UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

In re:	)	Chapter 11
	)	
ATA HOLDINGS CORP., *et al.*[1]	)	Case No. 04-19866-BHL-11
	)	Jointly Administered
	)	
Debtors.	)	

REPORT OF KENNETH J. MALEK, CPA, CIRA, EXAMINER
APPOINTED BY THE OFFICE OF UNITED STATES TRUSTEE

I am making this report pursuant to the Order of the United States Bankruptcy Court dated March 7, 2005. The United States Trustee appointed me on March 8, 2005. The Bankruptcy Court's Order of March 7, 2005 provides that I am to investigate and issue a written report on the following issues ("Examination Issues"):

(a) The facts and circumstances that may be relevant to a judicial determination of the enforceability or avoidability of any guarantees provided by Chicago Express Airlines, Inc. ("CEA") with respect to pre- and post-petition obligations of Debtors ATA Holdings Corp. ("ATAH") and/or ATA Airlines, Inc. ("ATAA"), including the nature and value of consideration provided to CEA in connection with such guarantees;

(b) The basis and validity or invalidity of the approximately $16.8 million inter-company claim listed in the Non-CEA Debtors' schedules as a payable to CEA from ATA Airlines, Inc., as well as any post-petition intercompany claims between CEA and the non-CEA Debtors; and

(c) Whether it is in the best interest of CEA to be sold as a going concern, as opposed to being liquidated, considering, among other factors, the resources available to Chicago Express.

[1] The Debtors are the following entities: ATA Holdings Corp. (04-19866); ATA Airlines, Inc. (04-19868); Ambassadair Travel Club, Inc. (04-19869); ATA Leisure Corp. (04-19870); Amber Travel, Inc. (04-19871); American Trans Air Execujet, Inc. (04-19872); ATA Cargo, Inc. (04-19873) (collectively, the "Non-CEA Debtors"); and Chicago Express Airlines, Inc. (04-19874). All of the foregoing are, collectively, the "Debtors.

I began my work in this case on the evening of March 8, 2005. Pursuant to the Court's order of March 7, 2005, I am required to provide a draft of this report to the Designated Parties (as listed on the service list attached hereto) by not later than March 17, 2005 and a final version to them by March 18, 2005. The fees and expenses for my work are capped at $75,000, absent my seeking and obtaining approval from the Court for an additional authorization. I do not intend to seek any such additional authorization for this report.

This report presents my conclusions based on the work I was able to complete within the above-described completion deadlines and budget. My conclusions might be modified if I had performed additional work.

During the course of my work, I found the management and financial staff at ATAH, ATAA and CEA to be cooperative and helpful. They promptly furnished all documentation that I requested and provided access to those employees with detailed knowledge of the matters I was examining. The members of the managements of ATAH, ATAA, and CEA whom I interviewed and the documents I reviewed are listed in Exhibit 1 hereto.

In the course of collecting data and preparing my report, I had regular telephonic, email, and/or in person discussions with counsel for the Debtors, counsel for NatTel, the Debtors' financial advisors, and the financial advisors for the Official Committee of Unsecured Creditors. These persons are also listed in Exhibit 1 hereto.

As part of my ongoing discussions with counsel for the Debtors and counsel for NatTel, I requested that they provide to me commentary on and analysis of certain legal and/or factual matters relevant to my report. The purpose of my report is not to analyze potentially applicable state statutes or the legal aspects of the positions of Counsel for the Debtors or Counsel for NatTel, but rather to set forth my factual findings relevant to the Examination Issues. However, for the convenience of the Court, the United States Trustee, and the other readers of this report, I frame certain of the Examination Issues by reference to my understanding, from a business perspective, of certain legal issues or standards.

I. Examiner's Findings of Facts Relating to Guarantees

Under potentially applicable state statutes (the Uniform Fraudulent Transfer Act, as adopted by the States of Georgia, Illinois, and Indiana), I understand that a trustee or a debtor in possession

may pursue avoidance of transfers of an interest of the debtor in property, or any obligation incurred by the debtor, that was made up to either four or five years in advance of the commencement of the debtor's bankruptcy case, if the debtor did not receive "reasonably equivalent value" in the transaction. My understanding is that, in determining reasonably equivalent value, the legal process must focus on the factual determination of "what the debtor received in return for what was surrendered."[2]

Timing and Amounts of Guarantees

The following table summarizes the more detailed information presented in Exhibit 2 hereto:

	Transaction / Issue Date	Maturity Date	Principal Amount ($ millions)	Originally Guaranteed by CEA?
2004 Notes	July 1997	August 1, 2004	$100.0	No[3]
2005 Notes	August 1998	December 15, 2005	$125.0	No[4]
2004 First Supplement	December 1999	August 1, 2004	$75.0	Yes
Exchange Offer for 2004 and 2005 Notes	January 30, 2004	February 1, 2009 and June 15, 2010	$(260.3)	
Unexchanged obligations guaranteed by CEA			$39.7	Yes
ATSB Loan	November 30, 2002	November 25, 2008	$168.0	Yes
2009 Notes	January 30, 2004	February 1, 2009	$163.1	Yes
2010 Notes	January 30, 2004	June 15, 2010	$110.2	Yes
Outstanding obligations guaranteed by CEA			$481.0	

