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June 15, 2010

Frontier Northwest Inc.

Ladies and Gentlemen:

We have acted as special counsel to Frontier Northwest Inc. (formerly known as Verizon Northwest Inc.) ("Frontier") in connection with the escrow agreement ("Escrow Agreement") among Frontier, Washington Utilities and Transportation Commission (the "WUTC") and the Bank of New York Mellon, as escrow agent (in such capacity, the "Escrow Agent"). Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Escrow Agreement. Frontier, the WUTC and the Escrow Agent are collectively referred to as the "Transaction Parties" or any one of them may be referred to as a "Transaction Party."

Pursuant to the WUTC's Final Order Approving and Adopting, Subject to Conditions, Multiparty Settlement Agreements and Authorizing Transaction (Docket UT-090842) (the "Order"), you have requested our opinion that the funds that Frontier deposits into the escrow under the Escrow Agreement, once deposited with the Escrow Agent, will remain subject to the requirements of the Joint Applicants/Staff Settlement, the Order and the WUTC's authority, and such escrowed funds are otherwise protected from creditors or similar entities, regardless of a Frontier bankruptcy, default or other adverse financial event.

The Order requires that the opinion be filed with the WUTC at least 15 days before the closing of the transactions contemplated by the

Agreement and Plan of Merger, dated as of May 13, 2009 (the "Merger Agreement"). We therefore are providing this opinion in advance of the effective date of the Merger (as defined below) and the deposit of the funds into escrow under the Escrow Agreement, which we understand will occur within 30 days of the closing of the Merger. To do so, we assume that the transactions described in the Merger Agreement and in the Escrow Agreement (cumulatively, the "Transactions") have been consummated as contemplated by the Merger Agreement and the current draft of the Escrow Agreement that we have been provided and that there are no changes to either Agreement that would be relevant to our opinion. We further assume that the facts and circumstances surrounding the Transactions will not change, and that there will be no change in applicable law between the date of this opinion and the closing of the Transactions. We do not undertake any obligation to advise you of any changes after the date of this opinion, whether before or after the closing of the Transactions, in the facts, circumstances or applicable law of which we become aware.

In that connection, we have examined originals, or copies certified or otherwise identified to our satisfaction, of such documents, corporate records and other instruments as we have deemed necessary or appropriate for the purposes of this opinion, including the current draft of the Escrow Agreement. In rendering this opinion, we have assumed (a) the due authorization, execution and delivery of the Escrow Agreement by all parties thereto, that such parties have the legal power and authority to execute, deliver and perform their obligations under such agreement and to act in the capacities in which they are to act thereunder and that the Escrow Agreement constitutes their valid and legally binding obligations, (b) the authenticity of all documents submitted to us as originals, (c) the conformity to the original documents of all documents submitted to us as copies and (d) the genuineness of all signatures on all documents submitted to us.

We also assume that no Transaction Party has entered into the transactions contemplated by the Escrow Agreement while insolvent or in contemplation of insolvency, or with a design to prefer one or more creditors to the exclusion in whole or in part of others or with an intent to hinder, delay or defraud any of its creditors. We further assume that Frontier's remaining property immediately after giving effect to the transactions contemplated by the Escrow Agreement is not an unreasonably small amount of capital for the business in which Frontier is engaged and that Frontier does not intend to and does not believe that it will incur debts beyond its ability to pay. We further assume that there has been and will be no fraud in connection with the transactions contemplated by the Escrow Agreement.

We express no opinion as to the treatment of the transactions described herein for purposes other than a properly presented and argued case under Title 11 of the United States Code, as amended (the "Bankruptcy Code"), in which Frontier was the debtor; without limitation, no opinion is expressed herein as to the treatment of such transactions for accounting, tax or regulatory purposes.

## FACTS AND ASSUMPTIONS

For the purpose of rendering our opinion, we have relied exclusively on those facts that have been provided to us by Frontier and have made no independent investigation of the facts referred to herein or of the accuracy of, or the present or future compliance by any of the Transaction Parties with, their respective representations, warranties, covenants and obligations contained in the Escrow Agreement, including those contained in Section 9.8 thereof with respect to perfecting, confirming, continuing, enforcing and protecting the back-up security interest granted to WUTC under the Escrow Agreement. We understand such facts to be as follows:

### 1. Underlying Transaction and WUTC Order

On May 29, 2009, Verizon Communications, Inc. ("Verizon") and Frontier (collectively, the "Joint Applicants") filed a joint application asking the WUTC to decline jurisdiction over, or in the alternative, for approval of the indirect transfer of control of Verizon's regulated Washington State operating subsidiaries to Frontier.

