United States Courts
Southern District of Texas
FILED
JUN 24 2002
Michael N. Milby, Clerk

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	Civil Action No. H-01-3624 (Consolidated)
This Document Relates To: MARK NEWBY, *et al.*, Individually and On Behalf of All Others Similarly Situated, Plaintiffs, -v.- ENRON CORP., *et al.*, Defendants.	
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, et al., Individually and On Behalf of All Others Similarly Situated, Plaintiffs, -v.- KENNETH L. LAY, *et al.*, Defendants.	

APPENDIX OF EXHIBITS IN SUPPORT OF CITIGROUP, INC.'S REPLY MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION TO DISMISS

907

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	Civil Action No. H-01-3624 (Consolidated)
This Document Relates To: MARK NEWBY, *et al.*, Individually and On Behalf of All Others Similarly Situated, Plaintiffs, -v.- ENRON CORP., *et al.*, Defendants.	**AFFIDAVIT OF RICHARD A. ROSEN**
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, et al., Individually and On Behalf of All Others Similarly Situated, Plaintiffs, -v.- KENNETH L. LAY, *et al.*, Defendants.	

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

RICHARD A. ROSEN, being sworn, states:

1. I am a member of the firm of Paul, Weiss, Rifkind, Wharton & Garrison, attorneys for defendant Citigroup, Inc. ("Citigroup") in this case.

2. This affidavit is filed in support of Citigroup's Reply Memorandum of Law in Support of its Motion to Dismiss and, in particular, to authenticate certain documents submitted in support of the motion. The following exhibits are true and correct copies of the original documents:

(a) Annexed as Exhibit A is the Financial Accounting Standards Board, Derivatives Implementation Group, Statement 133 Implementation Issue No. A9, May 17, 2000.

(b) Annexed as Exhibit B is the Financial Accounting Standards Board, Derivatives Implementation Group, Statement 133 Implementation Issue No. A20, October 2001 (Revised Tentative Guidance Released on May 6, 2002).

(c) Annexed as Exhibit C is an excerpt from the Offering Memorandum for Enron Credit Linked Notes Trust, 8.00% Enron Credit Linked Notes due 2005, dated August 17, 2000.

Richard A. Rosen

Sworn to before me this
21st day of June, 2002

Notary Public

CAROL SIMMONS
Notary Public, State of New York
No. 24-5001520
Qualified in Kings County
Commission Expires 9/8/02

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing instrument was this day forwarded via e-mail, facsimile, or overnight delivery to each of the counsel or parties listed on the attached Service List, pursuant to the Court's April 10, 2002 Order Regarding Service of Papers and Notice of Hearings.

Dated: June 24, 2002

By: Jacalyn D. Scott
Eugene B. Wilshire

The Service List

Attached

to this document

may be viewed at

the

Clerk's Office

RECYCLED

Derivatives Implementation Group

Statement 133 Implementation Issue No. A9

Title:	Definition of a Derivative: Prepaid Interest Rate Swaps
Paragraph references:	6, 9, 13
Date cleared by Board:	May 17, 2000

NOTE: The FASB currently has a project to amend certain requirements (including the definition of a derivative) of Statement 133. It is currently expected that such amendment will supersede the guidance in this Issue. An Exposure Draft of that amendment is expected to be issued in the second quarter of 2002. See **Implementation Issue A20**.

QUESTION

How does Statement 133 affect the accounting for a prepaid interest rate swap contract, that is, an interest rate swap contract for which the fixed leg has been prepaid (at a discounted amount)?

BACKGROUND AND DESCRIPTION OF TRANSACTION

In lieu of obtaining a pay-fixed, receive-variable interest rate swap that is settled net each quarter, an entity may choose to enter into a "prepaid interest rate swap" contract that obligates the counterparty to make quarterly payments to the entity for the variable leg and for which the entity pays the present value of the fixed leg of the swap at the inception of the contract. Different structures can be used for a prepaid interest rate swap contract, although the amount and timing of the cash flows under the different structures are the same, which makes the different structures of contract terms identical economically. For example, rather than entering into a 2-year pay-fixed, receive-variable swap with a $10,000,000 notional amount, a fixed interest rate of 6.65 percent, and a variable interest rate of 3-month US$ LIBOR (that is, the swap terms in Example 5 of Statement 133), an entity can effectively accomplish a prepaid swap by entering into a contract under either of the following structures.

