AEP TEXAS CENTRAL CO

FORM 8-K
(Current report filing)

Filed 10/11/2006 For Period Ending 10/11/2006

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Fiscal Year	12/31

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 OR 15(d) of The Securities Exchange Act of 1934

Date of Report (Date of earliest event reported) October 11, 2006

AEP Texas Central Company
(Exact name of registrant as specified in its charter)

State of Texas	**333-136787**	**74-0550600**
(State of other jurisdiction of incorporation)	**(Commission File Number)**	**(IRS Employer Identification No.)**

1 Riverside Plaza, Columbus, Ohio	**43215**
(Address of principal executive offices)	**(Zip Code)**

Registrant's telephone number, including area code (614) 716-1000

(Former name or former address, if changed since last report.)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Section 9. Financial Statements and Exhibits.

Item 9.01. Financial Statements and Exhibits .

(a) Not applicable.

(b) Not applicable.

(c) Exhibits:

5.1	Opinion of Sidley Austin LLP with respect to legality.
8.1	Opinion of Sidley Austin LLP with respect to federal tax matters.
23.1	Consent of Sidley Austin LLP (included in its opinions filed as Exhibits 5.1 and 8.1).
99.1	Opinion of Sidley Austin LLP with respect to constitutional matters.
99.2	Opinion of Bracewell & Giuliani LLP with respect to constitutional matters.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

AEP TEXAS CENTRAL COMPANY

By: /s/ Stephan T. Haynes
Stephan T. Haynes
Assistant Treasurer

Date: October 11, 2006

EXHIBIT INDEX

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99.1	Opinion of Sidley Austin LLP with respect to constitutional matters.
99.2	Opinion of Bracewell & Giuliani LLP with respect to constitutional matters.

Exhibit 5.1

SIDLEY AUSTIN LLP
ONE SOUTH DEARBORN
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(312) 853 7036 FAX

BEIJING GENEVA SAN FRANCISCO
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CHICAGO LONDON SINGAPORE
DALLAS LOS ANGELES TOKYO
FRANKFURT NEW YORK WASHINGTON, DC

FOUNDED 1866

October 11, 2006

AEP Texas Central Company
AEP Texas Central Transition Funding II LLC
1 Riverside Plaza
Columbus, Ohio 43215

Re: AEP Texas Central Transition Funding II LLC

Ladies and Gentlemen:

We have acted as special counsel to AEP Texas Central Transition Funding II LLC, a Delaware limited liability company (the "Company"), in connection with the preparation of the Registration Statement filed on Form S-3 (the "Registration Statement") with the Securities and Exchange Commission (the "Commission") under the Securities Act of 1933, as amended (the "Securities Act"), relating to the registration of transition bonds (the "Transition Bonds") of the Company to be offered in such manner as described in the form of the prospectus (the "Prospectus") included as part of the Registration Statement. The Transition Bonds are to be issued under an Indenture (the "Indenture") between the Company and The Bank of New York, a New York banking corporation, as indenture trustee (the "Indenture Trustee").

We are familiar with the proceedings taken and proposed to be taken by the Company in connection with the proposed authorization, issuance and sale of the Transition Bonds. We have examined and relied upon originals, or copies of originals, certified or otherwise identified to our satisfaction of such records of the Company and such agreements, certificates of public officials, certificates of officers or other representatives of the Company and other instruments, and examined such questions of law and satisfied ourselves to such matters of fact as we deemed relevant or necessary as a basis for this letter. In rendering the opinions expressed in this letter, 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 and the conformity with the original documents of any copies thereof submitted to us for examination. As to any facts material to the opinions expressed herein which we have not independently established or verified, we have relied upon statements and representations of officers and other representatives of the Company or others.

Based upon the foregoing, we are of the opinion that:

1. The Company is a limited liability company validly existing and in good standing under the laws of the State of Delaware.

2. The Company has limited liability company power and authority to execute and deliver the Indenture and to authorize and issue the Transition Bonds and to perform its obligations under the Indenture and the Transition Bonds.

3. Each series of Transition Bonds will be legally issued and binding obligations of the Company, except to the extent enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer or similar laws affecting creditors' and contracting parties rights generally or general principles of equity (regardless of whether enforceability is considered in a proceeding in equity or at law) when (i) the Registration Statement, as finally amended (including any post-effective amendments), shall have become effective under the Securities Act; (ii) the Indenture (including any necessary supplemental indenture) shall have been qualified under the Trust Indenture Act of 1939, as amended, and duly executed and delivered by the Company and the Indenture Trustee; (iii) a Prospectus Supplement with respect to such series of Transition Bonds shall have been filed (or transmitted for filing) with the Commission pursuant to Rule 424 under the Securities Act; (iv) all necessary orders, approvals and authorizations for the Company's purchase of the transition property from AEP Texas Central Company, a Texas corporation ("TCC"), in exchange for the net proceeds of the Transition Bonds, shall have been obtained by the Company; (v) the Transition Property Purchase and Sale Agreement between the Company and TCC, as seller, shall have been executed and delivered; (vi) the Transition Property Servicing Agreement between the Company and TCC, as servicer, shall have been executed and delivered; (vii) the Company shall have taken appropriate limited liability company action authorizing the issuance and sale of such series of Transition Bonds as contemplated by the Registration Statement and the Indenture; and (viii) such series of Transition Bonds shall have been duly executed and authenticated as provided in the Indenture and shall have been duly delivered to the purchasers thereof against payment of the agreed consideration therefor.

For the purposes of this letter, we have assumed that there will be no changes in the laws currently applicable to the Company and the validity, legally binding character or enforceability of the Transition Bonds, and that such laws will be the only laws applicable to the Company and the Transition Bonds.

We do not find it necessary for the purposes of this letter to cover, and accordingly we express no opinion as to, the application of the securities or blue sky laws of the various states to sales of the Transition Bonds.

We hereby consent to the filing of this letter as an exhibit to the report on Form 8-K filed on October 11, 2006 with respect to the above referenced Registration Statement and to all references to our firm included in or made a part of the Registration Statement. In giving the foregoing consents, we do not thereby admit that we are within the category of persons whose consent is required under Section 7 of the Securities Act or the related rules and regulations of the Commission. Except as stated above, without our prior written consent, this letter may not be furnished or quoted to, or relied upon by, any other person for any purpose.

Very truly yours,

/s/ Sidley Austin LLP

Exhibit 8.1

SIDLEY AUSTIN LLP
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FOUNDED 1866

October 11, 2006

AEP Texas Central Company
AEP Texas Central Transition Funding II LLC
1 Riverside Plaza
Columbus, Ohio 43215

Re: AEP Texas Central Transition Funding II LLC

Ladies and Gentlemen:

We have acted as special counsel to AEP Texas Central Company ("TCC") and AEP Central Transition Funding II LLC, a Delaware limited liability company (the "Company"), in connection with the preparation of the Registration Statement filed on Form S-3 (the "Registration Statement") with the Securities and Exchange Commission (the "Commission") under the Securities Act of 1933, as amended (the "Securities Act"), relating to the proposed issuance of up to $1,747,975,174 of transition bonds (the "Transition Bonds") of the Company to be offered in such manner as described in the form of the prospectus (the "Prospectus") included as part of the Registration Statement. The Transition Bonds are to be issued under an Indenture (the "Indenture") between the Company and The Bank of New York, a New York banking corporation, as indenture trustee (the "Indenture Trustee").

We are familiar with the proceedings taken and proposed to be taken by the Company in connection with the proposed authorization, issuance and sale of the Transition Bonds. We have examined and relied upon originals, or copies of originals, certified or otherwise identified to our satisfaction of such records of the Company and such agreements, certificates of public officials, certificates of officers or other representatives of the Company and other instruments, and examined such questions of law and satisfied ourselves to such matters of fact as we deemed relevant or necessary as a basis for this letter. In rendering the opinions expressed in this letter, 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 and the conformity with the original documents of any copies thereof submitted to us for examination. As to any facts material to the opinions expressed herein which we have not independently established or verified, we have relied upon statements and representations of officers and other representatives of the Company or others.

Based upon the foregoing, it is our opinion that for U.S. federal income tax purposes, (1) the Company will not be treated as a taxable entity separate and apart from TCC, (2) the Transition Bonds will be treated as debt of TCC and (3) interest paid on the Transition Bonds generally will be taxable to a U.S. bondholder as ordinary interest income at the time it accrues or is received in accordance with the U.S. bondholder's method of accounting for U.S. federal income tax purposes.

Our opinion is limited to the United States federal income tax matters specifically covered hereby, and we have not been asked to address, nor have we addressed, any other tax consequences regarding the transaction referred to above or any other transaction. This opinion is rendered as of the date hereof based on the current provisions of the Internal Revenue Code and the Treasury regulations issued or proposed thereunder, Revenue Rulings, Revenue Procedures and other published releases of the Internal Revenue Service and current case law, any of which can change at any time. Any change could apply retroactively and modify the legal conclusions upon which our opinions are based. This opinion is rendered as of the date hereof and we do not undertake, and hereby disclaim, any obligation to advise you of any changes in law or fact, whether or not material, which may be brought to our attention at a later date.

We are furnishing this opinion to you solely in connection with the issuance of the Transition Bonds described above, and this opinion is not to be relied on, circulated, quoted or otherwise referred to for any other purpose. However, we hereby consent to the filing of this opinion as an exhibit to the report on Form 8-K filed on October 11, 2006 with respect to the above referenced Registration Statement and to the references to this Firm in the Prospectus under the section captioned “Prospectus Summary — Federal Income Tax Status”, the Prospectus under the section captioned “Material U.S. Federal Income Tax Consequences”, the Prospectus under the section captioned “Legal Matters”, and the Prospectus Supplement under the section captioned “Material U.S. Federal Income Tax Consequences”. In giving such consent, we do not thereby admit that we are within the category of persons whose consent is required under Section 7 of the Securities Act, or the rules and regulations of the Commission thereunder.

Very truly yours,

/s/ Sidley Austin LLP

Exhibit 99.1

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FOUNDED 1866

October 11, 2006

To Each of the Persons Listed
on Schedule A Attached Hereto

Re: AEP Texas Central Transition Funding II LLC Senior Secured Transition Bonds
Series A Federal Constitution Issues

Ladies and Gentlemen:

We have served as special counsel to AEP Texas Central Company, a Texas corporation (" TCC "), in connection with the issuance and sale on the date hereof by AEP Texas Central Transition Funding II LLC, a Delaware limited liability company (the " Issuer "), of $1,739,700,000 aggregate principal amount of the Issuer's Senior Secured Transition Bonds, Series A (the " Bonds "), which are more fully described in the Prospectus Supplement dated October 4, 2006. The Bonds are being sold pursuant to the provisions of the Underwriting Agreement dated October 4, 2006 among TCC, the Issuer and Credit Suisse Securities (USA) LLC, J.P. Morgan Securities Inc. and Greenwich Capital Markets, Inc., as representatives of the underwriters named in Schedule I to such Underwriting Agreement. The Bonds are being issued pursuant to the provisions of the Indenture dated as of October 11, 2006 (the " Indenture "), as supplemented by the Series Supplement dated as of October 11, 2006 (together with the Indenture, the " Indenture "), between the Issuer and The Bank of New York, a New York state banking corporation, as indenture trustee (the " Indenture Trustee "). Under the Indenture, the Indenture Trustee holds, among other things, transition property as described below (the " Transition Property ") as collateral security for the payment of the Bonds.

"Transition property" is defined in the Texas Utility Code, Subchapter G of Chapter 39 of the Public Utility Regulatory Act, titled "An Act relating to electric utility restructuring and to the powers and duties of the Public Utility Commission of Texas, Office of Public Utility Counsel, and Texas Natural Resource Conservation Commission; providing penalties" (" PURA "). The Transition Property was created in favor of TCC, pursuant to a financing order (the " Order ") issued by the Public Utility Commission of Texas (the " PUCT ") on June 21, 2006, in Docket No. 32475; and the Transition Property was assigned to the Issuer pursuant to the provisions of the Transition Property Purchase and Sale Agreement dated as of October 11, 2006 between TCC and the Issuer in consideration for the payment by the Issuer to TCC of the proceeds of the sale of the Bonds, net of certain issuance costs. The Transition Property includes the right to impose and receive certain "non-bypassable" charges described in the Order (the " Charges "). The Charges constitute "transition charges" as defined in PURA and may be periodically adjusted, in the manner authorized in the Order, in order to enhance the probability that the revenues received by the Issuer from the Charges are sufficient to (i)

amortize the Bonds pursuant to the amortization schedule to be followed in accordance with the provisions of the Bonds and the Indenture, (ii) pay interest thereon and related fees and expenses and (iii) maintain the required reserves for the payment of the Bonds.

The Order was issued in response to an application for its issuance that was filed by TCC with the PUCT pursuant to the provisions of PURA. The Order became final and not subject to further appeal on July 6, 2006. TCC filed its Issuance Advice Letter with the PUCT on October 5, 2006, as required by the Order, and its Schedule TC-2 Tariff relating to the Charges on July 10, 2006, and its Rider TC-2 Tariff on October 5, 2006, as required by the Order.

Questions Presented and Opinions

Legislative Repeal, Amendment or Revocation

You have requested our opinion as to:

(a) whether the State Pledge creates a contractual relationship between the State of Texas (the " State ") and the holders of the Bonds (the " Bondholders ");

(b) whether the Bondholders could challenge successfully under the "contract clause" of the United States Constitution (Article I, Section 10 (the " Federal Contract Clause ")) the constitutionality of any legislation passed by the Texas legislature (the " Legislature ") which becomes law or any action of the PUCT exercising legislative powers (" Legislative Action ") that in either case limits, alters, impairs or reduces the value of the Transition Property or the Charges so as to impair (i) the terms of the Indenture or the Bonds or (ii) the rights and remedies of the Bondholders (or the Indenture Trustee acting on their behalf) (any impairment described in clause (i) or (ii) being referred to herein as an " Impairment ") prior to the time that the Bonds are fully paid and discharged [1];

(c) whether preliminary injunctive relief would be available under federal law to delay implementation of Legislative Action that limits, alters, impairs or reduces the value of the Transition Property or the Charges so as to cause an Impairment pending final adjudication of a claim challenging such Legislative Action under the Federal

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1 As discussed in more detail in the opinion of Bracewell & Giuliani LLP of even date herewith, the PUCT has acknowledged that it is bound by the State Pledge. Assuming that the PUCT is bound by the State Pledge as a matter of Texas law, a breach of the State Pledge by the PUCT exercising legislative powers would be treated the same as a breach of the State Pledge by the Legislature under the Federal Contract Clause.

Contract Clause and, assuming a favorable final adjudication of such claim, whether relief would be available to prevent permanently the implementation of the challenged Legislative Action; and

(d) whether, under the Fifth Amendment to the United States Constitution (made applicable to the State by the Fourteenth Amendment to the United States Constitution), which provides in part "nor shall private property be taken for public use, without just compensation" (the "Federal Takings Clause"), the State could repeal or amend PURA or take any other action in contravention of the State Pledge without paying just compensation to the Bondholders, as determined by a court of competent jurisdiction, if doing so (a) constituted a permanent appropriation of a substantial property interest of the Bondholders in the Transition Property or denied all economically productive use of the Transition Property; (b) destroyed the Transition Property other than in response to emergency conditions; or (c) substantially reduced, altered or impaired the value of the Transition Property so as to unduly interfere with the reasonable expectations of the Bondholders arising from their investments in the Bonds (a "Taking").

Based upon our review of relevant judicial authority, as set forth in this letter, but subject to the qualifications, limitations and assumptions (including the assumption that any Impairment would be "substantial") set forth in this letter, it is our opinion that a reviewing court of competent jurisdiction, in a properly prepared and presented case:

(i) would conclude that the State Pledge constitutes a contractual relationship between the Bondholders and the State;

(ii) would conclude that, absent a demonstration by the State that an Impairment is necessary to further a significant and legitimate public purpose, the Bondholders (or the Indenture Trustee acting on their behalf) could successfully challenge under the Federal Contract Clause the constitutionality of any Legislative Action determined by such court to limit, alter, impair or reduce the value of the Transition Property or the Charges so as to cause an Impairment prior to the time that the Bonds are fully paid and discharged;

(iii) should conclude that permanent injunctive relief is available under federal law to prevent implementation of Legislative Action hereafter taken and determined by such court to limit, alter, impair or reduce the value of the Transition Property or the Charges so as to cause an Impairment in violation of the Federal Contract Clause; and although sound and substantial arguments support the granting of preliminary injunctive relief, the decision to do so will be in the discretion of the court requested to take such action, which will be exercised on the basis of the considerations discussed in subpart B of Part II below; and

(iv) would conclude that the State would be required to pay just compensation to Bondholders if the State's repeal or amendment of PURA or taking of any other action in contravention of the State Pledge (a) constituted a permanent appropriation of a substantial property interest of the Bondholders in the Transition Property or denied all economically productive use of the Transition Property; (b) destroyed the Transition Property other than in response to emergency conditions; or (c) substantially reduced, altered or impaired the value of the Transition Property so as to unduly interfere with the reasonable expectations of the Bondholders arising from their investments in the Bonds.

Our opinion in the immediately preceding paragraph (i) is based upon our evaluation of existing judicial decisions and arguments related to the factual circumstances likely to exist at the time of a Federal Contract Clause challenge to Legislative Action; such precedents and such circumstances could change materially from those discussed below in this letter. Accordingly, such opinion is intended to express our belief as to the result that should be obtainable through the proper application of existing judicial decisions in a properly prepared and presented case.

We also note, with respect to such opinion, that existing case law indicates that the State would have to establish that any Impairment is necessary and reasonably tailored to address a significant public purpose, such as remedying or providing relief for a broad, widespread economic or social problem. The cases also indicate that the State's justification would be subjected to a higher degree of scrutiny, and that the State would bear a more substantial burden, if the Legislative Action impairs a contract to which the State is a party (which we believe to be the case here), as contrasted to a contract solely between private parties.

Discussion

I. Protection of State Pledge Under the Federal Contract Clause

Section 39.310 of PURA provides:

Transition bonds are not a debt or obligation of the state and are not a charge on its full faith and credit or taxing power. The state pledges, however, for the benefit and protection of financing parties and the electric utility, that it will not take or permit any action that would impair the value of transition property, or, except as permitted by Section 39.307 [regarding true-ups], reduce, alter, or impair the transition charges to be imposed, collected, and

> remitted to financing parties, until the principal, interest and premium, and any other charges incurred and contracts to be performed in connection with the related transition bonds have been paid and performed in full. Any party issuing transition bonds is authorized to include this pledge in any documentation relating to those bonds.

PURA § 39.310. As authorized by the foregoing statutory provision and the Order, the language of the State Pledge has been included in the Indenture and in the Bonds. Based on our analysis of relevant judicial authority, as set forth below, it is our opinion, subject to all of the qualifications, limitations and assumptions (including the assumption that any Impairment would be "substantial") set forth in this letter, that, absent a demonstration by the State that an Impairment is necessary to further a significant and legitimate public purpose, a reviewing court would conclude that the State Pledge provides a basis upon which the Bondholders (or the Indenture Trustee acting on their behalf) could challenge successfully, under the Federal Contract Clause, the constitutionality of any Legislative Action determined by such court to reduce, alter, or impair the value of the Transition Property or the Charges so as to cause an Impairment prior to the time that the Bonds are fully paid and discharged.

