or his representatives have attended all meetings of the Cash Management Committee, held every weekday at 8:00 a.m. to review any proposed disbursements, and have also received and reviewed voluminous materials provided by the Debtors that describe in detail every disbursement considered at each such meeting. In addition, the Examiner and/or his representatives have attended all meetings of the BTRC, held every Tuesday and Thursday at 1:00 p.m. to review proposed transactions and expenditures, and have also reviewed the materials provided in connection with the BTRC meetings that describe and analyze in detail every transaction and expenditure considered at each such meeting.

Fourth, the Examiner has held multiple meetings, both in person and by telephone, with representatives of the Movants and other parties. The Movants have explained to the Examiner their concerns regarding cash sweeps and intercompany transfers, among other issues. The

Examiner has also met with the Official Creditors' Committee and with counsel for the Debtors to get their perspectives regarding the tasks assigned to the Examiner.

Fifth, the Examiner and/or his representatives have reviewed a substantial quantity of materials, including charts relating to the structure of Enron and ENA and their subsidiaries, charts and descriptions relating to the Centralized Cash Management System, numerous balance sheets, financial statements, financial forecasts and related data, documents relating to intercompany transfers, documents relating to the allocation of overhead, documents relating to the DIP financing and proposed amendments thereto, ENA Corp. board minutes, documents prepared for the Cash Management Committee and BTRC meetings, commodities and financial contracts and other documents relating to the Trading Book and documents relating to pending or proposed transactions or expenditures, including written proposals and financial projections relating to such transactions or expenditures.

Sixth, the Examiner and/or his representatives have reviewed the Bankruptcy Court record, including pleadings, motions, hearing transcripts, deposition transcripts and related exhibits. The Examiner has also reviewed various news articles and other publications addressing issues relevant to his inquiry.

Seventh, as required by the Amended Cash Management Order, the Examiner and/or his representatives have been reviewing information relating to and involved in the preparation of (i) Weekly Reports on all disbursements made into and out of the ENA Accounts (defined below) and (ii) Monthly Reports regarding the status of ENA Cash and cash related assets and the status of ENA assets and liabilities.

In addition to meeting with individuals and reviewing numerous materials, the Examiner has been verifying and analyzing independently the information he has received. For example, the Examiner has been obtaining actual transaction data from Enron's treasury information system to verify independently the summary reports he has received regarding cash sweeps, cash balances and cash disbursements. Furthermore, the Examiner has been pursuing inquiries and information to assess independently the status and ultimate realization of ENA's assets. In addition, the Examiner has been considering various overhead allocation methodologies.

In sum, the Examiner has undertaken to compile and review relevant information on an expedited basis in order to file as complete a report as possible within the timeframe mandated by the Bankruptcy Court. However, the time available since his appointment has not been sufficient to enable the Examiner to respond fully and definitively to certain questions posed by the March 6 Order. Nonetheless, as discussed below, the Examiner can respond now to many of the questions the Bankruptcy Court posited.

### III.

#### **INTERIM FINDINGS AND RECOMMENDATIONS**

##### **A. ENA's Continued Participation in the Centralized Cash Management System**

Pursuant to the March 6 Order, the Examiner is required to make a recommendation regarding "ENA's continued participation in the Enron centralized cash management system," including "whether, and to what extent assets exist subject to the Junior Lien, as that term is defined in the Amended Cash Management Order, for repayment of ENA cash advances made and/or to be made to other Debtors under the Amended Cash Management Order."

At bottom, this assignment requires the Examiner to determine whether, how and when the ENA intercompany transfers will be repaid. In the Examiner's view this task requires an assessment and determination of, *inter alia*, (i) the amount of cash that has been swept up from ENA under the Centralized Cash Management System and the amount, if any, that is anticipated to be swept up going forward, (ii) the amount of cash returned to ENA by Enron, as well as ENA payroll expenses previously paid by Enron and the share of overhead expenses properly allocable to ENA, (iii) the extent to which cash or non-cash assets are available to repay ENA, (iv) Enron's "burn rate," *i.e.*, the present and likely future rates of expenditures by Enron and its non-ENA Debtor and non-Debtor subsidiaries and (v) the adequacy and efficacy of the procedures and credit limits established in connection with intercompany transfers to Debtors and non-Debtors.

