Vinson & Elkins
ATTORNEYS AT LAW

VINSON & ELKINS L.L.P
2300 FIRST CITY TOWER
1001 FANNIN STREET
HOUSTON, TEXAS 77002-6760
TELEPHONE (713) 758-2222
FAX (713) 758-2346

WRITER'S TELEPHONE
(713) 758-2222

WRITER'S FAX
(713) 758-2346

July 17, 1997

Enron Leasing Partners, L.P.
1400 Smith Street
Houston, Texas 77002

ATTORNEY-CLIENT PRIVILEGED

Ladies and Gentlemen:

We acted as special counsel to Enron Corp., then a Delaware corporation ("Enron"), Organizational Partner, Inc., a Delaware corporation ("OPI") and a 97 percent-owned subsidiary of Enron, and Enron Leasing Partners, L.P., a Delaware limited partnership ("Leasing Partners"), in connection with the transactions contemplated by (i) the Land and Facilities Lease Agreement (the "Lease"), dated as of April 14, 1997, between Brazos Office Holdings, L.P., a Delaware limited partnership ("Brazos"), and OPI, (ii) the Consent and Agreement (the "Lessee Consent"), of even date with the Lease, among OPI, Brazos and The Chase Manhattan Bank, a New York banking corporation, as agent (the "Agent") for the hereinafter defined Banks, (iii) the Parent Guaranty (the "Guaranty"), of even date with the Lease, executed by Enron, (iv) the Credit Agreement, of even date with the Lease, among Brazos, the lenders parties thereto (the "Banks") and the Agent (the "Credit Agreement"), (v) the Assignment and Assumption Agreement (the "Assignment"), of even date with the Lease, and (vi) the Sublease by and between Leasing Partners and Enron (the "Sublease"), of even date with the Lease. Unless otherwise noted, capitalized terms not otherwise defined herein have the meanings assigned to such terms in the Lease. You have requested our opinion with respect to certain federal income tax consequences of the transactions contemplated by the foregoing documents.

For the reasons set forth below, in our opinion Leasing Partners should be treated as the owner of the Building (as hereinafter defined) for federal income tax purposes.

FACTS

The Lease Transaction

On March 15, 1994, Enron renewed and restructured the lease financing covering an office building located at 1400 Smith Street, Houston, Texas (the "Building") with State Street Bank and

EC2 000033834

AUTHENTICATED U.S. GOVERNMENT INFORMATION GPO

HOUSTON DALLAS WASHINGTON D.C. AUSTIN MOSCOW LONDON SINGAPORE

Trust Company of Connecticut, National Association ("SSBTC"). SSBTC amended and restated the lease agreement (the "Prior Lease Agreement") covering the Building with Enron. SSBTC and Enron have terminated the Prior Lease Agreement. Upon termination of the Prior Lease Agreement, Enron had the right to reacquire the Building. Enron assigned its right to reacquire the Building to Brazos, which financed the acquisition of the Building through the Credit Agreement. Enron is not a member of the group of lenders providing financing under the Credit Agreement and has made no guarantees under the Credit Agreement. Brazos has a stated equity interest in the Building equal to 3 percent of the Acquisition Cost.

Pursuant to Section 5.01 of the Lease, Brazos leased the Building to OPI for an initial five-year term beginning April 14, 1997 and ending April 13, 2002. The Lease can be renewed at OPI's option for an initial renewal term of five years and thereafter for thirty Renewal Terms of one year, each in accordance with Section 11.03(a) of the Lease. If OPI chooses not to renew the Lease, or if OPI chooses to renew the Lease and Brazos is unable to obtain financing and equity contributions on terms acceptable to Brazos, its limited partners and OPI, Section 11.03(b) requires OPI either to purchase the Building for an amount of cash equal to the Acquisition Cost or arrange (at its own cost and expense) for the sale of the Building to a third party pursuant to Section 11.04 of the Lease.

Section 3.02(a) of the Lease provides that, for accounting and regulatory purposes, OPI and Brazos intend that the Lease be treated as an operating lease. For all other purposes of federal, state and local law, including income and *ad valorem* taxes and bankruptcy law, Section 3.02(b) of the Lease provides that OPI and Brazos intend that the Lease be treated as a financing transaction.[1] A Memorandum of Lease dated as of April 14, 1997 by and between Brazos and OPI was filed in the Office of the County Clerk of Harris County, Texas. In addition, two UCC financing statements relating to the Lease (the "Financing Statements") were filed in the UCC Records of Harris County, Texas and the Office of the Secretary of State of Texas, respectively.

OPI does not acquire record title to the Building as a result of the Lease. Under Section 11.01 of the Lease, after the third year of the Lease Term or at any time during any Renewal Term, OPI may terminate the Lease on any Basic Rent Payment Date and either purchase the Building for an amount of cash equal to the Acquisition Cost or arrange (at its own cost and expense) for the sale of the Building to a third party pursuant to Section 11.04 of the Lease. Under Section 11.02 of the

---

[1] In this regard, Section 3.02(b) of the Lease provides that OPI and Brazos intend that (i) the Lease be treated as the repayment and security provisions of a loan by Brazos to OPI in the amount of the Acquisition Cost of the Building; (ii) all payments of Basic Rent, Additional Rent, proceeds of sale, and other amounts payable under the Lease be treated as payments of principal, interest and other amounts owing with respect to such loan, (iii) OPI be treated as entitled to all benefits of ownership of the Building and any part thereof; (iv) the Lease be treated as a mortgage and security agreement or other similar instrument from OPI, as mortgagor, to Brazos, as mortgagee, and as a security agreement in favor of Brazos as secured party encumbering the Building to secure such loan. Section 3.02(b) of the Lease further provides that the Agent and Assignees, collectively, shall have all the rights, powers and remedies of a mortgagee and secured party available under applicable law following a Potential Default or an Event of Default to take possession of and sell (whether by foreclosure, power of sale, or otherwise) the Building.

Lease, Brazos can terminate the Lease on any Basic Rent Payment Date in the event that certain circumstances arise in which Brazos incurs (or, in its reasonable judgment, in the future would incur) certain state or local taxes that are not indemnified pursuant to the Lease or in which the Lease (or related instruments) is deemed to require the payment or permit the collection of interest in excess of the Maximum Rate. In the event of a termination of the Lease by Brazos pursuant to Section 11.02 of the Lease, OPI is required either to purchase the Building for an amount of cash equal to the Acquisition Cost or arrange (at its own cost and expense) for the sale of the Building to a third party pursuant to Section 11.04 of the Lease.

Section 11.04(a)(i) of the Lease provides that if a sale of the Building to a third party results in sale proceeds greater than the Acquisition Cost, Brazos will pay to OPI the excess of the sale proceeds over the Acquisition Cost. If the sale proceeds are equal to or less than the Acquisition Cost, but greater than or equal to 25 percent of the Acquisition Cost, OPI is obligated under Section 11.04(a)(ii) of the Lease to pay to Brazos the excess of the Acquisition Cost over the sale proceeds. If the sale proceeds are less than 25 percent of the Acquisition Cost, OPI is obligated to pay Brazos, pursuant to Section 11.04(a)(iii) of the Lease, an amount equal to 75 percent of the Acquisition Cost plus an amount that Brazos determines in good faith to be the amount that the residual value of the Building was reduced in excess of that attributable to normal wear and tear, plus an amount that Brazos determines in good faith to be the amount the sale proceeds have been reduced due to certain Liens attaching to the Building that arise out of OPI's acts or failure to act.

