

# **EXHIBIT A**

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UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT NEW YORK

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|---------------------------------------|---|--------------------------|
| In re:                                | : | Case No.: 05-17923 (ASH) |
|                                       | : |                          |
| DELTA AIR LINES, INC. <i>et al.</i> , | : | (Jointly Administered)   |
|                                       | : |                          |
| Debtors.                              | : | Chapter 11               |
|                                       | : |                          |

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**RESPONSE OF DFO PARTNERSHIP TO TIA/SLV OBJECTION 1:  
OBJECTION BY DELTA AIR LINES, INC. AND THE OFFICIAL  
COMMITTEE OF UNSECURED CREDITORS TO CERTAIN CLAIMS  
FILED BY DFO PARTNERSHIP AND THE BANK OF NEW YORK  
FOR TAX INDEMNITIES AND STIPULATED LOSS VALUES**

For its response to TIA/SLV Objection 1, DFO Partnership (“DFO”) respectfully states as follows:

**INTRODUCTION**

When the TIA/SLV issue was presented to the Court on January 31, 2007 as a hypothetical question, the Court directed the parties to “furnish me with the actual contractual documents that govern the transaction and address your arguments to those contractual documents.” Transcript of January 31, 2007, p. 96.

TIA/SLV Objection 1 (Docket No. 4267) does that only in part, for the Debtor and the Committee either continue to describe the relevant documents and the facts regarding the

challenged claims in broad strokes, or selectively discuss only certain provisions and ignore others. The result is unfortunately misleading.

This dispute is not over the question of whether Stipulated Loss Value (“SLV”), as calculated in the relevant documents, includes as one of its components a reimbursement for the taxes that may be related in part to the DFO Claims (although it is not clear, in the absence of further evidence, that the amount of such component is equal to the amount of DFO’s claims). No one disputes that it does. This dispute involves the question of whether inclusion of a tax reimbursement component in the calculation of SLV mandates disallowance of the DFO Claims. DFO respectfully submits that once the Court examines the specific inter-related provisions of the actual documents in detail, and reviews all relevant facts regarding the DFO Claims - as opposed to discussing them only in general terms - the Court will understand that TIA/SLV Objection 1 must be denied as to the DFO claims.

This response contains three sections.

The first section discusses the parties’ intentions by looking at the fundamental economics of these leveraged leasing transactions from the perspectives of DFO, the lenders and the Debtor. The generic description of the leveraged lease in TIA/SLV Objection 1 fails to give the Court a complete picture of the critical difference between leveraged leasing and conventional lending that is at the heart of the challenged claims. That difference resulted in significant economic benefits to the Debtor (millions of dollars saved by lowering its cost of funds to use the aircraft), but also entailed a significant risk to DFO (millions of dollars in potential tax liability) if the tax treatment that the parties expected from the transactions was destroyed by the Debtor’s actions. The transactions, and their benefits to the Debtor, were possible only because the Debtor agreed to indemnify DFO for the tax risk to which the

leveraged leasing structure exposed it. The lenders never were exposed to that risk and never bargained to receive any part of the Debtor's indemnity against such risk.

Of course, understanding the parties' objectives is only the first step in the analysis. The second step is a full appreciation of the words that the parties used to memorialize their agreement. As with its generic description of leveraged lease structures, the cursory and selective description of the actual agreements in TIA/SLV Objection 1 falls quite short of presenting an accurate picture of the way in which the parties allocated the risks to which the transaction exposed them. The second section of this response therefore focuses on the specific contractual terms that the Court must have in front of it to decide the pending objection.

The third section of this response examines the actual facts relevant to the sweeping proposition put forth by the Debtor and the Committee that the Debtor is "required to pay" SLV, and therefore is relieved from its obligations to DFO under the tax indemnity agreement. Here, the Debtor and the Committee are guilty of more than merely using selective provisions of the relevant documents to make their case. They failed to tell the Court that (a) with respect to three of the aircraft that are subject to the objection, the Debtor already has reached an agreement with the lenders which assures that the Debtor will not pay SLV; and (b) in the case of four of the other five aircraft, the lenders did not even file a claim seeking recovery of SLV. Thus, BNY's claims are not "SLV claims", the Debtor is not "required to pay" SLV and the cited exclusion from the tax indemnity does not require disallowance of the DFO claims.

