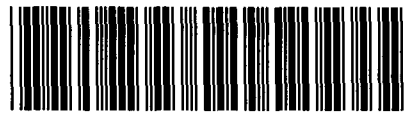

Control Number: 49421

Item Number: 148

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SOAH DOCKET NO. 473-19-3864
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APPLICATION OF CENTERPOINT	**§**	**BEFORE THE STATE OFFICE**
ENERGY HOUSTON ELECTRIC, LLC	**§**	**OF**
FOR AUTHORITY TO CHANGE RATES	**§**	**ADMINISTRATIVE HEARINGS**

May 10, 2019

Contact: Denise Hardcastle
CenterPoint Energy Houston Electric, LLC
1111 Louisiana Street
Houston, Texas 77002
Tel No: (713) 207-5767
Fax: (713) 207-9840
Denise.Hardcastle@CenterPointEnergy.com

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CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
2019 CEHE RATE CASE
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TEXAS INDUSTRIAL ENERGY CONSUMER
REQUEST NO.: TIEC02-01

QUESTION:

Please provide all credit rating agency reports in your possession, custody, or control that are related to CenterPoint Energy Houston Electric, LLC (CenterPoint) and/or CenterPoint Energy, Inc. (CNP) and were created over the last three years.

ANSWER:

Please see Schedule II-C-2.10 for the 2018 rating agency reports previously provided in our initial rate filing package. In addition, please see TCUC01-04 for copies of the credit rating agency reports from S&P, Moody's and Fitch that were created over the last three years.

SPONSOR:
Robert McRae (Robert McRae)

RESPONSIVE DOCUMENTS:

None

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
2019 CEHE RATE CASE
DOCKET 49421-SOAH DOCKET NO. 473-19-3864

TEXAS INDUSTRIAL ENERGY CONSUMER
REQUEST NO.: TIEC02-02

QUESTION:

Please provide all equity analyst reports in your possession, custody, or control that are related to CNP and were created over the last three years.

ANSWER:

Please see attachment TIEC02-02 2016-2019 Analyst Reports.zip.

The attachment is confidential and is being provided pursuant to the Protective Order issued in Docket No. 49421.

The requested information is voluminous and will be provided electronically to the propounding party only. It will also be made available in our Austin office. Please contact Alice Hart at (713) 207-5322 to make an appointment to view the materials. Please see attached index of voluminous material.

DATE	TITLE	PREPARER	PAGE NO(S)
Undated	TIEC02-02 2016-2019 Analyst Reports (confidential).zip	Robert McRae	N/A

SPONSOR:
Robert McRae (Robert McRae)

RESPONSIVE DOCUMENTS:

TIEC02-02 2016-2019 Analyst Reports (confidential).zip

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
2019 CEHE RATE CASE
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TEXAS INDUSTRIAL ENERGY CONSUMER
REQUEST NO.: TIEC02-03

QUESTION:

Please provide all credit rating agency reports in your possession, custody, or control that are related to Oncor Electric Delivery Company, LLC (Oncor). The scope of this question is limited to documents created in the last three years.

ANSWER:

Please see:
TIEC02-04 Fitch US Utility Parent Companies Handbook Nov 2016 (confidential).pdf
TIEC02-04 Moodys Utility holding companies converge at Baa (confidential).pdf
TIEC02-04 SP (confidential).pdf

Also, please see the documents provided with this response.**The attachments are confidential and are being provided pursuant to the Protective Order issued in Docket No. 49421**.

SPONSOR:
Robert McRae (Robert McRae)

RESPONSIVE DOCUMENTS:

TIEC02-03 Moodys - Utility Diversification Strategies Seek Growth While Limiting Risk (confidential).pdf
TIEC02-03 Moodys 20180618 Regulated Utilities 2019 Outlook Shifts to Negative (confidential).pdf

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
2019 CEHE RATE CASE
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TEXAS INDUSTRIAL ENERGY CONSUMER
REQUEST NO.: TIEC02-04

QUESTION:

Please provide all credit rating agency reports in your possession, custody, or control that are related to AEP Texas, Inc. (AEP Texas). The scope of this question is limited to documents created in the last three years.

ANSWER:

Please see the attached documents.**The attachments are confidential and is being provided pursuant to the Protective Order issued in Docket No. 49421.**

The requested information is also voluminous and will be provided to the propounding party only in electronic format on CD. Please contact Alice Hart at (713) 207-5322 to request a copy of the CD. Please see index of voluminous material below.

DATE	TITLE	Preparer	Number of Pages	Page No (s)
Nov 2016	TIEC02-04 AEP - Moodys (confidential).pdf	Robert McRae	9	1-9
Nov 2016	TIEC02-04 Fitch US Utility Parent Companies Handbook Nov 2016 (confidential).pdf	Robert McRae	306	1-306
Aug 2017	TIEC02-04 Moodys Issuer Comment - Hurrican Harvey_ August 31 2017 (confidential).pdf	Robert McRae	13	1-13
Nov 2018	TIEC02-04 Moodys Utility holding companies converge at Baa (confidential).pdf	Robert McRae	15	1-15
Jan 2018	TIEC02-04 Moodys 20180124 Tax Reform (confidential).pdf	Robert McRae	11	1-11
Jan 2018	TIEC02-04 Moodys Rating Action related to Tax Reform (confidential).pdf	Robert McRae	11	1-11
July 2018	TIEC02-04 Moodys report Utility Securitization (confidential).pdf	Robert McRae	9	1-9
July 2016	TIEC02-04 SP Credit Trends - 20160713 (confidential).pdf	Robert McRae	20	1-20
Nov 2018	TIEC02-04 SP (confidential).pdf	Robert McRae	15	1-15

SPONSOR:
Robert McRae (Robert McRae)

RESPONSIVE DOCUMENTS:

TIEC02-04 AEP - Moodys (confidential).pdf
TIEC02-04 Fitch US Utility Parent Companies Handbook Nov 2016 (confidential).pdf
TIEC02-04 Moodys Issuer Comment - Hurrican Harvey_ August 31 2017 (confidential).pdf
TIEC02-04 Moodys Utility holding companies converge at Baa (confidential).pdf
TIEC02-04 Moodys 20180124 Tax Reform (confidential).pdf
TIEC02-04 Moodys Rating Action related to Tax Reform (confidential).pdf
TIEC02-04 Moodys report Utility Securitization (confidential).pdf

TIEC02-04 SP Credit Trends - 20160713 (confidential).pdf
TIEC02-04 SP (confidential).pdf

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
2019 CEHE RATE CASE
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TEXAS INDUSTRIAL ENERGY CONSUMER
REQUEST NO.: TIEC02-05

QUESTION:

Please provide all equity analyst reports in your possession, custody, or control that are related to any other Texas transmission and distribution utilities operating in ERCOT. The scope of this question is limited to documents created in the last three years.

ANSWER:

Please see the documents provided in response to the request.

The attachments are confidential and is being provided pursuant to the Protective Order issued in Docket No. 49421.

The requested information is also voluminous and will be provided to the propounding party only in electronic format on CD. Please contact Alice Hart at (713) 207-5322 to request a copy of the CD. Please see index of voluminous material below.

DATE	TITLE	Preparer	Number of Pages	Page No (s)
Oct 2017	TIEC02-5 2017-10-26 - AEP - Guggenheim (confidential).pdf	Robert McRae	5	1-5
Oct 2017	TIEC02-5 2017-10-26 - AEP - RBC (confidential).pdf	Robert McRae	1	1-1
Oct 2017	TIEC02-5 2017-10-26 - AEP - SunTrust (confidential).pdf	Robert McRae	7	1-7
Oct 2017	TIEC02-5 2017-10-30 - SRE - Goldman Sachs (confidential).pdf	Robert McRae	7	1-7
Oct 2017	TIEC02-5 2017-10-30 - SRE - Guggenheim (confidential).pdf	Robert McRae	12	1-12
Oct 2017	TIEC02-5 2017-10-30 - SRE - RBC (confidential).pdf	Robert McRae	1	1-1
Oct 2017	TIEC02-5 2017-10-30 - SRE - Wells Fargo (confidential).pdf	Robert McRae	5	1-5
Oct 2017	TIEC02-5 BAML - PNM Resources - Oct 2017 (confidential).pdf	Robert McRae	18	1-18
Aug 2016	TIEC02-5 HIFR 2016 Multi (confidential).pdf	Robert McRae	64	1-64
Feb 2017	TIEC02-5 HIFR 2017 Wells (confidential).pdf	Robert McRae	13	1-13
July 2016	TIEC02-5 Oncor report from Mizuho (confidential).pdf	Robert McRae	12	1-12

SPONSOR:
Robert McRae (Robert McRae)

RESPONSIVE DOCUMENTS:

TIEC02-5 2017-10-26 - AEP - Guggenheim (confidential).pdf
TIEC02-5 2017-10-26 - AEP - RBC (confidential).pdf

TIEC02-5 2017-10-26 - AEP - SunTrust (confidential).pdf
TIEC02-5 2017-10-30 - SRE - Goldman Sachs (confidential).pdf
TIEC02-5 2017-10-30 - SRE - Guggenheim (confidential).pdf
TIEC02-5 2017-10-30 - SRE - RBC (confidential).pdf
TIEC02-5 2017-10-30 - SRE - Wells Fargo (confidential).pdf
TIEC02-5 BAML - PNM Resources - Oct 2017 (confidential).pdf
TIEC02-5 HIFR 2016 Multi (confidential).pdf
TIEC02-5 HIFR 2017 Wells (confidential).pdf
TIEC02-5 Oncor report from Mizuho (confidential).pdf

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
2019 CEHE RATE CASE
DOCKET 49421-SOAH DOCKET NO. 473-19-3864

TEXAS INDUSTRIAL ENERGY CONSUMER
REQUEST NO.: TIEC02-06

QUESTION:

Do any of CenterPoint' s debt or credit contracts, agreements, or other related documents contain cross-default provisions between CenterPoint and any of its affiliates or CNP? If so, please list the document(s) and the associated amount of debt.

ANSWER:

CenterPoint Energy Houston Electric's credit agreements and indentures do not contain cross default provisions by which a default by CNP Inc. or its other affiliates would cause a default at CenterPoint Energy Houston Electric. The cross default provision that is included in CenterPoint Energy Houston Electric's debt agreement only relates to Significant Subsidiaries of CenterPoint Energy Houston Electric, of which there are none. Additionally, a Change in Control, as defined in CenterPoint Energy Houston Electric's credit agreement, of CNP Inc. would constitute an Event of Default.

SPONSOR:
Robert McRae (Robert McRae)

RESPONSIVE DOCUMENTS:

None

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
2019 CEHE RATE CASE
DOCKET 49421-SOAH DOCKET NO. 473-19-3864

TEXAS INDUSTRIAL ENERGY CONSUMER
REQUEST NO.: TIEC02-07

QUESTION:

Do any of CenterPoint' s debt or credit contracts, agreements, or other related documents contain any financial covenants or rating agency triggers related to any entity other than CenterPoint? If so, please list all such documents and describe the debt, the covenant, and/or the trigger.

ANSWER:

No. The financial covenant in CenterPoint Energy Houston Electric's credit agreement is not related to any entity other than CenterPoint Energy Houston Electric.

SPONSOR:
Robert McRae (Robert McRae)

RESPONSIVE DOCUMENTS:

None

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
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DOCKET 49421-SOAH DOCKET NO. 473-19-3864

TEXAS INDUSTRIAL ENERGY CONSUMER
REQUEST NO.: TIEC02-08

QUESTION:

Has CenterPoint pledged any assets in respect of or guaranteed any debt or obligation of any of its affiliates or CNP? If so, please list the entity and describe the pledged debt or obligation.

ANSWER:

No. CenterPoint Energy Houston Electric has not pledged its assets in respect of or guaranteed any debt or obligation of any of its affiliates or CNP Inc. Per CenterPoint Energy Houston Electric's credit agreement, it is prohibited from pledging, mortgaging, hypothecating or granting a lien upon the property of CenterPoint Houston with only a few exceptions such as the first mortgage and general mortgage.

SPONSOR:
Robert McRae (Robert McRae)

RESPONSIVE DOCUMENTS:

None

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
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DOCKET 49421-SOAH DOCKET NO. 473-19-3864

TEXAS INDUSTRIAL ENERGY CONSUMER
REQUEST NO.: TIEC02-09

QUESTION:

Does CenterPoint share credit facilities with any affiliate(s) or CNP? If so, please list the affiliate/parent and describe the shared credit facility.

ANSWER:

No. CenterPoint Energy Houston Electric maintains its own stand alone credit facility.

SPONSOR:
Robert McRae (Robert McRae)

RESPONSIVE DOCUMENTS:

None

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
2019 CEHE RATE CASE
DOCKET 49421-SOAH DOCKET NO. 473-19-3864

TEXAS INDUSTRIAL ENERGY CONSUMER
REQUEST NO.: TIEC02-10

QUESTION:

Please explain in detail the governance process by which CenterPoint declares dividends for distribution to CNP. Are there any limitations on CNP's ability to determine the dividends CenterPoint must pay? If so, please list and describe all such limitations.

ANSWER:

Intercompany dividends and distributions are governed by section 10.4.2 of the CenterPoint Energy Authorization Policy (See TIEC02-10 Authorization Policy.pdf). CenterPoint Houston dividends must be made in compliance with the Annual Plan and related Financing Plan and must be approved by the Chief Financial Officer in consultation with the Corporate Secretary. In addition, the dividend must be declared by the CenterPoint Energy Houston Electric, LLC Sole Manager.
There are no limitations on CenterPoint Houston's ability to pay dividends, except if the dividend would result in a ratio of Consolidated Indebtedness for Borrowed Money to Consolidated Capitalization to exceed 65%, as defined in section 7.2.a of CenterPoint Houston's $300 million Credit Agreement dated as of March 3, 2016 (See TIEC02-10 CenterPoint Houston Credit Agreement March 3 2016.pdf).

The requested information is voluminous and will be provided to the propounding party only in electronic format on CD. Please contact Alice Hart at (713) 207-5322 to request a copy of the CD. Please see index of voluminous material below.

Date	Title	Preparer	Number of Pages	Page No(s)
Undated	TIEC02-10 CenterPoint Houston Credit Agreement March 3 2016	Robert McRae	120	1-120
Undated	TIEC02-10 Authorization Policy	Robert McRae	29	1-29

SPONSOR (PREPARER):
Robert McRae (Robert McRae)

RESPONSIVE DOCUMENTS:
TIEC02-10 Authorization Policy.pdf
TIEC02-10 CenterPoint Houston Credit Agreement March 3 2016.pdf

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC
2019 CEHE RATE CASE
DOCKET 49421-SOAH DOCKET NO. 473-19-3864

TEXAS INDUSTRIAL ENERGY CONSUMER
REQUEST NO.: TIEC02-11

QUESTION:

Within the last ten years, has CenterPoint ever requested a non-consolidation legal opinion that a bankruptcy court would not consolidate the assets and liabilities of CenterPoint with CNP and/or any of CenterPoint's affiliates? If so, please provide all such opinions.

ANSWER:

CenterPoint Houston objects to this question on the grounds that the information is neither relevant nor reasonably calculated to lead to the discovery of admissible information. This is a base rate proceeding initiated under Chapter 36 of the Public Utility Regulatory Act ("PURA"), in which the Public Utility Commission of Texas ("Commission") must establish just and reasonable rates. Accordingly, the issues in this case do not include whether CenterPoint Houston would hypothetically be consolidated with an affiliate undergoing a bankruptcy proceeding. Notwithstanding and without waiving its objection, CenterPoint Houston is providing a response to this question.

Please see the attached two opinions.

SPONSOR (PREPARER):
Shane Kimzey (Shane Kimzey)

RESPONSIVE DOCUMENTS:
TIEC02-11 Restoration BondCo BB Non-consolidation Opinion 11-25-09.pdf
TIEC02-11 BondCo IV BB Non-consolidation Opinion 01-19-12.pdf

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November 25, 2009

TO: THE ADDRESSEES ON APPENDIX A

Re: CenterPoint Energy Restoration Bond Company, LLC System Restoration Bonds

Ladies and Gentlemen:

We have acted as counsel to CenterPoint Energy Houston Electric, LLC, a limited liability company organized under the laws of the State of Texas ("CEHE"), and CenterPoint Energy Restoration Bond Company, LLC, a Delaware limited liability company (the "Issuer"), in connection with:

(i) the issuance of the Financing Order (as hereinafter defined);

(ii) the sale of the rights and interests by CEHE to the Issuer under the Financing Order, including the right to impose, collect, and receive System Restoration Charges (which rights upon such sale shall become the System Restoration Property, as hereinafter defined), pursuant to that certain System Restoration Property Sale Agreement, dated as of November 25, 2009 (the "Sale Agreement"), between CEHE and the Issuer;

(iii) the agreement to service the System Restoration Property pursuant to that certain System Restoration Property Servicing Agreement, dated as of November 25, 2009 (the "Servicing Agreement"), between CEHE, as servicer (in such capacity, the "Servicer"), and the Issuer;

(iv) the intercreditor agreement dated as of November 25, 2009 (the "Intercreditor Agreement") among CEHE in various capacities, the Trustee (as hereinafter defined), Deutsche Bank Trust Company Americas, as Initial System Restoration Bond Trustee, CenterPoint Energy Transition Bond Company, LLC, CenterPoint Energy Transition Bond Company II, LLC, CenterPoint Energy Transition Bond Company III, LLC and the Issuer; and

(v) the concurrent issuance of debt securities (the "System Restoration Bonds") by the Issuer secured by, among other things, the System Restoration Property

and all of the Issuer's rights under the Sale Agreement, pursuant to that certain Indenture, dated as of November 25, 2009 and that certain First Supplemental Indenture dated as of November 25, 2009 (collectively, the "Indenture"), between the Issuer, Deutsche Bank Trust Company Americas, a New York banking corporation ("Deutsche"), as trustee (in such capacity, the "Trustee").

All capitalized terms used herein and not otherwise defined shall have the meaning specified in Appendix A to the Indenture unless the context clearly indicates otherwise.

We have reviewed the following documents and any exhibits thereto for purposes of this opinion (collectively, the "Relevant Documents"):

1. the Sale Agreement and the related Bill of Sale;
2. the Servicing Agreement;
3. the Intercreditor Agreement;
4. the Indenture;
5. the Underwriting Agreement dated as of November 18, 2009 (the "Underwriting Agreement") among CEHE, the Issuer and the underwriters named therein;
6. the Administration Agreement dated as of November 25, 2009 (the "Administration Agreement") between CEHE and the Issuer;
7. the Certificate of Formation of the Issuer, dated as of August 6, 2009, (the "Certificate of Formation"), certified as of a recent date by the Secretary of State of Delaware;
8. the Limited Liability Company Agreement of the Issuer, effective as of September 28, 2009, as amended and restated by the Amended and Restated Limited Liability Company Agreement, dated November 25, 2009 (the "LLC Agreement");
9. the Application of CEHE to the Public Utility Commission of Texas (the "PUCT") dated July 8, 2009, together with the accompanying exhibits and testimony filed in connection therewith (collectively, the "Application");
10. that certain Financing Order, Docket Number 37200 (the "Financing Order") issued on August 26, 2009, by the PUCT pursuant to its authority under §§ 14.001, 39.303 and 39.403 of the Public Utility Regulatory Act ("PURA"), TEX. UTIL. CODE §§ 11.001-63.063;

11. that certain Issuance Advice Letter (the "Issuance Advice Letter") filed with the PUCT on November 19, 2009; and

12. the certificates of CEHE and the Issuer attached hereto as Exhibits A and B, respectively (the "Factual Certificates").

I. OPINIONS REQUESTED

You have requested our opinions as to:

(i) whether, in connection with any bankruptcy proceedings instituted by or on behalf of or against CEHE under Title 11 of the United States Code, 11 U.S.C.§§ 101 *et seq.* (the "Bankruptcy Code"), a court would order the substantive consolidation of CEHE with the Issuer, thereby pooling the assets and liabilities of the Issuer with the assets and liabilities of CEHE; and

(ii) whether, (regardless of whether the Issuer is a debtor in a Bankruptcy case) if CEHE were to become a debtor under the Bankruptcy Code, (a) the System Restoration Property (including the collections thereon (the "Collections")) would be property of the estate of CEHE under Sections 541(a)(1) or (a)(6) of the Bankruptcy Code, and (b) Section 362(a) of the Bankruptcy Code would not apply to prevent CEHE in its capacity as Servicer from paying Collections to the Issuer and its assigns.

II. ASSUMPTIONS

In rendering our opinion, we have made no independent investigation of the facts referred to herein and have relied for the purpose of rendering this opinion exclusively on the Relevant Documents and on facts provided to us by CEHE and the Issuer, as certified in the Factual Certificates, which we assume have been and will continue to be true.

In our examination, we have assumed the legal capacity of all natural persons, the genuineness of all signatures, the authenticity of all documents submitted to us as originals, the conformity to original documents of all documents submitted to us as facsimile, certified or photostatic copies and the authenticity of the originals of such latter documents. In making our examination of such documents, for purposes of this opinion we have assumed that all parties thereto had the requisite power, corporate or other, to enter into and perform all obligations thereunder and have also assumed the due authorization thereof by all requisite action, corporate or other, the execution and delivery by such parties of such documents, the validity and binding effect thereof and that such documents are enforceable against such parties.[1] In addition, we

[1] We refer you to our other opinions of even date herewith addressing the above-described issues as they relate to CEHE and the Issuer.

have assumed the validity, effectiveness and finality of PURA and all regulatory actions taken in connection therewith.[2]

For purposes of this opinion, we have also assumed the following matters set forth in this Section II.

A. Statutory Background

1. CEHE is a limited liability company engaged in the distribution and sale of electricity to the public in Texas and is a utility within the meaning of Subchapter G and Subchapter I of Chapter 36 of PURA and is an electric utility within the meaning of Section 31.002 of PURA. PURA § 31.002(6). Subchapter G of Chapter 39 of PURA allows Texas electric utilities to seek and obtain a "financing order" from the PUCT in order to recover "transition costs" which, among other things, authorizes the utility: (i) to impose, collect and receive a "transition charge" from retail customers, in connection with their consumption of electricity; (ii) to sell or assign to a third party (including a subsidiary of the utility) the right to receive the "transition charges" and (iii) to cause securities to be issued, the payment of which is supported by the "transition charges." "Transition Charges" means nonbypassable amounts to be charged for the use or availability of electric services, approved by the PUCT in a financing order to recover qualified costs (as defined in the financing order), that shall be collected by a utility, its successors, assignees or other collection agents as provided for in that financing order. Pursuant to Subchapter I of Chapter 36 of PURA, "financing order", as used in Subchapter G, includes a financing order authorizing the securitization of system restoration costs, which include costs expensed, charged to self-insurance reserves, deferred, capitalized, or otherwise financed, that are incurred by an electric utility due to any activity or activities conducted by or on behalf of the electic utility in connection with the restoration of service and infrastructure associated with electric power outages affecting customers of the electric utility as a result of any tropical storm or hurricane, ice or snow storm, flood, or other weather-related event or natural disaster that occurred in calendar year 2008 or thereafter. "Transition charges" include nonbypassable amounts to be charged for the use of electric services, approved by the PUCT in such financing order to recover system restoration costs, which amounts may be called "System Restoration Charges". Subchapter I of Chapter 36 of PURA specifies that the provisions of Subchapter G continue to govern any system restoration bonds issued pursuant to a financing order under Subchapter I. The securities issued pursuant to a financing order are referred to in PURA as "transition bonds." Pursuant to Subchapter I of Chapter 36 of PURA, "transition bonds" includes transition bonds issued in association with the recovery of system restoration costs (which may be called "System Restoration Bonds"). As used herein, "System Restoration Property" means the rights and interests of CEHE or its successor under the Financing Order, once those rights are first transferred to the Issuer or pledged in connection with the issuance of

3

[2] We refer you to our other opinions of even date herewith with respect to the above-described issues.

the Transition Bonds, including the irrevocable right to impose, collect and receive System Restoration Charges authorized by the Financing Order.

