

EXHIBIT B

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**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

----- X
: **Chapter 11**
: **Case No. 05-17923 (ASH)**
: **(Jointly Administered)**
----- X

In re:
DELTA AIR LINES, INC. et al.,
Debtors.¹

**TIA/SLV OBJECTION 1: REPLY MEMORANDUM OF DELTA AIR LINES, INC.
AND THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS**

This Objection Relates To:

Tail Numbers: N914DL, N915DL, N916DL, N954DL, N955DL, N956DL, N957DL and N958DL

Claim Nos.: 5330, 5335, 6694, 6741, 6976, and 6978
Filed by: The Bank of New York, as Indenture Trustee

Claim Nos.: 4914, 4915, 4916, 4921, 4925, 4929, 4930 and 4938
Filed by: DFO Partnership

¹ The Debtors are: ASA Holdings, Inc.; Comair Holdings, LLC; Comair, Inc.; Comair Services, Inc.; Crown Rooms, Inc.; DAL Aircraft Trading, Inc.; DAL Global Services, LLC; DAL Moscow, Inc.; Delta AirElite Business Jets, Inc.; Delta Air Lines, Inc.; Delta Benefits Management, Inc.; Delta Connection Academy, Inc.; Delta Corporate Identity, Inc.; Delta Loyalty Management Services, LLC; Delta Technology, LLC; Delta Ventures III, LLC; Epsilon Trading, Inc.; Kappa Capital Management, Inc.; and Song, LLC.

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Delta Air Lines, Inc. (“**Delta**”) and the Official Committee of Unsecured Creditors (the “**Committee**”), through their undersigned counsel, hereby submit this Reply (the “**Reply**”) in support of their objection to Proof of Claim Nos. 4914, 4915, 4916, 4921, 4925, 4929, 4930 and 4938 (the “**DFO Claims**”), asserted by DFO Partnership (“**DFO**”), seeking tax indemnities with respect to leveraged lease transactions involving the Aircraft identified above, and Proof of Claim Nos. 5330, 5335, 6694, 6741, 6976, and 6978 (the “**BNY Claims**”) asserted by The Bank of New York (“**BNY**”) as indenture trustee, seeking payment of stipulated loss values with respect to the same transactions.

I. The Asserted TIA Claims and SLV Claims Overlap And Seek Recovery For The Same Loss

The Debtors and the Committee contend that as a factual matter, under the circumstances of these cases, the parties’ TIA Claims and SLV Claims each seek compensation for the same loss. SLV Claims include a “tax component” that compensates the Owner Participant for the tax consequences of the events that give rise to the requirement that SLV be paid. The asserted TIA Claims seek compensation for the same tax losses.

DFO (as Owner Participant) has conceded that its TIA Claims overlap with the SLV Claims asserted by BNY in the transactions that are the subject of this Objection. DFO has acknowledged that “SLV and TV generally are calculated to produce enough funds to [among other things] pay all income tax liability resulting from the early termination of the Lease.” DFO refers to this amount as the “the tax reimbursement portion of SLV.” DFO Response at 9-10. DFO’s principal argument is that it did not pledge this “Tax Portion” of SLV to the Indenture Trustee, and that it instead retained all rights to the “Tax Portion” of SLV. DFO has even submitted an affidavit that purports to illustrate this “tax portion” of SLV. *See* Exhibit 6 attached

to Affidavit of Timothy C. Glenn in Support of Response of DFO Partnership to TIA/SLV Objection 1 (“**Glenn Aff.**”).

Other parties have made similar concessions. For example, Philip Morris Capital Corporation has conceded that “[t]he calculation of Stipulated Loss Value includes all amounts which comprise the Tax Indemnity Claims that have now been asserted in the Proof of Claim” and that for “each Leveraged Lease Transaction, the Tax Indemnity Claim amount so included in the calculation of Stipulated Loss Value is equal to the amount set forth in the Proof of Claim for that transaction.” *See* TIA/SLV Objection 3, Annex A.

Nevertheless, some parties – including the SLV Claimants whose claims are subject to this Objection – have refused to admit that an overlap exists, and have insisted that proof be obtained and offered. *See, e.g.*, Response of Cargill Financial Services, Inc. to TIA/SLV Objection 1, at 15-16; Response of Strategic Value Partners, LLC to TIA/SLV Objection 1, at 13-14; Response of Wilmington Trust Company, As Owner Trustee, to TIA/SLV Objection 1, at 20-21.² It is noteworthy that none of the parties who has demanded proof has denied that an overlap exists; they simply demand that proof of the overlap be submitted.

Litigants have the right to demand proof. To the extent that this Court were inclined to rule that DFO’s TIA Claims take priority over the pending SLV Claims, for example, the SLV Claimants would be entitled to discovery and to an evidentiary hearing to verify the amount of

² Strategic Value Partners has suggested that the lack of “evidence” is somehow a defect in the Objection itself. *See* Response of Strategic Value Partners LLC, at 2-3, 13-14. However, an objection to a claim merely “initiates a contested matter,” *In re Simmons*, 765 F.2d 547, 552 (5th Cir. 1985). A party is not required, in the Objection itself, to include all of the evidence that it might eventually use to prove its claims. The Objection must only “allege those facts necessary to support the objection . . . and provide a description of the theories on which it is based.” *See* RESNICK, ALAN N. & HENRY J. SOMMER, 9 COLLIER ON BANKRUPTCY - 15TH EDITION REV. ¶ 3007.01[3] (15TH ED. REV. 2006). The Objection has done just that.

the overlap between the claims. That evidence would be developed primarily through discovery of the pricing formulas that the Owner Participants used to generate the SLV schedules in the first place.

