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Enron Corp.
1400 Smith Street
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Privileged and Confidential
Attorney – Client Communication

Re: Tax Consequences of the Liquidations of the Chiricahua LLCs

Ladies and Gentlemen:

You have requested our opinion regarding certain federal income tax consequences of the liquidations of a series of limited liability companies owned by affiliates of Enron Corp. ("Enron"). Specifically, you have requested our opinion as to ability of the Enron consolidated group to recognize a loss on the liquidations and the effect the liquidations will have on the net operating loss position of the Enron consolidated group.

Background

Enron North America Corp. ("ENA"), a wholly owned subsidiary of Enron has historically entered into a variety of financial positions with third parties relating to the price of natural gas and other commodities. These positions include swaps, futures contracts, options and forward contracts. It was ENA's normal practice to enter into offsetting positions with its wholly-owned subsidiary Risk Management and Trading Corp. ("RMT") pursuant to an ISDA Master Agreement dated March 31, 1997 and the periodic confirmations executed in association with that agreement (collectively, the "ENA Master Swap").

On December 20, 2000 RMT and FS 360 Corp., a wholly-owned subsidiary of RMT ("FS 360 Corp.") formed 14 Delaware limited liability companies -- RMT Chiricahua I-XIV, (the "Chiricahua LLCs"). FS 360 Corp. is the managing member of each of the Chiricahua LLCs owning a .01% interest in capital, profits and losses. RMT owns a 99.99% interest in the capital, profits and losses of each of the Chiricahua LLCs. FS 360 Corp. acquired its interest in each Chiricahua LLC in exchange for a cash contribution to such entity. RMT acquired its interest in each Chiricahua LLC in exchange for a cash contribution and its agreement to enter into an ISDA Master Agreement dated December 20, 2000 between RMT and the Chiricahua

LLC and the associated confirmation dated December 27, 2000 (the "RMT Swaps"), which represented offsetting positions with respect to certain of the contracts held by RMT. Each of the RMT Swaps were substantially "in the money" at the time of execution and represented a transfer of value by RMT to the Chiricahua LLCs of approximately $__________ in the aggregate. The amount of the net cash payments required to be made under each of the RMT Swaps to a particular Chiricahua LLC was based upon the specific terms set forth in the associated confirmation based on the notional volumes and prices set forth therein. While it was possible on any particular payment date that a payment would be required to be made by the Chiricahua LLC to RMT, it was anticipated that a substantial net payment would be made by RMT to each Chiricahua LLC over the life of the RMT Swaps. Moreover, under the terms of the RMT Swaps, none of the Chiricahua LLCs were required to make any net payments in the aggregate to RMT in excess of the amounts actually received by such entity from RMT.

Following the execution of the RMT Swap, RMT entered into an ISDA Master Agreement dated December 20, 2000 between with Tularosa LLC, a Delaware limited liability company ("Tularosa") and an associated confirmation dated December 27, 2000 (the "Tularosa Swap") with respect to RMT's membership interest in each Chiricahua LLC. The members of Tularosa are ENA and Mangas I Corp., a wholly-owned subsidiary of ENA. Pursuant to the Tularosa Swap, RMT was entitled to receive from Tularosa on the settlement date a fixed sum equal to the fair market value of the RMT's membership interests in the Chiricahua LLCs on the initial contract date and RMT was required to pay to Tularosa the fair market value of the membership interests in the Chiricahua LLCs on the settlement date, plus the amount of any distributions received from the Chiricahua LLCs during the contract term. The contract date for the Tularosa Swap was December 27, 2000 and the settlement date was January 2, 2002. Tularosa's obligations under the Tularosa Swap were guaranteed by Enron Corp.

