SHEARMAN & STERLING

FAX: 202-508-8100

801 PENNSYLVANIA AVENUE, N.W.
WASHINGTON, D.C. 20004-2604
202 508-8000

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WRITER'S DIRECT NUMBER:

May 28, 1999

Privileged and Confidential

Enron Corp.
1400 Smith Street
P.O. Box 118
Houston, Texas 77241-118

Cherokee Finance V.O.F.
c/o Rabobank Management B.V.
Croeselaan 18
3521 CB Utrecht
The Netherlands

Sequoia Financial Assets LLC

Ladies and Gentlemen:

We have acted as tax counsel to Enron Corp., an Oregon corporation ("Enron"), in connection with (i) the formation of Sequoia Financial Assets LLC (the "Company"), a Delaware limited liability company that will elect to be treated as a financial asset securitization trust (a "FASIT") for U.S. federal income tax purposes, (ii) the sale to the Company by U.S. subsidiaries of Enron (the "Sellers") of certain accounts receivable arising from the operations of the Sellers and certain debt of Enron issued to the Sellers (the "Enron Debt"), (iii) the sale to the Company by Enron of certain debt of the Sellers guaranteed by Enron (the "Seller Debt"), and (iv) the issuance and sale by the Company of the Class O Interest, the Class A Interests, and the Secured Notes (including each Monthly Note and each Interim Note). You have requested our opinions as to certain United States federal income tax consequences regarding the formation of the Company and the issuance and sale of the Class O Interest, the Class A Interests and the Secured Notes.

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The Class O Interest and the Class A Interests are membership interests in the Company arising under the Sequoia Financial Assets LLC Company Agreement, dated as of May 28, 1999 (the "Company Agreement"), between Enron and the holder of the Class O Interest (the "Class O Interest Holder"). The Secured Notes will be issued by the Company in the form of debt instruments pursuant to the Security Agreement, dated as of May 28, 1999 (the "Security Agreement"), among the Company, Enron, Cherokee Finance V.O.F. ("Cherokee"), and the Class O Interest Holder and the Note Purchase Agreement, dated as of May 28, 1999 (the "Note Purchase Agreement"), between the Company and Cherokee as the Noteholder. The Company acquired, and will acquire, the accounts receivable, Enron Debt and Seller Debt from the Sellers and Enron pursuant to the Sale and Servicing Agreement, dated as of May 28, 1999 (the "Sale and Servicing Agreement"), among the Company, the Sellers and Enron, in its capacity as the Servicer. The Sale and Servicing Agreement, the Company Agreement, the Security Agreement and the Note Purchase Agreement together are hereinafter referred to as the "Transaction Documents." Capitalized terms used herein and not otherwise defined shall have the meaning given to such terms in the Transaction Documents.

In connection with your request, we have examined the Transaction Documents and such other materials relating to the transactions described therein as we have deemed necessary and appropriate. The opinions set forth are based on the following assumptions: (i) the Transaction Documents represent the entire legal documentation relevant to the formation and capitalization of the Company and all related transactions; (ii) all of the parties to the Transaction Documents will, at all times, comply with the provisions of the Transaction Documents; (iii) the facts and representations set forth in such Transaction Documents are accurate; and (iv) the Class O Interest, the Class A Interests, the Secured Notes and any other certificates or instruments issued by the Company will be issued and administered in a manner consistent with the descriptions contained in the Transaction Documents. In rendering our opinions, we have relied on the accuracy and completeness of the facts, information, covenants, statements and representations contained in the Transaction Documents and such other statements, information and documents as we have deemed relevant. To the extent that our opinions rest on matters set forth in the Transaction Documents or such other statements, information and documents as we have deemed relevant, our opinions are subject to the assumptions, qualifications, exceptions and limitations set forth in the Transaction Documents and any other statements or representation of facts with respect to such matters.