##### **1. Cash Sweeps From ENA**

From the Petition Date until February 25, 2002, the date of entry of the Amended Cash Management Order, cash sweeps from ENA to Enron totaled approximately \$581 million. During this period Enron provided ENA with approximately \$99 million to pay its operating

expenses. The difference between the total amount of cash swept up from ENA to Enron and the amounts Enron transferred back down to ENA to pay operating expenses is the net amount of cash that was swept up to Enron (the "Net Cash Sweep").<sup>27</sup> As of March 25, 2002, taking into account the return of approximately \$1.5 million to ENA since February 25, 2002, the Net Cash Sweep totals approximately \$481 million (plus accrued interest). The amount due ENA is the difference between the Net Cash Sweep and (i) Enron's non-reimbursed payroll payments for the benefit of ENA and (ii) ENA's allocated share of overhead expenses. This differential is hereinafter called the "Net Intercompany Receivable." The amount of Enron's non-reimbursed payroll payments for the benefit of ENA approximates \$38 million through the end of March 22, 2002. As noted, ENA's share of overhead expenses has not been determined yet. Accordingly, the Net Intercompany Receivable has not been determined definitively at this time, but, in any event, is no greater than \$443 million (plus accrued interest).

## **2. Assets Available to Repay ENA**

### **(a) Enron's Cash**

Enron has approximately \$470.3 million cash on hand ("Cash on Hand") as of March 22, 2002. Of this amount, \$100.4 million is in a DIP cash collateral account pursuant to ¶ 2.13 of the Credit Agreement.<sup>28</sup> To compute Enron cash assets now available to satisfy ENA's Junior Liens, this amount must be subtracted from Cash on Hand because it is subject to the priority claims of the DIP Lenders. Significantly, the proposed Amended DIP Facility currently being formulated

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<sup>27</sup> These numbers reflect the aggregate amount of transfers between Enron and ENA and do not separately account for the transfers to and from Enron and the individual subsidiaries of ENA Corp.

<sup>28</sup> If the Amended DIP Facility is approved, \$75 million of this amount will be released to Enron by the DIP Lenders.

would require Enron or an entity requesting an L/C to deposit into a cash collateral account cash equal to 110% of the amount of the aggregate letters of credit issued for the benefit of Enron or the requesting entity under the Amended DIP Facility. Under the Amended DIP Facility currently contemplated, therefore, the amounts Enron would be required to keep in its cash collateral account to secure L/Cs could exceed or be less than the current \$100.4 million, depending on the Enron L/C usage. In addition, all *pari passu* liens and all carve-outs and liens senior to the liens of the DIP Lenders must also be subtracted from this amount of cash in order to ascertain the extent to which Enron cash remains available to repay the ENA Junior Liens.<sup>29</sup> Such *pari passu* liens and carve-outs (\$2.5 million under the Amended DIP Facility) total approximately \$27.5 million as of March 22, 2002. Accordingly, the net amount of Cash on Hand for purposes of the Examiner's analysis is a minimum of approximately \$153.8 million and a maximum of approximately \$403.8 million (the difference accounted for by the potential L/C usage by Enron, which would need to be cash collateralized). In either event, Cash on Hand does not appear sufficient to repay the Net Intercompany Receivable fully at this time. However, as

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<sup>29</sup> In cases in which cash from a subsidiary other than ENA has been swept up to Enron, under the Amended Cash Management Order that subsidiary, as with ENA, is also entitled to Junior Liens that are *pari passu* with ENA's Junior Liens. In connection with the Examiner's determination of the amount of cash available to repay ENA, the Examiner evaluated whether any Cash on Hand was subject to Junior Liens belonging to entities other than ENA and whether, more generally, any Cash on Hand is subject to claims equal or superior to ENA's Junior Liens. Regarding other Junior Liens, the Examiner has been informed that Enron had swept approximately \$25 million from four Debtor subsidiaries other than ENA through March 22, 2002. Such other Debtor subsidiaries should, therefore, be entitled to Junior Liens of approximately \$25 million (plus accrued interest), less payroll and allocated overhead expenses. Regarding claims equal or superior to ENA's Junior Liens, while the Examiner has not completed his analysis of such liens, his initial inquiry suggests that they will not materially affect the repayment of the Junior Liens to ENA.

discussed below, Cash on Hand plus Enron's other assets should be sufficient ultimately to satisfy the ENA Junior Liens.

(b) Significant Enron Assets

Given the time available, the Examiner could not review all of Enron's material assets; however, a review and analysis of only a portion of Enron's portfolio of assets was sufficient to establish that the Junior Liens will likely be repaid. In that connection, the Examiner evaluated a number of major individual assets, as well as two groupings of assets. These assets and groupings are: (i) Portland General Electric Company ("PGEC"), (ii) other major assets sold or in the process of sale, (iii) the Enron Center South building and other real estate held in Smith Street Land Company and (iv) certain pipeline assets. The estimates of value are preliminary and are based on information provided by the Debtors and their advisors. The Examiner did, however, test the valuations on the basis of market comparable values (where available) and other pricing indicators. In many instances, the Enron assets are either under a contract of sale or a bid price exists. To estimate the amount and timing of cash proceeds potentially available from the sale of those assets the Examiner reviewed the terms of any contracts for the sale of the assets, the anticipated distribution of funds, any regulatory or other obstacles to the sale of the assets and the existence of any loans secured by these assets or other claims which may delay or otherwise impede the receipt of cash by Enron. The result of this review is described below.