No such further discovery or inquiry is required to resolve this particular Objection, however, because DFO (as Owner Participant) has conceded, on its part, that the overlap exists, and because the parties' agreements plainly provide that DFO's TIA claims must be extinguished whenever competing SLV Claims are payable, as explained below.

II. A Single Loss Can Only Give Rise To A Single Claim, And To The Extent That SLV Claims And TIA Claims Overlap, Only One Claim May Be Allowed

A "claim" in bankruptcy is a "right to payment." 11 U.S.C. § 101. The parties' collective "claims" against Delta in bankruptcy cannot exceed their collective "right to payment" outside bankruptcy. All parties have conceded that their collective "right to payment" outside bankruptcy does not exceed the "stipulated loss value" that is specified for each transaction. Delta and the Committee submit that this necessarily means that their collective TIA Claims and SLV Claims, in bankruptcy, cannot exceed the amount that would be payable (outside bankruptcy) as SLV.

Some parties have argued that the "losses" for which the Indenture Trustees and the Owner Participants are seeking recovery are not the same, because the Indenture Trustees are seeking to recover "debts" as "secured lenders." *See, e.g.,* Response of Strategic Value Partners, LLC to TIASLV Objection 1, at 16-17. However, the Indenture Trustees' "debt" claims are **not** claims against Delta. The "debt" claims may be asserted solely against the Owner Trustee, who borrowed money to finance the acquisition of the Aircraft. Delta is not an obligor on any of those debt obligations. The actual "claims" that are being asserted by the Indenture Trustees against Delta are not "debt" claims at all: they are SLV Claims that originally belonged to the

Owner Participants and the Owner Trustees, and that were pledged to the Indenture Trustee as collateral. Those SLV Claims address the same tax “losses” of the Owner Participants as are addressed through the tax indemnity agreements.

Other parties have contended that the position taken by Delta and the Committee allegedly would make the Tax Indemnity Agreements superfluous. *See* Response of the Verizon Owner Participant As Amicus Curiae to TIA/SLV Objections 1 through 4, at 8; Response of BNY Lease Equities (Cap Funding) LLC and BNY Capital Resources Corporation to TIA/SLV Objections 1, 2, 3, and 4, at 2; Response of The Northwestern Mutual Life Insurance Company to TIA/SLV Objection 2, at 4, 8. However, the Tax Indemnity Agreements cover tax losses that may arise in many different situations, and are not limited to situations in which SLV also is payable. A typical Tax Indemnity Agreement, for example, covers tax losses that arise out of “any” misrepresentation or action by the Lessee that results in a recapture of a depreciation deductions or a loss of other expected deductions. *See, e.g.*, TIA for N914DL, § 6 (Ex. B attached to First Amended Affidavit of David B. Gebler in Support of Response of DFO Partnership to TIA/SLV Objection 1 (“**Gebler Aff.**”). There are a host of situations in which the Tax Indemnity Agreements apply and in which SLV would not be payable. Just by way of example:

- If Lessee uses the aircraft outside the country, or subleases the Aircraft to a non-US person, the Owner Participant would lose depreciation deductions, and would be entitled to compensation under the TIA.
- Through the TIA, the Lessee promises to treat the Lease as a “true lease” for tax purposes, and has made various other representations relevant to the “true lease” characterization. *See* TIA, §§ 2(a), 3, 5(f) (Gebler Aff. Ex. B). If the Lessee were to

breach these representations, the Owner Participant would lose tax deductions and would be entitled to assert claims under the TIA.

- TIAs sometimes include “income inclusion” triggers that are applicable, for example, if a Lessee makes improvements to an Aircraft and if those improvements have the result of generating unexpected “Rent” income to the Lessor. *See* TIA, § 8.

Delta and the Committee are not seeking to expunge all claims that ever might be asserted under a Tax Indemnity Agreement. Delta and the Committee are merely seeking to eliminate duplication where, as here, the TIA Claims **do** overlap with SLV Claims.

The existence of two legal bases for the same recovery constitutes only one “claim,” and this is true regardless of whether the theories are asserted by a single creditor or by different creditors. *See* TIA/SLV Objection 1, at 10-13, and cases cited therein. Strategic Value Partners has contended that the cases cited by Delta and the Committee involved either a single creditor or “co-debtors” and that none of the cited cases involved claims “asserted by distinct creditors.” *See* Response of Strategic Value Partners LLC, at 18, ¶ 45 and n. 11. However, that is simply not true. Several of the decisions involved claims by different creditors arising out of different legal theories. *See, e.g., In re Brinke Transp., Inc.*, No. 87-03785, 1989 WL 233147, at *3 (Bankr. D.N.J. Jan. 23, 1989) (NLRB’s regulatory claim for unfair labor practice and union’s separate contract claim under collective bargaining agreement); *In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey*, 160 B.R. 882, 894 (Bankr. S.D.N.Y. 1993) (plan trustee’s claim for required plan contributions and PBGC’s statutory claim for unfunded benefit liabilities).³ The decision in each case was based on the fact that a single loss can give rise only

³ *See also In re Chauteaugay Corp.*, 115 B.R. 760 (Bankr. S.D.N.Y. 1990). In that case, although the PBGC asserted two claims, it did so in two different capacities: one as regulator, and one as the successor trustee of a pension plan.

to a single claim, and had nothing to do with “co-debtor” status. *See Brinke*, 1989 WL 233147, at *3 (union and NLRB both asserted claim against debtor to compensate for the same loss; no co-liability with debtor); *Finley, Kumble*, 160 B.R. at 894 (debtor’s liability was to PBGC or plan, not directly to plan participants).