Basic Rent under the Lease has two components: Basic Rent (Debt) and Basic Rent (Equity). In general, for any Basic Rent Payment Date (Debt), Basic Rent (Debt) equals the interest that would have been payable by Brazos under the Credit Agreement on such date if the Applicable Margin(s) (as defined in the Credit Agreement) were increased by the Brazos Margin (as specified in a letter dated February 24, 1997), provided that the interest rate under the Credit Agreement shall be deemed to be the Screen Rate.[2] Basic Rent (Equity) equals the product of the Equity Amount ($8,535,000) and a rate determined by formula. Under Section 6.03 of the Lease, OPI is required to pay Brazos, on demand, as Additional Rent, amounts required to reimburse Brazos for its costs and expenses (not previously included in Basic Rent) incurred in acquiring, financing and leasing the Building, as well as interest on any overdue amounts under the Lease.

Under Section 8.04 of the Lease, OPI may, at its expense, make additions and alterations to the Building so long as (i) no Event of Default has occurred and is continuing, (ii) the additions and alterations do not lessen the fair market value or impair the condition of the Building, (iii) the work is completed in a good and workmanlike manner in compliance with applicable Lease requirements (including insurance and legal requirements), (iv) no exterior walls or structural portion is demolished unless the structural integrity of the Building is maintained, and (v) the additions and

[2]Special rules apply in the case of an Event of Default under the Credit Agreement when no Event of Default has occurred and is continuing under the Lease.

alterations do not result in any Lien (except Permitted Encumbrances). OPI must notify Brazos if the costs of such alterations and additions exceed $5,000,000. Additions and alterations to the Building that are made at OPI's expense and that are not removable from the Building without impairing the functioning or resale value of the Building become the property of Brazos at the termination of the Lease.

Under Section 8.03 of the Lease, OPI is required to make all required reports to taxing authorities and, in general, to pay all taxes, assessments, levies, fees and all other charges (governmental or otherwise) which are imposed or levied upon or assessed against the Building, the Lease, the leasehold estate created by the Lease, the amounts payable pursuant to the Lease, or which arise in respect of the ownership, operation, occupancy, possession or use of the Property (other than certain franchise, estate, inheritance, transfer, federal income or similar taxes of Brazos or any Assignee). Section 9.01 of the Lease requires OPI to maintain liability and property damage insurance with respect to the Building at OPI's sole cost and expense. Section 8.02 of the Lease provides that OPI shall pay all costs, expenses, fees and charges incurred in connection with the ownership, use or occupancy of the property during the Lease Term and any Renewal Term thereof and shall at all times, at its own expense, keep the Building in good operating order, repair, condition and appearance. Under Sections 8.02 and 13.01 of the Lease, OPI assumes all risk of loss of or damage to the Building.

Pursuant to the Guaranty, Enron guarantees OPI's payments to Brazos under the Lease.

The Assignment

Pursuant to the Assignment, OPI assigned all of its rights under the Lease to Leasing Partners as a contribution to Leasing Partners in exchange for a 97 percent limited partner interest in Leasing Partners. The general partner of Leasing Partners is Enron Property Management Corp., a Delaware corporation and a wholly-owned subsidiary of Enron Cayman Leasing Ltd., a Cayman company and a wholly-owned subsidiary of Enron; the general partner has a 1 percent general partner interest in Leasing Partners. The remaining 2 percent limited partner interest in Leasing Partners is owned by an unrelated institutional investor.

Leasing Partners assumed all of OPI's obligations under the Lease. Enron's obligations under the Guaranty survived the Assignment. The Assignment was recorded in the real property records in Harris County, Texas.

The Sublease

OPI subleased the Building to Enron under the Sublease. Section 2.01 of the Sublease provides that the term of the Sublease is ten years (the "Initial Term"). Enron has the right to renew the Sublease for ten additional one-year terms (the "Renewal Terms"). Section 15.01 of the Sublease

provides that, at the end of the Initial Term and the ten Renewal Terms, Enron can purchase the Building at its then-appraised fair market value.

Section 2.02 of the Sublease provides that, at the end of the first five years of the Initial Term, Enron can make a payment to OPI equal to $130,867,380, plus all other sums then due and owing under the Sublease (the "Cancellation Payment"), to terminate the Sublease. If Enron elects to make the Cancellation Payment and terminate the Sublease, Section 7.02 of the Sublease gives OPI the right to purchase any improvements made by Enron during the Sublease at the then fair market value of such improvements.

Base Rent under Section 3.01 of the Sublease is initially set at $25.8631 per square foot of rentable area in the Building ($32,716,821.50 per year), subject to adjustments provided in the Sublease. Under Section 5.01 of the Sublease, Enron is responsible for taxes, maintenance, utilities, insurance and other operating expenses of the Building.

Section 7.01 of the Sublease provides that, so long as no Default under the Sublease has occurred and is continuing, Enron can make additions and alterations to the Building, subject to limitations related to impairment of the Building's condition, quality of work and similar matters. Additions and alterations in excess of $5,000,000 must be approved by OPI, although the Sublease provides that OPI may not unreasonably withhold its approval.

Enron may assign its interest in the Sublease to Enron Property & Services Company, a Delaware corporation and a wholly-owned subsidiary of Enron.

REPRESENTATIONS

In connection with your request that we furnish this opinion, certain representations have been made with respect to the existence of certain facts. These constitute material representations relied upon by us as a basis for our opinion, and our opinion is conditioned upon the initial and continuing accuracy of these representations. Specifically, it has been represented that:

1. The rental payments under the Sublease approximate the fair rental value of the Building.

2. Leasing Partners has entered into the Sublease and the Assignment with the expectation of earning a profit.

3. The remaining economic useful life of the Building as of April 14, 1997 is at least 50 years.

4. The marginal federal income tax rates of OPI, Enron and the partners of Brazos are substantially identical.

5. Neither OPI nor Enron has any ownership interest in Brazos.

6. Leasing Partners and Enron will treat the Sublease as a true lease for accounting and all other purposes.

In addition to the facts and representations set forth above, our opinion is conditioned upon our understanding that the transactions will be carried out strictly in accordance with the documents described or referenced herein and that there are no other agreements, arrangements, or understandings other than those described or referenced herein.

LAW AND ANALYSIS

A. Authorities.

Rules for determining tax ownership of property are not provided in the Code[3] or related Treasury regulations. Instead, a body of court cases, revenue rulings and revenue procedures provide guidance for making a determination of tax ownership. All of the authorities are based on the proposition that the person claiming ownership must demonstrate sufficient attributes of ownership to be treated as the owner for federal income tax purposes, but none of the authorities sets forth a definitive standard for evaluating such attributes.

Nearly all of the authorities state that the substance of a transaction prevails over its form.[4] In examining the substance of a transaction, the analysis applied by various authorities can be divided into two parts: the presence or absence of economic substance in the transaction and the possession of the benefits and burdens of property ownership.

---

[3]References herein to the Code are to the Internal Revenue Code of 1986, as amended, unless otherwise specified.

[4]*See, e.g., Helvering v. F. & R. Lazarus & Co.*, 308 U.S. 252 (1939) (at taxpayer's behest, a transaction in which the taxpayer transferred title to real estate to a bank and received back a 99-year lease with options to renew and to purchase the property was held to be, in substance, a financing transaction for tax purposes); Rev. Rul. 68-590, 1968-2 C.B. 66 (IRS applied *Lazarus* in determining that an acquisition of land from a corporation by a political subdivision through financing provided by industrial revenue bonds, followed by a leaseback to the corporation that included an option to renew and repurchase so that the lease term, including renewal terms, was 99 years, amounted to a financing arrangement).

