

Dear _____ :

This letter is in reply to your letter dated January 15, 1999, and other correspondence, asking the Internal Revenue Service to rule on the transaction described below.

FACTS

Parent is the common parent of an affiliated group of corporations that includes Company. Parent files a consolidated return for the group.

Company, a calendar year taxpayer that uses the accrual method of accounting, is an investor-owned electric utility in State A. Company generates, transmits, and distributes electricity to residential, commercial, industrial, and governmental customers within a designated territory. Company has a monopoly for providing electricity within its territory and is regulated by Department, the Federal Energy Regulatory Commission (FERC) and the Nuclear Regulatory Commission.

State A is deregulating the power-generation portion of its electric industry. . After industry restructuring, Company's customers will be allowed to contract directly with alternative suppliers of electricity, and Company will compete with other parties to sell electricity.

To facilitate development of a competitive market for electric generation, the Statute and an agreement approved by the Department (the Settlement Agreement) required the Company to divest certain of its generation assets, which has largely already been accomplished. Additionally, the Company has entered into a binding agreement to sell Property A to Corporation, for which Company is seeking regulatory approval from the Department, and several federal governmental agencies.

As a result of these asset divestitures and electric industry restructuring generally, some of Company's assets are being valued substantially below their book value and Company is incurring certain other external costs. The Settlement Agreement generally permits the Company to recover these costs (Transition Costs) through future rates, subject to a duty under the Statute to mitigate such Transition Costs to the greatest extent possible. The Settlement Agreement approved the Company's retail distribution rates, including its charge to customers (Transition Charge) for the recovery of its Transition Costs. Transition Charges due from a customer generally will be based on the amount of electricity purchased by that customer, regardless of the supplier of the electricity.

After enactment of the Statute, the Department confirmed in a settlement order (Settlement Order) that the Settlement Agreement was in substantial compliance with

the provisions of the Statute authorizing the approval of the recovery of certain restructuring costs. The Statute contemplates that securitization transactions will be executed pursuant to a financing order (Financing Order) issued by the Department, and provides a comprehensive framework for the recovery of Transition Costs and the securitization of that right (Transition Property) created by the Statute to recover Transition Costs.

PROPOSED TRANSACTION

On Date 1, Company applied for a Financing Order from the Department pursuant to the Statute. That Financing Order was issued on Date 2 authorizing Company to finance a portion of its Transition Costs, together with transaction costs and credit enhancement, through the issuance of Securities and Notes with an aggregate principal amount of approximately a. Under Statute, these amounts constitute "Reimbursable Transition Costs" amounts, the repayment of which is to be effected through the assessment and collection of a portion of Company's Transition Charge. A component of the Transition Charge is the RTC Charge, which is defined as a nonbypassable usage-based, per kilowatt hour charge payable by customers, that will yield the amounts necessary to provide for interest on Notes, the amortization of all Notes in accordance with the applicable expected amortization schedule, the payment of fees and expenses related to the issuance and servicing of the Notes, the collection of an overcollateralization amount and the replenishment of a capital subaccount. The RTC Charge is a usage based tariff on each retail users monthly bill until the Securities and Notes are discharged in full.

The principal asset to be used to support the Securities is Transition Property of the Company which includes (a) reimbursable transition costs amounts established by the Financing Order, (b) the RTC Charge authorized by the Financing Order, and (c) all rights to obtain periodic adjustments and non-routine adjustments to the RTC Charge. Pursuant to the Financing Order, the Transition Property and the RTC Charges are irrevocable, and cannot be reduced, rescinded altered, amended or impaired by either the Department or State A. The RTC Charges will be set to provide for recovery of the costs associated with billing and collecting the RTC Charges as well as for an excess amount (Overcollateralization Amount) that will eventually reach b percent of the original principal amount of the Securities. The Overcollateralization Amount will be collected ratably over the expected term of the Securities.

Company will form the SPE as a wholly owned limited liability company under State B law as a bankruptcy remote company for the special purpose of effectuating the proposed transaction. The SPE will use the accrual method of accounting, and Company effectively will be the sole member of the SPE. The Financing Entity will be

created as a State B business trust. The Financing Entity will not be an agency or instrumentality of State A.