2. Pursuant to PURA, CEHE filed its Application and obtained the Financing Order, which authorizes and approves, among other things, (i) CEHE's imposition and collection of System Restoration Charges; (ii) the assignment of the rights to impose and collect the System Restoration Charges to the Issuer (and upon such assignment or transfer, the above-mentioned rights will become System Restoration Property vested in the Issuer under PURA); (iii) the Issuer's issuance of System Restoration Bonds; (iv) the grant of a lien in favor of the Trustee on the System Restoration Property and other collateral that constitutes the Trust Estate; and (v) the filing with the PUCT of a system restoration charge tariff (together with any amendatory tariffs or notice filing tariffs filed with the PUCT in connection therewith, the "Tariffs"). The Financing Order has become effective in accordance with PURA and is in full force and effect as a valid, binding and enforceable decision of the PUCT. The Financing Order has become final and non-appealable in accordance with PURA.[3]

3. Pursuant to and in accordance with PURA, PURA and the Financing Order each provide that upon transfer of CEHE's rights under the Financing Order, legal and equitable title to the System Restoration Property passes to the Issuer in a true sale for purposes of Texas law, regardless of whether the Issuer has any recourse against the seller, or any other term of the parties' agreement, including CEHE's retention of an equity interest in the System Restoration Property, the fact that CEHE acts as the collector of the System Restoration Charges relating to the System Restoration Property, or the treatment of the transfer as a financing for tax, financial reporting, or other purposes. PURA § 39.308; Financing Order Conclusion of Law 35. As further required by PURA § 39.305, the Financing Order provides that the interests of an assignee, the Trustee, and the holders of the System Restoration Bonds in the System Restoration Property are not subject to setoff, counterclaim, surcharge, or defense by CEHE or any other person or in connection with the bankruptcy of CEHE or any other entity. Financing Order Conclusion of Law 32[4].

B. Formation and Separateness of the Issuer

1. The Issuer was created on August 6, 2009, as a special-purpose limited liability company organized under the laws of the State of Delaware. CEHE is, and at all times has been, the sole member ("Member") of the Issuer. The Issuer was formed for the sole purpose of purchasing and owning transition property (as defined under PURA), issuing the System

[3] We refer you to our other opinions of even date herewith with respect to the above-described issues.

[4] We refer you to another opinion from us to you, of even date herewith, as to the true sale (under PURA) of the System Restoration Property by CEHE to the Issuer.

Restoration Bonds, pledging its interest in the System Restoration Property and other collateral to the Trustee under the Indenture in order to secure the System Restoration Bonds, and performing activities that are necessary, suitable or convenient to accomplish these purposes. Under the terms of its LLC Agreement, the Issuer's business activities are limited to the immediately above-mentioned activities. The Issuer does not (and will not) have any material assets other than the System Restoration Property (and collections thereon), any future transition property (as defined under PURA) that may be created in its favor or transferred to it, other collateral, consisting of trust accounts held by the Trustee and other credit enhancements acquired or held to ensure payment of the System Restoration Bonds, and any money distributed by the Trustee from the Collection Account in accordance with the Indenture. At the closing (the "Closing") of the sale and issuance transactions contemplated by the Relevant Documents, CEHE will contribute to the equity of the Issuer in cash or cash equivalents an amount equal to approximately one-half of one percent of the principal amount of the System Restoration Bonds.

2. In accordance with the terms of its LLC Agreement, the Issuer will be managed by not fewer than three nor more than five managers (each a "Manager"). The Managers' rights and authority on behalf of the Issuer are similar to those of a board of directors for a corporation. The Issuer must and will at all times beginning immediately prior to the Closing have at least three Managers, one of whom must be an "Independent Manager" as defined in its LLC Agreement, i.e., a Manager who is not, and within the previous five years was not (except solely by virtue of such Person's serving as, or affiliation with any other Person serving as, an independent director or manager, as applicable, of CEHE, the Issuer or any bankruptcy remote special purpose entity that is an Affiliate of CEHE or the Issuer), (i) a stockholder, member, partner, director, officer, employee, Affiliate, customer, supplier, creditor or independent contractor of, or any Person that has received any benefit in any form whatsoever from (other than in such Manager's capacity as a ratepayer or customer of CEHE in the ordinary course of business), or any Person that has provided any service in any form whatsoever to, or any major creditor (or any Affiliate of any major creditor) of, the Issuer, CEHE or any of their Affiliates, or (ii) any Person owning beneficially, directly or indirectly, any outstanding shares of common stock, any limited liability company interests or any partnership interests, as applicable, of the Issuer, CEHE, or any of their Affiliates or of any major creditor (or any Affiliate of any major creditor) of any of the foregoing, or a stockholder, member, partner, director, officer, employee, Affiliate, customer, supplier, creditor or independent contractor of, or any Person that has received any benefit in any form whatever from, (other than in such Person's capacity as a ratepayer or customer of CEHE in the ordinary course of business), or any Person that has provided any service in any form whatever to, such beneficial owner or any of such beneficial owner's Affiliates, or (iii) a member of the immediate family of any person described above; provided that the indirect or beneficial ownership of stock through a mutual fund or similar diversified investment vehicle with respect to which the owner does not have discretion or control over the investments held by such diversified investment vehicle shall not preclude such owner from being an Independent Manager. The Independent Manager will be paid a fee determined by the Managers.

3. The LLC Agreement provides that, without the affirmative vote of all the Managers, including the Independent Manager, the Issuer will not file a voluntary petition for relief under the Bankruptcy Code or similar law or otherwise institute or consent to the institution of insolvency or bankruptcy proceedings with respect to the Issuer or take any company action in furtherance of any such filing or institution of a proceeding. The LLC Agreement further provides that, to the fullest extent permitted by applicable law (including, without limitation, Section 18-1101(c) of the Delaware Limited Liability Company Act) the fiduciary duty of each Manager, including the Independent Manager, in respect of any decision on any matter referred to above shall be owed solely to the Issuer (including its creditors) and not to CEHE as the Issuer's Member nor to any other holders of any equity interest in the Issuer as may exist at such time. The vote of all of the Managers, including the Independent Manager, is also required to amend the LLC Agreement with regard to any matter referred to above.

4. From and after the Closing, the LLC Agreement further prohibits the Issuer, without the prior unanimous written consent of the Managers, including the Independent Manager, from amending certain provisions of the LLC Agreement, including, without limitation, those designed to ensure the bankruptcy remoteness and the limited purpose, of the Issuer. The Issuer will have its own executive officers appointed by the Managers but will not have any employees.

5. The Issuer will at all times (i) ensure that all of its actions are duly authorized by its Managers and officers, as appropriate; (ii) have adequate capitalization for its business and operations; (iii) maintain corporate records and books of account separate from those of CEHE and the members of the CEHE Affiliated Group (defined below); (iv) allocate fairly and reasonably any overhead for office space shared with CEHE and; (v) be in full compliance with the terms of its Certificate of Formation and LLC Agreement. Each of the Issuer, CEHE, and, to the extent, CEHE's other Affiliates are parties thereto, such Affiliates, will at all times and in all respects which are material to the opinions expressed herein, comply with all provisions in the Relevant Documents to which they are parties. The Issuer intends to be adequately capitalized at all times.

6. The Issuer has not prior to the date hereof conducted any business, and from and after the date hereof, it will conduct its business solely in its own name and through its duly authorized officers or agents. Furthermore, all oral and written communications made by the Issuer (including, without limitation, letters, invoices, purchase orders, contracts, statements and applications) have been and will be made solely in its own name. Except as expressly set forth below, neither CEHE nor any other member of the CEHE Affiliated Group has held itself out, will hold itself out, or permit itself to be held out, as having agreed to pay or as being liable for the debts of the Issuer; and, conversely, the Issuer is not holding itself out, will not hold itself out, and will not permit itself to be held out, as having agreed to pay or as being liable for the debts of CEHE or any other member of the CEHE Affiliated Group. Neither CEHE nor any such Affiliate will guarantee any other obligations or debts of the Issuer, nor, except for the indemnities of CEHE set forth in the Servicing Agreement and the Sale Agreement (which we

understand are customary for transactions of the type of transaction provided for under the Relevant Documents, and cover matters ascertainable by CEHE in the ordinary course of business), indemnify any person or entity for losses resulting therefrom, and, in any event, the Issuer will not guarantee any of the obligations or debts of CEHE or CEHE's other Affiliates, nor indemnify any person from losses resulting therefrom[5]. Other than with respect to the Issuer's capitalization (as the same may change from time to time), in which CEHE's relationship to the Issuer is that of any parent making an equity investment in a subsidiary, the Issuer will continue to maintain an arm's-length relationship in any future dealings it may have with CEHE or any of CEHE's other Affiliates.

7. CEHE has entered into the Servicing Agreement and the Intercreditor Agreement, pursuant to which CEHE will be responsible for the billing and collection of the System Restoration Charges on behalf of the Issuer and for administering various matters relating to the day-to-day operations of the Issuer. As Servicer and collection agent, CEHE will have control over, and take actions in respect of, the System Restoration Property only to the extent necessary to fulfill its obligations under the Servicing Agreement and the Intercreditor Agreement, which obligations are such as would reasonably be required of a third-party servicer in the context of servicing transition property under PURA. The servicing fee and other compensation provided for under such agreements represents a reasonable and fair compensation such as would be obtained under an agreement among unaffiliated entities under otherwise similar circumstances and is typical of servicer arrangements made for servicing, administering and collecting securitized financial assets, and the servicing fee is capped in the Financing Order. Except for those expenses that CEHE has agreed to assume in consideration of the fees and other amounts paid to it under the above-described documents, the Issuer will pay its own operating expenses and liabilities (including but not limited to any fees paid to the Independent Managers) from its own separate assets, although CEHE has paid and may pay under the Administration Agreement expenses related to the formation of the Issuer and the consummation of the transactions described herein. The Issuer will not pay any of the operating expenses or other liabilities of CEHE or any of CEHE's other Affiliates.

8. CEHE will prepare year-end consolidated and consolidating financial statements on an annual basis in accordance with generally accepted accounting principles applied consistently and otherwise in accordance with the requirements of the Relevant Documents and such consolidated financial statements will be audited by independent certified public accountants. Such audited consolidated financial statements will contain footnotes or other information to the effect that: (i) the Issuer is the sole owner of the System Restoration Charges and the System Restoration Property; (ii) the holders of the System Restoration Bonds do not

[5] Pursuant to the Service Agreement and the Sale Agreement, CEHE makes certain representations and provides certain covenants that do not constitute a guarantee of collectibility of System Restoration Property. We understand that these representations and covenants are customary for transactions of the type of transaction provided for under the Relevant Documents, and cover matters ascertainable by CEHE in the ordinary course of business.

have recourse to any assets or revenues of CEHE; and (iii) the creditors of CEHE do not have recourse to any assets or revenues of the Issuer, including, without limitation, the System Restoration Property.

9. Under Treasury Regulation § 301.7701-3 (also known as the "check-the-box" regulation), CEHE has not elected to treat the Issuer as an association taxable as a corporation. Similarly, CenterPoint Energy (the parent of CEHE) has not elected to treat CEHE as an association taxable as a corporation. Consequently, the Issuer will, for federal income tax purposes, be treated as a division of CenterPoint Energy and, accordingly, (i) indebtedness of the Issuer will be reported for such tax purposes as indebtedness of CenterPoint Energy and (ii) income recognized in connection with the accrual and collection of the System Restoration Charges will be treated as income of CenterPoint Energy for federal income tax reporting purposes. This is acknowledged in the Indenture and in the System Restoration Bonds. CenterPoint Energy and CEHE will, however, treat the Issuer as the owner of the System Restoration Property for all non-tax purposes, including all regulatory and (except as noted in paragraph 8 above) accounting purposes, and will not make any statement or reference in respect of the System Restoration Property that is inconsistent with the ownership interests of the Issuer.

10. As a result of the Financing Order, the Issuer had, as of the date of conveyance, good title to and was the sole owner and holder of the System Restoration Property purported to be conveyed by it under the Relevant Documents, free and clear of any setoff, counterclaim, surcharge, or defense by CEHE or any other person or in connection with the bankruptcy of CEHE or any other entity, of any nature, and had the full right and authority, subject to no interest or participation of, or agreement with, any other person or entity, to transfer and assign and/or pledge the same. CEHE and the Issuer have made and will make all filings required by PURA and the Uniform Commercial Code or any other applicable law to "perfect" the creation, sales, assignments and pledges of the System Restoration Property and other collateral under the Relevant Documents, and such parties will make any future filings required to maintain the perfection of such transfers.[6]

11. No funds will be distributed, loaned or otherwise transferred from CEHE or CEHE's other Affiliates to the Issuer nor from the Issuer to CEHE or CEHE's other Affiliates, except for (i) payments required under or described in the Relevant Documents pursuant to the respective obligations of the Issuer and CEHE thereunder; (ii) returns of capital paid by the Issuer to CEHE which are properly authorized by requisite limited liability company action and which are reflected in the books and records of the Issuer, as applicable, and (iii) capital contributions made by CEHE to the Issuer which are permitted under the Relevant Documents and are properly reflected in the books and records of CEHE and the Issuer, as applicable.

[6] We refer you to our other opinion of even date herewith addressing the above-described issues regarding perfection.

12. The underwriters have agreed to purchase the System Restoration Bonds under the Underwriting Agreement, in reliance on the identity of the Issuer as a legal entity which is separate from CEHE and the other members of the CEHE Affiliated Group, and the System Restoration Bondholders have similarly purchased the System Restoration Bonds in reliance on such separate identity. For purposes of this opinion "CEHE Affiliated Group" shall mean CEHE and any Affiliate of CEHE. The prospectus and prospectus supplement pursuant to which the System Restoration Bonds have been sold to public investors expressly indicate that CEHE is not obligated to make any payment with respect to the System Restoration Bonds and that any payment on the System Restoration Bonds is intended to be based solely on the System Restoration Property and the other collateral that constitutes the Trust Estate.

13. The amounts received by CEHE constitute fair consideration and reasonably equivalent value for the transfer of the System Restoration Property. The Issuer has accepted the conveyance and the vesting of the System Restoration Property in good faith for fair consideration and reasonably equivalent value. The creation, transfer, assignment and pledge of the System Restoration Property have been publicly disclosed in accordance with applicable law and neither CEHE nor the Issuer has concealed such transactions from their respective creditors or otherwise entered into the transactions contemplated by the Relevant Documents with any intent to hinder, delay or defraud any of CEHE's creditors or any other interested party. CEHE will not make any future conveyances or transfers to, nor has it or will it hereafter incur any obligation to or for the benefit of, the Issuer with any intent to hinder, delay or defraud any creditor of CEHE.

14. CEHE was not and is not insolvent at the time of the creation of the System Restoration Property, and was not rendered insolvent as a result thereof nor, after giving effect to this transaction concluded today under the Sale Agreement, is CEHE engaged in any business or transaction for which its remaining property, taking into account all of the Relevant Documents, is unreasonably small in relation to its business. At the time of any transfer to or for the benefit of the Issuer, CEHE did not intend to incur, and did not incur, debts that were beyond its ability to pay as such debts matured.

15. The Issuer was not insolvent at the time of any conveyance or transfer made by it under the Relevant Documents, nor was the Issuer rendered insolvent as a result thereof. The Issuer has not engaged in any business or transaction for which its remaining property, taking into account all of the Relevant Documents, is unreasonably small in relation to its business. At the time of the creation and sale of the System Restoration Property pursuant to the Relevant Documents, the Issuer did not intend to incur, nor did it incur, debts that were beyond the ability of the Issuer to pay as such debts matured.

16. Other than the Relevant Documents, there are no other material agreements to which CEHE and/or the Issuer are parties relating to the System Restoration Property and there are no other agreements to which any such persons are party which would purport to modify,

contradict or otherwise conflict with the terms and provisions of the Relevant Documents or the assumptions set forth herein.

C. **The Sale and Servicing of the System Restoration Property**

1. Pursuant to the Sale Agreement, CEHE has, in consideration of the receipt of proceeds from the Issuer from the issuance of the System Restoration Bonds, made certain representations, warranties and covenants regarding the validity of the Financing Order and the System Restoration Property created thereby. The Sale Agreement provides that the Issuer will pay CEHE at closing all of the net proceeds received by it from the issuance of the System Restoration Bonds in consideration of CEHE's actions in creating, assigning and vesting the System Restoration Property in the Issuer, and no portion of such payment is or may be deferred. The Sale Agreement obligates CEHE to indemnify the Issuer and/or its assigns if there exists a breach of any of those representations, warranties or covenants contained in the Sale Agreement. CEHE has entered into the Sale Agreement in the belief, after reasonable inquiry on its part, that all of these representations and warranties are true and correct and that it will not be required to make any such indemnification payments. These indemnification obligations and representations and warranties are of a type commonly found in transactions involving the sale of assets such as the System Restoration Property and none of such representations, warranties and/or covenants contains a guarantee as to the ultimate collectibility of the System Restoration Property or the continued sale of services or goods by CEHE. CEHE has also covenanted in the Sale Agreement not to take certain actions which would impair or otherwise invalidate the value of the System Restoration Property.

2. Pursuant to the Sale Agreement, CEHE has sold and assigned to the Issuer all of its right, title and interest in and to the System Restoration Property. The Sale Agreement provides that the Issuer will pay CEHE at the Closing all of the net proceeds the Issuer receives from the issuance of the System Restoration Bonds in consideration of CEHE's transfer of the System Restoration Property to the Issuer, and no portion of such payment obligation is or may be deferred. The Sale Agreement further expressly provides that the sale of the System Restoration Property is intended to be a sale or other absolute transfer within the meaning of PURA, which transfer is intended to be unconditional and irrevocable, of all of CEHE's right, title and interest in and to the System Restoration Property.

3. The System Restoration Bonds have been issued pursuant to the Indenture and purchased by public investors. The System Restoration Bonds are secured by (i) all of the Issuer's right, title and interest in and to the System Restoration Property, (ii) the Collection Account and all subaccounts thereof; (iii) all of the Issuer's rights under each of the Relevant Documents to which the Issuer is a party and (iv) all other property of the Issuer, except for certain amounts released to the Issuer pursuant to the terms of the Indenture. The Issuer has applied the net proceeds of the sale of the System Restoration Bonds as payment in full for the purchase of and vesting in the Issuer's favor of the System Restoration Property from CEHE.

4. Pursuant to the Servicing Agreement, CEHE has agreed to act as Servicer (in such capacity, the "Servicer"), in which capacity it will bill and collect the System Restoration Charges on behalf of the Issuer and the Trustee and will take such legal or administrative actions, including defending against or instituting and pursuing legal actions and appearing or testifying in hearings or similar proceedings, as may be reasonably necessary to block or overturn any attempts to cause a repeal, modification or supplement to PURA or the Financing Order which would impair the rights of the System Restoration Bondholders or the owners of the System Restoration Property. The System Restoration Charges are based on expected usage of electricity by all Customers, other than Customers served at transmission voltage, and have been calculated in a manner which is intended to generate sufficient revenues to pay the principal of the System Restoration Bonds in accordance with the expected amortization schedule, pay interest on the System Restoration Bonds, together with servicing fees and other fees, costs and charges related thereto, and to fund and/or maintain any required reserves in the Capital Subaccount, all after giving effect to delays in bill collections and uncollectible bills.

5. In accordance with PURA §§ 36.404 and 39.306 and as authorized and directed by the Financing Order, the Servicer will, pursuant to the Servicing Agreement, impose and collect the System Restoration Charges on and from each REP serving customers at distribution voltage in the CEHE service area (or on and from customers directly as authorized) on and after the date of Closing.

6. Under the terms of the Financing Order as provided in PURA §§ 36.401 and 39.307, the System Restoration Charges will be subject to true-up adjustments if the collections are more or less than expected at the onset of each adjustment period. Such adjustments provide for reconciliation of undercollection and overcollection of System Restoration Charges by each REP in connection with payments made to the Servicer as described in Section 7(d) hereof and additionally protect against the risk of insufficient Collections over time. They serve as an important credit enhancement for the System Restoration Bonds. Such adjustments also help ensure that the value of the System Restoration Property remains reasonably equivalent to the consideration paid to CEHE notwithstanding significant changes in electricity usage patterns or Customer payment histories which may occur during the time that the System Restoration Bonds are outstanding. CEHE, as Servicer, will file Tariffs with the PUCT to evidence any such true-up adjustment. Pursuant to the Servicing Agreement, the Servicer has agreed to (and will) promptly apply for and provide all necessary information and file all necessary Tariffs in connection with such periodic adjustments. As required by PURA, any increase or decrease in the System Restoration Charges being charged will result in a corresponding increase or decrease in the amount deducted from CEHE's other charges.

7. (a) The Servicer will include System Restoration Charges on bills sent by CEHE to REPs, and such System Restoration Charges will be collected by the Servicer (acting through its collection agent under the Intercreditor Agreement) from such REPs that, in turn, collect such System Restoration Charges from the Customers. One or more of the REPs collecting System Restoration Charges may be considered by the PUCT to be "affiliated REPs"

for certain purposes under PURA whether or not there is any continuing affiliation (in the normal sense of ownership or control) that would cause such companies to be considered affiliates of CEHE for any other purpose.

(b) REPs may choose to contract with CEHE to bill and collect the System Restoration Charges from Customers. The credit and collection standards for all REPs are set forth in the Financing Order and are the most stringent that can be imposed on REPs under the Financing Order. The PUCT may implement different credit and collection standards for REPs only with prior written confirmation from the rating agencies that such modifications will not cause suspension, withdrawal or downgrade of the ratings on the System Restoration Bonds.

(c) In order to be an REP, each REP must establish its creditworthiness and support its obligations to collect and remit the System Restoration Charges by maintaining a satisfactory credit rating or providing (a) a cash deposit of up to two months' maximum expected collections, (b) an equivalent affiliate guarantee, surety bond or letter of credit in favor of the Trustee or (c) a combination of the foregoing. Cash deposits will be held by the Trustee, maintained in a segregated account, and invested in short-term high quality investments. The size of any deposit will be agreed upon by the Servicer and the REP and reviewed no more frequently than quarterly. Investment earnings will be considered part of the cash deposit and taken into consideration during the regular deposit review, so long as they remain on deposit with the Trustee. After each such review, excess amounts on deposit will be remitted by the Trustee to the REP and the REP will correct any deficiencies by depositing additional funds into the account. At the instruction of the Servicer, cash deposits will be remitted with investment earnings to the REP at the end of the term of the System Restoration Bonds unless otherwise utilized for the payment of the REP's obligations for System Restoration Charges.[7]

(d) Because of difficulties inherent in tracking Collections on a daily basis, REPs will pay System Restoration Charges billed to the REP within 35 days following billing by the Servicer. The remittance amount will be based on each REP's own charge-off history. Amounts remitted will be reconciled at least annually by the REP and Servicer so that the REP may receive credit for write-offs related to customers whose service has been permanently terminated and whose entire account has been written off. If an REP disputes any amount of billed System Restoration Charges, it must pay the disputed amount under protest and work with the Servicer to resolve the dispute. If the REP and the Servicer are unable to resolve the dispute informally, the dispute may be referred to the PUCT. If an REP successfully disputes an amount, the REP shall be entitled to interest on the disputed amount at a PUCT-approved rate. Except in limited circumstances, the Servicer shall pay the interest, which may be recovered through the true-up adjustment of System Restoration Charges unless the Servicer's claim is clearly unfounded.

[7] We express no opinions as to whether, in the event of a bankruptcy of any REP, funds on deposit in any REP deposit subaccount would be property of such REP's bankruptcy estate and therefore whether the automatic stay would impair the Trustee's access to those funds upon an REP payment default.

(e) If an REP defaults with respect to its system restoration charge obligations, under the Financing Order remedies are limited to one of the following, at the election of the REP: (i) a transfer of billing and collecting System Restoration Charges to the provider of last resort ("POLR") or a qualified REP of the Customer's choosing, (ii) implementing mutually agreeable arrangements with the Servicer (as limited by the Servicing Agreement and rating agencies) and (iii) arranging for remittance of amounts directly to a lockbox. Amounts deposited in a lockbox shall be applied first to System Restoration Charges before remaining amounts are distributed to REPs. The Servicing Agreement prohibits the Servicer from entering into any agreement with an REP in default other than the options described in clauses (i), (ii) and (iii) above. In the event that an REP fails to immediately select and implement one of the foregoing options, or if after selecting one of the foregoing options the REP fails to adequately meet its responsibilities thereunder, the Servicer will immediately allow the appropriate POLR or another qualified REP of the Customer's choosing to immediately assume responsibility for the billing and collection of System Restoration Charges from such Customer. In addition, after a 10 calendar-day grace period, the Servicer will seek recourse against any cash deposit, guaranty, surety bond, letter of credit, or combination thereof provided by the REP in accordance with the Financing Order, and avail itself of such legal remedies as may be appropriate to collect any remaining unpaid System Restoration Charges and associated penalties due the Servicer under the application of such deposit or other form of credit support.

