(713) 758-2192

November 4, 1993

Enron Corp.
1400 Smith Street
Houston, Texas 77002

Gentlemen:

You have requested our opinion concerning certain federal income tax consequences relative to the loans (the "Loans") to be made by Enron Capital LLC (the "Company") to Enron Corp. ("Enron") pursuant to that certain Loan Agreement to be entered into between the Company and Enron, as hereinafter described.

Based upon the facts, representations, assumptions, law and analysis all as set forth below, in our opinion for federal income tax purposes (i) the Company will be treated as a partnership, (ii) the Loans should be classified as indebtedness, and (iii) as such no tax will be required to be deducted and withheld by Enron pursuant to section 1441 of the Internal Revenue Code of 1986 (the "Code") from the interest payable to the Company in respect of the Loans.

FACTS

The Company is a limited life company organized under the laws of the Turks and Caicos Islands, and exists solely for the purpose of issuing its shares and lending the net proceeds thereof to Enron. The Company's current capitalization consists of 5,000 shares of $1 par value common stock (the "Common Shares"), of which 4,998 are issued and outstanding and owned by Enron. Prior to making the Loans to Enron, the Company's authorized capital will be increased by an additional class of 8,000,000 shares of $1 par value preferred stock (the "Preferred Shares"). Dividends on the Preferred Shares will (i) be cumulative, (ii) accrue from the date of original issue and (iii) be payable monthly in United States dollars at a rate on each Preferred Share of

8% of its stated liquidation preference of $25. Pursuant to an Underwriting Agreement,1 the Company will sell the Preferred Shares to several Underwriters for ultimate sale to the public.

After the sale of the Preferred Shares and pursuant to the terms of the Loan Agreement, the Company will loan to Enron an aggregate principal amount equal to the aggregate Liquidation Preference of the Preferred Shares issued and sold by the Company (approximately $200,000,000) plus the aggregate Common Share Payments (approximately $53,165,000). Enron is expected to use the proceeds of the Loans for general corporate purposes including the repayment of indebtedness. The Loan Agreement provides for fixed interest at an annual rate of 8%, with interest payable on the last day of each calendar month of each year commencing November 30, 1993, provided that Enron has the right to extend the interest payment period up to a maximum of 18 months so long as Enron is not in default in its payment of interest on the Loans. The entire principal amount of the Loans becomes due and payable, together with any accrued and unpaid interest thereon, on the earliest of (i) November 30, 2043, (ii) the date upon which Enron is dissolved or liquidated or (iii) the date upon which the Company is dissolved or liquidated.

The proceeds from any repayment of principal on the Loans will be applied to redeem the Preferred Shares at the Redemption Price, subject to the provision that any such amounts may be reloaned to Enron and not used for such redemption if, at the time of each such loan and as determined in the judgment of Enron, as Manager, and its financial advisor, (a) Enron is not in bankruptcy, (b) Enron is not in default on any Loan pertaining to the Preferred Shares, (c) Enron has made timely payments on the repaid Loan for the immediately preceding 18 months, (d) the Company is not in arrears on payments of dividends on the Preferred Shares, (e) Enron is expected to be able to make timely payment of principal and interest on such loan, (f) such loan is being made on terms, and under circumstances, that are consistent with those which a lender would require for a loan to an unrelated party, (g) such loan is being made at a rate sufficient to provide payments equal to or greater than the amount of dividends that accrue on the Preferred Shares, (h) the senior unsecured long-term debt of Enron is rated BBB- or better by Standard & Poor's Corporation or Baa3 or better by Moody's Investors Service, Inc. or the equivalent by any other nationally recognized statistical rating organization, (i) such loan is being made for a term that is consistent with market circumstances and Enron's financial condition and (j) the final maturity of such loan is not later than the 100th anniversary of the issuance of the Preferred Shares.