In our letter dated February 26, 2001, we analyzed the federal income tax treatment of the transactions described above (the "2000 Transactions") and concluded that while there was no authority directly addressing the federal income tax treatment of the entering into of a complex financial instrument similar to the RMT Swaps as a capital contribution to a partnership, and therefore the matter was not free from doubt, in our opinion, the 2000 Transactions should result in (i) a constructive sale of RMT's membership interests in the Chiricahua LLCs under section 1259 of the Internal Revenue Code of 1986, as amended[1], (ii) the recognition of gain in an amount equal to the excess of the fair market value of RMT's membership interests in the Chiricahua LLCs over its basis in such interests (which basis should not include any amount with respect to the RMT Swap), and (iii) an increase in RMT's basis in its membership interests in the Chiricahua LLCs by an amount equal to the gain recognized as a result of the constructive sale.

In reaching these conclusions, we reasoned that it would be appropriate to treat the RMT Swap in a manner similar to the contribution of a partner's own debt obligation to a partnership for purposes of determining RMT's basis in its membership interests in the Chiricahua LLCs. RMT would not receive any tax basis in its membership interests in the Chiricahua LLCs related

[1] Unless otherwise indicated, all section references herein are to the Internal Revenue Code of 1986, as amended.

to the RMT Swap until such time as payments are made on the RMT Swap because RMT had no basis in its own obligation.

Under this approach, following the execution of the Tularosa Swap, RMT's basis in each Chiricahua LLC membership interest would equal the amount of its cash contribution, plus the gain recognized as a result of the constructive sale. That basis would be adjusted upward to reflect additional contributions made to such Chiricahua LLC by RMT (including payments under the RMT Swap), as well as RMT's allocable share of income from the Chiricahua LLC, and would be adjusted downward to reflect distributions by Chiricahua to RMT (including payments under the RMT Swap) and RMT's allocable share of Chiricahua's losses.

With respect to the 2000 Enron consolidated federal income tax return, you have advised us as follows:

- Enron reported a net operating loss ("NOL") carryforward at the beginning of the year of $[3.0] billion.
- Enron reported a net operating loss of $[2.0] billion for 2000, excluding the gains from the 2000 Transactions.
- Consistent with this approach discussed above, Enron reported the 2000 Transactions as resulting in the recognition by RMT of $[5.25] billion of capital gain.
- The gain from the 2000 Transactions was offset by the losses generated in 2000 and the NOL carryforwards from prior years. Accordingly, the taxable income of the Enron consolidated group for 2000 was [$50,000,000].

Since the consummation of the 2000 Transactions several significant developments have occurred affecting the transactions described above. First, and most notably, on December 2, 2001, Enron Corp. and several of its affiliates, including ENA, filed for protection under Chapter 11 of the Bankruptcy Code. Second, although the RMT Swaps required periodic payments to be made by RMT and the Chiricahua LLCs on the dates set forth in the RMT Swaps, no such payments have been made. Instead, since the execution of the RMT Swaps amounts owed by RMT to the Chiricahua LLCs have accumulated and have been treated as an unsecured receivable from RMT. [Third, RMT's ability to satisfy its obligations to Chiricahua has deteriorated. Virtually all of RMT's assets derive their value from unsecured claims or commitments from ENA or Enron. RMT's assets consist of receivables from ENA and Enron, its rights against ENA under the ENA Master Swap and its rights against Tularosa under the Tularosa Swap. Tularosa's ability to make payments under the Tularosa Swap are principally supported by an Enron guarantee. As a result of Enron and ENA's current financial position and bankruptcy filings it is unlikely that RMT will have sufficient assets to make the remaining payments under the RMT Swap or make full payments on the receivables to Chiricahua.]

In light of these circumstances, RMT and FS360, the members of each of the Chiricahua LLCs, liquidated the Chiricahua LLCs on December __, 2001. You have advised us that the

only assets held by the Chiricahua LLCs at the time of their liquidation were receivables from RMT, the RMT Swaps and cash.