(i) Portland General

PGEC is a regulated electric utility company serving customers in Oregon and Washington. PGEC generates, transmits and distributes electric power. PGEC also owns a



number of related unregulated companies. PGEC is a direct, wholly owned non-Debtor subsidiary of Enron.

On October 1, 2001 Enron and Enron Northwest Assets, LLC entered into a Purchase and Sale Agreement with Northwest Natural Gas Company and Northwest Energy Corporation (collectively, "NWN") pursuant to which Enron agreed to sell its interest in PGEC to NWN for \$1.5 billion dollars in cash, plus \$250 million worth of securities.<sup>30</sup> The transaction is conditioned upon NWN obtaining adequate funding (the Examiner understands that as of the date of this Interim Report NWN has not arranged such financing). The transaction has been approved by the Federal Energy Regulatory Commission, but also requires approvals by the Oregon Public Utility Commission, the Washington Utilities and Transportation Commission, the Nuclear Regulatory Commission and the Securities and Exchange Commission. The Purchase and Sale Agreement is subject to termination if, among other reasons, the transaction does not close on or before December 8, 2002. The Examiner's review indicates that the purchase price is a fair and reasonable indication of value.

(ii) Other Major Assets in Process of Sale

a. Enron Wind

Enron has been negotiating the sale of the assets of a number of subsidiaries of Enron Wind Corp. ("Enron Wind"), an indirect, wholly owned Debtor subsidiary of Enron, to GE Power Systems. The initial negotiated price of approximately \$225 million was subject to higher bids at a subsequent auction (in addition to the cash purchase price, Enron Wind expects to

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<sup>30</sup> The securities are common equity shares and a derivative security, similar to convertible preferred shares, of Northwest Natural Gas Company. Certain of these securities are publicly traded; however, the re-sale of the securities will initially be restricted.

receive up to \$34 million from the collection of certain accounts receivable and from the release of monies escrowed as part of an earlier Enron Wind sale transaction). The Examiner has been informed that, as a result of a subsequent private auction, the purchase price has increased significantly. The transaction is subject to approval by the Official Creditors' Committee and the Bankruptcy Court. The Examiner also understands that the sale proceeds will be held by Enron Wind or by its various subsidiaries. Enron's ability to access these funds impacts directly the availability of such funds to repay the Junior Liens. The Examiner will continue to monitor this transaction closely.

b. Enron Oil & Gas India Ltd. ("EOGIL")

Enron Asset Holdings ("EAH"), an indirect non-Debtor subsidiary of Enron, has completed the sale of EOGIL to BG Energy Holdings Limited. The net sale proceeds were approximately \$262 million; of this amount, approximately \$84 million has been escrowed and the remaining cash is held by EAH. The actual amount due Enron had not been determined at the time of this Interim Report.

c. SK-Enron Co., Ltd.

SK-Enron Co., Ltd. ("SK-Enron") is a joint venture between Enron International Korea LLC ("Enron Korea") and SK Corp., South Korea's third largest industrial conglomerate. Enron Korea, an indirect, wholly owned non-Debtor subsidiary of Enron, owns 50% of the stock of SK-Enron. SK-Enron has interests in gas distribution companies, including five municipal gas distribution companies, each of which has local monopoly rights. SK-Enron also owns liquefied petroleum gas ("LPG") marketing businesses and other businesses (including a steam-electricity co-generation project). SK-Enron controls 25% of South Korea's natural gas market and 50% of

South Korea's LPG market. For regulatory and tax purposes, SK-Enron has not and does not intend to pay any cash dividends. Enron's book basis in SK-Enron is approximately \$310 million.

On February 1, 2002 Enron Korea signed a Purchase and Sale Agreement with Tractabel LNG Ltd., a United Kingdom subsidiary of Tractabel S.A. ("Tractabel"), pursuant to which Enron Korea agreed to sell to Tractabel all of its shares of SK-Enron in exchange for \$221 million in cash. At Tractabel's request, the agreement is subject to Bankruptcy Court approval. The sale is also subject to re-negotiation of a right of first refusal between Enron Korea and SK Corp. and approval under the Korean Monopoly Regulation and Fair Trade Act. Subject to the foregoing, the sale is scheduled to close by year-end 2002. Based upon the Debtors' projections of cash flow, the Examiner believes that the purchase price represents a fair price for the stock of SK-Enron.

