

Northwest represents that, if the Independent Fiduciary determines that the Pinnacle Stock previously contributed to the Plans was worth less at the time of the contribution than the amount attributed to it at the time of the contribution, Northwest shall contribute additional Pinnacle Stock or cash in amounts sufficient to make up the shortfall.

Lastly, the Department notes that the above described responsibilities to be undertaken by the Independent Fiduciary are material factors in the Department's determination to grant a final exemption.

#### **Additional Comments and Submissions**

##### *Northwest April 10, 2003 Submission*

On April 10, 2003, Northwest submitted additional documentation to the Department in connection with the January 15, 2003 contribution of Pinnacle Stock to the Contract Plan (April 10 Submission Documents). Northwest noted that the Pinnacle Stock is being held in an Investment Fund established in connection with the Master Trust, and the amounts were allocated to the Contract Plan and Salaried Plan consistent with the provisions of the Master Trust, as described in the Proposed Exemption. Northwest appointed Fiduciary Counselors investment manager of the Investment Fund and Fiduciary Counselors has accepted this appointment.

##### *Northwest April 26, 2003 Comment*

By letter dated April 26, 2003, Northwest responded to many of the comments the Department had received concerning the Proposed Exemption (April 26 Comment). Northwest observed that the comments submitted to the Department raised several concerns regarding the contribution of Pinnacle Stock to the Plans, as contemplated by the Proposed Exemption. Because many of the comments raise common concerns, Northwest organized its responses to address these common concerns.

##### **Airline Industry and Northwest Financial Condition**

*Comment:* A number of comments noted that the airline industry is experiencing significant financial troubles and that some other airlines are in bankruptcy. The comments expressed concern that Northwest is exposed to bankruptcy risk and that the Pinnacle Stock would have greatly reduced value if Northwest were to file for bankruptcy, because Pinnacle serves Northwest.

*Northwest Response:* Northwest responded that Northwest recognizes

that it and the airline industry face significant financial challenges. Northwest sought the exemption to permit the Pinnacle Stock contribution as part of its overall strategy of managing the current economic uncertainty. By permitting the contribution of Pinnacle Stock, Northwest is able to preserve needed cash so that it can withstand several years of losses. Maintaining liquidity is key to Northwest's strategy for avoiding bankruptcy.

Northwest strongly believes that Pinnacle Stock has significant value and that the value of Pinnacle Stock will increase when the IPO market improves for regional airlines. Regional airlines play an indispensable role in providing major airlines with important access to passengers, largely from markets too small to be serviced by a major airline. Pinnacle contributed over \$500 million in revenue to Northwest in 2002 and is expected to grow its regional jet flying approximately 30 percent per year through 2005. As Pinnacle grows to 95 aircraft, the number of passengers and revenue will more than double.

Northwest has entered into a 10-year ASA with Pinnacle through 2012 that provides substantial value. Pinnacle's compensation formula within the ASA contractually provides for a target operating margin of 14 percent from 2003 through 2007, with a guaranteed floor of 12 to 13 percent during this period. In 2008, the target operating margin will be reset to a market-based percentage, but it will be no less than 10 percent and no higher than 14 percent. Northwest will no longer guarantee a minimum operating margin in 2008. The target margin will be reset after 2008 based on historical and expected operating costs.

Northwest asserts that its beliefs in this regard have been independently verified. In connection with the Exemption Transactions, Northwest does not determine the value of Pinnacle Stock. The value of Pinnacle Stock is determined by an independent fiduciary, Fiduciary Counselors, based on the valuation provided by their independent valuation firm, Eclat. The valuation prepared by Eclat took into consideration current industry conditions. If the markets return, substantial upside will benefit the Plans. Future contributions of Pinnacle Stock will continue to be subject to independent review and valuation.

Northwest adds that under ERISA sections 406 and 407, Northwest could have contributed the stock of its parent company (traded under the symbol NWAC) to satisfy its funding obligations without seeking an exemption.

However, Northwest has proposed to contribute Pinnacle Stock because it believes that it is a superior investment for the Plans. The stock has long term upside potential because of the planned IPO. Indeed, the January 15, 2003 Valuation indicates that the Plans could receive a 20 percent IPO premium in connection with the Pinnacle Stock investment.

Finally, Northwest notes that regional airline stocks have generally been less volatile and better performing than the stocks of major airlines. Since September 10, 2001, regional airlines have lost 48% of their value while the major airlines have lost 78% (excluding U.S. Airways and United that have filed for Chapter 11 bankruptcy protection). Northwest also believes that the value of Pinnacle Stock is less exposed to bankruptcy risk than Northwest stock. This is because a regional airline derives its value from the value of its ASA with the major carrier and the major carrier is unlikely to terminate the ASA in bankruptcy because it would severely disrupt the flow of high yield passengers. In the case of United Airlines, for example, the airline has not rejected the ASAs it has entered into with its regional airline partners Atlantic Coast Airlines, SkyWest and Air Wisconsin. Similarly, U.S. Airways did not reject its ASA with its regional airline partners Mesa and Chautauqua. In addition, U.S. Airways has recently signed an agreement with Mesa for more regional aircraft. Wall Street analysts also look favorably on ExpressJet, the Continental Airlines regional airline partner. However, Northwest understands that some of United's airline services agreements have been renegotiated and that it has been reported that the airline services agreement between United and Atlantic Coast Airlines is the subject of current negotiations. Moreover, in connection with the Omnibus Agreement entered into between Fiduciary Counselors and Northwest, Fiduciary Counselors negotiated for limitations on Northwest's ability to unilaterally amend or terminate the ASA.

##### **Valuation of Pinnacle Stock**

*Comment:* A number of comments expressed concerns that Pinnacle Stock is a risky and illiquid investment and hard to value because there is no established market for the security.

*Northwest Response:* Northwest represents that it did not value Pinnacle Airlines for purposes of the Exemption Transactions. As a condition of the Proposed Exemption, Fiduciary Counselors, using the services of its independent appraisal firm Eclat,