8. The Servicer is responsible for collecting such Collections and remitting the amounts so collected to the Collection Account. Collections in respect of System Restoration Charges shall be allocated to the Servicer out of the initial collections received by CEHE, acting as collection agent on behalf of the Servicer and the Trustee, on the one hand, and certain other parties with an interest in such initial collections, on the other hand, in accordance with the terms and provisions of the Intercreditor Agreement. The Servicer shall remit to the General Subaccount of the Collection Account the total payments received by the Servicer from or on behalf of Customers on the second business day after receipt of such funds from the collection agent. Under Subchapter G of Chapter 39 of PURA, the Servicer is not required to segregate the System Restoration Charges from the other funds it collects from an REP or from its general funds until such amounts are remitted to the Trustee.

9. On each payment date for principal and interest on the System Restoration Bonds, funds on deposit in the Collection Account, including net earnings thereon, will be allocated and distributed in accordance with the terms and provisions of the Indenture towards the payment of certain fees and expenses (including operating expenses of the Issuer) and indemnities, scheduled payments of interest on and principal of the System Restoration Bonds, any required funding and/or replenishment of the Capital Subaccount to the extent that prior withdrawals have reduced the balance thereof below the required capital level (at least 0.5% of the original principal amount of the System Restoration Bonds). Thereafter amounts equal to investment earnings on amounts in the Capital Subaccount shall be released to the Issuer, and the balance if any, shall be allocated to the Excess Funds Subaccount or the Capital Subaccount for the benefit

of the System Restoration Bondholders. Any shortfalls or excess Collections will be taken into account in calculating subsequent true-up adjustments.

10. The System Restoration Charges will continue to be recovered only through November 25, 2024 (15 years from issuance date), provided that, as set forth in the Financing Order, if the System Restoration Bonds have not been paid in full at such time, end of period billings and delinquencies owed at such time may continue to be collected. Once the System Restoration Bonds have been paid in full, the Issuer will retain all right, title and interest in and to any funds remaining on deposit in the Collection Account, any Collections received by the Servicer but not yet remitted to the Collection Account and any rights to System Restoration Charges which have been previously billed but remain unpaid as of such date. The Issuer does not have any contractual duty to account to CEHE for such excess value of the System Restoration Property over the amount necessary to repay the System Restoration Bonds in full; CEHE will nonetheless retain an indirect interest in such excess value to the extent of its remaining equity interest in the Issuer, and will be required to treat any remaining excess value as a recovery of property for purposes of adjusting the rates it charges customers.

11. The parties have calculated that the Required Capital Amount, after taking into account the required true-up adjustments, will be reasonable and sufficient credit enhancement to ensure that the System Restoration Bondholders of each Tranche will be paid in full on the expected final payment date for such Tranche and that the Issuer will receive a reasonable return on the consideration paid for the ownership of the System Restoration Property. To the extent that the funds on deposit in the Capital Subaccount are less than their required levels at maturity of the System Restoration Bonds, the Issuer will not have any recourse to CEHE for such shortfalls. Conversely, to the extent that the funds on deposit in the Collection Account at maturity of the latest maturing System Restoration Bonds exceed the amount of the Required Capital Amount, CEHE will have no recourse to the Issuer for such excess amounts.

12. From time to time after the date hereof, in connection with the issuance of future System Restoration Bonds under the Indenture, additional transition property may be created in favor of the Issuer through action by CEHE in exchange for cash in an amount equal to the fair market value of such transition property. No such transition property will, however, be created with the intent (on the part of either CEHE or the Issuer) to mitigate losses on the System Restoration Property.

III. ANALYSIS

Substantive Consolidation

The equitable doctrine of substantive consolidation permits a court in a bankruptcy case to disregard the corporate separateness of two or more corporate entities and to consolidate the assets and liabilities of those entities as though held and incurred by a single entity. *See, e.g., In re Owens Corning*, 419 F.3d 195, 205 (3d Cir. 2005); *Reider v. FDIC (In re Reider)*, 31 F.3d

1102, 1104–06 (11th Cir. 1994); *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845, 847 (2d Cir. 1966).[8] Although the Bankruptcy Code does not expressly provide for the substantive consolidation of corporate entities, courts have consistently been willing to exercise their equitable power to order substantive consolidation in appropriate circumstances.[9] *See, e.g., In re Augie/Restivo Baking Co.*, 860 F.2d 515, 518 (2d Cir. 1988); *In re Vecco Construction Industries, Inc.*, 4 B.R. 407, 409 (Bankr. E.D. Va. 1980). Because the disregard of separate corporate existence is disfavored, a presumption exists against substantive consolidation, and the party seeking that result has the burden of establishing its necessity. *See, e.g., In re Auto-Train Corp., Inc.*, 810 F.2d 270, 276 (D.C. Cir. 1987); *Simon v. New Center Hospital (In re New Center Hospital)*, 187 B.R. 560, 567–68 (E.D. Mich. 1995).

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Courts have generally treated substantive consolidation as the exception rather than the rule because of the "possibility of unfair treatment of creditors who have dealt solely with the corporation having a surplus as opposed to those who have dealt with the related entities with deficiencies." *In re Continental Vending Machine Corp.*, 517 F.2d 997, 1001 (2d Cir. 1975), *cert. denied sub nom. James Talcott, Inc. v. Wharton*, 424 U.S. 913 (1976). *See also FDIC v. Colonial Realty Co.*, 966 F.2d 57, 61 (2d Cir. 1992) (identifying "fairness to creditors" as the sole aim of substantive consolidation); *Kheel*, 369 F.2d at 847 (holding that it should be the "rare case" where substantive consolidation is granted); *In re World Access, Inc.*, 301 B.R. 217, 222 (Bankr. N.D. Ill. 2003). Thus, although "the term [consolidation] has a disarmingly innocent sound, ... [it] is no mere instrument of procedural convenience . . . but a measure vitally affecting substantive rights" in equity. *In re Flora Mir Candy Corp.*, 432 F.2d 1060, 1062 (2d Cir. 1970). *See* also *Walter Business Int'l. LLC v. Kiss Packaging Systems, Inc.*, 2003 WL 21439844 (N.D. Ill. June 20, 2003). Because economic consolidation invariably redistributes resources and obligations among debtors and creditors, courts should order substantive consolidation only as a last resort, and only after considering other, more precise, remedies. *In re Owens Corning*, 419 F.3d at 211. Furthermore, because the rules for substantive consolidation are not statutorily provided, courts must examine the facts and circumstances of each case to determine if such an

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[8] Substantive consolidation should not be confused with procedural consolidation. Procedural consolidation, which Courts often refer to as joint administration, merely involves combining estates for administrative matters in the bankruptcy proceeding so as to reduce costs. *See, e.g., In re Amdura Corp.*, 121 B.R. 862, 868 (Bankr. D.Colo. 1990); *In re Hemingway Transport, Inc.*, 954 F.2d 1, 11–12 (1st Cir. 1992).

[9] The power to consolidate is derived from the general equitable powers set forth in section 105 of the Bankruptcy Code, which provides that, "the court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). *See also In re Reider*, 31 F.3d at 1105–06 (discussing the history and genesis of the doctrine). Note, however, that one court has stated that "there is clear statutory authority in the Bankruptcy Code for substantive consolidation in Chapter 11 cases" and that this statutory authority is found in 11 U.S.C. § 1123(a)(5)(C). *See In re Stone & Webster, Inc.*, 286 B.R. 532, 540–41 (Bankr. D. Del. 2002). This case is distinguishable from those which rely upon 11 U.S.C. § 105(a) because the court in this case had before it the question of whether a Chapter 11 plan could provide for substantive consolidation and did not actually reach the question of whether the facts existing in that case warranted substantive consolidation. *Id.* at 542.

order is warranted. *See* 5 COLLIER ON BANKRUPTCY 1100.06[1] (15th rev. ed. 2005) (stating that substantive consolidation cases are to a great degree *sui generis*).

Substantive consolidation was accomplished in early cases by "piercing the corporate veil" of the debtor, *i.e.*, by finding that the entity with which consolidation was sought was the "alter-ego" or an "instrumentality" of the debtor which was used by the debtor to hinder, delay or otherwise defraud creditors. *See, e.g., Maule Industries, Inc. v. Gerstel,* 232 F.2d 294 (5th Cir. 1956); *Fish v. East,* 114 F.2d 177 (10th Cir. 1940). Although later cases relaxed the requirement of fraud in favor of the two-part test described below, courts will still pierce the corporate veil to effect a substantive consolidation if fraud or similar activity is present. *See, e.g., In re New Center Hospital,* 187 B.R. at 567–68. *See also In re Daily,* 107 B.R. 996 (Bankr. D. Hawaii 1989) *rev'd on other grounds,* 940 F.2d 1306 (9th Cir. 1991); *In re Stop & Go of America, Inc.,* 49 B.R. 743 (Bankr. D. Mass. 1985); *In re Tureaud,* 45 B.R. 658 (Bankr. N.D. Okla. 1985), *aff'd,* 59 B.R. 973 (N.D. Okla. 1986).

Although in early substantive consolidation cases courts looked to state corporate "piercing" law for guidance,[10] modern courts have increasingly looked to a growing body of opinions decided under federal bankruptcy law. *See, e.g., Eastgroup Properties v. Southern Motel Assoc., Ltd.,* 935 F.2d 245 (11th Cir. 1991); *In re Augie/Restivo Baking Co.,* 860 F.2d 515 (2d Cir. 1988); *In re Auto-Train Corp., Inc.,* 810 F.2d 270 (D.C. Cir. 1987); *Continental Vending,* 517 F.2d at 1001; *In re Flora Mir Candy Corp.,* 432 F.2d 1060 (2d Cir. 1970); *Soviero v. Franklin National Bank,* 328 F.2d 446 (2d Cir. 1964); *Stone v. Eacho,* 127 F.2d 284 (4th Cir. 1942); *but see In Re Moran Pipe & Supply Co.,* 130 B.R. 588 (Bankr. E.D. Okla. 1991) (invoking substantive consolidation based on alter-ego theory); *In re Doctors Hospital of Hyde Park,* 360 B.R. 787, 849–853 (Bankr. N.D. Ill. 2007) (considering under Illinois corporate law, in the context of a series of securitized transactions, whether to treat certain payments to non-

[10] If a bankruptcy court in a case involving CEHE looked to state "piercing" law for guidance, it is not entirely clear which state's law would apply. The traditional choice-of-law rule for matters of corporate governance, including the extent of shareholder liability for corporate obligations, has been application of the laws of the state of incorporation. *See* Blumberg, The Law of Corporate Groups: Tort, Contract, and Other Common Law Problems in the Substantive Law of Parent and Subsidiary Corporations §26.02 (1987). This choice-of-law rule has often been disregarded, however, where another state bears a more significant relationship to the question, as may occur when the corporation has little contact with its state of incorporation other than the fact of incorporation. *Id.* at §26.03. *See, e.g., Secon Service System, Inc.* v. *St. Joseph Bank & Trust Co.,* 855 F.2d 406, 412 (7th Cir. 1988) (court applied "most significant contacts" approach in veil-piercing action to determine applicable state law). Under both the laws of Delaware (under whose law the Issuer is organized) and the laws of Texas (under whose law CEHE is incorporated and where both CEHE and the Issuer maintain their chief executive offices), courts have refused to pierce the corporate veil absent a showing that the entity to be consolidated was a mere alter ego of the other corporation and that maintaining their corporate separateness would allow such other corporation to perpetrate a fraud or something in the nature of a fraud. *See Mobil Oil Corp. v. Linear Films, Inc.,* 718 F. Supp. 260, 267 (D. Del. 1989); *Menetti v. Chavers,* 974 S.W.2d 168, 172–74 (Tex. App. 1998). Numerous precautions have been taken to make clear that the Issuer is a separate entity from CEHE, and nothing has come to our attention which would indicate that maintaining separateness would result in a fraud. Consequently, we do not think it likely that a court would pierce the corporate veil to consolidate the assets and liabilities of CEHE and the Issuer.

debtor trusts as interests of the Debtor). Consequently, modern federal courts almost uniformly rely on federal precedent rather than state corporate law doctrine when ruling on substantive consolidation proceedings.

Such courts have, in making the determination of whether substantive consolidation would be appropriate in a given case, reviewed a number of factors which appear to fall within two similar but not identical tests for whether substantive consolidation should be ordered. *See, In re Standard Brands Paint Co.*, 154 B.R. 563, 568 (Bankr. C.D. Cal. 1993) (discussing the D.C. Circuit test and the Second Circuit test for substantive consolidation). Both tests, however, focus on two areas of inquiry. First, they have evaluated the internal relationships of the affiliated entities to determine whether "there is substantial identity between the entities to be consolidated." *EastGroup Properties,* 935 F.2d at 250. Second, they have evaluated whether "consolidation is necessary to avoid some harm or realize some benefit" with respect to the creditors of the entities to be consolidated. *Id.* This second factor relates to whether "creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit." *In re Augie/Restivo*, 860 F.2d at 518. *See also In re Adelphia Comm'ns Corp.*, 361 B.R. 337, 359 (S.D.N.Y. 2007) (addressing recently the issue of substantive consolidation in reference to these two "critical factors"); *In re 599 Consumer Electronics, Inc.*, 195 B.R. 244, (S.D.N.Y. 1996) (noting that, "[c]onceivably, substantive consolidation could be warranted on either ground; the . . . use of the conjunction "or" suggests that the two cited factors are alternatively sufficient criteria.").

1. Substantial Identity.

With regard to the pre-bankruptcy interrelationship between the parties, many federal courts have articulated an objective list of factors to be applied in substantive consolidation cases. The court in *Vecco Construction*, 4 B.R. at 410, set forth seven factors for determining whether consolidation is appropriate:

1. The commingling of assets and business functions.
2. The degree of difficulty in segregating and ascertaining individual assets and liabilities.
3. The existence of parent and intercorporate guarantees on loans.
4. The transfer of assets without observance of corporate formalities.
5. The presence or absence of consolidated financial statements.
6. The unity of interests and ownership between the various corporate entities.
7. The profitability of consolidation at a single physical location.

Accord, In re Optical, 221 B.R. 909, 913 (Bankr. M.D. Fla. 1998); *White v. Creditors Serv. Corp. (In re Creditors Serv. Corp.),* 195 B.R. 680, 689 (Bankr. S.D. Ohio). *See also Fish v. East,* 114 F.2d 177, 191 (10th Cir. 1940) (setting forth a list of ten substantially similar factors).

We stress, however, that the factors set forth in *Vecco Construction,* along with additional factors formulated in other cases, are merely "examples of information that may be useful to courts charged with deciding whether there is a substantial identity between the entities to be consolidated and whether consolidation is necessary to avoid some harm or realize some benefit." *EastGroup Properties*, 935 F.2d at 249. *See also In re Creditors Serv. Corp.*, 195 B.R. at 690 (stating that the factors "standing alone, are not dispositive of the issue to consolidate"). Therefore, although a "proponent of consolidation may want to frame his argument using the seven factors outlined in *In re Vecco Construction Industries, Inc.*," the existence or absence of any number of those factors is not necessarily determinative. *EastGroup Properties*, 935 F.2d at 249. *See also, In re Creditors Serv. Corp.*, 195 B.R. at 690 (observing that the factors "merely provide the framework" for the court's inquiry). S*ee also Owens Corning*, 419 F.3d at 210–11 (lamenting the "rote following of a form containing factors where courts tally up and spit out a score without an eye on the principles that give the rationale for substantive consolidation").

On the basis of the facts and assumptions set forth herein, we believe that at least three of the seven factors listed in *Vecco Construction* - 1, 2 and 4 - have little or no applicability here and factors 3, 5, 6 and 7, although present here to a certain degree, when properly analyzed would not lead a court to substantively consolidate the Issuer with CEHE.

With regard to the first factor, there will be no commingling of the assets or business functions of the Issuer with any members of the CEHE Affiliated Group, except that Collections will be commingled with funds, that do not constitute Collections, that CEHE, acting in its capacity as collection agent under the Intercreditor Agreement collects as described in paragraph C.8. of Section II above. Based on the statutory framework of PURA and the fact that the Servicer will at all times account for Collections separately from the funds with which they may be commingled, we do not believe that such commingling of assets rises to the level that concerned the court in *Vecco Construction.* With respect to the commingling of business functions, the Issuer will have a primary business function (*i.e.,* the financing of the System Restoration Property and activities incidental thereto) which is different from the primary business function of CEHE.[11]

[11] In contrast, the WorldCom, Inc. enterprise was comprised of over 400 legal entities. Nevertheless, WorldCom structured its operations along functional lines rather than on entity lines and employed a complex accounting system that does not specifically account for legal entities but instead is based upon company codes. In *In re WorldCom, Inc.*, the Court noted that WorldCom used "more than 1,100 company codes notwithstanding that there are only approximately 400 legal entities." *In re WorldCom, Inc., et al.*, 2003 WL 23861928, *10 (Bankr. S.D.N.Y. October 31, 2003) (unpublished opinion). WorldCom did not track ownership of assets owned by each separate legal entity and was unable to create accurate financial statements for each legal entity. The court concluded that substantive consolidation was necessary because both prongs of the *Augie/Restivo* case were satisfied due to the high cost of disentangling the assets and because many of the creditors dealt with the debtors as a single economic unit. *Id.* at *11–16. Note, however, that this is not a case where a special purpose entity was consolidated, but instead multiple entities that comprised the WorldCom enterprise.

With regard to the second factor, it should not be difficult, at any time, to ascertain the individual assets and liabilities of the Issuer and to segregate such assets and liabilities from those of CEHE. The Issuer's and CEHE's respective accounting records (including all records maintained by CEHE as Servicer) will identify the System Restoration Property as property of the Issuer consistently with generally accepted accounting principles. The consolidated financial statements of CEHE will contain footnotes which describe such ownership and the separate existence of the Issuer. Furthermore, the Issuer's financial statements will, to the extent that System Restoration Property is recognized as an asset under generally accepted accounting principles, treat the System Restoration Property and collections thereon as assets owned by the Issuer.

With regard to the third factor, there will be no parent or intercorporate guarantees on any loans made to or by the Issuer. We note that CEHE has granted certain indemnities in the Relevant Documents in its capacity as Servicer which relate to its duties as Servicer. We also note that, pursuant to the Sale Agreement, CEHE has given certain indemnities to the Issuer which may be enforced by the Trustee as assignee of the Issuer. We also note that, as described above, the REPs will have obligations under the Tariffs to remit Collections to the Servicer on a timely basis regardless of actual collections, and will only be able to recover uncollectible amounts on an annual basis as described in the Tariffs. REPs may also be required by the Financing Order to provide a deposit, letter of credit, affiliate guaranty or surety bond in support of its obligations as REP. None of these guaranties and indemnities, however, rises to the level of an unconditional guarantee by CEHE of amounts, if any, owed by the Issuer to the System Restoration Bondholders.

With regard to the fourth factor, we note that there will be no commingling of assets between the Issuer and any members of the CEHE Affiliated Group except as described above. Moreover, there will be no transfers of assets from CEHE to the Issuer or from the Issuer to CEHE except for (a) transfers pursuant to the Sale Agreement, (b) payments of cash thereunder and payments of cash under the other Relevant Documents, all of which will be properly evidenced in CEHE's and the Issuer's accounting records, as applicable, and (c) capital contributions to the Issuer and/or returns on or distributions of capital from the Issuer to CEHE which will be properly evidenced in CEHE's and the Issuer's corporate and accounting records and which will otherwise comply with all necessary corporate and limited liability company formalities with respect thereto.[12]

With regard to the fifth factor, we believe that the court in *Vecco Construction* was concerned that the presence of consolidated financial statements would make it impossible for those creditors who read such statements to ascertain which assets were owned by which corporation within the consolidated group. We note that the requirement that a parent

[12] *Alexander v. Compton (In re Bonham)*, 229 F.3d 750 (9th Cir. 2000) highlighted the significance of these elements.

corporation prepare consolidated financial statements to include its majority-owned subsidiaries did not exist when *Vecco Construction* was decided. As noted above, the consolidated financial statements that will be prepared for CEHE will note that the Issuer is a separate entity, and that the System Restoration Property was created in favor of the Issuer when CEHE transferred the right to impose and collect the System Restoration Charges to the Issuer pursuant to the Sale Agreement.

We also believe that the sixth factor identified in *Vecco Construction* should not result in consolidation. While CEHE will be the sole member of the Issuer, courts have recognized a distinction between the ownership of a subsidiary's stock and of its assets. *See In re Beck Indus. Inc.*, 479 F.2d 410, 415 (2d Cir. 1973), *cert. denied*, 414 U.S. 858 (1973); *Danjaq, S.A.* v. *MGM/UA Communications, Co.*, 773 F. Supp. 194, 198 (C.D. Cal. 1991). We know of no reason why such principle would not be equally applicable to ownership of a limited liability company. The Issuer's Management Committee (which must include at least one Independent Manager), rather than CEHE's Board of Directors, will be charged with managing the Issuer's affairs and neither CEHE nor the other members of the CEHE Affiliated Group have management discretion over the Issuer's affairs.

The seventh factor identified in *Vecco Construction* should also not result in consolidation. The principal office of the Issuer will be located in Houston, Texas, where CEHE's principal offices are located. It could therefore be argued that Houston, Texas provides a "single physical location" at which CEHE could be profitably consolidated with the Issuer, at least with respect to the servicing, collection and enforcement of the System Restoration Property. We note, however, that the presence of even several of the *Vecco Construction* factors does not require consolidation. *See Eastgroup Properties*, 935 F.2d at 250; *In re Creditors Serv. Corp.*, 195 B.R. at 690; *In re Donut Queen Ltd.*, 41 B.R. 706, 709–710 (Bankr. E.D.N.Y. 1984); *In re Snider Bros. Inc.*, 18 Bankr. 230, 234 (Bankr. D. Mass. 1982). Accordingly, even if a court were to conclude that CEHE could be profitably consolidated with the Issuer at a single physical location, we would not expect a court to order consolidation based on this factor, after properly analyzing the intercompany relationships between CEHE and the Issuer within the framework of the other *Vecco* factors.

8. Benefit or Harm to Creditors.

The cases suggest that, in considering whether to impose substantive consolidation, a court should investigate the potential harm or benefit to creditors. The Second Circuit stressed this investigation when it stated that the "sole purpose of substantive consolidation is to ensure the equitable treatment of all creditors" and that the *Vecco Construction* factors are "merely variants on two critical factors: (i) whether creditors dealt with the entities as a single economic unit and 'did not rely on their separate identity in extending credit,' . . . or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors." *In re Augie/Restivo Baking Co. Ltd.*, 860 F.2d at 518–519. *See, e.g., In re 599 Consumer Electronics, Inc.*, 195 B.R. at 248; *In re Adelphia Comm'ns. Corp.*, 361 B.R. at 359. Where creditors rely on the separate

existence of corporate entities in extending credit, or would suffer more than minimal harm from disregarding such separate existence, the balance of equities weighs against substantive consolidation. *In re Donut Queen. Ltd.*, 41 B.R. at 710. The Eleventh Circuit, like the Second Circuit, has stressed creditor reliance and prejudice as the key factors in any consolidation analysis: if a party opposing substantive consolidation establishes that "(1) it has relied on the separate credit of one of the entities to be consolidated; and (2) it will be prejudiced by substantive consolidation," then substantive consolidation may be ordered only if the "demonstrated benefits of consolidation 'heavily' outweigh the harm." *Eastgroup Properties*, 935 F.2d at 249 (internal citations omitted) (citing *In re Auto-train*, 810 F.2d at 276). *See, e.g., In re Drexel Burnham Lambert Group Inc.*, 138 B.R. 723, 765 (Bankr. S.D. N.Y. 1992). *But see Owens Corning*, 419 F.3d at 210 (stating that the *Auto-Train* standard permits substantive consolidation to be considered at a "threshold not sufficiently egregious and too imprecise for easy measure").