Article I, Section 10 of the United States Constitution prohibits any state from impairing the "obligation of contracts," whether among private parties or among such state and private parties. [2] The general purpose of the Federal Contract Clause is "to encourage trade and credit by promoting confidence in the stability of contractual obligations." [3] The law is well-settled that "the [Federal] Contract Clause limits the power of the States to modify their own contracts as well as to regulate those between private parties." [4] Although the Federal Contract Clause appears literally to proscribe any impairment, the United States Supreme Court has made it clear that the proscription is not absolute: "Although the language of the Federal Contract Clause is facially absolute, its prohibition must be accommodated to the inherent police power of the State 'to safeguard the vital interests of its people.'" [5]

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2 Article I, Section 10, provides, in relevant part, "No State shall . . . pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts, ..." U.S. Const. art. I,. 10. Please see opinion of Bracewell & Giuliani., of even date herewith, with respect to the Contract Clause in the Texas Constitution.

3 See United States Trust Co. of New York v. New Jersey , 431 U.S. 1, 15 (1977) (cited in the text as " U.S. Trust ").

4 Id . at 17 (citations omitted).

5 Energy Reserves Group, Inc. v. Kansas Power & Light Co. , 459 U.S. 400, 410 (1983) (cited in the text as " Energy Reserves ") (citing Home Bldg. & Loan Ass'n v. Blaisdell , 290 U.S. 398, 434 (1934) (cited in the text as " Blaisdell ")).

In recent cases, the United States Supreme Court has applied a three-part analysis to determine whether a particular legislative action violates the Federal Contract Clause: [6]

(1) whether the legislative action operates as a substantial impairment of a contractual relationship;

(2) assuming such an impairment, whether the legislative action is justified by a significant and legitimate public purpose; and

(3) whether the adjustment of the rights and responsibilities of the contracting parties is reasonable and appropriate given the public purpose behind the legislative action.

The first inquiry contains three components: [7]

(1) does a contractual relationship exist;

(2) does the change in law impair that contractual relationship; and

(3) is the impairment substantial.

In addition, to succeed with a claim under the Federal Contract Clause, a party must show that the contractual relationship is not an invalid attempt to restrict or limit a state's "reserved powers." [8]

The following three subparts address: (i) whether a contract exists between the State and the holders of the Bonds; (ii) if so, whether such contract violates the "reserved powers" doctrine, which would render such contract unenforceable; and (iii) the State's burden in justifying an impairment. The determination of whether particular Legislative Action constitutes a substantial impairment of a particular contract is a fact-specific analysis, and nothing in this letter expresses any opinion as to how a court would resolve the issue of "substantial impairment" with respect to the Order, the Transition Property or the Bonds vis-a-vis a particular Legislative Action. Therefore, we have assumed for purposes of this letter that any Impairment

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6 Energy Reserves Group, Inc. v. Kansas Power & Light Co. , 459 U.S. 400, 411-12 (1983). See also Toledo Area AFL-CIO Council v. Pizza , 154 F.3d 307, 323 (6th Cir. 1998) (stating the three-part analysis).

7 General Motors Corp. v. Romein , 503 U.S. 181, 186 (1991).

8 See discussion under subpart B of this Part I.

resulting from the Legislative Action being challenged under the Federal Contract Clause would be substantial. [9] In the final subpart of this Part I, we address what relief would be likely to be granted if a Federal Contract Clause challenge were successfully asserted.

A. Existence of a Contractual Relationship

The courts have recognized the general presumption that, absent some clear indication that a legislature intends to bind itself contractually, "a law is not intended to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise." [10] This presumption is based on the fact that the legislature's principal function is not to make contracts, but to make laws that establish the policy of the state. Thus, a person asserting the creation of a contract with the State must overcome this presumption.

This general presumption can be overcome where the language of the statute indicates an intention to create contractual rights. In determining whether a contract has been created by statute, "it is of first importance to examine the language of the statute." [11] The courts have ruled that a statute creates a contractual relationship between a state and private parties if the statutory language contains sufficient words of contractual undertaking. [12] The United States Supreme Court has stated that a contract is created "when the language and circumstances evince a legislative intent to create private rights of a contractual nature enforceable against the State." [13]

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9 We note, however, that in U.S. Trust the United States Supreme Court found a substantial impairment where the States of New York and New Jersey repealed outright an "important security provision" securing repayment of bonds without any form of compensation to the bondholders, even in the absence of a finding of the extent of financial loss suffered by the bondholders as a result of the repeal. 431 U.S. 1, 19 (1977). See also Home Bldg. & Loan Ass'n v. Blaisdell , 290 U.S. 398, 429-35 (1934).

10 National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co. , 470 U.S. 451, 466 (1985) (cited in the text as "Nat'l R.R. ") (quoting Dodge v. Board of Educ. , 302 U.S. 74, 78 (1937) (cited in the text as "Dodge ")).

11 Dodge v. Board of Educ. , 302 U.S. 74, 78 (1937).

12 See Indiana ex rel. Anderson v. Brand , 303 U.S. 95, 104-05 (1938) (cited in the text as "Brand " (noting "he cardinal inquiry is as to the terms of the statute supposed to create such a contract"); United States Trust Co. of New York v. New Jersey , 431 U.S. 1, 18 (1977).

13 United States Trust Co. of New York v. New Jersey , 431 U.S. 1, 17 n.14 (1977).

In U.S. Trust , the United States Supreme Court affirmed the trial court's finding, which was not contested on appeal, that a statutory covenant of two states for the benefit of the holders of certain bonds gave rise to a contractual obligation between such states and the bondholders. [14] The covenant at issue limited the ability of the Port Authority of New York and New Jersey to subsidize rail passenger transportation from revenues and reserves pledged as security for such bonds. In finding the existence of a contract between such states and bondholders, the Court stated "[t]he intent to make a contract is clear from the statutory language: 'The two States covenant and agree with each other and with the holders of any affected bonds. . . . '" [15] Later, in Nat'l R.R. , the Court discussed the U.S. Trust covenant and noted: "[r]esort need not be had to a dictionary or case law to recognize the language of contract" in such covenant. [16]

Similarly, in Brand , the United States Supreme Court determined that the Indiana Teachers' Tenure Act created a contract between the state and specified teachers because the statutory language demonstrated a clear legislative intent to contract. The Court based its decision, in part, on the legislature's use of the word "contract" throughout the statute to describe the legal relationship between the state and such teachers. [17]

Like the language of the covenant considered in U.S. Trust , the language of the State Pledge plainly manifests the Legislature's intent to bind the State. [18] Indeed, the biggest

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14 Id . at 18.

15 Id. at 17. Although the issue of whether a contract existed between such states and the bondholders was never disputed on appeal, the Court reviewed the language of the covenant and the circumstances surrounding the covenant, and stated, "We therefore have no doubt that the 1962 covenant has been properly characterized as a contractual obligation of the two States." Id . at 18.

16 See National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co. , 470 U.S. 451, 470 (1985).

17 Indiana ex rel. Anderson v. Brand , 303 U.S. 95, 105 (1938). However, the mere use of the word "contract" in a statute will not necessarily evince the requisite legislative intent. As the Court cautioned in Nat'l R.R. , the use of the word "contract" alone would not signify the existence of a contract *with the government* . National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co. , 470 U.S. 451, 470 (1985). In Nat'l R.R. , the Court found that use of the word "contract" in the Rail Passenger Service Act defined only the relationship between the newly-created nongovernmental corporation (Amtrak) and the railroads, not the relationship between the United States and the railroads. The Court determined that "[l]egislation outlining the terms on which private parties may execute contracts does not on its own constitute a statutory contract." Id ., at 467.

18 It could be contended that the factual situation in the U.S. Trust case is distinguishable from the factual situation surrounding the issuance of the Bonds. In U.S. Trust , the bonds were issued by the Port Authority — a governmental agency — while the Bonds are being issued by a private entity. However, PURA dictates that a utility must obtain a financing order before any "transition bonds" such as the Bonds are issued. The authority to issue such an order rests with the State, acting through the PUCT, and therefore the issuance of the Bonds is state-sanctioned in a manner closely analogous to the situation in U.S. Trust .

difference between such language and the U.S. Trust statute is the use of the verb "pledge," rather than "covenant," but that difference is not, in our view, material. The definition of the Legislature's term — "pledge" — is "to bind by a promise." [19] Accordingly, this slight variation between the State Pledge and the language contained in the U.S. Trust statute appears inconsequential and not to provide a basis for distinguishing the wording of the two statutes. Unlike the statute construed in Nat'l R.R. , PURA expressly includes language indicating the State's obligation with respect to transition bond transactions. See PURA § 39.310 ("The State pledges . . . that it will not take or permit any action that would impair the value of transition property . . . until the principal, interest and premium . . . and contracts to be performed in connection with the related transition bonds have been paid and performed in full."). Id . (emphasis added). Moreover, it is important to note that the State also authorizes an issuer of transition bonds to include the State Pledge in contracts with the holders of transition bonds (such as the Bonds). Id .

In summary, the language of the State Pledge supports the conclusion that it constitutes a contractual relationship between the State and the Bondholders. We are not aware of any circumstances surrounding enactment of PURA that suggests that the Legislature did not intend to bind the State contractually by the State Pledge. [20]

B. Reserved Powers Doctrine

The "reserved powers" doctrine limits the State's ability to bind itself contractually in a manner which surrenders an essential attribute of its sovereignty. [21] Under this doctrine, if a contract limits a state's "reserved powers" — powers that cannot be contracted away — such contract is void. [22] Although the scope of these "reserved powers" has not been precisely

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19 WEBSTER'S NEW WORLD DICTIONARY 573 (2d ed. 1982).

20 In addition to the State Pledge, the PUCT's financing order contains the following language: "The Commission guarantees that it will act pursuant to this Financing Order as expressly authorized by PURA to ensure that expected transition charge revenues are sufficient to pay on a timely basis scheduled principal and interest on the transition bonds issued pursuant to this Financing Order and other costs, including fees and expenses, in connection with the transition bonds." We refer you to the opinion with respect to constitutional law issues of Bracewell & Giuliani LLP of even date herewith for a discussion of this language.

21 United States Trust Co. of New York v. New Jersey , 431 U.S. 1, 23 (1977).

22 Id . See generally United States v. Winstar Corp. , 518 U.S. 839, 888-90 (1996) (cited in the text as "Winstar ").

defined by the courts, case law has established that a state cannot contract away its police powers [23] or its power of eminent domain. [24] In contrast, the United States Supreme Court has stated that a state's "power to enter into effective financial contracts cannot be questioned." [25]

Under existing case law, the State Pledge does not, in our view, limit any "reserved powers" of the State. The State Pledge does not purport to contract away, or constitute a waiver of, the State's power of eminent domain or otherwise restrict the State's ability to legislate for the public welfare or to exercise its police powers. Through "financing orders" (such as the Order), the State will authorize electric utilities to issue "transition bonds" (such as the Bonds) and pledges not to impair the value of the "transition property" (such as the Transition Property) securing such instruments. In other words, the State Pledge constitutes an agreement made by the State not to impair the financial security for transition bonds in order to foster the capital markets' acceptance of such bonds, which are expressly authorized and will be issued as part of the transition to a new electric utility industry structure. The State Pledge is clearly an inducement offered by the State to investors to purchase the Bonds. As such, we believe that the State Pledge is akin to the type of "financial contract" involved in U.S. Trust , a promise that revenues and reserves securing the bonds at issue there would not be depleted beyond a certain level. [26]

C. State's Burden to Justify an Impairment

Any substantial impairment by a state of contractual rights which cannot be upheld under the "reserved powers" doctrine must be justified as a legitimate exercise of the state's police powers in order to be successfully defended against a challenge pursuant to the Federal Contract Clause. [27] In Blaisdell [28] , referred to by the United States Supreme Court in U.S. Trust as "the leading case in the modern era of [Federal] Contract Clause interpretation," [29] the Court found that the economic exigencies of the time (the Depression) justified a Minnesota law which (i) authorized county courts to extend the period of redemption from foreclosure sales on

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23 Stone v. Mississippi , 101 U.S. 814, 817 (1880).

24 West River Bridge Co. v. Dix , 47 U.S. 507, 525-26 (1848).

25 United States Trust Co. of New York v. New Jersey , 431 U.S. 1, 24 (1977).

26 Id . at 25.

27 Energy Reserves Group, Inc. v. Kansas Power & Light Co. , 459 U.S. 400, 411-12 (1983).

28 Home Bldg. & Loan Ass'n v. Blaisdell , 290 U.S. 398 (1934).

29 United States Trust Co. of New York v. New Jersey , 431 U.S. 1, 15 (1977).

mortgages previously made "for such additional time as the court may deem to be just and equitable," subject to certain limitations, and (ii) limited actions for deficiency judgments. [30] The Court stated that the "reserved powers" doctrine could not be construed "to permit the state to adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them." On the other hand, the Court also indicated that the Federal Contract Clause could not be construed [31]

> to prevent limited and temporary interpositions with respect to the enforcements [of contracts] if made necessary by a great public calamity such as fire, flood, or earthquake. [citation omitted] The reservation of state power appropriate to such extraordinary conditions may be deemed to be as much a part of all contracts, as is the reservation of state power to protect the public interest in other situations to which we have referred. And if state power exists to give temporary relief from the enforcement of contracts in the presence of disasters due to physical causes such as fire, flood or earthquake, that power cannot be said to be non-existent when the urgent public need demanding such relief is produced by other and economic causes.

In upholding the Minnesota law, the Court relied on the following: (1) an economic emergency existed which threatened the loss of homes and lands which furnish those persons in possession with necessary shelter and means of subsistence; (2) the law was not enacted for the benefit of particular individuals but for the protection of a basic interest of society; (3) the relief provided by the law was appropriate to the emergency, and could only be granted upon reasonable conditions; (4) the conditions on which the period of redemption was extended by the law did not appear to be unreasonable; and (5) the law was temporary in operation and limited to the emergency on which it was based. [32] In 1983, the United States Supreme Court stated in its

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30 The mortgagor was required to continue to pay the reasonable income or rental value of the property, as determined by the court, toward payment of taxes, insurance, interest and principal. The law stated that it was to remain in effect only during the current emergency and no later than May 1, 1935; no redemption period could be extended beyond the expiration of the law. Home Bldg. & Loan Ass'n v. Blaisdell , 290 U.S. at 415-18.

31 Id . at 439-40.

32 Id . at 444-47. Contemporaneous cases in which the United States Supreme Court struck down laws passed in response to an economic emergency reinforce the notion that, to be justified, the impairment must be a reasonable and specific response to the conditions. See Treigle v. Acme Homestead Ass'n , 297 U.S. 189 (1936); W.B. Worthen Co. v. Kavanaugh , 295 U.S. 56 (1935) (cited in the text as "Worthen "); W.B. Worthen Co. v. Thomas , 292 U.S. 426 (1934).

Energy Reserves opinion that "a significant and legitimate public purpose" is required to justify a substantial impairment of contract. [33] Similarly, the Court had earlier stated that, to be justifiable, an impairment must deal with "a broad, generalized economic or social problem." [34]

The deference to be given by a court to a legislature's determination of the need for a particular impairment depends on whether the contract is purely private or the state is a contracting party. In a 1987 decision evaluating a state statute under the Federal Contract Clause, the United States Supreme Court noted that it has repeatedly held that, unless a state is a contracting party (which we believe to be the case here), courts should defer to legislative judgment as to the necessity and reasonableness of a particular action. [35] Both the Energy Reserves and Spannaus opinions noted, however, that when a state is a contracting party the "stricter standard" of justification set forth in the U.S. Trust opinion is applicable. [36] The Energy Reserves Court also noted that "[i]n almost every case, the Court has held a governmental unit to its contractual obligations when it enters financial or other markets." [37]

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33 Energy Reserves Group, Inc. v. Kansas Power & Light Co. , 459 U.S. 400, 411 (1983).

34 Allied Structural Steel Co. v. Spannaus , 438 U.S. 234, 250 (1978) (cited in the text as " Spannaus ").

35 Keystone Bituminous Coat Ass'n v. DeBenedictis , 480 U.S. 470 (1987) (cited in the text as "DeBenedictis "). The decision involved a 1966 Pennsylvania law which authorized a state agency to revoke a coal mine operator's mining permit if removal of the coal caused damage to a structure or area protected by the law and the operator had not within six months taken certain remedial action. Several mine operators claimed that the law impaired their rights to enforce contractual waivers by the owners of the affected surface rights of any claims for liability due to surface damage. While agreeing that the 1966 law operated as a substantial impairment of the operators' contracts, the Court held that the state had a strong public interest in preventing the damage caused by underground mining, "the environmental effect of which transcends any private agreement between contracting parties." 480 U.S. at 505. Since 1966, the operators had conducted mining operations under approximately 14,000 structures protected by the law. The Court noted the "devastating effects" of subsidence caused by underground mining, including substantial damage to foundations, walls and other structural members, and the integrity of houses and buildings; sinkholes which made land difficult or impossible to develop or farm; and loss of groundwater and surface ponds. Id . at 475. The Court concluded that the law "plainly survives scrutiny under our standards for evaluating impairments of private contracts." Id. at 505-06.

36 Energy Reserves Group, Inc. v. Kansas Power & Light Co. , 459 U.S. 400, 412-13 n.14 (1983); Allied Structural Steel Co. v. Spannaus , 438 U.S. 234, 244 n.15 (1978). See also United States v. Winstar Corp. , 518 U.S. 839, 876 (1996) (noting "heightened Contract Clause scrutiny when States abrogate their own contractual obligations").

37 Energy Reserves Group, Inc. v. Kansas Power & Light Co. , 459 U.S. 400, 412 n.14 (1983) (citing United States Trust Co. of New York v. New Jersey , 431 U.S. 1 (1977); W.B. Worthen Co. v. Kavanaugh , 295 U.S. 56 (1935); and Murray v. Charleston , 96 U.S. 432 (1878) (cited in the text as "Murray ")). In Worthen , the United States Supreme Court reversed a decision of the Arkansas Supreme Court upholding the validity of legislative enactments which, in the words of the former, take "from [the] mortgage [securing bonds issued by municipal improvement districts pursuant to state law] the quality of an acceptable investment for a rational investor" by making it much more difficult and time consuming to foreclose upon the collateral posted as security for the mortgage. 295 U.S. at 60. Such enactments were accompanied by a legislative "declaration of an emergency, which was stated to endanger the peace, health and safety of a multitude of citizens." In Murray , the United States Supreme Court reversed a judgment of the Supreme Court of South Carolina upholding an ordinance of the City of Charleston which permitted the City to withhold, as a tax, a portion of the interest that was otherwise payable with respect to bonds issued by the City. This "tax" was held to violate the Federal Contract Clause: "no municipality of a State can, by its own ordinances, under the guise of taxation, relieve itself from performing to the letter all that it has expressly promised to its creditors." 96 U.S. at 448.

In U.S. Trust , the United States Supreme Court stated that an impairment of a contract with a state "may be constitutional if it is reasonable and necessary to serve an important public purpose." [38] The Court further stated, however, that "complete deference to a legislative assessment of reasonableness and necessity is not appropriate." [39] The "public purposes" advanced as justifications for the contractual impairment were the promotion of mass transportation, energy conservation and environmental protection, and encouragement of the use of public transportation rather than private automobiles. [40] The Court rejected those justifications because repeal of the covenant was "neither necessary to achievement of the plan nor reasonable in light of the circumstances." [41] The Court stated that a modification less drastic than total repeal would have permitted the states to achieve their plan to improve commuter rail service, and, in fact, the states could have achieved that goal without modifying the covenant at all. [42] For example, the states "could discourage automobile use through taxes on gasoline or parking . . . and use the revenues to subsidize mass transit projects." [43]

The U.S. Trust Court contrasted the legislation under consideration with the statute challenged in El Paso v. Simmons , [44] which limited to five years the reinstatement rights of defaulting purchasers of land from the state. For many years prior to the enactment of this statute, defaulting purchasers had been allowed to reinstate their claims upon written request and

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38 United States Trust Co. of New York v. New Jersey , 431 U.S. 1, 25 (1977).

39 Id . at 26.

40 Id . at 28-29. The Court noted that when the bills to repeal the covenant were pending "a national energy crisis was developing." Id . at 13-14.