It is the nature of the claim that is being asserted – **not** the identity of the assignee who holds the claim – that determines whether the claim is duplicative of another claim. If (as Strategic Value Partners and other parties seem to admit) the Owner Participant would be barred from obtaining a “double recovery” for its tax losses by asserted both a TIA Claim and an SLV Claim, the same result still holds true after the Owner Participant has assigned the SLV Claim to another party. The assignment does not change the fact that the claims seek recovery of the same loss, are duplicative of each other and cannot both be allowed. *See In re Simetco, Inc.*, 1996 WL 651001 (Bankr. N.D. Ohio Feb. 15, 1996) (rejecting duplicative claims asserted by PBGC in two different capacities – one of which the PBGC acquired from a prior plan trustee – and holding that “There is nothing in ERISA or the Bankruptcy Code which would indicate that a party with two related claims should recover on the second if the first is not fully paid.”).

Most importantly (for purposes of this particular Objection), DFO has not made many of the arguments that other parties have made. To the contrary: DFO argues that the reference to “Excepted Payments,” which includes payments “under the Indemnity Agreement,” should be interpreted as reducing the amount of the SLV claim that was pledged to the Indenture Trustee. DFO’s contractual argument necessarily admits that the two claims are one and the same.

III. DFO Pledged The Entirety Of The SLV Claim To The Indenture Trustees, And Not Just A Portion Of The SLV Claim

DFO acknowledges that the parties’ agreements provide two separate mechanisms for recovery of the same potential tax loss: (1) the recovery of SLV pursuant to the Lease, and (2)

the recovery of tax indemnity payments pursuant to the Indemnity Agreement. *See* DFO Response at 10-13. DFO points out that the parties' agreements reserve, for DFO, the rights to collect sums that are payable "under the Indemnity Agreement." DFO Response at 10-13. DFO then argues that this reservation should be interpreted as also carving out the "Tax Portion" of SLV from the collateral that was pledged to the Indenture Trustees. *Id.* However, that is contrary to what the underlying agreements state.

The collateral pledged to the Indenture Trustees under the Indentures excludes "Excepted Payments." By its terms, the definition of "Excepted Payments" is limited to "indemnity payments and interest thereon paid or payable by the Lessee to the Owner Participant . . . under the Indemnity Agreement." *See* Trust Indenture and Security Agreement ("**Indenture**"), at p. 8 (Gebler Aff. Ex. D). More particularly, the Indenture provides that "Excepted Payments" includes the following:

"Excepted Payments" means (i) indemnity payments and interest thereon paid or payable by the Lessee to the Owner Participant or the [Owner Trustee] in its individual capacity pursuant to Section 8 of the Participation Agreement or under the Indemnity Agreement . . .

Id. The definition of "Excepted Payments" does not refer to Stipulated Loss Value at all, and by its terms it does not encompass any amounts payable under the "Lease."

By contrast, DFO's pledge (to the Indenture Trustees) of all payments due under the Lease is clear and unqualified. The Indentures each state that the assigned collateral includes "[t]he lease and all Rent thereunder, including, without limitation, all amounts of Basic Rent and Supplemental Rent, and payments of any kind thereunder and including . . . powers or remedies on the part of the Owner Trustee, whether arising under the Lease . . . or otherwise arising out of any Lease Event of Default." *See* Indenture at 4, Granting Clause § 1 (Gebler Aff. Ex. D).

"Stipulated Loss Value" is payable under the Lease and plainly falls within this broad grant of

security interests. The Indenture assigns, to the Indenture Trustee, an interest in “all” payments under the Lease, with no exclusion for any “component” of SLV.

Furthermore, the definition of “Excepted Payments” – on which DFO relies so heavily – is limited to sums that are “payable” under the Indemnity Agreement. *See* Indenture at 8 (Definitions) (Gebler Aff. Ex. D). However, Section 7(c) of the Indemnity Agreement states plainly that no amounts are “payable” under the Indemnity Agreement in any situation in which a party is required to pay Stipulated Loss Value. *See* TIA, § 7(c) (Gebler Aff. Ex. B).

Section 7(c) provides:

“[T]he Owner Participant shall not be entitled to any payment . . . in respect of any Loss or any Foreign Tax Credit Loss arising as a result of one or more of the following events:

. . . .

(c) any event whereby a party to any of the Operative Documents is required to pay Stipulated Loss Value or Termination Value, except to the extent that the calculation of Stipulated Loss Value or Termination Value does not accurately reflect the timing of the loss of any tax benefit reflected in the calculation of Stipulated Loss Value or Termination Value. . . .”

See TIA, § 7(c) (Gebler Aff. Ex. B).

In these cases, therefore, the parties’ agreements plainly resolve the potential conflict between TIA Claims (which were not pledged) and SLV Claims (which were pledged). They do not do so by “carving out” the Tax Portion of SLV and setting that aside for the benefit of the Owner Participant, as DFO wrongly contends. Instead, the agreements resolve the conflict by giving priority to SLV Claims, and by eliminating the TIA Claims in their entirety in situations where SLV is recoverable. The “Excepted Payments” definition does not support a contrary interpretation, because under the terms of the TIAs it is clear that no amount is “payable” under the Indemnity Agreement whenever the Lessee is “required to pay” SLV.