The United States Court of Appeals for the Third Circuit has both criticized and expanded upon the *In re Auto-train* standard. Like the Second and Eleventh Circuits, the Third Circuit (which includes the Delaware federal courts) has offered a two-part inquiry that stresses creditor reliance: "In our Court what must be proven (absent consent) concerning the entities for whom substantive consolidation is sought is that (1) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors." *In re Owens Corning*, 419 F.3d 195, 211 (3d Cir. 2005). While the *Owens Corning* decision reaffirms and the basic framework, it also criticizes the traditional threshold of prejudice. *Id.* at 210 (stating that the *Auto-Train* standard permits substantive consolidation to be considered at a "threshold not sufficiently egregious and too imprecise for easy measure"). The *Owens Corning* test ultimately simplifies the *Augie/Restivo* test to a disregard and reliance test, and disfavors *Auto-train*'s lower threshold of prejudice. We believe that under *Owens Corning*, a motion for substantive consolidation of the parties, and their assets and liabilities, described in this opinion would receive the same treatment as outlined elsewhere in this letter.

Here the Issuer and the Trustee are entering into the Sale Agreement and the Indenture, respectively, and the underwriters are purchasing and marketing the System Restoration Bonds, in reliance on the System Restoration Property and in reliance on the Issuer's identity as a legal entity separate from CEHE.[13] One element of such reliance is their expectation that the System Restoration Property is not subject to the claims of creditors of CEHE or the other members of the CEHE Affiliated Group. Thus, the Issuer, the Trustee and the System Restoration Bondholders would be seriously prejudiced if consolidation were ordered. We assume that the

[13] Rejecting an argument to consolidate, the court in Doctors Hospitals specifically noted the parties reliance on the legal separateness of the entities at issue, that the parties had obtained a legal opinion regarding the risk of consolidation, and that they relied on unambiguous transaction documents. *In re Doctors Hospital of Hyde Park*, 360 B.R. at 847–49.

Issuer or the Trustee or the System Restoration Bondholders and their assigns or another party in interest would oppose any motion or proceeding to consolidate the Issuer with CEHE. Courts have relied upon the existence of such prejudice as grounds for denying substantive consolidation. *See, e.g. In re Flora Mir Candy Corp.*, 432 F.2d 1060, 1062–63 (2d Cir. 1970); *See, also, Anaconda Building Materials Co.* v. *Newland*, 336 F.2d 625, 628 (9th Cir. 1964).[14]

As noted above, a court would also consider the resulting harm to CEHE's creditors if consolidation were not ordered. As previously described, CEHE's consolidated financial statements will contain a footnote stating that the Issuer has both a separate existence and separate creditors. Creditors of CEHE, therefore, should not be able to claim reasonably that they had assumed the Issuer was merely a division of CEHE. Furthermore, none of CEHE's creditors should suffer any harm as a result of a court refusing to consolidate the Issuer with CEHE assuming, as we do, that CEHE has received fair value for causing the System Restoration Property to be granted to the Issuer.

Some courts have considered whether substantive consolidation increases the likelihood of the debtor's rehabilitation and reorganization. Factors considered include the potential savings in cost and time, the elimination of duplicate claims and whether there is a question of who among the debtors is liable. *See Continental Vending*, 517 F.2d at 1001.[15] Eliminating the need to disentangle assets, however, does not, without more, justify consolidation. "Substantive consolidation should be used only after it has been determined that all creditors will benefit because untangling is either impossible or so costly as to consume the assets." *Augie/Restivo*, 860 F.2d at 519; *see also Owens Corning*, 419 F.3d at 211 (reaffirming that substantive

[14] Conversely, courts have also noted the absence of objecting parties as a factor favoring consolidation. *See, e.g., In re Standard Brands Paint Co.*, 154 B.R. 563, 571–572 (Bankr. C.D. Cal. 1993) (court inferred lack of harm to creditors from the fact that no party in interest objected to consolidation); *In re Buckhead America Corp. et al.*, Case Nos. 92-978 through 92-986 (Bankr. D. Del. Aug. 13, 1992) (order granting substantive consolidation of a special purpose subsidiary with its parent after all objections from the subsidiary's creditors had been resolved through settlement); *In re Drexel Burnham Lambert Group*, 138 B.R. 723, 766 (Bankr. S.D.N.Y. 1992) (citing lack of objections from creditors in approving a plan of reorganization premised on substantive consolidation); *In re Frontier Airlines, Inc.*, 93 B.R. 1014, 1016 (Bankr. D. Colo. 1988) (granting substantive consolidation where "complete financial separation of the entities would be difficult to accomplish" and "[n]o party in interest" had objected). Accordingly, we express no opinion as to whether a bankruptcy court would order consolidation should no party in interest object to consolidation.

[15] *See also In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 723, 766 (Bankr. S.D.N.Y. 1992) (approving a plan of reorganization premised on substantive consolidation where no creditors had objected and where establishing to whom actual liability, if any, should be allocated would be a "herculean task, consuming years of costly professional services, thereby draining significant amounts of value from the Debtors' estates"); *In re James River Coal Co.*, 360 B.R. 139, 172–73 (Bkrtcy. E.D. Va. 2007) (stating that the already confirmed substantive consolidation saved creditors great amounts of time and money, and that directors who failed to object at confirmation could not later rely on the separate legal existence of the consolidated entitites); *but see In re Ark-La-Tex Timber Co., Inc.*, 482 F.3d 319, 327 n.7 (5th Cir. 2007) (holding that, contrary to the parties interpretation of a prior order, substantive consolidation "would have been impossible to effect" under the facts of the case, because neither of the target-affiliates were themselves debtors, notwithstanding their contributions to the bankruptcy estate).

consolidation is a remedy "of last resort," and not a means to simply "make postpetition accounting more convenient"); *In re Reserve Capital Corp.*, 2007 WL 880600, *5 (Bankr. N.D.N.Y. Mar. 21, 2007) (unpublished opinion) (applying Owens Corning for the same, denying substantive consolidation in part because the untangling of affairs "was not impossible"). Based on the facts and assumptions set forth herein, the assets and business functions of the Issuer will not be so entangled with those of CEHE as to make separate identification of each one's assets and liabilities impossible or prohibitively costly.

9. Conclusion

Based on the foregoing facts, and subject to the assumptions, qualifications and discussions contained herein and the reasoned analysis of analogous case law (although there is no precedent directly on point), it is our opinion that a United States Court sitting in bankruptcy, in the event of a case under the Bankruptcy Code involving CEHE as debtor (whether or not the Issuer is a debtor in a case under the Bankruptcy Code at the same time), would not disregard the separate limited liability company existence of the Issuer so as to consolidate the Issuer's assets and liabilities with those of CEHE. Our opinion is subject to the further qualifications that (i) the assumptions set forth herein have been, are and will continue to be true in all material respects, (ii) there are no additional facts that would materially affect the validity of the assumptions and conclusions set forth herein or upon which this opinion is based (and, to our knowledge and based on the Factual Certificates provided to us by CEHE and Issuer, there are no such additional material facts), (iii) such case is properly presented and argued and (iv) the law is properly applied.

B. Property of CEHE's Estate.

Sections 541(a)(1) and (a)(6) of the Bankruptcy Code provides that the property of a bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." Although federal law governs the extent to which a debtor's interest in property is part of that debtor's estate, *see, e.g., In re Crysen/Montenay Energy Co.*, 902 F.2d 1098, 1101 (2d Cir. 1990), "[p]roperty interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Butner v. United States*, 440 U.S. 48, 55 (1979). *Accord Barnhill v. Johnson*, 503 U.S. 393, 398 (1992) ("in the absence of any controlling federal law, 'property' and 'interests in property' are creatures of state law."); *Nobleman v. American Sav. Bank*, 508 U.S. 329 (1993 (same). Relying on *Butner*, the United States Court of Appeals for the Ninth Circuit has explained:

> Although section 541(a)(1) is broadly worded, it does not define the terms "property" or "interest in property."... Since the Bankruptcy Code itself does not determine the existence and scope

> of a debtor's interest in property, these threshold issues are properly resolved by reference to state law.

In re Harrell, 73 F.3d 218, 219 (9th Cir. 1996). *Accord In re Jason Realty, L.P.*, 59 F.3d 423, 427–30 (3d Cir. 1995); *In re Howard's Appliance Corp.*, 874 F.2d 88, 93 (2d Cir. 1989) (citing cases).

1. Debtor's Rights in Property — Bankruptcy Law and State Law

As discussed above, bankruptcy courts look to state law to determine the existence and scope of a debtor's rights in property. According to our opinion delivered concurrently with this opinion, Texas state law clearly provides that the System Restoration Property belongs to the Issuer and not to CEHE and that such property constitutes a present property right for purposes of contracts concerning the sale or pledge of property. PURA § 39.304. Accordingly, a bankruptcy court properly applying PURA to the transactions contemplated by the Financing Order (the "Transactions") would conclude that the System Restoration Property is property of the Issuer and that any proceeds of that property shall be held in trust for the Issuer. PURA § 39.309(e). 3

However, state property rights must be enforced in a manner consistent with federal bankruptcy policy. Where state property law expressly contravenes federal bankruptcy priorities, the provisions of the Bankruptcy Code preempt state law pursuant to the Supremacy Clause (Article VI) of the United States Constitution. For example, in *In re County of Orange*, 191 B.R. 1005 (Bankr. C.D. Cal. 1996), the court held that a California statute was invalid to the extent that it conflicted with federal bankruptcy law. Orange County sued Merrill Lynch for the return of marketable securities that the County had delivered to Merrill Lynch pursuant to various securities repurchase agreements. Merrill Lynch argued that the securities in dispute were purchased with funds which, pursuant to Section 27100.1 of the California Government Code,[16] were held in trust by the County and therefore were not the County's property. Merrill Lynch further argued that the trust which was impressed upon the non-county funds survived, notwithstanding that the trust funds had been commingled with County funds to such an extent that no tracing of the trust funds was possible.[17]

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[16] Section 27100.1 of the California Government Code provides: "when any public entity. . . who is required by law to deposit funds into the county treasury, makes a deposit, those funds shall be deemed to be held in trust by the county treasury on behalf of the depositing entity. . .the relationship of the depositing entity. . .and the county shall not be one of creditor-debtor."

[17] We note there have been attempts to federalize the question of whether a pre-bankruptcy sale should be recharacterized as a secured loan. See, e.g., S. 2798, 107th Cong. (2002); and H.R. 5221, 107th Cong. (2002). This type of legislation would attempt to override state statutes by authorizing federal bankruptcy judges to recharacterize a transaction as a secured loan, notwithstanding the state-law characterization. Thus far, no such federal recharacterization legislation of this type has become law. *See, generally*, Steven L. Schwarcz, "Securitization Post-Enron," 25 CARDOZO L. REV. 1539, 1539–43 (2004). We would note, however, that the power to recharacterize a transaction at the federal level has been legislated in other arenas. *See* 7 U.S.C. §499e(a) (1999) (part of the

It is a general rule of federal bankruptcy law that a creditor beneficiary of an insolvent trustee/debtor who is seeking to exclude funds from the trustee/debtor's estate under theories of state trust law must be able to trace its funds "or otherwise the funds become property of the debtor" and the beneficiary becomes a general unsecured creditor. *In re County of Orange*, 191 B.R. at 1015. *See also In re Hedged-Investments Assocs., Inc.*, 48 F.3d 470, 474 (10th Cir. 1995); *First Federal of Michigan v. Barrow*, 878 F.2d 912, 915 (6th Cir. 1989); *In re Bullion Reserve of North America*, 836 F.2d 1214, 1218 (9th Cir.), *cert. denied*, 486 U.S. 1056 (1988); *Elliot v. Bumb*, 356 F.2d 749, 754–55 (9th Cir. 1966).[18] The requirement that a creditor must sufficiently trace its funds in a debtor's estate furthers the federal policy of equal distribution among similarly situated creditors. *In re County of Orange*, 191 B.R. at 1016. After concluding that Section 27100.1 created a trust in favor of the entities that deposited funds with Orange County, the court, applying this general principle of federal bankruptcy law, held that to the extent Section 27100.1 "was intended to eliminate tracing when a debtor trustee is insolvent, it conflicts with federal bankruptcy law" and was therefore preempted.[19] *Id.; see also In re Unicorn Computer Corp.*, 13 F.3d 321, 325 n.6 (9th Cir. 1994) (state law establishing constructive trusts can be applied in bankruptcy only "in a manner not inconsistent with the federal bankruptcy law."); *Lone Star Milk Producers, Inc. v. Litzler*, 370 B.R. 671, 677–78 (Bankr. N.D. Tex. 2007) (holding that "a state may create a statute that imposes a trust excluding property from a bankruptcy estate as long as the statute also has valid non-bankruptcy applications and the trust attaches prior to the petition date"). In each case the state laws which attempted to eliminate any ordinary tracing requirement that typically applies to constructive trusts, ran afoul of the strong bankruptcy policy against state-created priorities that are designed to protect a particular class of creditors in bankruptcy without compliance with the requirements of the Bankruptcy Code and thus were inconsistent with the federal bankruptcy law. *See Elliot v. Bumb*, 356 F.2d at 754; *but see Lone Star Milk Producers, Inc.*, 370 B.R. at 678–80 (holding that

Perishable Agricultural Commodities Act "PACA", which mandates that proceeds from perishable commodities shall be held in trust for the benefit of all unpaid suppliers or sellers, giving an unsecured bona fide purchaser's claim priority over the claim of a secured lender); and *Reaves Brokerage Co. Inc. v. Sunbelt Fruit & Vegetable Co. Inc.*, 336 F.3d 410 (5th Cir. 2003) (even though the documentation treated the transaction as a sale, the Fifth Circuit concluded that, at least in the context of a PACA claim, the factoring agreement evidenced a secured loan rather than a sale. The court did not acknowledge a statute in the applicable state that characterized the transaction as a sale in its opinion).

[18] In 1994, Congress enacted Section 541(b)(5) of the Bankruptcy Code, which provides that cash proceeds of money order sales are not property of the estate of a money order seller, notwithstanding commingling with the seller's other assets, subject to certain conditions. Money order note issuers are normally protected by trusts created under state law. That Congress adopted a special provision of the Code to protect note issuers of money orders when insolvent sellers commingle money order proceeds confirms that, in general, the Bankruptcy Code does not protect the state law rights of trust beneficiaries when trust funds are commingled.

[19] It is not obvious that Section 27100.1 conflicts with federal bankruptcy law. Section 27100.1 on its face does not address the commingling of funds; it merely establishes a trust. The court could have simply conceded the existence of a trust and then applied traditional federal bankruptcy principles regarding the commingling of trust and non-trust funds by an insolvent trustee. The court did not address this issue.

chapter 181 of the Texas Agriculture Code created an express trust, and that although tracing was not required under the statute, the statute was valid and enforceable in a bankruptcy proceeding). Indeed, even a federal law that attempts to impose a trust by statute may be effective in bankruptcy only if the *res* that is the subject of the trust can be identified. *See, e.g., Begier v. United States*, 496 U.S. 53 (1991).

We note that PURA provides that the sale of the System Restoration Property is a true sale "regardless of . . . the fact that the electric utility acts as the collector of transition charges relating to the transition property." PURA § 39.308. PURA further provides a method of perfecting a security interest in the System Restoration Property, and states that such a security interest "is not impaired . . . by the commingling of funds arising from transition charges with other funds. . . If transition property has been transferred to an assignee, any proceeds of that property shall be held in trust for the assignee." PURA § 39.309(e). In light of the foregoing cases, however, we express no opinion as to whether a bankruptcy court would enforce these provisions of PURA in a CEHE bankruptcy proceeding to the extent such enforcement would exempt the Issuer or its assigns from the tracing requirements of federal bankruptcy law with respect to Collections that are in the possession of the Servicer, the collection agent or any member of the CEHE Affiliated Group. We note, however, that, were CEHE to default in its obligations under the Servicing Agreement due to any such inability to trace funds, then, under Section 365(b)(i) of the Bankruptcy Code, CEHE's right to assume the Servicing Agreement and therefore its right to continue receiving and remitting Collections would be subject to CEHE doing the following: (i) curing, or providing adequate assurance that it would promptly cure, such default; (ii) compensating, or providing adequate assurance that it would promptly compensate, the Issuer or the Trustee, as applicable, for actual pecuniary loss resulting from such default and (iii) providing adequate assurance of future performance under the Servicing Agreement.

Based on *In re County of Orange*, a bankruptcy trustee of CEHE, or CEHE, as debtor in possession, could also assert in a bankruptcy proceeding that PURA invalidly attempts to rewrite bankruptcy priorities by removing property from CEHE's bankruptcy estate (i.e., the System Restoration Property) that would otherwise be available to satisfy the claims of CEHE's general creditors. We do not believe that *In re County of Orange* should be interpreted so broadly. In *California v. Farmer's Markets (In re Farmer's Markets)*, 792 F.2d 1400, 1403 (9th Cir. 1986), the Ninth Circuit was asked to determine whether a California statute which disallowed the transfer of a liquor license until certain state taxes were paid conflicted with the Bankruptcy Code. The court said, in language that could apply with equal force to PURA:

> Section 24049 could arguably be cast as inconsistent with the bankruptcy process because parties claiming under it may fare better in bankruptcy than they would if there were no such statute. Yet this argument confuses the classification of an interest with the displacement of the Code's priority scheme. To classify what might otherwise be a lesser claim as a proprietary interest does not displace the priority provisions. It merely reclassifies an interest within that scheme. In *Artus*

> *v. Alaska Department of Labor, Employment Security Division (In re Anchorage International Inn, Inc.)*, 718 F.2d 1446 (9th Cir. 1983), we concluded that state law does not conflict with federal bankruptcy law merely because it favors one class of creditors over another. *Id.* at 1451. See also J.A. MacLachlan, *Handbook of the Law of Bankruptcy* 145 (1956) ("Priorities are to be distinguished from property rights."). The Code expressly recognizes such preferences in the form of perfected security interests and statutory liens. 11 U.S.C. §§ 506(a), 545 (1982). Although it does preempt state law schemes to circumvent the bankruptcy laws by invalidating liens or priorities triggered by the bankruptcy or insolvency of the debtor, 11 U.S.C. § 545 (1982), § 24049 presents no such problem.

Farmers Markets at 1403. PURA, to use the words of *Farmers Markets*, classifies an interest; it does not purport to displace the Bankruptcy Code's priority scheme.

In addition, the *Orange County* court noted that, according to the legislative history of §27100.1, the express intent of the California legislature in enacting that section was "to make sure that the funds of depositing entities would not be considered property of a bankrupt county." 191 B.R. at 1017. In this regard, the California legislature attempted to create a new statutory barrier which would keep creditors from obtaining the benefit of existing types of property of the debtor. By contrast, the Texas legislature enacted PURA as part of a comprehensive piece of legislation which provides for the deregulation of the Texas electric utility market. *See* 220 ILCS 5/16-101 et seq. As part of that enactment, the Texas legislature created transition property as an entirely new type of property and defined its extent, initial ownership, permissible possession and use, and methods of absolute transfer. The Texas legislature's definition of the contours of a new type of property fundamentally differs from the California legislature's attempted alteration of federal bankruptcy law applicable to existing types of property.

Courts have also found a "federal interest [that] requires a different result" in cases involving leases of real property. In cases involving leases under state statutory schemes for the issuance of industrial revenue bonds, for example, the private enterprise that will benefit from the bonds "leases" property from a governmental entity for a period of years, with an option to purchase the property at the end of the term for nominal consideration. Typically, state law (as well as the bankruptcy courts) would find such a lease not to be a true lease but to be a disguised financing transaction. In the industrial revenue bond context, however, state statutes often provide otherwise. The bankruptcy courts have ruled (although not uniformly) that the lease may be treated in bankruptcy as a secured financing. *See, e.g. City of Olathe v. KAR Dev. Assocs., L.P.* (*In re KAR Dev. Assocs., L.P.*), 180 B.R. 597 (Bankr. D. Kan 1994), aff'd, 180 B.R. 629 (D. Kan. 1995), and cases cited therein.

Thus, there is no clear line as to when a court will conclude that federal bankruptcy policy requires that it override state law to determine whether property is property of the estate under section 541(a)(1) or (a)(6). The Supreme Court established the basic principle that

although property rights in bankruptcy generally are determined in accordance with the relevant state law, this principle gives way when some type of federal interest or policy is defeated by respecting state law. The Supreme Court failed, however, to establish a framework to determine whether a federal policy or interest is involved and how to identify those federal policies that are sufficiently important to justify preemption. Nor does it appear that any other court has successfully done so. The cases seem to rely on a case-by-case approach in which the court must look at the underlying goals of bankruptcy and determine whether respecting state law under the circumstances would circumvent these bankruptcy goals. *But see Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1987) (court may not use general equitable powers to further underlying goals of bankruptcy or reorganization when to do so is contrary to a provision of the Bankruptcy Code.).

On balance, however, and except to the extent it could be construed to eliminate tracing requirements under federal bankruptcy law with respect to Collections that are in the possession of the Servicer, the collection agent or any other member of the CEHE Affiliated Group, we do not believe that PURA conflicts with federal bankruptcy law so as to justify a bankruptcy court's disregard of state law property rights created and intended to be created thereby.

2. Conclusion

Based on the foregoing facts, and subject to the qualifications and discussion contained herein and the reasoned analysis of analogous case law (although there is no precedent directly on point), it is our opinion that, if CEHE were to become a debtor under the Bankruptcy Code, a court would hold that the System Restoration Property (including the revenues and collections thereon) is not property of the estate of CEHE under Sections 541(a)(1) or (a)(6) of the Bankruptcy Code and Section 362(a) of the Bankruptcy Code would not apply to prevent CEHE in its capacity as Servicer from paying Collections to the Issuer and its assigns. We note, however, that Section 362(a)(3) of the Bankruptcy Code operates as a stay upon any acts to obtain possession of "property from the estate" without regard to whether such property belongs to the estate and we therefore express no opinion as to whether Section 362 would stay a party from obtaining possession of Collections or proceeds thereof which are in CEHE's possession and/or control pending a final order of the bankruptcy court authorizing and directing the distribution of such Collections and proceeds to the Issuer or its assignee.

Our opinion is subject to the further qualifications that (i) the assumptions set forth herein are and continue to be true in all material respects, (ii) there are no additional facts that would materially affect the validity of the assumptions and conclusions set forth herein or upon which this opinion is based (and, to our knowledge and based on the Factual Certificates provided to us by CEHE, the Issuer, there are no such additional material facts), (iii) such case is properly presented and argued and (iv) the law is properly applied.

IV. QUALIFICATIONS

We wish to note that the existing reported case law is not conclusive as to the relative weight to be accorded to the factors present in the Transactions and does not provide consistently applied general principles or guidelines with which to analyze all of the factors present in the Transactions. Indeed, we are not aware of any decisions addressing the vesting, creation or transfer of any transition property under PURA. Instead, judicial decisions as to questions of non-consolidation and true sale are usually made on the basis of an analysis of the facts and circumstances of the particular case. Furthermore, there are facts and circumstances in the Transactions which we believe to be relevant to our conclusion but which, because of the particular facts at issue in the reported cases, are not generally discussed in the reported cases as being material factors. Moreover, the authorities we have examined contain certain cases and authorities that are arguably inconsistent with our conclusions expressed herein. These cases and authorities are, however, in our opinion distinguishable in the context of the Transactions.

If CEHE were to become a debtor under the Bankruptcy Code and if it were asserted that the beneficial interest in and legal title to the System Restoration Property were part of CEHE's bankruptcy estate, we express no opinion as to how long the Issuer, the Trustee or any assignee could be precluded from exercising remedies against to CEHE or with respect to the System Restoration Property before the validity of such an assertion could be finally decided. We also express no opinion as to whether, if it were asserted that the beneficial interest in and legal title to any of the System Restoration Property and the collections were part of CEHE's bankruptcy estate, a court would permit such entities to use collections from the System Restoration Property without the consent of the Issuer, the Trustee or any assignee, either before deciding the issue or pending appeal after a decision adverse to the Issuer, the Trustee or any assignee.

We note further that CEHE's rights to service the System Restoration Property and its rights to be paid the servicing compensation under the Servicing Agreement would likely be property of CEHE's bankruptcy estate.

Additionally, we express no opinion as to any System Restoration Property or Collections that are commingled with CEHE's property as of the date of a bankruptcy filing[20], and we note that the court may, on an interim basis, impose a temporary or preliminary stay with respect to the System Restoration Property or the Collections thereon in order to afford itself time to ascertain the facts and apprise itself of the law. *See, e.g., In re Leisure Dynamics,* 33 B.R. 171 (Bankr. D. Minn. 1983) (letter of credit).