Structure 1

The entity pays $1,228,179 to enter into a prepaid interest rate swap contract that requires the counterparty to make quarterly payments based on a $10,000,000 notional amount and an annual interest rate equal to 3-month US$ LIBOR. The amount of $1,228,179 is the present value of the 8 quarterly fixed payments of $166,250, based on the implied spot rate for each of the 8 payment dates under the assumed initial yield curve in that example.

Structure 2

The entity pays $1,228,179 to enter into a structured note ("contract") with a principal amount of $1,228,179 and loan payments based on a formula equal to 8.142 times 3-month US$ LIBOR. (Note that 8.142 = 10,000,000 / 1,228,179.) The terms of the structured note specify no repayment of the principal amount either over the two-year term of

repayment of the principal amount either over the two-year term of the structured note or at the end of its term.

RESPONSE

The prepaid interest rate swap contract (accomplished under either structure) is a derivative instrument because it meets the criteria in paragraph 6 and related paragraphs of Statement 133. Accordingly, the prepaid interest rate swap (accomplished under either structure) must be accounted for as a derivative instrument and reported at fair value. Even though both structures involve a lending activity related to the prepayment of the fixed leg, the prepaid interest rate swap cannot be separated into a debt host contract and an embedded derivative because Statement 133 does not permit such bifurcation of a contract that, in its entirety, meets the definition of a derivative.

Discussion of Structure 1

The prepaid interest rate swap in Structure 1 has an underlying (three-month US$ LIBOR) and a notional amount (refer to paragraph 6(a)). The prepaid interest rate swap requires an initial investment ($1,228,179) that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, such as an 8-times impact for changes in LIBOR when applied to the initial investment (refer to paragraph 6 (b)). (Note that the reference to "8 times" is based on the ratio of the notional amount to the initial investment: 10,000,000 / 1,228,179 = 8.142.) In this example, the initial investment of $1,228,179 is smaller than an investment of $10,000,000 to purchase a note with a $10,000,000 notional amount and a variable interest rate of 3-month US$LIBOR-an instrument that provides the same cash flow response to changes in LIBOR as the prepaid interest rate swap.

Under the prepaid swap in Structure 1, neither party is required to deliver an asset that is associated with the underlying or that has a principal amount, stated amount, face value, number of shares, or other denomination that is equal to the notional amount (or the notional amount plus a premium or minus a discount) (refer to paragraphs 6(c) and 9(a)).

Discussion of Structure 2

The contract in Structure 2 has an underlying (three-month US$ LIBOR) and a notional amount (refer to paragraph 6(a)). The contract requires an initial investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, such as an eight-times impact for changes in US$ LIBOR (refer to paragraph 6(b)). The fact that the contract under Structure 2 involves an initial investment equal to the stated notional amount of $1,228,179 is not an impediment to satisfying the criterion in paragraph 6(b), even though paragraph 8 states, "A derivative instrument does not require an initial net investment in the contract that is equal to the notional amount (or the notional amount plus a premium or minus a discount) or that is determined by applying the notional amount to the underlying." The observation in paragraph 8 focuses on those contracts that do not involve leverage. When a contract involves leverage, its notional amount is effectively the stated notional amount times the multiplication factor that represents the leverage. The contract in Structure 2 is highly leveraged, resulting in an impact that is over eight times as great as simply applying the stated notional amount to the underlying. Thus, its initial investment is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors-the criterion in paragraph 6(b). (Note that even a contract with a much lower leverage factor than that illustrated in the above example would meet the criterion in paragraph 6(b).) The guidance in this issue is considered to be consistent with Statement 133 Implementation Issue No. A1, "Initial Net Investment," in which a required initial investment of $105 (to prepay a 1-year forward contract with a $110 strike price) is considered not to meet the criterion in paragraph 6(b).

