

TRUST PREFERRED SECURITIES - *ENRON* CASE

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On April 1, 1998, Enron Corp. ("Enron") filed a petition in the United States Tax Court contesting the disallowance by the Internal Revenue Service (the "IRS") of interest deductions taken by Enron in connection with two preferred securities transactions entered into in 1993 and 1994. In late December, the IRS conceded that the interest on the debt underlying both preferred securities transactions was deductible by Enron.

The loans at issue in the Enron case were a 100-year loan issued in 1993 and a 49-year loan issued in 1994. The 1994 loan was issued to a limited partnership, while the 1993 loan was issued to a limited liability company which each issued preferred securities to investors. The concession by the IRS, particularly with respect to the 1994 preferred securities at issue in the Enron case, is significant because the 1994 preferred securities are similar to many of the preferred securities issued into the capital markets within the last four years.

The result of the IRS' concession in the Enron case is that Enron will be permitted to deduct the interest payments with respect to the loans for the years under audit. We are not aware of any other cases pending that challenge the deductibility of interest in preferred securities transactions. As a result, disclosure of the IRS' position in Enron will not be necessary in future preferred securities offerings.

The position of the IRS is appropriate in light of the debt-like nature of the loans involved in typical preferred securities transactions. We continue to be willing to issue debt opinions in preferred securities transactions.

This memorandum is intended as merely an overview of the effect of the circumstances surrounding the IRS' concession in Enron. If you have any questions about the impact on a specific preferred securities transaction, please contact Dickson G. Brown (212-455-2850), Karen S. Handler (212-455-2684) or Marcy G. Dworkin (212-455-3543) or any other member of our tax department.

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