TESTIMONY OF DANIEL M. KASPER

LECG, LLC
CAMBRIDGE, MA

BEFORE THE
UNITED STATES DEPARTMENT OF LABOR

MAY 5, 2003

HEARING ON PROPOSED INDIVIDUAL EXEMPTION INVOLVING THE NORTHWEST AIRLINES SALARIED PLAN, PILOT PLAN AND CONTRACT PLAN

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A. Introduction & Qualifications

1. My name is Daniel M. Kasper. I am a Managing Director of LECG, LLC (formerly, The Law & Economics Consulting Group). I am also head of both the firm's transportation practice and its Cambridge, Massachusetts, office. LECG provides expert analysis and management consulting in economics, accounting, and finance. My business address is 350 Massachusetts Avenue, Suite 300, Cambridge, Massachusetts 02319. I have over 20 years of consulting experience at LECG, and prior to joining LECG, at Coopers & Lybrand, L.L.P. and Harbridge House, Inc. I previously served on the faculties of the Harvard Business School and the University of Southern California Graduate School of Business Administration. In 1993, I served as one of 15 members of the U.S. National Airline Commission, a body created by an act of Congress to evaluate and make recommendations on how to improve the performance of the U.S. airline and aerospace industries. I have frequently testified as an expert on airline and aviation industry matters before state and federal courts as well as legislative bodies, Executive Branch agencies, and international organizations. Before joining Harbridge House, I served at senior level positions at the United States Civil Aeronautics Board, including more than three years as Director of International Aviation, and was responsible for formulating and implementing the Board's policies with respect to fares and rates, competition, and regulatory policy and international aviation negotiations. I have authored two books on aviation as well as numerous articles, case studies, and research papers on various aspects of air

transportation and government policy. I earned my M.B.A. and J.D. degrees from the University of Chicago. A copy of my curriculum vitae is attached to this affidavit as Appendix A.

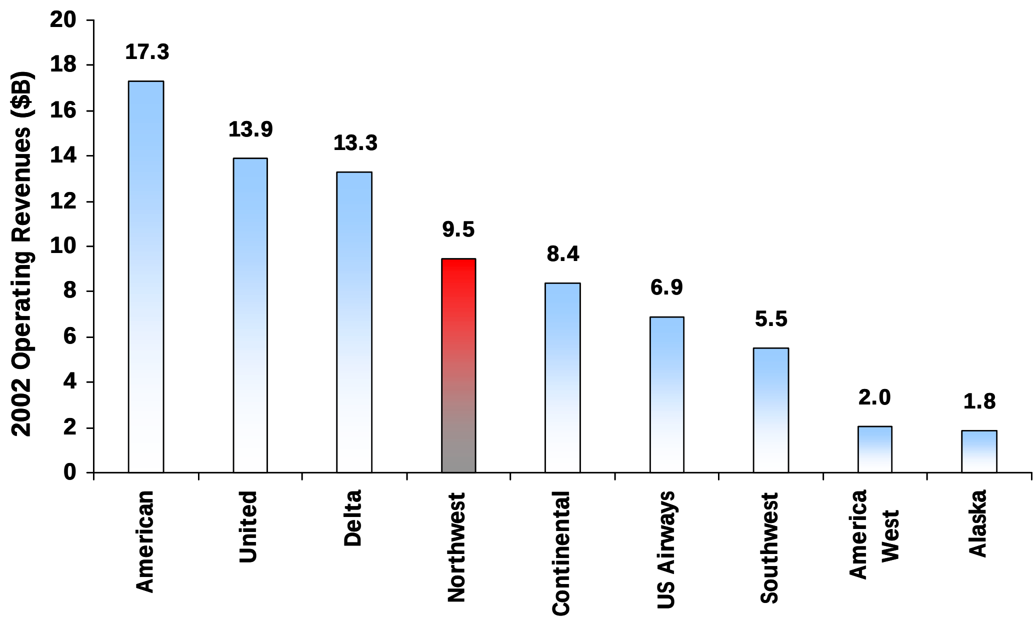
2. I have been asked by Northwest Airlines Inc. ("Northwest") to provide an analysis of the prospects for regional airlines in general, and Pinnacle Airlines Corp. ("Pinnacle) in particular. This report is a statement of my opinions as well as the bases for those opinions, as supported by the work that I have performed or supervised to date. My investigation and consideration of the issues in this matter are ongoing. Accordingly, my opinions are subject to revision based on the work I may complete in the future and further documents, testimony, and other materials I may review.

3. The remainder of this report is organized as follows. Section B provides a brief overview of Northwest's position in the U.S. airline industry. Section C examines the role and importance of regional airlines with respect to the major network carriers. Section D examines why Pinnacle Airlines is well positioned for continued, profitable growth. My conclusions in this matter are summarized in Section E.

B. OVERVIEW OF NORTHWEST'S POSITION IN THE U.S. AIRLINE INDUSTRY

4. Based on most commonly used industry metrics, Northwest is the fourth largest airline in the U.S. airline industry. As shown in Exhibit 1, for example, Northwest ranked fourth among U.S. major carriers in terms of revenues during 2002.[1]

EXHIBIT 1: REVENUES OF MAJOR U.S. CARRIERS (2002)

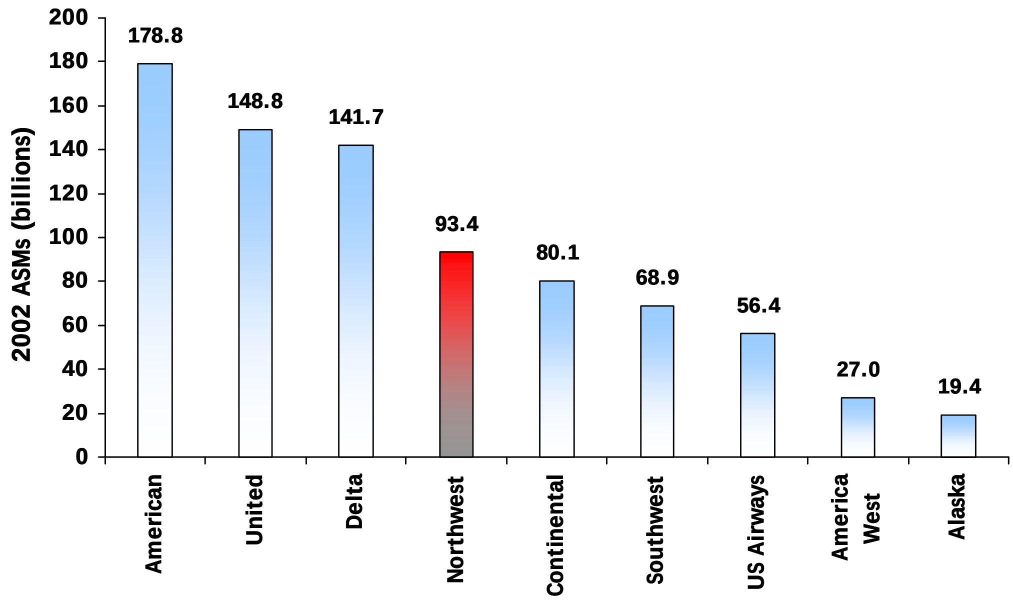


Sources: 2002 airline earnings reports, Forms 10-Q and 10-K.