The Loan Agreement contains a mandatory prepayment provision whereby, if the Company redeems Preferred Shares, the Loans become due and payable in a principal amount equal to the aggregate stated liquidation preference of the Preferred Shares so redeemed plus all accrued interest. Optional prepayment provisions in the Loan Agreement give Enron the right to prepay the Loans without premium or penalty (i) in whole or in part, together with all accrued and unpaid interest and Additional Interest on the portion being prepaid at any time following November 30, 1998, and (ii) in whole

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(or in part, provided such partial prepayment would not result in a delisting of the Preferred Shares) together with all accrued and unpaid interest and Additional Interest, at any time after Enron is or would be required to pay Additional Interest. However, Enron does not have the right to prepay the Loans based on (a) a technical obligation to pay Additional Interest because of a withholding obligation to the extent Enron would not incur any penalties, interest or tax under the Code or other applicable law if Enron did not withhold, or (b) a *de minimis* obligation to pay Additional Interest. For purposes of the foregoing, in the event that Enron is advised by independent legal counsel that more than an insubstantial risk exists that Enron will incur penalties, interest or tax under the Code or other applicable law if it does not withhold, Enron shall have the right to repay the Loans unless the obligation to pay Additional Interest if Enron does so withhold is a *de minimis* obligation.

The Loan Agreement provides that each of the Loans is subordinate and junior in right of payment to all Senior Indebtedness, which is defined as the principal, premium, if any, and interest on (i) all indebtedness of Enron, whether outstanding on the date of the Loan Agreement or thereafter created, incurred or assumed, which is for money borrowed or evidenced by a note or similar instrument given in connection with the acquisition of any business, properties or assets, (ii) any indebtedness of others of the kind described in the preceding clause for which Enron is responsible or liable as guarantor or otherwise, (iii) any indebtedness secured by a lien upon property owned by Enron and upon which indebtedness Enron customarily pays interest, even though Enron has not assumed or become liable for the payment of such indebtedness and (iv) amendments, renewals, extensions and refundings of any such indebtedness, unless in any instrument or instruments evidencing or securing such indebtedness or pursuant to which the same is outstanding, or in any such amendment, renewal, extension or refunding, it is expressly provided that such indebtedness is not superior in right of payment to the Loans. In the event that Enron defaults in the payment of any principal, premium or interest on any Senior Indebtedness or an Event of Default has occurred with respect to any Senior Indebtedness and written notice describing such Event of Default and requesting commencement of payment blockage on the Loans is given to Enron by the holders of Senior Indebtedness, the Loan Agreement prohibits Enron from making any direct or indirect payment with respect to the Loans until the default on the Senior Indebtedness has been cured or waived or ceases to exist. In the event of any insolvency, bankruptcy or other similar proceeding relating to Enron, all Senior Indebtedness must be paid in full before any payment or distribution on the Loans may be made.

The Loan Agreement provides for various Events of Default pursuant to which the Company has the right to declare all amounts payable under the Loan Agreement to be immediately due and payable and to enforce its other rights as a defaulted creditor with respect to the Loans. The Operative Documents further provide that (i) if the Company fails to pay dividends in full on the Preferred Shares for 18 consecutive monthly dividend periods (assuming that Enron has not exercised its right to extend the interest payment period), (ii) an Event of Default occurs and is continuing or (iii) Enron breaches any of its obligations under the Guarantee (described below), then the holders of a majority in liquidation preference of the outstanding Preferred Shares may appoint a trustee to enforce the Company's creditor rights under the Loan Agreement, enforce the obligations of Enron under the Guarantee and the Expense Agreement, and declare and pay dividends on the Preferred Shares.

As part of these transactions, Enron will execute and deliver a guarantee (the "Guarantee") for the benefit of the holders of the Preferred Shares, which Guarantee will constitute a guarantee of payment and not of collection and will rank (i) subordinate to all liabilities of Enron, (ii) *pari passu* with the most senior preferred or preference stock now or hereafter issued by Enron and with any Enron guarantee now or hereafter entered into by Enron by respect of any preferred or preference stock of any Enron affiliate, and (iii) senior to Enron's common stock. Under the Guarantee, Enron is unconditionally obligated to pay the Guarantee Payments (except to the extent paid by the Company) in full to the holders of the Preferred Shares regardless of any defense, right of set off or counterclaim which the Company may have or assert. The following payments (to the extent not paid by the Company) constitute Guarantee Payments: (i) any accumulated and unpaid dividends declared on the Preferred Shares out of funds legally available therefor, (ii) the Redemption Price payable out of funds legally available therefor with respect to Preferred Shares called for redemption by the Company, (iii) upon a liquidation of the Company, the lesser of (a) the Liquidation Distribution and (b) the amount of assets of the Company available for distribution to Preferred Shareholders in liquidation of the Company, and (iv) any Additional Amounts payable by the Company in respect of the Preferred Shares.