Tax Consequences of the Chiricahua Liquidations

The tax consequences of the liquidations of the Chiricahua LLCs will depend primarily upon RMT's basis in its the Chiricahua LLCs and the character of the assets distributed in the liquidations. Section 731(a)(1) of the Code provides that gain shall not be recognized to a partner as a result of a distribution from a partnership except to the extent that any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution. Section 731(a)(2) provides that no loss will be recognized to a partner upon receipt of a distribution from a partnership except upon a distribution in liquidation of a partner's interest in the partnership where no property other than money, unrealized receivables (as defined in section 751(c)) and inventory (as defined in section 751(d)) is received. In that case, loss shall be recognized to the extent of the excess of the adjusted basis of such partner's interest in the partnership over the sum of the money distributed and the basis to the distributee, as determined under section 732, of any unrealized receivables and inventory distributed. Any gain or loss recognized as a result of a distribution under section 731 shall be treated as gain or loss from the sale or exchange of the partnership interest of the distributee partner. Such gain or loss is treated as gain or loss from the sale or exchange of a capital asset under section 741 of the Code.

Section 751(c) generally defines "unrealized receivables" to include any rights (contractual or otherwise) to payment for (i) goods delivered or to be delivered to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or (ii) services rendered, or to be rendered. Under section 751(c) "unrealized receivables" also includes certain recapture items. Section 751(d) defines "inventory items" to mean any property of the partnership which, on sale or exchange by the partnership (or by the distributee partner) would be property other than a capital asset and other than property described in section 1231 of the Code.[2]

As discussed above, in our letter dated February 26, 2001, we concluded that the 2000 Transactions should result in a constructive sale of RMT's interests in the Chiricahua LLCs under section 1259 and an increase in RMT's basis in its membership interests in the Chiricahua LLCs by an amount equal to the gain recognized as a result of that constructive sale. Accordingly, under this approach RMT's basis in its interest in each of the Chiricahua LLCs would equal the amount of gain recognized under section 1259 with respect to such LLC, plus the initial cash contributions made to such LLC. You have advised us that the aggregate basis of RMT in the Chiricahua LLCs under this approach is [$________________].

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[2] Section 751(d) also defines inventory items to include any property of the partnership which, if sold or exchanged by the partnership (or the distributee partner), would result in gain taxable under section 1246(a) (relating to gain on foreign investment company stock).

Under section 732(a) loss will be recognized by RMT as a result of the liquidation of the Chiricahua LLCs only if the distributed property consists solely of cash, unrealized receivables and inventory items. In the liquidation of the Chiricahua LLCs two types of assets were distributed – cash and obligations of RMT. Upon their distribution to RMT, the obligations of RMT will be extinguished. Accordingly, whether loss will be recognized on the Chiricahua liquidations will depend upon the how the obligations RMT that are extinguished in the liquidation are treated.

The effect of a distribution of a partner obligation to the obligee partner by a partnership under section 731 depends upon the manner in which the distributing partnership acquired the obligation.[3] If a partnership loans money or property to a partner and the partner's indebtedness to the partnership is subsequently cancelled, Treas. Res. § 1.731-1(c)(2) provides that the obligor partner will be deemed to have received a distribution of money or property at the time of cancellation. Rules for the treatment of the distribution of obligations acquired by the partnership from a third party are set forth in Rev. Rul. 93-7, 1993-1 C.B. 125, which holds:

> If a partnership acquires indebtedness of a partner, and the partnership distributes (in a liquidating or nonliquidating distribution) the indebtedness to the partner so that the debt is extinguished, the distribution of property rules will apply to determine the consequences for the partnership and the partner will recognize capital gain or loss to the extent that fair market value of the indebtedness differs from the basis of the indebtedness determined under section 732 of the Code.

Unfortunately, there is no direct authority addressing the tax consequences of the distribution of an obligation of a partner to the obligee partner where the obligation was incurred in exchange for interest in the partnership. Neither Treas. Reg. § 1.731-1(c)(2) nor Rev. Rul. 93-7 nor is applicable because the obligation did not result from a loan to the partner and obligation was not acquired by the partnership from a third party.