1. *Frank Lyon Co. v. U.S.*

The leading authority for determining the tax ownership of leased property in the context of a sale-leaseback transaction is *Frank Lyon Co. v. U.S.*[5] In *Lyon*, Worthen Bank and Trust Company of Little Rock ("Worthen") was not permitted to own and finance its own building, then under construction, through conventional sources because of objections from federal and state banking regulators. In lieu of conventional financing, the banking authorities approved a sale-leaseback transaction involving the building.

Worthen leased the land under the bank building to Frank Lyon Co. ("Lyon"), a closely-held corporation engaged in the distribution of home furnishings, for a term of approximately 76 years.[6] Worthen constructed the bank building and sold it, in sections, for approximately $7,640,000 to Lyon. Lyon invested $500,000 of its own funds and financed the balance with recourse, institutional first mortgage financing payable over 25 years. Worthen then leased the building from Lyon for a primary term of 25 years. The lease included options to extend to a total term of approximately 65 years. In the eleventh, fifteenth, twentieth and twenty-fifth years of the lease, Worthen had an option to purchase the building for a fixed purchase price equal to (a) $500,000 plus six percent compound interest over the lease term, plus (b) the amount of the then-unpaid balance of the institutional financing. Worthen's rent for the primary term of the lease (the first 25 years) was the amount necessary to amortize fully the institutional financing. At the end of the primary term of the lease, if Worthen did not exercise its option to repurchase the building, Worthen could renew the lease for a rental stream that, after considering the ground rentals payable back to Worthen, repaid Lyon its $500,000 investment with six percent compound interest.

The Internal Revenue Service ("IRS"), in an audit of Lyon, determined that the transaction was a financing and disallowed the related deductions. The District Court ruled in Lyon's favor and held that the claimed deductions were allowable, concluding that the legal intent of the parties had been to create a bona fide sale-and-leaseback in accordance with the form and language of the documents evidencing the transactions. The Eighth Circuit reversed, in an opinion that found the benefits and burdens of ownership of the building had been retained by Worthen. Specifically, the Eighth Circuit noted that any appreciation in the value of the building would accrue to Worthen either upon destruction or condemnation or through its fixed price purchase options.

The Supreme Court reversed the decision of the Eighth Circuit in a frequently-cited holding:

> In short, we hold that where, as here, there is a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory

[5] 435 U.S. 561 (1978).

[6] The majority shareholder of Lyon also served on Worthen's board of directors.

> realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached, the Government should honor the allocation of rights and duties effectuated by the Parties. Expressed another way, so long as the lessor retains significant and genuine attributes of the traditional lessor status, the form of the transaction adopted by the parties governs for tax purposes. What those attributes are in any particular case will necessarily depend upon its facts. It suffices to say that, as here, a sale-and-leaseback, in and of itself, does not necessarily operate to deny a taxpayer's claim for deductions.[7]

In reaching its conclusion, the Supreme Court focused first on the economic substance of the transaction. To distinguish *Lazarus*,[8] the Court looked to the number of parties involved in the transaction, placing a strong emphasis on the presence of an institutional investor unrelated to the parties in the transaction, noting that the structure resulted from the restrictions imposed on Worthen by the banking authorities and pointing out that the tax rates of the parties were not disparate. The Court pointed out that more than one party was interested in participating in the transaction but that Lyon won the opportunity, reasoning that if Lyon had not participated in the transaction another interested investor would have.

The Court found economic substance and indicia of ownership in the recourse nature of Lyon's liability on the mortgage to the institutional investor. The Court was influenced by the business risk to Lyon through the primary liability on the debt that Lyon assumed, noting that Lyon's use of its capital for the purpose of the financing made Lyon less able to obtain financing for other business needs. Further, the likelihood that Worthen would exercise its option to purchase the property was viewed by the Court as uncertain, leaving Lyon with the potential for ownership of the property after the lease term. The Court did not view the six-percent compound fixed rate of return on Lyon's investment in the event Worthen exercised the purchase option to compel treatment of the transaction as a financing for tax purposes.

Although a substantial focus of the Supreme Court in *Lyon* was the economic substance of the transaction at issue, the Court examined other factors, some of which are discussed above, that are generally viewed as indicative of which party in a transaction is the tax owner of property. For example, the relationship between the amounts due under the lease and the amount of the financing, the accounting treatment of the parties, the relationship among the parties, the risk of depreciation/loss borne by Lyon, the reasonableness of the rentals and option purchase prices, and the residual interest in the building owned by Lyon were factors considered by the Court. In its holding, the Court restated its test for respecting the status of a lessor as a question of whether the lessor retained "significant and genuine attributes of the traditional lessor status," apparently

---

[7] *Id. at* 583-584.

[8] *See* note 4, *infra*.

referencing a type of benefits and burdens analysis in addition to the test for economic substance of a transaction. Various of the benefits and burdens factors considered by the Supreme Court in *Lyon*, as well as by other courts subsequent to the *Lyon* decision. are often advanced by the IRS as factors relevant in determining the tax ownership of leased property.[9]

2. Developments after *Frank Lyon Co.*

Since the Supreme Court decision in *Lyon*, courts have had a number of opportunities to consider the criteria for determining tax ownership of property, in the context of both sale-leasebacks and leveraged leases. A good example is the Tax Court's decision in *Torres v. Commissioner*,[10] in which it reviewed the tax ownership criteria in the context of a sale-leaseback. To evaluate the transaction in *Torres*, the Tax Court first applied an analysis similar to that of the Supreme Court in *Lyon* to determine whether the transaction in issue had sufficient economic substance to be recognized for federal income tax purposes. Specifically, the Tax Court determined that economic substance is present if the transaction has a business purpose and if the party claiming tax ownership has a reasonable expectation of profit apart from expected tax benefits (*i.e.*, a reasonable possibility that the purported owner could recoup its investment from the income potential and residual value of the property). Once the threshold issue of economic substance was resolved, the Tax Court went on to consider whether the transaction conferred sufficient benefits and burdens of ownership on Regency Associates, the putative owner-lessor of the subject equipment, for it to be considered the owner of the equipment for federal income tax purposes.

---

[9] *See* Rev. Rul. 55-540, 1955-2 C.B. 39 (enumerates factors considered by IRS in determining whether a putative lease of equipment is a lease or a conditional sales contract); Rev. Proc. 75-21, 1975-1 C.B. 715 (sets forth guidelines for advance ruling purposes in determining whether leveraged leases are true leases of property for federal income tax purposes). A discussion of factors set forth in Rev. Rul. 55-540 and Rev. Proc. 75-21, is set forth below. *See also* Rev. Rul. 83-47, 1983-1 C.B. 63 (a corporation that leased townhouses to potential buyers who could not qualify for mortgage loans with payments essentially equal to debt service on the properties and then sold the properties to the potential buyers once the buyers had built a good credit history was engaging in a financing arrangement).