For federal income tax purposes, the SPE is expected to be treated as a division of the Company and not as a separate entity. The SPE will not elect to be treated as an association taxable as a corporation under section 301.7701-3(b)(1) of the Procedure and Administration Regulations. Company will contribute, as equity to the SPE, cash equal to b percent of the total original issue price of the Securities. The SPE will invest the equity in financial instruments that are issued by parties unaffiliated with Company and that can be readily converted to cash.

Pursuant to the Financing Order, the SPE will issue Securities to the Financing Entity. The Securities will be nonrecourse to the Company but will be secured by the assets of the SPE including (a) the Transition Property, (b) accounts maintained for payments on the Securities (the "Collection Accounts"), (c) all amounts or investment property on deposit in or credited to the Collection Accounts, (d) all other property of whatever kind owned by the SPE, (less amounts owed to certain service providers) and (e) all rights of the SPE in and to the transaction documents such as the purchase agreement for the Transition Property. The Securities will not be subordinated to the claims of any creditors or equity owners of the SPE, other than for payments of trustee and servicing fees.

The Securities will be issued in one or more series. Each series of the Securities may be offered in one or more classes, each having a different principal amount, term, interest rate and amortization and legal maturity date. Company expects that the Securities will have scheduled maturities not longer than d years, and legal maturities not longer than e years. Scheduled maturity is the date on which the final principal payment is expected to be paid; legal maturity is the date on which nonpayment is a default.

The Securities are expected to be sold at or near par value and will not in any event be sold for more than par value. All accrued interest on the Securities will be paid semi-annually. Principal payments will be applied in the sequential order of each series and, within each series, in the sequential order of each class, until the outstanding balance of such class or series is reduced to zero. Under certain circumstances, the Securities will also be subject to call provisions.

The Financing Entity will issue Notes to underwriters, who will sell the Notes to public investors. The Notes will be secured by a lien created under the Statute in the Transition Property. The Notes will be pass-through certificates representing beneficial ownership interests in the Securities held by the Financing Entity. Each class of each series of Notes will represent fractional undivided beneficial interests in a class of a series of Securities held by the Financing Entity. Therefore, each class of

Notes will have a principal amount, term, interest rate, amortization, call provisions and maturities that are identical to the corresponding class of Securities.

The proceeds from the issuance of the Notes, net of issuance costs and any an Overcollateralization Amount will be transferred to the SPE in consideration for the Securities. The SPE will then transfer those proceeds to the Company in consideration for transferring the Transition Property to the SPE. The assets of the Financing Entity will consist of the Securities and any swap or other hedging agreement executed solely to permit the issuance of Notes bearing a floating rate of interest. The Notes are expected to be sold at or near par value.

If the Company is required to, or elects to, repurchase the Transition Property, the SPE will be required to redeem the Securities on or before the fifth business day following the date of repurchase, and the Financing Entity will be required to redeem the Notes on the same day. The SPE may redeem the Securities and cause the Financing Entity to redeem the Notes on any payment date if the outstanding principal of the series declines to c percent of the original issue price of the series. Because the classes will be allocated principal payments in sequential order, the mandatory redemptions for the Notes will apply only to the class with the longest maturity.

Upon issuance of the initial series of Securities, the SPE will establish the Collection Account, which will be held by the SPE Trustee for the benefit of the Securities holders. The Collection Account will consist of four subaccounts: entitled General, Reserve, Capital and Overcollateralization. Additional subaccounts may be established with respect to other credit enhancements or to accommodate defeasance or early redemption of the Securities.

Initially, Company will service the consumer accounts that are subject to the RTC Charges. As servicer, Company will, on a monthly basis, bill and collect RTC Charges, remit collected RTC Charges to the SPE Trustee and retain all books and records regarding the RTC Charges, subject to the right of the SPE and the Financing Entity to inspect those records. Monies deposited with the SPE Trustee will be held in the Collection Account. Only in the event that Company fails satisfactorily to perform its servicing functions will Company be subject to replacement as Servicer. Company's ability to resign as Servicer will be restricted.

The billed RTC Charges will be remitted to the Collection account on a daily basis. Beginning on Date 3, each Date 4 or Date 5 will be a Distribution Date with respect to the Notes and a Payment Date with respect to the Securities. On each Payment Date, amounts in the Collection Account, including net earnings thereon, will be allocated and disbursed as follows in the priority indicated: (1) Trustees' fees; (2) servicing fees; (3) administrative fees; (4) operating expenses; (5) interest payments; (6) principal payments; (7) additional operating expenses, if any; (8) deficits in the

Capital Subaccount; (9) deficits in the Overcollateralization Subaccount; and (10) to the Reserve Subaccount for distribution on subsequent payment dates.