We express no opinion herein as to the enforceability, perfection, validity, binding nature, or legality of any transfer, document, or agreement or any bankruptcy case affecting any entity other than CEHE.

[20] See our discussion in Section III.B.1 above.

All of the foregoing analyses and the conclusions set forth herein are premised upon, and limited to, the law and the documents evidencing and governing the transactions described herein in effect as of the date of this letter. Furthermore, we note that a court's decision regarding matters upon which we opine herein will be based on the court's own analysis and interpretation of the factual evidence before the court and of applicable legal principles.

Our opinions are limited to the specific opinions requested in Section I of this letter and are limited in all respects to laws and facts existing on the date of this letter. We express no opinions implicitly herein and we assume no obligation to advise you with respect to any issues not specifically addressed herein. The opinions set forth above are given as of the date hereof and we disavow any undertaking or obligation to advise you of any changes in law or any facts or circumstances that may hereafter occur or come to our attention that could affect such opinions. Furthermore, it is our and your understanding that the foregoing opinions are not intended to be a guaranty as to what a particular court would actually hold, but an opinion as to the decision a court should reach if the issue were properly presented to it and the court followed what we believe to be the applicable legal principles. In that regard, you should be aware that all of the foregoing opinions are subject to inherent limitations because of the pervasive equity powers of bankruptcy courts, the overriding goal of reorganization to which other legal rights and policies may be subordinated, the potential relevance to the exercise of judicial discretion of future-arising facts and circumstances and the nature of the bankruptcy process.

This opinion is solely for your benefit in connection with the Transactions and may not be relied upon or used by, circulated, quoted or referred to, nor may copies hereof be delivered to, any other person without our prior written approval; provided, however, that the parties listed on Schedule I hereto may rely on this opinion as if it were addressed to each of them.

We have assumed throughout this opinion (i) that there has been no (and will not be any) fraud in connection with the transactions described herein, (ii) the accuracy of the representations and warranties set forth in the Relevant Documents as to factual matters and (iii) the transactions contemplated by the Relevant Documents will not be subject to avoidance as a fraudulent transfer under the Bankruptcy Code or other insolvency laws. Our opinion is limited to the Federal laws of the United States of America and the State of Texas.

Very truly yours,

Baker Botts L.L.P.

APPENDIX A

Deutsche Bank Trust Company Americas
Structured Finance Services
Trust & Securities Services
Ref: CenterPoint Energy Restoration Bond Company, LLC
60 Wall Street, 26th Floor
Mail Stop NYC60 2606
New York, NY 10005

Standard and Poor's Ratings Services, a Standard and Poor's Financial Services LLC business
Attention: Asset Backed Surveillance Department
55 Water Street
New York, New York 10041

Moody's Investors Service, Inc.
Attention: ABS Monitoring Department
7 World Trade Center at 250 Greenwich Street
New York, New York 10007

Fitch, Inc.
Attention: ABS Surveillance
1 State Street Plaza
New York, New York 10004

Goldman, Sachs & Co.
85 Broad Street
New York, NY 10004

Citigroup Global Markets Inc.
388 Greenwich Street
New York, NY 10013

Morgan Stanley & Co. Incorporated
1585 Broadway
New York, NY 10036

RBS Securities Inc.
600 Washington Boulevard
Stamford, CT 06901

Loop Capital Markets, LLC
200 W. Jackson Boulevard, Suite 1600
Chicago, IL 60606

EXHIBIT A

FACTUAL CERTIFICATE OF CEHE

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC

Certificate

I, Marc Kilbride, do hereby certify that I am the Vice President and Treasurer of CenterPoint Energy Houston Electric, LLC, a Texas limited liability company ("CEHE"), and that the following statements are true and correct:

1. This certificate is being rendered in connection with:

(i) the establishment and creation of the System Restoration Property pursuant to the Financing Order;

(ii) the sale of the System Restoration Property from CEHE to the Issuer pursuant to the Sale Agreement;

(iii) the agreement to service the System Restoration Property pursuant to the Servicing Agreement; and

(iv) the concurrent issuance of the System Restoration Bonds by the Issuer secured by, among other things, the System Restoration Property and all of the Issuer's rights under the Sale Agreement, pursuant to that certain Indenture, dated as of November 25, 2009, and that certain First Supplemental Indenture dated as of November 25, 2009 (collectively, the "Indenture"), between CenterPoint Energy Restoration Bond Company, LLC, a Delaware limited liability company (the "Issuer"), and Deutsche Bank Trust Company Americas, a New York banking corporation ("Deutsche"), as trustee (in such capacity, the "Trustee").

All capitalized terms used above and below in this Certificate and not otherwise defined shall have the meanings specified in the Indenture unless the context clearly indicates otherwise.

2. The undersigned is familiar with the business of CEHE and the transactions and other factual matters described in the opinion rendered by Baker Botts L.L.P. of even date herewith with respect to (a) the substantive consolidation of the assets and liabilities of the Issuer with those of CEHE in the event of a bankruptcy of CEHE and (b) whether the System Restoration Property would constitute part of a bankruptcy estate of CEHE (the "Opinion"), and has made such investigations and inquiries as may be necessary to enable the undersigned to execute and deliver this Certificate.

3. The undersigned has reviewed the Relevant Documents (as such term is defined in the Opinion) and the Opinion and, with respect to the factual assumptions set forth in Section II of the Opinion, hereby certifies that each such factual assumption relating to CEHE is, to the best of his knowledge after due inquiry, true and correct in all

material respects and does not fail to state a material fact the omission of which makes the statement as it appears incomplete or misleading. The undersigned explicitly disclaims making any certifications as to any legal conclusions contained therein, including, without limitation: (a) the legal effect of the provisions of PURA (as such term is defined in the Opinion) and the Financing Order, (b) the legal effect of each of the Relevant Documents, (c) the legal status of the Financing Order, and (d) the legal effect under federal income or Texas tax laws of CEHE's election under the "check-the-box" regulation.

4. Baker Botts L.L.P. may rely on this Certificate in rendering the Opinion.

IN WITNESS WHEREOF, I have hereunto signed my name this [ ] day of _____, 2009.

Marc Kilbride
Vice President and Treasurer

HOU03:1217713

EXHIBIT B

FACTUAL CERTIFICATE OF THE ISSUER

CENTERPOINT ENERGY RESTORATION BOND COMPANY, LLC

Certificate

I, Marc Kilbride, do hereby certify that I am a Manager of CenterPoint Energy Restoration Bond Company, LLC, a Delaware limited liability company (the "Issuer"), and that the following statements are true and correct:

1. This certificate is being rendered in connection with:

(i) the establishment and creation of the System Restoration Property pursuant to the Financing Order;

(ii) the sale of the System Restoration Property from CEHE to the Issuer pursuant to the Sale Agreement;

(iii) the agreement to service the System Restoration Property pursuant to the Servicing Agreement; and

(iv) the concurrent issuance of the System Restoration Bonds by the Issuer secured by, among other things, the System Restoration Property and all of the Issuer's rights under the Sale Agreement, pursuant to that certain Indenture, dated as of November 25, 2009, and that certain First Supplemental Indenture dated as of November 25, 2009 (collectively, the "Indenture"), between the Issuer and Deutsche Bank Trust Company Americas, a New York banking corporation ("Deutsche"), as trustee (in such capacity, the "Trustee").

All capitalized terms used above and below in this Certificate and not otherwise defined shall have the meanings specified in the Indenture unless the context clearly indicates otherwise.

2. The undersigned is familiar with the business of the Issuer and the transactions and other factual matters described in the opinion rendered by Baker Botts L.L.P. of even date herewith with respect to (a) the substantive consolidation of the assets and liabilities of the Issuer with those of CEHE in the event of a bankruptcy of CEHE and (b) whether the System Restoration Property would constitute part of a bankruptcy estate of CEHE (the "Opinion"), and has made such investigations and inquiries as may be necessary to enable the undersigned to execute and deliver this Certificate.

3. The undersigned has reviewed the Relevant Documents (as such term is defined in the Opinion) and the Opinion and, with respect to the factual assumptions set forth in Section II of the Opinion, hereby certifies that each such factual assumption relating to the Issuer is, to the best of his knowledge after due inquiry, true and correct in all material respects and does not fail to state a material fact the omission of which makes

the statement as it appears incomplete or misleading. The undersigned explicitly disclaims making any certifications as to any legal conclusions contained therein, including, without limitation: (a) the legal effect of the provisions of PURA (as such term is defined in the Opinion) and the Financing Order, (b) compliance with the applicable Delaware law in the formation of the Issuer, (c) the legal effect of each of the Relevant Documents, (d) the legal status of the Financing Order, and (e) the legal effect under federal income or Texas tax laws of CEHE's election under the "check-the-box" regulation.

4. Baker Botts L.L.P. may rely on this Certificate in rendering the Opinion.

IN WITNESS WHEREOF, I have hereunto signed my name this [ ] day of _____, 2009.

_____
Marc Kilbride
Manager

SCHEDULE I

Additional Reliance Parties

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RIYADH
WASHINGTON

January 19, 2012

TO: THE ADDRESSEES ON APPENDIX A

Re: CenterPoint Energy Transition Bond Company IV, LLC Transition Bonds

Ladies and Gentlemen:

We have acted as counsel to CenterPoint Energy Houston Electric, LLC, a limited liability company organized under the laws of the State of Texas ("CEHE"), and CenterPoint Energy Transition Bond Company IV, LLC, a Delaware limited liability company (the "Issuer"), in connection with:

(i) the issuance of the Financing Order (as hereinafter defined);

(ii) the sale of the rights and interests by CEHE to the Issuer under the Financing Order, including the right to impose, collect, and receive transition charges (which rights upon such sale shall become the Transition Property, as hereinafter defined), pursuant to that certain Transition Property Sale Agreement, dated as of January 19, 2012 (the "Sale Agreement"), between CEHE and the Issuer;

(iii) the agreement to service the Transition Property pursuant to that certain Transition Property Servicing Agreement, dated as of January 19, 2012 (the "Servicing Agreement"), between CEHE, as servicer (in such capacity, the "Servicer"), and the Issuer;

(iv) the intercreditor agreement dated as of January 19, 2012 (the "Intercreditor Agreement") among CEHE in various capacities, the Trustee (as hereinafter defined), Deutsche Bank Trust Company Americas, as Initial Transition Bond Trustee, CenterPoint Energy Transition Bond Company, LLC, CenterPoint Energy Transition Bond Company II, LLC, CenterPoint Energy Transition Bond Company III, LLC, CenterPoint Energy Restoration Bond Company, LLC and the Issuer; and

(v) the concurrent issuance of debt securities (the "Transition Bonds") by the Issuer secured by, among other things, the Transition Property and all of the Issuer's rights under the Sale Agreement, pursuant to that certain Indenture, dated as of January

19, 2012 and that certain First Supplemental Indenture dated as of January 19, 2012 (collectively, the "Indenture"), between the Issuer, Deutsche Bank Trust Company Americas, a New York banking corporation ("Deutsche"), as trustee (in such capacity, the "Trustee").

All capitalized terms used herein and not otherwise defined shall have the meaning specified in Appendix A to the Indenture unless the context clearly indicates otherwise.

We have reviewed the following documents and any exhibits thereto for purposes of this opinion (collectively, the "Relevant Documents"):

1. the Sale Agreement and the related Bill of Sale;

2. the Servicing Agreement;

3. the Intercreditor Agreement;

4. the Indenture;

5. the Underwriting Agreement dated as of January 11, 2012 (the "Underwriting Agreement") among CEHE, the Issuer and the underwriters named therein;

6. the Administration Agreement dated as of January 19, 2012 (the "Administration Agreement") between CEHE and the Issuer;

7. the Certificate of Formation of the Issuer, dated as of October 14, 2011, (the "Certificate of Formation"), certified as of a recent date by the Secretary of State of Delaware;

8. the Limited Liability Company Agreement of the Issuer, effective as of October 21, 2011, as amended and restated on January 19, 2012 (the "LLC Agreement");

9. the Application of CEHE to the Public Utility Commission of Texas (the "PUCT") dated October 7, 2011, together with the accompanying exhibits and testimony filed in connection therewith (collectively, the "Application");

10. that certain Financing Order, Docket Number 39809 (the "Financing Order") issued on October 27, 2011, by the PUCT pursuant to its authority under §§ 14.001 and 39.303 of the Public Utility Regulatory Act ("PURA"), TEX. UTIL. CODE §§ 11.001-63.063;

11. that certain Issuance Advice Letter (the "Issuance Advice Letter") filed with the PUCT on January 11, 2012; and

12. the certificates of CEHE and the Issuer attached hereto as Exhibits A and B, respectively (the "Factual Certificates").

I. OPINIONS REQUESTED

You have requested our opinions as to:

(i) whether, in connection with any bankruptcy proceedings instituted by or on behalf of or against CEHE under Title 11 of the United States Code, 11 U.S.C.§§ 101 *et seq.* (the "Bankruptcy Code"), a court would order the substantive consolidation of CEHE with the Issuer, thereby pooling the assets and liabilities of the Issuer with the assets and liabilities of CEHE; and

(ii) whether, (regardless of whether the Issuer is a debtor in a Bankruptcy case) if CEHE were to become a debtor under the Bankruptcy Code, (a) the Transition Property (including the collections thereon (the "Collections")) would be property of the estate of CEHE under Sections 541(a)(1) or (a)(6) of the Bankruptcy Code, and (b) Section 362(a) of the Bankruptcy Code would not apply to prevent CEHE in its capacity as Servicer from paying Collections to the Issuer and its assigns.

II. ASSUMPTIONS

In rendering our opinion, we have made no independent investigation of the facts referred to herein and have relied for the purpose of rendering this opinion exclusively on the Relevant Documents and on facts provided to us by CEHE and the Issuer, as certified in the Factual Certificates, which we assume have been and will continue to be true.

In our examination, we have assumed the legal capacity of all natural persons, the genuineness of all signatures, the authenticity of all documents submitted to us as originals, the conformity to original documents of all documents submitted to us as facsimile, certified or photostatic copies and the authenticity of the originals of such latter documents. In making our examination of such documents, for purposes of this opinion we have assumed that all parties thereto had the requisite power, corporate or other, to enter into and perform all obligations thereunder and have also assumed the due authorization thereof by all requisite action, corporate or other, the execution and delivery by such parties of such documents, the validity and binding effect thereof and that such documents are enforceable against such parties.[1] In addition, we have assumed the validity, effectiveness and finality of PURA and all regulatory actions taken in connection therewith.[2]

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[1] We refer you to our other opinions of even date herewith addressing the above-described issues as they relate to CEHE and the Issuer.

[2] We refer you to our other opinions of even date herewith with respect to the above-described issues.

For purposes of this opinion, we have also assumed the following matters set forth in this Section II.

A. Statutory Background

1. CEHE is a limited liability company engaged in the distribution and sale of electricity to the public in Texas and is a utility within the meaning of Subchapter G and Subchapter I of Chapter 36 of PURA and is an electric utility within the meaning of Section 31.002 of PURA. PURA § 31.002(6). Subchapter G of Chapter 39 of PURA allows Texas electric utilities to seek and obtain a "financing order" from the PUCT in order to recover "transition costs" which, among other things, authorizes the utility: (i) to impose, collect and receive a "transition charge" from retail customers, in connection with their consumption of electricity; (ii) to sell or assign to a third party (including a subsidiary of the utility) the right to receive the "transition charges" and (iii) to cause securities to be issued, the payment of which is supported by the "transition charges." "Transition Charges" means nonbypassable amounts to be charged for the use or availability of electric services, approved by the PUCT in a financing order to recover qualified costs (as defined in the financing order), that shall be collected by a utility, its successors, assignees or other collection agents as provided for in that financing order. As used herein, "Transition Property" means the rights and interests of CEHE or its successor under the Financing Order, once those rights are first transferred to the Issuer or pledged in connection with the issuance of the Transition Bonds, including the irrevocable right to impose, collect and receive Transition Charges authorized by the Financing Order.

2. Pursuant to PURA, CEHE filed its Application and obtained the Financing Order, which authorizes and approves, among other things, (i) CEHE's imposition and collection of Transition Charges; (ii) the assignment of the rights to impose and collect the Transition Charges to the Issuer (and upon such assignment or transfer, the above-mentioned rights will become Transition Property vested in the Issuer under PURA); (iii) the Issuer's issuance of Transition Bonds; (iv) the grant of a lien in favor of the Trustee on the Transition Property and other collateral that constitutes the Trust Estate; and (v) the filing with the PUCT of a transition charge tariff (together with any amendatory tariffs or notice filing tariffs filed with the PUCT in connection therewith, the "Tariffs"). The Financing Order has become effective in accordance with PURA and is in full force and effect as a valid, binding and enforceable decision of the PUCT. The Financing Order has become final and non-appealable in accordance with PURA.[3]

3. Pursuant to and in accordance with PURA, PURA and the Financing Order each provide that upon transfer of CEHE's rights under the Financing Order, legal and equitable title to the Transition Property passes to the Issuer in a true sale for purposes of Texas law, regardless of whether the Issuer has any recourse against the seller, or any other term of the parties' agreement, including CEHE's retention of an equity interest in the Transition Property, the fact

[3] We refer you to our other opinions of even date herewith with respect to the above-described issues.

that CEHE acts as the collector of the Transition Charges relating to the Transition Property, or the treatment of the transfer as a financing for tax, financial reporting, or other purposes. PURA § 39.308; Financing Order Conclusion of Law 35. As further required by PURA § 39.305, the Financing Order provides that the interests of an assignee, the Trustee, and the holders of the Transition Bonds in the Transition Property are not subject to setoff, counterclaim, surcharge, or defense by CEHE or any other person or in connection with the bankruptcy of CEHE or any other entity. Financing Order Conclusion of Law 32[4].

B. Formation and Separateness of the Issuer

1. The Issuer was created on October 14, 2011, as a special-purpose limited liability company organized under the laws of the State of Delaware. CEHE is, and at all times has been, the sole member ("Member") of the Issuer. The Issuer was formed for the sole purpose of purchasing and owning transition property (as defined under PURA), issuing the Transition Bonds, pledging its interest in the Transition Property and other collateral to the Trustee under the Indenture in order to secure the Transition Bonds, and performing activities that are necessary, suitable or convenient to accomplish these purposes. Under the terms of its LLC Agreement, the Issuer's business activities are limited to the immediately above-mentioned activities. The Issuer does not (and will not) have any material assets other than the Transition Property (and collections thereon), any future transition property (as defined under PURA) that may be created in its favor or transferred to it, other collateral, consisting of trust accounts held by the Trustee and other credit enhancements acquired or held to ensure payment of the Transition Bonds, and any money distributed by the Trustee from the Collection Account in accordance with the Indenture. At the closing (the "Closing") of the sale and issuance transactions contemplated by the Relevant Documents, CEHE will contribute to the equity of the Issuer in cash or cash equivalents an amount equal to approximately one-half of one percent of the principal amount of the Transition Bonds.

2. In accordance with the terms of its LLC Agreement, the Issuer will be managed by not fewer than three nor more than five managers (each a "Manager"). The Managers' rights and authority on behalf of the Issuer are similar to those of a board of directors for a corporation. The Issuer must and will at all times beginning immediately prior to the Closing have at least three Managers, one of whom must be an "Independent Manager" as defined in its LLC Agreement, i.e., a Manager who is not, and within the previous five years was not (except solely by virtue of such Person's serving as, or affiliation with any other Person serving as, an independent director or manager, as applicable, of CEHE, the Issuer or any bankruptcy remote special purpose entity that is an Affiliate of CEHE or the Issuer), (i) a stockholder, member, partner, director, officer, employee, Affiliate, customer, supplier, creditor or independent contractor of, or any Person that has received any benefit in any form whatsoever from (other

[4] We refer you to another opinion from us to you, of even date herewith, as to the true sale (under PURA) of the Transition Property by CEHE to the Issuer.

than in such Manager's capacity as a ratepayer or customer of CEHE in the ordinary course of business), or any Person that has provided any service in any form whatsoever to, or any major creditor (or any Affiliate of any major creditor) of, the Issuer, CEHE or any of their Affiliates, or (ii) any Person owning beneficially, directly or indirectly, any outstanding shares of common stock, any limited liability company interests or any partnership interests, as applicable, of the Issuer, CEHE, or any of their Affiliates or of any major creditor (or any Affiliate of any major creditor) of any of the foregoing, or a stockholder, member, partner, director, officer, employee, Affiliate, customer, supplier, creditor or independent contractor of, or any Person that has received any benefit in any form whatever from, (other than in such Person's capacity as a ratepayer or customer of CEHE in the ordinary course of business), or any Person that has provided any service in any form whatever to, such beneficial owner or any of such beneficial owner's Affiliates, or (iii) a member of the immediate family of any person described above; provided that the indirect or beneficial ownership of stock through a mutual fund or similar diversified investment vehicle with respect to which the owner does not have discretion or control over the investments held by such diversified investment vehicle shall not preclude such owner from being an Independent Manager. The Independent Manager will be paid a fee determined by the Managers.

3. The LLC Agreement provides that, without the affirmative vote of all the Managers, including the Independent Manager, the Issuer will not file a voluntary petition for relief under the Bankruptcy Code or similar law or otherwise institute or consent to the institution of insolvency or bankruptcy proceedings with respect to the Issuer or take any company action in furtherance of any such filing or institution of a proceeding. The LLC Agreement further provides that, to the fullest extent permitted by applicable law (including, without limitation, Section 18-1101(c) of the Delaware Limited Liability Company Act) the fiduciary duty of each Manager, including the Independent Manager, in respect of any decision on any matter referred to above shall be owed solely to the Issuer (including its creditors) and not to CEHE as the Issuer's Member nor to any other holders of any equity interest in the Issuer as may exist at such time. The vote of all of the Managers, including the Independent Manager, is also required to amend the LLC Agreement with regard to any matter referred to above.

4. From and after the Closing, the LLC Agreement further prohibits the Issuer, without the prior unanimous written consent of the Managers, including the Independent Manager, from amending certain provisions of the LLC Agreement, including, without limitation, those designed to ensure the bankruptcy remoteness and the limited purpose, of the Issuer. The Issuer will have its own executive officers appointed by the Managers but will not have any employees.

5. The Issuer will at all times (i) ensure that all of its actions are duly authorized by its Managers and officers, as appropriate; (ii) have adequate capitalization for its business and operations; (iii) maintain corporate records and books of account separate from those of CEHE and the members of the CEHE Affiliated Group (defined below); (iv) allocate fairly and reasonably any overhead for office space shared with CEHE and; (v) be in full compliance with

the terms of its Certificate of Formation and LLC Agreement. Each of the Issuer, CEHE, and, to the extent, CEHE's other Affiliates are parties thereto, such Affiliates, will at all times and in all respects which are material to the opinions expressed herein, comply with all provisions in the Relevant Documents to which they are parties. The Issuer intends to be adequately capitalized at all times.

6. The Issuer has not prior to the date hereof conducted any business, and from and after the date hereof, it will conduct its business solely in its own name and through its duly authorized officers or agents. Furthermore, all oral and written communications made by the Issuer (including, without limitation, letters, invoices, purchase orders, contracts, statements and applications) have been and will be made solely in its own name. Except as expressly set forth below, neither CEHE nor any other member of the CEHE Affiliated Group has held itself out, will hold itself out, or permit itself to be held out, as having agreed to pay or as being liable for the debts of the Issuer; and, conversely, the Issuer is not holding itself out, will not hold itself out, and will not permit itself to be held out, as having agreed to pay or as being liable for the debts of CEHE or any other member of the CEHE Affiliated Group. Neither CEHE nor any such Affiliate will guarantee any other obligations or debts of the Issuer, nor, except for the indemnities of CEHE set forth in the Servicing Agreement and the Sale Agreement (which we understand are customary for transactions of the type of transaction provided for under the Relevant Documents, and cover matters ascertainable by CEHE in the ordinary course of business), indemnify any person or entity for losses resulting therefrom, and, in any event, the Issuer will not guarantee any of the obligations or debts of CEHE or CEHE's other Affiliates, nor indemnify any person from losses resulting therefrom[5]. Other than with respect to the Issuer's capitalization (as the same may change from time to time), in which CEHE's relationship to the Issuer is that of any parent making an equity investment in a subsidiary, the Issuer will continue to maintain an arm's-length relationship in any future dealings it may have with CEHE or any of CEHE's other Affiliates.