The Chapter 11 proceeding commenced on October 26, 2004. As a starting point, an amount between $0.0 and $39.7 million of obligations would have been guaranteed outside of the four-

[2] *In the matter of Bundles*, 856 F.2d 815 (7th Cir. 1988).
[3] Section 3 of the First Supplemental Indenture dated December 1999 makes CEA a guarantor of the original $100 million tranche of the 2004 notes.
[4] Section 3 of the Second Supplemental Indenture dated January 21, 2004 makes CEA a guarantor of the 2005 Notes.

year look-back period. I understand that an issuance of new debt (or granting of a new guarantee) in extinguishment of "old and cold" debt (or an old and cold guarantee) can be construed in at least some courts as meeting the reasonably equivalent value test. If this is the case, then although an additional $135.3 to $175.0 million of the $481.0 million of guaranteed indebtedness would have been guaranteed inside of the four-year look-back window, this would have been a guarantee potentially granted in a value-for-value exchange, in which the new guarantee was substituted for a guarantee made outside of the four-year look-back period. See footnotes 3 and 4. If the look-back period is five years, then $0.0 would have been guaranteed outside of the look-back period. This is because the earliest guarantee given by CEA was in December 1999, which is less than five years before October 26, 2004.

ATAH issued the 2009 Notes and the 2010 Notes in the exchange offer for the 2004 Notes and 2005 Notes, respectively. The use of proceeds, described in Exhibit 2, for each tranche of indebtedness does not identify specific proceeds as used for the benefit of CEA, but, on the other hand, it is probable that <u>at least some portion</u> of the proceeds of each of the 2004 First Supplement and the ATSB Loan were expended directly for the benefit of CEA. These tranches represent a maximum of $207.7 million, of the total $481.0 million that is guaranteed by CEA. However, because of issues relating to the fungibility of money when tracing use of funds,[5] it is conceivable that even with an unlimited budget I would be unable to definitively quantify the precise portions of the guaranteed obligations that were expended directly for the benefit of CEA.

Integrated Business Operations

Counsel for the Debtors in this case[6] has informed me of his position that ATAA and CEA were engaged in an integrated business operation, such that, absent the upstream guarantees provided by CEA, the business of ATAA would have ceased, with the result that the business of CEA would also have ceased, shortly following any refusal by CEA to execute an upstream guarantee. The *absence* of this potential cessation of the business of CEA, in the view of Counsel for the Debtors, represents an indirect benefit for CEA sufficient, in his view, to satisfy the reasonably equivalent value test.

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[5] By fungibility of money issues, I mean, for example, the allocation and timing considerations that arise when money from a debt issuance is deposited in a general corporate account, into which are also deposited revenues from operations, and from which are paid a combination of operating expenses and major and minor capital expenditures. See, e.g., Treasury Regulations §1.163-8T, which provides a relatively cumbersome and time-consuming series of conventions, for federal income tax purposes, for determining the uses to which debt proceeds were put.

[6] James M. Carr, of the law firm of Bakers & Daniels.

Since ATAH's purchase of CEA in April 1999, CEA has operated solely as a captive commuter feeder carrier for ATAA, operating solely under the name "ATA Connection" and providing connecting flights only onto ATA flights pursuant to an exclusive code-share arrangement with ATA. CEA's management informed me that, on multiple occasions during this period, they suggested to ATAA management that it allow them to pursue additional code share alliances with unaffiliated carriers, for the purpose of enhancing CEA's profitability, but ATAA's management declined to approve any such efforts.

Following the commencement of the Chapter 11 cases in October 2004, there was a period when CEA's management believed they would be providing profitable service from a hub in Indianapolis, again under an exclusive code-share arrangement with ATAA. However, these plans changed based on Northwest Airlines' competitive response to the ATAA and CEA service from the Indianapolis hub,[7] and, starting in approximately January 2005, ATAA's management encouraged CEA to pursue code share alliances with unaffiliated carriers.

There are multiple potential major or national carriers[8] that could benefit from having greater "feed" from a code-share regional carrier, at one or both ends of certain of their high-traffic routes, and 34-seat turboprop airplanes may be appropriate for providing that feed. This is consistent with the responses and expressions of interest received by Compass Advisers, LLP, from both strategic and financial buyers, in their marketing activities to date for the CEA operations.[9] However, in the current depressed industry state, financial buyers are hesitant to

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[7] See, e.g., "Northwest Unveils Third Indianapolis Schedule Expansion," http://www.nwa.com/corpinfo/newsc/2004/pr10420041522.html (November 1, 2004), announcing the third expansion of its schedule, resulting in a 160 percent increase in Northwest's daily departures from Indianapolis, by comparison to October 2003; "Northwest to Continue Indianapolis Schedule Buildup With New Nonstops to Dallas/Ft. Worth, Kansas City, Mo., Sarasota And West Palm Beach, Fla.," http://www.nwa.com/corpinfo/newsc/2004/pr120120041527.html (December 1, 2004); "Northwest To Offer Nonstop Service From Indianapolis To Four New Cities," http://www.nwa.com/corpinfo/newsc/2005/pr030920051567.html (March 9, 2005), announcing yet another service expansion; "Northwest Poised to Dominate In Indy," *Indianapolis Star* (March 10, 2005).