It appears that the distribution of a partner obligation received in exchange for an interest in the partnership back to the obligee partner should be viewed as a nonevent for federal income tax purposes.[4] In the circumstances covered by Rev. Rul. 93-7 and Treas. Reg. § 1.731-1(c)(2) the partner's basis in its partnership interest included, directly or indirectly, the funds used to acquire the partners note or loaned to the partner, respectively. In both of those instances treating the distribution as a distribution of money or other property is necessary to properly reflect the economic gain or loss of the partner. When a debt obligation is contributed to a partnership in exchange for a partnership interest, however, (i) the partner's basis in its partnership interest does not reflect the amount of the obligation until payments under the obligation are actually made, and (ii) the partnership has a zero basis in the obligation of the

[3] McKee, Nelson & Whitmire, Federal Taxation of Partnerships and Partners ¶ 19.02[5] (1997) ("McKee").

[4] *See* McKee at ¶ 19.02[5][c].

partner.5 Thus, treating the distribution of a contributed debt obligation back to the contributing partner as a nonevent is consistent the treatment of the contribution of the obligation.

Moreover, in the case of the Chiricahua liquidations where cash and the contributed partner obligations are the only assets distributed in the liquidation, treating the obligations as "other property" for purposes of section 731 would prevent the recognition of loss on the liquidation. Such a disallowance would be inconsistent with the rationale underlying Rev. Rul. 93-7, which holds that gain or loss should be recognized where following a partnership distribution no mechanism for the preservation of gain or loss exists. Specifically, Rev. Rul. 93-7 provides:

> when indebtedness of a partner is distributed to that partner, the debt is extinguished. Thus, just as in a situation involving the distribution of money, when debt is distributed by a partnership to its issuer, there is no mechanism for preserving gain or loss. Accordingly, current recognition of any gain or loss is appropriate. *See Cora-Texas Manufacturing Co., Inc. v. U.S.*, 222 F.Sup. 527 (E.D. La. 1963), aff'd per curiam, 341 F2nd 579 (5th Cir. 1965), which concluded that the partnership nonrecognition rules for distributions of property did not prevent the recognition of loss by a partner when a partnership distributed to a corporate partner that partner's preferred stock.

1993-1 C.B. 125.

Accordingly, although there is no direct authority addressing the distribution of partner obligations in this context, and therefore the matter is not free from doubt, in our opinion the distribution of the RMT Swap and associated receivables to RMT in the liquidation of the Chiricahua LLCs should be treated as a nonevent for federal income tax purposes and therefore RMT should be treated as receiving solely cash in the liquidations of the Chiricahua LLCs.

Assuming that the distributions of the RMT Swaps and related receivables are treated as nonevents for federal income tax purposes and RMT is treated as receiving solely cash in the liquidation of the Chiricahua LLCs, under section 731(a)(2) RMT will recognize a loss on the liquidation of each Chiricahua LLC in an amount equal to the excess of its basis in its LLC interest over the amount of cash distributed. Under section 731(a) in loss recognized will be

5 Section 722 provides that the basis of an interest in a partnership acquired by contribution of property, including money, to the partnership shall be the amount of such money and adjusted basis of such property to the contributing partner at the time of the contribution. Under section 722, if the property contributed to the partnership is an obligation of the contributing partner, the contributing partner=s basis in its partnership interest is not increased to reflect the partner=s obligation because the partner has no basis in its own obligation. *Gemini Twin Fund III v. Commissioner*, 62 T.C.M. 104 (1991); *Oden v. Commissioner*, 41 T.C.M. 1285 (1981); Rev. Rul. 80-235, 1980-2 C.B. 229; Tech. Adv. Mem. 8702006 (Sept. 26, 1986). Instead, Revenue Ruling 80-235 provides that Apayments on the written obligation are added to the partner=s basis in the partnership as the payments are actually made.@ 1980-2 C.B. at 230. This approach is consistent with the capital account rules promulgated under Section 704(b) of the Code. Treas. Reg. ' 1.704-1(d)(2) generally provides that if a promissory note is contributed to a partnership by a partner who is the maker of such note, such partner=s capital account will be increased with respect to such note only when there is a taxable disposition of such note by the partnership or when the partner makes principal payments on such note.

treated as a capital loss. You have advised us that under this approach the liquidation of each Chiricahua LLC resulted in a capital loss and that the total aggregate capital loss recognized as a result of the Chiricahua liquidations equals [$5.0 billion] (the "Chiricahua Capital Loss").