**I. TRANSFER AND PRESERVATION OF TAX BENEFITS IS AT THE VERY HEART OF LEVERAGED LEASING**

No party to TIA/SLV Objection 1 can or will dispute the fact that acquiring use of the subject aircraft through leveraged leases gave the Debtor access to these expensive capital

assets at a much lower cost of funds than the Debtor could have obtained at the time in the capital markets through other types of financings. The best way to understand this is to contrast the benefits received from a leveraged lease with those received from a conventional borrowing to finance 100% of the cost of an aircraft.

The analysis of the structure begins with the cash invested by the owner participant. In a leveraged lease transaction, the owner participant puts down cash (usually about 20% of the purchase price) in the form of an equity investment and then borrows the balance (usually about 80%) of the purchase price from third party lenders on a nonrecourse basis, leases the aircraft to the airline and uses the aircraft and the lease as collateral for the debt.

The owner participant, of course, could have made its investment in the form of a subordinated loan to the airline for 20% of the purchase price, which would have provided the lenders with the same 80% loan-to-value ratio (or equity cushion) as a leveraged lease, and still would have allowed the airline to finance 100% of its acquisition cost for the aircraft. The airline could reduce its cost of funds, however, by doing a leveraged lease, which would permit the owner participant to derive a portion of the economic return on its investment in the form of tax benefits--accelerated depreciation deductions on the asset and interest payment deductions on the debt. These tax benefits contributed to DFO's return on its investment in each of its lease deals with the Debtor. Affidavit of David B. Gebler ("Gebler Affidavit") at ¶ 4.

An owner participant in a leveraged lease structure expects a return on its investment just as the lenders do. Unlike the lenders in a leveraged lease, however, who receive their return from the repayment of principal with interest on their loan (which is funded by payments under the lease), an owner participant receives its return from three sources: payments under the lease, the residual value of the aircraft at the end of the lease and the anticipated tax

benefits of the transaction (both the tax deductions discussed above and protection against adverse tax consequences resulting from the lessee's actions). It is important to keep these separate elements in mind because when parties calculate SLV for their leveraged leases, they give value to each of these elements. Gebler Affidavit at ¶ 5. When the Court examines the provisions of the relevant documents it will see that not all of these components of SLV are treated the same way.

Acquiring and leasing an asset, rather than making a loan, however, exposes the owner participant to a significant risk that does not befall a subordinated lender in a default scenario. When a borrower defaults, its lenders are exposed to the risk that they will not receive the full amount of principal and interest owed to them on their loan, which will happen here, as unsecured claims will not be paid in full. By contrast, when a lessee in a leveraged lease defaults, the owner participant is exposed to two risks: the risk that it will lose its remaining investment and the return it expected to make on that investment to the date of termination (the equivalent of principal and interest on a loan) *and* the risk that it will be required to recognize a substantial amount of taxable income sooner than it projected when (as will happen here) the lenders foreclose on their collateral, or the collateral is otherwise disposed of (resulting in a recapture of tax deductions previously derived by the owner participant).

Under U.S. tax law, the disposition (including by foreclosure) of an aircraft is treated as a sale of the aircraft for the amount of the outstanding debt, and the owner participant realizes taxable income to the extent that such deemed sales price exceeds its basis in the collateral (which has been depreciated over the course of the lease). *Commissioner v. Tufts*, 461 U.S. 300 (1983); *Parker v. Delaney*, 186 F.2d 455 (1st Cir. 1950); Rev. Rul. 76-111, 1976-1 C.B. 214; Treasury Regulation Section 1.1001-2(a)(1). Like many (if not most) of Delta's

leveraged lease owner participants, DFO already has been asked to consent to the foreclosure of a number of its aircraft. Experience from other airline bankruptcies indicates that foreclosure of DFO's entire portfolio within a few months of the Debtor's emergence from bankruptcy is likely to occur. Gebler Affidavit at ¶ 6.

The parties understood this risk when the leveraged lease documents were drafted. It is the fundamental difference between lenders and owner participants in leveraged lease transactions: both can lose part or all of their original investment, plus their anticipated return (although the lenders have the equity cushion to fall back on), but only the owner participant can lose everything and at the same time be required to recognize a substantial amount of taxable income.

Because the Debtor received so much benefit from DFO through the leveraged lease structure, it agreed to indemnify DFO against such recapture of its previously claims tax deductions. As will be discussed in the next section, all parties agreed that, regardless of the collateral pledged to the lenders, and regardless of whether DFO received its tax indemnity from a claim under the Indemnity Agreement or from a payment of SLV by the Debtor, the tax indemnity belonged solely to DFO and would survive Lease termination and foreclosure. That indemnity (along with a smaller claim for DFO's expenses under general indemnity provisions in the relevant agreements) forms the basis of DFO's claims.