(iii) Smith Street Land Co. (Enron Center South Building)

Smith Street Land Co., a wholly-owned Debtor subsidiary of Enron, is trying to sell (i) the Enron Center South building, a 40 story, 1.3 million square foot Class A Plus office building located in downtown Houston, (ii) an adjacent 1,400 space parking garage, (iii) the site currently housing the Enron Day Care Facility and (iv) a nine acre tract on Beltway 8 where the Enron Data Center is under construction. Enron has established a data room and has signed confidentiality agreements with numerous parties. The sale is anticipated to close in June 2002. The Examiner has reviewed Enron's estimate of the expected proceeds of the sale or sales and concurs that they will be substantial.<sup>31</sup> Construction of the projects was funded by intercompany

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<sup>31</sup> Due to the confidential nature of certain information provided to the Examiner during his  
(continued...)

loans from Enron (and certain of its Debtor and non-Debtor affiliates may have provided a portion of the financing). Intercreditor issues may arise based upon potential competing claims by these Debtor and non-Debtor entities against the sale proceeds.

(iv) Pipeline Companies

Enron has an indirect interest in a number of gas transmission and coal slurry pipelines. The two companies in the pipeline group with the most significant value appear to be Transwestern Pipeline Company ("Transwestern") and Florida Gas Transmission Company ("FGT").

a. Transwestern

Transwestern owns and operates an interstate natural gas pipeline system, with transmission and other assets located in Texas, Oklahoma, New Mexico, Arizona and California. It is indirectly owned by Enron Transportation Services Company, which is an indirect Debtor subsidiary of Enron. Based upon an EBITDA multiple analysis, the Examiner believes that the value of this pipeline is substantial. Furthermore, earnings from this asset are regulated and, consequently, should approximate their current level.

b. FGT

FGT is an interstate natural gas pipeline in Texas, Louisiana, Alabama, Mississippi and Florida owned by Citrus Corp. ("Citrus"), a 50/50 joint venture of Enron and El Paso Corp. The Examiner believes that the equity value of this pipeline (based upon an EBITDA multiple and

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<sup>31</sup> (...continued)  
investigation, specific values for certain assets are not given because this Interim Report will be filed publicly. Nonetheless, as noted, the Examiner believes that the value of the assets referenced in this Interim Report is sufficient to repay the Net Intercompany Receivable.

capacity value analysis) is substantial. A Citrus subsidiary also conducts trading operations (independent of Enron or its subsidiaries), which further enhances the value of Citrus to Enron.

### **3. Adequacy of Assets to Repay ENA**

Based upon the Examiner's analysis of the cash and non-cash assets of Enron described above, he estimates that the value of Enron's assets substantially exceeds the amount of the Net Cash Sweep. Accordingly, the Examiner concludes that Enron likely has sufficient assets available to satisfy the Junior Liens and repay the Net Intercompany Receivable. Significantly, this conclusion assumes no increase in the Net Intercompany Receivable, no material reduction in the realizable value of the assets available and that at least a substantial portion of the proceeds relating to the sale of these assets can and ultimately will be transferred to Enron in a timely fashion.

### **4. Method and Timing for Repayment of ENA**

As noted, the projected value of the assets available to repay ENA does not present a complete picture in answering the questions of how and when ENA will actually be repaid. Hence, in addition to the above assumptions, a further important consideration is the burn rate of Enron and its Debtor and non-Debtor subsidiaries, *i.e.*, their present and future rates of expenditures (for purposes other than repaying ENA). In estimating this burn rate the Examiner has considered a number of categories of expenditures, including, but not limited to, (i) normal operating expenses, including payroll, rent, insurance, computer system and information technology costs, taxes, interest expense and legal costs and (ii) professional expenses, including professional expenses incurred by the Debtors and the Official Creditors' Committee.

The Examiner has been presented with various projections of Enron's estimated burn rate. Based on the information provided, the Examiner believes that over at least the next 90 days Enron should be able to fund its direct operating expenses from its existing and anticipated cash flow. Therefore, at least during the next 90 days (i) Enron should have no further need for cash sweeps from ENA and (ii) Enron should not need the proceeds of the sale of any of the assets described above to fund its operating expenses.

Accordingly, the Examiner recommends: (i) a further extension of the ENA Cash Freeze until July 8, 2002, during which Enron would be prohibited from sweeping up additional cash from ENA and (ii) that during this time period the Examiner, in consultation with the Debtors, the Official Creditors' Committee and the Movants, develop a plan for the repayment of the Net Intercompany Receivable due ENA and determine whether further cash sweeps from ENA should be permitted.<sup>32</sup> Developing such a repayment plan and determining whether further cash sweeps should be permitted will have to take account of a number of factors, including (i) the terms and timing of the sale of the Enron assets discussed above, (ii) how the projected cash inflow from the sale of these assets compares to the longer term burn rate of Enron and its subsidiaries and (iii) claims by any other parties against the proceeds of the sale of these assets. The Examiner proposes that at the end of this period he file a follow-up report addressing these issues, providing a suggested repayment plan and making a recommendation regarding ENA's continued participation in the Centralized Cash Management System.<sup>33</sup>

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<sup>32</sup> These restrictions would be without prejudice to a party in interest making an application on notice to interested parties to modify these restrictions for good cause shown.

