

To: Bill Horwitz 303

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Re: Tax Liability on Royalty Payments

From: Bill Leggatt *Bill*

Date: 6 February 1995

Today Roberto Figueroa, Bill Votaw and myself met with Alvaro Castellanos, Sunking's Counsel, to discuss the issue of withholding tax associated with payments to the Sunking group. He showed us the following documents:

- 1) The original agreement of Feb 24 1992, between Sunking and Texas Ohio that allowed for 16% of capacity payments, 21% of energy payments, and specifically absolved Sunking from payment of any tax.
- 2) The transfer of this contract from Texas Ohio to EDC on March 12, 1992
- 3) The letter from Haug, dated June 10 1992, to Sunking agreeing that payments could be made to any account of Sunking's choice.

We subsequently showed him the amendment of (1) above, executed by Texas Ohio and Sunking dated March 12 1992, changing the payment to 6% of all revenues, and withdrawing the tax benefit. Alvaro was obviously aware of the existence of this document, and made it plain that it had been the topic of discussion at group meetings on many occasions.

Alvaro told us that there was a split in Sunking regarding the tax issue. This was between those who realised there was no legal basis to claim the payment on a grossed up basis, which comprises Alvaro and Henrik, at a minimum. The other side claims that, on the basis of precedent and a very optimistic interpretation of the agreements, the payments should be grossed up.

We told Alvaro that as far as Enron was concerned there was certainly no precedent either way (since there has been no tax so far), and that we could not see any justification in the documents we had that would give Sunking this security.

We reiterated that the intent of all this was to get the Sunking payment on a more legitimate basis, for the benefit of all; Sunking, PQPC and Enron. However, before we could meet to discuss alternative methods of payment, a formal resolution would have to be made on the tax issue. Therefore, on the

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basis of this discussion, Alvaro promised to come back to us with a formal Sinking position. Only then will we know whether we will have to dispute this issue, or whether the Group will accept the benefit of the situation so far, and accede the future liability gracefully. Alvaro promised this response only within a 10 day time frame, since at least one of the group is out of the country.

However, it is apparent that should the response be unfavorable, then this issue can only be resolved at a management level, since Alvaro, from a legal basis, did not contradict our own position/interpretation in any way, nor did he produce any new documentation that would cause our analysis of the situation to alter.