In other words, in leveraged lease transactions, both the lenders and the owner participant are exposed to the lessee's credit risk and, although they allocate that risk through the documents, it is never entirely eliminated. In the bankruptcy context, even though the lenders have the equity cushion to include in their claims, their unsecured claims may be paid in "tiny

bankruptcy dollars”<sup>1</sup> with the result that they do not recover the full amount of principal and interest owed to them; the owner participant takes the risk that it will lose its entire remaining investment to the lenders, just as a subordinated lender would recover principal and interest on its loan only after the senior lenders had been paid in full. Only the owner participant, however, is exposed to the additional risk of tax liability. Although the owner participant also may recover only “tiny bankruptcy dollars” on its unsecured tax indemnity claim, it would never agree to “go totally naked” as to this risk.

Two often-cited treatises on leveraged leasing succinctly capture both the essential benefits of leveraged leasing from an airline’s perspective and the critical role the tax indemnity plays in allowing the airline to secure those benefits. See 1 *Equipment Leasing – Leveraged Leasing* 614 (Bruce E. Fritch, Albert F. Reisman & Ian Shrank eds., 3d ed. 1988) (Lessee Economics, “Thus, the primary objective in a leasing transaction is often the sale of tax benefits to the lessor in exchange for a lease rate that is lower than the lessee’s borrowing rate.”).

Because “tax benefits are fundamental ingredients of the economic rationale for [leveraged lease] transactions. . . , *the preservation of those benefits is a high priority*” and is accomplished through “[t]he most significant aspect of a tax-oriented lease instrument . . . , [namely,] the elaborate detail with respect to indemnities for federal income taxes.” [emphasis supplied] 4 *Asset-Based Financing: A Transaction Guide* § 35.08 at 35-24, 35-25 (Howard Ruda ed., Matthew Bender 1993).

With this understanding of the parties’ different risks, we can turn to the analysis of how those risks were allocated in the relevant documents.

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<sup>1</sup> See *In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey*, 160 B.R. 882, 883 (Bankr. S.D.N.Y. 1993).

## II. THE OPERATIVE DOCUMENTS PRESERVED THE TAX INDEMNITY SOLELY FOR DFO

Analysis of the duplication question presented by TIA/SLV Objection 1 requires the Court to take a detailed look at both the elements that make up a SLV computation and how those separate elements are treated.

Attached to the Gebler Affidavit are four Operative Documents critical to the Court's analysis, all from one representative DFO transaction (capitalized terms are as defined in these agreements): the Lease, Indemnity Agreement, Participation Agreement and Indenture. This section of the response first discusses the precise elements that make up the SLV computation and then looks at how the parties preserved either the claim under the Indemnity Agreement or the tax reimbursement portion of SLV for DFO under all circumstances.

As with any contract dispute, the Court should find a way to harmonize all provisions of each of the Operative Documents. *In re Vanderveer Estates Holdings, Inc.*, 283 B.R. 122, 134 (Bankr. E.D.N.Y. 2002) (“Agreements that are executed together as part of a single transaction must be construed in a way that harmonizes them.”); *Liberty USA Corp. v. Buyer's Choice Ins. Agency LLC*, 386 F. Supp. 2d 421, 425 (S.D.N.Y. 2005) (“In New York, it is the general rule that written contracts executed simultaneously and for the same purpose must be read and interpreted together.”); *India.Com, Inc. v. Dalal*, 412 F.3d 315, 323 (2d Cir. 2005) (citing *Reda v. Eastman Kodak Co.*, 649 N.Y.S.2d 555, 557 (N.Y. App. Div. 1996)) (“[U]nder New York law, ‘effect and meaning must be given to every term of the contract, and reasonable effort must be made to harmonize all of its terms.’”); *In re Aerovias Nacionales de Colombia, S.A. Avianca*, 323 B.R. 879, 888 (Bankr. S.D.N.Y. 2005) (“It is a cardinal principle of contract construction that a document should be read to give effect to all its provisions and to render them consistent with each other.”). The way to do so here already exists in the Operative Documents,

for the parties drafted for the circumstance where DFO suffers a taxable event at the same time that the Indenture Trustee exercises remedies under the Lease.