As part of the Loan Agreement, Enron will covenant that, so long as any Preferred Shares remain outstanding, neither it nor any majority-owned subsidiary will declare or pay any dividend on, or redeem, purchase, acquire or make a liquidation payment with respect to, any of its capital stock, or make any guarantee payments with respect to the foregoing (other than (i) payments under the Guarantee, (ii) dividends or guarantee payments to Enron, or (iii) dividends on common stock paid by Enron Oil & Gas Company) if at such time Enron is in default with respect to its payment or other obligations under the Guarantee or the Expense Agreement or there has occurred any event that, with the giving of notice or the lapse of time or both, would constitute an Event of Default under the Loan Agreement. Enron will also covenant that so long as any Preferred Shares remain outstanding (i) it will maintain direct or indirect 100% ownership of the Common Shares and any other shares of the Company other than the Preferred Shares, (ii) it will cause at least 21% of the total value of the Company and at least 21% of all interests in the capital, income, gain, loss, deduction and credit of the Company to be represented by Common Shares, (iii) it will not voluntarily dissolve, wind-up or liquidate the Company, (iv) it will remain the Manager of the Company and timely perform all of its duties as Manager of the Company (provided that any permitted successor of Enron under the Loan Agreement may succeed to Enron's duties as Manager), and (v) it will use reasonable efforts to cause the Company to remain a limited life company and otherwise continue to be treated as a partnership for United

States federal income tax purposes.

The Articles of Association of the Company (referred to therein and herein as "Regulations") provide, in Regulation 15, that a Common Shareholder ceases to be a Member of the Company if such Common Shareholder attempts to make a transfer of his share in breach of the provisions of the Regulations. Regulation 16 provides that the transfer of any Common Shares in the Company is prohibited absolutely. Regulation 34 provides that the Manager (which is defined in the Regulations to mean Enron, any permitted successor to Enron, or any other holder of the Common Shares) will cause at least 21 percent of the total value of the Company and at least 21 percent of all interests in the capital, income, gain, loss, deduction and credit of the Company to be represented by Common Shares.

Regulation 52 provides that the Company shall be in dissolution automatically and without requirement of any other act upon the bankruptcy, resignation, withdrawal, expulsion, termination, cessation or dissolution under U.S. law of the holder of a majority of the Common Shares. Regulation 56 provides that when the Company is in dissolution, the Manager shall serve as liquidator unless and until the majority of the former Common Shareholders who were Members immediately preceding the commencement of dissolution and winding up by majority vote appoint a liquidator to replace the Manager.

REPRESENTATIONS AND ASSUMPTIONS

In connection with your request that we furnish this opinion you have made and we have relied upon the following representations, and our opinion is conditioned upon the initial and continuing accuracy of these representations and upon the assumptions set forth below:

1. At the time the Loans are made, (a) Enron is expected to be able to make timely payment of all principal and interest on the Loans, (b) the Loans are being made on terms, and under circumstances, that are consistent with those which a lender would require with respect to a loan of similar tenor and subordination to an unrelated party, and (c) the Loans are being made for a term that is consistent with market circumstances and Enron's financial condition.

2. The Company will enforce its creditor rights against Enron as specified in the Operative Documents in the case of an Event of Default or any other event giving rise to such rights under the Operative Documents.

3. Enron expects to continue its corporate existence and substantial business operations at least for the term of the Loans.

4. At the time the Loans are made, Enron could have borrowed the amount

of the Loans on similar terms from unrelated independent lenders.

5. The Company has been organized and at all times will be operated in conformance with the provisions of the Regulations, all of which provisions are effective under applicable law to establish the rights and obligations of the holders of the Common Shares and the holders of the Preferred Shares among themselves and with the public at large.