41 Id . at 29.

42 Id . at 30.

43 Id . at 30 n.29.

44 El Paso v. Simmons , 379 U.S. 497 (1965).

payment of delinquent interest, unless the rights of third parties had intervened. In the judgment of the U.S. Trust Court, this older (19th century) statute "had effects that were unforeseen and unintended by the legislature when originally adopted," *i.e.* , "speculators were placed in a position to obtain windfall benefits," and therefore adoption of a statute of limitations was reasonable to restrict parties to gains reasonably expected from the contract when the original statute was adopted. [45] In contrast, the U.S. Trust Court stated that the need for mass transportation was not a new development and the likelihood that publicly owned commuter railroads would produce substantial deficits was well known when the covenant was adopted. [46] Although, the Court noted, public perception of the importance of mass transit undoubtedly grew between 1962, when the covenant was adopted, and 1974, when it was repealed, "these concerns were not unknown in 1962, and the subsequent changes were of degree and not of kind . . . . and [did not] cause the covenant to have a substantially different impact in 1974 than when it was adopted in 1962." [47]

The U.S. Trust Court also distinguished its earlier decision in Faitoute Iron & Steel Co. v. City of Asbury Park , [48] which, according to the Court, was the "only time in this century that alteration of a municipal bond contract has been sustained." [49] Faitoute involved a state municipal reorganization act under which bankrupt local governments could be placed in receivership by a state agency. Pursuant to that act, the holders of certain municipal revenue bonds received new securities bearing lower interest rates and later maturities. According to the Court in U.S. Trust , the earlier decision rejected the dissenting bondholders' Federal Contract Clause claims on the theory that the "old bonds represented only theoretical rights; as a practical matter the city could not raise its taxes enough to pay off its creditors under the old contract terms," and thus the plan "enabled the city to meet its financial obligations more effectively." [50] The U.S. Trust Court further quoted Faitoute to the effect that the obligation in that case was "discharged, not impaired" by the plan. [51]

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45 United States Trust Co. of New York v. New Jersey , 431 U.S. 1, 31 (1977).

46 Id . at 31-32.

47 Id . at 32.

48 Faitoute Iron & Steel Co. v. City of Asbury Park , 316 U.S. 502 (1942) (cited in the text as "Faitoute ").

49 United States Trust Co. of New York v. New Jersey , 431 U.S. 1, 27 (1977).

50 Id . at 28.

51 Id . (quoting 316 U.S. at 511).

The Court's opinion in Winstar , even though not a Federal Contract Clause case, is consistent with U.S. Trust in imposing a more rigorous standard of justification where the government is a contracting party. One issue in Winstar was whether the contract claim was barred by the "sovereign acts" doctrine, *i.e.* , the government's "public and general" acts cannot amount to a breach of contract. Although the legislation alleged to constitute a contractual breach had as its purposes "preventing the collapse of the [thrift] industry, attacking the root causes of the crisis, and restoring public confidence", [52] the Court held a "sovereign acts" defense was unavailable: "[w]hile our limited enquiry into the background and evolution of the thrift crisis leaves us with the understanding that Congress acted to protect the public in the FIRREA legislation, the extent to which this reform relieved the Government of its own contractual obligations precludes a finding that the statute is a 'public and general' act for purposes of the sovereign acts defense." [53]

Thus, the relevant case law demonstrates that a state bears a substantial burden when attempting to justify an impairment of a contract to which it is a party. A mere recitation that the impairment is in the public interest is insufficient. Instead, a specific and significant state interest must be established, and the impairment must be necessary to further that interest. Furthermore, "a state is not free to impose a drastic impairment when an evident and more moderate course would serve its purposes equally well." [54]

II. Relief Granted in a Federal Contract Clause Challenge

A. Permanent Injunctive Relief

In a Federal Contract Clause challenge to Legislative Action alleged to cause an Impairment, the remedies which the plaintiff would be expected to seek are (i) a declaration of the invalidity of such Legislative Action and (ii) an order permanently enjoining State officials from enforcing the provisions of such Legislative Action; a claim for money damages against the State would appear less likely. Whether such a declaration of invalidity could be obtained will depend on application of the principles discussed in Part I, as well as a demonstration that such law effected a substantial impairment. If such a declaration were obtained, the plaintiff would then have to meet several requirements in order to obtain a permanent injunction. Texas law would govern the requirements for issuance of a permanent injunction if the case were brought in

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52 United States v. Winstar Corp. , 518 U.S. 839, 856 (1996).

53 Id . at 903.

54 United States Trust Co. of New York v. New Jersey , 431 U.S. 1, 31 (1977).

State court, [55] while federal law would govern those requirements if the case were brought in federal court. [56] The following discussion relates to federal law only.

Federal case law applies the following test in determining whether to grant permanent injunctive relief: (i) success on the merits of the claim; [57] (ii) a demonstration of irreparable harm; (iii) a showing of the inadequacy of legal remedies; and (iv) a determination that granting the injunction will not disserve the public interest. [58] The first requirement, a showing of likely success on the merits of the claim, will have been satisfied by obtaining the aforementioned declaration of the invalidity of such Legislative Action. [59] The party seeking a permanent injunction must also establish that it has no adequate remedy at law, for example, money damages. It seems doubtful that the Bondholders (or the Indenture Trustee acting on their behalf) could obtain adequate money damages from the State or its officials. [60] Such party must further show that without permanent injunctive relief, it would suffer irreparable harm. The "irreparable harm" and "inadequate legal remedies" tests are closely related. However, one way to distinguish the two tests is to interpret the "irreparable harm" requirement to mean that the wrongful act be of a continuing nature, as opposed to a one-time denial of rights. [61] It appears to us that any substantial Impairment would, in all likelihood, constitute a transgression of a continuing nature supporting the grant of permanent injunctive relief. For example, the Fifth Circuit has acknowledged that a federal court may enjoin state officials from enforcing an unconstitutional statute under certain "unusual" circumstances that require equitable relief. In

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55 Please see the Bracewell & Giuliani LLP opinion, of even date herewith, for an analysis of Texas law and permanent injunctive relief.

56 However, if the case is brought to federal court via diversity jurisdiction, it is possible that the federal court would use state law in deciding whether or not to issue an injunction.

57 Texas Commerce Bank-San Angelo, N.A. v. Shurley (In re Shurley) , 171 B.R. 769, 787-89 (W.D. Tex. 1994).

58 Beacon Theatres, Inc. v. Westover , 359 U.S. 500, 506-07 (1959); Calmes v. United States , 926 F. Supp. 582, 591 (N.D. Tex. 1996); Wenner v. Texas Lottery Commission , 123 F.3d 321, 325 (5th Cir. 1997).

59 Calmes , 926 F. Supp. at 591; Shurley , 171 B.R. at 788.

60 Examples of hurdles to the receipt of such damages might include, but are not limited to, State sovereign immunity to suit in a particular forum, State administrative procedures for filing claims, legislative refusal to appropriate funds to pay a damages award, and the limited funds available to State officials.

61 United States v. W.T. Grant Co. , 345 U.S. 629, 633 (1953); Posada v. Lamb County, Texas , 716 F.2d 1066, 1070 (5th Cir. 1983) (". . . to win [a permanent injunction], a petitioner must show a clear threat of continuing illegality portending immediate harmful consequences irreparable in any other manner") (emphasis added); Shanks v. City of Dallas , 752 F.2d 1092, 1097 (5th Cir. 1985).

Let's Help Florida v. McCrary , [62] the Fifth Circuit upheld the issuance of an injunction against enforcement of two statutes limiting political contributions because the timing of the next election, which was to be held a few weeks later, meant that the plaintiffs would suffer an irreparable loss of their First Amendment rights if they were barred from making contributions that they were constitutionally permitted to make. Had the court refused to provide equitable relief while awaiting a trial on the merits, the plaintiffs would have permanently lost their opportunity to affect the outcome of that election through their contributions. The court ruled that such a situation constituted the necessary unusual circumstances that could justify equitable relief. For the reasons stated above, we believe that a substantial Impairment in this case would constitute the unusual circumstances that are required for the grant of permanent injunctive relief from a court sitting in the Fifth Circuit.

B. ***Preliminary Injunctive Relief***

Whether a preliminary injunction delaying implementation of Legislative Action being challenged under the Federal Contract Clause as a substantial Impairment could be obtained by the Bondholders (or the Indenture Trustee acting on their behalf) pending an adjudication on the merits of such claim will depend on several considerations. As noted in subpart B of this Part II with respect to the availability of permanent injunctive relief, an action challenging such Legislative Action, and therefore an accompanying request for preliminary injunctive relief, could be brought in either a Texas court or a federal court, and Texas law or federal law, respectively, would provide the basis for determining whether such relief should be granted. [63] The following discussion relates to federal law only.

The function of preliminary injunctive relief is to preserve the latest uncontested status quo prior to the action which is the subject of the legal challenge. [64] The latest uncontested status quo with respect to the Bonds prior to the challenged Legislative Action would appear to

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62 61 F.2d 195, 199 (5th Cir. 1980) ("A federal court may enjoin state officials from enforcing an unconstitutional statute. . . . An injunction is proper in this case because no legal remedy could correct the irreparable injury to plaintiffs' first amendment rights, important for an election only weeks away."); but see Wightman v. Texas Supreme Court , 84 F.3d 188, 191 (5th Cir. 1996) ("The possible unconstitutionality of a statute 'on its face' does not in itself justify an injunction against good faith attempts to enforce it," especially absent "any showing of bad faith, harassment, or any other unusual circumstance that would call for equitable relief.") (quoting Younger v. Harris , 401 U.S. 37, 53-54 (1971)).

63 Once again, if the case enters federal court via diversity jurisdiction, the federal court may use Texas law in deciding whether to issue an injunction.

64 University of Texas v. Camenisch , 451 U.S. 390, 395 (1981) ("The purpose of a preliminary injunction is merely to preserve the relative positions of the parties until a trial on the merits can be held."); Wenner , 123 F.3d at 326 ("Preliminary injunctions commonly favor the status quo and seek to maintain things in their initial condition so far as possible until after a full hearing permits final relief to be fashioned.").

be the continued effectiveness of the Order and the validity of the Transition Property and Charges. The factors considered by federal courts in ruling on a request for preliminary injunctive relief are: (i) the party seeking relief must show a substantial likelihood of success on the merits; (ii) such party will suffer a substantial threat of irreparable injury if the preliminary injunction is not granted; (iii) the threatened injury to the plaintiff outweighs the injury the injunction would cause to the defendant; and (iv) the injunction must not be adverse to the public interest. [65] The third part of the test, the balancing of hardships, is often done on a "sliding scale" basis: the showing of hardship required by a party seeking relief is inversely related to the strength on the merits of such party's claims. [66]

Assuming that the injunction is not adverse to the public interest, that the Federal Contract Clause claim appears to the court to be meritorious (based on the application of the principles discussed in Part I), and further assuming that the challenged Legislative Action effects a substantial Impairment, the requirement of likelihood of success on the merits should be met. However, decisions in several federal courts have found that a delay in the scheduled receipt of payments until final judgment is not the type of "irreparable harm" which a preliminary injunction seeks to prevent, absent countervailing circumstances — such as the possibility that such delay could result in the insolvency or the destruction of the business of the party seeking the preliminary injunction or could result in the other party's insolvency (thereby rendering a judgment worthless). [67] Notwithstanding these decisions, there are arguments why payment delays on the Bonds should be accepted as "irreparable harm," and why the Bondholders would experience greater harm if preliminary injunctive relief were denied than any

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65 Sierra Club v. Federal Deposit Insurance Corporation , 992 F.2d 545, 551 (5th Cir. 1993); DFW Vending, Inc. v. Jefferson County, Texas , 991 F. Supp. 578, 587 (E.D. Tex. 1998).

66 Texas v. Seatrain International, S.A. , 518 F.2d 175, 180 (5th Cir. 1975) ("[the inability to prove with certainty eventual success on the merits] does not foreclose the possibility that temporary restraint may be appropriate. . . . the importance and nature of the requirement can vary significantly, depending upon the magnitude of the injury which would be suffered . . . and the relative balance of the threatened hardship faced by each of the parties. . . . [N]one of the four prerequisites has a fixed quantitative value. Rather, a sliding scale is utilized, which takes into account the intensity of each in a given calculus."); Hunt v. Commodity Futures Trading Commission , 93 B.R. 484, 492 (N.D. Tex 1988); Apple Barrel Productions, Inc. v. Beard , 730 F.2d 384, 398, n.11 (5th Cir. 1984).

67 See , e.g. , Centurion Reinsurance Co. v. Singer , 810 F.2d 140 (7th Cir. 1987); Roland Mach. Co. v. Dresser Indus., Inc. , 749 F.2d 380, 386 and n.1 (7th Cir. 1984). Federal courts with jurisdiction over Texas have similar, if less explicit, case law. See also , Federal Savings & Loan Insurance Corp. v. Dixon , 835 F.2d 554, 560 (5th Cir. 1987) (holding that while, generally, injunctions are not permissible to secure post-judgment damages, because such an injunction would be acting as a prejudgment attachment, which is subject to state law under FRCP 64, equitable powers are "extremely flexible" and an injunction may issue under some circumstances in order to prevent difficulty in collecting a damage judgment, such as an injunction preventing a corporate defendant from selling its assets in such a way that it could be impossible for a winning plaintiff to subsequently collect those assets).

other party would suffer if it were granted. For example, if imposition and collection of the Charges, and accordingly payments to the Issuer, were stopped or reduced, the ratings on the Bonds would likely be downgraded, causing a loss of value in the Bonds and possibly causing institutional Bondholders to sell their Bonds at depressed market prices, and Bondholders could experience delays or omissions in the receipt of payments of interest or principal on their Bonds. In addition, any such loss on sale or additional interest due the Bondholders as the result of the payment interruption probably could not be recovered from the likely defendant (the State) in the proceeding on the merits.

III. Federal Takings Clause

A. Analysis

The Federal Takings Clause — "nor shall private property be taken for public use, without just compensation." — is made applicable to state action via the Fourteenth Amendment. Webb's Fabulous Pharmacies v. Beckwith , 449 U.S. 155, 160 (1980). The Federal Takings Clause covers both tangible and intangible property. Ruckelshaus v. Monsanto Co. , 467 U.S. 986, 1003 [68] . Rights under contracts can be property for purposes of the Federal Takings Clause. Lynch v. United States , 292 U.S. 571, 577 (1934), but legislation that "disregards or destroys" contract rights does not always constitute a taking. Connolly v. Pension Benefit Guaranty Corporation , 475 U.S. 211 (1986) at 224. Where intangible property is at issue, state law will determine whether a property right exists. If a court determines that an intangible asset is property, a court will next look to whether the owner of the property interest had a "reasonable investment-backed expectation" that the property right would be protected. [69]

The United States Supreme Court has suggested that the Federal Takings Clause may be implicated by a diverse range of government actions, including when the government (a)

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68 The Monsanto case involved a federal law requiring disclosure of certain data related to Monsanto products. The Supreme Court was asked to determine whether Monsanto had a property interest in this information as a trade secret and whether that property interest was protected under the Federal Takings Clause. One focus of the Supreme Court's analysis was whether Monsanto had a reasonable investment-backed expectation in the privacy of this property. The Court concluded that at most times prior to the enactment of the law and at all times after the enactment of the law, Monsanto did not have and would not have a reasonable expectation that its information would be kept private. However, the Court noted for a six year period from 1972 to 1978, federal law had provided that an entity submitting information to the government could designate such information as a trade secret and that federal law guaranteed such information would be kept a secret. Accordingly, the Court concluded that with respect to such information designated as a trade secret from 1972 to 1978, Monsanto had a property interest that was protected by the Federal Takings Clause.

69 Rotunda and Nowack, Treatise on Constitutional Law: Substance and Procedure, 3d Edition (1999), Volume 2 page 702.

permanently appropriates or denies all economically productive use of property [70]; (b) destroys property other than in response to emergency conditions [71]; or (c) reduces, alters or impairs the value of property so as to unduly interfere with reasonable investment-backed expectations. [72] In determining what is an undue interference, a court would consider the nature of the

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70 Connolly v. Pension Benefit Guaranty Corporation , 475 U.S. at 225 (noting that in that case the government did not "permanently appropriate" any of the employer's assets for its own use); Palazzolo v. Rhode Island , 533 U.S. 606, 607 ("regulation which 'denies all economically beneficial or productive use of land' will require compensation under the Takings Clause") (citing Lucas v. South Carolina Coastal Council , 505 U.S. 1003, 1015 (1992), which notes that for personal property, however, some regulations that limit use of personal property may not be compensable takings given the state's "traditionally high degree of economic control over commercial dealings"; U.S. v. Security Industrial Bank , 459 U.S. 70, 77 (1982), citing Armstrong v. U.S. , 364 U.S. 40, 48 (1960) ("The total destruction by the Government of all values of these liens, which constitute compensable property, has every possible element of a Fifth Amendment 'taking' and is not a mere 'consequential incidence' of a valid regulatory measure"); See also Lingle v. Chevron USA, 544 U.S. 528, 538 (2005) (noting that regulatory action will be deemed a per se taking of property if it requires an owner to suffer a "permanent" physical invasion of property or completely deprives the owner of *all* economically beneficial use of such property. The Supreme Court has also held that legislation that terminates a property interest can be considered a taking for which compensation is due. Hodel v. Irving , 481 U.S. 704 (federal law escheating certain fractional interests in tribal property to an Indian tribe was a compensable taking). See also Rotunda and Nowack, Volume 2, 746.

71 The emergency exception to the just compensation requirement of the Federal Takings Clause appears in several Supreme Court decisions. See generally Rotunda and Novack Volume 2 at 738. Several of these decisions involve the government's activities during military hostilities. See for example , United States v. Caltex, Inc. , 344 U.S. 149 (1952), rehearing denied 344 U.S. 919 (1953) (no compensable taking when Army destroys property to prevent enemy forces from obtaining it); United States v. Central Eureka Mining Co. , 357 U.S. 155 (1958), rehearing denied 358 U.S. 858 *1958)(no compensable taking when government forces gold mines to cease operations to conserve resources for war effort); National Board of Young Men's Christian Associations v. United States , 395 U.S. 85 (1969) (no compensable taking where private property destroyed when US troops take shelter there). Compare United States v. Pewee Coal Co. , 341 U.S. 114 (1951)(compensable taking when occupation is physical rather than regulatory, emergency notwithstanding). The emergency exception is not limited to wartime activities, however. See for example Miller v. Schoene , 276 U.S. 272 (1928)(no compensable taking where trees destroyed to prevent disease from spreading to other trees); Dames & Moore v. Regan , 453 U.S. 654 (1981) (no compensable taking resulting from executive order nullifying attachments on Iranian assets and permitting those assets to be transferred out of the country). The emergency exception is not limited to the physical destruction of property by the government, see Central Eureka Mining , 357 U.S. at 168, but the Supreme Court has suggested it does not apply to physical occupation of property, see Pewee , 341 U.S. at 116-17, or permanent appropriation, see Lingle , 544 U.S. at 538, both of which constitute a per se taking. Moreover, we believe that a permanent appropriation of property by the government would be generally inconsistent with the concept of an "emergency". See Central Eureka , 357 U.S. at 168 (describing wartime restrictions as "temporary in character").

72 Connolly v. Pension Benefit Guaranty Corporation , 475 U.S. at 225 (nothing that one point of Federal Takings Clause analysis is "the extent to which the regulation has interfered with distinct investment-backed expectations")) (citing Penn Central Transportation Co. , 438 U.S. at 124); United States v. Central Eureka Mining Co. , 357 U.S. 155 (1958), rehearing denied 358 U.S. 858 (1958) (no compensable taking when government forces gold mines to cease operations to conserve resources for war effort).

governmental action and weigh the public purpose served thereby against the degree to which it interferes with legitimate property interests and distinct investment-backed expectations of the Bondholders.