In their application, the Joint Applicants proposed a series of transactions that, in the end, would result in the transfer of control of Verizon Northwest Inc. ("Verizon NW") to Frontier pursuant to a parent company merger (the "Merger"). The Joint Applicants have entered into a stock transaction in which a newly formed Verizon affiliate, which controls and owns, directly or indirectly, all of the equity interests in all the subsidiaries involved in the transaction, is merged into Frontier using a tax free "Reverse Morris Trust" structure.

The transaction will take place subject to the terms of the Merger Agreement, under which Frontier will acquire control of approximately 4.8 million access lines and related assets currently owned by subsidiaries of Verizon in Arizona, Idaho, Illinois, Indiana, Michigan, Nevada, North Carolina, Ohio, Oregon, South Carolina, Washington, West Virginia, Wisconsin and a small portion of California. In Washington, Frontier will acquire control of approximately 578,000 access lines in a total of 79 tariffed exchanges. Upon completion of the transaction, Verizon NW will be a wholly owned, indirect subsidiary of Frontier offering service as Frontier NW.

A number of parties opposing the proposed transaction were able to resolve their objections by entering into several separate settlement agreements which were submitted to the WUTC for approval. These settlement agreements contain numerous commitments on which the opposing parties conditioned their support for the transaction.

The WUTC Staff's ("Staff") settlement agreement with the Joint Applicants is the most comprehensive of the several settlement agreements and

the only one that is the subject of this opinion. The Joint Applicants/Staff Settlement Agreement includes many commitments by Frontier, including a commitment to spend at least $40 million on broadband deployment in Washington by December 2014. Additionally, the Settlement Agreement requires Frontier to set aside and deposit $40 million within 30 days of closing in an irrevocable escrow account deposited in a WUTC-approved account with a third party escrow agent that may release funds only based upon written instruction from the WUTC. Thereafter, Frontier would be able to petition the WUTC for reimbursement, on a quarterly basis, of expenditures made on Washington broadband projects that are consistent with the specific broadband commitments enumerated in the Joint Applicants/Staff Settlement Agreement. Whether to grant such a petition and to issue instructions to release funds would be within the discretion of the WUTC.

On April 16, 2010, the WUTC approved and adopted, subject to several conditions, the Joint Applicants/Staff Settlement Agreement and authorized Frontier to acquire indirect control of Verizon NW. Among other conditions, the WUTC requires Frontier "to obtain an opinion letter from outside legal counsel that verifies that the funds, once deposited with the third party escrow agent, will remain subject to the requirements of the settlement, this Order, and [the WUTC's] authority, and such escrowed funds are otherwise protected from creditors or similar entities, regardless of a Frontier bankruptcy, default, or other adverse financial event." Order ¶ 205.

2. Escrow Agreement

The Escrow Agreement creates an irrevocable escrow account. Under the Escrow Agreement, within 30 days after the closing of the Merger, Frontier is to deposit an amount in cash equal to $40 million (the "Escrow Amount") with the Escrow Agent to be held in the escrow account identified on Schedule 1 to the Escrow Agreement (the "Escrow Account"). Under the Escrow Agreement, Escrowed Funds held by the Escrow Agent in the Escrow Account must be invested and reinvested by the Escrow Agent as directed in writing by Frontier in certain investment types enumerated in the Escrow Agreement. The Escrow Agent will have the authority to liquidate any investments held to provide funds necessary to make required payments under the Escrow Agreement.

Upon each delivery by the WUTC to the Escrow Agent (with a copy to Frontier) of an executed disbursement certificate in the form of Exhibit A to the Escrow Agreement, the Escrow Agent is required to disburse to Frontier an amount from the escrowed funds equal to the amount specified in the disbursement certificate (or, if the amount of the remaining escrowed funds is less than the amount specified in the disbursement certificate, the amount of the remaining escrowed funds).

The Escrow Agreement provides that Frontier will not have a beneficial or equitable interest in the escrowed funds and that Frontier and WUTC

intend that if Frontier becomes a debtor in a case under the Bankruptcy Code, the Escrow Account and the Escrowed Funds will not be property of Frontier's estate under section 541 of the Bankruptcy Code.