Under the contract in Structure 2, neither party is required to deliver an asset that is associated with the underlying or that has a principal amount, stated amount, face value, number of shares, or other denomination that is equal to the notional amount (or the notional amount plus a premium or minus a discount) (refer to paragraphs 6(c) and 9(a)). Although the investor may surrender (deliver) the evidence of indebtedness (the structured note) to the issuer at maturity, the stated amount of the note ($1,228,179) is not equal to the actual notional amount ($10,000,000).

The above response has been authored by the FASB staff and represents the staff's views, although the Board has discussed the above response at a public meeting and chosen not to object to dissemination of that response. Official positions of the FASB are determined only after extensive due process and deliberation.

Copyright Permission Terms and Conditions

RECYCLED

Derivatives Implementation Group

Statement 133 Implementation Issue No. A20

Title:	Definition of a Derivative: Application of Paragraph 6(b) regarding Initial Net Investment
Paragraph references:	6, 8, 9, 12-16
Date released:	October 2001 **(Revised Tentative Guidance Released on May 6, 2002)**

Note: The guidance in this Issue is tentative and may be finalized if an amendment to FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* is issued. The Board issued the Exposure Draft, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities,* on May 1, 2002.

QUESTION

How should paragraph 6(b) be applied for contracts that involve elements of a financing?

BACKGROUND

The Exposure Draft, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities,* proposes that paragraph 6(b) of Statement 133 be replaced by the following:

> b. If it is an option-based contract,* it has an initial net investment equal to the fair value of the option component. If it is not an option-based contract (hereafter referred to as a non-option-based contract), it requires an initial net investment that is less than 5 percent of the fully prepaid amount.†
>
> *An option-based contract is a contract that either is a freestanding option or has an embedded option. A contract that contains an embedded option for which the strike price is fair value at the time of exercise should be considered non-option-based for purposes of applying this paragraph.
>
> † For non-option-based contracts, judgment of whether an initial net investment is less than 5 percent of the fully prepaid amount should be made based on comparison of the initial net investment to the amount of investment that would result in the contract becoming fully prepaid. Non-option-based contracts are fully prepaid if one party invests the fair value of all its future cash outflows under the contract and no longer has to sacrifice additional assets to settle the contract.

Paragraph 12 of Statement 133 states, in part:

> An embedded derivative instrument shall be separated from the host contract and accounted for as a derivative instrument pursuant to this Statement if and only if all of the following criteria are met:
>
> a. The economic characteristics and risks of the embedded

derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract....

b. The contract ("the hybrid instrument") that embodies both the embedded derivative instrument and the host contract is not remeasured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur.

c. A separate instrument with the same terms as the embedded derivative instrument would, pursuant to paragraphs 6-11, be a derivative instrument subject to the requirements of this Statement. (The initial net investment for the hybrid instrument shall not be considered to be the initial net investment for the embedded derivative.)

The Exposure Draft proposes adding the following language to paragraph 12:

> A contract that, in its entirety, meets the definition of a derivative but is a non-option-based contract that requires an initial net investment that is less than 5 percent of the fully prepaid amount (as discussed in paragraph 6(b)) may be accounted for as either (1) a derivative in its entirety or (2) a hybrid instrument that must be bifurcated into a debt host and a derivative with a fair value of zero at acquisition of the hybrid instrument.

This issue addresses the application of that proposed guidance to three example structures.

Example 1—Prepaid Interest Rate Swap Contract
Company A pays $1,228,179 to enter into a prepaid interest rate swap contract that requires the counterparty to make quarterly payments based on a $10,000,000 notional amount and an annual interest rate equal to 3-month US$ LIBOR. Company A pays the present value of the fixed leg of the swap at the inception of the contract. (Alternatively, Company A could have entered into a plain-vanilla 2-year pay-fixed, receive-variable swap with a $10,000,000 notional amount, a fixed interest rate of 6.65 percent, and a variable interest rate of 3-month US$ LIBOR.) The amount of $1,228,179 is the present value of the 8 quarterly fixed payments of $166,250, based on the implied spot rate for each of the 8 payment dates under the assumed initial yield curve in that example.