6. At all times during the existence of the Company, the Common Shares will represent at least 21 percent of all interests in the capital, income, gain, loss, deduction and credit of the Company.

7. None of the Loans will be secured by an interest in real property.

8. At least 90 percent of the gross income of the Company for each taxable year will consist of interest on the Loans.

9. At no time will the Company be engaged in the conduct of a financial or insurance business.

10. Each of the Loans will be registered with Enron as to both principal and interest, and the transfer of each Loan may be effected only by surrender of the note evidencing such Loan and either the reissuance by Enron of the note to the new holder or the issuance by Enron of a new note to the new holder evidencing such Loan.

11. The Company will file timely and periodically with Enron a duly completed and executed Internal Revenue Service Form W-8 stating that the Company is the beneficial owner of the Loans and that it is not a United States person.

12. Enron will comply with its covenants in the Loan Agreement.

We have assumed that the holders of the Preferred Shares at no time will own (directly or through application of the attribution rules of section 318(a) as modified by section 871(h)(3)(C) of the Code) stock of Enron representing 10 percent or more of the total combined voting power of all classes of stock entitled to vote, and that the holders of the Preferred Shares will file such forms appropriate to, or will otherwise, establish their exemption from U.S. withholding tax with respect to distributions on the Preferred Shares.

LAW AND ANALYSIS

The Loans

Neither the Code nor the Treasury Regulations promulgated thereunder specifically defines the characteristics which an interest must possess in order to be characterized for federal income tax purposes as indebtedness. Section 385, added to the Code in 1969, authorizes the Internal Revenue Service (the "Service") to prescribe regulations as necessary to determine whether an interest in a corporation is to be treated as debt or equity. Section 385(b) lists as factors to be addressed in those regulations: (1) whether there is a written unconditional promise to pay on demand or on a specified date a sum certain in money in return for adequate consideration in money or money's worth, and to pay a fixed rate of interest, (2) whether there is subordination to or preference over any other indebtedness of the corporation, (3) the ratio of debt to equity of the corporation, and (5) the relationship between holdings of stock in the corporation and holdings of the interest in question.

In the context of loans from a subsidiary to its parent corporation, the principal tax issue is whether the stockholder withdrawal is classified as a loan or as a constructive dividend. While the Supreme Court has not addressed the issue of characterization in the context of a subsidiary-to-parent loan, the Court has addressed the characterization of an instrument in the converse situation of advances by shareholders to their corporations. In *John Kelley Co. v. Commissioner*, 326 U.S. 521 (1946), the Supreme Court concluded that the characterization of an instrument as debt or equity for federal tax purposes depends on a facts and circumstances analysis in which, generally, no single factor is controlling. While this facts and circumstances analysis has resulted in outcomes which are frequently confusing and difficult to reconcile, a recent Tax Court decision enumerated many of the factors which courts have identified and used as aids in determining whether an instrument constitutes debt or equity (including a constructive dividend): (i) the name given the instrument evidencing the indebtedness, (ii) the presence or absence of a fixed maturity date, (iii) the source of payments, (iv) the right to enforce payments, (v) participation in management as a result of the advances, (vi) subordination to other creditors, (vi) intent of the parties to create debt, (viii) whether the purported creditors are also stockholders, (ix) the debt to equity ratio, (x) the ability of the debtor to otherwise obtain credit from outside sources, (xi) the use to which the advances will be put, (xii) the failure of the debtor to repay and (xiii) the risk involved in making the advances. *Dixie Dairies Corp. v. Commissioner*, 74 T.C. 476 (1980).