DFO's arguments to the contrary are not consistent with the plain language of the agreements. DFO argues as though the definition of "Excepted Payments" applies not only to amounts payable "under the Indemnity Agreement," but instead applies to all amounts payable under the Indemnity Agreement "or under the Lease, to the extent that they also constitute compensation for potential tax losses of the Owner Participant, including the Tax Portion of Stipulated Loss Value." *See* DFO Response at 10-13. However, that is not what the documents say.

DFO's argument also defies common sense. If (as DFO contends) the parties had intended to exclude the "Tax Portion of SLV" from the collateral package, it would have been easy to say so. Similarly, if the parties had really intended that the "Tax Portion" of SLV would be payable to DFO, then presumably the Stipulated Loss Value tables that are attached to the Lease would have had two columns: one specifying the "Tax Portion" of SLV, and one specifying the "Other Portion" of SLV. However, that is not the way the agreements were constructed. Exhibit B to the Lease, which specifies SLV that is payable over time, lists just a single calculation, and belies DFO's assertion that "the Tax Portion of SLV" was carved out from the pledged collateral and was to be treated separately.

IV. The Contracts Extinguish DFO's TIA Claims Whenever SLV Is Recoverable, Regardless Of Whether SLV Is Partially Collected Through Offsets And Other Recoveries

In each of the transactions that is the subject of this Objection, the Tax Indemnity Agreement provides that DFO has no tax indemnity claim in "any event" where "any party" to any of the Operative Documents is "required to pay Stipulated Loss Value or Termination Value." *See* Section 7 of each TIA (*e.g.*, Gebler Aff. Ex. B). In DFO's view, Section 7(c) of the TIA does not apply unless the Lessee is required to make a cash payment in the full amount of SLV, with no credit or offset for other recoveries or payments. DFO Response at 16. In this

respect, too, DFO's argument is contrary to the plain language of the parties' contracts and to ordinary and well-settled rules of contract interpretation.

A. DFO's Interpretation Is Contrary To The Plain Language of the Lease

The gist of DFO's argument is that the "default" provisions in Section 15 of the Lease do not "require payment" of SLV, because the Lessee's payment obligation is offset by other recoveries. DFO Response at 16. However, the Lease itself treats the Lessee's obligation as equal to the full amount of SLV, and requires the payment of interest on such amount. Furthermore, the Lease itself equates the payment of "offsetted" amounts with the "actual payment" of Stipulated Loss Value.

If an Event of Default occurs under Section 15 of the Lease, the "Lessor" – or the Indenture Trustee by virtue of the assignment of the Lease – has the right to pursue various remedies. Section 15(c) provides that the Lessor may demand payment of the following:

. . . installment of Basic Rent with respect to the Aircraft . . . plus an amount equal to the excess, if any, of (i) the Stipulated Loss Value for the Aircraft computed as of the date specified in Exhibit B hereto . . . over (ii) the Fair Market Value for the Aircraft . . . and, together with such excess, interest, to the extent permitted by applicable law, at the Past Due Rate on the amount of such Stipulated Loss Value, from the date as of which such Stipulated Loss Value is computed to the date of actual payment of such amount;

Lease, § 15(c) (emphasis added) (Gebler Aff. Ex. A).

The Lease itself (through the foregoing interest computation) therefore treats the full amount of Stipulated Loss Value as the payment obligation owed by the Lessee, and requires that the Lessee pay interest on that full amount. Furthermore, the interest computation equates the overall recoveries under Section 15(c) – including the payment of an "offsetted" amount – with an "actual payment" of Stipulated Loss Value. If DFO were correct – and if Section 15(c) were interpreted as meaning that the Lessee is not "required to pay" SLV at all – then the foregoing

interest computation could not be made, because there never would be an “actual payment” of Stipulated Loss Value.

Paragraph 15(d) of the Lease provides that if the Lessor sells the Aircraft, a similar amount is due, but with the “sale proceeds” (rather than fair market value) applied as an offset.

Section 15(d) provides for payment of the following:

. . . an amount equal to the excess, if any, of (i) the Stipulated Loss Value for the Aircraft . . . over (ii) the net proceeds of such sale (after deduction of all expenses of such sale), and, together with such excess, interest, to the extent permitted by applicable law, at the Past Due Rate on the amount of such Stipulated Loss Value, from the date as of which such Stipulated Loss Value is computed to the date of actual payment;

Lease, § 15(d) (emphasis added) (Gebler Aff. Ex. A). Once again, the Lease confirms that the Lessee’s obligation is to pay Stipulated Loss Value; interest is computed on that amount, and the recoveries specified in Section 15(d), including sale proceeds, are treated as “actual payment” of Stipulated Loss Value.

Section 15(e) similarly provides that, prior to a sale, the Lessor may demand payment of Stipulated Loss Value, and then later repay the sale proceeds if and when a sale occurs. In that event, the Lease provides for payment of the following:

. . . an amount equal to Stipulated Loss Value for the Aircraft . . . together with interest, to the extent permitted by applicable law, at the Past Due Rate on the amount of such Stipulated Loss Value, from the date as of which such Stipulated Loss Value is computed to the date of actual payment of such amount; and upon such payment of liquidated damages and the payment of all other Rent then due hereunder, Lessor shall proceed to exercise its best efforts promptly to sell the Airframe and each Engine and shall pay over the Lessee the net proceeds of such sale (after deducting from such proceeds, all costs and expenses whatsoever incurred by Lessor in connection therewith and all other amounts which may become payable to Lessor or the Owner Participant) up to the amount of Stipulated Loss Value actually paid;

Lease, § 15(e) (Gebler Aff. Ex. A).

