

INTERNAL REVENUE SERVICE

MEMORANDUM

Senate Finance Committee

EXHIBIT 41

21 December 1999

to: Bill Bissell, Houston District Counsel, Stop #8000-HAL

Gerald A. Richards, International Examiner, Group #1408, Houston District

subject: Puerto Quetzal Power Corporation (EIN: 76-0381261) -- Tax Court Petition filed 12 Nov. 1999

I have been requested, by Janet Balboni, to respond in detail to the above Petition. As a result, the following responses are submitted.

PETITION, Page #4, last sentence, Item #5 (a)(ii) – *“Pursuant to the O&M Agreement, Petitioner agreed to pay EEG, the Operator, all “reimbursable expenses” on a monthly basis. Fuel Oil expenses constituted “reimbursable expenses” under the O&M Agreement.”*

The Operation and Maintenance Agreement signed November 13, 1992, by and between Puerto Quetzal Power Corp (PQPC) – OWNER – and Electricidad Enron de Guatemala, S.A. (EEG) – OPERATOR, defines “Reimbursable Expense” in section 1.29 as follows:

Reimbursable Expense: Subject to Section 4.1, any reasonable expense or expenditure incurred by Operator in the performance of the work, including, without limitation, (i) purchases of spare parts, tools, equipment, consumables, materials and supplies (other than fuel), (ii) Labor Costs, (iii) the direct cost of subcontract labor or services needed to perform services otherwise covered by this agreement, (iv) insurance premiums and (v) any other item covered in an approved Annual Budget.

PETITION, Page #4, Item #5 (a)(iii) – *“On March 13, 1993, Petitioner and EEG amended the O&M Agreement to provide that the Project’s fuel oil requirements would be supplied by Enron Power Oil Supply Corporation (“EPOS”), a domestic sister company of EDC. EEG also agreed to make certain payments to Sun King Trading Company (“Sun King”), an unrelated party, on behalf of Petitioner.”*

Amendment #1 to Operation and Maintenance Agreement dated as of March 31, 1993, is between PQPC (OWNER) and EEG (OPERATOR). Section 1.13 of the O&M Agreement dated 13 November 1992, is deleted in its entirety and the following provision substituted:

“1.13 Fuel Agreements: The fuel supply and transportation agreements for the Project’s fuel oil requirements, entered into

(i) on October 16, 1992, between Enron Marketing Company (“EPMC”) and Enron Power Corp. (“EPC”), as modified by that certain Modification of Agreement dated March 30, 1993 between EPC and EPMC and as assigned by EPC to Enron Power Oil Supply Corp. (“EPOS”) pursuant to that Assignment and Assumption Agreement dated as of March 31, 1993, and

(ii) on October 27, 1992, between Texaco International Traders, Inc. (“Texaco”) and EPC, as modified by that certain Modification of Agreement dated March 30, 1993 between EPC and Texaco as assigned by EPC to EPOS pursuant to that Assignment and Assumption Agreement dated as of March 31, 1993 ...”

Section 1.29 of the O&M Agreement is hereby deleted in its entirety and the following provision substituted:

"1.29 Reimbursable Expense: Subject to Section 4.1, any reasonable expense or expenditure incurred by Operator in the performance of the work, including without limitation, (i) purchases of spare parts, tools, equipment, consumable, materials and supplies, including fuel oil which Operator supplies of causes to be supplied to Owner hereunder ..."

On 1 April 1993, a Fuel Supply and Management Agreement was entered into by and between EEG (Operator) and EPOS. Section 5 of this Agreement provides in part:

"Price: Payments. In exchange for the fuel supply and management services to be provided by EPOS hereunder, Operator agrees to pay, or cause to be paid, to EPOS an amount each month equal to the sum of

(i) an amount equal to six percent (6%) of the gross monthly revenues of Puerto Quetzal in such month ("the Monthly Fee"), and

(ii) the invoice amounts actually paid by EPOS to its fuel oil suppliers to procure the supplies that are delivered in such month pursuant to this Agreement..."

As a result of Amendment #1 to the O&M Agreement dated 31 March 1993, and the Fuel Supply and Management Agreement dated 1 April 1993, nothing is mentioned regarding EEG's (Operator) agreement to make certain payments to Sun King Trading Company ("Sun King"), on behalf of PQPC (Owner). Please, see CONFIDENTIAL memorandum dated 26 May 1993, (pages 2 and 3) which addresses why the Fuel Supply and Management Agreement was drawn up between EPOS and EEG. In other words, to set up a mechanism to move funds from PQPC (Owner) to EEG (Operator) to EPOS (Fuel Manager) to satisfy the Sun King "finders fee".

PETITION, Page #5, Item 5 (b)(i) – *"TOP had entered into an agreement with Sun King pursuant to which TOP agreed to pay certain fees to Sun King in consideration of Sun King's services in assisting TOP in developing and negotiating the PPA (the "Sun King Commission")."*

refer to Memorandum dated 13 December 1993, and the following quotes:

"The group is formed by friends (pal's) who have in common being well off. They are not formal partners in any other endeavors but Sun King. This is not a formal business group like you find in other cases: sugar, coffee, banking, etc. As wealthy individuals that they are, they have the capacity to establish contacts, make pressure, and represent your interests. One of the guys seems to be closer to the army than others, this can be of some benefit if in a given situation if we need to approach the army, but as a group, Sun King is meaningless. In other words, we could be much better off by sustaining individual relationships with one or the other guy, than by having them as a group."

"If any of the above is true, I sincerely believe that Enron has a valid case in presenting a claim, a formal complaint, a dissatisfaction. I doing so, Enron has to stress that it's association with Sun King brought very little benefits, that sharing all that investment with them is too much for the benefits that were NOT there. Personally, I feel that what S.K. did, was introduce Texas Ohio to President Serrano, and talk him into signing the contract. It is the typical "finder fee" arrangement, with the only difference that the fee was -for that service- completely out of hand".

"This possible claim, could put Enron in a much better position for a buy out. It's simple: Sun King would know, that if they dare sue you for not complying our contract, Enron's defense would also be powerful. If you convey the idea that Enron' in many respects is not happy, you'll be sending the correct message to induce a buy out."

PETITION, Page #5, Item 5(b)(iv) – “The Sun King Commission is a liability incurred by EDC to acquire the PPA.”

Again, the Sun King obligation existed by and between Texas Ohio Power and the Sun King group prior to EDC's purchase of the Power Sales Agreement (PPA) from TOP. The central question is the nature of this liability, and I think the four memorandums address clearly (1) the origins of and (2) the substance of the Sun King obligation. The periodic (1995) payments tendered to Sun King, and deducted by PQPC – “reimbursable (fuel oil) expenses” – are not ordinary and necessary business expenditures of PQPC. The \$12,000,000 payment tendered as a component of the Sun King “Buy-Out” is a lump-sum installment on prospective “finders fees” due the Sun King group.

Both the 1995 “reimbursable expenses” and the 1995 “buy-out” payment are capital expenditures. The only asset classification to place such expenditures is “Goodwill Sun King Group”. Since the Sun King group is not a formal Guatemalan business entity or association, “Goodwill Sun King Group” can only be deemed to have an indefinite useful life, and hence deductible upon dissolution of PQPC.

JR

cc: Janet Balboni