5. In terms of the standard unit of industry capacity, available seat miles ("ASMs"), Northwest also ranks fourth among the major U.S. carriers, as demonstrated in Exhibit 2 below.

[1] The term "Major Carrier" is defined by the U.S. Department of Transportation as a U.S. scheduled carrier with annual revenues in excess of $1 billion.

EXHIBIT 2: U.S. MAJOR AIRLINE CAPACITY (2002)



Sources: 2002 airline earnings reports, Forms 10-Q and 10-K.

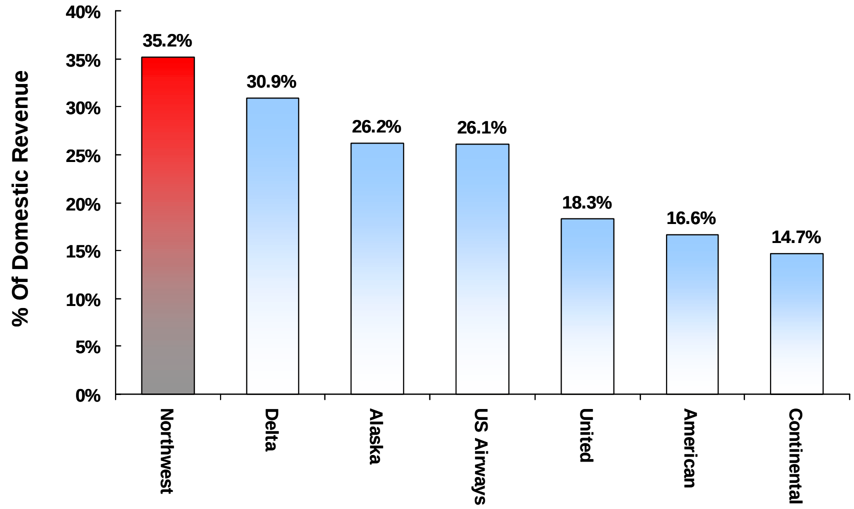
6. Compared to the other large network carriers,[2] Northwest's route structure is the "thinnest;" i.e., Northwest generates a higher proportion of its revenue from small markets than any other major airline. As a result, Northwest is more dependent than other major airlines on small markets.

7. Exhibit 3 summarizes the proportion of domestic revenue generated by the large network carriers in markets with 100 or fewer passengers per day.[3] While some carriers such as Continental, American and United generate only 15%–18% of their domestic revenue in these thin markets, Northwest

[2] Network carriers are those that utilize "hub and spoke" route systems. By combining traffic flows from numerous flights at connecting complexes called "hubs", these networks make it possible network airlines to exploit economies of density and thereby increase both the number of city-pairs served and flight frequencies.
[3] In an effort to avoid any temporary distortions caused by 9/11, I have used for this analysis, data from 2000, the most recent "normal" year. Relative rankings would be unchanged using 2002 data.

generates over 35% of its domestic revenue in markets with 100 or fewer passengers per day.

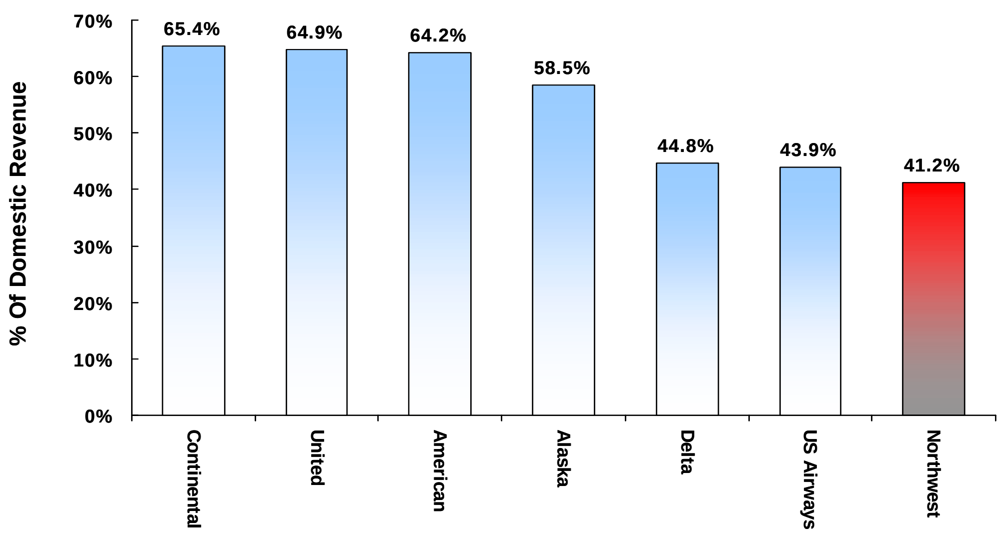
EXHIBIT 3: PERCENTAGE OF DOMESTIC REVENUE GENERATED IN MARKETS WITH 100 OR FEWER DAILY PASSENGERS



Source: U.S. DOT DB1A Database.
Notes: Data from 2000. Markets defined as non-directional city-pairs.

8. Likewise, the proportion of domestic revenue Northwest generates in markets serving 500 *or more* daily passengers is the lowest of all the major network carriers, as shown in Exhibit 4.

EXHIBIT 4: PROPORTION OF DOMESTIC REVENUES GENERATED IN MARKETS SERVING 500 OR MORE DAILY PASSENGERS



Source: U.S. DOT DB1A Database.
Notes: Data from 2000. Markets defined as non-directional city-pairs.

9. Although Northwest had enjoyed somewhat better financial performance than most of its large network peers since 1990, all large network carriers have suffered a significant deterioration in profitability since 2000.

10. Following the collapse of the dot-com "bubble" and the attacks of September 11th, most large network carriers found they could no longer sustain their existing—and uneconomically high—cost structures, particularly in the face of growing competition from low cost carriers (LCCs)[4]. Consequently, they have been forced to significantly reduce their costs—particularly, their labor costs—either by means of Chapter 11 (e.g., US Airways and United) or through collective bargaining (e.g., American). Northwest is currently in negotiations with its unions seeking to obtain competitive labor cost reductions sufficient to maintain its cost competitiveness with both reorganized majors and LCCs.