In case, despite the intentions of Frontier and WUTC expressed in the Escrow Agreement, the escrowed funds are in fact property of Frontier or of its bankruptcy estate, or if such escrow is for any reason ineffective or unenforceable, the Escrow Agreement also (a) expresses Frontier's and WUTC's intent that the Escrow Agreement shall be a security agreement under the Uniform Commercial Code and any other applicable law and (b) provides that the deposit of the Escrow Amount as provided for in Section 1.2(a) of the Escrow Agreement constitutes a grant by Frontier to WUTC of a security interest in all of Frontier's rights (including the power to convey title thereto), title and interest, whether then owned or thereafter acquired, in and to the Escrow Account and the escrowed funds, to secure the performance by Frontier of its obligations under the Escrow Agreement and the Order. Under the Escrow Agreement, Frontier agreed that, promptly upon request, it would execute any and all such documents, and take all further action that may be required under applicable law or that WUTC may reasonably request, for the purpose of perfecting, confirming, continuing, enforcing or protecting the security interest granted to WUTC under the Escrow Agreement.

3. Fairness of the Transaction

The Escrow Agreement resulted from arm's-length bona fide negotiations among the parties thereto. Frontier has determined that the transactions contemplated by the Escrow Agreement are in the best interests of Frontier and its creditors and represents a practicable course of action without impairing the rights and interests of its creditors.

4. Disclosure of the Transaction

Frontier, in its financial statements and in any communications to the public or other third parties, in accordance with generally accepted accounting principles, will report the effect of the transactions contemplated by the Escrow Agreement in a manner that is consistent with the intent of the Transaction Parties as expressed in the Escrow Agreement. The financial statements of Frontier will also disclose that the escrowed funds are not available to pay creditors of Frontier.

## DISCUSSION

1. *New York Escrow Law in General*

As a general matter, according to New York law, a deposit of money operates as an escrow if (i) an agreement exists as to the terms of the escrow account, including the subject matter and delivery of the deposit, (ii) the deposit is delivered to a third party depository, with future payment conditioned upon the performance of a future act or the occurrence of a future event, and (iii)

the grantor relinquishes control over the deposit. 55 N.Y. Jur. 2d Escrows § 3 (2010); see also Musso v. N.Y. State Higher Educ. Servs. Corp. (In re Royal Bus. School, Inc.), 157 B.R. 932, 938 (Bankr. E.D.N.Y. 1993); Nat'l Union Fire Ins. Co. v. Proskauer Rose Goetz & Mendelsohn, 165 N.Y.S.2d 609, 614 (Sup. Ct. N.Y. Cty. 1994), aff'd, 642 N.Y.S.2d 505 (1st Dep't 1996). To be valid, a delivery in escrow must be made with instructions to a third party who takes delivery and agrees to act as escrow agent. See FDIC v. Knostman, 966 F.2d 1133, 1140 (7th Cir. 1992); Press v. Marvalan Indus., Inc., 422 F. Supp. 346, 349 n* (S.D.N.Y. 1976). The instructions must specify the condition upon which the escrowed property is to be delivered or returned, pursuant to the primary agreement. Press, 422 F. Supp. at 349 n.*. The disposition of the deposited property must be based upon the fulfillment or failure of the condition governing the escrow. Hassett v. Blue Cross and Blue Shield of Greater N.Y. (In re O.P.M. Leasing Servs., Inc.), 46 B.R. 661, 667 (Bankr. S.D.N.Y. 1985). For an escrow to be valid, the transfer must be otherwise irrevocable. In re Royal Business School Inc., 157 B.R. at 940.

Typically, the grantor is deemed to retain a right to the funds and the incidents of ownership until the conditions are satisfied. In re Rosenhein, 136 B.R. 368, 372 (Bankr. S.D.N.Y. 1992). The right that the grantor retains is only legal title, however, and the deposit in escrow "creates in the grantee such an equitable interest in the property that upon full performance of the conditions according to the escrow agreement, title will vest at once in him." In re O.P.M. Leasing Servs., Inc., 46 B.R. at 667 (quoting, 28 Am. Jur. 2d Escrow § 10 (1964)). Before the fulfillment of the condition governing the escrow, the parties each have a contingent interest in the escrowed property. Id. at 667. Upon fulfillment or failure of the condition, one party's contingent interest is extinguished.