[10] 88 T.C. 702 (1987). The facts in *Torres* are somewhat involved. Copylease was in the business of leasing photocopying equipment to end-users. Copylease sold the equipment subject to a lease to Curtis Corp. in exchange for $1,200,000 in cash and a nonrecourse note for $8,800,000. Copylease then leased the equipment back from Curtis Corp. Rental payments under the lease consisted of a fixed portion and a contingent portion based on the cash flow to Copylease from the leases. Torres was the general partner of a limited partnership known as Regency Associates. Simultaneously with the execution of the agreements between Curtis Corp. and Copylease, Regency Associates purchased from Curtis Corp. the equipment and lease rights that Curtis Corp. had acquired through the sale-leaseback transaction with Copylease. Regency Associates paid Curtis Corp. $115,000 in cash and delivered a nonrecourse note for $9,985,000. The nonrecourse note executed by Regency Associates required payment of principal and interest over a 15-year period. To the extent rental payments from Copylease were not made when due, Regency Associates could defer payment on the nonrecourse note to Curtis Corp. The Tax Court held that Regency was the owner of the equipment for federal income tax purposes.

In *Torres*, the Tax Court considered a number of factors as indicative of the benefits and burdens of ownership outside the context of a sale-leaseback, including the passage of legal title, the treatment of the parties, the obligation of the seller to deliver a deed and of the buyer to make payments. In the context of a sale-leaseback, the Tax Court noted that such factors as whether the purchaser had the right of possession, paid property taxes, bore the risk of loss or damage to the property and received profit from the operation of the property were less relevant factors because such factors are the normal result of a lease transaction. The Tax Court considered several other factors to be of greater importance, including: a useful life that extended beyond the lease term, existence of a purchase option at less than fair market value, and a provision for renewal of the lease term at less than fair market value.

More recently, in *Regents Park Partners v. Commissioner*,[11] the Tax Court again applied both the economic substance analysis and the benefits and burdens analysis to determine that the partners in the partnership acquired basis in the property from the nonrecourse acquisition debt only up to the fair market value of the property, which was less than the outstanding indebtedness.

Recent decisions of the Tax Court, together with the Supreme Court's decision in *Frank Lyon Co.*, indicate that the factors relevant to the benefits and burdens of ownership should be weighed once a determination has been made that a transaction has economic substance. The following therefore divides factors to be considered in making a determination of tax ownership of property into two parts.

3. Factors indicating economic substance.

The foregoing authorities identify the following factors as indicative that a transaction has economic substance:

a. Parties. The Supreme Court in *Lyon* viewed the relationship between the parties, the relative tax rates of the parties and the existence of a third, independent party to the transaction as indicative that the form of the transaction advanced by the parties had economic substance.

b. Business Purpose. The existence of a business purpose for the transaction other than potential tax benefits was considered indicative of economic substance by the Tax Court in *Torres*.

[11] 63 T.C.M. 3131 (1992) (partnership acquired buildings from HUD; buildings were purchased subject to non-recourse indebtedness that exceeded the appraised value of the buildings).

c. Profit Expectation. The availability or expectation of profit by the parties to the transaction has been a factor indicating tax ownership of the property.[12]

4. Factors indicating benefits and burdens of ownership.

Once a determination is made that a transaction has economic substance, the benefits and burdens of ownership test is applied. Factors from the foregoing authorities that may be considered in determining which party has the benefits and burdens of ownership include, among others:

a. Possession. Possession of the property was listed by the Tax Court in *Regents Park* as a factor indicating ownership for federal income tax purposes. However, in *Torres*, the Tax Court noted that a lessor is not normally vested with the right of possession during the term of a lease. There, the Tax Court found the extension of the useful life of the property beyond the term of the lease so as to give the purchaser a meaningful future possessory right in the property to be more indicative of tax ownership in the context of a lease.

b. Property Taxes. Responsibility for the payment of property taxes was cited by the Tax Court in *Regents Park* as a factor indicating tax ownership of property. The Tax Court noted in *Torres* that "because net leases are common in commercial settings, it is less relevant that [the lessor] was not responsible for the payment of property taxes." [13]

c. Risk of Casualty Loss. According to the Tax Court in *Regents Park*, responsibility for the risk of loss or damage to the property is a factor indicating tax ownership of property. As with payment of property taxes, this is a responsibility that is often allocated to the lessee in a net lease; thus, the Tax Court recognized in *Torres* that the factor is less relevant in a commercial setting.[14]

d. Likelihood of Exercise of Renewal Option. The existence of a renewal option at a nominal amount indicated to the Tax Court in *Torres* that the arrangement is a financing rather than a lease, and favors treatment of the nominal lessee as the tax owner of the building.

---

[12] *See Regents Park Partners v. Commissioner*, *supra*; Rev. Proc. 75-21, 1975-1 C.B. 715.

[13] *Torres v. Comm'r*, *supra* at 721 (1987).

[14] *Id.* at 721.

e. Treatment by Parties for Accounting and Other Purposes. The Supreme Court in *Lyon* stated its awareness that the treatment of a transaction for financial accounting purposes need not necessarily be the same as that for federal income tax purposes. However, the Court noted that consistency of treatment of the transaction for financial accounting purposes favored treating the nominal lessor as the tax owner of the property. In *Torres*, the Tax Court considered the treatment of the parties for accounting and other purposes to be relevant to a determination of which party bore the benefits and burdens of ownership.

f. Benefit of Appreciation/Risk of Depreciation. Liability on purchase money indebtedness or risk of loss in the event of the devaluation of the property was seen by the Supreme Court in *Lyon* as a factor favoring treatment of the nominal lessor as the tax owner of the property. The Tax Court in *Illinois Power Co. v. Commissioner*,[15] viewed the fixed rate of return to one of the parties to be that of a lender and therefore indicative that the risk of loss fell on the other party to the transaction.

g. Legal Title. Passage of legal title to the property is a factor considered by the Tax Court in *Torres* and *Regents Park* to be relevant in determining tax ownership of property.

h. Payments Apply to Equity. Where a portion of the payments under the agreement are made specifically applicable to an equity interest to be acquired by the lessee, or legal title to the property passes under the agreement, treatment of the nominal lessee as the tax owner is favored.[16] Passage of legal title to the property was also a factor considered by the Tax Court in *Torres* and *Regents Park* to be relevant in determining tax ownership of property.

In addition to the foregoing, in analyzing the benefits and burdens of ownership with respect to leased property, the courts have also taken into account to varying degrees many of the factors that are considered relevant by the IRS as reflected in its revenue rulings and revenue procedures. These administrative authorities are discussed in greater detail below.

---

[15] 87 T.C. 1417 (1986) (Illinois Power Co. ("IPC") created a subsidiary ("IPFC"), gave 50 percent of the stock of IPFC to a university, sold nuclear fuel to IPFC, which purchased the fuel through commercial paper the payment of which was guaranteed by IPC. IPFC simultaneously leased back the fuel to IPC. The Tax Court held that IPC could disavow the form of the sale-leaseback and treat the transaction as a financing).

[16] *See also* Rev. Rul. 55-540, *supra*.