Based upon, and subject to, the analysis set forth below and the assumptions and statements referred to herein, having regard for such legal counterclaims as we have deemed relevant, and subject to the qualifications set forth herein, we are of the opinion that for U.S. federal income tax purposes:

(1) The Company will qualify as a FASIT.

(2) The Class O Interest will be a FASIT ownership interest.

(3) Each Monthly Note, each Interim Note and each Class A Interest will be a FASIT regular interest.

(4) The Class O Interest Holder will be able to deduct the discount on the FASIT regular interests and such deductions may offset its income on the Assets and its upfront gain (if any) from the transfer of the Assets to the Company.

(5) The transfers of the accounts receivable by the Sellers should be respected as true sales.

(6) Enron and the Sellers should not be denied, or required to defer, their deduction for interest paid or accrued on the Enron Debt or the Seller Debt sold to the Company by reason of section 163(j).

(7) Based on the exception for portfolio debt investments and certain income tax treaties applicable to the holders of member interests in Cherokee,[1] the interest payments made by the Company to Cherokee on the regular interests held by Cherokee should not be subject to U.S. withholding tax.

Our opinions in this regard are based upon the Internal Revenue Code of 1986, as amended, the Treasury regulations promulgated thereunder, the relevant case law and administrative pronouncements of the Internal Revenue Service (the "IRS"), all as of the date hereof. Our opinions are limited to the federal income tax laws of the United States and we do not express any opinion herein as to any other law. In particular, we

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[1] Convention Between Netherlands and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, which was signed on December 18, 1992 and entered into force on December 31, 1993; Convention Between the United States of America and the Grand Duchy of Luxembourg with Respect to Taxes on Income and Property, which was signed on December 18, 1962 and entered into force on January 1, 1964; Convention Between the Government of the Grand Duchy of Luxembourg and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, which was signed on April 3, 1996 and has not yet entered into force. Cherokee will rely on the exception for portfolio debt investments and will not take a treaty-based return position that it would have to disclose.

have not considered and do not express any opinion as to the consequences of the transactions under any state, local or foreign tax law.

The opinions expressed above are furnished by us as counsel to you, and are solely for your benefit in connection with the transactions described herein. Without our prior written consent, you shall not be entitled to rely on this letter for any other purpose or in any other capacity, and no other person shall be entitled to rely on this letter for any purpose whatsoever. The opinions expressed should not be accepted as guarantees that a court of law or an administrative agency will concur in the opinions. In particular, our analysis of the foregoing issues is not binding on the IRS or the courts. No assurance can be given that the IRS will not challenge our analysis of the tax treatment of certain matters discussed herein or, if it does, that it will not be successful. No rulings have been requested or received from the IRS as to any of the matters discussed herein.

This letter speaks only as of the date hereof. We do not undertake to advise you of any development or circumstance of any kind, including any change of law or fact that may occur after the date hereof, irrespective of whether such development, circumstance or change may affect the legal analysis, a legal conclusion, or any other matter set forth in or relating to this letter.

The comments set forth below are intended to provide you with additional analysis and information regarding certain of our opinions, as we have deemed appropriate.

(1) A tax is imposed on income earned by a FASIT on loans it originates. Section 860L(e)(2)(C). The Company is not an originator of the accounts receivable, which are originated by the Sellers in the ordinary courses of their businesses. A question may arise, however, as to whether the Company is the originator of the Enron Debt and the Seller Debt. While the Seller Debt will be originally issued by the Sellers to Enron and the Enron Debt originally issued by Enron to the Sellers, the Company may acquire the Enron Debt and the Seller Debt immediately following its issuance pursuant to an arrangement. We believe the prohibition against origination was intended to prevent FASITs from being engaged in an active lending business and was certainly not intended to preclude acquisitions of debt instruments shortly after their issuance. For example, credit card receivables are generally acquired by securitization vehicles immediately following their creation pursuant to a prearranged plan. Such arrangements are typical in revolving credit card receivable financings, which the FASIT rules are

intended to facilitate.[2] The Company's activities are consistent with those necessarily performed by a vehicle for revolving credit securitizations and are, furthermore, essentially passive. *Cf.* Treas. Reg. § 1.864-4(c)(5) (foreign entity acting merely as a financing vehicle for borrowing funds is not considered to be in the active conduct of the business of banking or financing in the U.S.). Given the passivity of the Company in the present situation, we believe that, while there is no official guidance regarding engaging in origination, the Company is not an originator of the Enron Debt or the Seller Debt.