**A. SLV Consists of Different Components, Which Are Treated Differently under the Relevant Documents.**

SLV and Termination Value (“TV”) are intended as liquidated damage amounts applicable under loss, default or other lease termination scenarios. SLV and TV are defined identically in the Lease to mean, for any particular date, the amount determined by multiplying the percentage set forth on Exhibit B to the Lease for such date against the Lessor’s Cost (roughly the purchase price for the Aircraft). See Lease, Section 1 (definitions of “Stipulated Loss Value” and “Termination Value”).

The calculations described in Exhibit B result in a number – that number is then used in different provisions of the Lease to describe what the Debtor must pay on a particular date to satisfy its obligations under the Lease when it terminates early. TV is used to determine what the Debtor pays when it voluntarily terminates the Lease because the aircraft is obsolete or surplus to its needs; SLV is used to determine what the Debtor pays when an Event of Loss occurs and the Debtor elects not to replace the Aircraft, or when a Lease Event of Default has occurred, the Lease terminates and the Debtor must pay liquidated damages. See Lease, Sections 9 (Voluntary Termination), 10 (Loss, Destruction, Requisition, etc.) and 15 (Remedies).

SLV and TV generally are calculated to produce enough funds to (i) repay the debt, with or without premium; (ii) pay to the equity investor the portion of its original investment not yet recovered through the cash flows under the Lease or the tax benefits derived by it to date; (iii) pay to the equity investor its yield on the amount described in clause (ii), from the date of the last rent payment; (iv) provide the equity investor with the present value of its residual interest in the aircraft remaining after the scheduled expiration of the Lease term; and

(v) pay all income tax liability resulting from the early termination of the Lease. *See* 1 *Equipment Leasing – Leveraged Leasing* 154-155 (Bruce E. Fritch, Albert F. Reisman & Ian Shrank eds., 3d ed. 1988). That was done here. Gebler Affidavit at ¶ 5.

The amount described in clause (i) above represents the lenders' remaining investment in the transaction, consisting of the outstanding principal on their loans, together with interest through the date of termination, and premium, if applicable (hereinafter, the "Debt Amount"). The amounts described in clauses (ii) through (iv) above represent the owner participant's entire remaining investment in the transaction and its return on that investment to the date of termination (hereinafter, the "Equity Cushion"). The amount described in clause (v) above represents the tax reimbursement portion of SLV (hereinafter, the "Tax Portion of SLV").

As discussed further below, the relevant documents allocated the risks addressed by each of the components of SLV to the parties in different ways, depending upon the situation. Before turning to the specific SLV provisions in the relevant documents, however, it is necessary to examine the Indemnity Agreement in detail.

**B. The Indemnity Agreement and Related Provisions of Other Relevant Documents Ensure that Only DFO is Entitled to the Debtor's Indemnity for Taxes.**

The Indemnity Agreement generally requires the Debtor to indemnify DFO for any income taxes it incurs from an early termination of the Lease.<sup>2</sup> To this extent, there is a relationship between claims made under the Indemnity Agreement and the Tax Portion of SLV, but any duplication is eliminated when the structure of the transaction and specific provisions of

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<sup>2</sup> See Indemnity Agreement, Section 8 (requiring the Debtor to indemnify DFO for, among other things, additional Federal income taxes payable by DFO for any taxable year in which DFO, by reason of acts or omissions of the Debtor, must include in its gross income amounts greater than those assumed or earlier than at such times as assumed).

the documents relating to the interplay between claims under the Indemnity Agreement and adjustments to SLV under the Lease are examined.

The Court first should note that the Indemnity Agreement is a bilateral agreement between the Debtor and DFO. None of the Owner Trustee, the Indenture Trustee or the lenders is a party to the Indemnity Agreement or has any rights under it. This structure ensures that the indemnities provided by the Indemnity Agreement run directly to DFO and are not included in the Indenture Estate held by the Owner Trustee. Thus, when the Owner Trustee pledged collateral to the Indenture Trustee to secure the debt, it did not pledge the Indemnity Agreement or any rights under it to the Indenture Trustee for the benefit of the lenders.

In addition, the Granting Clause of the Indenture expressly excludes from the collateral pledged to secure the debt certain property defined as “Excepted Payments.” In order to make absolutely clear that no part of DFO’s indemnities under the Indemnity Agreement was intended to be pledged to the Indenture Trustee, “Excepted Payments” is defined to include “(i) indemnity payments and interest thereon paid or payable by the Lessee to the Owner Participant. . . under the Indemnity Agreement,” and any right to enforce the payment of any such amounts. Indenture, Article I, Definition of “Excepted Payments”, clauses (i) and (v).