In all of these situations, the Lease confirms that the Lessee's obligation is to pay Stipulated Loss Value, and interest is computed on that full amount. Partial payment is made through other means, but the Lease itself treats these other recoveries as "actual payments" of Stipulated Loss Value.

B. DFO's Interpretation Would Deprive Section 7(c) Of Any Meaning And Would Render It A Nullity

DFO argues that the Lessee is not "required to pay" Stipulated Loss Value or Termination Value unless the Lessee must pay that amount with no offset for other payments or recoveries. A careful review of the Lease, however, shows that in every situation – including the "Event of Loss" provisions cited by DFO – the Lessee's obligation to pay SLV or Termination Value is offset by some other amount. If Section 7(c) were interpreted in the manner that DFO suggests, it would have no meaning and no application whatsoever.

Section 7(c) of the Indemnity Agreement provides, for example, that there is no tax indemnity claim in any event where the Lessee is required to pay "Termination Value." *See* TIA, § 7(c). DFO acknowledges, however, that there is only one situation in which the "Termination Value" concept is invoked under the Lease: namely, in the event of an optional termination pursuant to Section 9 of the Lease, which gives the Lessee the option to terminate the Lease due to the obsolescence of the leased Aircraft. *See* Lease, § 9 (Gebler Aff. Ex. A); *see also* DFO Response at 9. Section 9 of the Lease provides that in such an event the Aircraft should be sold, and the Lessee "shall pay to Lessor . . . the amount, if any, by which the Termination Value . . . exceeds the sales price received by Lessor" from the sale of the aircraft. *See* Lease, § 9 (emphasis added) (Gebler Aff. Ex. A).

Under DFO's reasoning, the requirement in Section 9 of the Lease would not trigger the exclusion of Section 7(c) because Section 9 requires the Lessee to pay only the excess of

Termination Value over the sales price. Such an interpretation, however, would deprive Section 7(c) of any meaning insofar as it relates to Termination Value, because Section 9 of the Lease is the only circumstance under which the “Termination Value” concept is invoked.

The same is true regarding the reference to “Stipulated Loss Value.” DFO recognizes that its interpretation of Section 7(c) would make no sense unless DFO could identify a circumstance under which a party must pay SLV without any offset, and DFO has attempted to use the provisions relating to an “Event of Loss” to fill that void. However, DFO’s argument is contrary to what the Lease provides. Section 11 of the Lease requires the Lessee to maintain insurance; if an Event of Loss occurs, the insurance proceeds are paid directly to the Owner Participant (or, by virtue of the Indenture, to the Indenture Trustee). The Lease states that these insurance proceeds are then “applied in reduction of Lessee’s obligation to pay . . . Stipulated Loss Value” with respect to the Aircraft. *See* Lease, § 11(a) (emphasis added). Therefore, even if an Event of Loss occurs, the Lessee’s obligation to pay SLV is offset by a payment from another source.

In every instance in which the Lease refers to “Stipulated Loss Value” and “Termination Value” – whether in the Default provisions, the Event of Loss provisions, the early termination provisions, or otherwise – the Lease provides that the Lessee’s obligation to pay SLV or Termination Value is to be offset by other recoveries and payments, either in the form of sale proceeds, fair market value, insurance proceeds or governmental payments. Thus:

- If a default occurs, the Lessor may elect to recover the difference between Stipulated Loss Value and the fair market value (or the actual sale proceeds if the Aircraft is sold). *See* Lease, § 15.

- If payments are received from governmental authorities, Section 10 of the Lease provides that such payments “shall be paid to the Indenture Trustee in reduction of Lessee’s obligation to pay [SLV]” or, “if [SLV is] already paid by Lessee, shall . . . be applied to reimburse Lessee for its payment of such Stipulated Loss Value.” *See* Lease, § 10(c)(i).
- If an Event of Loss occurs, as noted above, insurance proceeds are applied “in reduction” of Lessee’s obligation to pay SLV. *See* Lease, § 11.
- If a Termination Event occurs, the Lessee must pay the “excess” of Termination Value over the sale proceeds. Lease, § 9.

If DFO were correct – and if the presence of an “offset” meant that the Lessee is not “required to pay” Stipulated Loss Value or Termination Value – then Section 7(c) would have no meaning at all. It is axiomatic, however, that no contract should be interpreted in a manner that renders any of its provisions meaningless. *See Two Guys from Harrison-N.Y., Inc. v. S.F.R. Realty Assoc.*, 63 N.Y.2d 396, 403, 472 N.E.2d 315, 318 (1984) (“In construing a contract, one of a court’s goals is to avoid an interpretation that would leave contractual clauses meaningless.”) (citations omitted); *Cornhill Corp. v. S.D. Plants, Inc.*, 9 N.Y.2d 595, 599, 176 N.E.2d 37, 38 (N.Y. 1961) (“It is a cardinal rule of construction that a court should not adopt an interpretation which will operate to leave a provision of a contract . . . without force and effect.”) (internal quotations and citations omitted).

C. DFO’s Argument Also Is Contrary To Common Sense

DFO’s argument is strained in other respects. DFO contends that the only circumstance in which Section 7(c) applies is if an “Event of Loss” occurs under Section 10 of the Lease. However, Section 7(c) refers generally to “any event whereby a party to any of the Operative

Documents is required to pay Stipulated Loss Value or Termination Value.” *See* TIA, § 7(c) (Gebler Aff. Ex. B). If (as DFO contends) the parties had only intended to apply Section 7(c) to an Event of Loss, they would have said so, and they hardly would have chosen such a roundabout and inexact way of accomplishing that objective.