11. Despite the worst three-year period in commercial aviation history, however, Northwest's liquidity position has remained relatively strong in comparison to other large network carriers,[5] and this has benefited Northwest's debt ratings, as summarized by Exhibit 5 below.

[4] Since the airline industry was deregulated, airline competition has been intensified by the rapid expansion of low cost carriers. These carriers typically provide point-to-point service in dense city-pair markets relying on lower costs to provide them with a competitive advantage over network airlines.

[5] See "Airlines: Assessing War Scenario Underscores Investment Strategies", Credit Suisse First Boston, March 18, 2003; "Airlines: Iraq War Scenario Analysis," Salomon Smith Barney, March 19, 2003; and company financial reports.

EXHIBIT 5: SUMMARY OF MAJOR CARRIER DEBT RATINGS

Carrier	Moody's (Senior Implied)	Standard & Poor's (Corporate)	Fitch (Senior Unsecured)
Southwest	N/A*	A	A
Alaska	B1	BB	--
Delta	B1	BB-	B+
Northwest	B2	B+	B
Continental	B3	B	CCC+
US Airways	Caa3	B	--
America West	Caa3	B-	--
American	B3	CCC	CCC+
United	Caa3	D	--

Sources: Bloomberg; press releases from S&P, Moody's, and Fitch.
Note: Ranked in descending order of S&P ratings.
* No senior implied rating assigned to investment grade issuers.

C. THE ROLE AND IMPORTANCE OF REGIONAL AIRLINES IN THE U.S. AIRLINE INDUSTRY

12. Regional airlines (also called commuter airlines) constitute an important and growing part of the U.S. air transportation system. Since the majority of communities in the United States do not generate sufficient traffic to support large jet service, regional airlines operating smaller aircraft—traditionally, aircraft with 70 or fewer seats—often provide the only air link smaller communities have to the national air transportation network. Thus, of the 726 North American airports that received commercial air service in 2001, 68%

(or 494 airports) relied exclusively on regional airlines for access to the U.S. air transport system.[6]

13. Regional carriers typically provide short-haul service between smaller communities and larger airports that serve as hubs for major airlines. By providing service to these hubs, regional airlines give small communities one-stop access to hundreds of destinations across the country and around the world. More recently, advances in aircraft technology—in particular, the development of small regional jets ("RJs")—have permitted regional airlines to fly longer (but still typically thin) routes, thus allowing hub carriers to expand the scope of their networks.

14. The overwhelming majority of regional airline traffic in the United States (98% in 2001) is carried under "code-sharing" agreements with major airlines.[7] Regional code sharing agreements are contractual arrangements whereby a regional airline lists its flights in computer reservation systems under the designator code of the larger airline. Regional airlines that participate in code-share agreements with major airlines seek to provide passengers originating at or destined to smaller communities with a relatively seamless journey—including, for example, through ticketing and baggage handling and convenient connections—comparable to that experienced by a passenger making a connection between two flights operated solely by the

[6] Source: *Regional Airline Association 2002 Annual Report*, page 10.
[7] Ibid, page 10.

larger airline. As part of these code-sharing arrangements, affiliated regionals typically paint their planes in the colors of the major and adopt a name variation of the major airline's name (e.g., Northwest Airlink or American Eagle). In addition, majors and their regional affiliates typically share numerous responsibilities and costs, including facilities, check-in and ticketing, and baggage handling.

15. The relationship between a major airline and its regional affiliates is perhaps best described as symbiotic. Since most passengers using regional airlines ultimately connect to flights on large carriers, major airlines benefit from the increased flow traffic through their hubs and the ability to offer service to destinations they would otherwise not be able to economically serve. Regional airlines, in turn, obtain a number of important benefits by code sharing with a major airline. These include an increase in the number of connecting passengers as well as important consumer marketing advantages from using the name and designator code of a larger, better-known airline. Major airlines typically provide their regional affiliates with internal reservations and yield management systems (or services) and preferential listings on computerized reservations systems. Major airlines also provide—and may absorb some portion of the regional affiliate's costs—for the use of facilities (gates, ticket counters, baggage handling, etc.) at airports served by both carriers. Regional airlines also benefit from major airlines' substantial expenditures on advertising and other marketing programs as well as from

participation in major airline frequent flyer programs. The benefit of being associated with a well-known airline brand name is important to a regional airline because of consumer concerns about safety in general, and about the safety of the smaller regional aircraft, in particular.

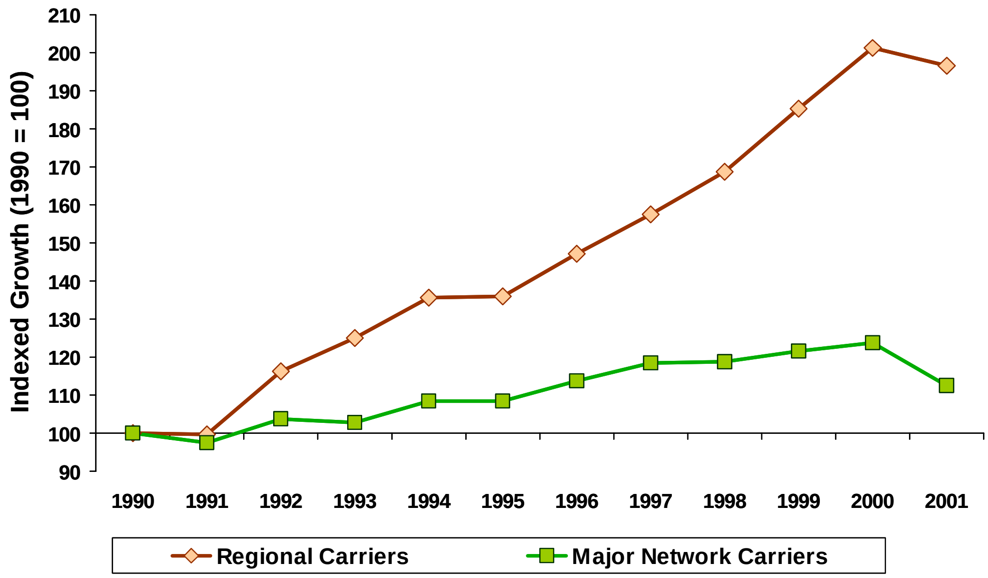
16. Over time, many of the most successful regional carriers, initially began as independent airlines, became subsidiaries of the major carriers with whom they code-shared. This occurred for several reasons, including: (a) the desire by major airlines to protect what had become an increasingly important source of feed traffic at their hubs, whose competitiveness and economic viability depend to an important degree on obtaining cost effective feeder service by regional aircraft; (b) the increased cost of regional aircraft (which made it more difficult for regional airlines to finance their aircraft); and (c) competitive pressures that forced major airlines to provide passengers with frequent flights, closely-coordinated flight schedules and consistent levels of "product" quality throughout their route networks. More recently, as regional airlines have grown in size and sophistication, there has been some movement in the direction of spinning off regional carriers as publicly traded companies.