Further, to ensure that DFO always would receive such tax indemnities, as well as other Excepted Payments owed to it, the Indenture contains a clawback mechanism which provides that “[n]otwithstanding anything to the contrary contained herein, any sums received by the Indenture Trustee which constitute Excepted Payments shall be distributed promptly upon receipt by the Indenture Trustee directly to the Person or Persons entitled thereto.” Indenture, Section 5.04(c). Payments to the lenders under the “waterfall” distribution provisions of the Indenture after an Indenture Event of Default are expressly subject to the foregoing provision, so

that any Excepted Payments owing to DFO are excluded from amounts paid to the lenders and instead are paid by the Indenture Trustee directly to DFO. See Indenture, Section 5.03.

The separateness of these rights from the collateral pledged to the debt is reinforced by Section 10 of the Indemnity Agreement, which provides that the Debtor's obligations under the Indemnity Agreement survive termination of the Lease, and transfer of the Aircraft, the Lease or the Participation Agreement pursuant to any exercise of remedies by the Indenture Trustee until all such obligations have been met and such liabilities have been paid in full.

Section 13 of the Indemnity Agreement states that payments made by the Debtor thereunder shall be paid directly to DFO "and no such payment shall constitute a part of the corpus of the Trust or the Indenture Estate."

With all of the care that the parties took to ensure that the Debtor's indemnity under the Indemnity Agreement would go solely to DFO, the Court well may ask why the Tax Portion of SLV even was included in SLV in the first place (the entire basis of the duplication argument) and not just addressed separately through the Indemnity Agreement.

The answer to that question is that SLV is payable under a variety of circumstances and that practical concerns make inclusion of the tax reimbursement component in the SLV payment desirable. Two examples will demonstrate how the relevant documents carry out the parties' business objective of assuring that amounts due DFO would be paid to DFO with both speed and certainty.

When there is an Event of Loss, SLV is intended to be and generally is paid from insurance proceeds<sup>3</sup>.

The owner participant wants the insurer to cover its entire exposure, including its tax exposure, in a loss situation. This is accomplished by including an amount to cover tax liability in SLV; insurance proceeds are paid to the Indenture Trustee (so long as the Indenture is in effect) and, after the debt has been paid, flow through the waterfall in the Indenture, to the Owner Trustee for distribution to the owner participant.<sup>4</sup>

Another reason an amount for tax liability is included in SLV is that the Indemnity Agreement contains complex provisions for making demand on the Debtor for a tax indemnity claim, for third party verification and for contesting that claim.<sup>5</sup> At a minimum, making a claim under the Indemnity Agreement will involve a delay in receiving payment that generally does not occur when payments of SLV are made under the Lease. Again, the parties addressed that by including the Tax Portion of SLV in SLV.

**C. The SLV Adjustment Mechanism Eliminates the Alleged Duplication of Claims.**

One of the major shortcomings of TIA/SLV Objection 1 is that by describing the relevant documents only in the broadest terms without focusing on the precision that the parties

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<sup>3</sup> Section 11, first proviso of the Lease requires Lessee to maintain hull insurance in an amount not less than SLV; under the fifth paragraph of that section, all policies covering loss or damage must provide that losses are payable solely to the Indenture Trustee so long as the Indenture is in effect.

<sup>4</sup> The Court approved a Loss Payment Agreement following an Event of Loss in this bankruptcy [Docket No. 4759]. An unredacted copy of the Loss Payment Agreement is filed as Exhibit E to the Gebler Affidavit so that the Court can see how this waterfall works.

<sup>5</sup> These are detailed in Section 6, 8 and 9 of the Indemnity Agreement.

employed in crafting and documenting their agreement, the pleading fails to convey to the Court the care that the parties to the Operative Documents took to preserve the tax indemnity for DFO - whether paid through the Indemnity Agreement or under the Lease as the Tax Portion of SLV - while still avoiding duplication of claims.

Although TIA/SLV Objection 1 refers to bankruptcy principles that protect creditors from another creditor's receiving more than a ratable distribution by making two claims for the same loss, that risk does not exist here, because the relevant documents contain a mechanism that assures that the Debtor will not make duplicate payments. As noted in paragraph 31 of the TIA/SLV Objection 1, the Participant Agreement provides that SLV is adjusted downward (and the Indenture Trustee's claim adjusted accordingly) upon payment of an indemnity claim due DFO. See Participation Agreement, Section 8(c).