DFO also contends that the reason why Section 7(c) allegedly is limited to an Event of Loss – and allegedly excludes situations where the SLV obligation is offset by other recoveries – is supposedly to ensure that DFO actually receives the Tax Portion of SLV. *See* DFO Response at 16. However, this explanation makes no sense.

Assume, for example, that the SLV as of a given date were \$100; that the Aircraft was insured in the amount of \$80; that the outstanding debt was \$60; and that the fair market value of the Aircraft was \$50. In those situations the Lease provides as follows:

(a) If an Event of Loss occurred, (i) the insurance proceeds of \$80 would be paid to the Indenture Trustee, (ii) the Lessee would pay \$20 to the Indenture Trustee (the difference between SLV and the insurance proceeds), (iii) the Indenture Trustee would repay the outstanding debts of \$60, and (iv) the Indenture Trustee would pay the \$40 balance to the Owner Participant.

(b) If a default occurred, (i) the Indenture Trustee would sell the Aircraft for \$50, (ii) the Lessee would pay \$50 to the Indenture Trustee (the difference between SLV and the sale proceeds), (iii) the Indenture Trustee would repay the outstanding debts of \$60, and (iv) the Indenture Trustee would pay the \$40 balance to the Owner Participant.

In each case the Owner Participant’s recovery would be the same, and would include “full payment” of the “Tax Portion” of SLV. In DFO’s view, however, DFO would still be able to

assert a TIA Claim in the circumstances described in subparagraph (b), above. This makes no sense.

The only reasonable way to interpret Section 7(c) is to apply its exclusion where, as here, Stipulated Loss Value is recoverable, regardless of whether the “payment” of Stipulated Loss Value is partially accomplished through the application of offsets and other recoveries.

V. DFO’s Allegations Regarding Its Individual Financial Interests and Purposes Are Not Relevant In Resolving The Issues Raised By This Objection

DFO argues that the Court should interpret the agreements at issue in light of “the parties’ intentions.” DFO Response at 2, 3-7. According to DFO, among these “intentions” was DFO’s personal desire that it not “go ‘totally naked’ as to [the] risk [at issue].” DFO Response at 7. DFO asks that the Court interpret the “Excepted Payments” definition in light of this alleged “purpose.” This argument is misguided for two reasons.

First, the contractual provisions at issue are susceptible of only one reasonable interpretation. The agreements should be enforced as written, and no inquiry into “purposes” or motives is appropriate unless an ambiguity exists that cannot be resolved through ordinary rules of contract interpretation. *See Schmidt v. Magnetic Head Corp.*, 97 A.D.2d 151, 157, 468 N.Y.S.2d 649, 654 (2d Dep’t 1983); *805 Third Ave. v. M.W. Realty Assoc.*, 58 N.Y.2d 447, 451, 448 N.E.2d 445, 461 N.Y.S.2d 778 (1983); *Rowe v. Great Atl. & Pac. Tea Co.*, 46 N.Y.2d 62, 69, 412 N.Y.S.2d 827, 831 (N.Y. 1978).

Second, DFO’s argument focuses exclusively on DFO’s *individual* financial incentives and purposes, rather than the *mutual* objectives of the contracting parties. DFO’s individual purposes, however, are not the kind of “purposes” that would be relevant to the interpretation of the parties’ contracts, even if an ambiguity were to be found.

Parties to a contract often have purposes that are diametrically opposed to each other. In any purchase agreement, for example, the buyer's purpose is to obtain as low a price as possible. On the other hand, the seller's purpose is to obtain as high a price as possible. If there is a dispute over the interpretation of a purchase price calculation, the buyer cannot reasonably argue that the provision should be interpreted in light of the buyer's desire to obtain a low price – any more than the seller could reasonably argue that the provision should be interpreted in light of the seller's desire to obtain a high price. A buyer and seller have different purposes in that regard, and those conflicting “purposes” are of no use in resolving disputes over the interpretation of agreements that buyers and sellers enter into.

The same is true in this case. DFO argues that, as an Owner Participant, it had a strong financial interest in protecting itself against tax liabilities. However, DFO also acknowledges that it borrowed money to finance the acquisition of the Aircraft. In connection with that borrowing, DFO no doubt wished to provide as little collateral as possible. The lenders (through the Indenture Trustee) had the opposite “purpose.” Their purpose was to obtain as much collateral as possible to secure the repayment of the sums they loaned.

The fact that DFO had a financial incentive to retain the right to compensation for its tax losses therefore is of no use in determining whether DFO actually did retain that right pursuant to the underlying documents, or whether it instead pledged that right to the Indenture Trustee. DFO admits, for example, that the calculation of SLV included a component that was intended to provide an “equity cushion” to DFO itself. *See* DFO Glenn Aff. Ex. 6. DFO had a financial incentive to protect that “equity cushion” portion of the SLV calculation and to keep that recovery for itself. Yet DFO acknowledges that it has pledged the “equity cushion” portion of the SLV calculation to the Indenture Trustee as collateral for the borrowed funds. In that

instance, by its own admission, DFO pledged a right when it would have been in DFO's financial interests not to do so.