(2) A FASIT regular interest is any interest issued by a FASIT, which is designated as a FASIT regular interest, if it meets certain requirements. Section 860L(b)(1)(A). In particular, a FASIT regular interest must unconditionally entitle the holder to receive a specified principal amount (or similar amount) and must not have a stated maturity (including options to renew) of more than 30 years. Section 860L(b)(1)(A)(i) and (ii).[3]

(a) The question may arise whether a member interest issued by a limited liability company, such as a Class A Interest, may be a FASIT regular interest. The definition of a "FASIT regular interest" clearly provides that it may be any interest issued by a FASIT meeting listed requirements so long as it is designated as a FASIT regular interest. Furthermore, for federal income tax purposes, a FASIT regular interest is treated as a debt instrument even if it is not otherwise a debt instrument. Section 860H(c)(1). Each Class A Interest issued by the Company will be designated as a FASIT regular interest and will meet all of the listed requirements for FASIT regular interests. Consequently, each Class A Interest will be a FASIT regular interest.

(b) The fact that the holders of the Secured Notes and the Class A Interests are expected to reinvest the proceeds of those interests upon maturity may raise the question of whether the requirement that a FASIT regular interest entitle the holder to receive a specified principle amount is met. Each Secured Note and each Class A Interest entitles the holder to payment of a specified principal amount and matures no later than the end of the month in which it was issued. While the holders are expected to reinvest such amounts, the holders have the

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[2] *See* New York State Bar Report on Proposed Regulations to be Issued Under FASIT Provisions (1997).

[3] Application of the FASIT anti-abuse rule, section 860L(h), is discussed below in relation to the discussion of section 163(j).

discretion to stop reinvesting and to receive the stated principal amount. The planned reinvestment does not, therefore, violate the unconditional entitlement requirement. *See* Rev. Rul. 81-238, 1981-2 C.B. 248 (dividend reinvestment plan merely creates agency relationship where investor has discretion to terminate reinvestments); P.L.R. 6407295200A (July 29, 1964) (dividends subject to reinvestment in regulated investment company pursuant to plan allowing investor to withdraw at any time are paid for purposes of dividends paid deductions). While the principal amount is not delivered to the holders, the holders have control over the principal amount and are paid for federal income tax purposes.

(c) Because the holders are expected to reinvest the amounts received on each Secured Note and each Class A Interest, the question might also arise whether the Secured Notes and the Class A Interests have stated maturities of less than 30 years. As noted, the holders are not required to reinvest and may stop reinvesting upon the maturity of a Secured Note or a Class A Interest. Because the Secured Notes and the Class A Interests mature each month and are paid at that time, they do not have terms to maturity of more than one month.

(3) The FASIT ownership interest is the interest issued by a FASIT that is designated as an ownership interest and that is not a FASIT regular interest. Section 860L(b)(2). The Class O Interest will be designated as the ownership interest in the Company and will not be designated or treated as a regular interest. The question may arise whether the form will be respected in this case where (i) the Class A Interests entitle the holder to control the Company, (ii) the holder of the Class A Interests is entitled to receive a fee for servicing the assets of the Company, and (iii) the holder of the Class A Interest has indemnified the Class O Interest Holder for any taxes imposed on the Class O Interest Holder as a consequence of holding the ownership interest. One of the purposes of the FASIT rules is to provide certainty as to the classification of interests for federal income tax purposes, regardless of traditional debt/equity analysis. Consequently, we believe that these factors will not cause the designation of the Class O Interest as the ownership interest to be disregarded or the Class A Interests to be treated as an ownership interest. First, as discussed above, the FASIT rules anticipate that a FASIT regular interest may be a membership interest in a limited liability company (or some other form of equity interest in a business entity). Since many securitization transactions are structured to make the ownership interest as small as possible, it was foreseeable that membership interests treated as debt for tax purposes might entitle the holders thereof to the right to control the entity. Consequently, it was foreseeable that the holder of the designated ownership interest in the FASIT might not have such control. Second, FASITs are intended to