[8] According to the formal FAA classification, airlines with annual revenues between $100 million and $1 billion are classified as national airlines.

[9] In the conference call with the court and certain interested parties on Friday, March 11, 2005, and in subsequent telephone discussions with the Examiner, Compass reported that they sent out over 300 "teaser" sales documents for CEA's operations, that 29 parties signed confidentiality agreements and received confidential offering memoranda, and that they continue to be in active discussion with 10 of such parties. NatTel, whose principal Mr. Jack Robinson is a former executive of the Eastern Airlines commuter operations, is one of such parties. Compass believes that one or more of such parties will provide a confirmable offer substantially in excess of liquidation value.

invest in a commuter airline before it has a contractually committed, viable , and operating code-share arrangement with a major or national flying partner. And the major or national flying partner is reluctant to establish a new code-share arrangement with a commuter carrier currently in bankruptcy, especially when it has potential significant unresolved liabilities associated with the operations of its current affiliates. This explains the fact that CEA has not, prior to the subject sales process, been able to secure a code-share arrangement with a partner other than ATA.[10]

My budget has not allowed me to study the traffic and revenue levels of ATAA's and CEA's routes, so as to determine when bankruptcy became imminent. This would have occurred some time prior to October 2004. Prior to bankruptcy being imminent, it is certainly possible, had ATAA's management permitted, that CEA could have established a code-share arrangement in addition to or in replacement of that which it had with ATAA. Whether the existence of such a possibility would be sufficient to cause the upstream guarantees by CEA to fail the reasonably equivalent value test is, to my business impression, a complex legal and factual issue. The costs and time required to resolve this complex issue are inconsistent with the value and time sensitivities of CEA's bankruptcy estate.

However, if a purchaser wishes to purchase stock and have the case against CEA dismissed, such that the purchaser would be buying the stock in a manner that the purchaser would assume the risk of either negotiating with the holders of the guaranteed debt or of prevailing in any legal contest of the issue, that should not be of concern to the Debtors and their counsel, so long as the purchaser would be paying at least the liquidation value of CEA in cash equivalent value. I believe that, so long as a highest bidder will be providing cash equivalent value at least equal to the liquidation value, the best interest of creditors test can be met with respect to that bidder. This is discussed in greater detail in Section III of my report.

Whether Upstream Guarantees Are Released Upon a Sale of CEA's Stock

Counsel for NatTel[11] provided to me a summary memorandum dated March 10, 2005 describing the bases upon which he believes that his client's proposed purchase of the stock of CEA would extinguish the upstream guarantees.

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[10] A sale of the operations of CEA as a going concern pursuant to a sale under §363(b) of the Bankruptcy Code should alleviate these concerns of potential code-share partners.

[11] Aaron L. Hammer of the law firm of Freeborn & Peters.

Counsel for the Debtors provided to me his summary memorandum, dated March 16, 2005, stating his reasons for believing that NatTel's proposed purchase of the stock of CEA would not extinguish the upstream guarantees.

I attached both of these memoranda as Exhibit 3.

My conclusions regarding this second aspect of the guarantee issue are the same as my conclusions regarding whether the guarantees are voidable by reason of a failure of the reasonably equivalent value test: I believe that, so long as a highest bidder will be providing cash equivalent value at least equal to the liquidation value, the best interest of creditors test can be met with respect to that bidder.

II. Examiner's Findings of Facts Relating to Pre - and Post-Petition Intercompany Receivables and Payables

As I mentioned previously, since ATAH's purchase of CEA in April 1999 CEA has operated solely as a captive commuter feeder carrier for ATAA, operating under the name "ATA Connection." Approximately 75-80 percent of CEA's traffic has been connecting traffic, onto ATA's network, and 20-25 percent has been origination and destination traffic. During this period, CEA has operated flights on behalf of ATAA, and ATAA has been entitled to receive all revenue associated with operation of CEA's aircraft and controls and is responsible for all marketing, scheduling, pricing, ticketing, and seat inventories. CEA has borne no costs or expenses of its own for any of the infrastructure associated with these activities. CEA's only costs and expenses relate principally to the lease, operation, and maintenance of its fleet of aircraft; flight crew and cabin crew payroll; payroll costs of operating and costs of the ownership or lease and maintenance of ground and baggage handling equipment; payroll of gate personnel and allocated gate costs; and lease, payroll, and other costs for home office financial and management functions.

The only written contracts between CEA and ATAH or ATAA may be the sublease contracts (and possibly the direct lease contracts, for the two planes owned by ATAA) for CEA's current fleet of eight Saab 340B 34-seat aircraft. Six of such aircraft are leased under long-term leases

from AMR Leasing Corporation to ATAA, who then subleases the aircraft to CEA. The remaining two aircraft are owned by ATAA and then leased to CEA.