The only constraint on such recomputation of SLV is that after making the adjustments, SLV cannot be reduced below an amount equal to principal and interest, and premium (if any), on the debt. See Lease, Section 1 (Definition of "Stipulated Loss Value"), clause (y); Section 23. The Operative Documents are filled with instances where SLV can be adjusted up or down by the Debtor and DFO, *without the consent of the Indenture Trustee*, so long as that adjustment does not result in a number that is less than the amount owed to the debt.<sup>6</sup>

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<sup>6</sup> See Participation Agreement, Section 8(c)(if any amount is paid by Lessee to the DFO under the Indemnity Agreement, SLV shall be recomputed as set forth in 3(e) of the Lease); Sections 20 (Refunding of Debt), 21 (Transition Status of Aircraft) and 22 (Adjustments and Reoptimization)(providing for circumstances under which SLV may be adjusted); but see Section 22(a)(last sentence)(no adjustments pursuant to Sections 21 or 22 shall reduce SLV below the amount due on the debt); Lease, Section 23 (no provision of the Participation Agreement or the Lease shall result in adjustments to SLV below the amount equal to the debt then outstanding).

Reading the SLV adjustment provisions in isolation, one might conclude that the only amount of SLV that the lenders bargained for as collateral was the first component--the Debt Amount; why else give another party the right to make that adjustment without their consent? But, as noted, the Court cannot interpret the Operative Documents by reviewing only selective portions. Instead, all provisions must be harmonized and given effect.

When that is done it is clear that the adjustment to SLV required by the Participation Agreement when a payment is made under the Indemnity Agreement affects only the portion of SLV relating to DFO's tax risk, which is the only portion for which the DFO claims seek recovery.<sup>7</sup>

**D. When All Relevant Provisions of the Documents are Read Together, They Not Only Harmonize but They Also Produce a Result that is Consistent with the Way the Parties Allocated Risk.**

A good example of how all of the provisions discussed above work in the context of a Lease termination is the treatment of an Event of Loss under the relevant documents. When an Event of Loss occurs with respect to the Aircraft, the Debtor has the option of (i) paying SLV, together with certain other amounts, and terminating the Lease or (ii) replacing the Aircraft and continuing the Lease (with an adjusted SLV and TV schedule, if necessary). See Lease, Section 10(a)(i) and (ii).

As discussed above, if the Debtor exercises the option to terminate the Lease (which is required under certain circumstances), the payment of SLV generally is funded by the Debtor's insurance carrier, so the parties can be reasonably sure that the full payment will be made.

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<sup>7</sup> DFO's proofs of claim also seek recovery of its out of pocket expenses under the general indemnity provisions of the Participation Agreement. TIA/SLV Objection 1 does not object to this portion of DFO's claims.

As detailed in Exhibit E to the Gebler Affidavit, the insurance proceeds are paid to the Indenture Trustee, who then distributes the payment received in accordance with the waterfall provisions of the Indenture, with the result that after the Debt Amount, together with certain fees and expenses, are paid in full, the remainder of SLV is paid to the Owner Trustee for distribution to the Owner Participant under the Trust Agreement. See Indenture, Section 5.02.

The result is that the lenders receive the Debt Amount and the Owner Participant receives the Equity Cushion and the Tax Portion of SLV. As the Lessee has fully performed under the Lease and the Owner Participant has been paid an amount in respect of its taxes, the Owner Participant specifically agrees pursuant to Section 7(c) of the Indemnity Agreement to waive a claim under the Indemnity Agreement for its tax liability resulting from the Event of Loss.

Significantly, the exclusion in Section 7(c) of the Indemnity Agreement applies only “to the extent that the calculation of [SLV] . . . accurately reflect[s] the timing of the loss of any tax benefit reflected in the calculation of [SLV].” Whether or not the calculation of SLV accurately reflects the timing of the Owner Participant’s loss of tax benefits is relevant, of course, only to the Owner Participant. Hence, the language of the exclusion itself, by applying only when SLV is tailored to accurately reflect the Owner Participant’s loss, also indicates that the exclusion is intended to apply only when the Owner Participant actually receives the Tax Portion of SLV. That result occurs only when the Debtor is “required to pay” SLV in the Event of Loss scenario.

The treatment of SLV is different in a default scenario. Here, the Court must look to the remedies section of the Lease.