5. Rev. Rul. 55-540.

Rev. Rul. 55-540, 1955-2 C.B. 39, sets forth a number of factors that the IRS considers, in the context of an equipment lease, in determining whether a transaction is treated as a lease or a financing arrangement for federal income tax purposes. The ruling provides that the "intent of the parties as evidenced by the provisions of the agreement, read in the light of the facts and circumstances existing at the time the agreement was executed," governs the determination of whether an agreement is a lease or a conditional sales contract. As noted above, there have been developments in case law subsequent to the release of Rev. Rul. 55-540, and the ruling must be read in light of those developments. Nonetheless, Rev. Rul. 55-540 still provides helpful guidance to the extent that it offers insight into the factors considered by the IRS in making such tax ownership determinations and is frequently cited by the IRS in its rulings.[17]

Rev. Rul. 55-540 provides that, although no single fact is controlling, the following conditions (in addition to certain of the factors listed above) are helpful in determining the tax ownership of property in a sale-leaseback transaction:

a. Rentals Disproportionate. When the total amount to be paid by the lessee for a relatively short period of use is an inordinately large portion of the total required to be paid to secure transfer of title, treatment of the nominal lessee as the tax owner is favored.

b. Rentals Exceed Fair Market Value. Treatment of the nominal lessee as tax owner is favored when the agreed rental payments materially exceed the current fair rental value of the leased property, indicating an element other than compensation for the use of property.

c. Bargain Option to Purchase. The existence of an option to acquire the leased property for a price that is nominal in relation to its value at the time of the exercise of the purchase option indicates that the nominal lessee is the owner of the property for federal income tax purposes.[18]

d. Designation of Portion of Payments as Interest. The designation of some portion of the rental payments as interest is indicative of ownership by the nominal lessee.

---

[17] *See, e.g.*, Priv. Ltr. Rul. 93-13-001 (Apr. 7, 1992) (leases for the use of automobiles by retail customers were true leases).

[18] *See also* Rev. Proc. 75-21, 1975-1 C.B. 715.

e. Rental Payments Based on Use. The existence of rental payments at an hourly, daily or weekly rate, or based on production, use, mileage or a similar measure and not directly related to the normal purchase price, is a factor indicating tax ownership by the nominal lessor, provided that, if there is an option to purchase, the option price reasonably approximates the fair market value of the property on the option date.

f. Rental Payments not Required throughout Lease Term. Where the sum of specified rentals over a relatively short part of the expected useful life of the property approximates the price at which the property could have been purchased, plus interest and/or carrying charges, and the lessee may continue to use the equipment for an additional period approximating its remaining estimated useful life for relatively nominal or token amounts, the nominal lessee is favored as tax owner.

g. Payments Approximate Purchase Price. Where the sum of the rentals payable under an agreement, plus the exercise prices of any options to purchase the property, approximate the purchase price of the property plus a stated return, the agreement more closely resembles a financing than a lease. In such case, the nominal lessee would appropriately be treated as the owner of the underlying property.

6. Rev. Proc. 75-21.

In Rev. Proc. 75-21, 1975-1 C.B. 715, the IRS set forth guidelines that it will use for advance ruling purposes in determining whether certain transactions ("leveraged leases") are leases rather than financing arrangements. Although the guidelines were intended to clarify the circumstances in which an advance ruling recognizing the existence of a lease ordinarily will be issued, the IRS stated in Section 3 of Rev. Proc. 75-21 that it would consider ruling in cases where the guidelines are not satisfied, based on all the facts and circumstances. The ruling guidelines established in Rev. Proc. 75-21 have been applied by the IRS in recent years in the context of private rulings.[19] Certain of the facts and circumstances set forth in Rev. Proc. 75-21 that the IRS considers relevant in establishing that the lessor in a leveraged lease is the owner of the property for federal income tax purposes have been discussed *infra*. The following additional facts and circumstances are identified in Rev. Proc. 75-21:[20]

---

[19] *See, e.g.*, Priv. Ltr. Rul. 91-45-008 (Aug. 12, 1991) (sale-leaseback of paper-mill equipment was determined to be a true lease); Priv. Ltr. Rul. 91-44-001 (May 14, 1991) (lease for use of an airplane and related facilities was determined to be a true lease); Priv. Ltr. Rul. 89-51-002 (Sept. 13, 1989) (Partnership that leased automobiles to third parties was not the owner of the automobiles for depreciation purposes).

[20] Like Rev. Proc. 55-540, Rev. Proc. 75-21 provides guidelines for determining whether a transaction may be treated as a lease for federal income tax purposes in the context of an equipment lease. However, like Rev. Rul. 55-540, Rev. Proc. 75-21 is helpful to the extent that it offers insight into the guidelines applied by the IRS in making tax

a. Minimum Unconditional "At Risk" Investment. When the property is first placed in service or use by the lessee, the minimum investment made by the lessor in the property must be 20 percent of the cost of the property. The lessor must maintain the minimum investment of 20 percent throughout the term of the lease and must demonstrate that an amount equal to 20 percent of the cost of the property is a reasonable estimate of the market value of the property at the end of the lease term.

b. Lessor Cannot Force Purchase by Lessee. When the property is first placed in service or use by the lessee, the lessor may not have a contractual right to cause any party to purchase the property.

c. No Investment by Lessee. No part of the cost of the property may be furnished by the lessee. No portion of the cost of improvements or additions to the property, except for improvements or additions that are owned by the lessee and are readily removable without causing material damage to the property, may be paid by the lessee.

d. No Lessee Loans or Guarantees. The lessee may not lend any of the funds necessary to acquire the property to the lessor and may not guarantee any indebtedness created in connection with the acquisition of the property by the lessor.

B. Analysis of the Lease.

In analyzing the effect of the Lease on tax ownership of the Building, it is important to note that the parties to the Lease have clearly indicated their intent in Section 3.02(b) of the Lease that, for all purposes other than accounting and regulatory purposes, including for bankruptcy and tax purposes, the Lease is to be treated as a financing transaction. Thus, the express, stated intent of the parties to the Lease is that the transaction be treated as a secured loan for all but limited accounting and regulatory purposes.[21] Accordingly, for state law enforceability purposes and all purposes other than accounting and regulatory purposes, assuming that the expressed intent of the parties is

---

ownership determinations.

[21]Because the taxpayer chooses the form of the transaction, the courts have imposed restrictions on the ability of taxpayers to submit evidence of the substance of a transaction when seeking to disavow its form. The Third Circuit, in *Commissioner v. Danielson*, 378 F. 2d 771 (3d Cir. 1967), imposed a stringent burden of proof requirement that allows a taxpayer to challenge the tax consequences of a transaction's form only by a showing of mistake, undue influence, fraud or duress or any other ground that in an action between the transacting parties would be sufficient to set aside an agreement or to alter its construction. With regard to the transactions contemplated in the Lease, the treatment of the transaction as a financing for federal income tax purposes is fully consistent with the intent of the parties as evidenced by Section 3.02(b) of the Lease. Accordingly, the IRS will not face conflicting taxpayer characterizations of the Lease such that the *Danielson* rule would prevent the parties to the Lease from treating the Lease in conformity with the stated intent and substance of the Lease rather than its label.

respected, the Lease should be treated as a mortgage lien or security interest in the Building in favor of Brazos.[22]

State law defines the rights of the parties to a transaction and the legal consequences of the transaction; it is from that point that an analysis of the federal income tax consequences of the transaction may proceed.[23] The starting point for analyzing the Lease should therefore be a determination that the form of the Lease, as intended by the parties, is a financing, despite the labels placed on the operative documents. In continuing the analysis with respect to the Lease, as noted above it is necessary to determine whether the Lease has sufficient economic substance to be recognized for federal income tax purposes, and then to consider whether the Lease confers sufficient benefits and burdens of ownership on OPI for it to be considered the owner of the Building for federal income tax purposes (prior to the Assignment).