Regional Carriers Have Grown Faster Than Large Network Carriers

17. Over the past decade, regional carriers have grown at a far faster pace than major network carriers. Exhibit 6 summarizes the growth in enplanements of the regional versus large network carriers. To make the two series directly

comparable, the scale has been indexed to a starting value of 100 for both types of carriers. While enplanements on the large network carriers grew by roughly 20% between 1990 and 2000, regional carrier enplanements increased by almost 100%.

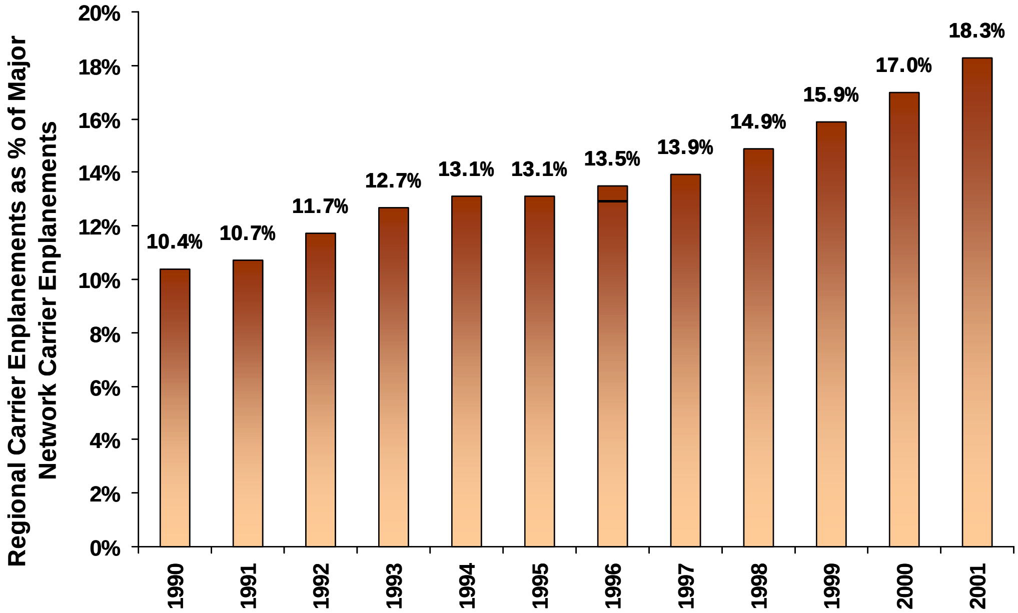
EXHIBIT 6: REGIONAL VS. MAJOR NETWORK CARRIER ENPLANEMENT GROWTH 1990-2001



Notes: Major network carriers include Alaska, America West, American, Continental, Delta, Eastern, Northwest, TWA, United, and US Airways. Regional carriers include all RAA members.
Sources: RAA Annual Reports, U.S. DOT Form 41.

18. Consequently, regional carrier enplanements as a proportion of major network carrier enplanements increased from 10.4% in 1990 to 18.3% in 2001, as shown Exhibit 7 below.

EXHIBIT 7: REGIONAL CARRIER ENPLANEMENTS AS A % OF NETWORK CARRIER ENPLANEMENTS, 1990-2001

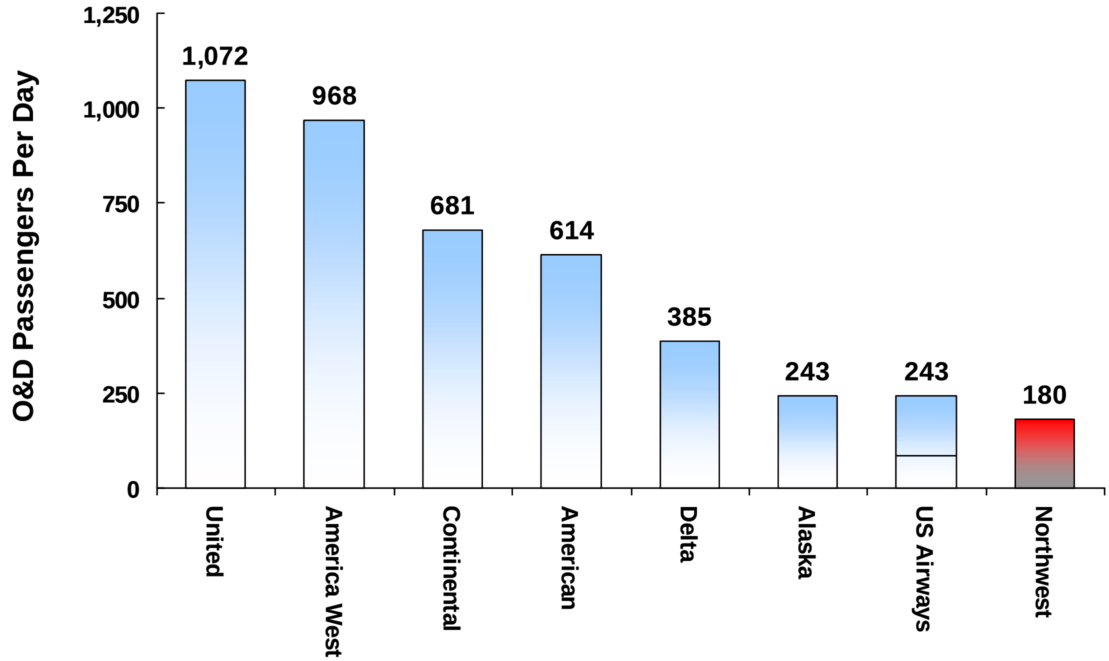


Notes: Major network carriers include Alaska, America West, American, Continental, Delta, Eastern, Northwest, TWA, United, and US Airways. Regional carriers include all RAA members.
Sources: RAA Annual Reports, U.S. DOT Form 41.

19. Regional airlines play a crucial role in the networks of all large network carriers, but their current and future role in Northwest's network is particularly important because of the high proportion of Northwest's routes that are "thin". As shown in Exhibit 8, the median non-stop route served by Northwest's mainline fleet generated only 180 origin and destination ("O&D") passengers per day during 2000, less than half the number of passengers on Delta's median non-stop route and roughly one-sixth as many as United's median non-stop route.[8]

[8] O&D (or "local") passengers count travelers based on the starting and ending point of their journey, regardless of whether or not they are making a connection.