From May 1999 through December 2001, the system of intercompany revenue and cost sharing adopted between ATAA and CEA resulted in CEA operating at a loss, which accumulated to a $19.6 million operating loss (resulting in a $14.1 million net loss) over the 32-month period. Effective January 1, 2002, ATAA and CEA adopted a new revenue and cost-sharing convention between the companies, pursuant to the internal memorandum dated April 3, 2002, attached as Exhibit 4. The stated purpose of such memorandum was to cause CEA to operate at a profit. Under the April 3, 2002 memorandum, ATAA pays CEA a fixed departure fee for each origination and destination route that CEA flies and imposes fixed charges against CEA for late departures and cancelled flights. From January 1, 2002 through January 31, 2005, under this arrangement CEA recorded operating profits aggregating $29.9 million (net income aggregating $18.0 million).

Whether Intercompany Accounting Gives Rise to Valid Intercompany Claims

Early code-sharing agreements in the airline industry compensated independent regional carriers via a pro-rate agreement. Under a pro-rate agreement, the regional carrier controlled its flights and inventory. Regional carriers were paid a pro-rata portion of the revenue received from a connecting passenger who flew one leg of his journey on the regional and one leg on a flight operated by the major. Regional carriers would receive 100 percent of all local passenger revenues.

Fixed-fee contracts were first introduced by Mesaba and Northwest Airlines, and after a few years they became the industry standard. Fixed fee contracts are also known in the industry as "fee per departure," "capacity purchase," or "available seat mile (ASM) buy" agreements. Under a fixed-fee contract, the regional carrier is paid for complete flights, typically with some incentives for reliability, on-time performance, and baggage handling. Sometimes, though not always, there is a small per-passenger fee built into the contract. However, the responsibility for scheduling the flights and controlling the seating inventory rests with the major carrier. Thus, the fees received by the regional carrier are designed to provide the regional carrier with essentially a fixed profit margin.

Fixed fee contracts have been intended to and in fact have strengthened market valuations of regional carriers. This is illustrated by the successful public spin-offs of ExpressJet (NYSE:XJT), the regional affiliate for Continental Airlines, and Pinnacle Air (NASDAQ:PNCL), the regional affiliate for Northwest Airlines. These contracts are intended to remove many of the risks typically associated with the airline business, including risks associated with variations in yield, load factor, fuel, and route-level competition.

Thus, the fee per departure contract between CEA and ATAA is consistent with standard industry structure. It does, however, provide to CEA a revenue rate per ASM that is in excess of that earned by other regional carriers:

Regional Airline	**Network Carrier**	**Year**	**Average Stage Length (Miles)**	**Revenue per ASM (USD)**	**Profit per ASM (USD)**	**ASM (000)**
ExpressJet	Continental	2003	491	0.1557	0.021	8,425,000
Mesaba	Northwest	2004	N/A	0.1490	0.004	1,774,931
Pinnacle Airlines	Northwest	2003	384	0.1706	0.024	2,678,000
SkyWest	Continental, Delta, United	2003	393	0.1510	0.017	5,875,029
Mesa Air Group Consolidated [1]	America West, US Airways, United	2003	337	0.1340	0.011	4,453,707
Chicago Express [2]	ATA	2004	176	0.2658	0.031	303,019

[1] Includes operations of Mesa Airlines, Air Midwest and Freedom Airlines

[2] Sources for Chicago Express Data: Ken Scarinze (Stage Length), 2004 Consolidating Income Statement (Revenue & Profit) and the Bureau of Transportation Statistics (ASM).

The shorter the stage length, the higher the percentage of costs that will relate to take-offs, landings, passenger enplanements and deplanements, and baggage handling. Thus, the $0.031 profit per ASM for CEA is not unreasonable in view of the $0.021 and $0.024 for ExpressJet and Pinnacle, respectively. When viewed in terms of the profit per ASM, the revenue per ASM is not unreasonable. Indeed, CEA's management reported that, at the April 2002 time of establishing the fee per departure arrangement, CEA was contemplating adding regional jets and aspired to become a major player among regional jet carriers. A robust fixed fee contract, under those circumstances, could have given CEA a robust market capitalization. Thus, in view of all these facts and circumstances, I conclude that the intercompany pricing arrangements are not unreasonable.

From January 1, 2002 through January 31, 2005, the intercompany account receivable by CEA from ATAA was derived from the following activity (see Exhibit 5):

($ 000s)	January 1, 2002 to October 31, 2004	November 1, 2004 to January 31, 2005
Opening balance	$(19,928)	$0
Intercompany revenues booked, based on fixed departure fees	$210,898	$16,567
Cash funding for payroll and other payables	$(129,136)	$(10,627)
Lease and sublease costs for CEA's aircraft	$(17,379)	$(1,638)
Other (fuel and tax expense allocations as well as other miscellaneous charges)	$(26,628)	$(7,018)
Ending balances	$ 17,827	$(2,716)

CEA also owed ATAH an offsetting amount of $1,950,000[12], derived from the following activity:

(in 000s)	January 1, 2002 to October 31, 2004	November 1, 2004 to January 31, 2005
Opening balance	$1,950	$0
Activity	0	0
Ending balances	$1,950	$0