be passive entities, as discussed with respect to origination. The need to pay a servicer is a consequence of the passive nature of a FASIT. Therefore, the fact that the Company pays an arms-length servicing fee to Enron, which happens to be the holder of the Class A Interest is not significant. Third, the FASIT rules require that the holder of the ownership interest, which must be a domestic, taxable corporation, take into account the tax items of the FASIT. The rule is intended to assure that certain income does not escape taxation at the corporate level. While the Class A Interest holder will indemnify the Class O Interest Holder for any taxes imposed that are attributable to the FASIT, the Class O Interest Holder is not relieved of its liability for such taxes. The indemnification is a separate contractual relationship between the Class A Interest Holder and the Class O Interest Holder that exists outside of the FASIT and does not affect the status of the Class A Interest as a regular interest or the Class O Interest as an ownership interest. *See* Treas. Reg. § 1.860G-2(i)(1) (form respected where contractual rights are coupled with real estate mortgage investment conduit ("REMIC") regular interests). The status of the Class O Interest as the ownership interest is also supported by the real economic investment by the Class O Interest Holder, the yield on which depends on the performance of the Company's assets.

(4) The income from the disposition of an asset by a FASIT is generally subject to the tax on prohibited transactions. Section 860L(e)(2)(B). Because the Company may dispose of an account receivable if it is not paid on the due date, the question may arise whether the Company would be subject to the tax on prohibited transactions. There is an exception to the rule for dispositions incident to foreclosure, default or imminent default on the debt instrument. Sections 860L(e)(3)(A)(i) and 860F(a)(2)(A)(iii). According to the Sale and Servicing Agreement, default occurs in the event that nonpayment of a scheduled payment is not cured within three days of receipt of written notice by the Seller and the Servicer. While "imminent default" is not defined in the Code, we believe that nonpayment of a scheduled payment gives rise to a situation where default is imminent. Therefore, the Company will not be subject to the tax on prohibited transactions upon a disposition of an account receivable upon non-payment.

(5) Property acquired by a FASIT from someone other than the holder of the ownership interest is treated (i) as having been acquired by the holder of the ownership interest for an amount equal to the FASIT's cost of acquiring the property and (ii) as having been sold to the FASIT by such holder at its value. Section 860I(a)(2). For this purpose, value is determined under special FASIT valuation rules. If the value of the property exceeds the ownership interest holder's

cost basis in the property, the holder of the ownership interest recognizes gain to the extent of such excess ("upfront gain"). Section 860I(a)(1).

For purposes of determining its taxable income, the holder of the ownership interest is treated as the direct owner of all assets acquired by the FASIT, and as the direct obligor on all liabilities (regular interests) issued by the FASIT. If the holder recognizes upfront gain, the holder's basis in the assets of the FASIT is increased by the amount of gain recognized. Consequently, the holder of the ownership interest will recognize a gain each month with respect to the receivables and other assets of the FASIT equal to the sum of (i) the upfront gain, if any, and (ii) the excess of (x) the face amount of the assets over (y) the holder's basis in the assets (adjusted for upfront gain, if any). That gain generally should equal the interest expense on the regular interests issued by the FASIT.[4]

The holder of the ownership interest will be entitled to offset its upfront gain (if any) with interest expense on the regular interests, even in the unlikely event that the upfront gain is treated as derived outside of the FASIT. The FASIT provisions do not prohibit the use of FASIT losses (*i.e.*, interest expense on the regular interests) from offsetting non-FASIT gains. The FASIT rules only prohibit using non-FASIT losses to offset FASIT gains. *See* section 860J(a).