EXHIBIT 8: MEDIAN O&D DENSITY OF ROUTES SERVED NONSTOP BY MAINLINE FLEET

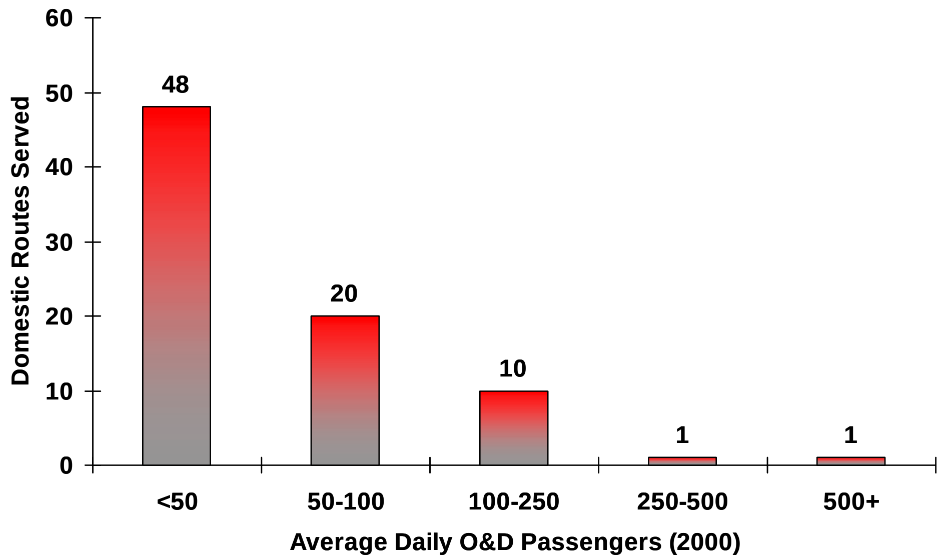


Source: U.S. DOT DB1A and T100 Databases.
Notes: Routes served by mainline aircraft with at least one roundtrip per weekday in July 2002. Median density figures based on Data from 2000.

20. The "feeder" routes served by Pinnacle are even thinner. As shown the Exhibit 9, the majority of routes served non-stop by Pinnacle generate fewer than 50 local passengers per day, a level that cannot typically be served economically using mainline aircraft.[9]

[9] The optimal equipment size for a given route depends on a number of factors, including the amount of local and flow traffic it generates, the carrier's desired flight frequency on the route, and the distribution of demand throughout the day.

EXHIBIT 9: MEDIAN O&D PASSENGERS IN ROUTES SERVED NONSTOP BY PINNACLE



Notes: Routes served by Pinnacle with at least 1 roundtrip per weekday during March 2003. Historical entry probability based on Entries by Southwest, Frontier, AirTran, ATA and Jetblue between 1992 and 2002.

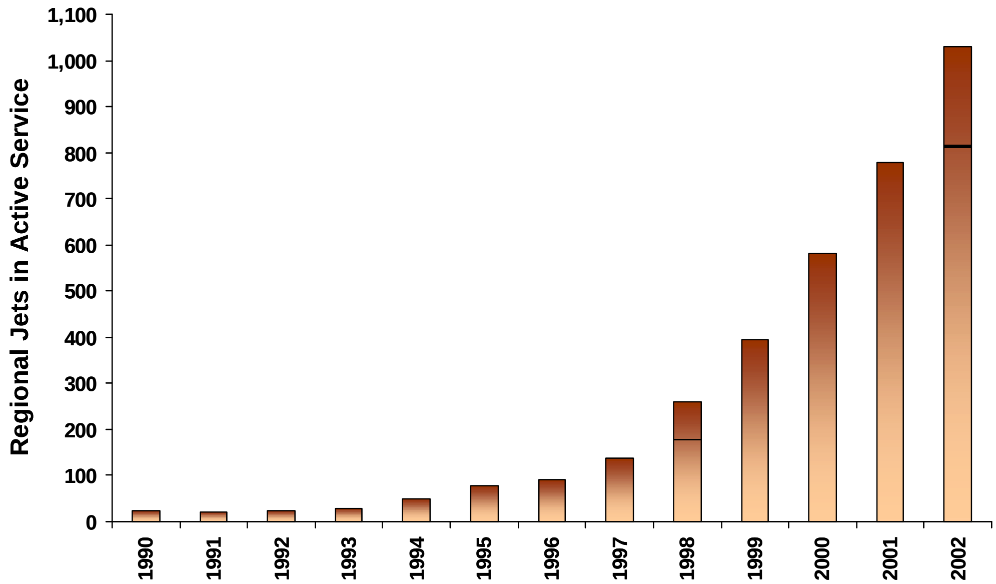
Regional Jets Are A Key Factor in the Rapid Growth of Regional Carriers

21. The dramatic growth of regional carriers in recent years has been due in large measure to the increased use of regional jets. These small jets have enabled network carriers to economically expand the scope of their networks to include routes too thin to be served with mainline aircraft but too long to be feasibly served with turboprop aircraft.[10] In addition, RJs can be used to "in fill" flight schedules at times when demand may not be sufficient to support service by large jet equipment. Thus, by permitting airlines to better capacity to demand, RJs allow airlines to offer more frequent service throughout the day. Moreover, since RJs are less expensive to acquire than large jets and are

[10] See, for example, *Profile: Regional Jets and Their Emerging Roles in the U.S. Aviation Market*, U.S. Department of Transportation, Office of the Assistant Secretary for Aviation and International Affairs, June 1998.

operated by regional carriers with significantly lower labor rates than those paid by large network carriers, RJs are far more economical than mainline aircraft for serving thin markets, thus providing carriers that deploy them with a competitive cost advantage.[11] As a result, the number of regional jets has grown dramatically over the past decade, as shown in Exhibit 10.

EXHIBIT 10: REGIONAL JETS IN ACTIVE SERVICE, 1990-2002



Note: Includes all RJs in service by RAA members. Figures for 2002 based on RJs in use by major network carriers' codeshare partners.
Source: RAA Annual Reports.

22. Although other network carriers such as Delta and Continental have, for the most part, transitioned the bulk of their regional flying to regional jets, Northwest has been relatively slow in adopting RJs. Thus, as shown in Exhibit 11, Northwest's RJ fleet as a proportion of its mainline fleet is among the lowest of the major network carriers, and lags far behind both Delta and

[11] The economic importance of expanded RJ usage to major airlines is illustrated by the substantial increases obtained by US Airways in its plan of reorganization. That plan permits US Airways to place 200 firm orders plus 300 options for RJs. Source: US Airways Press Release, August 11, 2002. See also, "US Airways: Small Planes, Big Payoffs?" *Pittsburgh Post Gazette*, May 12, 2002.