DFO's financial interests are not of any use in determining whether the SLV Claims actually were pledged in full (as the Indenture Trustees contend) or whether, as DFO contends, the pledge allegedly "carved out" the Tax Portion of SLV. The only "intent" that is relevant in the interpretation of a contract is the mutual intent that is discernible from the words that the parties actually used in their agreement. *See Hotchkiss v. Nat'l City Bank of New York*, 200 F. 287, 293 (S.D.N.Y. 1911) (Hand, J.) ("A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties. A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent."). This "objective" rule of contract interpretation has long been applied in New York, whose law governs the contracts that are at issue in this Objection. *See Porter v. Commercial Casualty Ins. Co.*, 292 N.Y. 176, 183 (1944) ("What is in the mind of parties to a contract is evidenced by word or deed and must be determined therefrom.") As Judge Easterbrook held in *Skycom Corp. v. Telstar Corp.*, 813 F.2d 810, 814-15 (7th Cir. 1987):

. . . "intent" does not invite a tour through [a party's] cranium, with [the party] as the guide. . . . "The intent of the parties [to be bound] must necessarily be derived from a consideration of their words, written and oral, and their actions."

(Internal citations omitted). Here, the parties' contracts are clear, and they do not support the interpretations that DFO urges.

VI. Alternatively, The Court Should Adjust The Indenture Trustees' SLV Claims

The Indenture Trustees have argued that if DFO's claims are allowed, the Participation Agreement would not allow the adjustment of SLV Claims unless the Indenture Trustees consented to that adjustment. *See, e.g.*, Response of Strategic Value Partners, LLC to TIA/SLV

Objection 1, at 27-30; Response of Bank of America, N.A. to TIA/SLV Objection 2, at 26-28; Response of the Bank of New York, As Indenture Trustee, to TIA/SLV Objection 2, at 6-7. Since the DFO Claims must be disallowed, for the reasons stated above, the Court does not need to resolve these issues in the context of this Objection. Lest there be any confusion about this, however – and since these issues may be relevant to other objections as well as the pending Objection – the Debtors and the Committee must note that the Indenture Trustees’ arguments are not consistent with the plain language of the underlying agreements.

A. The Owner Participant’s “Optional” Rights To Revise SLV Are Not Relevant To The Pending Objections

Strategic Value Partners has cited to Section 5.09 of the Indenture for one of the Aircraft, which permits the Owner Participant and the Owner Trustee to make changes to SLV without the consent of the Indenture Trustee in certain circumstances, and argues that the Owner Participant and the Owner Trustee did not retain those particular rights because an Event of Default is outstanding. *See* Response of Strategic Value Partners, LLC to TIA/SLV Objection 1, at 25-27.⁴ However, this argument is purely a “straw man.”

The SLV adjustment that is at issue in these Objections is not an “optional” adjustment, and has nothing to do with the “rights” of the Owner Participant under Section 5.09 of the Indenture. The adjustment mechanism that is relevant to this particular objection is the one set forth in section 6(d) of the Participation Agreement, which provides:

If any amount is paid by the Lessee to the Owner Participant pursuant to the Indemnity Agreement, the amounts of Stipulated Loss Value and Termination Value set forth in Exhibit C to the Lease shall be recomputed in the manner set forth in Section 3(e) of the Lease to the extent any such payment affects such Stipulated Loss Value and Termination Value amounts.

⁴ The cited provisions do not appear in the Indentures for all of the Aircraft.

See Participation Agreement, § 6(d).⁵

Section 6(d) provides that the adjustment “shall” be made. There is nothing “optional” about it, and there is nothing about it that is conditioned on any party’s “consent.” It does not matter whether the Owner Participant, the Owner Trustee or the Indenture Trustee has the power to exercise rights under the Lease; the adjustment “shall” be made, no matter who is in charge.

B. The Indenture Trustees Do Not Have The Power To Veto The Adjustment Required By Section 6(d) Of The Participation Agreement

Section 6(d) of the Participation Agreement requires that Stipulated Loss Value “shall” be “recomputed” in the “manner” set forth in Section 3(e) of the Lease. Section 3(e) of the Lease, however, does not refer back to Section 6(d) of the Participation Agreement. Instead, Section 3(e) of the Lease describes the manner in which adjustments are made in the event of a “Refunding” pursuant to Section 3(c) of the Lease.

Section 3(c) of the Lease requires an adjustment to Basic Rent, as well as to Stipulated Loss Value, in the event of a “Refunding,” and Section 3(e) then provides as follows:

(e) Manner of Making Adjustments. All adjustments pursuant to Section 3(c) hereof shall be made as promptly as practicable after either the Owner Participant or Lessee gives written notice to the other that an event has occurred which might require an adjustment. All adjustments shall be made in a manner which (A) maintains the Owner Participant’s Net Economic Return, (B) to the extent consistent with clause (A) and the other requirements of this Section 3(e), minimizes the Net Present Value of Rents, (C) is in conformance with the same general parameters as the structure agreed to by the Owner Participant and Lessee in entering into the transactions contemplated by the Operative Documents, and (D) in a manner which will maintain the Owner Participant’s aggregate earnings over the succeeding five years, with no reduction in any prior year’s earnings. Any recalculation of Basic Rent, Stipulated Loss Value percentages, and Termination Value percentages shall be determined by the Owner Participant,

⁵ The relevant language is found in Section 6(d) of some of the Participation Agreements and in Section 8(c) in other Participation Agreements (including Gebler Aff. Ex. C). However, the language is the same. For simplicity, Delta and the Committee have referred to all of these provisions as “Section 6(d).”

such recalculated percentages being subject to verification by Babcock & Brown Financial Corporation, on the basis of the same methodology and assumptions used by the Owner Participant in determining the Basic Rent, Stipulated Loss Value percentages, and Termination Value percentages as of the Refunding Date . . . Such recalculated Basic Rent, Stipulated Loss Value percentages and Termination Value percentages shall be set forth in a supplement to this Lease.

Lease, § 3(e) (emphasis added).

