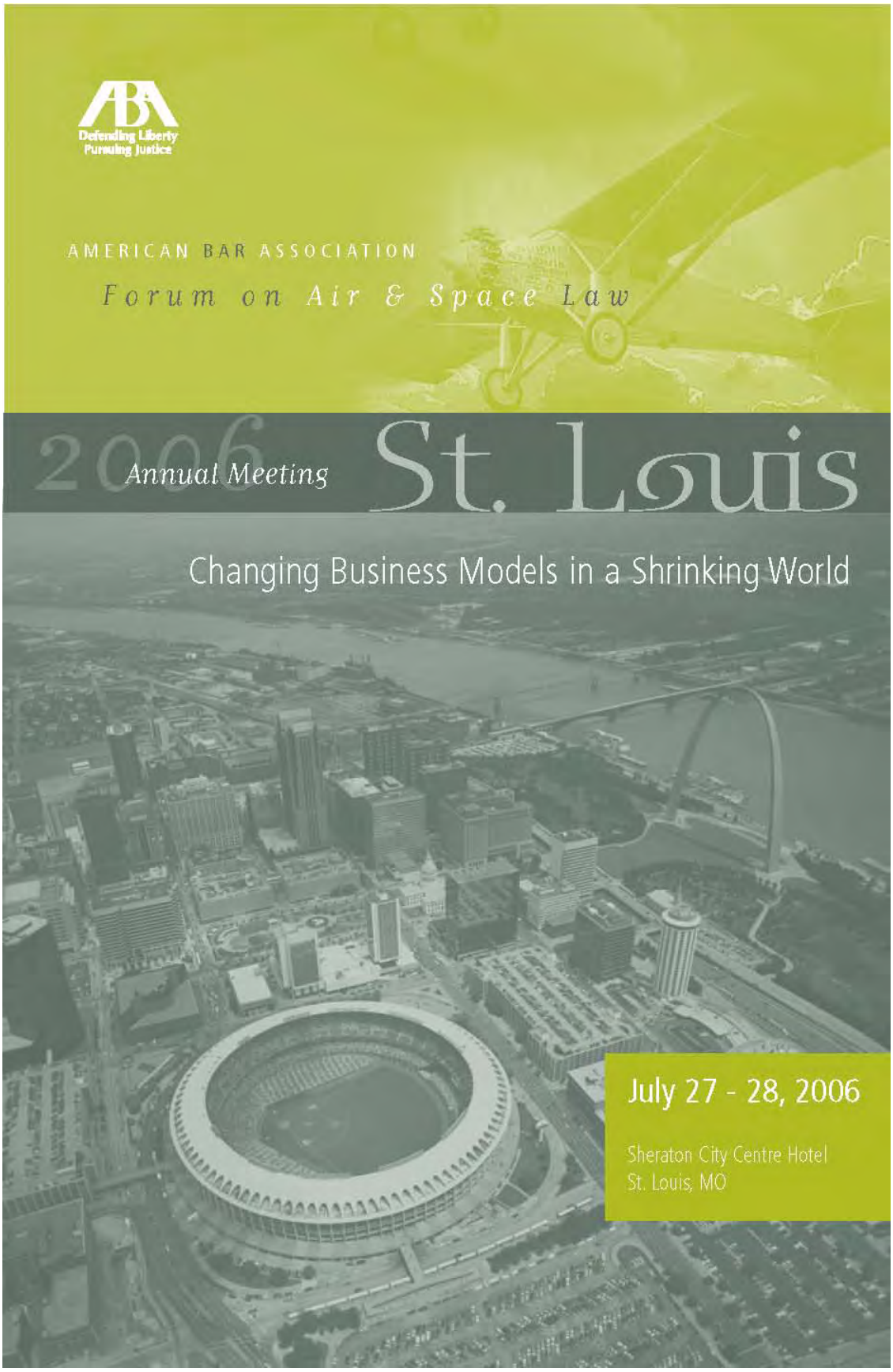
Defending Liberty
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AMERICAN BAR ASSOCIATION
Forum on Air & Space Law
2006 Annual Meeting
St. Louis
Changing Business Models in a Shrinking World
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Outline of Remarks Delivered at
The American Bar Association Forum on Air & Space Law 2006 Annual Meeting
Panel on Regional Airlines – Reinventing The Model For Today's Challenges
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Thank you for the privilege of speaking to you here today.

I have been asked to try and address three somewhat disparate areas in my comments today. They are (a) federal agencies and changes in how they deal with express carriers; (b) express carriers and bankruptcies; and (c) changes and proposals for the future of express contracting.

(a) Federal Agencies and Changes in How They Deal With Express Carriers

Clearly the biggest change in the regulatory environment for express carriers, as it has been for all carriers, is the addition of the Transportation Security Administration to the field of regulatory authorities. This change, however, is more dramatic for express carriers because prior to the federalization of aviation security on February 17, 2002, the security checkpoints at airports were generally managed by the carrier with the largest number of enplanements operating beyond that checkpoint. Thus, the large carriers managed an overwhelming majority of the checkpoints. The express carriers' experience with security regulations were, therefore, generally confined to the basic security identification display area (SIDA) requirements.