The Loan Agreement and Loans will have the form of a debt instrument and provide for (i) a market interest rate, (ii) a fixed date for maturity, (iii) the enforcement of the terms under certain conditions such as events of default and (iv) no participation in management of Enron as a result of the advances. These provisions evidence the clear intent of the parties to create indebtedness on the part of Enron to the Company. The fact that the maturity date of the Loans does not occur for 50 years (and that interest may be payable only every 18 months) is but one factor to be weighed in the debt determination. As the Tax Court noted in *Monon Railroad v. Commissioner*, 55 T.C. 345, 359 (1970), "[a]lthough 50 years might under some circumstances be considered as a long time for the principal of a debt to be outstanding, [the court] must take into consideration the substantial nature of the [taxpayer's] business and the fact that it had been in corporate existence . . . [for] 61 years prior to the issuance of the debentures." The *Monon* court emphasized that the instruments at issue contained a definite maturity date without reservation or condition and concluded that, based on the facts and circumstances, a 50-year term was not unreasonable. *Id. See also Ruspyn Corp. v. Commissioner*, 18 T.C. 769 (1952) (debentures with 89-year term due 4 years after expiration of lease covering corporation's principal asset constituted debt); *Mayerson v. Commissioner*, 47 T.C. 340, 352 (1966) (purported mortgage with 99-year term held valid debt obligation as "definite contractual obligation was created which would have to be fulfilled by or before a definite date in the future"). In *Swoby Corp. v. Commissioner*, 9 T.C. 887 (1947), however, the Tax Court held that an "income debenture" with a 99-year maturity date issued by a new corporation whose principal asset was a building which had an anticipated life of less than 33 years represented equity. The Loans can be distinguished from the situation in *Swoby Corp.* because Enron (including its predecessors) has been in business for many years and is expected to continue its corporate existence and substantial business operations at least for the term of the Loans.

The absence of realistic creditor safeguards is indicative of an equity contribution rather than a loan. The Tax Court has stated that "[t]he right to enforce the payment of interest is one of the requisites of a genuine indebtedness." *Gokey Properties, Inc. v. Commissioner*, 34 T.C. 829, 835 (1960). The Loan Agreement provides protection for the Company pursuant to the enforcement provisions available in case of a continuing Event of Default. Moreover, neither the Operative Documents nor applicable law restricts payment on the Loans to the corporate earnings of Enron or otherwise makes Loan payments contingent on the success of Enron. *See* Rev. Rul. 73-122, 1973-1 C.B. 66 (payments not dependent on earnings or at discretion of the organization favors debt characterization); *Estate of Mixon v. United States*, 464 F.2d 394 (5th Cir. 1972) (when repayment is possible only out of corporate earnings transaction reflects equity contribution). These characteristics are reflective of indebtedness rather than an equity interest.

Subordination of a debt to claims of general creditors is an important indication that the debt is really equity. *Harlan v. United States*, 409 F.2d 907 (5th Cir. 1969). However, subordination *per se* is not a fatal impediment to establishing a bona fide indebtedness. The bonds in *John Kelley Co. v. Commissioner, supra*, were subordinated; however, the Supreme Court, after weighing all the facts, held that such bonds constituted valid debt. Generally, if the holders of the instruments in question have rights which take precedence over those of shareholders and there is substantial equity in the corporation, these circumstances suggest that the instruments are in fact debt even though the creditors' claims are subordinated to those of general business creditors. *Monon Railroad*, 55 T.C. at 360. In Rev. Rul. 68-54, 1968-1 C.B. 69, the Service noted that the subordination of registered debentures raised questions as to the true nature of the debentures, yet concluded that the instruments qualified as valid indebtedness on the basis of other factors, including the fact that the claims of the debenture holders had priority over the claims of all equity holders. *See also* Rev. Rul

73-122, *supra* (concluding that the presence of other factors, including the priority of all equity interests over the debentures, outweighed the subordination of the debentures at issue).

While the Fifth Circuit, in one case, appeared to place greater emphasis on the effects of subordination than the Tax Court, later cases have clarified that the Fifth Circuit now employs a facts and circumstances analysis in which no one factor is determinative. In *Tomlinson v. 1661 Corp.*, 377 F.2d 291 (5th Cir. 1967), the court stated that the fact that an instrument is subordinated to all other indebtedness of the corporation, whether already incurred or to be incurred in the future with no limitation on the amount of such indebtedness, would "weigh heavily" toward an equity participation and against the existence of a bona fide debtor-creditor relationship. *Id.* at 298, discussing *United States v. Snyder Bros. Co.*, 367 F.2d 980 (5th Cir. 1966). In subsequent cases, however, the Fifth Circuit recognized that the subordination of an obligation to the claims of other creditors does not necessarily indicate that the purported debt is in reality an equity contribution, particularly where the advance is given a superior status to that of other equity contributions. *Estate of Mixon v. United States,* 464 F.2d 394, 406 (5th Cir. 1972). Like the Tax Court, the Fifth Circuit views the subordination of an instrument to other creditors, but not equity holders, as merely a factor to be considered in the facts and circumstances analysis of characterizing an instrument.