Example 2—Structured Note Company B pays $1,228,179 to enter into a structured note with a principal amount of $1,228,179 and loan payments based on a formula equal to 8.142 times 3-month US$ LIBOR. (Note that 8.142 = 10,000,000 / 1,228,179.) The terms of the structured note specify no repayment of the principal amount either over the two-year term of the structured note or at the end of its term.

Example 3—Interest Rate Swap with Floating Rate Capped
Company C enters into a two-year interest rate swap that receives floating-rate cash flows based on LIBOR and pays fixed-rate cash flows. The swap has a $10,000,000 notional amount, a fixed rate of 6.64 percent, and a variable interest rate of 3-month LIBOR. The floating rate of the swap is capped at 6 percent. That is, if LIBOR exceeds the 6 percent threshold, the floating leg is calculated using the 6 percent rather than the current higher rate. The writer of the cap (the entity receiving LIBOR) receives no premium at the inception of the swap. Rather the premium of $18,838 is received over the life of the swap on a pro rata basis as part of each payment under the swap. The fixed rate on the swap has been adjusted from 6.65 percent to 6.64 percent so that the fair value of the swap is zero at inception. As a result, the swap component has terms that are off-market.

All three examples meet the characteristic of a derivative in paragraph 6(a), because they have underlyings and notional amounts. In Example 2, the true notional amount for the contract is the stated notional amount times the leverage factor. All three examples also meet the characteristic of a derivative in paragraph 6

examples also meet the characteristic of a derivative in paragraph 6 (c) because neither party is required to deliver an asset that is associated with the underlying or that has a principal amount, stated amount, face value, number of shares, or other denomination that is equal to the notional amount (refer to paragraph 9(a)). In Example 2, although the investor may deliver the structured note to the issuer at maturity, the stated amount of the note ($1,228,179) is not equal to the actual notional amount ($10,000,000).

RESPONSE

As discussed in the Background section, for contracts that are non-option-based, the characteristic in paragraph 6(b) of Statement 133 is satisfied only if the initial investment in the contract is less than 5 percent of the amount required to fully prepay the contract. Option-based contracts (that is, freestanding options or instruments with embedded options) that involve an initial net investment equal to the fair value of the option component satisfy the characteristic in paragraph 6(b). Depending on the specific terms of the contract, the fair value of the option component may incorporate time and intrinsic value.

Contracts that do not meet the definition of a derivative in paragraph 6 of Statement 133 are considered hybrid instruments that must be evaluated under paragraphs 12-16 of Statement 133 to determine whether bifurcation of an embedded derivative is required. If a non-option-based contract has an initial net investment that is less than 5 percent of the fully prepaid amount and the characteristics in paragraphs 6(a) and 6(c) are also met, an entity is permitted to account for the contract as either a derivative in its entirety or a hybrid instrument that must be bifurcated into a debt host and a derivative whose fair value is zero at acquisition of the hybrid instrument.

The analysis of the three examples in the Background section is below.

Examples 1 and 2
The prepaid interest rate swap discussed in Example 1 and the structured note discussed in Example 2 do not meet the characteristic of a derivative in paragraph 6(b). Both contracts are non-option-based contracts that require an initial investment of $1,228,179, which is the amount that results in the contracts becoming fully prepaid. Therefore, both contracts should be evaluated under paragraph 12 of Statement 133. The contracts should be bifurcated into a debt host contract and an interest rate swap whose fair value is zero at inception of the hybrid instrument, in accordance with Statement 133 Implementation Issue No. B20, "Must the Terms of a Separated Non-Option Embedded Derivative Produce a Zero Fair Value at Inception?"

In both Examples 1 and 2, bifurcation of an embedded interest rate swap is required because LIBOR may decrease to such a level that the investor may not recover its initial net investment of $1,228,179. Therefore, the embedded interest rate swap is not considered clearly and closely related to the host contract under paragraph 13(a) of Statement 133. Paragraph 61(a), which further explains paragraph 13 (a), states that if an embedded interest rate derivative contains a provision that permits any possibility whatsoever that the investor's (or creditor's) undiscounted net cash inflows over the life of the instrument would not enable the investor to recover substantially all of its initial recorded investment in the hybrid instrument under its contractual terms, the contract must be bifurcated.