The actual petition date for CEA's Chapter 11 case is October 26, 2004, and pre-petition balances in the Debtors' statement of affairs are apparently based on accounting entries made through the close of business on October 26, 2004. However, the monthly intercompany revenue allocation from ATAA to CEA for the entire month does not occur until the close of the month, as part of month-end accounting. Accordingly, to estimate the intercompany balance as of October 26, 2004, I have subtracted 5/30th of the net November 2004 activity from the balance as of October 31, 2004. This has the effect of slightly decreasing the post-petition payable by CEA to ATAA

[12] ATAH funded CEA's purchase of aircraft engines in this amount prior to December 31, 2001.

and slightly decreasing the pre-petition receivable by CEA from ATAA. This results in the following balances as of October 26, 2004:

(in 000s)		Pre-petition		Post-petition
Amount receivable as of October 31, 2004 by CEA from ATAA		$17,827		$(2,716)
Reclassification of five days' activity (based on average November net activity)		$(235)		$235
Amount payable as of October 26, 2004 by CEA to ATAH		(1,950)		0
Net pre- and post-petition receivables by CEA	Pre-petition	$15,642	Post-petition	$(2,481)

"An account stated is a manifestation of assent by debtor and creditor to a stated sum as an accurate computation of an amount due the creditor." Restatement (Second) of Contracts §282(1) (1981), cited in *Black's Law Dictionary*, 7th ed. (West Group, 1999), p. 17. An account stated is defined as "[a] balance that parties to a transaction or settlement agree on, either expressly or by implication." *Ibid.* The treatment of regularly maintained intercompany-affiliate indebtedness, reported consistently by debtor and creditor on each company's books and records, has recently been respected as creating a valid claim for bankruptcy purposes, which did not require any further substantiation or documentation. *In re Dornier Aviation (North America) Inc.*, No. 02-8199, Memorandum Opinion (Bankr. E.D. Va., Alexandria Division, February 8, 2005)(vaeb.uscourts.gov), pp. 25, 28-29, and 37.

The Court, the United States Trustee, and other readers should note that the parentheses relating to the post-petition balance means that the books and records report a post-petition payable, as of January 31, 2005, from CEA to ATAA. The reason for this is a December 2004 income tax allocation on the books of ATAH and its subsidiaries, whereby companies reporting net taxable income are allocated income tax expense even though the affiliated group reports a net tax loss that is carried back or forward to different years. The income tax expense allocated post-petition in December 2004 to CEA appears to be in the range of $4 million, although the records I have reviewed to date do not allow me to determine the precise amount. Also, this intercompany tax allocation entry appears to relate to an entire tax year. If this becomes a material issue for the parties, it should be a relatively straightforward task to refine this number, including determining pre- versus post-petition portions of the income tax allocation and whether this and other income

tax items within the intercompany accounts should be reversed for purposes of determining allowable claims.

Conclusion Regarding Intercompany Claims

Subject to the possible adjustments for income tax items described above, I am of the opinion that CEA has a valid pre-petition receivable from ATAA of $17,592,000, that CEA owes ATAH a pre-petition amount of $1,950,000, and that CEA owes ATAA a post-petition amount of $2,481,000.

III. Whether It Is in the Best Interest of the CEA Bankruptcy Estate to Be Sold as a Going Concern, as Opposed to Being Liquidated

This is the most important area of my examination. I begin with my analysis of the liquidation value of CEA, which I compute in Exhibit 6. In computing the liquidation value, I interviewed and reviewed CEA's January 31, 2005 balance sheet with James Carr (counsel for the Debtor), Aaron Hammer (counsel for NatTel), Harvey Tepner and David Imbert (Compass Advisers), Jack E. Robinson, Esq. (principal of NatTel), Gary Marsh (President, CEA), and Ken Scarinze (CFO, CEA).

Compass Advisers maintained that, as to rotables and equipment, in a controlled liquidation environment CEA should be able to recover 50-100 percent of current book value. They based this assertion on the fact that ATA, with an ongoing presence at Midway, could house the rotables, equipment, and expendables in idle hangar space, assign one full-time employee to the liquidation, and sell parts and equipment to others in the industry, when and as needed.

At the other end of the spectrum were CEA executives Gary Marsh and Ken Scarinze. I found their views of likely realization in liquidation highly credible. They cited the fact that approximately 40 percent of American's fleet of Saab 340-series turboprops is parked in the desert and American (or its regional affiliate Simmons, operating as American Eagle) has a large stockpile of both rotables and expendables for these aircraft. Recently, CEA was able to acquire from American a new Saab 340 engine, normally costing $0.5 million, for approximately $250,000. CEA believes that although American's stockpile covers 340A, 340B and 340BPlus models, the parts are largely interchangeable among the series of aircraft. CEA's fleet is entirely the 340B model of aircraft, and hence its inventory of rotables and expendables are nominally for that model.

There currently are a reasonable number of Saab 340's in active service by regional carriers, and my general understanding is that there are no plans in the industry to accelerate their retirement. Following is a summary of regional carriers currently operating Saab 340-series aircraft:

American Eagle (from AMR Corp's 2004 10-K)

Operating: 35 total planes at average age of 10 years (two owned / seven capital leased /25 operating leased with one operating leased Saab temporarily in storage as of 12/31/04).
Non-operating: 50 total planes (two owned / 48 leased).