In 2000, the last year for which we have data uninfluenced by 9/11, 90% of FAA security cases closed against just 15 carriers.

By contrast, in the post-federalization period, anecdotal evidence suggests that 20% of cases are now against express carriers.

With federalization has come a much more stringent security regulatory regime.

The TSA under its "ENFORCEMENT SANCTION GUIDANCE POLICY" categorizes different types of violations as meriting "Minimum," "Moderate," or "Maximum" fines. For air carriers, of the nineteen categories listed, only one type of violation – "Failure to train or to maintain training records" is categorized as "Minimum" and that one is actually Minimum-Moderate.

Moreover, while it was always a possibility (and extremely rare reality) with the FAA, the TSA has made it a somewhat regular practice to issue letters of investigation to individuals, including to management employees.

Examples:

1. Manager helping with checkpoint operations.
2. Employee being waived through a checkpoint at a small airport.

(b) Express Carriers and Bankruptcies

My second topic today covers a bit about express carriers and bankruptcy.

Given the excellent panel yesterday on Labor Issues and Aviation and the speakers' focus on labor contracts and Section 1113 of the Bankruptcy Code, I will focus on contract issues.

Reorganization under Chapter 11 gives debtors significant leverage. The leverage is, of course, derived from the fact that counterparties to agreements with the debtor cannot use bankruptcy as a basis for termination (that is, *ipso facto* clauses are not enforceable) and debtors can assume or reject contracts. Clearly that puts express carriers in a perilous position if their mainline carriers have filed.

There are three possible reactions, which are the same as applicable to all of the debtor/creditors relationships:

(1) engage with the debtor/creditor,
(2) ignore the issue, or
(3) take an adverse or hostile approach.

Options (2) and (3), while common are not productive. Option (1) is clearly the most favorable choice. In doing so, however, it is important to have counsel from an attorney who both understands the business and also bankruptcy law. That latter characteristic is particularly important. Having worked through two airline bankruptcies it is astounding and disappointing how many attorneys represent themselves to their own clients as knowing bankruptcy law when, in fact, they don't. All too often I found them trying to apply common law contract principals without regard to the Bankruptcy Code under which they often do not apply.

Likely the greatest difficulty in bankruptcy is getting vendors/creditors to continue performing. Here a major/mainline carrier has the advantage of a big name.

Example:

> Hotel willing to continue doing business with US Airways, Inc., but not US Airways, Inc. d/b/a MidAtlantic Airways d/b/a US Airways Express, *i.e.*, the same exact entity.

It must also be understood that upon the filing, the risk profile of post-petition matters change because of the classification of post-petition debts as administrative claims. Thus, whether or not there is an assumption and whether or not prepetition debts are secured, the post-petition debts will be administrative claims, *i.e.*, first in line to be paid. Thus, as long as business is continuing, threats to cease performance generally accomplish nothing but aggravate those involved. Getting creditors to have the perception of an express carrier as a viable and continuing entity, in order to obtain continued performance, is the difficult objective. To that end, a clear and broad communications plan is necessary.

(c) Changes and Proposals for the Future of Express Contracting

My third topic today, again unrelated to the first two, is a brief discussion of the actual agreements between express and mainline carriers.

They generally come in two forms:

1. Express service agreement, which is essentially a code sharing agreement without operations under the express carrier's code.

2. Purchase of whole aircraft (all seats) and fly where directed (like a wet lease, but it is taboo to call it that).

Both types are known under various names. All essentially boil down to allocation of business decision rights, *e.g.*, where to operate, and allocation of risk, *i.e.*, who pays for those rights.

Comparative analysis is possible because such agreements are generally "material" for one or both parties and, therefore, filed (albeit in redacted form) with the SEC.

Often the language in such agreements is very heavy on "boiler plate," but shy on operational details. For example, many include pages of trademark materials (likely an expertise of the drafter), but neglect to mention the coding issue altogether.

Addressing the business issues are key to proper understanding and allocation of risk.

This has been an interesting area in which to work as, in my opinion, it often reflects the perceptions that the carriers have of themselves. Many mainline carriers view themselves as the 800 pound gorilla and express carriers as the banana. Many express carriers have the same perception. To the contrary, as one vice president of an express carrier noted, "We are a $1 billion company." The truth is often somewhere in the middle and, in candor, generally favors the mainline carrier. Nevertheless, even while the "banana-to-gorilla" is often a reasonable metaphor of the negotiating situation, and the result is an expected one-sided agreement, that is often more readily recognized in the indemnity provisions. The significant business issues, however, are often neglected, *e.g.*, who will hold the leases for facilities? Provide ground handling services? Check-in passengers? Purchase fuel? Issues that ought to be negotiated to, at least, address the true relationship. More comprehensive addressing of such issues would allow for a more accurate assessment of risk as well as avoid disputes.

Thank you for your kind attention.