(6) The transfer of accounts receivables to the Company is structured as a transfer of the right to collect the full amount of the accounts receivable owed by the Seller's customers. The Sellers have agreed with their customers to offset the amount owed by the customers on the accounts receivable against the amounts owed by the Sellers to the customers. It might be argued that when the Company acquires the accounts receivable from the Sellers, it is acquiring a net position. We understand that the netting arrangement relates only to the manner and method of payment of the accounts receivable; the netting arrangement does not alter the obligations of a customer to the respective Seller in any other manner. Consequently, based on the form of the accounts receivable, a customer is unconditionally obligated to pay the full amount of the account receivable and the Seller has a legally enforceable right to receive the full amount of the receivable. Furthermore, at the time a customer takes delivery and incurs its obligation the amount of the offset is not determinable. Regardless of the netting, therefore, the gross amount of the accounts receivable transferred by the Sellers should have

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[4] The holder of the ownership interest presumably will recognize some taxable income, however, reflecting at a minimum the economic income generated by the ownership interest.

economic significance. *See, e.g., Peracchi v. Comm'r*, 98-1 U.S.T.C. 84,009 (9th Cir. 1998). Consequently, while there is no authority directly on point, the customers' obligations should be respected as independent obligations for the full amount of the receivables. *See e.g., Sacks v. Comm'r*, 69 F.3d 982, 989-90 (9th Cir. 1995).

(7) If the transfers of the accounts receivable to the Company are not treated as sales, but as pledges of the assets to secure repayment of amounts advanced to the Sellers, the Company would be viewed as holding debt instruments issued by the Sellers. While such debt instruments should be good assets for purposes of the FASIT asset qualification tests under section 860L(c)(1)(B), this characterization would raise the origination issue[5] and could result in the application of the anti-abuse rule relating to section 163(j), described in more detail below.

To determine whether a transfer constitutes a sale for federal income tax purposes, the courts and the IRS have adopted a multi-factor analysis to ascertain whether the "substantial incidents of ownership" have been relinquished in the transfer. *See, e.g., Mathers v. Comm'r*, 57 T.C. 666, 674 (1972), *acq.*, 1973-1 C.B. 1; PLR 8338043 (June 17, 1983); GCM 34602 (Sept. 9, 1971); GCM 38147 (Oct. 26, 1979); GCM 37848 (Feb. 5, 1979); *see generally*, TAM 9237004 (April 8, 1992). Two key factors clearly indicate that a sale has occurred. First, the Company acquires the accounts receivable from the Sellers for a price fixed up-front so that the Company enjoys all of the benefits, in the form of increased yield by reason of earlier than expected prepayment of the accounts receivable, and bears all of the burdens, in the form of decreased yield by reason of later than expected prepayments, of ownership of the accounts receivable. Second, the Company bears all of the credit risk associated with the accounts receivable. While Enron ultimately bears the risk of loss due to defaults up to a certain level, which includes all expected losses, it bears that risk in its capacity as the holder of the Class A Interests in the Company and not as owner of the assets of the Company.[6] Neither Enron nor the Sellers act as guarantors of the accounts receivable, however, and the holders of interests in the Company bear all of the risk that the obligations of the Company will exceed the value of its assets. On the other hand, the Company lacks the power to dispose of the assets, except in the event of non-payment or other default, which is the third of three key indicia of a sale. The Sellers themselves,

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[5] As discussed above, the Company is not an originator.

[6] Enron will also indirectly own a 60% interest in each Secured Note.

however, have no retained interest in the assets transferred to the Company and should not be viewed as having retained ownership of the assets, which tends to undermine the argument that they merely pledged the assets. On the basis of the transfer of credit risk and prepayment risk, therefore, the transfer should be viewed as a true sale of the assets to the Company.