2. *Escrowed Funds as Property of the Estate*

Upon the commencement of a case under the Bankruptcy Code, "all legal or equitable interests of the debtor in property" become property of the estate under section 541(a)(1) of the Bankruptcy Code. 11 U.S.C. § 541(a)(1). Section 541(a)(1) has been construed broadly to include "all apparent interests of the debtor." Cedar Rapids Meats, Inc. v. Hager (In re Cedar Rapids Meats, Inc.), 121 B.R. 562, 566 (N.D. Iowa 1990) (quoting In re Peterson, 897 F.2d 935, 936 (8th Cir. 1990); see also United States v. Whiting Pools, Inc., 462 U.S. 198 (1983). The broad definition of the debtor's estate is explicitly limited by section 541(d), however, which states:

> Property in which the debtor holds as of commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate under subsection (a) of this section only to the extent that the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

11 U.S.C. § 541(d). As such, to the extent a debtor holds only a legal title without any equitable interest, the estate acquires only that legal title without any equitable interest. In re Cedar Rapids Meats, Inc., 121 B.R. at 566 (quoting In re N.S. Garrott & Sons, 772 F.2d 462, 466 (8th Cir. 1985)). Accordingly, "an interest limited in the hands of the debtor is equally limited in the hands of the estate." In re N.S. Garrott, 772 F.2d at 466.

Applicable nonbankruptcy law defines whether a debtor has an interest in property. Butner v. United States, 440 U.S. 48, 55 (1979); In re N.S. Garrott, 722 F.2d at 466. Once the court determines whether a debtor has an interest in property, federal bankruptcy law dictates "to what extent that interest is property of the estate." In re N.S. Garrott, 772 F.2d 462. Therefore, courts look first to nonbankruptcy law to determine whether the debtor has any interest in escrowed property.

The general rule under New York law regarding escrow accounts is that unless the grantor retains an interest in the escrowed property over and above the interest of the grantee, the grantor does not have a sufficient interest in the escrowed property to permit the grantor's creditors to reach it upon an execution on a judgment. See Jamaica Sav. Bank v. Lefkowitz, 390 F. Supp. 1357, 1363 (E.D.N.Y.), aff'd 423 U.S. 802 (1975); Creel v. Birmingham Trust Nat'l Bank, 383 F. Supp. 871, 879 (N.D. Ala. 1974), aff'd, 510 F.2d 1363 (5th Cir. 1975); Sapir v. Eli Haddad Corp. (In re Coco), 67 B.R. 365 (Bankr. S.D.N.Y. 1986); In re Treiling, 21 B.R. 940, 943 (Bankr. E.D.N.Y. 1982). As such, courts applying New York law have held that escrow funds cannot be reached as property of the estate, In re Atlantic Gulf Communities Corp., 369 B.R. 156, 165 (Bankr. D. Del. 2007); In re Royal Bus. School, Inc., 157 B.R. 932, and that in bankruptcy preference litigation, where the Bankruptcy Code determines whether property was property of the debtor at the time of the alleged preference based on whether the property was beyond the reach of a judgment creditor, escrowed property is not property of the debtor. In re O.P.M. Leasing Servs., Inc., 46 B.R. at 668.

Where the court determines that, as under New York law, the debtor as escrow grantor does not retain any equitable interest in the escrowed funds, the escrowed funds are not property of the estate. See, e.g., Carlson v. Farmers Home Administration (In re Newcomb), 744 F.2d 621, (8th Cir. 1984); TTS, Inc. v. Citibank, N.A. (In re TTS, Inc.), 158 B.R. 583, 585 (D. Del. 1993); Salber Equip. Corp. v. F/S Computer Corp. (In re F/S Computer Corp.), 38 B.R. 384, 390 (Bankr. W.D. Pa. 1984). Thus, a bankruptcy court enforced both the letter and the intent of an escrow agreement, where a state agency guaranteed a loan to a business but required that the loan proceeds be placed in escrow immediately after the bank disbursed them to the debtor until such time as the agency authorized their release, concluding that title to the funds did not pass to the debtor before bankruptcy because the debtor had not performed in the manner required to obtain release of the funds. Creative Data Forms, Inc. v. Pa. Minority

Bus. Dev. Auth. (In re Creative Data Forms), 72 B.R. 619, 623 (E. D. Pa. 1985). Another bankruptcy court enforced an escrow agreement and denied recovery of the escrowed funds to the bankruptcy trustee of the seller of a business who placed a portion of the sale proceeds into an escrow account for the benefit of the purchaser to cover certain liabilities, including environmental clean-up costs and other pending litigation, which the purchaser did not assume. Dynasty Express Corp. v. Kurtzman (In re AGSY, Inc.), 120 B.R. 313, 319 (Bankr. S.D.N.Y. 1990).