1. Economic Substance.

The factors enumerated above as indicating economic substance can be applied to the arrangement evidenced by the Lease as follows:

a. Parties. It has been represented that neither Enron nor OPI has any ownership interest in Brazos; thus, Brazos and OPI are not related parties. Further, it has been represented that the marginal federal income tax rates of OPI and the partners of Brazos are substantially identical. The independence of the parties and the relative tax rates of the parties support treatment of the Lease in accordance with its form.

b. Business Purpose. The existence of a business purpose for the Lease, long-term financing of the Building, supports treatment of the Lease in accordance with its form.

c. Profit Expectation. OPI will be able to capture the benefits of any appreciation in the value of the Building as a result of OPI's option to purchase the Building for the Acquisition Cost after the third anniversary of the Lease Term.

---

[22]Reference is made to our opinion letter dated April 14, 1997, which sets forth our opinion that the Lease and the Memorandum of Lease are sufficient to create a valid mortgage lien or security interest in favor of Brazos encumbering the Building and that the Lease is a legal, valid and binding obligation of OPI, subject to the qualification that our opinion should not be construed as meaning the Lease would be enforced as a lease. Our opinion states that it is predicated upon our conclusion that for state law purposes the transaction under the Lease and related documents would be characterized as a loan in keeping with the parties' expressed intent.

[23]*See Comm'r v. Crichton*, 122 F. 2d 181 (5th Cir. 1941) (mineral rights were real property under Louisiana law and, as real property, were of a like kind with improved city real estate); Rev. Rul. 55-749, 1955-2 C.B. 295 (where applicable state law considers water rights to be real property rights, the exchange of perpetual water rights for a fee interest in land constituted a nontaxable exchange of property of like kind).

Rental payments under the Lease are computed based on a formula that provides a specified return to Brazos after the payment of debt service on the Building pursuant to the Credit Agreement. The profit expectation of Brazos is therefore that of a lender, rather than an owner of the Building. The Acquisition Cost of the Building is $284,500,000, regardless of the fair market value of the Building at the time of the exercise of the option. This factor supports treatment of the Lease in accordance with its form.

The above-described factors support a determination that the Lease transaction has economic substance and that, accordingly, the Lease transaction should be recognized for federal income tax purposes in accordance with its form. As discussed above, the parties' intention that the Lease transaction be a financing for all purposes other than accounting and regulatory purposes, including lien enforceability purposes, should be respected as the form of the transaction for federal income tax purposes. Having crossed the economic substance threshold, it is appropriate to address the benefits and burdens of ownership factors.

2. Benefits and Burdens of Ownership.

An application of the factors enumerated above indicating benefits and burdens of ownership follows:

a. Possession. So long as the Lease is in effect, OPI will have possession of the Building. However, a lessor is not normally vested with the right of possession during the term of a lease. The relevant inquiry, therefore, is whether the useful life of the Building extends beyond the term of the Lease. The parties have represented that the remaining economic useful life of the Building as of April 14, 1997 is at least 50 years. The Initial Term of the Lease, plus all Renewal Terms, is 40 years. Accordingly, the useful life of the Building extends well beyond the term of the Lease. This factor therefore favors Brazos as tax owner of the Building.

b. Property Taxes. The Lease requires OPI to pay property taxes. As indicated by the Tax Court's decision in *Torres*, this factor is less relevant in the context of a commercial lease; however, the payment of property taxes by OPI favors OPI as tax owner of the Building.

c. Risk of Casualty Loss. The Lease requires OPI to maintain insurance on the Building. As indicated by the Tax Court's decision in *Torres*, this factor, like property taxes, is less relevant in the context of a commercial lease; however, OPI's responsibility for risk of casualty loss is a factor supporting OPI as tax owner of the Building.

d. Likelihood of Exercise of Renewal Option. OPI has no option to renew the Lease for a nominal rental amount. However, if OPI chooses not to renew the Lease, Section 11.03(b) of the Lease requires OPI to (a) purchase the Building for cash at the Acquisition Cost or (b) arrange for the property to be sold for cash pursuant to Section 11.04 of the Lease. The lack of a nominal renewal amount does not literally support OPI as tax owner of the Building, but a consideration of the consequences to OPI of non-renewal supports the likelihood of OPI renewing the Lease until the end of the Lease term.

e. Treatment of Parties for Accounting and Other Purposes. Brazos will be treated as the owner of the Building for financial accounting purposes pursuant to Section 3.02(a) of the Lease. Although the Supreme Court in *Frank Lyon Co.* recognized that this factor is not dispositive, federal income tax treatment consistent with that of financial accounting would indicate that Brazos should be treated as tax owner of the Building. For all other purposes, including bankruptcy and real estate lien enforceability purposes, the parties' express their intent in Section 3.02(b) of the Lease that OPI be treated as the owner of the Building and that the Lease be treated as the repayment and security provisions of a loan. Since accounting treatment is not dispositive and since the parties intend to treat the Lease as a financing for all other purposes, this factor appears to favor OPI as tax owner of the Building.

f. Benefit of Appreciation/Risk of Depreciation. Through its option to purchase the Building for the Acquisition Cost, OPI can effectively enjoy all of the benefit of appreciation in the value of the Building during the Lease. On any renewal date, if OPI chooses not to exercise its option to renew the Lease, OPI must either purchase the Building for cash at the Acquisition Cost or arrange for its sale to a third party pursuant to Section 11.04 of the Lease. Further, if OPI chooses to renew the Lease and Brazos is unable to obtain financing and equity contributions on terms acceptable to Brazos, its limited partners and OPI, Section 11.03(b) of the Lease requires OPI to either purchase the Building for an amount of cash equal to the Acquisition Cost or arrange for its sale to a third party. To the extent that proceeds of a sale of the Building to a third party exceed the Acquisition Cost, OPI receives such excess proceeds. In the event of a sale to a third party at a price less than the Acquisition Cost, the risk of depreciation loss depends on the sale price obtained. If the sale proceeds are 25 percent or more of the Acquisition Cost, OPI must pay Brazos the difference between the sale proceeds and the Acquisition Cost. If the sale proceeds are less than 25 percent of the Acquisition Cost, OPI is obligated to pay Brazos 75 percent of the Acquisition Cost plus an amount that Brazos determines in good faith to be the amount that the residual value of the Building was reduced in excess of that attributable to normal wear and tear, plus an amount that Brazos determines in good faith to be the amount the sale proceeds have been reduced due to certain Liens attaching to the Building that arise out of OPI's acts or failure to act. If OPI elects to

renew the Lease but the Building depreciates significantly, Brazos will be unable to obtain nonrecourse financing for the Building on terms identical to those under the Credit Agreement or otherwise acceptable to Brazos. In such case, the economic effect of the Lease provisions is to place the risk of depreciation loss on OPI. Thus, through the last renewal date of the Lease, OPI bears most of the risk of depreciation on the Building. Because Brazos has financed the Building with nonrecourse debt, in the event that the Building were significantly depreciated at the end of the final Renewal Term and Brazos and the Banks had not identified the depreciation prior to such time, permitting Brazos to invoke the Lease provision requiring OPI to purchase or arrange for the purchase of the Building if acceptable financing were not available, the Banks would bear the risk of the depreciation. On balance, this factor favors OPI as tax owner of the Building, because OPI enjoys all of the benefits of any appreciation of the Building and substantially all of the risk of depreciation of the Building.

g. Legal Title. Legal title to the Building is vested in Brazos during the term of the Lease. This factor favors Brazos as tax owner of the Building.