In Lingle v. Chevron USA , 544 U.S. 528 (2005), the Supreme Court identified two categories where regulatory action constitutes per se takings – regulations that involve a permanent physical invasion of property and regulations that deprive of the owner of all economically beneficial use of the property – plus a third category of other regulatory takings. In cases in this third category, the Supreme Court has eschewed any set formula and has relied instead on ad hoc, factual inquiries into the circumstances of each particular case. Connolly v. Pension Benefit Guaranty Corp ., 475 U.S. 211, 224 (1986); Penn Central Transportation Co. v. New York , 438 U.S. 104, 124 (1978). According to the Connolly decision, a regulation constitutes a taking if it denies a property owner "economically viable use" of that property, which is determined by three factors: (i) the character of the governmental action; (ii) the economic impact of the regulation on the claimant; and (iii) the extent to which the regulation has interfered with distinct investment-backed expectations. Connolly , 475 U.S. at 224, citing Penn Central , 438 U.S. at 124.

The first factor described above requires the court to examine "the purpose and importance of the public interest reflected in the regulatory imposition" and "to balance the liberty interest of the private property owner against the Government's need to protect the public interest through imposition of the restraint." Loveladies Harbor, Inc v. U.S. , 28 F.3d 1171, 1176 (Fed. Cir. 1994); see Keystone Bituminous Coal Ass'n v. DeBenedictis , 480 U.S. 470 (1987).

The second factor described above incorporates the principle enunciated by Justice Holmes: "Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law." Penn Coal Co. v. Mahon , 260 U.S. 393 (1922); Loveladies , 28 F. 3D at 1176-77. "Not every destruction of injury to property by governmental action has been held to be a 'taking' in the constitutional sense"; Armstrong v. U.S ., 364 U.S. 40, 48 (1960). Diminution in property value alone, thus, does not constitute a taking; there must be serious economic harm.

The third factor described above is "a way of limiting recovery under the Federal Takings Clause to owners who could demonstrate that they bought their property in reliance on a state of affairs that did not include the challenged regulatory regime." Loveladies , 28 F. 3d at 1177. The burden of showing such interference is a heavy one. Keystone , 480 U.S. at 493. Thus, a reasonable investment-backed expectation "must be more than a 'unilateral expectation or an abstract need." Monsanto , 467 U.S. at 1005. Further, "[l]egislation adjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations." Usery v. Turner Elkhorn Mining Co. , 428 U.S. 1 (1976). "[T]he fact that legislation disregards or destroys existing

contractual rights does not always transform the regulation into an illegal taking….This is not to say that contractual rights are never property rights or that the Government may always take them for its own benefit without compensation." Connolly , 475 U.S. at 223-24. In order to sustain a claim under the Federal Takings Clause, the private party must show that it had a "reasonable expectation" at the time the contract was entered that it "would proceed without possible hindrance" arising from changes in government policy. Chang v. U.S. , 859 F. 2d 893 (Fed Cir. 1988). With respect to this third factor, we note that PURA expressly provides for the creation of transition property in connection with the issuance of the Bonds, and further provides that the Order, once final, is irrevocable. Moreover, through the State Pledge, the State has pledged, "for the benefit and protection of financing parties" not to impair the value of such Transition Property. Given the foregoing, we believe it would be hard to dispute that Bondholders have reasonable investment expectations with respect to their investments in the Bonds.

We are not aware of any case law which addresses the applicability of the Federal Takings Clause in the context of the proper exercise by a state of its police power to abrogate or impair contracts otherwise binding on the state. The outcome of any claim that interference by the State with the value of the Transition Property without compensation is unconstitutional, would likely depend on factors such as the State interest furthered by that interference and the extent of financial loss to Bondholders caused by that interference, as well as the extent to which courts would consider that Bondholders had a reasonable expectation that changes in government policy and regulation would not interfere with their investment.

B. Conclusion

Based on our analysis of relevant judicial authority, as set forth above, it is our opinion, subject to all of the qualifications, limitations and assumptions set forth in this letter, that, under the Federal Takings Clause, a reviewing court would hold that the State would be required to pay just compensation to Bondholders if the State's repeal or amendment of PURA or taking of any other action by the State in contravention of the State Pledge (a) constituted a permanent appropriation of a substantial property interest of the Bondholders in the Transition Property or denied all economically productive use of the Transition Property; (b) destroyed the Transition Property other than in response to emergency conditions; or (c) substantially reduced, altered or impaired the value of the Transition Property so as to unduly interfere with the reasonable expectations of the Bondholders arising from their investments in the Bonds. As noted earlier, in determining what is an undue interference, a court would consider the nature of the governmental action and weigh the public purpose served thereby against the degree to which it interferes with the legitimate property interests and distinct investment-backed expectations of the Bondholders. There can be no assurance, however, that any such award of just compensation would be sufficient to pay the full amount of principal of and interest on the Bonds. [73]

* * * * *

We note that judicial analysis of issues relating to the Federal Contract Clause and the retroactive effect to be given to judicial decisions has typically proceeded on a case-by-case basis and that the court's determination, in most instances, is usually strongly influenced by the facts and circumstances of the particular case. We further note that there are no reported controlling judicial precedents of which we are aware directly on point. Our analysis is necessarily a reasoned application of judicial decisions involving similar or analogous circumstances. Moreover, the application of equitable principles (including the availability of injunctive relief or the issuance of a stay pending appeal) is subject to the discretion of the court which is asked to apply them. We cannot predict the facts and circumstances which will be present in the future and may be relevant to the exercise of such discretion. Consequently, there can be no assurance that a court will follow our reasoning or reach the conclusions which we believe current judicial precedent supports. It is our and your understanding that none of the

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[73] We express no opinion as to whether any court would have or exercise jurisdiction to hear such a Federal Taking Clause challenge, when such a challenge would be ripe, or whether the State would be entitled to assert sovereign immunity in a particular forum. As to the question of sovereign immunity, to the extent that there is a taking without just compensation and just compensation is unavailable through State or federal procedures, Bondholders (or the Indenture Trustee on their behalf) or the Issuer could seek to enjoin enforcement of the State action by suing individual officers under Ex Parte Young , 42 U.S.C. 123 (1908) and 42 U.S.C. §1983.

foregoing opinions is intended to be a guaranty as to what a particular court would actually hold; rather each such opinion is only an expression as to the decision a court ought to reach if the issue were properly prepared and presented to it and the court followed what we believe to be the applicable legal principles under existing judicial precedent. The recipients of this letter should take these considerations into account in analyzing the risks associated with the subject transaction.

Any opinion expressed herein with respect to enforceability is subject to the qualifications, limitations and assumptions set forth in the Bankruptcy Opinion.

This letter is limited to the federal laws of the United States of America.

This letter is being delivered solely for the benefit of the persons to whom it is addressed; accordingly, it may not be quoted, filed with any governmental authority or other regulatory agency or otherwise circulated or utilized for any other purpose without our prior written consent. We hereby consent to the filing of this letter as an exhibit to the Form 8-K filed on October 11, 2006 with respect to the above-referenced Registration Statement and to all references to our firm included in or made a part of the Registration Statement. In giving the foregoing consents, we do not thereby admit that we are within the category of persons whose consent is required under Section 7 of the Securities Act or the related rules and regulations of the Commission. We assume no obligation to update or supplement this letter to reflect any facts or circumstances which may hereafter come to our attention with respect to the opinions or statements expressed above, including any changes in applicable law which may hereafter occur.

Very truly yours,

/s/ Sidley Austin LLP

SCHEDULE A

The Bank of New York,
as Indenture Trustee
101 Barclay Street
New York, New York 10286

Fitch Ratings
One State Street Plaza
New York, New York 10004

Moody's Investors Service, Inc.
99 Church Street
New York, New York 10007

Standard & Poor's Ratings Service
55 Water Street, 40 th Floor
New York, New York 10041

Each of the following, for itself and as Representatives of the Underwriters of the Bonds:

Credit Suisse Securities (USA) LLC
11 Madison Avenue
New York, New York 10010

J.P. Morgan Securities Inc.
270 Park Avenue
New York, New York 10017

Greenwich Capital Markets, Inc.
600 Steamboat Road
Greenwich, Connecticut 06830

Exhibit 99.2

[Bracewell& Giuliani LLP Letterhead]

October 11, 2006

To Each of the Persons Listed
on Schedule A Attached Hereto

Re: AEP Texas Central Transition Funding LLC Senior Secured Transition Bonds, Series A

Ladies and Gentlemen:

We have served as local Texas counsel to AEP Texas Central Company, a Texas corporation (" TCC "), and AEP TCC Transition Funding LLC, a Delaware limited liability company (" Bond Issuer "), in connection with the issuance and sale on the date hereof by the Bond Issuer, of $1,739,700,000 aggregate principal amount of the Bond Issuer's Senior Secured Transition Bonds, Series A (the " Bonds "), which are more fully described in the Prospectus Supplement dated October 4, 2006 and related Prospectus dated October 4, 2006. The Bonds are being sold pursuant to the provisions of the Underwriting Agreement dated October 11, 2006, among TCC, the Bond Issuer and Credit Suisse Securities (USA) LLC, J.P. Morgan Securities Inc. and Greenwich Capital Markets, Inc., as representatives of the underwriters named in Schedule II to such Underwriting Agreement. The Bonds are being issued pursuant to the provisions of the Indenture dated as of October 11, 2006 (the " Indenture "), as supplemented by the Series Supplement dated as of October 11, 2006 (together with the Indenture, the " Bond Indenture "), between the Bond Issuer and The Bank of New York, as indenture trustee (the " Indenture Trustee "). Under the Bond Indenture, the Indenture Trustee holds, among other things, certain transition property as described below (the " Transition Property ") as collateral security for the payment of the Bonds.

"Transition Property" is defined in Subchapter G of Chapter 39 of the Public Utility Regulatory Act (" PURA "), TEX. UTIL. CODE ANN., Title 2 (Vernon 1998 & Supp. 2006). The Transition Property was created in favor of TCC, pursuant to a financing order (the " Financing Order ") issued by the Public Utility Commission of Texas (the " PUCT ") on June 21, 2006, in Docket No. 32475; and the Transition Property was assigned to the Bond Issuer pursuant to the provisions of the Transition Property Purchase and Sale Agreement dated as of October 11, 2006 between TCC and the Bond Issuer in consideration for the payment by the Bond Issuer to TCC

of the proceeds of the sale of the Bonds, net of certain issuance costs. The Transition Property includes the right to impose and receive certain "non-bypassable" charges described in the Financing Order (the " Charges "). The Charges constitute "transition charges" as defined in PURA and may be periodically adjusted, in the manner authorized in the Financing Order, in order to ensure the expected recovery of amounts sufficient to (i) amortize the Bonds pursuant to the amortization schedule to be followed in accordance with the provisions of the Bonds and the Bond Indenture, (ii) pay interest thereon and related fees and expenses, and (iii) maintain the required reserves for the payment of the Bonds.

The Financing Order was issued in response to an application for its issuance that was filed by TCC with the PUCT pursuant to the provisions of PURA. The Financing Order became final and not subject to further appeal on July 6, 2006. TCC filed its Issuance Advice Letter with the PUCT on October 5, 2006, as required by the Financing Order, and its Schedule TC-2 Tariff relating to the Charges on July 10, 2006, and its Rider TC-2 Tariff on October 5, 2006, as required by the Financing Order.

Section 39.310 (the " State Pledge ") of PURA, provides:

> PLEDGE OF STATE. Transition bonds are not a debt or obligation of the state and are not a charge on its full faith and credit or taxing power. The state pledges, however, for the benefit and protection of financing parties and the electric utility, that it will not take or permit any action that would impair the value of transition property, or, except as permitted by Section 39.307 [relating to true-up], reduce, alter, or impair the transition charges to be imposed, collected, and remitted to financing parties, until the principal, interest and premium, and any other charges incurred and contracts to be performed in connection with the related transition bonds have been paid and performed in full. Any party issuing transition bonds is authorized to include this pledge in any documentation relating to those bonds.

As authorized by the foregoing statutory provision and the Financing Order, the language of the State Pledge has been included in the Bonds and in the Bond Indenture.

Questions Presented and Opinions

You have requested our opinion as to:

1. whether Texas courts would uphold the validity of the State Pledge;

2. whether the Texas Constitution permits Subchapter G of Chapter 39 of PURA to be amended or repealed by citizen initiative or referendum;

3. (a) whether the holders of the Bonds (the " Bondholders ") could challenge successfully under Article I, Section 16 of the Texas Constitution, which provides in part, "No . . . law impairing the obligation of contracts, shall be made" [1] (the " Texas Contract Clause "), the constitutionality of any legislation passed by the Texas legislature (the " Legislature ") which becomes law that repeals the State Pledge or limits, alters, impairs or reduces the value of the Transition Property or the Charges so as to cause a substantial TEX. CONST. art. I, § 16. impairment, of (i) the terms of the Bond Indenture or the Bonds or (ii) the rights and remedies of the Bondholders (or the Indenture Trustee acting on their behalf) prior to the time that the Bonds are fully paid and discharged (" State Impairment Legislation ");

(b) whether a substantial impairment of a legislative character by the PUCT (" PUCT Impairment Action ") would be treated in the same manner as State Impairment Legislation under the Texas Contract Clause; and

(c) whether preliminary injunctive relief would be available under Texas law to delay implementation of State Impairment Legislation or PUCT Impairment Action pending final adjudication of a claim challenging such State Impairment Legislation or PUCT Impairment Action under the Texas Contract Clause and, assuming a favorable final adjudication of such claim, whether relief would be available to prevent permanently the implementation of the challenged State Impairment Legislation or PUCT Impairment Action; and

4. whether action taken by the State of Texas, including the PUCT and its other agencies and instrumentalities (the " State "), in violation of the State Pledge would constitute a compensable taking under Article 1, Section 17 of the Texas Constitution which states in part, "No person's property shall be taken, damaged or destroyed for or applied to public use without adequate compensation being made, unless by the consent of such person; and, when taken, except for the use of the State, such compensation shall be first made, or secured by a deposit of money" [2] (the " Texas Takings Clause ").

Based upon our review of relevant judicial authority, as set forth in this letter, but subject to the qualifications, limitations and assumptions set forth in this letter, it is our opinion that a reviewing court, in a properly prepared and presented case:

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1 TEX. CONST. art. I, § 16.

2 TEX. CONST. art. I, § 17.

1. would uphold the validity of the State Pledge;

2. would conclude that the Texas Constitution does not provide for the amendment or repeal of Subchapter G of Chapter 39 of PURA by citizen initiative or referendum;

3. (a) would conclude that the Bondholders (or the Indenture Trustee acting on their behalf) could successfully challenge under the Texas Contract Clause the constitutionality of State Impairment Legislation (other than a law passed by the Legislature in the valid exercise of the State's police power necessary to safeguard the public safety and welfare);

(b) would conclude that PUCT Impairment Action would be treated in the same manner as State Impairment Legislation under the Texas Takings Clause; and

(c) should conclude that Bondholders are entitled to permanent injunctive relief under state law to prevent implementation of State Impairment Legislation or PUCT Impairment Action hereafter passed by the Legislature or otherwise taken in violation of the Texas Contract Clause; and although sound and substantial arguments support the granting of preliminary injunctive relief, the decision to do so will be in the discretion of the court requested to take such action, which will be exercised on the basis of the considerations discussed in subpart (c) of Part 3 below; and

4. would find a compensable taking under the Texas Takings Clause if (a) it concludes that the Transition Property is property of a type protected by the Texas Takings Clause and (b) the State takes action that, without paying just compensation to the Bondholders, (i) permanently appropriates the Transition Property or denies all economically productive use of the Transition Property; or (ii) destroys the Transition Property, other than in response to emergency conditions; or (iii) substantially reduces, alters or impairs the value of the Transition Property, if the action unduly interferes with the Bondholders' reasonable investment backed expectations; provided that, the court's conclusion that a compensable taking had occurred would depend upon its resolution of the issues discussed in Part 4 below.

Our opinion in the immediately preceding subparagraphs 1, 2, 3 and 4 and in our discussion below is based upon our evaluation of existing judicial decisions and arguments related to the factual circumstances likely to exist at the time of a Texas Contract Clause or Texas Takings Clause challenge to State Impairment Legislation, or to PUCT Impairment Action, or to other State action claimed to be a taking of the Bondholders' property and is intended to express our belief as to the result that should be obtainable through the proper

application of existing judicial decisions in a properly prepared and presented case. Such precedents and such circumstances could change materially from those discussed below in this letter.

In addition, our opinion assumes that any State Impairment Legislation or PUCT Impairment Action effects a substantial impairment of (i) the terms of the Bond Indenture or the Bonds or (ii) the rights and remedies of the Bondholders (or the Indenture Trustee acting on their behalf) prior to the time that the Bonds are fully paid and discharged (or such payment is provided for), if it prevents payment of the Bonds or significantly affects the security for the Bonds. The determination of whether particular legislative action constitutes a substantial impairment of a particular contract is a fact-specific analysis, and nothing in this letter expresses any opinion as to how a court would resolve the issue of "substantial impairment" with respect to the Financing Order, the Charges, the Transition Property, the Bond Indenture or the Bonds vis-a-vis a particular legislative action. See the discussion in Subpart (a)(2) of Part 3 below.

DISCUSSION

1. Validity of State Pledge . While the State Pledge was not specifically mentioned, in *City of Corpus Christi v. Public Utility Comm'n* , 51 S.W.3d 231 (Tex. 2001), the Texas Supreme Court upheld the constitutionality of Subchapter G of Chapter 39 of PURA.

A pledge similar to the State Pledge was held to be valid exercise of legislative authority by the Texas Supreme Court in *Lower Colorado River Auth. v. McCraw* , 83 S.W.2d 629 (Tex. 1935). *McCraw* involved an action in mandamus to compel the Texas Attorney General to approve the issuance of bonds by the Lower Colorado River Authority, a conservation and reclamation district created by the State of Texas under TEX . CONST . art. 16, § 59, and to issue a certificate that the bonds had been issued in accordance with law. Among the provisions of the act creating the district that the Texas Supreme Court considered was Section 8, containing the following language:

> Nothing herein shall be construed as depriving the State of Texas of its power to regulate and control fees and/or charges to be collected for the use of water, water connections, power, electric energy, or other service, provided that the State of Texas does hereby pledge to and agree with the purchasers and successive holders of the bonds issued hereunder that the state will not limit or alter the power hereby vested in the District to establish and collect such fees and charges as will produce revenues sufficient to pay the items in subparagraphs (a), (b), (c) and (d) of this Section 8 [to pay expenses necessary to the operation and maintenance of the properties and facilities of the District; to pay interest on and principal of all bonds issued

> under this Act when and as the same shall become due and payable; to pay all sinking fund and/or reserve fund payments agreed to be made in respect of any such bonds, and payable out of such revenues, when and as the same shall become due and payable; and to fulfill the terms of any agreements made with the holders of such bonds and/or with any person in their behalf], or in any way to impair the rights or remedies of the holders of the bonds, or of any person in their behalf, until the bonds, together with the interest thereon, with interest on unpaid installments of interest and all costs and expense in connection with any action or proceedings by or on behalf of the bondholders and all other obligations of the District in connection with such bonds are fully met and discharged. *McCraw* , 83 S.W.2d at 637.

The Texas Supreme Court sustained Section 8 of the act creating the district, including the above language, against the contention that it constituted an unlawful delegation and surrender of legislative authority, stating that:

> . . . the Legislature had the right to confer on the district authority to fix adequate rates to accomplish the purposes set forth in section 8 of the act; and further the Legislature had the power to guarantee the continuation of such rates as long as the lawful obligations of the district are outstanding. If this were not so, bonds of the district, based on income, would be idle and vain things. *McCraw* , 83 S.W.2d at 638.