If the RTC Charges collected in any period are insufficient to satisfy the Financing Entity's payment obligations on the Notes, the Trustee may draw on amounts in the Reserve Subaccount, the Overcollateralization Subaccount, and the Capital Subaccount up to the amount of the shortfall, in order to make the transfers described above. To the extent that amounts in the General Subaccount are insufficient to make the transfers to the Capital Subaccount or the Overcollateralization Subaccount, the Trustee will draw from amounts in the Reserve Subaccount to make the required transfers. To the extent that amounts in the Capital Subaccount or the Overcollateralization Subaccount are used to satisfy scheduled principal and interest payments, future RTC Charges will be adjusted to replenish those subaccounts.

Investment income earned on amounts in the Collection Account also may be used to satisfy scheduled interest and principal payments on Notes, and to replenish the SPE's equity and the Overcollateralization Amount. Any excess earnings will be remitted to the SPE, and after the last scheduled date for payment of accrued interest and principal on the Notes, will be distributed to the Company for the benefit of its ratepayers (except in the case of earnings on the Capital Subaccount, which may periodically be remitted to the Company for its account).

The Securities will provide for the following events of default: (1) a default of five days or more in the payment of accrued interest on any class of Securities; (2) a default in the payment of outstanding principal as of the legal maturity date; (3) a default in payment of the redemption price following an optional clean-up call as of the redemption date; (4) certain breaches of covenants, representations or warranties by the SPE in the indenture under which the Securities are issued; and (5) certain events of bankruptcy, insolvency, receivership, or liquidation of the SPE. In the event of a default on the Securities, the Financing Entity trustee or holders of a majority in principal amount of all series then outstanding may declare the principal of all classes of the Securities to be immediately due and payable.

ISSUES

1. Does the issuance of the Financing Order result in gross income to Company?
2. Does the issuance of the Securities or the Notes result in gross income to Company?
3. Are the Securities obligations of the Company?

LAW

Section 61 of the Internal Revenue Code generally defines gross income as "income from whatever source derived", except as otherwise provided by law. Gross income includes income realized in any form, whether in money, property, or services. Section 1.61-1(a) of the Income Tax Regulations. This definition encompasses all "accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955), 1955-1 C.B. 207.

The right to collect the RTC Charge is of significant value in producing income for Company, and State A's action in making the RTC Charge rights transferable has enhanced that value. Generally, the granting of a transferable right by the government does not cause the realization of income. Rev. Rul. 92-16, 1992-1 C.B. 15 (allocation of air emission rights by the Environmental Protection Agency does not cause a utility to realize gross income); Rev. Rul. 67-135, 1967-1 C.B. 20 (fair market value of an oil and gas lease obtained from the government through a lottery is not includible in income).

The economic substance of a transaction generally governs its federal tax consequences. Gregory v. Helvering, 293 U.S. 465 (1935), XIV-1 C.B. 193. Affixing a label to an undertaking does not determine its character. Rev. Rul. 97-3, 1997-1 C.B. 9. An instrument secured by property may be an obligation of the taxpayer or, alternatively, may be a disposition of the underlying property by the taxpayer. Cf. id. (the Small Business Administration is the primary obligor of certain guaranteed payment rights that are created under its participating security program).

CONCLUSIONS

Based on the facts as represented, we rule as follows:

(1) The issuance by the Department of the Financing Order authorizing the collection of the Transition Costs, will not result in gross income to Company.

(2) The issuance of the Securities and the Notes will not result in gross income to the Company.

(3) The Securities will be obligations of Company.

Except as specifically ruled on above, no opinion is expressed or implied regarding the federal tax aspects of the transaction.

This ruling is directed only to Company. Under section 6110(k)(3) of the Code, this ruling may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax return of Company for the taxable years that include the transaction described in this letter.

Sincerely yours,
Assistant Chief Counsel
(Financial Institutions & Products)

By: _____
Marshall Feiring
Senior Technician Reviewer, Branch 2