

**Minutes of the Meeting of the
Air Transportation Stabilization Board
December 28, 2001**

The meeting of the Air Transportation Stabilization Board (“Board”) was held in the offices of the Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, Washington, D.C., on Friday, December 28, 2001 starting at 4:07 p.m.

The following people were present at the meeting:

Board

Edward M. Gramlich, Chairman of the Board, and Governor, Federal Reserve Board
Peter R. Fisher, Voting Member of the Board, and Under Secretary for Domestic Finance,
Department of the Treasury
Kirk K. Van Tine, Voting Member of the Board, and General Counsel, Department of
Transportation

Board Staff

Joseph P. Adams, Jr., Executive Director Nominee (via telephone)
Roger E. Kodat, Acting Executive Director, and Deputy Assistant Secretary for Government
Financial Policy, Department of the Treasury
Michael D. Scott, Acting Chief Administrative Officer, and Senior Advisor to the Deputy
Assistant Secretary for Government Financial Policy, Department of the Treasury

Others

Federal Reserve Board

J. Virgil Mattingly, General Counsel
Donald J. Winn, Assistant to the Board
Daniel E. Sichel, Senior Economist, Division of Research and Statistics
Christopher W. Clubb, Senior Counsel

Department of the Treasury

Mark K. Wiedman, Senior Advisor to the Assistant Secretary for Financial Markets
Peter Bieger, Attorney, Office of General Counsel
James McCament, Attorney, Office of General Counsel

Department of Transportation

Terence W. Carlson, Attorney, Office of General Counsel
Nancy Kessler, Attorney, Office of General Counsel
Regis Milan, Associate Director, Office of Aviation Analysis, Office of the Assistant Secretary
for Aviation and International Affairs
Janet Forsgren, Program Analyst, Office of the Assistant Secretary for Budget and Programs
Bernard Fishman, Office of Inspector General
Suzanne Shaps, Office of Inspector General

GAO did not attend this meeting.

Governor Gramlich called the meeting to order.

Document to authorize the hiring of outside legal counsel was approved.

Appointment of Joseph P. Adams, Jr. as Executive Director was approved by unanimous vote.

Mr. Kodat provided a summary of the America West application. This summary included:

1. An introduction into America West's background.
2. A discussion of the proposed transaction.
3. A discussion of the evaluative criteria.
4. A discussion of America West's business plan and the consultants' reports.
5. A discussion of the credit subsidy estimates.

Mr. Kodat provided a description of the policy alternatives available to the Board The alternatives discussed were:

1. Accept America West's application as presented.
2. Accept America West's application conditional on additional compensation to the Government.
3. Reject America West's Application

Mr. Van Tine identified a list of major concerns with the staff recommendations and the consultants' reports:

1. DOT expected analysis of how the agreement is a necessary part of maintaining a safe, efficient and viable commercial aviation system in the United States.
2. Fees paid by the carrier — fees are substantial.
 - a. Need to lower fees, the more in fees, the less that is available to repay the loan.
 - b. Wants to look at the word "practicable" in the OMB regulations as a way to say that it is not practicable because it lowers the applicant's ability to repay the loan.
3. Methodology in credit subsidy
 - a. Important consideration is risk of default tied to similar credit ratings. Concerned that the credit subsidy rate in this instance may not be accurate, because the credit subsidy estimate is partially based on the yearly default rates of companies with a similar credit rating as applicant, but not with a recent cash infusion, such as a loan or an equity financing. Questions whether this is the appropriate measure. The default model does not appear to capture companies' default rates after receiving the new credit. Going forward, would like to meet with OMB to modify model for particular circumstances.
4. Distribution costs – disagrees that consultant's approach in cutting them 50% is correct approach.
 - a. Does not have a clear understanding on why 50% estimate was selected by consultant.
 - b. While some amount of reduction is appropriate, 50% is excessive.
5. Competition from Southwest
 - a. [REDACTED].
 - b. Questions the methodology used to measure competition.
6. Fuel Forecasts
 - a. Questions use of Goldman Sachs forecast because it represented the high end of forecasts.
 - b. In the future, wants consultants to utilize a number of forecasts in order to be more precise and accurate.
7. Regional jet operations. Issue is projected fuel costs. Consultant notes actual fuel costs were [REDACTED] higher than plan. Believes America West has reasonable explanation for price of fuel used in plan.

8. Proposed alternative. Significantly reducing fees not a negative but a positive. Increases ability to repay loan.
9. OMB and CBO credit subsidy estimates of the entire program is 25% and 30% respectively.