(8) Under section 163(j), the deduction for interest paid on a debt obligation by a domestic taxpayer to a related foreign entity may be deferred and ultimately denied. The Secretary of the Treasury is directed to issue regulations under section 163(j) as appropriate to prevent avoidance of that section. The legislative history of section 163(j) indicates the regulations should be issued recharacterizing back-to-back loans through third parties as direct loans to related parties. H. R. Rep. No. 101-247, at 1246-47. If the Company were disregarded for federal income tax purposes, the FASIT regular interests might be treated as debt instruments issued by the Seller to Enron and Cherokee.

(a) No regulations have been issued in final form to date. The existence of the Company should not be disregarded under general conduit principles. *See, e.g., Addison International, Inc. v. Comm'r*, 90 T.C. 1207, 1221 (1988), *aff'd*, 887 F.2d 660 (6th Cir. 1989) (corporation formed to qualify as a domestic international sales corporation may not be disregarded as a conduit, even though disqualified, and is imbued with business purpose); *Jet Research, Inc. v. Comm'r*, 60 T.C.M. 613 (1990) (same).

(b) Under regulations proposed in 1991, the IRS may disregard entities created with a principal purpose of avoiding the rules of section 163(j). Prop. Reg. § 1.163(j)-1(f). The regulations would be retroactive to 1989 if finalized in their current form. The principal purpose of the arrangement is to create a revolving securitization vehicle for accounts receivable generated by the Sellers. The obligors on the accounts receivable are not related to Cherokee and section 163(j) would not apply if they were transferred directly to Cherokee and the income on the accounts receivable were treated as interest. Only the interest paid on the Enron Debt and the Seller Debt would be subject to section 163(j) if transferred directly to Cherokee. The Enron Debt and the Seller Debt is used only for the purpose of making up for shortfalls in the amount of accounts receivable, which primarily occur due to prepayments during the month. Under the expected economic scenarios, (i) in most months, no Enron Debt or Seller Debt will be acquired at the beginning of the month, and (ii) a substantial portion of the accounts receivable are expected to be paid on or about the 25th of such month. Consequently, the anti-abuse rule in the proposed regulations should not be

applicable to disregard the Company, because no principal purpose of the transaction is to avoid section 163(j).[7]

(c) The Secretary of the Treasury is instructed to issue regulations to prevent the abuse of the FASIT rules "through transactions which are not primarily related to securitization of debt instruments by a FASIT." Section 860L(h). No such regulations have yet been issued. More importantly, as noted above, the principal purpose of the arrangement is to securitize accounts receivable generated by the Sellers. Therefore, the existence of the Company will not be disregarded under the FASIT anti-abuse rule.

(d) For purposes of section 864 and 956, income from the acquisition of trade receivables from related parties is treated as if it were interest on a loan to the obligor on the receivable. Regulations suggest that if a FASIT were to acquire receivables and issue regular interests to a party related to the Seller, the FASIT would be disregarded. Treas. Reg. § 1.864-8T(c)(3)(iv), Example 2. The regulation is not applicable for purposes of section 163(j). Even if it were applicable, the obligors under the receivables are unrelated to Cherokee and section 163(j) would not apply to deny or defer a deduction for the deemed interest payments on the receivables.

(9) Under section 881(a), a withholding tax of 30% is imposed on certain income, including interest income, of foreign corporations received from sources within the United States. If this rule were applicable to the payments on the Secured Notes to Cherokee,[8] the "interest" paid would be subject to a 30% tax, unless otherwise excluded.[9] For the reasons set forth below and in paragraph 10, the interest payments on the Secured Notes should not be subject to withholding tax.