Even in cases where the escrow arrangement acted as an assurance or guarantee fund in favor of a state agency, courts have typically found that the escrow funds are not property of the estate. In re Newcomb, 744 F.2d at 624. For example, where the debtor home builder had deposited into an escrow funds that the debtor was authorized to withdraw upon an engineer's certification that adequate water and sewer facilities had been built, the court determined that the escrowed funds were not property of the estate. In re Atlantic Gulf Communities Corp., 369 B.R. at 165. In re Palm Beach Heights Dev. & Sales Corp. reached the same conclusion in rejecting the debtor in possession's attempt to recover an escrow that the debtor home builder had established under an agreement with the state Division of Land Sales "to post certain sums [to] be available to assure the installation of the roads and the drainage canals" that the debtor had agreed to construct as part of a subdivision. 52 B.R. 181, 182 (Bankr. S. D. Fla. 1985). The court found that the debtor would have an interest in the fund "only upon completion of the improvements," so the fund was not property of the estate. Id. at 182, 183. The courts have also reached the same result with respect to funds that a debtor deposited into escrow for a state Insurance Commissioner "to act as security to guarantee" the debtor's payment of workers' compensation claims. The court concluded:

> "that the escrow fund itself is not property of the estate, and that the debtor is entitled to only its interest in the contingency or claim against the fund, are in line with the broader principles of property of the estate. . . . '[A]n interest limited in the hands of the debtor is equally limited in the hands of the estate.'"

In re Cedar Rapids Meats, Inc., 121 B.R. at 567, 569 (quoting In re N.S. Garrott, 772 F.2d at 466); accord Dolphin Titan Int'l, Inc. v. Gray & Co., Inc. (In re Dolphin Titan Int'l, Inc.), 93 B.R. 508, 512 (Bankr. S.D. Tex. 1988) (workers' compensation guarantee fund). In one of the further extensions of the doctrine, a New York bankruptcy court has even held that funds that a debtor deposited in escrow, pending final resolution of the debtor's liability to repay a state agency for overpayments, were not property of the estate. In re Royal Bus. School, Inc., 157 B.R. 932.

The result is no different under New York law when the escrow beneficiary is not a state agency. In re O.P.M. Leasing Servs., Inc., 46 B.R. at 668

(escrow agreement "to provide [the creditor] with security for the performance by [the debtor] of its reimbursement obligation").

The decisions, however, are not uniform, and some courts have held that the debtor had a property interest in escrowed funds, as a result of which the funds became property of the estate. See, e.g., Wilson v. United Sav. of Tex. (In re Missionary Baptist Foundation of Am., Inc.), 792 F.2d 502, 506 (5th Cir. 1986); World Commun's Inc. v. Direct Market'g Guaranty Trust (In re World Commun's, Inc.), 72 B.R. 498 (D. Utah 1987); Gassen v. Universal Bldg. Materials, Inc. (In re Berkley Multiunits, Inc.), 69 B.R. 638, 642 (Bankr. M.D. Fla. 1987). The differences can be explained, however, by differences in the underlying state law or by differences in the underlying factual pattern.

In re Missionary Baptist Foundation of Am., Inc. held that, unlike under New York law, an escrow account was property of the estate under Texas law because "when a grantor executes an escrow agreement and deposits the subject matter into escrow, he retains legal title to the subject matter." 792 F.2d at 504. Similarly, in analyzing down payments placed in escrow pending the closing of a real estate transaction, In re Berkley Multiunits, Inc. ruled that, unlike under New York law, "[u]nder Florida law legal title to property placed in escrow remains with the grantor until the occurrence of the condition specified in the escrow agreement." 69 B.R. at 641. Finally, contrary to the line of cases above, a Utah court stated that whether an escrow constitutes property of a debtor's estate depends not on state law, but "entirely on the nature and circumstances of the escrow in question." In re World Commun's, Inc., 72 B.R. at 501.

These cases do not detract from the general principle the courts have enunciated in the cases applying New York law to facts similar to the facts in this transaction.