If the structured note in Example 2 is a debt security within the scope of FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* and is classified by the holder as a trading security, the contract would not require bifurcation in accordance with paragraph 12(b) of Statement 133.

Example 3
The interest rate swap with the floating rate cap discussed in Example 3 does not meet the characteristic of a derivative in

Example 3 does not meet the characteristic of a derivative in paragraph 6(b). The contract has an embedded option and therefore should be evaluated as an option-based instrument under paragraph 6(b). The contract does not meet the characteristic of a derivative in paragraph 6(b) because the initial net investment is zero, rather than the fair value of the option component ($18,838). Therefore, this structure should be evaluated under paragraph 12 and should be bifurcated into a debt host (with a value equal to the option premium of $18,838) and a compound derivative comprised of an at-the-money swap component and a written cap component. In the case of an option-based embedded derivative, in accordance with Statement 133 Implementation Issue No. B22, "Whether the Terms of a Separated Option-Based Embedded Derivative Must Produce a Zero Fair Value (Other than Time Value)," the terms of the option-based embedded derivative should not be adjusted to result in the derivative's being at-the-money at the inception of the hybrid.

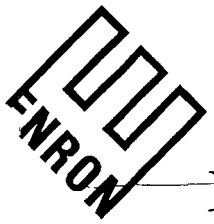
Effective Date and Transition
The effective date of the revised implementation guidance in this Issue is the first day of the first fiscal quarter beginning after November 15, 2002. If an entity had been accounting for a contract as a derivative under Statement 133 Implementation Issue No. A9, "Prepaid Interest Rate Swaps," the entity should continue to account for the contract as a derivative. The accounting for existing instruments as derivatives should not be changed. Entities should apply the revised guidance prospectively for future transactions.

The above response represents a tentative conclusion. The status of the guidance will remain tentative until it is formally cleared by the FASB and incorporated in an FASB staff implementation guide, which is contingent upon an amendment of Statement 133 being issued. Constituents should send their comments, if any, to Suzanne Bielstein, Director of Major Projects and Technical Activities, FASB, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116 (or by e-mail to derivatives@fasb.org) by July 1, 2002.

Copyright Permission Terms and Conditions

RECYCLED

OFFERING MEMORANDUM



$500,000,000

Enron Credit Linked Notes Trust

(a Delaware statutory business trust)

8.00% Enron Credit Linked Notes due 2005

The 8.00% Enron Credit Linked Notes due 2005 (the "Notes") represent debt obligations of the Trust secured by the assets of the Trust. The Notes are structured such that payments from sources of funds available to the Trust are expected to be sufficient to pay the amount that would have been paid on the Notes if the Notes were senior unsecured obligations of Enron Corp. having the same principal amount and interest rate as the Notes.

Application has been made to list the Notes on the Luxembourg Stock Exchange.

Investing in the Notes involves certain risks. See "Risk Factors" beginning on page 9.

The Notes have not been and will not be registered under the Securities Act of 1933, as amended (the "Securities Act"), or any state securities laws and may not be offered or sold except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws. The Notes are being offered and sold in the United States only to "Qualified Institutional Buyers" (as defined under Rule 144A under the Securities Act) and outside the United States in accordance with Regulation S under the Securities Act. For a description of certain restrictions on transfers of the Notes, see *"Plan of Distribution"* and *"Notice to Investors."*

	Per Note	Total
Price to Investors	99.827%	$499,135,000

The Trust will receive all of the proceeds of the sale of the Notes. The price to investors set forth above does not include accrued and unpaid interest, if any. Interest on the Notes will accrue from August 25, 2000 and must be paid by the investors if the Notes are delivered after August 25, 2000.

The Initial Purchasers named below expect to deliver the Notes in book-entry form only through The Depositary Trust Company on or about August 25, 2000.

Book-Running Lead Manager

Salomon Smith Barney

Joint Lead Manager

Lehman Brothers

Manager

Deutsche Banc Alex. Brown

August 17, 2000