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[7] As noted above, if the transfer of the accounts receivable were not respected as a sale to the Company, the Company might be viewed as holding debt issued by the Sellers and secured by the accounts receivable. In that event, the section 163(j) anti-abuse rule might apply. Even in that event, however, the principal purpose for the arrangement was to securitize the accounts receivable.

[8] Cherokee is a corporation for U.S. federal income tax purposes.

[9] The Secured Notes are principal only regular interests and therefore do not provide for payments of "interest." References to interest payments herein relate to the discount on the Secured Notes that is deductible to the FASIT or the holder of the ownership interest.

(a) As discussed above, the Secured Notes have terms to maturity of less than one month and are FASIT regular interests. For U.S. federal income tax purposes, a FASIT regular interest is treated as a debt instrument. Section 860H(c)(1). Because the terms of the Secured Notes are less than one year, all of the interest payable on the Secured Notes will be original issue discount. *See* Treas. Reg. § 1.1273-1(c)(5). Original issue discount is subject to withholding tax only to the extent provided in section 881(a)(3). For purposes of section 881, however, original issue discount on obligations with terms to maturity of less than 183 days are not subject to withholding tax. Section 871(g)(1)(B). Consequently, the interest income on the Secured Notes should not be subject to withholding tax.

(b) Even if the interest on the Secured Notes were not excepted from the withholding tax under the short-term obligation exception, "portfolio interest" -- including interest on obligations issued in registered form such as the Secured Notes[10] -- is generally not subject to withholding tax unless it is received by a "10-percent shareholder" or unless it is received by a controlled foreign corporation from a related person. Section 881(c).

(i) In the case of an obligation issued by a corporation, a 10-percent shareholder is any person that owns 10 percent or more of the total combined voting power of all classes of stock of such corporation. Section 871(h)(3)(B)(i). In the case of an obligation issued by a partnership, a 10-percent shareholder is any person that owns 10 percent or more of the capital or profits interest in such partnership. Section 871(h)(3)(B)(ii). It is not clear whether the owner of the FASIT ownership interest or the FASIT itself is the issuer of the regular interests for federal income tax purposes. If the Secured Notes are treated as issued by the ownership interest holder, a corporation, Cherokee is not a 10-percent shareholder. The rules, however, provide only that the FASIT regular interests will be treated as liabilities of the holder of the ownership interest for purposes of determining the holder's taxable income. Section 860H(b)(1). It might be argued that the FASIT is the issuer of the Secured Notes. In that case it is not clear how the 10-percent shareholder rule would be applied. A FASIT is not treated as a corporation or a partnership for federal income tax purposes, section 860H(a), so the definition set forth in section 871(h)(3)(B) is not directly applicable. That provision suggests that a 10-percent shareholder has some form of

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[10] The portfolio interest exception applies to interest paid on certain obligations in registered form with respect to which the issuer receives a statement that the holder is not a United States person. Section 881(c)(2)(B).

ownership interest in the issuer. The FASIT rules themselves were intended to provide a statutory securitization vehicle to provide tax certainty in situations where it was difficult under the traditional tax analysis to clearly identify interests in the securitization vehicle as debt or equity. Under the FASIT rules, all interests designated as regular interests are treated as debt for all purposes, section 860H(c)(1), and only a single interest is treated as an ownership interest, section 860L(a)(1)(C), which is subject to specific tax accounting rules. Section 860H(b). On the basis of this statutory scheme, Cherokee should not be viewed as having an equity interest in the Company and should not be a 10-percent shareholder.

(ii) As stated above, the portfolio interest exception also does not apply to interest received by a controlled foreign corporation from a related person, as defined in section 864(d)(4). Section 881(c)(3)(C). Cherokee is a controlled foreign corporation. Section 864(d), in general, deals with certain related party factoring transactions and section 864(d)(4) provides a definition of related parties. Under that definition of a related person, this exception to the portfolio interest exception should not apply to Cherokee and the FASIT or the ownership interest holder. [11]

(10) The exception from withholding tax for portfolio interest may not be applicable to payments of interest to the FASIT regular interest holders if the FASIT regular interests were treated as debt issued by the Sellers. *See* section 881(c)(3). Certain intermediate entities in back-to-back financing arrangements may be disregarded as conduits. Treas. Reg. § 1.881-3.