3. *Escrow Account as a Security Interest*

Revised Article 9 of the New York version of the Uniform Commercial Code applies "to any transaction (regardless of its form) which is intended to create 'an interest in personal property which secured payment or performance of an obligation.'" N.Y. U.C.C. Law §§ 9-109(a)(1) (scope of Revised Article 9), 1-201(37) (definition of "security interest") (McKinney 2001). Because an escrow creates an interest in favor of the grantee upon performance of a condition, an escrow could be subject to Revised Article 9. If so, escrowed property deposited by a debtor/grantor would remain property of the debtor, subject to a security interest in favor of the grantee to secure performance of the grantor's obligation to the grantee. In that case, either possession of the property by the grantee or his agent or the filing of a financing statement under Revised Article 9 would be required to perfect the grantee's interest and protect the property from the grantor's creditors under section 9-317. Id. at § 9-317.

Early in the life of Article 9, some courts adopted this reasoning. In re Copeland, 531 F.2d 1195 (3d Cir. 1976). However, as the discussion above shows, more recent cases and New York courts generally have not followed this reasoning, applying instead common law principles governing escrows and ruling that the deposit of funds into a valid escrow divests the grantor's interest in the funds so that the funds are no longer property of the debtor in which a creditor can obtain a direct lien. Therefore, it does not appear that the Escrow Account will be subject to Revised Article 9.

4. *Backup Security Interest*

Under section 9.8 of the Escrow Agreement, Frontier grants WUTC a security interest in all of its rights, title and interest in and to the Escrow Account and the Escrowed Funds, to secure the performance by Frontier of the obligations under the Escrow Agreement and the Order. A security interest is defined by the N.Y. U.C.C. as "an interest in personal property which secures payment or performance of an obligation." § 1-201(37). A security interest is valid and enforceable only if there is evidence of an intent "[t]o create a security interest." Gibson v. Resolution Trust Corp., 51 F.3d 1016, 1022 (11th Cir. 1995); see also Mid-Atlantic Supply, Inc. of Virginia v. Three Rivers Aluminum Co., 790 F.2d 1121, 1127 (4th Cir. 1986); Looney v. Nuss (In re Miller), 545 F.2d 916, 918 (5th Cir. 1977); Transport Equip. Co. v. Guaranty State Bank, 518 F.2d 377, 380 (10th Cir. 1975); Bruce Lincoln-Mercury Inc. v. Universal C.I.T. Credit Corp., 325 F.2d 1118, 1120 (8th Cir. 1973); In re O.P.M. Leasing Servs. Inc., 46 B.R. at 669. The intent of the parties to create a security interest is ascertained by examining the parties' contractual agreement. In re Miller, 790 F.2d at 918; In re Cedar Rapid Meats, Inc., 121 B.R. at 572; In re O.P.M. Leasing Servs. Inc., 46 B.R. at 669.

Adequately demonstrating the intent to create a security interest is typically an easy task. In Transport Equip., the court found that a loan to purchase body kits was a security interest because the agreement included a section which stated "[defendant] grants to [plaintiff] to the extent it has capacity to do so a security interest in the consigned goods for the purpose of securing . . . the payment of any and all indebtedness, liabilities and obligations of [defendant]." 518 F.2d at 380. In the context of a bankruptcy, In re Miller extended the concept even further by finding a security agreement existed, absent any such specific language, simply because a consignment of profits from the sale of artwork was irrevocable, and the plaintiff could have fashioned a private 'foreclosure' remedy by purchasing the artwork and waiting for the proceeds to be remitted to her. 545 F.2d at 919. Finally, in In re O.P.M. Leasing Servs., Inc. a New York bankruptcy court found the parties adequately demonstrated their intent to create a security interest by stating in the escrow agreement that the "parties hereto hereby enter into this agreement to provide [grantee] with certain security for the performance by [grantor]." 46 B.R. at 669.

Security interests are generally respected in actions commenced under the Bankruptcy Code. 11 U.S.C. § 506(a). Although under section 544(a) of the Bankruptcy Code, the trustee has the power to avoid certain transfers of property of the debtor that are voidable by a hypothetical judicial lien creditor, whether a hypothetical lien creditor could obtain a judicial lien on property that is already the subject of a security agreement is determined by state law. 11 U.S.C. § 547(e)(1)(B); In re O.P.M. Leasing Servs., Inc., 46 B.R. at 669. Here, the relevant state law is N.Y. U.C.C. § 9-317 which provides that a trustee's interest as a lien creditor is superior only to those security interests which are unperfected as of the filing of the petition. In re O.P.M. Leasing Servs., Inc., 46 B.R. at 669.