In *Rose v. Commissioner,* 435 F.2d 149 (5th Cir. 1970), the Fifth Circuit addressed the risks assumed by the lender in making advances to the borrower, and concluded that "[t]he ultimate question presented here is whether the investment, analyzed in terms of economic reality, constitutes risk capital subject to the fortunes of the venture, or whether it represents a strict debtor-creditor relationship." The Loans will be made generally on terms similar to those on which Enron could have borrowed similar amounts from independent lenders, and do not entitle the Company to share in any of the potential appreciation in the value of Enron other than to the extent of repayment of principal and interest on the Loans. The fact that the Underwriters, representing the global securities markets, will purchase the newly issued Preferred Shares which depend on the loans for their value is indicative of Enron's sound financial condition. Therefore, the risks assumed by the Company comport with a characterization of the Loans as indebtedness.

The Revenue Reconciliation Act of 1993 added section 7701(l) to the Code effective August 10, 1993, which states as follows:

> *Regulations Relating to Conduit Arrangements.* -- The Secretary may prescribe regulations recharacterizing any multiple-party financing transaction as a transaction directly among any 2 or more of such parties where the Secretary determines that such recharacterization is appropriate to prevent avoidance of any tax imposed by this title.

The legislative history accompanying this provision indicates that it would be within the proper scope of the provision to issue regulations dealing with multiple-party transactions involving debt guarantees or equity investments. To date, no regulations have been proposed under section 7701(l), and accordingly we are unable to express an opinion on the effect of new section 7701(l) on the characterization of the Loans for federal income tax purposes. We do note, however, that the existing authorities cited in that legislative history dealt with situations in which an intermediary party was disregarded as a conduit for federal income tax purposes. In each case, a purported payment to the intermediary was treated as in substance a payment directly by the first party to the third party; in no case was the character of the first party's payment as interest questioned. Indeed, in Technical Advice Memorandum 9133004, a payment of interest by the first party to an intermediary party and a related payment of dividends by the intermediary party to a third party was treated as a payment of *interest* directly by the first party to the third party.

Based on the facts, representations, assumptions, law and analysis set forth above, in our opinion the Loans should be classified as indebtedness for federal income tax purposes.

Classification of the Company

Section 7701(a)(2) of the Code provides that the term "partnership" includes a syndicate, group, pool, joint venture or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not a trust or estate or a corporation.

Section 301.7701-1(b) of the Treasury Regulations states that the Code prescribes certain categories or classes into which various organizations fall for purposes of taxation. These categories, or classes, include associations (which are taxable as corporations), partnerships, and trusts. The tests, or standards, which are to be applied in determining the classification of an organization are set forth in sections 301.7701-2 through 301.7701-4 of the Treasury Regulations.

Section 301.7701-2(a)(2) of the Treasury Regulations provides that the determination of whether an organization is to be treated as a partnership or as an association taxable as a corporation depends on whether there exists centralization of management, continuity of life, free transferability of interests, and limited liability. Section 301.7701-2(a)(3) of the Treasury Regulations provides that an unincorporated organization shall not be classified as an association unless such organization has more corporate characteristics than noncorporate characteristics.

Section 301.7701-2(b)(1) of the Treasury Regulations provides that if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will cause a dissolution of the organization, continuity of life does not exist.

Section 301.7701-2(e)(1) of the Treasury Regulations provides that an organization has the corporate characteristic of free transferability of interests if each of the members or those members owning substantially all of the interests in the organization have the power, without the consent of other members, to substitute for themselves in the same organization a person who is not a member of the organization. In order for this power of substitution to exist in the corporate sense, the member must be able, without the consent of other members, to confer upon his substitute all the attributes of his interest in the organization. Thus, the characteristic of free transferability of interests does not exist in a case in which each member can, without the consent of other members, assign only his right to share in profits but cannot so assign his right to participate in the management of the organization.