<sup>33</sup> While the Examiner estimates that for at least the next 90 days ENA will have sufficient cash on hand to meet its operating costs, the Examiner will, as required, continue to  
(continued...)

**5. Adequacy of Procedures  
Governing Intercompany Transfers**

As the Bankruptcy Court directed, the Examiner also considered whether Enron has adequate Debtor and non-Debtor credit limits and procedures in place to assure repayment of intercompany advances from Debtor entities to other Debtor and non-Debtor entities. In addition, the Examiner reviewed Enron's procedures for the approval of transactions and disbursements.

**(a) Credit Limits**

The Examiner's analysis focused on an evaluation of Enron's compliance with paragraphs 5(d) and 6 of the Amended Cash Management Order, which specifically provide protections concerning transfers of cash or property from Debtors to other Debtor and/or non-Debtor entities. As noted, according to the Amended Cash Management Order, a Debtor may not transfer cash or property to another Debtor unless the aggregate fair value of the assets of the Beneficiary Debtor, "prior to the transfer, exceeds the sum of (x) all outstanding DIP Obligations in excess of the cash collateral being held in escrow for the benefit of the DIP Agents, (y) all claims against the proposed Beneficiary Debtor that are expressly senior to or carved out from, claims in respect to the DIP financing obligations . . . and (z) all Junior Reimbursement claims allowable against the recipient Debtor immediately after such transfer." Amended Cash Management Order, at ¶ 5(d). The Amended Cash Management Order also provides that a Debtor may not transfer cash or property to a non-Debtor affiliate unless the fair value of the assets of the non-Debtor affiliate recipient, immediately prior to the transfer, exceeds the

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<sup>33</sup> (...continued)  
monitor and report on ENA's cash needs.

aggregate liabilities of the non-Debtor affiliate recipient by at least 15%. *See id.*, at ¶ 6.

With respect to transfers from Debtor entities to other Debtor entities, in consultation with Zolfo Cooper and PwC Enron management has established credit limits to guide the various business units in considering post-Petition intercompany advances. The credit limit is set at 50% of the fair value of the recipient entity's assets and an alert limit is set at 25% of the fair value of the recipient entity's assets. In determining the fair market value of the assets of Debtor entities receiving intercompany advances, the Debtors considered a number of factors. For assets available for sale, the purchase price for a pending transaction or bid prices were used to quantify value. Where no market tested indication of value existed, to estimate value the Debtors looked at an entity's realizable trade receivables or contract rights. The alert limits were set to advise business unit managers when greater scrutiny would be applied to a request for funds.<sup>34</sup> The credit limits were set to establish a point after which no further transfer of funds to the relevant entity would be permitted.

Enron management has advised the Examiner that it is working on developing a similar credit limit system or other protocol regarding transfers of funds from Debtors to non-Debtors, but no such system is yet in place. Business unit managers must now seek approval of such requests through the Cash Management Committee (described below). The Risk Assessment and Control Group ("RACG")<sup>35</sup> is also consulted on proposed advances to non-Debtors, but was

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<sup>34</sup> These limits are advisory tools since all transactions, even those falling within the approved alert and credit limits, are processed through the cash disbursement system and are reviewed by the Cash Management Committee.

<sup>35</sup> The RACG is an Enron staff group whose primary function prior to bankruptcy and now is to evaluate the risk/reward tradeoff on significant business transactions. Several members of the RACG sit on the BTRC.



apparently not involved in developing the credit limits that govern transfers to Debtors and is not actively involved in establishing a more formalized protocol for the review of transfers to non-Debtors.

The Examiner believes that to ensure the repayment of transfers to Debtors and non-Debtors and more fully comply with paragraphs 5(d) and 6 of the Amended Cash Management Order, Enron needs to improve its procedures regarding transfers to Debtors and non-Debtors. While the existing credit limit system provides a degree of assurance respecting the repayment of intercompany advances, the efficacy of this credit limit system depends on the valuations upon which it based. Accordingly, the Examiner recommends that the RACG be actively involved in establishing the initial valuation amounts and in setting the corresponding credit limits and periodically reviewing such credit limits, at least once a quarter. The Examiner suggests that the RACG also be involved similarly in developing a protocol regarding transfers from Debtor to non-Debtor entities. The Examiner recommends further that the credit limits and any revisions thereof, as well as the protocol regarding transfers from Debtor to non-Debtor entities, should be submitted to the Cash Management Committee or the BTRC for their review and/or approval.

Supplementing the credit limits, the BTRC and Cash Management Committee review procedures govern all transactions and disbursements, including transfers to Debtors and non-Debtors. These procedures are described and discussed below.<sup>36</sup>

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<sup>36</sup> According to the Debtors, the BTRC and Cash Management Committee procedures and decisions are framed by the various Orders entered by the Bankruptcy Court the day after the Petition Date, the DIP Credit Agreement and the Amended Cash Management Order.