7. CEHE has entered into the Servicing Agreement and the Intercreditor Agreement, pursuant to which CEHE will be responsible for the billing and collection of the Transition Charges on behalf of the Issuer and for administering various matters relating to the day-to-day operations of the Issuer. As Servicer and collection agent, CEHE will have control over, and take actions in respect of, the Transition Property only to the extent necessary to fulfill its obligations under the Servicing Agreement and the Intercreditor Agreement, which obligations are such as would reasonably be required of a third-party servicer in the context of servicing transition property under PURA. The servicing fee and other compensation provided for under such agreements represents a reasonable and fair compensation such as would be obtained under an agreement among unaffiliated entities under otherwise similar circumstances and is typical of

[5] Pursuant to the Service Agreement and the Sale Agreement, CEHE makes certain representations and provides certain covenants that do not constitute a guarantee of collectibility of Transition Property. We understand that these representations and covenants are customary for transactions of the type of transaction provided for under the Relevant Documents, and cover matters ascertainable by CEHE in the ordinary course of business.

servicer arrangements made for servicing, administering and collecting securitized financial assets, and the servicing fee is capped in the Financing Order. Except for those expenses that CEHE has agreed to assume in consideration of the fees and other amounts paid to it under the above-described documents, the Issuer will pay its own operating expenses and liabilities (including but not limited to any fees paid to the Independent Managers) from its own separate assets, although CEHE has paid and may pay under the Administration Agreement expenses related to the formation of the Issuer and the consummation of the transactions described herein. The Issuer will not pay any of the operating expenses or other liabilities of CEHE or any of CEHE's other Affiliates.

8. CEHE will prepare year-end consolidated and consolidating financial statements on an annual basis in accordance with generally accepted accounting principles applied consistently and otherwise in accordance with the requirements of the Relevant Documents and such consolidated financial statements will be audited by independent certified public accountants. Such audited consolidated financial statements will contain footnotes and will be accompanied by other notes or other information to the effect that: (i) the holders of the Transition Bonds do not have recourse to any assets or revenues of CEHE; and (ii) the creditors of CEHE do not have recourse to any assets or revenues of the Issuer, including, without limitation, the Transition Property.

9. Under Treasury Regulation § 301.7701-3 (also known as the "check-the-box" regulation), CEHE has not elected to treat the Issuer as an association taxable as a corporation. Similarly, Utility Holding, LLC (the parent of CEHE) has not elected to treat CEHE as an association taxable as a corporation. Consequently, the Issuer will, for federal income tax purposes, be treated as a division of Utility Holding, LLC and, accordingly, (i) indebtedness of the Issuer will be reported for such tax purposes as indebtedness of Utility Holding, LLC and (ii) income recognized in connection with the accrual and collection of the Transition Charges will be treated as income of Utility Holding, LLC for federal income tax reporting purposes. This is acknowledged in the Indenture and in the Transition Bonds. Utility Holding, LLC and CEHE will, however, treat the Issuer as the owner of the Transition Property for all non-tax purposes, including all regulatory and (except as noted in paragraph 8 above) accounting purposes, and will not make any statement or reference in respect of the Transition Property that is inconsistent with the ownership interests of the Issuer.

10. As a result of the Financing Order, the Issuer had, as of the date of conveyance, good title to and was the sole owner and holder of the Transition Property purported to be conveyed by it under the Relevant Documents, free and clear of any setoff, counterclaim, surcharge, or defense by CEHE or any other person or in connection with the bankruptcy of CEHE or any other entity, of any nature, and had the full right and authority, subject to no interest or participation of, or agreement with, any other person or entity, to transfer and assign and/or pledge the same. CEHE and the Issuer have made and will make all filings required by PURA and the Uniform Commercial Code or any other applicable law to "perfect" the creation, sales, assignments and pledges of the Transition Property and other collateral under the Relevant

Documents, and such parties will make any future filings required to maintain the perfection of such transfers.[6]

11. No funds will be distributed, loaned or otherwise transferred from CEHE or CEHE's other Affiliates to the Issuer nor from the Issuer to CEHE or CEHE's other Affiliates, except for (i) payments required under or described in the Relevant Documents pursuant to the respective obligations of the Issuer and CEHE thereunder; (ii) returns of capital paid by the Issuer to CEHE which are properly authorized by requisite limited liability company action and which are reflected in the books and records of the Issuer, as applicable, and (iii) capital contributions made by CEHE to the Issuer which are permitted under the Relevant Documents and are properly reflected in the books and records of CEHE and the Issuer, as applicable.

12. The underwriters have agreed to purchase the Transition Bonds under the Underwriting Agreement, in reliance on the identity of the Issuer as a legal entity which is separate from CEHE and the other members of the CEHE Affiliated Group, and the Transition Bondholders have similarly purchased the Transition Bonds in reliance on such separate identity. For purposes of this opinion "CEHE Affiliated Group" shall mean CEHE and any Affiliate of CEHE. The prospectus and prospectus supplement pursuant to which the Transition Bonds have been sold to public investors expressly indicate that CEHE is not obligated to make any payment with respect to the Transition Bonds and that any payment on the Transition Bonds is intended to be based solely on the Transition Property and the other collateral that constitutes the Trust Estate.

13. The amounts received by CEHE constitute fair consideration and reasonably equivalent value for the transfer of the Transition Property. The Issuer has accepted the conveyance and the vesting of the Transition Property in good faith for fair consideration and reasonably equivalent value. The creation, transfer, assignment and pledge of the Transition Property have been publicly disclosed in accordance with applicable law and neither CEHE nor the Issuer has concealed such transactions from their respective creditors or otherwise entered into the transactions contemplated by the Relevant Documents with any intent to hinder, delay or defraud any of CEHE's creditors or any other interested party. CEHE will not make any future conveyances or transfers to, nor has it or will it hereafter incur any obligation to or for the benefit of, the Issuer with any intent to hinder, delay or defraud any creditor of CEHE.

14. CEHE was not and is not insolvent at the time of the creation of the Transition Property, and was not rendered insolvent as a result thereof nor, after giving effect to this transaction concluded today under the Sale Agreement, is CEHE engaged in any business or transaction for which its remaining property, taking into account all of the Relevant Documents, is unreasonably small in relation to its business. At the time of any transfer to or for the benefit

[6] We refer you to our other opinion of even date herewith addressing the above-described issues regarding perfection.

of the Issuer, CEHE did not intend to incur, and did not incur, debts that were beyond its ability to pay as such debts matured.

15. The Issuer was not insolvent at the time of any conveyance or transfer made by it under the Relevant Documents, nor was the Issuer rendered insolvent as a result thereof. The Issuer has not engaged in any business or transaction for which its remaining property, taking into account all of the Relevant Documents, is unreasonably small in relation to its business. At the time of the creation and sale of the Transition Property pursuant to the Relevant Documents, the Issuer did not intend to incur, nor did it incur, debts that were beyond the ability of the Issuer to pay as such debts matured.

16. Other than the Relevant Documents, there are no other material agreements to which CEHE and/or the Issuer are parties relating to the Transition Property and there are no other agreements to which any such persons are party which would purport to modify, contradict or otherwise conflict with the terms and provisions of the Relevant Documents or the assumptions set forth herein.

C. **The Sale and Servicing of the Transition Property**

1. Pursuant to the Sale Agreement, CEHE has, in consideration of the receipt of proceeds from the Issuer from the issuance of the Transition Bonds, made certain representations, warranties and covenants regarding the validity of the Financing Order and the Transition Property created thereby. The Sale Agreement provides that the Issuer will pay CEHE at closing all of the net proceeds received by it from the issuance of the Transition Bonds in consideration of CEHE's actions in creating, assigning and vesting the Transition Property in the Issuer, and no portion of such payment is or may be deferred. The Sale Agreement obligates CEHE to indemnify the Issuer and/or its assigns if there exists a breach of any of those representations, warranties or covenants contained in the Sale Agreement. CEHE has entered into the Sale Agreement in the belief, after reasonable inquiry on its part, that all of these representations and warranties are true and correct and that it will not be required to make any such indemnification payments. These indemnification obligations and representations and warranties are of a type commonly found in transactions involving the sale of assets such as the Transition Property and none of such representations, warranties and/or covenants contains a guarantee as to the ultimate collectibility of the Transition Property or the continued sale of services or goods by CEHE. CEHE has also covenanted in the Sale Agreement not to take certain actions which would impair or otherwise invalidate the value of the Transition Property.

2. Pursuant to the Sale Agreement, CEHE has sold and assigned to the Issuer all of its right, title and interest in and to the Transition Property. The Sale Agreement provides that the Issuer will pay CEHE at the Closing all of the net proceeds the Issuer receives from the issuance of the Transition Bonds in consideration of CEHE's transfer of the Transition Property to the Issuer. The Sale Agreement further expressly provides that the sale of the Transition Property is intended to be a sale or other absolute transfer within the meaning of PURA, which

transfer is intended to be unconditional and irrevocable, of all of CEHE's right, title and interest in and to the Transition Property.

3. The Transition Bonds have been issued pursuant to the Indenture and purchased by public investors. The Transition Bonds are secured by (i) all of the Issuer's right, title and interest in and to the Transition Property, (ii) the Collection Account and all subaccounts thereof; (iii) all of the Issuer's rights under each of the Relevant Documents to which the Issuer is a party and (iv) all other property of the Issuer, except for certain amounts released to the Issuer pursuant to the terms of the Indenture. The Issuer has applied the net proceeds of the sale of the Transition Bonds as payment in full for the purchase of and vesting in the Issuer's favor of the Transition Property from CEHE.

4. Pursuant to the Servicing Agreement, CEHE has agreed to act as Servicer (in such capacity, the "Servicer"), in which capacity it will bill and collect the Transition Charges on behalf of the Issuer and the Trustee and will take such legal or administrative actions, including defending against or instituting and pursuing legal actions and appearing or testifying in hearings or similar proceedings, as may be reasonably necessary to block or overturn any attempts to cause a repeal, modification or supplement to PURA or the Financing Order which would impair the rights of the Transition Bondholders or the owners of the Transition Property. The Transition Charges are based on expected usage of electricity by all Customers, and have been calculated in a manner which is intended to generate sufficient revenues to pay the principal of the Transition Bonds in accordance with the expected amortization schedule, pay interest on the Transition Bonds, together with servicing fees and other fees, costs and charges related thereto, and to fund and/or maintain any required reserves in the Capital Subaccount, all after giving effect to uncollectible bills.

5. In accordance with PURA §39.306 and as authorized and directed by the Financing Order, the Servicer will, pursuant to the Servicing Agreement, impose and collect the Transition Charges on and from each REP serving customers in the CEHE service area (or on and from customers directly as authorized) on and after the date of Closing.

6. Under the terms of the Financing Order as provided in PURA §39.307, the Transition Charges will be subject to true-up adjustments if the collections are more or less than expected at the onset of each adjustment period. Such adjustments provide for reconciliation of each REP's charge-offs of uncollectible amounts and each REP's allowance for charge-offs reflected in payments made to the Servicer as described in Section 7(d) hereof and additionally protect against the risk of insufficient Collections over time. They serve as an important credit enhancement for the Transition Bonds. Such adjustments also help ensure that the value of the Transition Property remains reasonably equivalent to the consideration paid to CEHE notwithstanding significant changes in electricity usage patterns or Customer payment histories which may occur during the time that the Transition Bonds are outstanding. CEHE, as Servicer, will file Tariffs with the PUCT to evidence any such true-up adjustment. Pursuant to the Servicing Agreement, the Servicer has agreed to (and will) promptly apply for and provide all

necessary information and file all necessary Tariffs in connection with such periodic adjustments. As required by PURA, any increase or decrease in the Transition Charges being charged will result in a corresponding increase or decrease in the amount deducted from CEHE's other charges.

7. (a) The Servicer will include Transition Charges on bills sent by CEHE to REPs, and such Transition Charges will be collected by the Servicer (acting through its collection agent under the Intercreditor Agreement) from such REPs that, in turn, collect such Transition Charges from the Customers.

(b) REPs may choose to contract with CEHE to bill and collect the Transition Charges from Customers. The PUCT may implement different credit and collection standards for REPs only with prior written confirmation from the rating agencies[7] that such modifications will not cause suspension, withdrawal or downgrade of the ratings on the Transition Bonds.

(c) Each REP must establish its creditworthiness and support its obligations to collect and remit the Transition Charges by maintaining a satisfactory credit rating or providing (a) a cash deposit of up to two months' maximum expected collections, (b) an equivalent affiliate guarantee, surety bond or letter of credit in favor of the Trustee or (c) a combination of the foregoing. Cash deposits will be held by the Trustee, maintained in a segregated account, and, when invested, are invested in short-term high quality investments. The size of any deposit will be agreed upon by the Servicer and the REP and reviewed no more frequently than quarterly. Investment earnings will be considered part of the cash deposit and taken into consideration during the regular deposit review, so long as they remain on deposit with the Trustee. After each such review, excess amounts on deposit will be remitted by the Trustee to the REP and the REP will correct any deficiencies by depositing additional funds into the account. At the instruction of the Servicer, cash deposits will be remitted with investment earnings to the REP at the end of the term of the Transition Bonds unless otherwise utilized for the payment of the REP's obligations for Transition Charges.[8]

(d) REPs will pay Transition Charges billed to the REP within 35 days following billing by the Servicer. The remittance amount will be based on each REP's own charge-off history. Amounts remitted will be reconciled at least annually by the REP and Servicer so that the REP may receive credit for write-offs related to customers whose service has been permanently terminated and whose entire account has been written off. If an REP disputes any

[7] We understand from one of the rating agencies, Fitch, Inc., that it does not provide such ratings confirmation letters. In addition, we acknowledge that the rating agencies, including Fitch, Inc., maintain the right to provide rating agency commentary regarding REP credit and collection standards.

[8] We express no opinions as to whether, in the event of a bankruptcy of any REP, funds on deposit in any REP deposit subaccount would be property of such REP's bankruptcy estate and therefore whether the automatic stay would impair the Trustee's access to those funds upon an REP payment default.

amount of billed Transition Charges, it must pay the disputed amount under protest and work with the Servicer to resolve the dispute. If the REP and the Servicer are unable to resolve the dispute informally, the dispute may be referred to the PUCT. If an REP successfully disputes an amount, the REP shall be entitled to interest on the disputed amount at a PUCT-approved rate. Except in limited circumstances, the Servicer shall pay the interest, which may be recovered through the true-up adjustment of Transition Charges unless the Servicer's claim is clearly unfounded.

(e) If an REP defaults with respect to its transition charge obligations, under the Financing Order remedies are limited to one of the following, at the election of the REP: (i) a transfer of billing and collecting Transition Charges to the provider of last resort ("POLR") or a qualified REP of the Customer's choosing, (ii) implementing mutually agreeable arrangements with the Servicer (as limited by the Servicing Agreement and rating agencies) and (iii) arranging for remittance of amounts directly to a lockbox. Amounts deposited in a lockbox shall be applied first to Transition Charges before remaining amounts are distributed to REPs. The Servicing Agreement prohibits the Servicer from entering into any agreement with an REP in default other than the options described in clauses (i), (ii) and (iii) above. In the event that an REP fails to immediately select and implement one of the foregoing options, or if after selecting one of the foregoing options the REP fails to adequately meet its responsibilities thereunder, the Servicer will immediately allow the appropriate POLR or another qualified REP of the Customer's choosing to immediately assume responsibility for the billing and collection of Transition Charges from such Customer. In addition, after a 10 calendar-day grace period, the Servicer will seek recourse against any cash deposit, guaranty, surety bond, letter of credit, or combination thereof provided by the REP in accordance with the Financing Order, and avail itself of such legal remedies as may be appropriate to collect any remaining unpaid Transition Charges and associated penalties due the Servicer under the application of such deposit or other form of credit support.

8. The Servicer is responsible for collecting such Collections and remitting the amounts so collected to the Collection Account. Collections in respect of Transition Charges shall be allocated to the Servicer out of the initial collections received by CEHE, acting as collection agent on behalf of the Servicer and the Trustee, on the one hand, and certain other parties with an interest in such initial collections, on the other hand, in accordance with the terms and provisions of the Intercreditor Agreement. The Servicer shall remit to the General Subaccount of the Collection Account the total payments received by the Servicer from or on behalf of Customers on or before the second business day after receipt of such funds from the collection agent. Under Subchapter G of Chapter 39 of PURA, the Servicer is not required to segregate the Transition Charges from the other funds it collects from an REP or from its general funds until such amounts are remitted to the Trustee.

9. On each payment date for principal and interest on the Transition Bonds, funds on deposit in the Collection Account, including net earnings thereon, will be allocated and distributed in accordance with the terms and provisions of the Indenture towards the payment of

certain fees and expenses (including operating expenses of the Issuer) and indemnities, scheduled payments of interest on and principal of the Transition Bonds, any required funding and/or replenishment of the Capital Subaccount to the extent that prior withdrawals have reduced the balance thereof below the required capital level (at least 0.5% of the original principal amount of the Transition Bonds). Thereafter amounts equal to investment earnings on amounts in the Capital Subaccount shall be released to the Issuer, and the balance if any, shall be allocated to the Excess Funds Subaccount or the Capital Subaccount for the benefit of the Transition Bondholders. Any shortfalls or excess Collections will be taken into account in calculating subsequent true-up adjustments.

10. The Transition Charges will continue to be recovered only through January 19, 2027 (15 years from issuance date), provided that, as set forth in the Financing Order, if the Transition Bonds have not been paid in full at such time, end of period billings and delinquencies owed at such time may continue to be collected. Once the Transition Bonds have been paid in full, the Issuer will retain all right, title and interest in and to any funds remaining on deposit in the Collection Account, any Collections received by the Servicer but not yet remitted to the Collection Account and any rights to Transition Charges which have been previously billed but remain unpaid as of such date. The Issuer does not have any contractual duty to account to CEHE for such excess value of the Transition Property over the amount necessary to repay the Transition Bonds in full; CEHE will nonetheless retain an indirect interest in such excess value to the extent of its remaining equity interest in the Issuer, and will be required to treat any remaining excess value as a recovery of property for purposes of adjusting the rates it charges customers.

11. The parties have calculated that the Required Capital Amount, after taking into account the required true-up adjustments, will be reasonable and sufficient credit enhancement to ensure that the Transition Bondholders of each Tranche will be paid in full on the expected final payment date for such Tranche and that the Issuer will receive a reasonable return on the consideration paid for the ownership of the Transition Property. To the extent that the funds on deposit in the Capital Subaccount are less than their required levels at maturity of the Transition Bonds, the Issuer will not have any recourse to CEHE for such shortfalls. Conversely, to the extent that the funds on deposit in the Collection Account at maturity of the latest maturing Transition Bonds exceed the amount of the Required Capital Amount, CEHE will have no recourse to the Issuer for such excess amounts.

12. From time to time after the date hereof, in connection with the issuance of future Transition Bonds under the Indenture, additional transition property may be created in favor of the Issuer through action by CEHE in exchange for cash in an amount equal to the fair market value of such transition property. No such transition property will, however, be created with the intent (on the part of either CEHE or the Issuer) to mitigate losses on the Transition Property.

III. ANALYSIS

A. Substantive Consolidation

The equitable doctrine of substantive consolidation permits a court in a bankruptcy case to disregard the corporate separateness of two or more corporate entities and to consolidate the assets and liabilities of those entities as though held and incurred by a single entity. *See, e.g., In re Owens Corning*, 419 F.3d 195, 205 (3d Cir. 2005); *Reider v. FDIC (In re Reider)*, 31 F.3d 1102, 1104–06 (11th Cir. 1994); *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845, 847 (2d Cir. 1966).[9] Although the Bankruptcy Code does not expressly provide for the substantive consolidation of corporate entities, courts have consistently been willing to exercise their equitable power to order substantive consolidation in appropriate circumstances.[10] *See, e.g., In re Augie/Restivo Baking Co.*, 860 F.2d 515, 518 (2d Cir. 1988); *In re Vecco Construction Industries, Inc.*, 4 B.R. 407, 409 (Bankr. E.D. Va. 1980). Because the disregard of separate corporate existence is disfavored, a presumption exists against substantive consolidation, and the party seeking that result has the burden of establishing its necessity. *See, e.g., In re Auto-Train Corp., Inc.*, 810 F.2d 270, 276 (D.C. Cir. 1987); *Simon v. New Center Hospital (In re New Center Hospital)*, 187 B.R. 560, 567–68 (E.D. Mich. 1995).

Courts have generally treated substantive consolidation as the exception rather than the rule because of the "possibility of unfair treatment of creditors who have dealt solely with the corporation having a surplus as opposed to those who have dealt with the related entities with deficiencies." *In re Continental Vending Machine Corp.*, 517 F.2d 997, 1001 (2d Cir. 1975), *cert. denied sub nom. James Talcott, Inc. v. Wharton*, 424 U.S. 913 (1976). *See also FDIC v. Colonial Realty Co.*, 966 F.2d 57, 61 (2d Cir. 1992) (identifying "fairness to creditors" as the sole aim of substantive consolidation); *Kheel*, 369 F.2d at 847 (holding that it should be the "rare case" where substantive consolidation is granted); *In re World Access, Inc.*, 301 B.R. 217, 222 (Bankr. N.D. Ill. 2003). Thus, although "the term [consolidation] has a disarmingly innocent sound, ... [it] is no mere instrument of procedural convenience . . . but a measure vitally affecting

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[9] Substantive consolidation should not be confused with procedural consolidation. Procedural consolidation, which Courts often refer to as joint administration, merely involves combining estates for administrative matters in the bankruptcy proceeding so as to reduce costs. *See, e.g., In re Amdura Corp.*, 121 B.R. 862, 868 (Bankr. D.Colo. 1990); *In re Hemingway Transport, Inc.*, 954 F.2d 1, 11–12 (1st Cir. 1992).

[10] The power to consolidate is derived from the general equitable powers set forth in section 105 of the Bankruptcy Code, which provides that, "the court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). *See also In re Reider*, 31 F.3d at 1105–06 (discussing the history and genesis of the doctrine). Note, however, that one court has stated that "there is clear statutory authority in the Bankruptcy Code for substantive consolidation in Chapter 11 cases" and that this statutory authority is found in 11 U.S.C. § 1123(a)(5)(C). *See In re Stone & Webster, Inc.*, 286 B.R. 532, 540–41 (Bankr. D. Del. 2002). This case is distinguishable from those which rely upon 11 U.S.C. § 105(a) because the court in this case had before it the question of whether a Chapter 11 plan could provide for substantive consolidation and did not actually reach the question of whether the facts existing in that case warranted substantive consolidation. *Id.* at 542.

substantive rights" in equity. *In re Flora Mir Candy Corp.*, 432 F.2d 1060, 1062 (2d Cir. 1970). *See* also *Walter Business Int'l. LLC v. Kiss Packaging Systems, Inc.*, 2003 WL 21439844 (N.D. Ill. June 20, 2003). Because economic consolidation invariably redistributes resources and obligations among debtors and creditors, courts should order substantive consolidation only as a last resort, and only after considering other, more precise, remedies. *In re Owens Corning*, 419 F.3d at 211. Furthermore, because the rules for substantive consolidation are not statutorily provided, courts must examine the facts and circumstances of each case to determine if such an order is warranted. *See* 5 COLLIER ON BANKRUPTCY 1100.06[1] (15th rev. ed. 2005) (stating that substantive consolidation cases are to a great degree *sui generis*).

Substantive consolidation was accomplished in early cases by "piercing the corporate veil" of the debtor, *i.e.*, by finding that the entity with which consolidation was sought was the "alter-ego" or an "instrumentality" of the debtor which was used by the debtor to hinder, delay or otherwise defraud creditors. *See, e.g., Maule Industries, Inc. v. Gerstel,* 232 F.2d 294 (5th Cir. 1956); *Fish v. East,* 114 F.2d 177 (10th Cir. 1940). Although later cases relaxed the requirement of fraud in favor of the two-part test described below, courts will still pierce the corporate veil to effect a substantive consolidation if fraud or similar activity is present. *See, e.g., In re New Center Hospital*, 187 B.R. at 567–68. *See also In re Daily*, 107 B.R. 996 (Bankr. D. Hawaii 1989) *rev'd on other grounds,* 940 F.2d 1306 (9th Cir. 1991); *In re Stop & Go of America, Inc.*, 49 B.R. 743 (Bankr. D. Mass. 1985); *In re Tureaud,* 45 B.R. 658 (Bankr. N.D. Okla. 1985), *aff'd*, 59 B.R. 973 (N.D. Okla. 1986).