Contrary to SVP's argument, Section 6(d) of the Participation Agreement does not import all of the terms in Section 3(e) of the Lease, including the requirement that a "supplement to this Lease" be executed. Section 6(d) of the Participation Agreement merely states that if a payment is made under the Indemnity Agreement, then Stipulated Value must be "recomputed" in the "manner" set forth in Section 3(e) of the Lease. Section 6(d) states:

If any amount is paid by the Lessee to the Owner Participant pursuant to the Indemnity Agreement, the amounts of Stipulated Loss Value and Termination Value set forth in Exhibit C to the Lease **shall be recomputed in the manner set forth in Section 3(e) of the Lease** to the extent any such payment affects such Stipulated Loss Value and Termination Value amounts.

See Participation Agreement, § 6(d) (emphasis added).

The requirement that SLV be "recomputed" in the "manner" specified in Section 3(e) means that the principles that must be used in making the recomputation are those that are set forth in Section 3(e) of the Lease. There is nothing in Section 6(d) of the Participation Agreement that requires that the adjustment to SLV be "documented" in the same manner as an adjustment pursuant to Sections 3(c) and 3(e) of the Lease.

SVP's elaborate argument – (i) that Section 6(d) purportedly incorporates the requirement that a lease supplement be executed, (ii) that a lease supplement ordinarily cannot be executed without the consent of the Indenture Trustee, and (iii) that the Indenture Trustee therefore purportedly has a "veto power" over the adjustment specified in Section 6(d) – is

absurd, and is flatly contrary to the requirement, in Section 6(d) of the Participation Agreement, that Stipulated Loss Value “shall” be recomputed in the event of a payment under the Indemnity Agreement.

C. The Reference In Section 6(d) To A “Payment” Under the TIA Does Not Bar A Recomputation Of SLV

SVP, and other parties, have argued that Section 6(d) is not triggered unless a “payment” is first made under the TIAs. However, if this Court were to find that the TIA Claims were valid, and that they took precedence over the SLV Claims, then in fact “payment” of the TIA Claims might well occur prior to payment of the SLV Claims.

More importantly, however, SVP’s focus on the literal language of Section 6(d) misses the point. TIA Claims and SLV Claims seek recovery for the same injury, and the overlaps among them must be eliminated. To the extent that the Court finds – based on Section 6(d) and other factors – that TIA Claims were intended to take priority over SLV Claims, then the SLV Claims should be adjusted. This is true regardless of what the parties’ contracts say and regardless of whether the contracts themselves would compel this result. The outcome is required because fairness to other creditors requires that only one compensation for a single injury be allowed.

D. Section 22 of the Lease Does Not Bar A Recomputation of SLV

Finally, SVP argues that Section 22 of the Lease provides that the “amount” of SLV may not be reduced below the “amount required” to pay outstanding debts. This provision merely states that the “amount” of the SLV Claim cannot be less than the amount of accrued principal and interest on the outstanding debts. SVP argues that this provision in the Lease should instead be interpreted so that it gives the SLV claimant a “floating” claim that is adjusted from time to

time as bankruptcy distribution percentages change. That is not a reasonable reading of the provision.

VII. Various Arguments Made By The Owner Participants Who Have Filed *Amicus* Briefs, And Other Arguments Made By The Indenture Trustees, Do Not Need To Be Resolved By The Court In The Context of This Objection

The Court has received a number of submissions that urge the Court to make its decision based on factors other than those discussed above. Delta and the Committee submit that these matters are not relevant to the decision of the Objection that is pending before the Court.

First, Wilmington Trust Company has argued that DFO's claims should be disallowed because DFO voluntarily transferred its interests in the Aircraft, thereby invoking the exclusion in Section 7(b) of the Tax Indemnity Agreement. Response of Wilmington Trust Company, As Owner Trustee, to TIA/SLV Objection 1, at 14-16. Delta and the Committee have reserved that objection and will pursue it if the pending Objection is not resolved in favor of the disallowance of the DFO Claims. However, that issue is not properly before the Court on March 30.

Second, many Owner Participants and Indenture Trustees have urged the Court to interpret the parties' agreements in light of their own individual "purposes" in entering into the transactions – much in the way DFO has argued that the contracts should be interpreted in light of DFO's own purposes. For the reasons discussed above, however, the individual financial purposes of the parties – which were mostly in conflict with each other – are not relevant in deciding the issues raised by this Objection.

Third, some Owner Participants have argued that it would be "absurd" if they did not receive, in bankruptcy, a portion of the distribution on an allowed SLV Claim. However, there would be nothing at all "absurd" about that result; it is simply the natural consequence of the fact that the SLV Claim seeks compensation for the same loss, and the fact that the Owner Participant pledged that SLV Claim to somebody else.

Notice

Delta and the Committee have served notice of this Reply consistent with the procedures set forth in the Claims Objection Procedures Order. In addition, consistent with the procedures described in the Court's Order Approving Notice, Case Management and Administrative Procedures entered October 6, 2005 (the "**Case Management Order**"), Delta and the Committee have served notice of this Reply on (a) the Core Parties (as that term is defined in the Case Management Order) and (b) the Non-ECF Service Parties (as that term is defined in the Case Management Order).

Relief Requested

For the foregoing reasons, Delta and the Committee respectfully request (a) the disallowance of the DFO Claims; (b) in the alternative, the reduction of the DFO Claims and/or the BNY Claims to eliminate the overlap among them; and (c) such other and further relief as is deemed just and proper.

Dated: New York, New York
March 27, 2007

Respectfully submitted,

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