(b) The BTRC Procedures

Working in conjunction with the Cash Management Committee, the BTRC provides a high level of scrutiny to the subset of transactions or expenditures that are outside the ordinary course of business.<sup>37</sup> The focal point of the BTRC approval process is the evaluation of a Deal Approval Sheet (the "DASH"), a one to two page summary of the proposed transaction and an explanation of its economic value. The DASH is prepared jointly by the business group seeking approval of the transaction and the RACG.<sup>38</sup> Depending on the transaction, the DASH may require approval by the Functional Group Head or the Business Group Head of the relevant business unit submitting the transaction for approval. In addition, transactions<sup>39</sup> with a value greater than \$500,000 and divestitures with a value greater than \$5 million must be approved by Enron's Chief Executive Officer ("CEO"); new transactions with a value greater than \$5 million and divestitures with a value greater than \$25 million must be approved by Enron's Board of Directors ("Board"). Any DASH that requires CEO or Board approval must have BTRC approval prior to CEO and/or Board review and signoff.<sup>40</sup>

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<sup>37</sup> According to the Debtors, a transaction outside the normal course of business is any transaction that is beyond the everyday expenditures and similar ordinary course transactions that are necessary to keep the company running.

<sup>38</sup> The RACG advises the relevant business unit throughout the DASH preparation and BTRC approval process.

<sup>39</sup> According to the Debtors, new transactions are transactions that require the expenditure of funds.

<sup>40</sup> Transactions below the relevant thresholds may be looked at by the BTRC, but do not require formal approval.

The BTRC meets every Tuesday and Thursday to evaluate proposed transactions and disbursements outside the ordinary course of business.<sup>41</sup> According to the Debtors, the BTRC's evaluation of a transaction (and the evaluation by the Cash Management Committee) involves an assessment of, *inter alia*, (i) whether the transaction will add or preserve value, (ii) whether the transaction is of "a mission critical nature" and (iii) whether the relevant vendor is the sole vendor or is otherwise approved. The BTRC can approve the transaction, disapprove the transaction or request further information. Approved transactions are put on hold until they require the actual commitment of cash, at which time they are submitted to the Cash Management Committee for approval (discussed below).<sup>42</sup>

(c) The Cash Management Committee Procedures

All post-Petition disbursements require Cash Management Committee approval. Transactions not in the ordinary course of business and in excess of \$500,000 require both BTRC and Cash Management Committee approval. Enron's protocol for the review of all post-Petition disbursements channels requests into one of five tracks, according to transaction type, method of

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<sup>41</sup> The BTRC is comprised of David Gorte, Vice President of Enron and Managing Director of Risk Assessment and Control, Ray Bowen, Executive Vice President and Chief Financial Officer of Enron, Wade Cline, Managing Director of Enron, Legal, Jeff Donahue, Managing Director of Enron, Corporate Development, Jim Ginty, Vice President of Enron, Tax, Jordan Mintz, Vice President of Enron, Tax, Barry Schnapper, Vice President of Enron, Global Finance, Chip Schneider, Vice President of Enron, Risk Management and Control, Doug Sewell, ENA Corp. Director and Lou Stoler, Assistant General Counsel. In addition, attorneys from Weil, Gotshal & Manges LLP ("WG&M"), a representative of Blackstone, a representative of PwC and a representative of Zolfo Cooper participate in meetings of the BTRC and attorneys from Milbank, Tweed, Hadley & McCloy LLP, a representative from Houlihan Lokey Howard & Zukin Financial Advisors, Inc. and a representative of E&YCF (attorneys, restructuring and financial advisors to the Official Creditors' Committee, respectively) participate by telephone.

<sup>42</sup> Many of the transactions submitted to the BTRC are also subject to the approval of the Official Creditors' Committee and the Bankruptcy Court.

request and/or the time required before payment is required. These tracks are: goods and services requisitioning (Track 1), automated payment of invoices with due dates of more than seven days (Track 2), automated trade payments, taxes and field projects (Track 3), manually submitted invoices requiring normally timed payment in two to seven days (Track 4) and manually submitted expedited invoices requiring same or next day payment (Track 5).

Automated goods and services requisitioning, invoice payments and trade payments, taxes and field projects (Tracks 1, 2, and 3) are automated systems with a chain of approval that in all cases includes the business unit Chief Accounting Officer ("CAO"). The SAP Payment System is the central collection point for all requests, whether submitted manually or through the automated requests in Track 1, 2 and 3. When payments are within two days of requiring payment, the business unit CAO must reapprove the transactions to unblock them. Once approved, such payments are submitted to the so-called "Cash Czar" (George Wasaff, an Enron Managing Director), who may approve, reject or place the transaction on hold. Approved transactions are then reviewed by the Cash Management Committee, whose approval is required before payment is scheduled.