Although in early substantive consolidation cases courts looked to state corporate "piercing" law for guidance,[11] modern courts have increasingly looked to a growing body of opinions decided under federal bankruptcy law. *See, e.g., Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245 (11th Cir. 1991); *In re Augie/Restivo Baking Co.*, 860 F.2d 515

[11] If a bankruptcy court in a case involving CEHE looked to state "piercing" law for guidance, it is not entirely clear which state's law would apply. The traditional choice-of-law rule for matters of corporate governance, including the extent of shareholder liability for corporate obligations, has been application of the laws of the state of incorporation. *See* Blumberg, The Law of Corporate Groups: Tort, Contract, and Other Common Law Problems in the Substantive Law of Parent and Subsidiary Corporations §26.02 (1987). This choice-of-law rule has often been disregarded, however, where another state bears a more significant relationship to the question, as may occur when the corporation has little contact with its state of incorporation other than the fact of incorporation. *Id.* at §26.03. *See, e.g., Secon Service System, Inc. v. St. Joseph Bank & Trust Co.*, 855 F.2d 406, 412 (7th Cir. 1988) (court applied "most significant contacts" approach in veil-piercing action to determine applicable state law). Under both the laws of Delaware (under whose law the Issuer is organized) and the laws of Texas (under whose law CEHE is incorporated and where both CEHE and the Issuer maintain their chief executive offices), courts have refused to pierce the corporate veil absent a showing that the entity to be consolidated was a mere alter ego of the other corporation and that maintaining their corporate separateness would allow such other corporation to perpetrate a fraud or something in the nature of a fraud. *See Mobil Oil Corp. v. Linear Films, Inc.*, 718 F. Supp. 260, 267 (D. Del. 1989); *Meneffi v. Chavers*, 974 S.W.2d 168, 172–74 (Tex. App. 1998). Numerous precautions have been taken to make clear that the Issuer is a separate entity from CEHE, and nothing has come to our attention which would indicate that maintaining separateness would result in a fraud. Consequently, we do not think it likely that a court would pierce the corporate veil to consolidate the assets and liabilities of CEHE and the Issuer.

(2d Cir. 1988); *In re Auto-Train Corp., Inc.*, 810 F.2d 270 (D.C. Cir. 1987); *Continental Vending*, 517 F.2d at 1001; *In re Flora Mir Candy Corp.*, 432 F.2d 1060 (2d Cir. 1970); *Soviero v. Franklin National Bank*, 328 F.2d 446 (2d Cir. 1964); *Stone v. Eacho*, 127 F.2d 284 (4th Cir. 1942); *but see In Re Moran Pipe & Supply Co.*, 130 B.R. 588 (Bankr. E.D. Okla. 1991) (invoking substantive consolidation based on alter-ego theory); *In re Doctors Hospital of Hyde Park*, 360 B.R. 787, 849–853 (Bankr. N.D. Ill. 2007) (considering under Illinois corporate law, in the context of a series of securitized transactions, whether to treat certain payments to non-debtor trusts as interests of the Debtor). Consequently, modern federal courts almost uniformly rely on federal precedent rather than state corporate law doctrine when ruling on substantive consolidation proceedings.

Such courts have, in making the determination of whether substantive consolidation would be appropriate in a given case, reviewed a number of factors which appear to fall within two similar but not identical tests for whether substantive consolidation should be ordered. *See, In re Standard Brands Paint Co.*, 154 B.R. 563, 568 (Bankr. C.D. Cal. 1993) (discussing the D.C. Circuit test and the Second Circuit test for substantive consolidation). Both tests, however, focus on two areas of inquiry. First, they have evaluated the internal relationships of the affiliated entities to determine whether "there is substantial identity between the entities to be consolidated." *EastGroup Properties*, 935 F.2d at 250. Second, they have evaluated whether "consolidation is necessary to avoid some harm or realize some benefit" with respect to the creditors of the entities to be consolidated. *Id.* This second factor relates to whether "creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit." *In re Augie/Restivo*, 860 F.2d at 518. *See also In re Adelphia Comm'ns Corp.*, 361 B.R. 337, 359 (S.D.N.Y. 2007) (addressing recently the issue of substantive consolidation in reference to these two "critical factors"); *In re 599 Consumer Electronics, Inc.*, 195 B.R. 244, (S.D.N.Y. 1996) (noting that, "[c]onceivably, substantive consolidation could be warranted on either ground; the . . . use of the conjunction "or" suggests that the two cited factors are alternatively sufficient criteria.").

1. Substantial Identity.

With regard to the pre-bankruptcy interrelationship between the parties, many federal courts have articulated an objective list of factors to be applied in substantive consolidation cases. The court in *Vecco Construction*, 4 B.R. at 410, set forth seven factors for determining whether consolidation is appropriate:

1. The commingling of assets and business functions.
2. The degree of difficulty in segregating and ascertaining individual assets and liabilities.
3. The existence of parent and intercorporate guarantees on loans.
4. The transfer of assets without observance of corporate formalities.
5. The presence or absence of consolidated financial statements.
6. The unity of interests and ownership between the various corporate entities.
7. The profitability of consolidation at a single physical location.

Accord, In re Optical, 221 B.R. 909, 913 (Bankr. M.D. Fla. 1998); *White v. Creditors Serv. Corp. (In re Creditors Serv. Corp.)*, 195 B.R. 680, 689 (Bankr. S.D. Ohio). *See also Fish v. East*, 114 F.2d 177, 191 (10th Cir. 1940) (setting forth a list of ten substantially similar factors).

We stress, however, that the factors set forth in *Vecco Construction*, along with additional factors formulated in other cases, are merely "examples of information that may be useful to courts charged with deciding whether there is a substantial identity between the entities to be consolidated and whether consolidation is necessary to avoid some harm or realize some benefit." *EastGroup Properties*, 935 F.2d at 249. *See also In re Creditors Serv. Corp.*, 195 B.R. at 690 (stating that the factors "standing alone, are not dispositive of the issue to consolidate"). Therefore, although a "proponent of consolidation may want to frame his argument using the seven factors outlined in *In re Vecco Construction Industries, Inc.*," the existence or absence of any number of those factors is not necessarily determinative. *EastGroup Properties*, 935 F.2d at 249. *See also, In re Creditors Serv. Corp.*, 195 B.R. at 690 (observing that the factors "merely provide the framework" for the court's inquiry). *See also Owens Corning*, 419 F.3d at 210–11 (lamenting the "rote following of a form containing factors where courts tally up and spit out a score without an eye on the principles that give the rationale for substantive consolidation").

On the basis of the facts and assumptions set forth herein, we believe that at least three of the seven factors listed in *Vecco Construction* - 1, 2 and 4 - have little or no applicability here and factors 3, 5, 6 and 7, although present here to a certain degree, when properly analyzed would not lead a court to substantively consolidate the Issuer with CEHE.

With regard to the first factor, there will be no commingling of the assets or business functions of the Issuer with any members of the CEHE Affiliated Group, except that Collections will be commingled with funds, that do not constitute Collections, that CEHE, acting in its capacity as collection agent under the Intercreditor Agreement collects as described in paragraph

C.8. of Section II above. Based on the statutory framework of PURA and the fact that the Servicer will at all times account for Collections separately from the funds with which they may be commingled, we do not believe that such commingling of assets rises to the level that concerned the court in *Vecco Construction*. With respect to the commingling of business functions, the Issuer will have a primary business function (*i.e.*, the financing of the Transition Property and activities incidental thereto) which is different from the primary business function of CEHE.[12]

With regard to the second factor, it should not be difficult, at any time, to ascertain the individual assets and liabilities of the Issuer and to segregate such assets and liabilities from those of CEHE. The Issuer's and CEHE's respective accounting records (including all records maintained by CEHE as Servicer) will identify the Transition Property as property of the Issuer consistently with generally accepted accounting principles. The consolidated financial statements of CEHE will contain footnotes which describe such ownership and the separate existence of the Issuer. Furthermore, the Issuer's financial statements will, to the extent that Transition Property is recognized as an asset under generally accepted accounting principles, treat the Transition Property and collections thereon as assets owned by the Issuer.

With regard to the third factor, there will be no parent or intercorporate guarantees on any loans made to or by the Issuer. We note that CEHE has granted certain indemnities in the Relevant Documents in its capacity as Servicer which relate to its duties as Servicer. We also note that, pursuant to the Sale Agreement, CEHE has given certain indemnities to the Issuer which may be enforced by the Trustee as assignee of the Issuer. We also note that, as described above, the REPs will have obligations under the Tariffs to remit Collections to the Servicer on a timely basis regardless of actual collections, and will only be able to recover uncollectible amounts on an annual basis as described in the Tariffs. REPs may also be required by the Financing Order to provide a deposit, letter of credit, affiliate guaranty or surety bond in support of its obligations as REP. None of these guaranties and indemnities, however, rises to the level of an unconditional guarantee by CEHE of amounts, if any, owed by the Issuer to the Transition Bondholders.

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[12] In contrast, the WorldCom, Inc. enterprise was comprised of over 400 legal entities. Nevertheless, WorldCom structured its operations along functional lines rather than on entity lines and employed a complex accounting system that does not specifically account for legal entities but instead is based upon company codes. In *In re WorldCom, Inc.*, the Court noted that WorldCom used "more than 1,100 company codes notwithstanding that there are only approximately 400 legal entities." *In re WorldCom, Inc., et al.*, 2003 WL 23861928, *10 (Bankr. S.D.N.Y. October 31, 2003) (unpublished opinion). WorldCom did not track ownership of assets owned by each separate legal entity and was unable to create accurate financial statements for each legal entity. The court concluded that substantive consolidation was necessary because both prongs of the *Augie/Restivo* case were satisfied due to the high cost of disentangling the assets and because many of the creditors dealt with the debtors as a single economic unit. *Id.* at *11–16. Note, however, that this is not a case where a special purpose entity was consolidated, but instead multiple entities that comprised the WorldCom enterprise.

With regard to the fourth factor, we note that there will be no commingling of assets between the Issuer and any members of the CEHE Affiliated Group except as described above. Moreover, there will be no transfers of assets from CEHE to the Issuer or from the Issuer to CEHE except for (a) transfers pursuant to the Sale Agreement, (b) payments of cash thereunder and payments of cash under the other Relevant Documents, all of which will be properly evidenced in CEHE's and the Issuer's accounting records, as applicable, and (c) capital contributions to the Issuer and/or returns on or distributions of capital from the Issuer to CEHE which will be properly evidenced in CEHE's and the Issuer's corporate and accounting records and which will otherwise comply with all necessary corporate and limited liability company formalities with respect thereto.[13]

With regard to the fifth factor, we believe that the court in *Vecco Construction* was concerned that the presence of consolidated financial statements would make it impossible for those creditors who read such statements to ascertain which assets were owned by which company within the consolidated group. We note that the requirement that a parent company prepare consolidated financial statements to include its majority-owned subsidiaries did not exist when *Vecco Construction* was decided. As noted above, the consolidated financial statements that will be prepared for CEHE will note that the Issuer is a separate entity, and that the Transition Property was created in favor of the Issuer when CEHE transferred the right to impose and collect the Transition Charges to the Issuer pursuant to the Sale Agreement.

We also believe that the sixth factor identified in *Vecco Construction* should not result in consolidation. While CEHE will be the sole member of the Issuer, courts have recognized a distinction between the ownership of a subsidiary's stock and of its assets. *See In re Beck Indus. Inc.*, 479 F.2d 410, 415 (2d Cir. 1973), *cert. denied*, 414 U.S. 858 (1973); *Danjaq, S.A.* v. *MGM/UA Communications, Co.*, 773 F. Supp. 194, 198 (C.D. Cal. 1991). We know of no reason why such principle would not be equally applicable to ownership of a limited liability company. The Issuer's Management Committee (which must include at least one Independent Manager), rather than CEHE's Board of Directors, will be charged with managing the Issuer's affairs and neither CEHE nor the other members of the CEHE Affiliated Group have management discretion over the Issuer's affairs.

The seventh factor identified in *Vecco Construction* should also not result in consolidation. The principal office of the Issuer will be located in Houston, Texas, where CEHE's principal offices are located. It could therefore be argued that Houston, Texas provides a "single physical location" at which CEHE could be profitably consolidated with the Issuer, at least with respect to the servicing, collection and enforcement of the Transition Property. We note, however, that the presence of even several of the *Vecco Construction* factors does not require consolidation. *See Eastgroup Properties*, 935 F.2d at 250; *In re Creditors Serv. Corp.*,

[13] *Alexander v Compton (In re Bonham)*, 229 F.3d 750 (9th Cir. 2000) highlighted the significance of these elements.

195 B.R. at 690; *In re Donut Queen Ltd.*, 41 B.R. 706, 709–710 (Bankr. E.D.N.Y. 1984); *In re Snider Bros. Inc.*, 18 Bankr. 230, 234 (Bankr. D. Mass. 1982). Accordingly, even if a court were to conclude that CEHE could be profitably consolidated with the Issuer at a single physical location, we would not expect a court to order consolidation based on this factor, after properly analyzing the intercompany relationships between CEHE and the Issuer within the framework of the other *Vecco* factors.

8. Benefit or Harm to Creditors.

The cases suggest that, in considering whether to impose substantive consolidation, a court should investigate the potential harm or benefit to creditors. The Second Circuit stressed this investigation when it stated that the "sole purpose of substantive consolidation is to ensure the equitable treatment of all creditors" and that the *Vecco Construction* factors are "merely variants on two critical factors: (i) whether creditors dealt with the entities as a single economic unit and 'did not rely on their separate identity in extending credit,' . . . or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors." *In re Augie/Restivo Baking Co. Ltd.*, 860 F.2d at 518–519. *See, e.g., In re 599 Consumer Electronics, Inc.*, 195 B.R. at 248; *In re Adelphia Comm'ns Corp.*, 361 B.R. at 359. Where creditors rely on the separate existence of corporate entities in extending credit, or would suffer more than minimal harm from disregarding such separate existence, the balance of equities weighs against substantive consolidation. *In re Donut Queen, Ltd.*, 41 B.R. at 710. The Eleventh Circuit, like the Second Circuit, has stressed creditor reliance and prejudice as the key factors in any consolidation analysis: if a party opposing substantive consolidation establishes that "(1) it has relied on the separate credit of one of the entities to be consolidated; and (2) it will be prejudiced by substantive consolidation," then substantive consolidation may be ordered only if the "demonstrated benefits of consolidation 'heavily' outweigh the harm." *Eastgroup Properties*, 935 F.2d at 249 (internal citations omitted) (citing *In re Auto-train*, 810 F.2d at 276). *See, e.g., In re Drexel Burnham Lambert Group Inc.*, 138 B.R. 723, 765 (Bankr. S.D. N.Y. 1992). *But see Owens Corning*, 419 F.3d at 210 (stating that the *Auto-Train* standard permits substantive consolidation to be considered at a "threshold not sufficiently egregious and too imprecise for easy measure").

The United States Court of Appeals for the Third Circuit has both criticized and expanded upon the *In re Auto-train* standard. Like the Second and Eleventh Circuits, the Third Circuit (which includes the Delaware federal courts) has offered a two-part inquiry that stresses creditor reliance: "In our Court what must be proven (absent consent) concerning the entities for whom substantive consolidation is sought is that (1) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors." *In re Owens Corning*, 419 F.3d 195, 211 (3d Cir. 2005). While the *Owens Corning* decision reaffirms and the basic framework, it also criticizes the traditional threshold of prejudice. *Id.* at 210 (stating that the *Auto-Train* standard permits substantive consolidation to be considered at a "threshold not sufficiently egregious and too

imprecise for easy measure"). The *Owens Corning* test ultimately simplifies the *Augie/Restivo* test to a disregard and reliance test, and disfavors *Auto-train*'s lower threshold of prejudice. We believe that under *Owens Corning*, a motion for substantive consolidation of the parties, and their assets and liabilities, described in this opinion would receive the same treatment as outlined elsewhere in this letter.

Here the Issuer and the Trustee are entering into the Sale Agreement and the Indenture, respectively, and the underwriters are purchasing and marketing the Transition Bonds, in reliance on the Transition Property and in reliance on the Issuer's identity as a legal entity separate from CEHE.[14] One element of such reliance is their expectation that the Transition Property is not subject to the claims of creditors of CEHE or the other members of the CEHE Affiliated Group. Thus, the Issuer, the Trustee and the Transition Bondholders would be seriously prejudiced if consolidation were ordered. We assume that the Issuer or the Trustee or the Transition Bondholders and their assigns or another party in interest would oppose any motion or proceeding to consolidate the Issuer with CEHE. Courts have relied upon the existence of such prejudice as grounds for denying substantive consolidation. *See, e.g. In re Flora Mir Candy Corp.*, 432 F.2d 1060, 1062–63 (2d Cir. 1970); *See, also, Anaconda Building Materials Co.* v. *Newland*, 336 F.2d 625, 628 (9th Cir. 1964).[15]

As noted above, a court would also consider the resulting harm to CEHE's creditors if consolidation were not ordered. As previously described, CEHE's consolidated financial statements will contain a footnote stating that the Issuer has both a separate existence and separate creditors. Creditors of CEHE, therefore, should not be able to claim reasonably that they had assumed the Issuer was merely a division of CEHE. Furthermore, none of CEHE's creditors should suffer any harm as a result of a court refusing to consolidate the Issuer with CEHE assuming, as we do, that CEHE has received fair value for causing the Transition Property to be granted to the Issuer.

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[14] Rejecting an argument to consolidate, the court in Doctors Hospitals specifically noted the parties reliance on the legal separateness of the entities at issue, that the parties had obtained a legal opinion regarding the risk of consolidation, and that they relied on unambiguous transaction documents. *In re Doctors Hospital of Hyde Park*, 360 B.R. at 847–49.

[15] Conversely, courts have also noted the absence of objecting parties as a factor favoring consolidation. *See, e.g., In re Standard Brands Paint Co.*, 154 B.R. 563, 571–572 (Bankr. C.D. Cal. 1993) (court inferred lack of harm to creditors from the fact that no party in interest objected to consolidation); *In re Buckhead America Corp. et al*, Case Nos. 92-978 through 92-986 (Bankr. D. Del. Aug. 13, 1992) (order granting substantive consolidation of a special purpose subsidiary with its parent after all objections from the subsidiary's creditors had been resolved through settlement); *In re Drexel Burnham Lambert Group*, 138 B.R. 723, 766 (Bankr. S.D.N.Y. 1992) (citing lack of objections from creditors in approving a plan of reorganization premised on substantive consolidation); *In re Frontier Airlines, Inc.*, 93 B.R. 1014, 1016 (Bankr. D. Colo. 1988) (granting substantive consolidation where "complete financial separation of the entities would be difficult to accomplish" and "[n]o party in interest" had objected). Accordingly, we express no opinion as to whether a bankruptcy court would order consolidation should no party in interest object to consolidation.

Some courts have considered whether substantive consolidation increases the likelihood of the debtor's rehabilitation and reorganization. Factors considered include the potential savings in cost and time, the elimination of duplicate claims and whether there is a question of who among the debtors is liable. *See Continental Vending*, 517 F.2d at 1001.[16] Eliminating the need to disentangle assets, however, does not, without more, justify consolidation. "Substantive consolidation should be used only after it has been determined that all creditors will benefit because untangling is either impossible or so costly as to consume the assets." *Augie/Restivo*, 860 F.2d at 519; *see also Owens Corning*, 419 F.3d at 211 (reaffirming that substantive consolidation is a remedy "of last resort," and not a means to simply "make postpetition accounting more convenient"); *In re Reserve Capital Corp.*, 2007 WL 880600, *5 (Bankr. N.D.N.Y. Mar. 21, 2007) (unpublished opinion) (applying Owens Corning for the same, denying substantive consolidation in part because the untangling of affairs "was not impossible"). Based on the facts and assumptions set forth herein, the assets and business functions of the Issuer will not be so entangled with those of CEHE as to make separate identification of each one's assets and liabilities impossible or prohibitively costly.

9. Conclusion

Based on the foregoing facts, and subject to the assumptions, qualifications and discussions contained herein and the reasoned analysis of analogous case law (although there is no precedent directly on point), it is our opinion that a United States Court sitting in bankruptcy, in the event of a case under the Bankruptcy Code involving CEHE as debtor (whether or not the Issuer is a debtor in a case under the Bankruptcy Code at the same time), would not disregard the separate limited liability company existence of the Issuer so as to consolidate the Issuer's assets and liabilities with those of CEHE. Our opinion is subject to the further qualifications that (i) the assumptions set forth herein have been, are and will continue to be true in all material respects, (ii) there are no additional facts that would materially affect the validity of the assumptions and conclusions set forth herein or upon which this opinion is based (and, to our knowledge and based on the Factual Certificates provided to us by CEHE and Issuer, there are no such additional material facts), (iii) such case is properly presented and argued and (iv) the law is properly applied.

[16] *See also In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 723, 766 (Bankr. S.D.N.Y. 1992) (approving a plan of reorganization premised on substantive consolidation where no creditors had objected and where establishing to whom actual liability, if any, should be allocated would be a "herculean task, consuming years of costly professional services, thereby draining significant amounts of value from the Debtors' estates"); *In re James River Coal Co.*, 360 B.R. 139, 172–73 (Bkrtcy. E.D. Va. 2007) (stating that the already confirmed substantive consolidation saved creditors great amounts of time and money, and that directors who failed to object at confirmation could not later rely on the separate legal existence of the consolidated entities); *but see In re Ark-La-Tex Timber Co., Inc.*, 482 F.3d 319, 327 n.7 (5th Cir. 2007) (holding that, contrary to the parties interpretation of a prior order, substantive consolidation "would have been impossible to effect" under the facts of the case, because neither of the target-affiliates were themselves debtors, notwithstanding their contributions to the bankruptcy estate).

B. Property of CEHE's Estate.

Sections 541(a)(1) and (a)(6) of the Bankruptcy Code provides that the property of a bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." Although federal law governs the extent to which a debtor's interest in property is part of that debtor's estate, *see, e.g., In re Crysen/Montenay Energy Co.*, 902 F.2d 1098, 1101 (2d Cir. 1990), "[p]roperty interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Butner v. United States*, 440 U.S. 48, 55 (1979). *Accord Barnhill v. Johnson*, 503 U.S. 393, 398 (1992) ("in the absence of any controlling federal law, 'property' and 'interests in property' are creatures of state law."); *Nobleman v. American Sav. Bank*, 508 U.S. 329 (1993 (same). Relying on *Butner*, the United States Court of Appeals for the Ninth Circuit has explained:

> Although section 541(a)(1) is broadly worded, it does not define the terms "property" or "interest in property."... Since the Bankruptcy Code itself does not determine the existence and scope of a debtor's interest in property, these threshold issues are properly resolved by reference to state law.

In re Harrell, 73 F.3d 218, 219 (9th Cir. 1996). *Accord In re Jason Realty, L.P.*, 59 F.3d 423, 427–30 (3d Cir. 1995); *In re Howard's Appliance Corp.*, 874 F.2d 88, 93 (2d Cir. 1989) (citing cases).

1. Debtor's Rights in Property — Bankruptcy Law and State Law

As discussed above, bankruptcy courts look to state law to determine the existence and scope of a debtor's rights in property. According to our opinion delivered concurrently with this opinion, Texas state law clearly provides that the Transition Property belongs to the Issuer and not to CEHE and that such property constitutes a present property right for purposes of contracts concerning the sale or pledge of property. PURA § 39.304. Accordingly, a bankruptcy court properly applying PURA to the transactions contemplated by the Financing Order (the "Transactions") would conclude that the Transition Property is property of the Issuer and that any proceeds of that property shall be held in trust for the Issuer. PURA § 39.309(e).