Mr. Adams provided his thoughts on America West:

1. [] level is more like an equity instrument and less like a debt obligation.
2. Lowering fees would help in maintaining liquidity but highlights the fact that the company is a very weak credit.
3. There is a [] risk that the company could default in [].
4. Agreed with Mr. Van Tine that the fuel and distribution cost issues are of lesser importance than that which the consultant's report indicated.
5. Counterbalancing argument to the weak financial status of America West was that the loan guarantee program was designed to assist those air carriers for which credit was not otherwise reasonably available.

Mr. Kodat provided responses to Mr. Van Tine's concerns.

1. Safe, efficient and viable analysis - The GRA report of December 10, 2001 addressed the question of safe, efficient and viable on pages 25-27. The December 20, 2001 report incorporated the December 10th report.
2. Fees - Mr. Kodat expressed concern that substantial reduction in compensation, while providing cash flow relief to America West, might be contrary to the OMB regulation that requires that the ATSB be compensated for the risk in making the guarantees. He reiterated that this was a matter for the Board.
3. Methodology in credit subsidy – Mr. Kodat indicated he could not respond to this concern but agreed that it was a good idea to look at in the future.
4. Distribution costs – Mr. Kodat acknowledged that GRA's discount assumptions could be subject to debate.
5. Competition from Southwest – Mr. Kodat indicated that there could be a debate about the level of competition that Southwest presented but that the Board's consultants provided a well reasoned analysis for their position.
6. Fuel Forecasts – Mr. Kodat agreed that more forecasts should be utilized by the Board's consultants.
7. Regional jet operations and projected fuel costs – Mr. Kodat indicated that he prefers to be conservative and based on GRA's report that he has no reason to dispute the methodology applied in the analysis.
8. Proposed alternative – Mr. Kodat addressed this concern in item 2 above.
9. OMB and CBO credit subsidy estimates – Mr. Kodat indicated that he could not provide a response to this issue, as he was not aware of the numbers that were mentioned.

Mr. Fisher indicated that he could not support approval of the application, either as is, with higher compensation or with lower compensation. Mr. Fisher read the following:

I cannot support approval of the revised application of America West Airlines for a federal guarantee of 85.3 percent of a planned \$445 million financing, even with the additional compensation as suggested in the draft letter.

While I understand that this program was created to provide financing for air carriers that cannot obtain credit in private markets on reasonable terms as a result of the September 11th terrorist attacks – and I recognize that the Board's mission necessarily involves exposing

taxpayers to some considerable measure of risk – in my opinion this application fails to meet the requirements of the statute and the regulations which must guide our decisions.

Most importantly, the application fails to demonstrate that there is a reasonable assurance that the borrower will be able to repay the planned financing according to its terms. The expert advice received by the Board suggests that, at present, this is unlikely to occur. An event that is unlikely to occur cannot be one for which there is a reasonable assurance that it will occur. No amount of compensation to the government can correct this deficiency.

In addition, the application fails to put forward a business plan that seriously addresses the operating conditions that the applicant faces. The applicant's forecast of unit revenue and simultaneous improvement in profit margins in the face of weak economic conditions and effective competition on many of its routes is not likely to occur and does not provide a realistic basis on which to assess the carrier's prospects.

Even in the unlikely event that this decision results in anything other than a temporary postponement of the need for a more fundamental restructuring of the applicant's business, approval of this application would likely impede, rather than promote, real progress toward a safe, efficient and viable air transportation system for our country.

Mr. Van Tine indicated that the consultants have concern about liquidity and that liquidity concerns could be addressed with lower fees. Mr. Van Tine would like to vote to approve as submitted but will consider an approval with conditions.

Governor Gramlich acknowledged Mr. Fisher's concerns regarding the probability of repayment. Governor Gramlich suggested, however, that, as discussed in the staff memo of December 26, 2001, a key issue is whether the government is sufficiently compensated for its risk in issuing a guarantee. He indicated that, if America West provides the government with sufficient additional compensation, in line with the second policy alternative presented in the staff memo, and the resulting estimated credit subsidy is reasonable, he would be prepared to support the application.

Governor Gramlich voted in favor of approval, conditional on America West providing the government with additional compensation in the form of warrants representing 33 percent of the company's stock on a fully diluted basis and at a strike price to be negotiated.

Mr. Fisher voted to reject.

Mr. Van Tine voted for a conditional approval.

A conditional approval for America West Airlines was approved by a vote of 2 to 1.

Governor Gramlich instructed Mr. Kodat to fax a letter to America West consistent with the approval.

The meeting adjourned at 5:57 p.m.

[redacted]