Continental. Given the relative thinness of Northwest's route system and the favorable economics of deploying regional jets in thin markets, it is likely that Northwest will continue to increase its reliance on RJs in the future.

EXHIBIT 11: RJS AS A PERCENTAGE OF MAINLINE FLEET, 2002

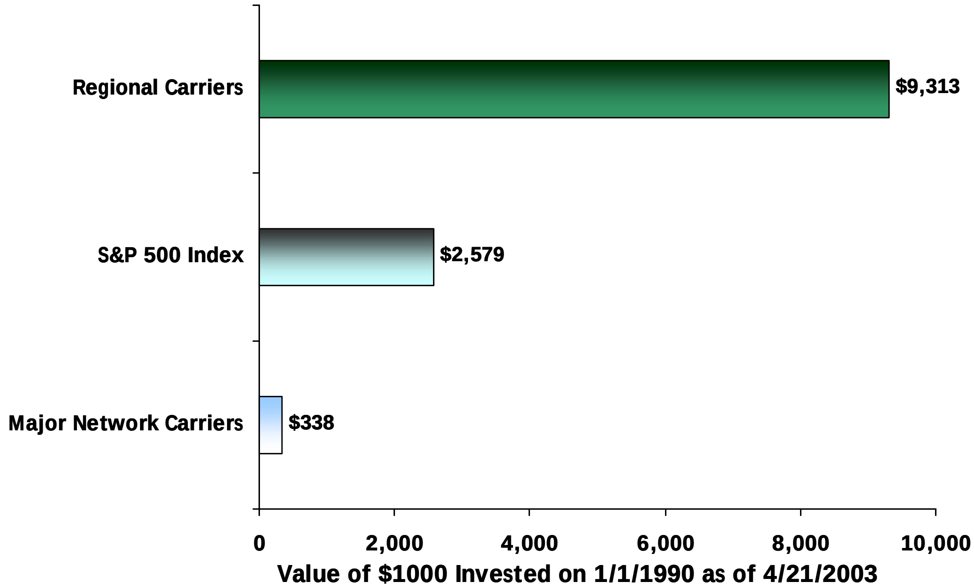
Carrier	Mainline	Regional Jets	RJs as a % of Mainline
Delta	573	323	56.4%
Continental	366	188	51.4%
US Airways	280	78	27.9%
United	567	143	25.2%
American	752	163	21.7%
America West	143	31	21.7%
Northwest	419	87	20.8%
Alaska	105	16	15.2%

Notes: Reflects move of 12 Chautauqua Regional Jets from America West service to Delta. Also reflects American's plan to retire 74 Fokker 100's. Mainline aircraft do not include freighters.
Sources: Major Carrier and Regional Carrier websites.

The Stocks of Publicly Traded Regional Carriers Have Outperformed Those of The Major Network Carriers

23. The stocks of regional carriers—as a group—have significantly outperformed those of the major network carriers and the broader market in recent years. Exhibit 12, for example, shows the current value of $1,000 invested in each of two baskets of publicly traded airline stocks (major network carriers and regional carriers) on January 1, 1990. The Standard and Poor's 500 Index is also included for comparison.

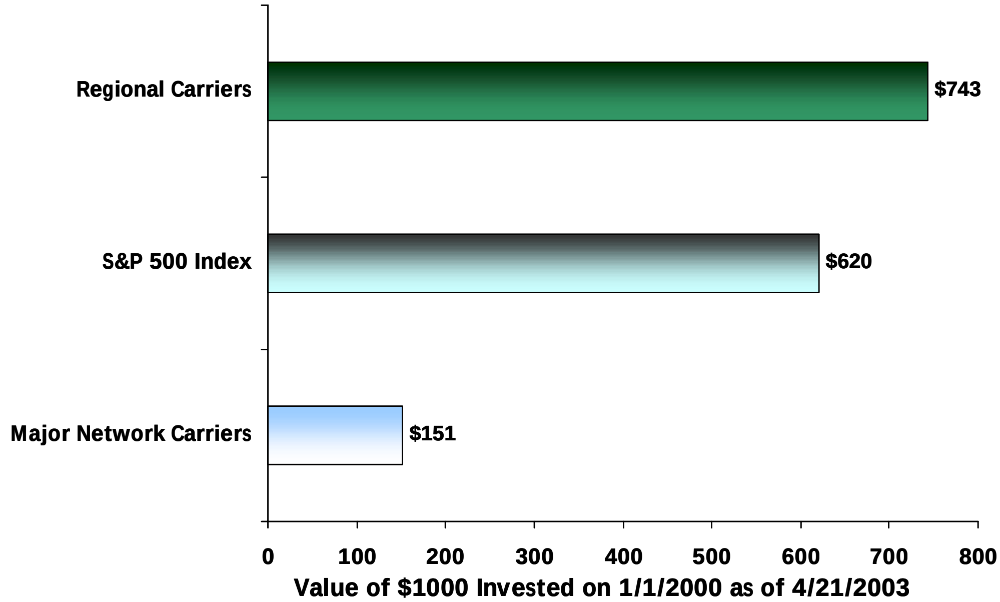
EXHIBIT 12: VALUE OF $1,000 INVESTED IN AIRLINE STOCKS ON JANUARY 1, 1990



Notes: Major network carriers include Alaska, America West, American, Continental, Delta, Northwest, United, and US Airways. Regional carriers include Mesa, Mesaba, Atlantic Coast, Express Jet and SkyWest. Portfolio based on equal weights of each carrier in its respective group.
Source: Yahoo Finance.

24. Likewise, regional airline stocks have outperformed both major network airline stocks and the S&P 500 over the past 28 months. As shown in Exhibit 13, $1,000 invested in a basket of regional carriers on January 1, 2000 would currently (as of April 21, 2003) be worth at $743. In contrast, $1,000 invested in major network carrier stocks on January 1, 2000, would now be valued at only $151 while $1,000 invested in the S&P 500 would now be worth only $620.