Colgan Air (operates thru US Airways Express (as of 12/11/99) and Continental Connection (as of 7/1/97))

According to company website (www.colganair.com), Colgan operates 11 Saab 340Bs.
No info in US Airways or Continental 10-Ks on Saab aircraft. Apparently Colgan is now flying some or all of the 340B aircraft that were previously leased and operated by CEA, with respect to aircraft leases that CEA rejected earlier in 2005. It is unclear whether the 11 340Bs indicated on the website includes the former CEA aircraft.

Mesaba (MAIR Holdings) (from MAIR 10-K for year ended 3/31/04)

As of 4/30/04, Mesaba had operating leases on 64 Saab 340Bs.
"Mesaba leases its Saab aircraft, either directly from aircraft leasing companies, through leases with Pinnacle under operating leases with initial terms of up to seven years, or through subleases with Northwest under operating leases with initial terms of up to 17 years. The lease and sublease agreements with the aircraft leasing companies Pinnacle and Northwest contain certain requirements of Mesaba regarding the payment of taxes on the aircraft, acceptable use of the aircraft, the level of insurance to be maintained, the maintenance procedures to be performed and the condition of the aircraft upon their return. The Airlink Agreement allows Mesaba to return aircraft to Northwest upon the occurrence of certain events, including termination of the Airlink Agreement."
During FY2004, Mesaba returned six Saab 340Bs to lessors.

Peninsula Airways (largest commuter airline in Alaska - partners with Alaska Airlines)

According to company website (www.penair.com), Peninsula operates 40 aircraft total, at least two of which are Saab 340Bs.

Shuttle America Corp (United Express and possibly US Airways partner based in DC)

According to company website (www.shuttleamerica.com), Shuttle America operates a "fleet" of Saab 340s.
General research shows that Shuttle America may be flying Saab 340As (not 340Bs). In March 2002, Shuttle America leased 18 340As from Saab.

The CEA executives cited their own experiences when they retired their fleet of Jetstream model 31 ("J-31") 19-seat turboprop airplanes. This occurred in approximately 2000, at the time CEA upgraded its fleet to the Saab 340B's. CEA had the option to store the J-31 rotables and expendables in a hangar and attempt to sell at retail, when and as other operators of J-31's needed

parts, but decided that it would realize maximum value by selling through an auction process in one single transaction to a parts broker. This avenue of liquidation avoided the payroll and carrying costs of continuing to house and inventory the parts and hold them out for sale. An additional factor is that some of the parts, for safety reasons, have only a certain shelf life, after which they must be disposed. The CEA executives indicated that their realization, net of disposal costs, was approximately 10 cents on the dollar for the J-31 rotables and expendables.

Back on the subject of the Saab-340B rotables and expendables, the CEA executives indicated that, as one would expect, their inventory comprises a wide range of bigger-ticket and smaller-ticket items, and certainly it is conceivable that they might realize 50-80 percent of cost for engines and propellers. However, on passenger seating and cabin interior panels (which are color-coordinated with ATA's corporate color scheme), the realization will probably be zero. Overall, they believed that "we could get 15 cents on the dollar as a reasonable expectation, 20 cents if we were lucky, and 10 cents if we were unlucky. After considering costs of disposition, we're probably looking at 10 cents." Ten cents on the dollar is what I used for the liquidation value of the rotables and expendables, net of direct costs of liquidation.

As to other categories of assets (e.g., restricted cash, deposits, prepaids), I interviewed the CEA executives as to individual components of each category and their expectations for realization. These expectations are summarized on Exhibit 6.

As to unrestricted cash, I am recommending that the parties attempt to sell CEA's operations, if at all practicable, on a going-concern basis. My starting point in the calculations of liquidation proceeds is CEA's book balance sheet as of January 31, 2005. Since my calculations of liquidation value are for purposes of establishing a cash value floor in a going-concern sale, I have included in the book balance sheet the approximately $300,000 unrestricted cash balance that CEA has as of January 31, 2005, since that appears to be a reasonable operating cash balance.

As to the $17,592,000 pre-petition intercompany receivable from ATAA, I have not included any value for this receivable in my expected proceeds of liquidation. This is because I assume that a purchaser would not acquire such asset, since it is easier to leave such asset with the bankruptcy estates so as to fund potential creditor recoveries independent of the risk of business operations of CEA's fleet and other business assets.

In addition to estimated direct costs of liquidation, which I have netted into my estimated liquidation proceeds for individual assets, I also take into account estimated trustee fees equal to three percent of estimated liquidation proceeds and estimated legal fees of $250,000.

The result of my liquidation analysis is expected proceeds of liquidation of approximately one million dollars, net of all costs and expenses (see Exhibit 6). This is the minimum amount that I believe a purchaser should be committed to pay to the Debtors' bankruptcy estates, in immediate cash equivalent value, as a condition to being treated as a qualified bidder. Any lesser amount would not satisfy the best interest of creditors test, because a liquidation would result in greater value.