(a) An intermediate entity will not be treated as a conduit, however, unless its participation in the financing arrangement "reduces the tax imposed by section 881 (determined by comparing the aggregate tax imposed under section 881 on payments made on financing transactions making up the financing arrangements with the tax that would have been imposed under [Treas. Reg. § 1.881-3(d)])."[12] Treas. Reg. § 1.881-3(a)(4)(i)(A). For purposes of determining

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[11] The regulations under section 864(d)(4) provide authority to disregard certain intermediate parties, discussed in paragraph 8(d) above. Treas. Reg. § 1.864-8T(c)(3)(iv). The cross reference to section 864(d)(4) in section 881(c)(3)(C) should not make these regulations applicable to the Company. The regulations deal with the meaning of indirect acquisitions and not the meaning of "related persons," which is defined in a different section of the regulations, at Treas. Reg. § 1.864-8T(b)(2).

[12] The participation of the intermediate entity must also be pursuant to a "tax avoidance plan." Treas. Reg.
(footnote continued on next page...)

the amount of tax reduction, the "financing entity" (Cherokee in this case) may "claim the benefits of any income tax treaty under which it is entitled to benefits." Treas. Reg. § 1.881-3(d)(2) cross-referencing Treas. Reg. § 1.881-3(a)(3)(ii)(C). Because Cherokee is entitled to an exemption from withholding tax under the U.S.-Netherlands treaty, the interposition of the Company does not reduce withholding taxes that would otherwise be payable and the Company is not a conduit. Therefore, the existence of the Company will not be disregarded under section 881.

(b) If a taxpayer takes a return position that any treaty of the United States overrules or modifies any provision of the Code to reduce the amount of tax owed, the taxpayer must disclose such return position. Treas. Reg. § 301.6114-1(a). Because Cherokee will not be relying primarily on a treaty-based exception from withholding, it will not file such a disclosure.

(i) It might be argued that a taxpayer is not entitled to a treaty benefit unless it files such disclosure. We do not view this requirement as affecting a taxpayer's entitlement to a benefit under a treaty as a matter of law, but rather as a mechanism for claiming the benefit. The benefit of the treaty is not being claimed in this case, and will not be claimed unless the Company is disregarded under section 881. We believe that Cherokee is entitled to the benefit of the treaty under the terms of the treaty, and could have claimed such benefit by filing the required disclosure, so that, under the regulations, the Company is not a conduit.

(ii) It might also be argued that the taxpayer is taking a return position, that the Company is not a conduit, on the basis of a treaty and must, therefore, disclose the return position to claim the benefit. Because, however, the regulations under section 881 give the IRS discretion to disregard an entity, reliance on the treaty is contingent on the assertion of the authority to disregard the Company by the IRS. Furthermore, assuming that the terms of the transfers of assets to the Company and of the FASIT regular interests are at the market, the Company might have participated in the arrangement without the purchase by Enron or Cherokee of FASIT regular interests and is therefore, on that basis, not a conduit. *See* Treas. Reg. § 1.881-3(a)(4)(i)(C)(2). This position is

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[12](...footnote continued from preceding page)
§ 1.881-3(a)(4)(i)(B). The existence of a tax avoidance plan is determined by considering all of the facts and circumstances, including whether there is a significant reduction in tax, as determined above. Treas. Reg. § 1.881-3(b)(2)(i).

independent of any treaty benefit to the Company. Consequently, based on the contingent nature of the conduit assertion and the independent authority for avoiding conduit status, the taxpayer should not be viewed as taking a treaty-based return position and need not file a disclosure under section 6114.

Very truly yours,

Shearman & Sterling