In *Lower Colorado River Auth. v. City of San Marcos* , 523 S.W.2d 641, 645 (Tex. 1975), the Texas Supreme Court further concluded that the powers reserved by the State of Texas under Section 8 of the act creating the Lower Colorado River Authority included the right to regulate the rates charged by the district, indicating that "this reserved power will not be exercised in a manner that will prejudice the bondholders or prevent the collection of revenues required for the purposes of the four subparagraphs [of Section 8]."

Based on such case law, it is our opinion that a reviewing Texas state court would uphold the validity of the State Pledge.

2. Citizen Initiative or Referendum . With the exception of T EX . C ONST . art. VIII, § 24, which provides for a statewide referendum on the question of imposing an income tax on natural persons, no provision in the Texas Constitution provides for citizen initiative to propose state legislation or referendum on existing state legislation. [3] The Texas Constitution provides

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[3] The Texas Constitution also contains provisions: (i) authorizing elections on local option laws regarding the sale of alcoholic beverages, T EX . C ONST . art. XVI, § 20;. (ii) requiring submission to the voters of salary recommendations for certain state officials, T EX . C ONST . art. III, § 24; and (iii) requiring submission to the voters of constitutional amendments, T EX . C ONST . art. XVII, § 1.

that: "The Legislative power of this State shall be vested in a Senate and House of Representatives, which together shall be styled 'The Legislature of the State of Texas.'" TEX. CONST. art. III, § 1. Accordingly, the Legislature exercises legislative power in Texas, and, subject to the exception mentioned above, such power is not exercised directly by the citizens. Therefore, it is our opinion that a reviewing Texas state court would conclude that the Texas Constitution does not provide for citizen initiative or referendum with respect to Subchapter G of Chapter 39 of PURA.

3. Impairment of the Obligation of Contract

(a) It is likely that any State Impairment Legislation could be successfully challenged by Bondholders as an impairment of contract under the Texas Contract Clause assuming that the State Impairment Legislation did not constitute a valid exercise of the State's police powers, which generally refer to the State's powers to protect the health, safety and welfare of the public. Article I, Section 16 of the Texas Constitution states: "No . . . law impairing the obligation of contracts shall be made." In considering challenges to State legislation or action which impairs an existing contract, Texas courts have traditionally looked to and applied federal law developed under the Federal Contract Clause, as well as applying their own analyses of the Texas Contract Clause. *Lester v. First Am. Bank, Bryan, Texas* , 866 S.W.2d 361, 365-66 (Tex. App.—Waco 1993, writ denied).

(1) Federal Law Under the Federal Contract Clause

As mentioned above, the Texas courts have traditionally looked to federal case law to determine whether a contract has been unconstitutionally impaired by an action of the State. In *Travelers' Ins. Co. v. Marshall* , 76 S.W.2d 1007, 1010 (Tex. 1934), the Texas Supreme Court struck down a Texas statute which created a moratorium on certain foreclosures of real property due to existing economic conditions within Texas. In performing its analysis, the court conducted an extensive review of federal law pertaining to the contract clause of the U.S. Constitution (" Federal Contract Clause "), [4] noting that the Texas Contract Clause adopted in 1876 was "derived from" the Federal Contract Clause, which is nearly identical in wording. *Marshall* , 76 S.W.2d at 1012. Thus, the court reasoned, the interpretation of the Federal Contract Clause by the federal courts is of critical importance in understanding the meaning of the Texas Contract Clause at the time it was adopted. The court went on to conclude that at the time of adoption in 1876, both federal and Texas case law had established "that moratory legislation of almost every conceivable type was void. Since we adopted the contract clause without change, it must be held

4 U.S. CONST. art. 1, § 10, cl. 1 ("No State shall …pass any…Law impairing the Obligation of Contracts").

that we likewise adopted the fixed and definite interpretation which had been given it by the courts generally." *Marshall* , 76 S.W.2d at 1020. [5]

The conclusion in *Marshall* that federal case law is to be applied by Texas courts in construing the Texas Contract Clause has been restated more recently. In *Lester*, the Waco Court of Appeals reviewed *Marshall* 's discussion of the state and federal clauses and stated:

> But for this…exception, however, the two clauses have been generally accorded the same meaning and effect. 1 G EORGE D. B RADEN ET AL ., T HE C ONSTITUTION OF THE S TATE OF T EXAS : A N A NNOTATED AND C OMPARATIVE A NALYSIS 61 (1977). What offends one offends the other. Moreover, the Texas Supreme Court has not departed from a mirror-image interpretation of the two clauses in any decision issued subsequent to *Marshall* . *Lester* , 866 S.W.2d at 365-66. [6]

This language confirms that in the modern era the Texas courts have interpreted the Texas Contract Clause in a manner consistent with the federal courts' interpretation of the Federal Contract Clause. Thus it is reasonable to assume that any rights Bondholders would have to challenge State Impairment Legislation under the Federal Contract Clause would also apply to any challenge under the Texas Contract Clause.

We have not made an independent analysis of whether bondholders could successfully challenge State Impairment Legislation under the Federal Contract Clause, but have reviewed the analysis of that question by Sidley Austin LLP contained in its opinion of this date related to the Federal Contract Clause question. In that opinion, Sidley Austin LLP states that a reviewing court, in a properly prepared and presented case:

> (i) would conclude that, absent a demonstration by the State that an Impairment is necessary to further a significant and legitimate public purpose, the Bondholders (or the Indenture Trustee acting on their behalf) could successfully challenge under the Federal Contract Clause the constitutionality of any Legislative Action determined by such court to limit, alter, impair or reduce the value of the Transition Property or the Charges so as to cause an Impairment prior to the time that the Bonds are fully paid and discharged;

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5 While establishing this precedent, the court went on to declare the Texas moratorium law unconstitutional despite a U. S. Supreme Court opinion upholding the constitutionality of a similar law. *See Home Building & Loan Assn. v. Blaisdell,* 290 U.S. 398, 54 S.Ct. 231, 78 L.Ed. 413 (1934). The *Marshall* court distinguished *Blaisdell* because the latter case was based on the Supreme Court's conclusion that a state may enact legislation pursuant to its police powers which has only an incidental effect on pre-existing contracts. The *Marshall* court went on to hold that this particular federal interpretation of the Federal Contract Clause cannot be applied in Texas since Article I, Section 29 of the Texas Constitution exempts the entire Texas Bill of Rights (of which the Texas Contract Clause is one such right) from the police powers of the state government, something that is not present in the federal Constitution. As noted below, this aspect of *Marshall* has been restricted by recent cases.

6 The "exception" noted in *Lester* pertained to the *Marsha* ll court's rejection for purposes of the Texas Contract Clause the U.S. Supreme Court's holding in *Blaisdell* concerning the Federal Takings Clause discussed in Note 6 *supra* .

We have analyzed the reasoning in the Sidley Austin LLP opinion in order to ascertain if there would be any apparent basis for a reviewing state court in Texas to conclude that the applicable federal law pertaining to the Federal Contract Clause is inconsistent with or otherwise should not be applied in a challenge based on the Texas Contract Clause. We have found no such basis and thus conclude that if the Bondholders could successfully mount such a challenge under the Federal Contract Clause, that challenge should succeed in a case involving the Texas Contract Clause.

(2) The Texas Contract Clause

Aside from reliance on federal cases interpreting the Federal Contract Clause, Texas courts have also conducted their own analyses of the Texas Contract Clause outside of a federal analysis. The Texas Contract Clause states, "No . . . law impairing the obligation of contracts, shall be made." TEX. CONST. art. 1 § 16. There is no bright line test for what constitutes an "impairment" under the Texas Contract Clause, but the Texas Supreme Court has provided precedential guidance on the issue. In two older cases, the Texas Supreme Court specifically addressed impairment of the obligation of contract as it relates to bondholders' rights. [7] In examining impairment of obligations under the Texas Contract Clause more recently, the Texas Supreme Court has examined whether the impairment is directed against the terms of the contract or has an incidental effect on the contract, and whether the impairment is a valid exercise of the state's police power.

(i) Bondholders' Rights

The case law regarding impairment of bonds is for the most part quite limited and somewhat dated. Two Texas Supreme Court cases directly address the issue of state legislation which potentially impairs the rights of bondholders.

In *City of Aransas Pass v. Keeling* , 247 S.W. 818, 821 (Tex. 1923), the Texas Supreme Court stated:

> State and federal authorities are uniform that, when an act of a state Legislature, authorizing a bond issue, creates, or authorizes the creation of, a certain fund for the bond's payment, such provision of the act enters into the

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7 In *City of Aransas Pass v. Keeling* , 247 S.W. 818 (Tex. 1923), the court did not distinguish whether it was analyzing impairment of contract under the Texas Constitution or the U. S. Constitution. In *City of Austin v. Cahill* , 88 S.W. 542 (Tex. 1905), the court addressed impairment of bondholders' rights under the Federal Contract Clause.

> contract between the debtor and the holders of the bonds, so that it cannot be repealed by subsequent legislation without the substitution of something of equal efficacy. The subsequent legislation would impair the obligations of the contract, and therefore come under constitutional condemnation. *City of Austin v. Cahill* , 99 Tex. 195, 88 S.W. 542, 89 S.W. 552; *Basset v. El Paso* , 88 Tex. 168, 30 S.W. 893; *Morris & Cummings v. State* , 62 Tex. 745; *Fletcher v. Peck* , 6 Cranch, 87, 3 L.Ed. 162; Seibert v. Lewis, 122 U. S. 184, 7 Sup. Ct. 1190, 30 L. Ed. 1161.

In the earlier case of *City of Austin v. Cahill,* 99 Tex. 195, 88 S.W. 542, 89 S.W. 552 (1905), the Texas Supreme Court dealt with a situation in which the City of Austin asserted that the Legislature had amended the Charter of the City of Austin by withdrawing the city's taxing power to repay certain previously issued or unrefunded bonds. The court held that the adversely affected bondholders had a contractual right to compel by mandamus a tax levy which related back to the time when such taxes should have been levied in order for the city to be able to meet its financial obligations under the bonds. The Texas Supreme Court went on to state:

> Much strength is also imparted to this view by the consideration that the Legislature must be presumed to have known that it was not within its constitutional power to impair the contract with the holders of the unrefunded bonds by withdrawing the taxing power which was a part of the obligation of the contract. U.S. Const. art. 1, § 10. *Cahill* , 88 S.W. at 546.

These cases, while quite old, suggest that the Texas courts will look seriously at any effort by the Legislature to impair the rights of the Bondholders to recoup their investment in the Bonds, particularly given the significance of the State Pledge in the issuance of the Bonds.

In a recent case, the Texas Supreme Court has commented upon the validity of *Keeling* , noting "that when the Legislature provides for the creation of a certain fund for the payment of a bond issue, the provision 'cannot be repealed by subsequent legislation without the substitution of something of equal efficacy'." *Edgewood Ind. Sch. Dist. v. Meno* , 917 S.W.2d 717, 742 (Tex. 1995) (quoting *Keeling*). The *Edgewood* court also pointed out that a lower court had invalidated a limitation on a city's annual tax increases because of the likelihood that the limitation would leave the city with a tax rate which would be insufficient to meet the city's debt service obligations on its bonds. *Determan v. City of Irving* , 609 S.W.2d 565, 570 (Tex. Civ. App.—Dallas 1980, no writ). However, the *Edgewood c* ourt drew a distinction between an impairment which results in "the unmitigated *repeal* of a funding source" and one which results in an entity being "clearly able to repay its obligations within statutory and constitutional limitations . . .". *Edgewood* at 742 (emphasis in opinion). Thus, a critical question which may be examined in a challenge to any State Impairment Legislation under Texas law is whether the Bonds could be repaid despite the impairment.

(ii) Direct vs. Incidental Effect

Subsequent to its decision in *Edgewood* , the Texas Supreme Court has suggested that the focus of the Texas Contract Clause is on whether or not legislation alleged to violate the Texas Contract Clause is directed specifically against the terms of the contract, or whether the legislation has only "incidental effects" on the contract. *Barshop v. Medina County Underground Water Conservation District* , 925 S.W.2d 618 (Tex. 1996). In framing such analysis, the *Barshop* court discussed two earlier cases, *Marshall, supra* , and *Henderson Co. v. Thompson* , 300 U.S. 258, 266 (1937).

In *Henderson* , the U.S. Supreme Court addressed legislation that defined different types of natural gas and prohibited extraction of certain types of gas from certain sources, thus affecting previously agreed contracts for the extraction and sale of gas. *Henderson* , 300 U.S. at 266. Interpreting the Texas Contract Clause, the U.S. Supreme Court restricted the application of *Marshall* to statutes that were specifically directed against the terms of a contract. *Henderson* , 300 U.S. at 266. The *Henderson* court noted that the Texas Constitution had "never been held to avoid a police statute dealing directly with physical things in the interest of the public welfare, and touching contractual relationships only incidentally as they may have attached to those physical things prior to the passage of the statute." *Id* . Thus, the natural gas statute at issue in that case was not found to be in violation of the Texas Contract Clause.

In *Barshop* , the Texas Supreme Court dealt with legislation regulating the extraction of water from an aquifer. The court favorably cited the *Henderson* analysis that *Marshall* applies only to statutes that directly impair a contract pursuant to the police power. The court also cited *Henderson* 's holding that statutes enacted pursuant to the police power and which have only an incidental effect on a contract are not unconstitutional violations of the Texas Contract Clause. *Barshop* , 925 S.W.2d at 634-35. Because the legislation dealing with water regulation was a valid exercise of the police power necessary to safeguard the public safety and welfare, the Texas Supreme Court upheld the legislation. *Barshop* , 925 S.W.2d at 634-35.

Under this analysis, a court likely would find that legislation directly impairing the rights of Bondholders violates the Texas Contract Clause. Section 39.310 of PURA specifically authorizes the Bond Issuer to include the State Pledge in documentation related to the Bonds. Accordingly, legislation that repealed or significantly modified the State Pledge or was directed at reducing, altering, or impairing the value of the Transition Property or the Charges would be directed at a material term of the contract, would not be considered "incidental" and would likely be held to be an unconstitutional violation of the Texas Contract Clause, unless the State could demonstrate that the impairment was a legitimate exercise of its police powers to safeguard the public safety and welfare. [8]

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[8] As we previously discussed, the Texas Supreme Court in *Marshall* held that the entire Bill of Rights in the Texas Constitution (including the Texas Contract Clause) is exempted from the police powers of the State. Thus, *Marshall* , as modified by *Barshop* , would preclude any State Impairment Legislation which directly impaired the terms of the Bondholders' contract, as opposed to having an incidental effect on the contract, even if enacted as part of the State's police powers.

(iii) Police Power

As explained in *Barshop* , an exception to the Texas Contract Clause would exist if the legislature could demonstrate that it was exercising the police power necessary to safeguard the public safety and welfare and the impairment is "directed against the terms of a contract." *Barshop* at 634. A survey of Texas law reveals many instances in which the legislature was justified in impairing contractual rights when it exercised the police power to protect the public safety and welfare, but none that involve the contractual rights of a bondholder. *E.g., Trail Enters., Inc. v. City of Houston* , 957 S.W.2d 625 (Tex. App.—Houston [14th Dist.], 1997, pet denied) (prohibition on mineral drilling was valid exercise of police power); *Texas State Teachers Ass'n v. State* , 711 S.W.2d 421, 425 (Tex. App.–Austin, 1986, writ ref d n.r.e.) (legislation concerning teacher testing was valid exercise of police power to protect the safety, health, security, and general welfare of the community); *State Bd. of Registration for Prof'l Eng'rs v. Wichita Eng. Co.* , 504 S.W.2d 606, 608 (Tex. Civ. App.—Fort Worth, 1973, writ ref'd n.r.e.) (statute regulating engineering industry such that private party could not use the term "engineering" in name was valid exercise of police power); *Dovalina v. Albert* , 409 S.W.2d 616, 619 (Tex. Civ. App.—Amarillo, 1966, writ ref'd n.r.e.) (holding that test for licensing of polygraph operators did not unconstitutionally impair a polygraph operator's contract because regulation of professional services, such as polygraph operation, was legitimate use of police power); *Biddle v. Bd. of Adjustment* , 316 S.W.2d 437, 440-441 (Tex. Civ. App.—Houston, 1958, writ ref'd n.r.e.) (favorably citing *Henderson* , and holding that zoning ordinance that indirectly affected contractual property rights was valid exercise of police power). While the foregoing Texas judicial decisions have held that contracts are not protected by the Texas Contract Clause from an impairment that resulted from a valid exercise of the State's police power necessary to safeguard the public safety and welfare, none of the decisions involved a pledge similar to the State Pledge or contractual rights of bondholders.

(iv) Summary

While case law from the Texas Supreme Court on the subject of the scope and breadth of the Texas Contract Clause is limited, based on the above discussion, we are of the opinion that a reviewing court would conclude that the Bondholders (or the Indenture Trustee acting on their

behalf) could successfully challenge under the Texas Contract Clause the constitutionality of any State Impairment Legislation (other than a law passed by the Legislature in the valid exercise of the state's police power necessary to safeguard the public safety and welfare).

(b) Impairment by the PUCT

The Texas cases cited above have addressed impairments of contractual obligations by the Legislature or a local governmental body. Nevertheless, if the PUCT were to take action which limits, alters, impairs, or reduces the value of the Transition Property or the Charges, the Bondholders could also challenge the PUCT under the Texas Contract Clause. Ratemaking by a regulatory agency, such as the PUCT, has been characterized as being a legislative activity. *Railroad Commission v. Houston Natural Gas Corp.* , 289 S.W.2d 559, 562 (Tex. 1956); *Central Power and Light Co., et. al. v. Public Utility Commission of Texas* , 36 S.W.3d 547, 554 (Tex. App.—Austin, 2001, pet. denied). In addition, in reviewing regulatory actions by the PUCT, Texas courts have applied the constitutional prohibitions against ex post facto and retroactive laws. *Public Utility Comm'n v. Southwestern Bell Tel. Co.* , 615 S.W.2d 947 956-57 (Tex. App.—Austin, 1981), *writ ref'd n.r.e per curium* 622 S.W. 2d 82 (Tex. 1981); *Central Power and Light* , 36 S.W.3d at 554. These prohibitions, like the constitutional prohibition on impairment of contracts, are found in Article I, §16 of the Texas Constitution.

Thus, if the PUCT were to exercise ratemaking or other legislative powers that substantially impaired the Transition Property or Charges created under the Financing Order, such action would give rise to state claims, similar to actions of the Legislature taken in derogation of the State Pledge. PURA § 39.304(b) states, "The financing order shall remain in effect and the property shall continue to exist for the same period as the pledge of the state described in Section 39.310." This statutory provision and the terms of the Financing Order discussed below support the conclusion that a reviewing Texas state court likely would treat action by the PUCT repudiating the pledge in the in the Financing Order not to impair the Charges in a manner similar to a repeal of the State Pledge by the Legislature. *See, Lower Colorado River Auth. v. McCraw* , 83 S.W.2d 629 (Tex. 1935). Texas state courts have enjoined unconstitutional action by members of a state agency, as discussed below. *State Bd. of Ins. v. Prof'l & Bus. Men's Ins. Co.* , 359 S.W.2d 312, 315 (Tex. Civ. App.—Austin, 1962, writ ref'd n.r.e.).

In Conclusion of Law No. 40 of the Financing Order, the PUCT acknowledges that it is bound by the State Pledge:

> Pursuant to PURA § 39.310, the State of Texas has pledged for the benefit and protection of all financing parties and TCC that it (including the Commission) will not take or permit any action that would impair the value

> of transition property, or, except as permitted by PURA § 39.307, reduce, alter or impair the transition charges to be imposed, collected, and remitted to any financing parties, until the principal, interest and premium, and any other charges incurred and contracts to be performed in connection with the transition bonds have been paid and performed in full. [Bond Issuer], in issuing transition bonds, is authorized pursuant to PURA § 39.310 and this Financing Order to include this pledge in any documentation relating to the transition bonds.