An entity organized under foreign law is treated as an unincorporated organization and thus is classified for federal tax purposes on the basis of the characteristics set forth in the Treasury Regulations under section 7701 of the Code. Rev. Rul. 88-8, 1988-1 C.B. 403. However, it is the local law of the foreign jurisdiction that must be applied in determining the legal relationships of the members of the organization among themselves and with the public at large, as well as the interests of the members of the organization in its assets. Rev. Rul. 73-254, 1973-1 C.B. 613.

In Rev. Rul. 93-4, 1993-3 I.R.B. 5, the Service ruled that where the organic documents of a foreign entity require dissolution upon the bankruptcy of an interest holder, without further action, the entity lacks the corporate characteristic of continuity of life (regardless of the identity of the interest holders and their relationship to each other).

In Rev. Proc. 92-33, 1992-1 C.B. 782, the Service provided a "numerical interpretation" of the phrase "substantially all" as it appears in section 301.7701-2(e)(1) of the Treasury Regulations for purposes of ruling whether an organization has the corporate characteristic of free transferability of interests. The Service stated that generally it will rule that a partnership lacks free transferability of interests if, throughout the life of the partnership, the partnership agreement expressly restricts the transferability of partnership interests representing more than 20 percent of all interests in partnership capital, income, gain, loss, deduction and credit.

Under section 7701(i) of the Code, any entity (including a partnership) that constitutes a "taxable mortgage pool" will be taxable as a separate corporation which may not be treated as a member of a consolidated group of corporations for purposes of section 1501 of the Code. To be classified as a taxable mortgage pool, (i) substantially all of the assets of such entity must consist of "debt obligations (or interests therein)", and (ii) more than 50 percent of such debt obligations must consist of "real estate mortgages (or interests therein)".

Under section 7704 of the Code, a publicly traded partnership is generally treated as a corporation. However, section 7704(c) provides that the treatment of a publicly traded partnership as a corporation shall not apply to any publicly traded partnership for any taxable year if 90 percent or more of the gross income of such partnership for such taxable year consists of "qualifying income", which section 7704(d) of the Code defines to include interest (other than interest derived in the conduct of a financial or insurance business or interest the determination of the amount of which depends in whole or in part on the income or profits of any person) and dividends.

Under the Regulations and as represented above, the Common Shares of the Company at all times will represent at least 21 percent of the total value of the Company and at least 21 percent of all interests in the capital, income, gain, loss, deduction and credit of the Company. The transfer of any Common Shares in the Company is prohibited absolutely, and if a Common Shareholder attempts to make a transfer of its shares in breach of the Regulations, the Common Shareholder ceases to be a Member of the Company. Accordingly, we conclude that the Company does not possess the corporate characteristic of free transferability of interests.

The Regulations provide that the Company shall be in dissolution automatically and without the requirement of any other act upon the bankruptcy, resignation, withdrawal, expulsion, termination, cessation, or dissolution of the holder of a majority of the Common Shares. Accordingly, we conclude that the Company lacks the corporate characteristic of continuity of life.

Because none of the Loans will be secured by an interest in real property, we conclude that the Company will not constitute a taxable mortgage pool under section 7701(i) of the Code. Because at least 90 percent of the gross income of the Company for each taxable year will consist of interest on the Loans, we also conclude that the Company will not be treated as a corporation pursuant to section 7704 of the Code.

Because we have concluded that the Company will not possess the corporate characteristics of continuity of life and free transferability of interests, we conclude that the Company will not have more corporate characteristics than noncorporate characteristics. We have also concluded that the Company will not constitute a taxable mortgage pool, or be treated as a corporation under section 7704 of the Code. Accordingly, in our opinion the Company will be treated as a partnership rather than as an association taxable as a corporation for federal income tax purposes.

Withholding Tax Under Section 1441

Section 1441 of the Code provides generally that all persons paying interest from sources within the United States to any nonresident alien individual or any foreign partnership shall withhold a tax equal to 30 percent thereof. Section 1441(c)(9) of the Code provides that no tax shall be required to be deducted and withheld from portfolio interest (within the meaning of section 871(h) of the Code) unless the person required to deduct and withhold tax from such interest knows, or has reason to know, that such interest is not portfolio interest by reason of section 871(h)(3) of the Code.