Section 15 of the Lease sets forth the remedies available to the Indenture Trustee, as assignee of the Owner Trustee:

- (a) the Indenture Trustee can demand return of the Aircraft or can enter the Debtor's premises to repossess it;
- (b) the Indenture Trustee can sell the Aircraft at a public or private sale, or re-lease the Aircraft to another user, or keep it idle;
- (c) the Indenture Trustee can, by written notice to the Debtor, demand that the Debtor pay the excess of SLV over the Fair Market Value of the Aircraft (as determined through negotiation with the Debtor or an appraisal process);
- (d) if the Indenture Trustee has sold the Aircraft, it can by written notice to the Debtor, demand that the Debtor pay the excess of SLV over the net proceeds of such sale;
- (e) if the Indenture Trustee has not sold the Aircraft, it can by written notice to the Debtor demand that the Debtor pay SLV, together with certain other amounts, provided that upon its receipt of such amounts, the Indenture Trustee must then use its best efforts to sell the Aircraft and must pay over to the Debtor the net proceeds of such sale; and
- (f) the Indenture Trustee can terminate the Lease or exercise any other remedy available to it at law or proceed in court to enforce the terms of the Lease or recover damages for the Debtor's breach. See Lease, Section 15 (for convenience, the letter designation for each remedy described above corresponds to the paragraphs in Section 15 in which such remedy is described).

None of these remedies contemplates a scenario in which the Lessee keeps possession of the Aircraft. Indeed, a provision commonly known as "equity squeeze" protection prohibits the elimination of the Owner Participant's interest only to have the Indenture Trustee

and the Lessee make a side deal (as is happening across Delta's fleet) that allows the Lessee to keep possession of the Aircraft.<sup>8</sup>

Among the remedies available to the Indenture Trustee, only the remedy set forth in Section 15(e) involves a demand that the Debtor pay SLV. Sections 15(c) and (d) of the Lease mention SLV, but require that the Debtor pay an amount that is less than SLV. Sections 15(a), (b) and (f) do not mention SLV. This, no doubt, is why the Debtors and the Committee maintain that the basis for the BNY's claims is Section 15(e) of the Lease. TIA/SLV Objection 1, ¶ 28.

Significantly, unlike the situation when an Event of Loss has occurred and the Debtor has failed to replace the Aircraft, the occurrence of an Event of Default and an exercise of remedies is not an event where the Debtor automatically "is required to pay" SLV. Rather, the Indenture Trustee must confer with the lenders, decide upon its remedy and make a demand upon the Debtor for payment. In reality, this process takes time. The Indenture Trustee may, in fact, never demand the payment of SLV under Section 15(e) of the Lease (as is the case here, as discussed in the next section of this response), as several other remedies are available to it under the Lease.

Until the Indenture Trustee makes its demand, however, the Debtor is not "required to pay" SLV under Section 15(e) of the Lease and the exclusion in Section 7(c) of the Indemnity Agreement does not apply. Thus, even if the Debtor's and the Committee's interpretation of Section 15(e) were correct, before the Indenture Trustee makes its demand under Section 15(e), DFO could demand payment under the Indemnity Agreement and adjust

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<sup>8</sup> See, e.g., Indenture, Section 7.02(a)(last sentence)(providing that the Indenture Trustee can foreclose the lien of the Indenture or otherwise dispossess the Owner Trustee of title to the Aircraft only to the extent that, if it is then entitled to do so, the Indenture Trustee proceeds to exercise one or more of the remedies with respect to the Aircraft referred to in Section 15 of the Lease).

SLV under the Lease, with the result that the Indenture Trustee would be deprived of the Tax Portion of SLV which the Debtors and the Committee contend is pledged to secure the debt.

In other words, the logic of the Debtor and the Committee, considered in context, leads to the conclusion that the first of the Indenture Trustee and DFO to demand SLV or a payment under the Indemnity Agreement, respectively, from the Debtor gets the tax claim. Surely the parties did not intend to set up such a contest.<sup>9</sup>

In fact, although Section 15(e) of the Lease at first appears to require payment of SLV, an examination of the entire provision reveals that such payment triggers a sale of the Aircraft by the Indenture Trustee *and* a return of the net proceeds of sale to the Debtor. Hence, the Debtor is not really “required to pay” SLV under this provision at all--this remedy is no different from that contained in Section 15(d), except as to the timing of the sale and payment.