The statute and the Financing Order also contain language prohibiting the PUCT from impairing the Financing Order and the Charges. Section 39.303(d) of PURA states:

> A financing order shall become effective in accordance with its terms, and the financing order, together with the transition charges authorized in the order, shall thereafter be irrevocable and not subject to reduction, impairment, or adjustment by further action of the Commission, except as permitted by Section 39.307 (relating to true ups).

This statement is reiterated in Ordering Paragraph 47 of the Financing Order. In addition, Ordering Paragraph 52 of the Financing Order states:

> **Further Commission Action.** The Commission guarantees that it will act pursuant to this Financing Order as expressly authorized by PURA to ensure that expected transition charge revenues are sufficient to pay on a timely basis scheduled principal and interest on the transition bonds issued pursuant to this Financing Order and other costs, including fees and expenses, in connection with the transition bonds.

Therefore, we are of the opinion that a reviewing Texas state court would treat a substantial impairment of the Financing Order or PURA by PUCT in the same manner as, and subject to the same qualifications as, State Impairment Legislation.

(c) Remedies for Impairment

An unconstitutional impairment of contract may be challenged in many ways, and we do not express an opinion as to the form of such a challenge or the remedies that may be available in any given case. However, Texas law does afford an adequate forum to address whether legislative or administrative action is unconstitutional. Specifically, we have been asked to address the remedies of (1) a declaratory judgment that the legislative or administrative action which will allegedly cause an impairment of the contract is invalid and (2) a permanent and / or temporary injunction enjoining state officials from enforcing such legislative or administrative action.

(1) Declaratory Relief

The Texas Uniform Declaratory Judgments Act provides in pertinent part:

> A person . . . whose rights, status, or other legal relations are affected by a statute, municipal ordinance, contract, or franchise may have determined any question of construction or validity arising under the instrument, statute, ordinance, contract, or franchise and obtain a declaration of rights, status, or other legal relations thereunder.

TEX. CIV. PRAC. & REM. CODE § 37.004(a). Thus, the validity of legislation effecting the impairment the obligation of contract is an appropriate matter for declaratory relief.

"Private parties may seek declaratory relief against state officials who allegedly act without legal or statutory authority . . . . This is because suits to compel state officers to act within their official capacity do not attempt to subject the State to liability . . . . Therefore, certain declaratory-judgment actions against state officials do not implicate the sovereign-immunity doctrine." *Texas Natural Res. Conservation Comm'n v. IT-Davy* , 74 S.W.3d 849, 855 (Tex. 2002) (internal citations omitted). Further, whether to provide declaratory relief is subject to the courts' discretion: "A trial court has discretion to enter a declaratory judgment so long as it will serve a useful purpose or will terminate the controversy between the parties." *Bonham State Bank v. Beadle* , 907 S.W.2d 465, 468 (Tex. 1995).

Whether a declaration of the invalidity of legislation impairing the obligation of contract will be available will hinge on the matters discussed previously in this opinion. Specifically, it must be demonstrated that (i) such legislative or administrative action caused a substantive impairment which significantly affected the security for the Bonds or prevented payments of the Bonds and (ii) the legislative or administrative action was an invalid exercise of the State's police power. If such a declaration were obtained, a plaintiff may also be entitled to permanent injunctive relief.

(2) Permanent Injunctive Relief

Texas Civil Practice & Remedies Code § 65.011 provides that:

> A writ of injunction may be granted if:

> (1) the applicant is entitled to the relief demanded and all or part of the relief requires the restraint of some act prejudicial to the applicant;. . .
>
> (3) the applicant is entitled to a writ of injunction under the principles of equity and the statutes of this state relating to injunctions;. . .
>
> (5) irreparable injury to real or personal property is threatened, irrespective of any remedy at law.

Texas courts require that a party seeking permanent injunctive relief demonstrate the following: (1) the existence of a wrongful act, (2) the existence of imminent harm, (3) the existence of irreparable injury, and (4) the absence of an adequate remedy at law. *Pinebrook Properties, Ltd. v. Brookhaven Lake* , 77 S.W.3d 487, 505 (Tex. App.—Texarkana 2002, pet. denied); *Jordan v. Landry's Seafood Restaurant, Inc.*, 89 S.W.3d 737, 742 (Tex. App.—Houston [1 st Dist.] 2002, pet. denied); *Priest v. Texas Animal Health Comm'n,* 780 S.W.2d 874, 875 (Tex. App.-Dallas, 1989, no writ). [9] "The decision to grant or deny a temporary injunction lies in the sound discretion of the trial court, and the court's grant or denial is subject to reversal only for a clear abuse of discretion." *Walling v. Metcalfe*, 863 S.W.2d 56, 58 (Tex. 1993) (citing *State v. Walker* , 679 S.W.2d 484 (Tex. 1984)).

Here, if the legislative or administrative action is found to be unconstitutional, then the plaintiffs could obtain an injunction prohibiting state officers from enforcing such legislation or regulation. A plaintiff may seek injunctive relief when the government acts in a way that exceeds its authority granted by the constitution. *Dir. of Dept. of Agric. and Env't v. Printing Indus. Ass'n of Texas* , 600 S.W.2d 264, 265-66 (Tex. 1980) (further noting that "[i]t is also a correct statement of the law that an entity or person whose rights have been violated by the unlawful action of a State official, may bring suit to remedy the violation or prevent its occurrence, and such suit is not against the State requiring legislative or statutory authorization."). *See also Marshall* , 76 S.W.2d at 1008 (enjoining the enforcement of an unconstitutional Moratorium Law passed during the Great Depression); *Texas Workers' Comp.*

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9 Additionally, Courts generally balance equities to determine whether granting an injunction is proper. Thus, if the public interest is involved, courts will determine whether granting a writ will cause harm to the public disproportionate to the harm to the private litigant seeking protection of the injunction. *Storey v. Central Hide & Rendering Co.* , 226 S.W.2d 615 (Tex. 1950); *Hooks Tel. Co. v. Leary,* 352 S.W.2d 755 (Tex. Civ. App.—Texarkana, 1961, no writ). If damage to private individuals outweighs the benefit accruing to the public, the injunction will be granted. *Mitchell v. City of Temple,* 152 S.W.2d 1116, 1117 (Tex. Civ. App.—Austin, 1941, writ ref'd w.o.m.) (discussing a temporary injunction). Here, for the state officials to claim that the legislative or administrative action is warranted, they will most likely argue that there is a public interest to be protected by such action. In *Mitchell* , for example, the Court held that the harm to the 15,000 residents of Temple by enjoining the operation of a sewage plant outweighed the harm to individual citizens claiming injury from continued operation of the plant. Conversely, in *Burrow v. Davis, 226* S.W.2d 199 (Tex. Civ. App.—Amarillo, 1949, writ ref'd n.r.e.), the Court refused to enjoin completion of construction of a building or require that structure to be torn down even though it slightly inconvenienced the public because it encroached upon two public streets, since on balancing the equities, the harm to the individual owners of destroying their property was greater than the harm to the adjacent property owners.)

Comm'n v. Horton , 187 S.W.3d 282, 285 (Tex. App.—Beaumont 2006, no pet.) ("[A] suit for injunctive relief against a state agency is maintainable only if the pleadings, together with the relevant evidence, show that the agency's activity is unlawful because it lacks statutory authorization.").

(i) Wrongful Act

As noted above, the "existence of a wrongful act" must be shown in order for a permanent injunction to be issued. *Pinebrook* , 77 S.W.3d at 505; *Jordan* , 89 S.W.3d at 742; *Priest* , 780 S.W.2d at 875. The requirement of showing a wrongful act could most likely be satisfied by demonstrating that the legislative or administrative action is unconstitutional. Texas courts have granted injunctions prohibiting the enforcement of unconstitutional statutes. *Edwards Aquifer Auth. v. Chem. Lime, Ltd.* , No. 03-04-00379-CV, 2006 Tex. App. LEXIS 4745, *24 (Tex. App.—June 2, 2006) ("[T]he district court's final judgment declaring the EAA Act unconstitutional . . . placed outside the powers of government (*i.e.* , rendered void) its enforcement.") (citing *City of Beaumont v. Bouillion* , 896 S.W.2d 143, 148–49 (Tex. 1995)); *Pierce v. Stephenville* , 206 S.W.2d 848, 851–52 (Tex. Civ. App.—Eastland, 1947, no writ) (upholding the issuance of a temporary injunction preventing the enforcement of a city ordinance imposing an occupation tax on itinerant photographers).

Texas courts have consistently recognized that "the unlawful acts of public officials may be restrained when they would cause irreparable injury or when such remedy is necessary to prevent a multiplicity of suits." *Texas State Bd. Of Examiners in Optometry v. Carp* , 343 S.W.2d 242, 245 (Tex. 1961). In *Dallas v. Sweitzer,* 881 S.W.2d 757 (Tex. Civ. App.—Dallas, 1994, writ denied), for example, a plaintiff brought suit on behalf of litigants in Dallas County, seeking to enjoin the County from collecting court-related fees not authorized by the law. *Id.* at 762–64. The appellate court upheld the trial court's decision to enjoin the collection of some of these fees, which violated the open courts provision of the Texas Constitution. *Id.* at 769. Citing *Carp* , the Court noted that injunction was the proper remedy to restrain unlawful acts of public officials which would cause irreparable harm or which would result in a multitude of lawsuits. *Id.* As a result, the wrongful act requirement will have been satisfied if the court finds the legislative or administrative action unconstitutional.

(ii) Imminent and Irreparable Harm

The existence of imminent and irreparable harm must be demonstrated in order for a permanent injunction to be issued. *Pinebrook* , 77 S.W.3d at 505; *Jordan* , 89 S.W.3d at 742; *Priest* , 790 S.W.2d at 875. In *Missouri, K & T. Ry. Co. of Texas v. Shannon,* 100 S.W. 138 (Tex. 1907), the Texas Supreme Court held that it had the power to enjoin members of the state tax board from taking action under a state statute concerning valuation of intangible assets alleged to be

unconstitutional. *Id.* at 140. The Court looked to cases decided by the U.S. Supreme Court—most notably to Justice Holmes' opinion in *Fargo v. Hart* , 193 U.S. 490 (1904)—for guidance in determining when a court may prevent officials from acting under statutory authority. *Shannon* , 100 S.W. at 140. After review of such precedent, the Court held that it could act to prevent future acts under an invalid statute only when such acts were likely to occur. *Id.*

The *Shannon* Court stated that it could not enjoin state officers from acting under an unconstitutional statute "unless the officers are about to do some act which, if not authorized by law, constitutes an unlawful interference with [the complainants'] rights." *Id.* at 140. Consequently, an injunction will not issue unless it is shown that the respondent will engage in the activity enjoined. *State v. Morales* , 869 S.W.2d 941, 946 (Tex. 1994). *See also Frey v. DeCordova Bend Estates Owners Ass'n* , 647 S.W.2d 246, 248 (Tex. 1983) (holding that the fear or apprehension of the possibility of injury is not a basis for injunctive relief).

An injunction applicant must also allege that, if an injunction is not issued, the harm that will occur is irreparable. *Town of Palm Valley v. Johnson* , 87 S.W.3d 110, 110 (Tex. 2001). Texas precedent dictates that the harm caused by a violation of constitutionally protected rights is, as a matter of law, irreparable. *See S.W. Newspapers Corp. v. Curtis* , 584 S.W.2d 362, 368 (Tex. App.—Amarillo 1979, no pet.) ("The publisher has plead [sic] and shown by nonconflicting evidence the denial of a constitutionally guaranteed right which, as a matter of law, inflicts an irreparable injury."). This proposition was echoed by the Court in *Operation Rescue Nat'l v. Planned Parenthood,* 937 S.W.2d 60 (Tex. App.—Houston [14th Dist], 1996), judgment affirmed as modified on other grounds, *Operation Rescue Nat'l v. Planned Parenthood of Houston and Southeast Texas, Inc.,* 975 S.W.2d 546 (Tex. 1998), rehearing of cause overruled (Oct. 15, 1998), in which the Court recognized that "[u]nder Texas-law, a violation of a constitutionally guaranteed right inflicts irreparable injury warranting injunctive relief." *Operation Rescue Nat'l* , 937 S.W.2d at 77 (enjoining the violent protests of anti-abortion advocates). Of course, various other types of injuries may be deemed irreparable. Disruption of business, for instance, may constitute the type of harm for which an injunction may issue. *Liberty Mut. Ins. Co. v. Mustang Tractor & Equip. Co.* , 812 S.W.2d 663, 666 (Tex. App.—Houston [14 th Dist.] 1991, no writ).

The requirement of irreparability implies an ongoing, rather than a singular, wrong. "When the jury finds violations occurring and continuing up to or near the date of the trial, the trial court may, in equity, determine that the defendant has engaged in a settled course of conduct and may assume that it will continue, absent clear proof to the contrary." *State v. Texas Pet Foods, Inc.* , 591 S.W.2d 800, 804 (Tex. 1979). In such a situation, a court's exercise of its equity powers in issuing an injunction is proper, even if the defendant promises cessation of a wrongful activity. *Id. See also Operation Rescue Nat'l* , 937 S.W.2d at 77 ("[w]hen the clinic faced a continuation of picketing and harassment by abortion protesters, we determined that a suit for money damages

for loss of business was insufficient, and the only adequate remedy was an injunction limiting the protests.") (citing *Right to Life Advocates, Inc. v. Aaron Women's Clinic* , 737 S.W.2d 564, 571 (Tex. App.—Houston [14 th Dist.] 1987, writ denied), *cert. denied* , 488 U.S. 824 (1988)); *Tri-Star Petroleum Co. v. Tipperary Corp.* 101 S.W.3d 583, 591 (Tex. App.—El Paso 2003, pet. denied) (finding the irreparable injury requisite to support an injunction because the applicants were "suffering ongoing and continuing harm" because of an oil operator's wrongful refusal to cease operations). As is clear from the *Operation Rescue* and *Southwestern Newspapers* opinions, a violation of rights guaranteed or protected by the constitution is the type of irreparable harm the injunction statute was intended to prevent. *Id.* at 77; *see also Iranian Muslim Org. v. City of San Antonio* , 615 S.W.2d 202, 208 (Tex. 1981) ("The federal courts have also held that the denial of First Amendment rights inflicts irreparable injury.").

An unconstitutional government action negatively affecting the value or payment of Bonds would, in all likelihood, amount to the type of ongoing, irreparable harm necessary to support the issuance of a permanent injunction. In many cases, courts have concluded that injunctive relief was appropriate to prevent the improper expenditure of funds by government officials. For example, courts have held that an injunction is appropriate to enjoin government officials from diverting public funds from a statutorily required to an unauthorized use. *See City of Dallas v. Mosely*, 286 S.W. 497, 499 (Tex. Civ. App.—Dallas, 1926), *aff'd 17* S.W.2d 36 (Tex. Comm'n. App. 1929) ("A writ of injunction will properly issue to restrain the diversion of public funds entrusted to public officers for special use."). Courts have also enjoined the illegal expenditure of public funds. *See Osborne v. Keith* , 177 S.W.2d 198, 200 (Tex. 1944) (recognizing the right of Courts to enjoin public officials to spend funds pursuant to an illegal contract); *Bexar County v. Wentworth*, 378 S.W.2d 126, 129 (Tex. Civ. App.—San Antonio, 1964, writ ref'd n.r.e.) (upholding the grant of a temporary injunction restraining a government official from spending money on goods for the government under a contract in which he had an interest). Furthermore, as noted by the Texas Supreme Court in *Calvert v. Hull* , 475 S.W.2d 907 (Tex. 1972), private citizens may sue public officials (*i.e* ., the comptroller) to enjoin the expenditure of appropriated funds. *Id.* at 908.

In accordance with this Texas precedent, legislative or administrative action which would divert funds pledged to the Bonds would probably be construed as action which causes irreparable harm to the Bondholders. The Transition Property at issue is limited in time, and diverted funds may not be replaced. Furthermore, the continued existence of legislation or regulation which effectuates diminution of the Bonds' value is not a one time occurrence but a persistent threat to the Bondholders' rights.

(iii) No Adequate Remedy at Law

A party seeking permanent injunctive relief must further establish that it has no adequate remedy at law. *Pinebrook* , 77 S.W.3d at 505; *Jordan* , 89 S.W.3d at 742; *Priest* , 790 S.W.2d at 875. "Although the equitable remedy of an injunction may not be obtained if there is an adequate remedy at law, that remedy must be as 'plain and complete, and as practical and efficient to the end of justice and its prompt administration as a remedy in equity.' Thus, a party requesting a temporary injunction has the duty to negate the existence of adequate legal remedies." *Minexa Arizona, Inc. v. Staubach* , 667 S.W. 2d 563, 567 (Tex. App.—Dallas 1984, no writ) (quoting *Hancock v. Bradshaw* , 350 S.W.2d 955, 957 (Tex. Civ. App.—Amarillo 1961, no writ)). The requirements of "irreparable injury" and "no adequate remedy at law are inextricably linked." One way to establish irreparable injury is to show the damages 'cannot be measured by any certain pecuniary standard.'" *Wright v. Sport Supply Group, Inc.* , 137 S.W.3d 289, 294 (Tex. App.—Beaumont 2004, no pet.) (citing *Butnaru v. Ford Motor Co.* , 84 S.W.3d 198, 204 (Tex. 2002)). If there is "no real legal measure of damages or none that can be determined with a sufficient degree of certainty, *i.e.* , a noncompensable injury," injunctive relief is appropriate. *Synergy Ctr., Ltd. v. Lone Star Franchising, Inc.* , 63 S.W.3d 561, 567 (Tex. App.—Austin 2001, no pet.).

The requirement of a lack of an adequate remedy at law may be demonstrated in any number of ways. For example, in *Telephone Equip. Network, Inc. v. TA/Westchase Place, Ltd.* , 80 S.W.3d 601 (Tex. App.—Houston [1 st Dist.] 2002), a landlord, who had previously brought an action against a commercial tenant for breach of contract, secured an injunction restraining the holder of promissory notes signed by the tenant from selling or transferring the tenant's property. *Id.* at 610. The holder intended to foreclose on all of the tenant's assets, which would have led to the tenant's insolvency. *Id.* In *Ebony Lake Healthcare Center v. Texas Dept. of Human Services* , 62 S.W.3d 867 (Tex. App.—Texarkana 2003, no pet.), the court issued a temporary injunction prohibiting the release of confidential information obtained during employment, pursuant to a Public Information Act request. *Id.* at 874. An injunction could also issue, for instance, to prevent the use of a trade name, where the applicant testifies that the name confusion was hurting his company, but in which the applicant could not ascertain how many potential customers were lost. *Thompson v. Thompson Air Conditioning and Heating, Inc.* , 884 S.W.2d 555, 560 (Tex. App.—Texarkana 1994).

In the instant situation, it may be the situation that the Bondholders could not obtain adequate money damages or that they could not quantify their loss with certainty, even if they were authorized to pursue such damages. The United States Supreme Court recognized the difficulty in assessing damages to bondholders stemming from a repeal of a statutory pledge in *U.S. Trust Co. v. New Jersey* , 431 U.S. 1 (1977). In *U.S. Trust Co.* , the states of New York and New Jersey entered into a legislative compact with each other and with holders of bonds which were issued by the Port Authority of New York and New Jersey to finance the construction of the World Trade Center and the acquisition of the Hudson & Manhattan Railroad. *Id.* at 8–9.