h. Acquisition of Title or Equity Interest. OPI does not acquire title to the Building or a stated equity interest in the Building merely upon payment of a specified amount of rentals, a factor favoring Brazos as tax owner of the Building.

i. Rental Payments Not Disproportionate. Rental payments under the Lease are based solely on the cost of borrowing and a return on equity for Brazos. Accordingly, rental payments will remain relatively level throughout the term of the Lease, except for adjustments based on interest rate changes. Therefore, the total amount to be paid by OPI for a relatively short period of use is not an inordinately large portion of the total required to be paid to secure transfer of title. This factor favors Brazos as tax owner of the Building.

j. Rentals Relation to Fair Market Value. Rental payments under the Lease are based on the cost of borrowing and return on equity for Brazos, not on the fair market value rental for the Building. The fact that rental payments are based on the cost of funds supports treatment of OPI as tax owner of the Building to the extent that the determination of rental amounts are made without regard to fair rental value. On the other hand, to the extent that the agreed rental payments do not materially exceed the current fair rental value, reduced weight should be accorded to this factor.

k. Bargain Purchase Option. OPI has an option to purchase the Building at the Acquisition Cost or arrange for a third party to purchase the Building under Section 11.04 of the Lease. OPI's option to purchase functions as a bargain purchase option to the extent it confers on OPI all of the benefits of appreciation of the Building.

Although OPI's purchase option will not necessarily result in a bargain or nominal price purchase, because the option exercise price does not take into account appreciation of the Building, this factor provides support for the treatment of OPI as tax owner of the Building.

l. Designation of Payments as Interest. Base Rent under the Lease contains a component, Basic Rent (Debt), that is based on the cost of funds to Brazos. In addition, Section 3.02(b) of the Lease indicates that for all but limited accounting and regulatory purposes, including for bankruptcy and tax purposes, the Lease is intended to be treated as a loan and all payments of Basic Rent, Additional Rent, proceeds of sale and other amounts payable under the Lease be treated as principal, interest and other amounts owing with respect to such loan. This factor favors OPI as tax owner of the Building.

m. Rental Payments Measured Based on Passage of Time, Not Purchase Price. Rental payments under the Lease are based on (a) the cost of funds related to the debt incurred by Brazos to purchase the Building and (b) a specified return on the equity contributed by Brazos to purchase the Building. Rental payments are therefore based on the purchase price of the Building. The rental payment structure favors OPI as tax owner of the Building.

n. Rental Payments Required Throughout Lease Term. Rental payments based on the carrying cost of the Building to Brazos are required throughout the Lease Term. The Lease does not permit OPI to use the Building for relatively nominal amounts after a certain amount of rental payments have been made. This factor supports Brazos as tax owner of the Building.

o. Minimum Unconditional At Risk Investment. Brazos has a stated equity interest in the Building of 3 percent of the Acquisition Cost of the Building. Brazos does not meet the requirement of Rev. Proc. 75-21 that the minimum initial investment of the lessor be 20 percent of the cost of the property and that the minimum initial investment remain at 20 percent at all times throughout the term of the lease. The comparatively small magnitude of the unconditional at risk investment on the part of Brazos is a factor favoring OPI as tax owner of the Building.

p. Payments Approximate Purchase Price. Under the Lease, the sum of the rentals payable by OPI, plus the Acquisition Cost of the Building, approximates the purchase price of the Building plus debt service and a stated return to Brazos. The structure of the Lease payments is consistent with that of a financing transaction, the form intended for the Lease transaction by the parties.

q. Lessor Can Force Purchase. Under Section 11.02 of the Lease, Brazos can force OPI to purchase the Building or find a third party to purchase the Building in certain circumstances described in Section 11.02(b) of the Lease. Further, if OPI elects to renew the Lease but Brazos is unable to obtain financing on terms identical to the Credit Agreement or terms otherwise acceptable to Brazos, Brazos may force OPI to purchase the Building or find a third party to purchase the Building. This factor favors OPI as tax owner of the Building.

r. Investment by Lessee. The cost of any additions and improvements to the Building are to be paid by OPI, pursuant to Section 8.04 of the Lease, so long as there is no Event of Default. OPI is permitted under the Lease to make additions and alterations subject to a requirement to notify (not obtain the consent of) Brazos if the cost of such additions and alterations exceeds $5,000,000. This factor favors OPI as tax owner of the Building.

s. Lessee Loans or Guarantees. Enron, OPI's parent, has guaranteed the payments by OPI under the Lease. OPI has indemnified Enron for any payments Enron is required to make under the Guaranty. Neither OPI nor Enron has guaranteed the payments to be made by Brazos under the Credit Agreement. This factor favors Brazos as tax owner of the Building.

On balance, an examination of the factors listed above indicates that the Lease should be treated as a financing for federal income tax purposes and that OPI should be treated as the tax owner of the Building. The principal factors that support the treatment of OPI as the tax owner of the Building are (i) the intent of the parties, expressed in the Lease, that for all purposes other than accounting and regulatory purposes the Lease is to be treated as a financing transaction, (ii) the option of OPI to purchase the Building at the Acquisition Cost, (iii) the ability of Brazos under certain circumstances to force OPI to purchase the Building at the Acquisition Cost or arrange for the purchase of the Building by a third party pursuant to Section 11.04 of the Lease, (iv) the fact that rental payments are based on the cost of funds plus a specified return to Brazos, and (v) the fact that OPI bears most of the risk of financial loss and enjoys the benefits of any appreciation in the value of the Building.

Based on this analysis, prior to the Assignment OPI should be treated as the owner of the Building for federal income tax purposes. As noted above, pursuant to the Assignment OPI assigned all of its rights under the Lease to Leasing Partners, and Leasing Partners assumed all of OPI's obligations under the Lease. Accordingly, following the Assignment Leasing Partners should be treated as the owner of the Building for federal income tax purposes.

C. Analysis of the Sublease.

Following the Assignment, Leasing Partners subleased the Building to Enron pursuant to the Sublease. Accordingly, it is necessary to analyze the Sublease in order to conclude that Leasing Partners should continue to be treated as the owner of the Building following the Sublease.

As with the Lease, it is appropriate to bifurcate the tax ownership analysis of the Sublease into two parts: economic substance and benefits and burdens of ownership. The factors enumerated above can be applied to the arrangement evidenced by the Sublease as follows:

1. Economic Substance.

a. Parties. Enron controls Leasing Partners through its wholly-owned subsidiary, OPI. Enron also guarantees the payments to Brazos under the Lease; however, OPI, the 97 percent limited partner of Leasing Partners, has indemnified Enron for any payments Enron is required to make under the Guaranty. This factor supports Leasing Partners as tax owner of the Building.

b. Business purpose. Leasing Partners is receiving fair market value rental for the Building, while Enron is receiving the use of the Building. These valid business purposes for the Sublease support treatment of Leasing Partners as tax owner of the Building in accordance with the form of the transaction.

c. Profit Expectation. Rental payments under the Sublease are expected to exceed debt service payable by Leasing Partners to Brazos. Leasing Partners therefore has the expectation of profit from the lease arrangement, a factor supporting treatment of Leasing Partners as tax owner of the Building in accordance with the form of the transaction.

Unlike the Lease, the Sublease does not evidence an intent by the parties that it be treated as a financing transaction or anything other than a sublease for all purposes. Thus, application of the factors indicating economic substance support treating the Sublease as a true lease in accordance with its form and, accordingly, treating Leasing Partners as remaining the tax owner of the Building following the Sublease. Having crossed the economic substance threshold, it is appropriate to address the benefits and burdens of ownership factors.