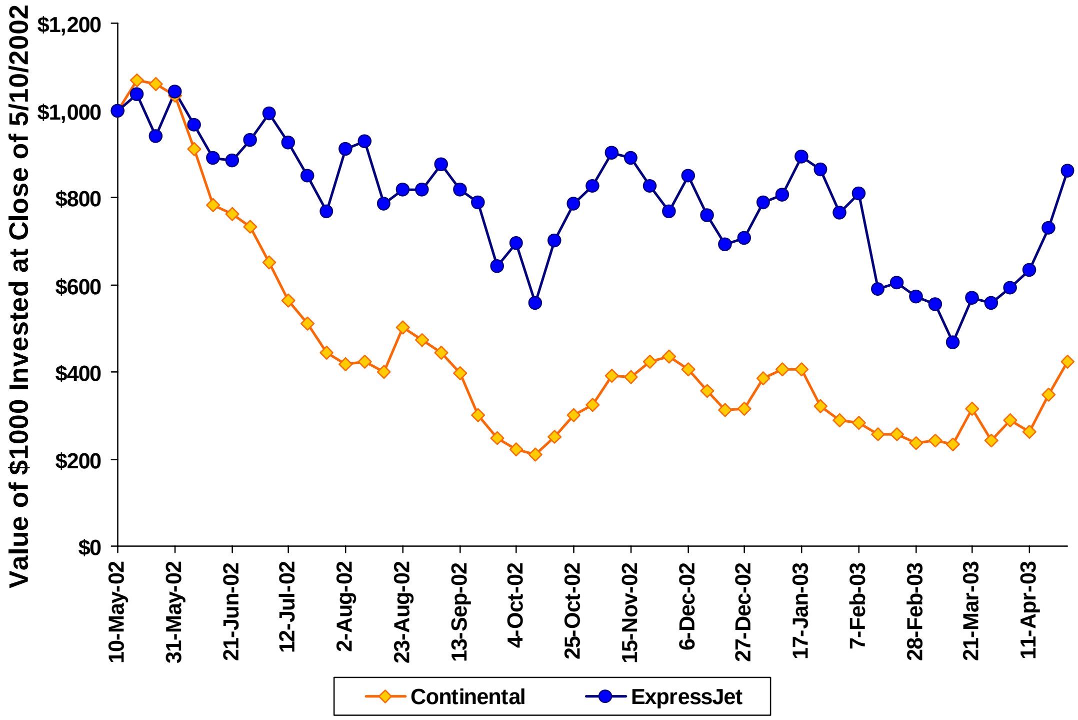
EXHIBIT 13: VALUE OF $1,000 INVESTED IN AIRLINE STOCKS ON JANUARY 1, 2000



Notes: Major network carriers include Alaska, America West, American, Continental, Delta, Northwest, United, and US Airways. Regional carriers include Mesa, Mesaba, Atlantic Coast, Express Jet and SkyWest. Portfolio based on equal weights of each carrier in its respective group.
Source: Yahoo Finance.

25. ExpressJet, formerly Continental Express, provides an interesting point of reference for evaluating Pinnacle. Prior to its partial spin off by Continental in April 2002, ExpressJet was a wholly owned, all-jet subsidiary of a major airline. Since its initial public offering, ExpressJet's stock has outperformed its former parent company, Continental Airlines, by a considerable margin as shown in Exhibit 14.

EXHIBIT 14: EXPRESSJET VS. CONTINENTAL AIRLINE' STOCK PERFORMANCE, MAY 2002-APRIL 2003

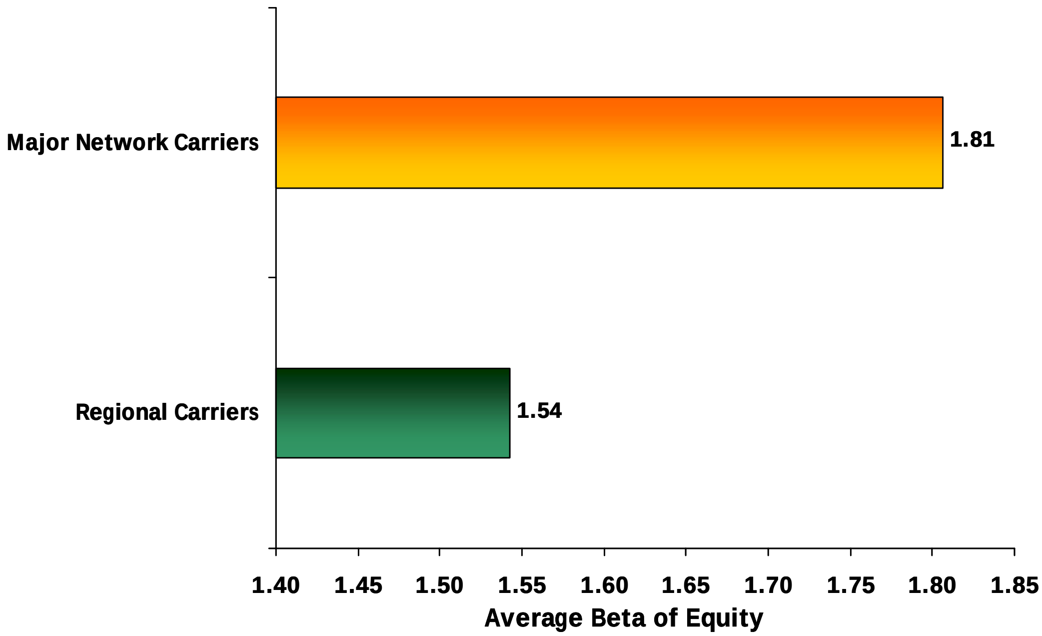


26. And while Continental recently reported a net loss of $221 million for the first quarter of 2003, ExpressJet reported a first quarter *profit* of $25.6 million on revenues that were 16% higher than those from the first quarter of 2002.[12] As explained in Paragraph 40 below, ExpressJet, like Pinnacle, operates under a "cost plus" air services agreement that allocates most of the normal business risk `to the major carrier. Hence, as long as these regional airlines can maintain a few cost items (e.g., labor, corporate overhead) within or below committed levels, their profitability is assured.

[12] See "Continental Airlines Reports First Quarter Loss", Reuters, April 15, 2003 and "ExpressJet Holdings Reports First Quarter Earnings of $25.6 Million", PR Newswire, April 15, 2003.

27. Moreover, while airline stocks, as a group, tend to be fairly cyclical, the stocks of publicly traded regional carriers have been considerably less volatile than those of the major network carriers. Exhibit 15 compares the average "*beta*" for the regional carriers over the past five years has been 1.54 versus an average *beta* of 1.81 for the large network carriers.[13]

EXHIBIT 15: AVERAGE BETAS OF REGIONAL VS. LARGE NETWORK CARRIER STOCKS



Notes: Major network carriers include Alaska, America West, American, Continental, Delta, Northwest, United, and US Airways. Regional carriers include Mesa, Mesaba, Atlantic Coast, and SkyWest. Time periods for carriers' betas are 5 years, when available, and minimum of 2.5 years.
Source: Yahoo Finance.