I am told that David Grende of Huron Consulting Group, financial advisors for the Debtors, is in the process of performing additional work on liquidation value, and that there is a possibility that he will support a slightly higher liquidation value, perhaps as high as $1.5 million. I am willing to review his work product should the parties choose to furnish it to me. The CEA executives also offered to put me in contact with Steve Lechmeyer, CEA's Vice President of Maintenance and Director of Maintenance, who could assemble for me detailed schedules of rotable and expendable components, and could attempt to value these on a line-item basis. I determined that such a detailed analysis is beyond the scope of my investigation.

Sale as a Going Concern

Currently, there is a motion filed on behalf of the Debtors ("Sale Motion") calling for a deadline for the submission of bids of 4:00 PM Eastern Standard Time on March 25, 2005, and requiring a good faith deposit equal to not less than 10 percent of the amount of the bid. The motion also requests a sale hearing beginning at 1:30 PM Eastern Standard Time on April 1st before the U.S. Bankruptcy Court, to approve any sale resulting from the auction process.

Counsel for NatTel has filed an objection to the Sale Motion, on the basis that it will destroy going concern value because CEA will likely loose all of its fleet of aircraft by April 1, 2005.

The circumstances of CEA's fleet and its FAA Carrier Certificate and DOT Fitness Authority are as follows:

(1) There is an approximately $840,000 aggregate lease payment due to be paid by ATAA on Wednesday, March 22, 2005 to AMR Leasing, with respect to the six Saab

340B aircraft currently leased from AMR Leasing to ATAA, and then subleased by ATAA to CEA. ATAA will not be making the $840,000 payment. Instead, ATAA will file a motion for rejection of the leases. In view of all the facts and circumstances, the Examiner does not believe that ATAA should make this payment.[13]

(2) ATAA owns directly two Saab 340B aircraft and is willing to allow a purchaser of CEA's operations to assume operation of such aircraft, provided that ATAA and the purchaser can agree on mutually acceptable terms.

(3) CEA's current fleet of eight aircraft may be of significant value to prospective purchasers desiring to operate 34-seat Saab 340B aircraft. That is because apparently the only other used aircraft of this type that are currently available for purchase are the 50 American Eagle planes that are parked in the desert in Arizona. CEA's executives believe that it would cost an incremental over $2 million, in aggregate, to put eight of these American Eagle planes in service, over and above base acquisition cost or lease payments. The incremental $2 million would need to be incurred to complete "heavy check" maintenance for each aircraft (over $250,000 per aircraft), to add terrain avoidance systems (required by FAA regulations after these planes were parked in the desert), to add cockpit security doors, and to complete maintenance procedures required by FAA service bulletins. Moreover, CEA executives believe that the American Eagle Saab 340's are primarily the older 340A models, with less remaining service life.

(4) The previous 340B aircraft for which the leases were rejected by CEA are now being used by Colgan Air to provide commuter service for Continental Airlines' Houston Hub, and CEA's executives believe that Colgan would be interested in operating CEA's remaining aircraft should CEA's operation not be sold on a going-concern basis.

(5) It is likely that ATAA's aircraft leases themselves (for CEA's Saab 340B's) are not valuable assets, insofar as the leases were negotiated during better times for the airline industry, prior to unprecedented escalations in the price of fuel. However, I

[13] The lynchpin of ATA's reorganization plan is its code share alliance with Southwest, and Southwest does not operate a hub and spoke route system. Therefore, it appears that CEA has no potential for a "home" with the go-forward ATA. Southwest has verbally indicated to ATA management that it will not permit any other airline, including a regional commuter feeder airline, to code-share with ATA on any route on which Southwest is a code-share partner with ATA.

have not compared the lease terms to current market terms as part of my investigation.

(6) If the lease rejection motion goes forward, CEA's six Saab 340B's leased from AMR Leasing would be subject to return to AMR Leasing's control on Monday or Tuesday, March 28th or 29th. However, since the bid deadline is Friday, March 25th, the winning bidder or potential winning bidders should be known in advance of March 28th, and interested bidders should be talking to AMR Leasing and ATA now, to arrange terms under which CEA could continue to fly the Saab 340B's pending finalization of the sale and approvals from the FAA and DOT.

(7) ATA has received advice from aviation specialists that it is *possible* that the FAA and DOT will allow CEA to retain its Air Carrier Certificate and Fitness Authority if it retains five "Certificate Employees"[14] and continues to maintain at least one of the Saab 340B's owned by ATA. This would allow CEA to cease regular service but hopefully not lose these two valuable intangible assets. However, depending upon whom I interview, I get different levels of comfort as to whether the "not fly but maintain" scenario will ensure maximum value from these assets. This is because the Certificate and Fitness Authority are not *per se* transferable, and the ability of a purchaser of CEA's operations as a going concern (or semi-going concern) to retain the benefit of these assets is subject to approval of these regulatory bodies, and, the more operational CEA is at the time of transfer the more likely is the approval.

Based on all the facts and circumstances of CEA, including the foregoing concerning its fleet of aircraft, its FAA Certificate and its DOT Authority, and the possible continuing existence of significant upstream guarantee obligations, I believe that it is possible to structure the sale of CEA's operations as a going concern, and that such a sale could provide maximum benefit to creditors. The overall architecture of such a sale would likely be as follows:

(1) Minimum cash equivalent bid for CEA's assets of $1 million.[15] If no bidder provides at least this level of consideration in immediate cash equivalent value, then CEA should be liquidated.