2. Benefits and Burdens of Ownership.

a. Possession. So long as the Sublease is in effect, Enron will have possession of the Building. However, a lessor is not normally vested with the right of possession during the term of a lease. The relevant inquiry, therefore, is whether the useful life of the Building extends beyond the term of the Sublease. The parties have

represented that remaining economic useful life of the Building as of April 14, 1997 is at least 50 years. The Initial Term of the Sublease, plus all Renewal Terms, is 20 years. Accordingly, the useful life of the Building extends well beyond the term of the Sublease. This factor therefore favors Leasing Partners as tax owner of the Building.

b. Property Taxes. The Sublease requires Enron to pay property taxes. As indicated by the Tax Court's decision in *Torres*, this factor is less relevant in the context of a commercial lease; however, the payment of property taxes by Enron favors Enron as tax owner of the Building.

c. Risk of Casualty Loss. The Sublease requires Enron to maintain insurance on the Building. As indicated by the Tax Court's decision in *Torres*, this factor, like property taxes, is less relevant in the context of a commercial lease; however, Enron's responsibility for risk of casualty loss is a factor supporting Enron as tax owner of the Building.

d. Likelihood of Exercise of Renewal Option. Enron has no option to renew the Sublease for a bargain rental amount, a factor that favors recognition of Leasing Partners as tax owner of the Building.

e. Treatment of Parties for Accounting and Other Purposes. The Sublease is silent with respect to the financial accounting treatment of the Sublease by the parties. Leasing Partners and Enron have represented that they will treat the Sublease as a true lease for accounting and other purposes. Although the Supreme Court in *Frank Lyon Co.* recognized that this factor is not dispositive, federal income tax treatment consistent with that of financial accounting would indicate that Leasing Partners should be treated as tax owner of the Building.

f. Benefit of Appreciation/Risk of Depreciation. At the end of five years, pursuant to the terms of the Lease, if Enron does not exercise its right to make the Cancellation Payment and cancel the Sublease, Leasing Partners can terminate the Lease. To terminate the Lease, Leasing Partners will be required to purchase the Building from Brazos at the Acquisition Cost or to arrange for the sale of the Building to a third party pursuant to Section 11.04 of the Lease. Under Section 11.04 of the Lease, if the purchase price of the Building does not equal or exceed the Acquisition Cost, Leasing Partners is at risk to pay Brazos all or at least a substantial portion of the shortfall. Accordingly, Leasing Partners bears the risk of loss if the Sublease is not renewed at the end of the Initial Term, a factor indicative of tax ownership by Leasing Partners. Enron has the right to purchase the Building only at its then-appraised fair market value at the end of the Sublease. Thus, as between Leasing Partners and Enron, Leasing Partners will enjoy the benefit of any

appreciation of the Building. This factor favors Leasing Partners as tax owner of the Building.

g. Legal Title. Legal title to the Building is vested in Brazos during the term of the Lease. This factor does not clearly favor either Enron or Leasing Partners as tax owner of the Building.

h. Payments Applicable to Equity. Enron does not acquire an equity interest in or title to the Building through payment of rents, a factor favoring Leasing Partners as tax owner of the Building.

i. Rental Payments Not Disproportionate. Rental payments under the Sublease are level throughout the term of the Sublease, except for adjustments based on the Consumer Price Index. Enron has no option to acquire the Building at other than fair market value. Therefore, the total amount to be paid by Enron for a relatively short period of use is not an inordinately large portion of the total required to be paid to secure transfer of title. This factor favors Leasing Partners as tax owner of the Building.

j. Rentals Do Not Exceed Fair Market Value. Rental payments under the Sublease do not exceed fair market value. Enron and Leasing Partners have represented that the rental payments required under the Sublease approximate fair market value rental for the Building. Fair market value rental payments support Leasing Partners as tax owner of the Building.

k. Bargain Purchase Option. Enron has an option to purchase the Building at a price equal to fair market value at the end of the Initial Term and both Renewal Terms of the Sublease. The lack of a bargain purchase option on the part of Enron favors treating Leasing Partners as tax owner of the Building.

l. Designation of Portion of Payments as Interest. No portion of the rental payments under the Sublease are designated as interest, a factor favoring Leasing Partners as tax owner of the Building.

m. Rental Payments Based on Use. Rental payments under the Sublease are required monthly and are based on the amount of space rented. Rental payments are not based on the normal purchase price of the Building. Except for annual adjustments based on the Consumer Price Index, rental payments under the Sublease are level throughout the Initial Term and both Renewal Terms. The rental payment structure favors Leasing Partners as tax owner of the Building.

n. Rental Payments Required throughout Lease Term. Rental payments are required under the Sublease throughout the Initial Term and both Renewal Terms. This factor supports Leasing Partners as tax owner of the Building.

o. Minimum Unconditional At Risk Investment. Leasing Partners does not meet the requirement of Rev. Proc. 75-21 that the minimum initial investment of the lessor be 20 percent of the cost of the property and that the minimum initial investment remain at 20 percent at all times throughout the term of the lease. Lack of a 20 percent minimum unconditional at risk investment on the part of Leasing Partners is a factor favoring Enron as tax owner of the Building.

p. Payments do not Approximate Purchase Price. Enron has an option to purchase the Building only at the end of the Initial Term and both Renewal Terms for the Building's then-appraised fair market value. Thus, the sum of the rentals payable by Enron under the Sublease, plus the exercise price of the option to purchase the Building, far exceed the purchase price of the Building plus a stated return. Accordingly, the form of the Sublease should be respected as a sublease.

q. Lessor Cannot Force Purchase. Under the Sublease, Leasing Partners has no right to force Enron or any other party to purchase the Building. This factor favors Leasing Partners as tax owner of the Building.

r. Investment by Lessee. The cost of any additions and improvements to the Building are to be paid by Enron. This factor favors Enron as tax owner of the Building.

s. Lessee Loans or Guarantees. Enron has guaranteed the payments by Leasing Partners under the Lease with Brazos. This factor favors Enron as tax owner of the Building.

On balance, an examination of the factors listed above indicates that the Sublease should be treated as a true lease for federal income tax purposes and that Leasing Partners should be treated as the tax owner of the Building. The lack of a bargain purchase option by Enron, the lack of an equity accumulation from the rental payments by Enron and the fact that Leasing Partners bears the risk of financial loss and enjoys any appreciation from a change in the value of the Building are facts and circumstances that support Leasing Partners as tax owner of the Building for federal income tax purposes.

CONCLUSION

Based upon the facts, representations, law and analysis set forth above, in our opinion (i) prior to the Assignment OPI should be treated as the owner of the Building for federal income tax purposes, (ii) following the Assignment Leasing Partners should be treated as the owner of the Building for federal income tax purposes, and (iii) the Sublease should be treated as a sublease and accordingly Leasing Partners should continue to be treated as the owner of the Building for federal income tax purposes following the Sublease.

The opinions expressed herein are as of the date hereof, and we assume no obligation to update or supplement such opinions to reflect any facts or circumstances that may hereafter come to our attention or any changes in law that may hereafter occur or become effective.

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 the transactions contemplated by the Lease, the Assignment and the Sublease) or to other persons without our prior written consent.

Very truly yours,

Vinson & Elkins L.L.P.

VINSON & ELKINS L.L.P.

VEHOU02:80773.1