This compact included a covenant that so long as any bonds remained outstanding and unpaid, neither the states nor the Port Authority would apply any of the revenues or reserves which were then or would be in the future pledged as security for the bonds to any railroad purposes other than certain enumerated purposes. *Id.* at 9-10. The governors of both states subsequently signed legislation effectively repealing the covenant, in response to a national energy crisis. *Id.* at 10. The legislation was intended to allow the Port Authority to assume greater deficits than permitted by the covenant, for the purpose of subsidizing a rail project not included in the covenant's permitted purposes. *Id.* at 10-12. The Supreme Court held that the repeals violated the contract clause of the Federal Constitution, finding that the repeals impaired valid contracts between the states and the Bondholders. *Id.* at 28.

The parties in *U.S. Trust Co.* sharply disagreed about the value of the covenant and about the damages the Bondholders may have suffered as a result of the states' repeal. *Id.* at 18–19. The Supreme Court found in the trial record significant evidence that the market price for the Port Authority Bonds was adversely affected immediately after the covenant was repealed. *Id.* at 19. The appellees responded by noting that the bonds had retained their "A" Rating. *Id* . Without ruling on the bond's valuation, the Court described the difficulty of assessing the monetary impact of the repeal of the covenant upon the market price of the bonds. *Id* . After establishing that it could not ascertain with certainty that the fluctuations in market price were caused by the repeal of the covenant, the Court simply determined that " *no one can be sure precisely how much financial loss the bondholders suffered* ." *Id*. at 19 (emphasis added).

Thus, *U.S. Trust Co.* , involving the repeal of a covenant analogous to the State Pledge, establishes the difficulty of ascertaining damages in this case. Even if such damages could be assessed with certainty, the Bondholders may not have an adequate state law vehicle to effectuate recovery. As a result, there may well be no adequate remedy at law for the Bondholders, and it is likely that a substantial impairment in this case would justify the granting of permanent injunctive relief.

(3) Temporary Injunctive Relief

(i) Preserving the Status Quo

Temporary injunctive relief is warranted when an applicant shows that it is entitled to preserve the latest uncontested status quo of the subject matter of the suit pending trial on the merits. *31-W Insulation Co., Inc. v. Dickey* , 144 S.W.3d 153, 156 (Tex. App.—Fort Worth 2004, pet. withdrawn). The status quo to be preserved is "the last, actual, peaceable, non-contested status that preceded the pending controversy." *Law v. William Marsh Rice Univ.* , 123 S.W.3d 786, 791 (Tex. App.—Houston [14 th Dist.] 2003, pet. denied) (quoting *State v. Southwestern Bell Tel. Co.*, 526 S.W.2d *526,* 528 (Tex. 1975)).

"It is also a rule of law that District Courts may restrain the enforcement of administrative orders of State Boards and agencies for the purpose of preserving the status quo pending trial on the merits of a suit to set aside such order." *State Bd. of Ins. v. Prof l & Bus. Men's Ins. Co.*, 359 S.W.2d 312 (Tex. Civ. App.—Austin 1962 , writ ref d n.r.e.) (citing *R.R. Comm'n v. Shell Oil Co.* , 206 S.W.2d 235, 242 (Tex. 1947). Further, "t]he rules applicable to injunctions pending trial are directed at, *inter alia*, preventing the risk of injustice occasioned when a party would otherwise be denied a course of conduct that he may have a legal right to pursue." *Simon Prop. Group, L.P. v May Dep't Stores*, 943 S.W.2d 64, 70 (Tex. App.—Corpus Christi, 1997, writ denied)

The relevant, latest, uncontested status quo in this case would be the state of the Bonds immediately prior to the enactment of any challenged legislation or regulation. Specifically, the Bonds would be subject to the State Pledge, the Financing Order would remain in effect, and the Transition Property and Charges would continue to be operative. To be entitled to temporary injunctive relief, maintaining this status quo pending and throughout a trial in which the Bondholders seek declaratory or permanent injunctive relief, the Bondholders would be required to prove the typical requirements for injunctive relief—namely, imminent and irreparable harm and no adequate remedy at law. *Southwestern Bell*, 526 S.W.2d at 528; *Simon Prop. Group, L.P.*, 943 S.W.2d at 70. [10]

(ii) Probable Right to Recovery

In addition, applicants for temporary injunctions must prove a probable right to recovery in the underlying lawsuit. *Butnaru* , 84 S.W.3d at 204. A probable right to recovery could be shown by demonstrating that the legislative or administrative action was unconstitutional. The Bondholders would not be required to establish that they would ultimately prevail, but only that they are entitled to preservation of the status quo pending trial on the merits. *Universal Health Services v. Thompson* , 24 S.W.3d 570, 576 (Tex. App.—Austin 2000, no pet.), *Walling* , 863 S.W.2d at 58. In *Walgreen*, the State Board of Pharmacy revoked operation permits from 59 pharmacies based on a state statute requiring pharmacies to post a list of the most prescribed drugs, along with the maximum prices of these drugs. *Id.* at 846–47. The pharmacies sought a declaratory judgment that the statute violated the equal protection laws in the U.S. Constitution, and sought a temporary injunction in the interim, pending final resolution. *Id.* at 846. The court granted the request for temporary injunction, after determining from the pleadings and evidence adduced at trial that the applicants' claims were bona fide and that irreparable harm would ensue if the appellees were not immediately enjoined. *Id.* at 848. The court concluded that the status quo must be maintained to ensure the effectiveness of the stores' permits. *Id.*

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10 In the case of regulation affecting the Bonds, Bondholders may be required to show that administrative remedies which would normally be available would be an inadequate means of redress. *Texas State Bd. of Pharmacy v. Walgreen Texas Co.*, 520 S.W.2d 845 (Tex. Civ. App.—Austin, 1975, writ *refd* n.r.e.).

Assuming that the injunction is not adverse to the public interest [11] it is likely that the Bondholders would be entitled to temporary injunctive relief, pending the outcome of a trial for declaratory or permanent injunctive relief. As noted above, the Bondholders would not be required to prove that they would prevail. Rather, they would be held to the burden of demonstrating a meritorious, bona fide complaint and entitlement to preservation of the status quo. *Universal Health Services* , 24 S.W.3d at 570.

(iii) Imminent and Irreparable Harm/Lack of Adequate Remedy at Law

Applicants seeking temporary injunctions must show that they will suffer imminent and irreparable harm and an absence of any adequate remedy at law in the interim period. *Southwestern Bell*, 526 S.W.2d at 528; *Simon Prop. Group, L.P.*, 943 S.W.2d at 70. To satisfy these requirements, Bondholders would most likely need to establish the possibility of harm such as suspended payments, reduction in the market price of the bonds, and a possible default by the issuer of the Bonds. Texas courts have often considered the probability that a party will not be able to respond in damages or that the party is insolvent as factors in determining whether to issue temporary injunctions. *See Loye v. Travelhost, Inc.* , 156 S.W.3d 615 (Tex. App.—Dallas 2004) ("A plaintiff does not have an adequate remedy at law if the defendant is insolvent."); *Texas Indus. Gas v. Phoenix Megallurgical Corp.* , 828 S.W.2d 529, 534 (Tex. App.—Houston [1 st Dist.] 1992) (temporary injunction was proper where the uncontroverted evidence showed that the party against whom injunction was sought was a slow payer and apparently had liabilities greater than its assets). In *Walling* , the Supreme Court of Texas looked to *Roland Mach. Co. v. Dresser Indus.*, 749 F.2d. 380, 386 (7th Cir. 1984) for guidance in determining when an injunction applicant may not have an adequate remedy at law. In that case, the Seventh Circuit identified the following situations in which temporary injunctive relief was particularly appropriate:

> (a) The damage award may come too late to save the plaintiff s business. He may go broke while waiting, or may have to shut down his business but without declaring bankruptcy. . . .
>
> (b) The plaintiff may not be able to finance his lawsuit against the defendant without the revenues from his business that the defendant is threatening to destroy. . . .

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11 As in the case of permanent injunctions, a court considering whether to issue a temporary injunction will balance the equities between the parties to determine whether an injunction should issue. *See* the discussion at Note 10, *supra* .

> (c) Damages may be unobtainable from the defendant because he may become insolvent before a final judgment can be entered and collected. . . .
>
> (d) The nature of the plaintiff's loss may make damages very difficult to calculate.

Id. at 386.

Bondholders could proffer a colorable argument that they would suffer irreparable harm if state legislative or administrative action caused delays in payment and threats of default on the Bonds. For example, if the Charges or payments to the Bond Issuer were halted or reduced, this could result in a downgrade of the Bond's ratings. This downgrade would likely produce a loss of value in the Bonds and could cause Bondholders to sell their Bonds at prices lower than they could have sold them prior to any repeal. Delays in payment or non-payment of interest or principal on the Bonds could also result. Regardless, as noted by the U.S. Supreme Court in U.S. Trust Co., it would be very difficult to place a monetary valuation on any such damages. 431 U.S. at 19. Further, any monetary loss due the Bondholders because of ratings downgrade and the resulting decrease in market value of the bonds could probably not be recovered from the State of Texas in a proceeding at law. "Our State does not recognize a common law cause of action for damages to enforce constitutional rights." *Beaumont* , 896 S.W.2d at 150.

Texas courts might find that a delay of payments or non-payment until final judgment is not the type of "irreparable harm" which a temporary injunction seeks to prevent pending resolution of the matter, unless the delay resulted in the insolvency of either party or in the destruction of a party's business. For instance, in *LeFaucheur v. Williams*, 807 S.W.2d 20 (Tex. App.—Austin, 1991, no writ), the court refused to issue a temporary injunction in part because the plaintiff failed to allege or prove that the defendant could not satisfy an money judgment. *Id.* at 23.

A court's determination of the appropriateness of a temporary injunction in this case will depend on the facts and evidence presented to the court. If the court finds that the Bondholders have demonstrated a probable right to recovery, as well as imminent and irreparable harm for which there is no adequate remedy at law, the court will issue a temporary injunction, restoring the status quo immediately preceding any contested legislation or regulation.

4. State Action and the Texas Takings Clause.

The power of the State of Texas to take private property for public use "is a right inherent in an organized society." *Texas Highway Dept. v. Weber* , 219 S.W.2d 70, 71 (Tex. 1949). Texas courts have construed the Texas Takings Clause as a limitation on the State. This provision does

not alter the State's right to take property, but instead requires the government, when it exercises its power to take private property, to adequately compensate the person whose property is taken, damaged or destroyed. *Sheffield Development Co., Inc. v. City of Glenn Heights* , 140 S.W.3d 660, 669 (Tex. 2004). The federal takings clause, [12] which applies to State actions through the Fourteenth Amendment, [13] also restricts a state's power to take private property for public use without just compensation. *Palazzolo v. Rhode Island* , 533 U.S. 606, 617 (2001). [14]

Because of the substantial similarities between the Texas Takings Clause and the federal takings clause, Texas courts have relied in a number of cases on the United States Supreme Court's interpretation of the federal takings clause to construe the Texas Takings Clause. *See e.g* ., *Town of Flower Mound v. Stafford Estates Ltd.* , 135 S.W.3d 620, 630-31 (Tex. 2004) (assuming uniform application of the two constitutional provisions in the absence of argument that differences in wording were significant to the issues in question); *City of Austin v. Travis County Landfill Co* ., 73 S.W.3d 234, 238 (Tex. 2002) (looking to federal law to determine whether civilian overflights affecting a landfill constituted a taking); *City of Corpus Christi* , 51 S.W.3d at 241-243 (examining federal law to determine whether utility charges amounted to a taking). Accordingly, Texas judicial decisions hold that governmental action will result in a compensable taking where the governmental action deprives the landowner all economically viable use of property or renders the property valueless. *Mayhew v. Town of Sunnyvale* , 964 S.W.2d 922, 935 (Tex. 1998) (citing *Dolan v. City of Tigard*, 512 U.S. 374, 114 S.Ct. 2309, 129 L.Ed.2d 304 (1994), *and Lucas v. S.C. Coastal Council* , 505 U.S. 1003, 112 S.Ct. 2886, 120 L.Ed.2d 798 (1998)); *City of College Station v. Turtle Rock Corp.* , 680 S.W.2d 802, 806 (Tex. 1984); *City of Austin v. Teague* , 570 S.W.2d 389, 393 (Tex. 1978).

As discussed in Subpart 4.B. below, the Texas courts also recognize that, where governmental action falls short of a total taking or complete destruction of the value of property, a claim for a "regulatory taking" can be asserted where the government action has unreasonably interfered with an owner's right to use and enjoy property. *See Sheffield*, 140 S.W.3d at 671-79; *Mayhew* , 964 S.W.2d at 933-38.

Furthermore, the Texas Supreme Court has interpreted the Texas Takings Clause as providing greater protection to owners of private property than the federal takings clause because, unlike the language of the federal takings clause that refers only to "taking," the Texas Takings Clause applies more broadly to "taking," "damaging," or "destroying" private property. *City of Dallas v. Jennings* , 142 S.W.3d 310, 313 (Tex. 2004); *Steele v. City of Houston* , 603 S.W.2d 786, 790-791 (Tex. 1980).). Thus, the language of the Texas Takings Clause would

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12 U.S. C ONST . amend. V (". . . nor shall private property be taken for public use, without just compensation.").

13 U.S. C ONST . amend. XIV.

14 For a more detailed analysis of the application of the federal takings clause to State Impairment Legislation and to PUCT Impairment Action, we refer you to the opinion of Sidley Austin LLP of even date.

enable a court to determine that "damage" to the Transition Property, short of a complete taking resulting in non-payment of the Bonds, constituted a violation of the Texas Takings Clause. In *Steele* , 603 S.W.2d at 789-90, the Texas Supreme Court noted:

> The government's duty to compensate for damaging property for public use after 1876 was not dependent upon the transfer of property rights. . . To entitle the party to compensation under our present constitution, it is not necessary that his property shall be destroyed, nor is it necessary that it shall be even taken. It is sufficient to entitle him to compensation that his property has been damaged.

The Texas Supreme Court stated that the purpose of the word "damage" was to prevent a narrow construction of the word "taking." *Steele* , 603 S.W.2d at 790. If a reviewing Texas state court were willing to apply the Texas Takings Clause to the Transition Property, governmental action that diminished but did not completely eliminate the value of the Transition Property might also be found to violate the Texas Takings Clause under the approach discussed in Subpart 4.B. below. For example, State Impairment Legislation or PUCT Impairment Action that affected the market value of the Bonds might constitute "damaging" of property under the Texas Takings Clause, even it did not rise to the level of a "taking" under the federal takings clause. However, it is possible that a reviewing Texas state court might decline to apply a Texas Takings Clause analysis to a claim based on State Impairment Legislation or PUCT Impairment Action, since, for example, the court might determine that a Texas Contract Clause analysis rather than a Texas Takings Clause analysis should be applied.

To establish a takings claim under the Texas Takings Clause, the Texas Supreme Court has held that a plaintiff must demonstrate that:

(i) The State intentionally performed certain acts

(ii) that took, damaged or destroyed protected property

(iii) for public use.

General Services Commission v. Little-Tex Insulation Company , 39 S.W.3d 591, 598 (Tex. 2001) (" *Little-Tex* ").

A. The *Little-Tex* factors:

(1) Is the act of the State intentional?

The State will be liable to compensate a private party for a taking of property only if the State intended to perform the act that caused the taking. *Little-Tex* , 39 S.W.3d at 598; *State v. Holland* , 161 S.W.3d 227, 232 (Tex. App.—Corpus Christi 2005, no pet.). [15] On the other hand, when the taking or damage is merely the unintended result of the government's act, the act does not provide any public benefit, and the property cannot be said to have been "taken or damaged *for public use* ." *Id.* at 313-14 (emphasis in original) (quoting *Texas Highway Dep't v. Weber* , 219 S.W.2d at 71). Thus, negligence on the part of the State or its agents which contributes to the destruction of private property cannot support a taking claim and would be subject to a sovereign immunity defense. *City of Tyler v. Likes* , 962 S.W.2d 489, 505 (Tex. 1997) (no taking where City action to unclog sewer backup caused a sewage flood that damaged Plaintiff's property). [16]

The Texas Supreme Court has also concluded that the State does not have the requisite intent when money or property is taken or withheld in the context of a contractual dispute with an entity that has contracted to provide a good or service to the State. *Little-Tex* , 39 S.W.3d at 598-99.

> Texas courts have long recognized that the State wears two hats: the State as a party to the contract and the State as a sovereign. The State in acting within a color of right to take or withhold property in a contractual situation, is acting akin to a private citizen and not under any sovereign powers. In this situation, the State does not have the intent to take under its eminent domain powers; the State only has an intent to act within the scope of the contract.

Id . at 599 (internal citations omitted). The Court reasoned that when the State is acting under colorable contractual rights it does not have the requisite intent to take property under any eminent domain powers. *Id.* ("The State and DalMac simply disagree about DalMac's right to additional payments under the contract. Because TAMU was acting under colorable contractual rights, it did not have the requisite intent to take DalMac's labor and materials under any eminent domain powers."); see also *Smith v. Lutz* , 149 S.W.3d 752, 760-61 (Tex. App.—Austin 2004, no writ) ("The State, *in acting within a color of right* to take or withhold property in a contractual situation, is acting akin to a private citizen and not under any sovereign powers."[emphasis added]).

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15 The intent standard for a "takings" claim under the Texas Constitution is distinct from the intent standard for a constitutional claim of "damage or destruction." *City of Dallas* , 142 S.W.3d at 313; *Holland* , 161 S.W.3d at 232. To hold a governmental entity liable for damage to private property a plaintiff must prove that the entity (1) knows that a specific act is causing identifiable harm; or (2) knows that the specific property damage is substantially certain to result from an authorized government action. *City of Dallas* , 142 S.W.3d at 313.

16 By further example, the Texas Supreme Court in *Texas Highway Dep't v. Weber* rejected a takings claim where state highway department employees burning grass along a highway negligently burned the Plaintiff's hayfield. *Texas Highway Dep't v. Weber* , 219 S.W.2d at 219.

To the extent the State Pledge, the related provisions of Subchapter G of Chapter 39 of PURA, and the Financing Order creating the Transition Property and Charges effectively create a contract between the State and the Bondholders, [17] such a "contract" is distinguishable from a typical goods or services contract with the State. First, the purpose of the contract is to reduce costs to consumers of electricity by securing the highest credit rating achievable (triple-A) for the Bonds and inducing the Bondholders to invest in the Bonds at a low interest rate based on that credit rating. Second, the nature and language of the State Pledge and the other related statutes make it clear that the Legislature is acting on behalf of the State as sovereign. [18] The Legislature's objective in so acting is to further the interests of the citizens of the State as consumers of electricity. [19] Accordingly, it is not apparent that in enacting State Impairment Legislation or taking PUCT Impairment Action, the State would be "acting within a color of right to take or withhold property in a contractual situation" within the meaning of *Little-Tex.* 39 S.W.3d at 598-99.

The State Pledge, the related provisions of Subchapter G of Chapter 39 of PURA, and the Financing Order creating the Transition Property and Charges are intended to protect the Bondholders' interests. The purpose of the statutory provisions and the Financing Order is to reduce costs to electricity consumers in Texas of recovering stranded costs and regulatory assets, because securitization financing will result in lower financing costs. *See* PURA Section 39.301. The Legislature intentionally enacted the State Pledge and the other provisions of Subchapter G of Chapter 39 of PURA under which the issuance of the Bonds has been authorized.

While it is not possible to anticipate the particular form which State action might take, legislation enacted by the Legislature or an order adopted by the PUCT whose purpose would be to specifically limit, impair, or reduce the value of the Transition Property and Charges would be intentional acts of the State. Therefore, a reviewing Texas state court likely would find the element of intentional action by the State involved in connection with any State Impairment Legislation or PUCT Impairment Action.

(2) Is there a protected property interest?

The second element of a Texas Takings Clause claim requires proof of a taking, damage, or destruction of a protected property interest. To evaluate this element a court would need to examine whether the State Pledge, the Financing Order and the Bond Indenture create property rights in favor of the Bondholders and whether those property rights are to be afforded constitutional protection under the Texas Takings Clause.