Section 871(h)(2)(B) of the Code defines the term "portfolio interest" to include any interest (including original issue discount) which is paid on an obligation which is in registered form and with respect to which the United States person who would otherwise be required to deduct and withhold tax from such interest under section 1441 receives a statement (which meets the requirements of section 871(h)(5)) that the beneficial owner of the obligation is not a United States person.

Section 871(h)(7) of the Code provides that the term "registered form" has the same meaning given such term by section 163(f) of the Code. The Treasury Regulations under section 163(f) provide that an obligation is in registered form if the obligation is registered as to both principal and any stated interest with the issuer (or its agent) and the transfer of the obligation may be effected only by the surrender of the old instrument and either the reissuance by the issuer of the old instrument to the new holder or the issuance by the issuer of a new instrument to the new holder.

Section 871(h)(5) of the Code provides that the statement with respect to an obligation must be made by the beneficial owner of such obligation, or a securities clearing organization, a bank, or other financial institution that holds customers' securities in the ordinary course of its trade or business, provided the Secretary of the Treasury has not published a determination that any statement from such person (or any class including such person) does not meet the requirements of section 871(h)(5) of the Code at least one month before the payment of interest on the obligation.

Treasury Regulation § 35a.9999-5(b)A-9 provides that interest on a registered obligation may be treated as portfolio interest by a United States person otherwise required to deduct and withhold tax under section 1441 of the Code if that person receives a statement that (i) is signed by the beneficial owner under penalties of perjury, (ii) certifies that such owner is not a United States person, or in the case of an individual that he is neither a citizen nor a resident of the United States, and (iii) provides the name and address of the beneficial owner. This statement may be made, at the option of the person otherwise required to withhold, on a Form W-8 or a substitute form that is substantially similar to Form W-8 and must be prepared, renewed and retained in accordance with the procedures prescribed at Treasury Regulation § 1.6049-5(b)(2)(iv). Treasury Regulation § 35a.9999-5(d) provides that an information return on Form 1042S, accompanied by the statement or Form W-8, is required to be filed with the Internal Revenue Service for the calendar year in which the interest payment is made.

Section 871(h)(3) of the Code provides that "portfolio interest" shall not include any interest which is received by a 10-percent shareholder. A "10-percent shareholder" means, in the case of an obligation issued by a corporation, any person who owns 10 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote. For this purpose, the attribution rules of section 318(a) of the Code, as modified by section 871(h)(3)(C) of the Code, apply.

The Loans are issued by a corporation (Enron) to a partnership (the Company) which does not directly own any of the voting stock of Enron. We have assumed that the holders of the Preferred Shares at no time will own (directly or through application of the attribution rules of section 318(a) as modified by section 871(h)(3)(C) of the Code) 10 percent or more of the voting stock of Enron. Further, it has been represented that each of the Loans will be registered as to both principal and interest and that the Company will file timely and periodically with Enron a duly completed and executed Form W-8 stating that the Company is the beneficial owner of the Loans and that it is not a United States person. Therefore, we conclude that interest paid on the Loans will qualify as portfolio interest within the meaning of section 1441(c)(9) of the Code. Accordingly, in our opinion Enron will not be required to deduct and withhold tax pursuant to section 1441 of the Code with respect to interest on the Loans paid to the Company.

We express no opinion as to the tax treatment of any of the transactions contemplated by the Operative Documents which is not specifically addressed in the foregoing opinion. Our opinion is based upon the existing provisions of the Code, regulations (and administrative pronouncements) promulgated or proposed thereunder, and interpretations thereof by the Internal Revenue Service and the courts, all as of the date hereof, all of which are subject to change with prospective or retroactive effect, and our opinion could be adversely affected or rendered obsolete by any such change. This opinion is given to you by us solely for your use and is not to be quoted or otherwise referred to or furnished to any governmental agency (other than the Internal Revenue Service in connection with an examination of Enron or the Company) or to other persons without our prior written consent.

Very truly yours,

VINSON & ELKINS L.L.P.

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