Expedited payments (Track 4) must be approved first by the business unit CAO, a business unit representative at the vice president level and a member of the Cash Management Committee. Immediate or next day payments (Track 5) must be approved first by the business unit CAO, a business unit representative at the vice president level, George Wasaff and, depending on the transaction, the full Cash Management Committee. Track 4 and 5 requests are then submitted to George Wasaff and the Cash Management Committee for final approval.

The Cash Management Committee meets daily at 8 a.m.<sup>43</sup> Payments in all five Tracks, regardless of their size, are reviewed by the Cash Management Committee. Typically, the bulk of the Cash Management Committee's time is devoted to payments in Tracks 4 and 5.

Notably, pre-Petition payables of Debtor entities have been blocked by the system; no mechanism exists for releasing these payables except with the approval of the business unit CAO, a lawyer with the business unit and the Cash Management Committee. In addition, intercompany transfers to non-Debtors must be reviewed by the RACG and approved by the Cash Management Committee on an exception basis.

As noted, the Examiner and/or his representative attends all meetings of the Cash Management Committee. The Examiner and/or his representative meets daily with the ENA representative on the Cash Management Committee, as well as a representative of PwC, to discuss, *inter alia*, the transactions discussed at that day's Cash Management Committee meeting that relate to ENA, the assets, operations and activities of ENA, cash movements within ENA and its subsidiaries and cash accounting, book accounting and reporting issues.

The Examiner believes that the credit limits, if revised as suggested, as well as the BTRC and Cash Management Committee procedures described above, the Examiner's continued participation therein and the discharge of his other duties as set forth in the February 21 and March 6 Orders (i) provide an important and effective mechanism for monitoring and controlling

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<sup>43</sup> The Cash Management Committee consists of George Wasaff, Ray Bowen and/or Tim DeSpain, a Managing Director & Deputy Treasurer of Enron, Dave Gorte, Doug Sewell, a representative of the Enron Accounting Department, a representative of the Enron Tax Department, a representative of the Enron Legal Department, an attorney from WG&M, a representative of Zolfo Cooper, a representative of E&YCF, a representative of PwC and a representative of Batchelder Associates. Doug Sewell is the ENA representative on the Cash Management Committee.

transactions and disbursements by and among Enron and its Debtor and non-Debtor subsidiaries, (ii) provide significant protection of ENA Cash, assets and liabilities and (iii) provide significant assurance that the Net Intercompany Receivable will ultimately be repaid.

**B. Allocation of Overhead Costs to ENA**

As noted, the Examiner has been directed to investigate and make recommendations regarding "the allocation of certain overhead costs to ENA, including, but not limited to, any allocation for the use of any intellectual property . . . ." March 6 Order, at p. 2. Overhead allocation is central to the calculation of the Net Intercompany Receivable owed by Enron to ENA.

In connection with this task, the Examiner continues to review how costs were and are being allocated among the various Debtors and non-Debtors, including the allocation of costs to ENA. In that regard, the Examiner has met on a number of occasions with Enron and PwC and has reviewed Enron's and PwC's evolving formulation respecting overhead allocation. In addition, the Examiner continues to conduct his own independent review of overhead allocation issues.

As noted, formulating an appropriate methodology for allocating overhead is a complex task, which requires the consideration of, *inter alia*, complicated cost-accounting issues, the multiple components of overhead expenses (such as rents, payroll, benefits, severance, retention and incentive payments, insurance, information technology, intellectual property, professional fees and taxes) and the numerous entities to which the methodology for allocating overhead will be applied. Indeed, the intercreditor issues that have arisen in these bankruptcy proceedings make it imperative that the Examiner not only analyze methodologies for allocating overhead,

but also test such methodologies as applied to the various Debtor and non-Debtor entities so the Examiner can determine how such methodologies will ultimately affect the Debtor and non-Debtor entities, their estates and their creditors.

The Examiner's work regarding the allocation of overhead is still in process. The Examiner expects to continue his pursuit of overhead allocation issues as expeditiously as possible and will submit a subsequent report containing an appropriate recommendation addressing this matter.

**C. ENA Expenditures**

The March 6 Order requires the Examiner to "participate in all meetings of the Enron Corp. Cash Management Committee and the Risk Assessment Committee [the BTRC] relevant to the assets and cash of ENA" and that the Examiner "shall immediately report to this Court [the Bankruptcy Court] any expenditure that he/she deems to be improper." *See* March 6 Order, at p. 3.

As noted, the Examiner and/or his representatives have attended all meetings of the Cash Management Committee and BTRC since March 15, 2002. At these meetings, various expenditures relating to ENA have been discussed and submitted for approval. The Examiner reviewed the expenditures to determine, as required by the Bankruptcy Court, whether any such expenditures were improper. In making this determination, the Examiner adhered to the following standard: a proper expenditure is an expenditure that is calculated to preserve or enhance the value of the ENA estate within a reasonable period of time. This standard is consistent with and part of the Debtors' duty, as debtors in possession, to maximize the estate for the benefit of creditors. The Examiner observed no expenditure presented for review at the Cash

Management Committee and BTRC that he believes was not calculated to preserve and enhance the value of the ENA estate within a reasonable period of time.