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17 *See* opinion of Sidley Austin LLP of even date.

18 PURA section 39.310 is captioned "Pledge of State" and expressly declares, "[t]he *state* pledges, however, for the benefit and protection of financing parties and the electric utility, that it will not take or permit any action and would impair the value of transition property . . . ."

19 PURA § 39.301 sets forth that the objective of the provisions of Subchapter G of Chapter 39 of PURA is to reduce the costs to consumers of recovering stranded costs and regulatory assets.

Significantly, PURA defines the Transition Property as a present property right when it is transferred in connection with the issuance of the Bonds. Section 39.304 of PURA states in relevant part:

> (a) The rights and interests of an electric utility or successor under a financing order, including the right to impose, collect, and receive transition charges authorized in the order shall be only contract rights *until they are first transferred to an assignee or pledged in connection with the issuance of transition bonds, at which time they become "transition property."*
>
> (b) *Transition property shall constitute a present property right* for purposes of contracts concerning the sale or pledge of property, even though the imposition and collection of transition charges depends on further acts of the utility or others that have not yet occurred.

TEX. UTIL. CODE ANN. § 39.304 (emphasis added). PURA § 39.304(b) is intended to establish the property nature of the Transition Property for purposes of contract.

Texas court decisions have considered intangible property to be property protected from an uncompensated governmental taking. For example, in *City of Corpus Christi* , 51 S.W.3d at 242, the Texas Supreme Court cited the proposition that in setting rates for a public utility, the government cannot set rates so low that a reasonable rate of return cannot be generated through the regulated rates. The Court observed that if governmental authority were to set rates at a confiscatory level, the action of the state entity would constitute a taking. S *ee also, Lone Star Gas Co. v. City of Fort Worth* , 98 S.W.2d 799 (Tex. Comm. App. 1936) (recognizing that where a city acquires a gas distribution system as a going concern through eminent domain, items that enter into arriving at the compensation award include intangible property, such as contract rights).

In a case addressing property rights that are more analogous to the intangible interests of the Bondholders, the Austin Court of Appeals held that a bank's perfected security interest in the receivables of a business was constitutionally protected property. *Texas Workforce Commission v. MidFirst Bank* , 40 S.W.3d 690, 696 (Tex. App.—Austin 2001, pet. denied). In *MidFirst* , the Texas Workforce Commission ("TWC") attempted to use a corporation's receivables to satisfy statutory liens arising from the corporation's failure to pay former employees' wage claims and unemployment taxes. *Id* . at 692. However, the Austin Court of Appeals concluded that TWC's

action, which deprived MidFirst Bank of its security interest in the receivables, constituted a taking in violation of the Texas Takings Clause. In so doing, the Austin Court of Appeals expressly rejected TWC's argument that takings claims under the Texas Constitution are confined to the taking of real property by eminent domain. *Id* . ("[W]e will not limit takings-clause actions to situations involving eminent domain."). Similarly, other courts of appeals have extended the protections of the Texas Takings Clause to the rights of secured lienholders in manufactured housing [20] and to the property rights of patent holders. [21]

The Transition Property could be viewed as being analogous to a franchise, which is defined as "a special privilege conferred by government upon an individual or organization which does not belong to the citizenry at large, and in which activity one otherwise could not engage without the franchise." *State/Operating Contractors ABS Emissions , Inc. v. Operating Contractors/State* , 985 S.W.2d 646, 653 (Tex. App.–Austin 1999, pet. denied) (" *ABS Emissions, Inc* ."). As the Austin Court of Appeals observed, "[u]nder Texas case law, a franchise impresses its owner with vested rights" and "generally take[s] the form of utilities, or other monopolies, created to further the public interest." *Id* . The Texas Supreme Court has stated that franchises have long been considered as property in Texas. *Brazosport Sav. And Loan Ass'n v. American Sav. And Loan Ass'n* , 342 S.W.2d 747, 750 (Tex. 1961) ("[i]n character and nature a franchise is essentially in all respects property, and is governed by the same rules as to its enjoyment and protection and is regarded by the law precisely as other property"). "Whether an instrument, ordinance, or contract amounts to a franchise depends largely upon the manner of its performance in compliance with its terms." *ABS Emissions , Inc.* , 985 S.W.2d at 653. [22]

Nevertheless, there are Texas court of appeals decisions questioning whether the Texas Takings Clause extends beyond takings of real property to deprivation of property rights not attendant to real property. *See DeMino v. Sheridan* , 176 S.W.3d 359 (Tex. App.—Houston [1st Dist.], 2004, no pet.); *City of Houston v. North Mun. Util. Dist. No. 1* , 73 S.W.3d 304, 310-11 (Tex. App.—Houston [1st Dist.] 2001, pet. denied); *Texas State Technical College* , 983 S.W.2d 821, 826 (Tex. App.—Waco 1998, pet. denied). [23] This limitation does not appear to be

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20 *See County of Burleson v. General Electric Capital Corporation* , 831 S.W.2d 54, 60 (Tex. App.—Houston [14th Dist.] 1992, writ denied); *Hunt County v. Green Tree Servicing Corp* ., _____S.W.3d _____(Tex. App. – Dallas, 2006, pet. filed).

21 *State v. Holland* , 161 S.W.3d 227, 230-32 (Tex. App.—Corpus Christi 2005, no pet.).

22 In *ABS Emissions, Inc* ., the Austin Court of Appeals held that the legislative repeal of a centralized automobile emissions testing program was a valid exercise of the police power and that such repeal did not give rise to a compensable taking of contracts between certain operating contractors and a managing contractor to operate emissions testing facilities. However, the Austin Court of Appeals suggested that the repeal may have qualified as a taking if the operating contractors had possessed a vested right, such as a franchise from the state, which the court determined they lacked. 985 S.W.2d at 653-56.

23 *Bates* contains the following footnote which concludes as follows:

> In our search, we could find no cases that hold that "property" applies to an individual's property interest in continued employment. Rather, our search indicated that "property" as stated in the Texas Constitution refers to real property.
> 983 S.W.2d at 826 n. 8.

supported by the language of the Texas Takings Clause, which does not confine its scope simply to "real property," but extends to "property." *See* TEX. CONST. art. 1, § 17 ("No person's property shall be taken…for public use without adequate compensation"). Also, the court of appeals decisions suggesting that the scope is limited to real property appear to be out of step with the decisions cited above of other Texas appellate courts, which have held that intangible property is protected by the Texas Takings Clause and the decisions cited above in which the Texas Supreme Court addressed takings jurisprudence as applying to non-real property.

The cases cited above, such as *Corpus Christi* and *MidFirst*, that address non-real property rights which are more analogous to the intangible property rights possessed by the Bondholders in the context of constitutional taking, appear to us more consistent with the language of the Texas Takings Clause, which accords protection to "property," and not just to "real property."

Based on the foregoing, if a reviewing Texas state court were to determine that the Transition Property constitutes a protected property interest, it is our opinion that the court likely would find that State action that either destroyed the Transition Property completely or, subject to the analysis discussed in Subpart 4.B below, that substantially diminished, but did not eliminate the value of the Transition Property completely, would be compensable under the Texas Takings Clause.

(3) Is the property taken for a public use?

The Texas Takings Clause provides private citizens with compensation only if property is "taken . . . for or applied to public use." *Tarrant Regional Water District v. Gragg* , 151 S.W.3d 546, 554-55 (Tex. 2004); *Steele v. City of Houston* , 603 S.W.2d 786, 790 (Tex. 1980). The state is without authority to take private property except for a public use. A court will enjoin action by governmental officials to take property that benefits only private individuals. *See Maher v. Lasater* , 354 S.W.2d 923, 924-25 (Tex. 1962) (enjoining county commissioners court from declaring a private road across claimants' property to be a public highway); *Marrs v. Railroad Comm'n* , 177 S.W.2d 941, 948-49 (Tex. 1944) (enjoining Railroad Commission proration orders where effect of orders would allow oil from petitioner's land to flow onto and accumulate on neighboring land). The public use requirement serves two objectives: (1) to ensure that when the State must compensate a private person for a taking, the public has received some benefit; and (2) to distinguish a taking, which is the act of the sovereign, from those actions, such as tortious acts or takings for a private purpose, which are the acts of individuals acting outside of their official capacities. *See Sheffield*, 140 S.W.3d at 669-70; *Texas Highway Dep't v. Weber* , 219 S.W.2d at 71-72. When faced with a takings claim, a reviewing Texas state court must therefore analyze whether or not the state action was for a public use. A reviewing Texas state court's analysis of any State action would obviously depend upon the particular facts involved.

While it is not possible to anticipate what particular form State action might take, presumably such action would be taken to provide relief to ratepayers subject to the Charges. However, the fact that the State action is likely to be directed at protecting particular consumers of electricity should not lead a reviewing Texas state court to decide the State action is not for a public use or purpose. Texas judicial decisions indicate that a state action that provides a direct benefit to only a select group of persons can nevertheless be related to furtherance of a public purpose. *See Texas Workforce Commission v. MidFirst Bank* , 40 S.W.3d at 696-697. In *MidFirst Bank* , the TWC was seeking to collect from funds being held at MidFirst Bank, receivables of a health care facility to satisfy tax liens and wage claims against the health care facility. The money recovered for the wage claims would have gone directly to individual claimants. *Id.* at 696. In defending against a takings claim by MidFirst Bank (which held a superior lien on the funds and was attempting to collect the funds for itself), the TWC argued its actions in attempting to collect the wage claims were not subject to the Texas Takings Clause, because these actions were not for a public purpose. *Id.* The Austin Court of Appeals held that the TWC, in enforcing the Texas labor code and obtaining funds that were rightfully the property of MidFirst, was "acting in furtherance of a public purpose" for purposes of a takings claim. *Id.* at 697. The Austin Court of Appeals stated "the fact that the benefit inures to a specific group of people does not lessen the importance of enforcement of the labor code to the public at large." *Id.* at 696.

Based on the probable nature of State Impairment Legislation or PUCT Impairment Action, including the likelihood that it is likely to constitute the exercise of the State's authority to protect the interests of electric consumers, it is our opinion that a reviewing Texas state court would scrutinize the overall purpose of such State action and likely find that the public use prong of the analysis under the Texas Takings Clause is satisfied.

B. Additional considerations when the State effects a regulatory taking.

All private property is held subject to the valid exercise of the State's police power. *Turtle Rock Corp.* , 680 S.W.2d at 803, citing *Lombardo v. City of Dallas* , 73 S.W.2d 475, 478 (Tex. 1934). Thus, the State has the authority to enact "reasonable regulations to promote the health, safety, and general welfare of its people." *Turtle Rock Corp.* , 680 S.W.2d at 805; *Ellis v. City of West University Place* , 175 S.W.2d 396, 397 (Tex. 1943). The government will not be required to make compensation "for losses occasioned by the proper and reasonable exercise of its police power." *Turtle Rock Corp.* , 680 S.W.2d at 803. Nonetheless, the State may not defend its actions merely by labeling them as an exercise of its police power. As the Texas Supreme

Court has stated: "this court has moved beyond the earlier notion that the government's duty to pay for taking property rights is excused by labeling the taking as an exercise of police powers." *Steele* , 603 S.W.2d at 789.

When a claim is made that the State's exercise of its police power constitutes a regulatory taking that unduly and unreasonably affects or impairs the value of private property and upsets distinct investment-backed expectations, a reviewing Texas state court will examine whether such exercise has "gone 'to far'" and, thus, fails to constitute a reasonable exercise of the police power. *Sheffield,* 140 S.W.3d at 671; *see id* . at 671-79; *Mayhew* , 964 S.W.2d at 933-38. In describing the examination the court must undertake, the Texas Supreme Court has stated: "There is…no one test and no one single sentence rule . . . . The need to adjust the conflicts between private ownership of property and the public's interest is a very old one which has produced no single solution." *Turtle Rock Corp* ., 680 S.W.2d at 804 (quoting *Teague* , 570 S.W.2d at 392); *accord Sheffield* , 140 S.W.3d at 670.

In conducting its examination of an alleged regulatory taking, a reviewing Texas state court will follow an analysis derived from federal regulatory takings cases. *See Sheffield* 140 S.W.3d at 672; *Mayhew* , 964 S.W.2d at 937 (relying on *Penn Central Transportation Co. v. New York* , 438 U.S. 104, 57 L. Ed. 2d 631, 98 S. Ct. 2646 (1978); *Lucas v. S.C. Coastal Council* , 505 U.S. 1003, 120 L. Ed. 2d 798, 112 S. Ct. 2886 (1992); *Dolan v. City of Tigard* , 512 U.S. 374, 114 S.Ct. 2309, 129 L.Ed.2d 304 (1994)). These cases require a "careful analysis of how the regulation affects the balance between the public's interest and that of" private citizens. *Sheffield* , 140 S.W.3d at 672. Although not exhaustive of the considerations a reviewing Texas state court may take into account in such an analysis, at a minimum the court will examine the following factors:

1. the character of the governmental action; [24]
2. the economic impact of the regulation on the claimant; [25] and
3. the extent to which the regulation interferes with distinct investment-backed expectations. [26]

In considering the character of the governmental action and the extent to which regulation interferes with distinct investment-back expectations, a reviewing Texas state court will look at whether the action asserted to be a regulatory taking substantially advances the

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24 *Sheffield* , 140 S.W.3d at 672.

25 *Id* .; *Mayhew* , 964 S.W.2d at 937.

26 *Sheffield* , 140 S.W.3d at 672; *Mayhew* , 964 S.W.2d at 937.

State's legitimate governmental interests. *Sheffield*, 140 S.W.3d at 673, *Mayhew*, 964 S.W.2d at 933-34. The action must be reasonable, and cannot be arbitrary. *Turtle Rock Corp .*, 680 S.W.2d 805, *City of University Park v. Benners* , 485 S.W.2d 773 (Tex. 1972), *appeal dismissed* , 411 U.S. 901 (1973)).

In examining the economic impact on the claimant, a reviewing Texas state court will consider the economic and financial circumstances faced by the claimant. For example, in *Sheffield* , the Texas Supreme Court upheld zoning ordinances against a takings claim by a developer that had purchased land within the City of Glenn Heights. Subsequent to the developer's purchase, the city altered the zoning restrictions on the land, reducing the number of residences that could be built on the property. The developer argued that the ordinances constituted a taking of his property, but the Texas Supreme Court rejected his claims. In examining the above-listed factors, the Texas Supreme Court appeared to focus primarily on the developer's investment-backed expectations. The Texas Supreme Court noted that the actual investment backing the developer's purchase was minimal. *Sheffield* , 140 S.W.3d at 678. The proposed development was also speculative, because the property had lain dormant for several years before he purchased it. *Id.* Ultimately what seemed most important to the Court was the fact that "the City's zoning decisions . . . were not materially different from zoning decisions made by cities every day." *Id.* at 679. The Texas Supreme Court cited *Lucas* for this proposition and quoted the following language from that case: "It seems to us that the property owner necessarily expects the use of his property to be restricted, from time to time, by various measures newly enacted by the State in the legitimate exercise of its police powers. . . ." *Id.* at 679 n.92 (quoting *Lucas* , 505 U.S. at 1027).

For example, in the event State Impairment Legislation is enacted or PUCT Impairment Action is taken, it is our opinion that the facts regarding the economic effect on the Bondholders and interference with their distinct investment-backed expectations would be distinguishable from the circumstances considered in *Sheffield* . The Bondholders here will have invested $1.74 billion to purchase the Bonds, hardly a minimal amount. The *Sheffield* Court found the developer's expectations to be speculative. *Id* . at 678. In contrast, the amount the Bondholders have paid for the Bonds is known, as are the Bondholders' investment expectations—they expect to receive timely payment of principal and interest in return for their investment in the Bonds. Finally, while in *Sheffield* the Texas Supreme Court found the occurrence of modification of cities' zoning decisions to be routine, *id.* , State Impairment Legislation or PUCT Impairment Action would constitute an extraordinary and unanticipated event. In *Sheffield* , there was no language similar to the State Pledge expressly promising not to impair the developer's development rights. In fact, the *Sheffield* court noted that no one from the city had ever represented to the developer that the zoning restrictions would stay the same, *see id.* , although it did note the developer had legitimately been surprised by the zoning change. Here, however, the

Legislature has enacted an express statutory statement, in the form of the State Pledge, that the State will not impair the Transition Property. It is reasonable to conclude that the Bondholders should be entitled to rely upon the State's express statement in the State Pledge that the Bondholders' rights will not be impaired.

Accordingly, based on the above, we are of the opinion that a reviewing Texas state court would find a compensable taking under the Texas Takings Clause if (a) it concludes that the Transition Property is property of a type protected by the Texas Takings Clause and (b) the State takes action that, without paying just compensation to the Bondholders, (i) permanently appropriates the Transition Property or denies all economically productive use of the Transition Property; or (ii) destroys the Transition Property, other than in response to emergency conditions; or (iii) substantially reduces, alters or impairs the value of the Transition Property, if the action unduly interferes with the Bondholders' reasonable investment backed expectations.

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We note that judicial analysis of issues relating to the Texas Contract Clause and the Texas Takings Clause and the retroactive effect to be given to judicial decisions has typically proceeded on a case-by-case basis and that the court's determination, in most instances, is usually strongly influenced by the facts and circumstances of the particular case. We further note that there are no reported controlling judicial precedents of which we are aware directly on point. Our analysis is necessarily a reasoned application of judicial decisions involving similar or analogous circumstances. Moreover, the application of equitable principles (including the availability of injunctive relief or the issuance of a stay pending appeal) is subject to the discretion of the court which is asked to apply them. We cannot predict the facts and circumstances which will be present in the future and may be relevant to the exercise of such discretion. Consequently, there can be no assurance that a court will follow our reasoning or reach the conclusions which we believe current judicial precedent supports. It is our and your understanding that none of the foregoing opinions is intended to be a guaranty as to what a particular court would actually hold; rather each such opinion is only an expression as to the decision a court ought to reach if the issue were properly prepared and presented to it and the court followed what we believe to be the applicable legal principles under existing judicial precedent. The recipients of this letter should take these considerations into account in analyzing the risks associated with the subject transaction.

The opinions set forth above are based on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty

to update or supplement these opinions to reflect any facts or circumstances that may hereafter come to our attention or to reflect any changes in any law that may hereafter occur or become effective.

It is to be understood that the rights of the Bondholders may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights heretofore or hereafter enacted to the extent constitutionally applicable and that their enforcement may also be subject to the exercise of judicial discretion in appropriate cases.

This opinion speaks only as of its date and only in connection with the Bonds and may not be applied to any other transaction. Further, this opinion is specifically limited to the laws of the State of Texas.

This letter is being delivered solely for the benefit of the persons to whom it is addressed; accordingly, it may not be relied upon by any other person, quoted, filed with any governmental authority or other regulatory agency or otherwise circulated or utilized for any other purpose without our prior written consent. In accordance with the Prospectus on file with the United States Securities and Exchange Commission ("SEC"), a copy of this letter is to be filed as an exhibit to the Registration Statement (Registration No. 333-136787) filed with the SEC on September 5, 2006. We hereby consent to the filing of this letter as an exhibit to the report on Form 8-K filed on October 11, 2006, with respect to said Registration Statement, and to the references to our firm included or made a part of said Registration Statement under the headings "The Restructuring Act—TCC and Other Utilities May Securitize Qualified Costs—Constitutional Matters," and "Legal Matters" in the Prospectus and "Legal Matters" in the Preliminary Prospectus. In giving the foregoing consents, we do not thereby admit that we are within the category of persons whose consent is required under Section 7 of the Securities Act or the related rules and regulations of the SEC.

Very truly yours,

/s/ Bracewell & Giuliani LLP

/pm

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