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[14] The five employees are Scott Hall (Director of Operations), Steve Lechmeyer (Vice President of Maintenance and Director of Maintenance), Drew Cooper (Director of Safety), Rob Blisset (Quality Assurance Director), and Jeff Davis (Chief Pilot). CEA's executives have told me that all five have given verbal indications that they are willing to stay in the employ of CEA through mid-April. However, some or all are believed to have employment offers from other air carriers.

[15] I am anticipating that, to the extent unrestricted cash is less than approximately $300,000, that the bid terms would contemplate an equivalent reduction in the bid price.

(2) Bidder (or bidders) negotiate with AMR Leasing and ATAA for interim lease terms to retain the Saab 340B aircraft in regular service while the winning bidder secures commitment from the FAA and DOT that it will be able to retain CEA's Certificate and Fitness Authority.

(3) Bidder (or bidders) negotiate with bankruptcy counsel for the Debtors a cash collateral arrangement that would allow the winning bidder to fund and receive the benefit of operating CEA's aircraft during the period between March 28th and the time of final closing of the sale. The time of final closing presumably would be on or after the date that the winning bidder would receive approval from the FAA and DOT, and final closing would be conditioned on such approval.[16]

(4) The purchase of assets of CEA can take the form of a sale under §363(b) of the Bankruptcy Code[17], so that purchasers take assets essentially free and clear. It may be helpful to also acquire CEA's stock, since the Certificate and Fitness Authority are not *per se* transferable. However, in view of the potential upstream guarantee liabilities, the assets probably should be cleansed through the §363(b) sale mechanism. Once the FAA and DOT approvals are received, it may be possible, subject to advice from legal counsel, to have CEA's Chapter 11 case dismissed.

(5) Should a purchaser desire to purchase only stock and leave the assets in corporate solution, then that purchaser would need to address any issues relating to the upstream guarantees. However, so long as such a purchaser would be willing to pay at least $1 million cash equivalent value, the fact that the purchaser wants to purchase stock and not assets should not prevent it from becoming the winning bidder.

(6) Similarly, so long as a purchaser is willing to pay at least $1 million cash equivalent value that can be used to fund payments to current creditors of CEA, the purchaser should not be disqualified from becoming the winning bidder merely because it has not submitted a business plan to counsel for the Debtors. The FAA and the DOT will do what is necessary to ensure the safety of the flying public, and it is not necessary for the Debtors or their advisors to attempt to replicate any activities of the FAA and DOT in terms of ensuring that potential bidders have capability to operate an airline.

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[16] Such a cash collateral is not uncommon in bankruptcy proceedings, such as when a secured lender forecloses on property owned by a leasing company but then gives it back to the debtor to continue managing for the benefit of the lender.

[17] This is only an example, and I am not intending to limit the possible transaction structure to sales under §363(b).

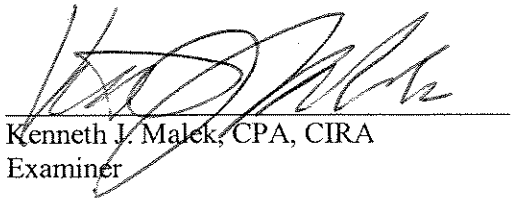
The highly competitive nature of the airline industry makes it understandable that a bidder would not want to disclose its business plans.

(7) The transfer of consideration could be as follows: (a) $1 million or greater cash equivalent value paid by the winning bidder to CEA's bankruptcy estate in a §363(b) sale; (b) CEA distributes $1 million or greater and intercompany account receivable to ATAH, to hold on behalf of CEA's creditors; and (c) CEA's stock is sold to the winning bidder, with corporate shell remaining subject to pre-petition liabilities. These liabilities would eventually be dealt with under the global ATAH plan of reorganization. The source of payment for these liabilities, absent a substantive consolidation plan, would be principally the $1 million or greater cash equivalent value plus the proceeds from the pre-petition intercompany account receivable. I have not determined the extent to which these two assets are currently subject to claims of secured creditors.

I believe that this structure can be employed to maximize the value of CEA to the estates, in the context of a sales process that requires a bid deadline of March 25th and court approval of the winning bidder on April 1st. It is not necessary to stop ATA from rejecting on March 22nd the leases on the Saab 340B's leased from AMR Leasing. It is also not necessary to make any changes to the bidding process currently proposed by the Debtors. If there are parties wishing to purchase and continue the operations of CEA as a going concern, then the foregoing overall structure should facilitate that happening, providing they are willing to pay at least $1 million in cash equivalent value.

I believe that it is in the best interests of CEA's bankruptcy estate to continue with the foregoing sales process with the bid deadline of March 28th, in an attempt to generate more than the $1 million liquidation value of CEA for its creditors, insofar as this process has a possibility of resulting in the sale of CEA's operations as a going concern.

Respectfully submitted,



Kenneth J. Malek, CPA, CIRA
Examiner

Dated: March 18, 2005

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