Section 1212(a)(1) provides that if a corporation has a net capital loss for any taxable year, the loss may be carried back to each of the three taxable years preceding the loss years but only to the extent such loss does not increase or produce a net operating loss for the taxable year to which it is being carried back.

You have asked us to apply the capital loss carryback rules in section 1212 to the Chiricahua Capital Loss assuming that there are no other capital gains or losses during the 2000 and 2001 tax years of the Enron consolidated group other than the gains recognized on the 2000 Transactions and the Chiricahua Capital Loss.

Example 4 and Example 5 of Treas. Reg. § 1.1212-1(a)(3) provide relevant guidance to the application of these rules in this context. Example 4 provides:

Year	**Operating Income or Loss (Exclusive of Capital Gain or Loss)**	**Capital Gain or Loss**
1967	($20,000)	$24,000
1968	$20,000	-0-
1969	$20,000	-0-
1970	($25,000)	($20,000)

The net capital loss of $20,000 for 1970 is carried back to 1967 and applied against the $24,000 net capital gain (capital gain net income for taxable years beginning after December 31, 1976) realized in that year only to the extent of $4,000, the maximum amount to which the 1970 capital loss carryback can be applied without producing a net operating loss for 1967. The unused $16,000 balance of the 1970 net long-term capital loss can be carried forward to 1971 and subsequent taxable years.

Example 5 provides:

Year	Operating Income or Loss (Exclusive of Capital Gain or Loss)	Capital Gain or Loss
1967	-0-	-0-
1968	($20,000)	-0-
1969	-0-	$24,000
1970	$20,000	($24,000)

> The net capital loss of $24,000 for 1970 is carried back to 1969 and applied against the $24,000 net capital gain (capital gain net income for taxable years beginning after December 31, 1976) realized in that year to the extent of $24,000. The application of the capital loss carryback is not limited as it was in Example (4) because such carryback neither increases nor produces a net operating loss, as such, for 1969. The $20,000 net operating loss for 1968 is then carried forward to 1970 to eliminate the $20,000 of operating income for that year.

Assuming that there are no other capital gains or losses during the 2000 and 2001 tax years of the Enron consolidated group other than the gains recognized on the 2000 Transactions and the Chiricahua Capital Loss, under section 1212 Enron will be entitled to carry back the Chiricahua Capital Loss to 2000 to the extent of $3.25 billion (*i.e.*, the excess of the $5.25 billion capital gain recognized as a result of the 2000 transactions over the taxable loss of the Enron Consolidated Group of $2.0 billion for 2000 calculated without regard to the gain recognized from the 2000 transactions).

Finally, the above discussion assumes that the 2000 Transactions are respected and are treated in the manner described in our letter dated February 26, 2001. However, because (i) the parties to the 2000 Transactions were related, (ii) RMT and Chiricahua did not follow the terms of the RMT Swap, and (iii) the Chiricahua LLCs have failed to engage in other trading operations for their own account as originally contemplated, there is a risk that the IRS could assert that the 2000 transactions should be disregarded. Moreover, the Chiricahua liquidations increase this risk because the liquidations resulted in putting RMT in a position very similar to where it would have been had the 2000 transactions never occurred.

Even if the IRS were successful in such a challenge, however, in our opinion there should not be an adverse effect on the Enron tax position. If the 2000 Transactions were disregarded, Enron would not recognize gain under section 1259 in 2000 as a result of those transactions and would not recognize loss as a result of the Chiricahua liquidations. The net effect would be that Enron would have a net operating loss of [$2.0 billion] for 2000 and would have a net operating loss carryforward at the beginning of 2001 of [$5.2 billion].

Our opinion is based upon (i) our understanding of the relevant facts surrounding the 2000 Transactions and the Chiricahua Liquidations as set forth herein and in our letter dated February 26, 2001, and (ii) the existing provisions of the Internal Revenue Code of 1986, as amended, 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 such change.

This opinion is given to you by us solely for your use and benefit, 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 the transactions contemplated by the rescission agreement) or to any other person without our prior written consent.

Very truly yours,