However, state property rights must be enforced in a manner consistent with federal bankruptcy policy. Where state property law expressly contravenes federal bankruptcy priorities, the provisions of the Bankruptcy Code preempt state law pursuant to the Supremacy Clause (Article VI) of the United States Constitution. For example, in *In re County of Orange*, 191 B.R. 1005 (Bankr. C.D. Cal. 1996), the court held that a California statute was invalid to the extent that it conflicted with federal bankruptcy law. Orange County sued Merrill Lynch for the return of marketable securities that the County had delivered to Merrill Lynch pursuant to various securities repurchase agreements. Merrill Lynch argued that the securities in dispute

re purchased with funds which, pursuant to Section 27100.1 of the California Government ode,[17] were held in trust by the County and therefore were not the County's property. Merrill inch further argued that the trust which was impressed upon the non-county funds survived, notwithstanding that the trust funds had been commingled with County funds to such an extent at no tracing of the trust funds was possible.[18]

It is a general rule of federal bankruptcy law that a creditor beneficiary of an insolvent rustee/debtor who is seeking to exclude funds from the trustee/debtor's estate under theories of ate trust law must be able to trace its funds "or otherwise the funds become property of the ebtor" and the beneficiary becomes a general unsecured creditor. *In re County of Orange*, 191 .R. at 1015. *See also In re Hedged-Investments Assocs., Inc.*, 48 F.3d 470, 474 (10th Cir. 995); *First Federal of Michigan v. Barrow*, 878 F.2d 912, 915 (6th Cir. 1989); *In re Bullion Reserve of North America*, 836 F.2d 1214, 1218 (9th Cir.), *cert. denied*, 486 U.S. 1056 (1988); *Elliot v. Bumb*, 356 F.2d 749, 754–55 (9th Cir. 1966).[19] The requirement that a creditor must ufficiently trace its funds in a debtor's estate furthers the federal policy of equal distribution mong similarly situated creditors. *In re County of Orange*, 191 B.R. at 1016. After concluding hat Section 27100.1 created a trust in favor of the entities that deposited funds with Orange ounty, the court, applying this general principle of federal bankruptcy law, held that to the xtent Section 27100.1 "was intended to eliminate tracing when a debtor trustee is insolvent, it

[17] Section 27100.1 of the California Government Code provides: "when any public entity. . . who is required by law to deposit funds into the county treasury, makes a deposit, those funds shall be deemed to be held in trust by the county treasury on behalf of the depositing entity. . .the relationship of the depositing entity. . .and the county shall not be one of creditor-debtor."

[18] We note there have been attempts to federalize the question of whether a pre-bankruptcy sale should be recharacterized as a secured loan. See, e.g., S. 2798, 107th Cong. (2002); and H.R. 5221, 107th Cong. (2002). This type of legislation would attempt to override state statutes by authorizing federal bankruptcy judges to recharacterize a transaction as a secured loan, notwithstanding the state-law characterization. Thus far, no such federal recharacterization legislation of this type has become law. *See, generally*, Steven L. Schwarcz, "Securitization Post-Enron," 25 CARDOZO L. REV. 1539, 1539–43 (2004). We would note, however, that the power to recharacterize a transaction at the federal level has been legislated in other arenas. *See* 7 U.S.C. §499e(c) (1999) (part of the Perishable Agricultural Commodities Act "PACA", which mandates that proceeds from perishable commodities shall be held in trust for the benefit of all unpaid suppliers or sellers, giving an unsecured bona fide purchaser's claim priority over the claim of a secured lender); and *Reaves Brokerage Co. Inc. v. Sunbelt Fruit & Vegetable Co Inc.*, 336 F.3d 410 (5th Cir. 2003) (even though the documentation treated the transaction as a sale, the Fifth Circuit concluded that, at least in the context of a PACA claim, the factoring agreement evidenced a secured loan rather than a sale. The court did not acknowledge a statute in the applicable state that characterized the transaction as a sale in its opinion).

[19] In 1994, Congress enacted Section 541(b)(5) of the Bankruptcy Code, which provides that cash proceeds of money order sales are not property of the estate of a money order seller, notwithstanding commingling with the seller's other assets, subject to certain conditions. Money order note issuers are normally protected by trusts created under state law. That Congress adopted a special provision of the Code to protect note issuers of money orders when insolvent sellers commingle money order proceeds confirms that, in general, the Bankruptcy Code does not protect the state law rights of trust beneficiaries when trust funds are commingled.

conflicts with federal bankruptcy law" and was therefore preempted.[20] *Id.*; *see also In re Unicorn Computer Corp.*, 13 F.3d 321, 325 n.6 (9th Cir. 1994) (state law establishing constructive trusts can be applied in bankruptcy only "in a manner not inconsistent with the federal bankruptcy law."); *Lone Star Milk Producers, Inc. v. Litzler*, 370 B.R. 671, 677–78 (Bankr. N.D. Tex. 2007) (holding that "a state may create a statute that imposes a trust excluding property from a bankruptcy estate as long as the statute also has valid non-bankruptcy applications and the trust attaches prior to the petition date"). In each case the state laws which attempted to eliminate any ordinary tracing requirement that typically applies to constructive trusts, ran afoul of the strong bankruptcy policy against state-created priorities that are designed to protect a particular class of creditors in bankruptcy without compliance with the requirements of the Bankruptcy Code and thus were inconsistent with the federal bankruptcy law. *See Elliot v. Bumb*, 356 F.2d at 754; *but see Lone Star Milk Producers, Inc.*, 370 B.R. at 678–80 (holding that chapter 181 of the Texas Agriculture Code created an express trust, and that although tracing was not required under the statute, the statute was valid and enforceable in a bankruptcy proceeding). Indeed, even a federal law that attempts to impose a trust by statute may be effective in bankruptcy only if the *res* that is the subject of the trust can be identified. *See, e.g., Begier v. United States*, 496 U.S. 53 (1991).

We note that PURA provides that the sale of the Transition Property is a true sale "regardless of . . . the fact that the electric utility acts as the collector of transition charges relating to the transition property." PURA § 39.308. PURA further provides a method of perfecting a security interest in the Transition Property, and states that such a security interest "is not impaired . . . by the commingling of funds arising from transition charges with other funds. . . If transition property has been transferred to an assignee, any proceeds of that property shall be held in trust for the assignee." PURA § 39.309(e). In light of the foregoing cases, however, we express no opinion as to whether a bankruptcy court would enforce these provisions of PURA in a CEHE bankruptcy proceeding to the extent such enforcement would exempt the Issuer or its assigns from the tracing requirements of federal bankruptcy law with respect to Collections that are in the possession of the Servicer, the collection agent or any member of the CEHE Affiliated Group. We note, however, that, were CEHE to default in its obligations under the Servicing Agreement due to any such inability to trace funds, then, under Section 365(b)(i) of the Bankruptcy Code, CEHE's right to assume the Servicing Agreement and therefore its right to continue receiving and remitting Collections would be subject to CEHE doing the following: (i) curing, or providing adequate assurance that it would promptly cure, such default; (ii) compensating, or providing adequate assurance that it would promptly compensate, the Issuer or the Trustee, as applicable, for actual pecuniary loss resulting from such default and (iii) providing adequate assurance of future performance under the Servicing Agreement.

[20] It is not obvious that Section 27100.1 conflicts with federal bankruptcy law. Section 27100.1 on its face does not address the commingling of funds; it merely establishes a trust. The court could have simply conceded the existence of a trust and then applied traditional federal bankruptcy principles regarding the commingling of trust and non-trust funds by an insolvent trustee. The court did not address this issue.

Based on *In re County of Orange*, a bankruptcy trustee of CEHE, or CEHE, as debtor in possession, could also assert in a bankruptcy proceeding that PURA invalidly attempts to rewrite bankruptcy priorities by removing property from CEHE's bankruptcy estate (i.e., the Transition Property) that would otherwise be available to satisfy the claims of CEHE's general creditors. We do not believe that *In re County of Orange* should be interpreted so broadly. In *California v. Farmer's Markets (In re Farmer's Markets)*, 792 F.2d 1400, 1403 (9th Cir. 1986), the Ninth Circuit was asked to determine whether a California statute which disallowed the transfer of a liquor license until certain state taxes were paid conflicted with the Bankruptcy Code. The court said, in language that could apply with equal force to PURA:

> Section 24049 could arguably be cast as inconsistent with the bankruptcy process because parties claiming under it may fare better in bankruptcy than they would if there were no such statute. Yet this argument confuses the classification of an interest with the displacement of the Code's priority scheme. To classify what might otherwise be a lesser claim as a proprietary interest does not displace the priority provisions. It merely reclassifies an interest within that scheme. In *Artus v. Alaska Department of Labor, Employment Security Division (In re Anchorage International Inn, Inc.)*, 718 F.2d 1446 (9th Cir. 1983), we concluded that state law does not conflict with federal bankruptcy law merely because it favors one class of creditors over another. *Id.* at 1451. See also J.A. MacLachlan, *Handbook of the Law of Bankruptcy* 145 (1956) ("Priorities are to be distinguished from property rights."). The Code expressly recognizes such preferences in the form of perfected security interests and statutory liens. 11 U.S.C. §§ 506(a), 545 (1982). Although it does preempt state law schemes to circumvent the bankruptcy laws by invalidating liens or priorities triggered by the bankruptcy or insolvency of the debtor, 11 U.S.C. § 545 (1982), § 24049 presents no such problem.

Farmers Markets at 1403. PURA, to use the words of *Farmers Markets*, classifies an interest; it does not purport to displace the Bankruptcy Code's priority scheme.

In addition, the *Orange County* court noted that, according to the legislative history of §27100.1, the express intent of the California legislature in enacting that section was "to make sure that the funds of depositing entities would not be considered property of a bankrupt county." 191 B.R. at 1017. In this regard, the California legislature attempted to create a new statutory barrier which would keep creditors from obtaining the benefit of existing types of property of the debtor. By contrast, the Texas legislature enacted PURA as part of a comprehensive piece of legislation which provides for the deregulation of the Texas electric utility market. *See* 220 ILCS 5/16-101 et seq. As part of that enactment, the Texas legislature created transition property as an entirely new type of property and defined its extent, initial ownership, permissible possession and use, and methods of absolute transfer. The Texas legislature's definition of the contours of a new type of property fundamentally differs from the California legislature's attempted alteration of federal bankruptcy law applicable to existing types of property.

Courts have also found a "federal interest [that] requires a different result" in cases involving leases of real property. In cases involving leases under state statutory schemes for the issuance of industrial revenue bonds, for example, the private enterprise that will benefit from the bonds "leases" property from a governmental entity for a period of years, with an option to purchase the property at the end of the term for nominal consideration. Typically, state law (as well as the bankruptcy courts) would find such a lease not to be a true lease but to be a disguised financing transaction. In the industrial revenue bond context, however, state statutes often provide otherwise. The bankruptcy courts have ruled (although not uniformly) that the lease may be treated in bankruptcy as a secured financing. *See, e.g. City of Olathe v. KAR Dev. Assocs., L.P.* (*In re KAR Dev. Assocs., L.P.*), 180 B.R. 597 (Bankr. D. Kan 1994), aff'd, 180 B.R. 629 (D. Kan. 1995), and cases cited therein.

Thus, there is no clear line as to when a court will conclude that federal bankruptcy policy requires that it override state law to determine whether property is property of the estate under section 541(a)(1) or (a)(6). The Supreme Court established the basic principle that although property rights in bankruptcy generally are determined in accordance with the relevant state law, this principle gives way when some type of federal interest or policy is defeated by respecting state law. The Supreme Court failed, however, to establish a framework to determine whether a federal policy or interest is involved and how to identify those federal policies that are sufficiently important to justify preemption. Nor does it appear that any other court has successfully done so. The cases seem to rely on a case-by-case approach in which the court must look at the underlying goals of bankruptcy and determine whether respecting state law under the circumstances would circumvent these bankruptcy goals. *But see Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1987) (court may not use general equitable powers to further underlying goals of bankruptcy or reorganization when to do so is contrary to a provision of the Bankruptcy Code.).

On balance, however, and except to the extent it could be construed to eliminate tracing requirements under federal bankruptcy law with respect to Collections that are in the possession of the Servicer, the collection agent or any other member of the CEHE Affiliated Group, we do not believe that PURA conflicts with federal bankruptcy law so as to justify a bankruptcy court's disregard of state law property rights created and intended to be created thereby.

2. Conclusion

Based on the foregoing facts, and subject to the qualifications and discussion contained herein and the reasoned analysis of analogous case law (although there is no precedent directly on point), it is our opinion that, if CEHE were to become a debtor under the Bankruptcy Code, a court would hold that the Transition Property (including the revenues and collections thereon) is not property of the estate of CEHE under Sections 541(a)(1) or (a)(6) of the Bankruptcy Code and Section 362(a) of the Bankruptcy Code would not apply to prevent CEHE in its capacity as Servicer from paying Collections to the Issuer and its assigns. We note, however, that Section 362(a)(3) of the Bankruptcy Code operates as a stay upon any acts to obtain possession of

"property from the estate" without regard to whether such property belongs to the estate and we therefore express no opinion as to whether Section 362 would stay a party from obtaining possession of Collections or proceeds thereof which are in CEHE's possession and/or control pending a final order of the bankruptcy court authorizing and directing the distribution of such Collections and proceeds to the Issuer or its assignee.

Our opinion is subject to the further qualifications that (i) the assumptions set forth herein are and continue to be true in all material respects, (ii) there are no additional facts that would materially affect the validity of the assumptions and conclusions set forth herein or upon which this opinion is based (and, to our knowledge and based on the Factual Certificates provided to us by CEHE, the Issuer, there are no such additional material facts), (iii) such case is properly presented and argued and (iv) the law is properly applied.

IV. QUALIFICATIONS

We wish to note that the existing reported case law is not conclusive as to the relative weight to be accorded to the factors present in the Transactions and does not provide consistently applied general principles or guidelines with which to analyze all of the factors present in the Transactions. Indeed, we are not aware of any decisions addressing the vesting, creation or transfer of any transition property under PURA. Instead, judicial decisions as to questions of non-consolidation and true sale are usually made on the basis of an analysis of the facts and circumstances of the particular case. Furthermore, there are facts and circumstances in the Transactions which we believe to be relevant to our conclusion but which, because of the particular facts at issue in the reported cases, are not generally discussed in the reported cases as being material factors. Moreover, the authorities we have examined contain certain cases and authorities that are arguably inconsistent with our conclusions expressed herein. These cases and authorities are, however, in our opinion distinguishable in the context of the Transactions.

If CEHE were to become a debtor under the Bankruptcy Code and if it were asserted that the beneficial interest in and legal title to the Transition Property were part of CEHE's bankruptcy estate, we express no opinion as to how long the Issuer, the Trustee or any assignee could be precluded from exercising remedies against to CEHE or with respect to the Transition Property before the validity of such an assertion could be finally decided. We also express no opinion as to whether, if it were asserted that the beneficial interest in and legal title to any of the Transition Property and the collections were part of CEHE's bankruptcy estate, a court would permit such entities to use collections from the Transition Property without the consent of the Issuer, the Trustee or any assignee, either before deciding the issue or pending appeal after a decision adverse to the Issuer, the Trustee or any assignee.

We note further that CEHE's rights to service the Transition Property and its rights to be paid the servicing compensation under the Servicing Agreement would likely be property of CEHE's bankruptcy estate.

Additionally, we express no opinion as to any Transition Property or Collections that are commingled with CEHE's property as of the date of a bankruptcy filing[21], and we note that the court may, on an interim basis, impose a temporary or preliminary stay with respect to the Transition Property or the Collections thereon in order to afford itself time to ascertain the facts and apprise itself of the law. *See, e.g., In re Leisure Dynamics,* 33 B.R. 171 (Bankr. D. Minn. 1983) (letter of credit).

We express no opinion herein as to the enforceability, perfection, validity, binding nature or legality of any transfer, document, or agreement or any bankruptcy case affecting any entity other than CEHE.

All of the foregoing analyses and the conclusions set forth herein are premised upon, and limited to, the law and the documents evidencing and governing the transactions described herein in effect as of the date of this letter. Furthermore, we note that a court's decision regarding matters upon which we opine herein will be based on the court's own analysis and interpretation of the factual evidence before the court and of applicable legal principles.

Our opinions are limited to the specific opinions requested in Section I of this letter and are limited in all respects to laws and facts existing on the date of this letter. We express no opinions implicitly herein and we assume no obligation to advise you with respect to any issues not specifically addressed herein. The opinions set forth above are given as of the date hereof and we disavow any undertaking or obligation to advise you of any changes in law or any facts or circumstances that may hereafter occur or come to our attention that could affect such opinions. Furthermore, it is our and your understanding that the foregoing opinions are not intended to be a guaranty as to what a particular court would actually hold, but an opinion as to the decision a court should reach if the issue were properly presented to it and the court followed what we believe to be the applicable legal principles. In that regard, you should be aware that all of the foregoing opinions are subject to inherent limitations because of the pervasive equity powers of bankruptcy courts, the overriding goal of reorganization to which other legal rights and policies may be subordinated, the potential relevance to the exercise of judicial discretion of future-arising facts and circumstances and the nature of the bankruptcy process.

This opinion is solely for your benefit in connection with the Transactions and may not be relied upon or used by, circulated, quoted or referred to, nor may copies hereof be delivered to, any other person without our prior written approval; provided, however, that the parties listed on Schedule I hereto may rely on this opinion as if it were addressed to each of them.

We have assumed throughout this opinion (i) that there has been no (and will not be any) fraud in connection with the transactions described herein, (ii) the accuracy of the representations and warranties set forth in the Relevant Documents as to factual matters and (iii) the transactions

[21] See our discussion in Section III.B.1 above.

contemplated by the Relevant Documents will not be subject to avoidance as a fraudulent transfer under the Bankruptcy Code or other insolvency laws. Our opinion is limited to the Federal laws of the United States of America and the State of Texas.

Very truly yours,

Baker Botts L.L.P.

APPENDIX A

CenterPoint Energy Transition Bond Company IV, LLC
1111 Louisiana, Suite 4664B
Houston, Texas 77002

CenterPoint Energy Houston Electric, LLC
1111 Louisiana
Houston, Texas 77002

Deutsche Bank Trust Company Americas
60 Wall Street
27th Floor
New York, New York 10005
Attn: Structured Finance Services, Trust & Securities Services

Standard & Poor's Ratings Services, a Standard & Poor's Financial Services LLC business
Attention: Asset Backed Surveillance Department
55 Water Street
New York, New York 10041

Moody's Investors Service, Inc.
Attention: ABS Monitoring Department
7 World Trade Center at 250 Greenwich Street
New York, New York 10007

Fitch, Inc.
Attention: ABS Surveillance
1 State Street Plaza
New York, New York 10004

As Representatives of the Underwriters named in Schedule II to the Underwriting Agreement:

Goldman, Sachs & Co.
200 West Street
New York, New York 10282

Citigroup Global Markets Inc.
388 Greenwich Street
New York, New York 10013

Morgan Stanley & Co. LLC
1585 Broadway
New York, New York 10036

EXHIBIT A

FACTUAL CERTIFICATE OF CEHE

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC

Certificate

I, Linda Geiger, do hereby certify that I am the Assistant Treasurer of CenterPoint Energy Houston Electric, LLC, a Texas limited liability company ("CEHE"), and that the following statements are true and correct:

1. This certificate is being rendered in connection with:

(i) the establishment and creation of the Transition Property pursuant to the Financing Order;

(ii) the sale of the Transition Property from CEHE to the Issuer pursuant to the Sale Agreement;

(iii) the agreement to service the Transition Property pursuant to the Servicing Agreement; and

(iv) the concurrent issuance of the Transition Bonds by the Issuer secured by, among other things, the Transition Property and all of the Issuer's rights under the Sale Agreement, pursuant to that certain Indenture, dated as of January 19, 2012, and that certain First Supplemental Indenture dated as of January 19, 2012 (collectively, the "Indenture"), between CenterPoint Energy Transition Bond Company IV, LLC, a Delaware limited liability company (the "Issuer"), and Deutsche Bank Trust Company Americas, a New York banking corporation ("Deutsche"), as trustee (in such capacity, the "Trustee").

All capitalized terms used above and below in this Certificate and not otherwise defined shall have the meanings specified in the Indenture unless the context clearly indicates otherwise.

2. The undersigned is familiar with the business of CEHE and the transactions and other factual matters described in the opinion rendered by Baker Botts L.L.P. of even date herewith with respect to (a) the substantive consolidation of the assets and liabilities of the Issuer with those of CEHE in the event of a bankruptcy of CEHE and (b) whether the Transition Property would constitute part of a bankruptcy estate of CEHE (the "Opinion"), and has made such investigations and inquiries as may be necessary to enable the undersigned to execute and deliver this Certificate.

3. The undersigned has reviewed the Relevant Documents (as such term is defined in the Opinion) and the Opinion and, with respect to the factual assumptions set forth in Section II of the Opinion, hereby certifies that each such factual assumption relating to CEHE is, to the best of her knowledge after due inquiry, true and correct in all

material respects and does not fail to state a material fact the omission of which makes the statement as it appears incomplete or misleading. The undersigned explicitly disclaims making any certifications as to any legal conclusions contained therein, including, without limitation: (a) the legal effect of the provisions of PURA (as such term is defined in the Opinion) and the Financing Order, (b) the legal effect of each of the Relevant Documents, (c) the legal status of the Financing Order, and (d) the legal effect under federal income or Texas tax laws of CEHE's election under the "check-the-box" regulation.

4. Baker Botts L.L.P. may rely on this Certificate in rendering the Opinion.

IN WITNESS WHEREOF, I have hereunto signed my name this 19th day of January, 2012.

Linda Geiger
Assistant Treasurer

EXHIBIT B

FACTUAL CERTIFICATE OF THE ISSUER

CENTERPOINT ENERGY TRANSITION BOND COMPANY IV, LLC

Certificate

I, Linda Geiger, do hereby certify that I am an Authorized Officer of CenterPoint Energy Transition Bond Company IV, LLC, a Delaware limited liability company (the "Issuer"), and the following statements are true and correct:

1. This certificate is being rendered in connection with:

(i) the establishment and creation of the Transition Property pursuant to the Financing Order;

(ii) the sale of the Transition Property from CEHE to the Issuer pursuant to the Sale Agreement;

(iii) the agreement to service the Transition Property pursuant to the Servicing Agreement; and

(iv) the concurrent issuance of the Transition Bonds by the Issuer secured by, among other things, the Transition Property and all of the Issuer's rights under the Sale Agreement, pursuant to that certain Indenture, dated as of January 19, 2012, and that certain First Supplemental Indenture dated as of January 19, 2012 (collectively, the "Indenture"), between the Issuer and Deutsche Bank Trust Company Americas, a New York banking corporation ("Deutsche"), as trustee (in such capacity, the "Trustee").

All capitalized terms used above and below in this Certificate and not otherwise defined shall have the meanings specified in the Indenture unless the context clearly indicates otherwise.

2. The undersigned is familiar with the business of the Issuer and the transactions and other factual matters described in the opinion rendered by Baker Botts L.L.P. of even date herewith with respect to (a) the substantive consolidation of the assets and liabilities of the Issuer with those of CEHE in the event of a bankruptcy of CEHE and (b) whether the Transition Property would constitute part of a bankruptcy estate of CEHE (the "Opinion"), and has made such investigations and inquiries as may be necessary to enable the undersigned to execute and deliver this Certificate.

3. The undersigned has reviewed the Relevant Documents (as such term is defined in the Opinion) and the Opinion and, with respect to the factual assumptions set forth in Section II of the Opinion, hereby certifies that each such factual assumption relating to the Issuer is, to the best of her knowledge after due inquiry, true and correct in all material respects and does not fail to state a material fact the omission of which makes the statement as it appears incomplete or misleading. The undersigned explicitly

disclaims making any certifications as to any legal conclusions contained therein, including, without limitation: (a) the legal effect of the provisions of PURA (as such term is defined in the Opinion) and the Financing Order, (b) compliance with the applicable Delaware law in the formation of the Issuer, (c) the legal effect of each of the Relevant Documents, (d) the legal status of the Financing Order, and (e) the legal effect under federal income or Texas tax laws of CEHE's election under the "check-the-box" regulation.

4. Baker Botts L.L.P. may rely on this Certificate in rendering the Opinion.

IN WITNESS WHEREOF, I have hereunto signed my name this 19th day of January, 2012.

Linda Geiger
Assistant Treasurer

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SCHEDULE I

Additional Reliance Parties

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of May 2019, a true and correct copy of the foregoing document was served on all parties of record in accordance with 16 Tex. Admin. Code § 22.74.