Thus, contrary to the assertion in TIA/SLV Objection 1 and to the situation that applies if an Event of Loss occurs, there is no provision in the remedies section of the Lease under which the Debtor actually is “required to pay” SLV. The economic rationale for this understanding is that the Aircraft will be repossessed and either sold or re-leased. See Lease, Section 15(a), (b), (c), (d) and (e). Hence (as discussed in the next section of this response when we examine the substance of the BNY claims), the proceeds of the disposition are available to offset the Debtor’s payment obligation and the Debtor is not be required to pay SLV. As a result, the exclusion in Section 7(c) of the Indemnity Agreement does not apply and DFO is

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<sup>9</sup> Another result dictated by the Debtor’s and the Committee’s interpretation of how the exclusion in Section 7(c) of the Indemnity Agreement and the remedies in Section 15(e) of the Lease work together is that after the Tax Portion of SLV is paid to the lenders (together with the Debt Amount and the Equity Cushion), the Debtors will receive the net proceeds from the sale of the Aircraft--all at a time when DFO will incur an enormous tax liability for which it retains no indemnity. The parties could not have intended this result.

entitled to claim its indemnity under Indemnity Agreement, while the amount of SLV set forth in the Lease then is adjusted accordingly.

This is not only the result intended by the parties, it is the right result. The SLV set forth in the Lease after such adjustment will continue to include not only the Debt Amount, but also the Equity Cushion. The claim for the tax indemnity, however, will go to DFO, which after all, is the party that now actually will incur the tax liability for which the tax indemnity was given.

In summary, DFO respectfully suggests that when its leveraged lease documents are examined with the same care with which they were drafted, the alleged duplication issue falls away. No party is receiving more than it bargained for and no party is paying more than the relevant documents require.

### **III. THE FACTS UNDERLYING THE DFO CLAIMS SHOW THAT THE DEBTOR IS NOT REQUIRED TO PAY SLV BECAUSE THE INDENTURE TRUSTEE AND THE LENDERS HAVE NOT EVEN DEMANDED SUCH PAYMENT**

The contention that the Debtor is “required to pay SLV” not only is wrong as a matter of contract interpretation, it is not supported by the facts and circumstances currently existing with respect to the DFO aircraft.

DFO filed claims in respect of eight separate aircraft. Three of those aircraft (N914DL, N915DL and N916DL) are included in the “Bingham Group” – a consortium of lenders who negotiated a global agreement with the Debtor to restructure their leases. That restructuring term sheet (attached to Docket No. 2097) shows that rather than paying an amount equal to SLV (or TV) on account of the rejection of the prepetition leases and losing possession of the Aircraft, as TIA/SLV Objection 1 contends that the Leases require, the Debtor is both keeping possession of the Aircraft and getting credit for, among other things, the present value of

future rentals and the residual value of the aircraft, and thus paying damages far below SLV (or TV).

Similarly, attached to the Gebler Affidavit are copies of the proofs of claim filed in respect of four other aircraft (N954 DL, N955DL, N956DL and N957DL) which show that the Indenture Trustee reduced its claim by an anticipated amount of the residual value of the aircraft (as required by the remedies discussed in Section II. D of this response) and thus is not even seeking to recover SLV.

Of the entire DFO portfolio, only one claim was filed (by the same Indenture Trustee but through a different law firm) for SLV. DFO served discovery regarding the disposition of this aircraft (N958DL) and reserves the right to present testimony at the hearing on TIA/SLV Objection 1 that the exclusion does not apply because of the facts and circumstances regarding that aircraft, just as it does not apply to the rest of the DFO portfolio.

[Conclusion and Signature Page Follows]

## CONCLUSION

TIA/SLV Objection 1 must be denied, insofar as it requests disallowance of the DFO claims, for two reasons. First, the portion of SLV computed with reference to DFO's adverse tax consequences must be reduced when DFO properly files a claim under the Indemnity Agreement (as it has here), so this is not an instance where two parties are seeking recovery for the same claim. Second, an examination of the Lease remedies, as well as the underlying facts relating to these aircraft, shows that the Debtor is not required to pay SLV, so the exclusion cited in TIA/SLV Objection 1 as the alternate basis for the objection to the allowance of the DFO claims does not apply.

Denial of TIA/SLV Objection 1 as to the DFO claims not only is the right decision; it is fair to all parties, for it then leads to the precise implementation of the agreement they struck. As discussed above, and as noted by the Debtor and the Committee in paragraph 31 of their papers, once the DFO claims are paid, an appropriate adjustment is made to the relevant SLV schedules and to the BNY claims, putting each party to the Operative Documents in exactly the position it bargained for in a default scenario.

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