Additionally, governmental units are further protected under the Bankruptcy Code by an exception to the automatic stay, which allows a governmental unit to "enforce [its] police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's or organization's police or regulatory power." 11 U.S.C. § 362(b)(4). As such, the WUTC should be able to enforce the Order and any security interest that the Escrow Agreement grants despite a Frontier bankruptcy, based on § 362(b)(4) of the Bankruptcy Code.

## OPINION AND ANALYSIS

Based on the foregoing, and subject to the assumptions, limitations and qualifications and discussion contained herein and the reasoned analysis of analogous case law, for the reasons set forth below we are of the opinion that, IF Frontier were to become a debtor in a case under the Bankruptcy Code, the escrowed funds, once deposited with the Escrow Agent, will remain subject to the requirements of the Joint Applicants/Staff Settlement Agreement, the Order and the WUTC's authority, and such escrowed funds are otherwise protected from creditors or similar entities.

First, under the Escrow Agreement (i) an agreement exists as to the terms of the escrow account, including the subject matter and delivery of the deposit, (ii) the deposit will be delivered to a third party depository, with future payment conditioned upon the performance of a future act or the occurrence of a future event, and (iii) the Frontier will relinquish control over the deposit. As such, the Escrow Agreement creates a valid escrow under New York law.

Second, Frontier does not have a beneficial or equitable interest in the escrowed funds deposited in the Escrow Account, so the escrowed funds would not be property of Frontier's estate, and thus would remain subject to the requirements of the Joint Applicants/Staff Settlement Agreement, the Order and the WUTC's authority, and such escrowed funds will otherwise be protected from creditors or similar entities, regardless of a Frontier bankruptcy, default, or other adverse financial event.

Third, should the Escrow Agreement fail to create a valid escrow, WUTC will have a perfected security interest in the escrowed funds that will defeat the trustee's avoiding powers under section 544 of the Bankruptcy Code. As such, even if the Escrow Agreement is deemed a security agreement, the escrowed funds will remain subject to the requirements of the Joint Applicants/Staff Settlement Agreement, the Order and the WUTC's authority, and such escrowed funds will otherwise be protected by the security interest and by section 362(b)(4) of the Bankruptcy Code from creditors or similar entities, regardless of a Frontier bankruptcy, default, or other adverse financial event.

ADDITIONAL QUALIFICATIONS AND LIMITATIONS

It is our and your understanding that the opinions expressed above are not a prediction as to what a particular court would actually hold, but opinions based on legal principles generally applicable in bankruptcy cases. Judicial analysis has typically proceeded in a case-by-case basis. The determination is usually made on the basis of an analysis of the facts and circumstances of the particular case, rather than as a result of the application of consistently applied legal doctrines. Thus, existing reported decisional authority is not conclusive as to the relative weight to be accorded to the factors present in the transaction and does not provide consistently applied general principles or guidelines with which to analyze all of the factors present in the transaction.

We also note that legal opinions on bankruptcy law matters, due to unavoidable uncertainties, have inherent limitations that generally do not exist with respect to other legal issues on which opinions to third parties are typically given. These uncertainties are based largely on the prevailing goals of reorganization and the pervasive, discretionary and equitable powers of bankruptcy courts, the emphasis placed on reorganization as a goal, even at the expense of other legal rights and policies, the potential relevance to the exercise of judicial discretion of the facts and circumstances which may arise in the future and the nature of the bankruptcy process. Bankruptcy courts have been known to use their equity powers to promote the goal of reorganization, even at the cost of the enforcement of absolute legal rights.

We are admitted to practice in the State of New York. We express no opinion as to matters governed by any laws other than the laws of the State of New York and the Federal laws of the United States of America.

The opinions set forth herein are expressly subject to there being no additional facts that would materially affect the validity of the assumptions and conclusions set forth herein or upon which this opinion is based.

We are furnishing this opinion to you solely for your benefit. This opinion letter is not intended to be employed in any transaction other than the one described above and is being delivered to you on the understanding that neither it nor its contents may be relied upon by any other person or for any other purpose

or used, circulated, quoted, published, communicated or otherwise made available, in whole or in part, to any other person or entity without, in each instance, our specific prior written consent.

Very truly yours,

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