**D. Weekly and Monthly Reports on ENA Cash and Assets**

The Examiner filed his first Weekly Report on April 9, 2002 and will file the first Monthly Report on or about May 1, 2002.<sup>44</sup>

As required by the March 6 Order, the initial Weekly Report provides a listing of all deposits and disbursements made into and out of ENA Accounts (as defined below).<sup>45</sup> The initial Weekly Report covers the period March 18, 2002 through and including March 22, 2002 and notes that the total amount of deposits into ENA Accounts is \$88,977,049.90; total disbursements from ENA Accounts amount to \$8,590,127.32.

As required by the March 6 Order, the initial Monthly Report will address “the status of ENA Cash . . . including gross and net collections and expenditures and the status of ENA assets

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<sup>44</sup> As noted, during the 20 business days provided for this Interim Report the Examiner has only been able to examine cash inflow and outflow relating to ENA. The Examiner, therefore, may not have ascertained fully the beneficial interests and/or economic benefits that have accrued to ENA by virtue of relationships with various business units and non-ENA entities; hence, he cannot be certain at this point that he has captured all ENA cash activity.

<sup>45</sup> As noted in the initial Weekly Report, the March 6 Order directed the Examiner to “file with this Court a weekly list of all deposits and disbursements made into and out of the Consolidation Account, as that term is defined in the Amended Cash Management Order . . . .” March 6 Order, at p. 3. However, the Amended Cash Management Order did not define “Consolidation Account.” The Amended Cash Management Order did, however, direct ENA to “establish a separate cash concentration account in accordance with Section 5.07 of the DIP Credit Agreement.” Amended Cash Management Order, at ¶ 10. As it is not yet clear that cash from all ENA subsidiaries and/or affiliates is routinely deposited into a single “concentration account,” the Examiner believes it appropriate to report on deposits and disbursements made into and out of each ENA account (the “ENA Accounts”) he has been able to identify to date, unless otherwise directed by the Bankruptcy Court.



and liabilities” and will likely provide, among other things, a summary of the deposit and disbursement information provided in the Weekly Reports, as well as information regarding ENA’s assets and liabilities, including the Trading Book and the proceeds of the UBS sale.<sup>46</sup>

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<sup>46</sup> The Examiner cannot yet be certain that he will be in a position to value the ENA Trading Book by the time of the filing of the initial Monthly Report, as valuation of ENA’s Trading Book depends on a number of critical variables, including the state of the market on the dates contracts are terminated and the outcome of negotiations with counterparties on such matters as (i) the choice of a discount rate for calculating present value, (ii) an assessment of current and future commodity prices and (iii) contractual provisions covering such matters as netting arrangements.

#### IV.

##### **SUMMARY OF RECOMMENDATIONS**

Based on his investigation to date the Examiner makes the following recommendations:

1. That the ENA Cash Freeze be extended until July 8, 2002, during which intervening period ENA should not participate in the Centralized Cash Management System.
2. That within this same timeframe the Examiner meet with the parties to discuss and file a follow-up report regarding (i) a proposed methodology for the repayment of the Net Intercompany Receivable and (ii) a final recommendation regarding whether ENA should continue to participate in the Centralized Cash Management System.
3. That within the same time period the Examiner file a follow-up report regarding other intercompany advances between ENA Corp. and its subsidiaries and Enron and between ENA Corp. and its subsidiaries, if any, and their impact on the individual ENA entities and on repayment of the Net Intercompany Receivable.
4. That the Examiner work with the BTRC to improve Enron's credit valuation and other procedures regarding transfers to Debtors and non-Debtors.
5. That the Examiner report subsequently on overhead cost allocation issues and recommend an appropriate methodology in that regard.
6. With questions having been raised as to whether the ENA Cash Freeze extends to transfers from certain subsidiaries of ENA Corp. up to ENA Corp. and, further, whether the Cash Freeze applies to transfers from ENA Corp. down to its subsidiaries, that the Bankruptcy Court determine whether the Examiner should investigate and file a follow-up report on cash sweeps from ENA subsidiaries to ENA Corp. and payments from ENA Corp. to its subsidiaries,

including a recommendation as to whether such transactions should continue.

7. That following a Court-ordered modification to the Debtors' DIP financing, the Examiner file a supplemental report addressing how such modification affects (i) ENA and (ii) the recommendations included herein and in any subsequent report.

8. That with ENA in the process of winding down the Trading Book and selling its other assets, the ENA case move as expeditiously as possible toward plan confirmation.

Dated: New York, New York  
April 9, 2002

/s/ Harrison J. Goldin  
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