[13] A stock's *beta* is a measure of its volatility relative to the market as a whole. Stocks with betas greater than one are more volatile than the overall market, whereas stocks with betas less than one are less volatile than the overall market. See *Principles of Corporate Finance*, fifth edition, Richard Brealey and Stewart Myers. New York: McGraw-Hill, 1996.

D. PINNACLE AIRLINES IS WELL-POSITIONED FOR CONTINUED, PROFITABLE GROWTH

28. Pinnacle Airlines is currently the 12th largest U.S. regional carrier, as illustrated by the following exhibit.[14]

EXHIBIT 16: RANKING OF THE 15 LARGEST U.S. REGIONAL CARRIERS, 2002

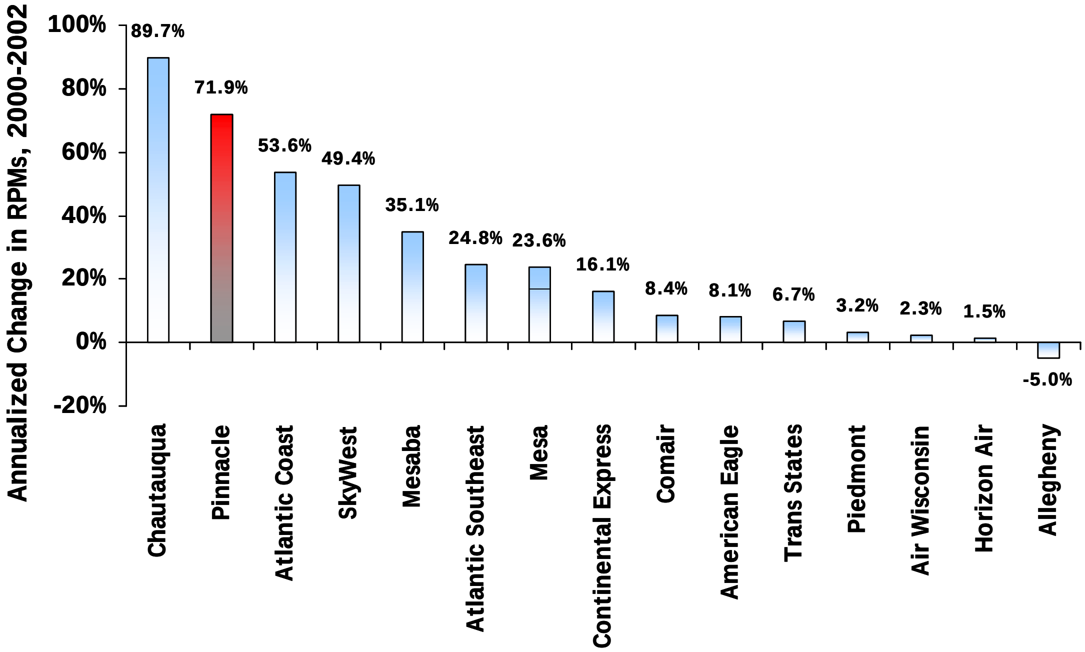
Rank	Regional Carrier	Revenue Passenger Miles (000s)
1	Continental Express	1,837,964
2	American Eagle	1,771,688
3	Comair	1,706,206
4	Atlantic Southeast	1,518,012
5	SkyWest	1,362,910
6	Atlantic Coast	1,318,949
7	Mesa	908,373
8	Air Wisconsin	751,061
9	Mesaba	745,032
10	Horizon Air	703,582
11	Chautauqua	668,827
12	Pinnacle	477,177
13	Piedmont	331,548
14	Trans States	255,556
15	Executive	206,162

Note: Data are from first half of 2002.
Sources: "Number Of U.S. Regional Routes Continue To Grow", Commuter/Regional Airline News, 10/21/2002.

29. Pinnacle has also been one of the fastest growing regional airlines over the past several years, as shown in Exhibit 17.

[14] A revenue passenger miles ("RPMs") is a standard industry measure that equals one fare paying passenger traveling one mile.

EXHIBIT 17: RPM GROWTH RATES OF THE LARGEST 15 REGIONAL CARRIERS (2000-2002)



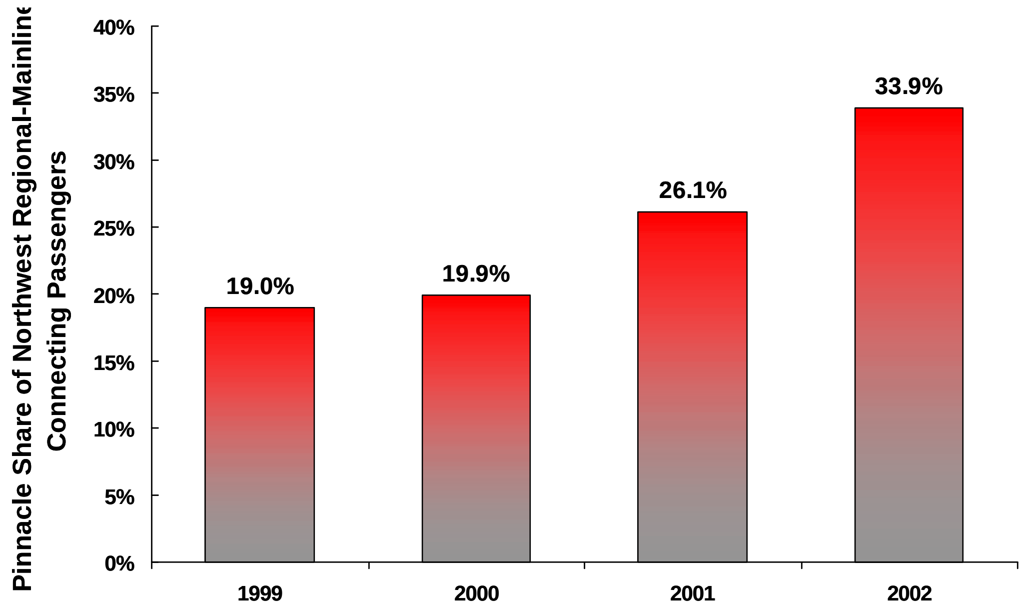
Note: Data are from first half of 2000 and 2002.
Sources: "Number Of U.S. Regional Routes Continue To Grow", Commuter/Regional Airline News, 10/21/2002; "Traffic Jumps 20 Percent for U.S. Regionals in Second Quarter", Commuter/Regional Airline News, 11/13/2000.

Pinnacle's Growth Is Likely To Continue

30. Moreover, Pinnacle is poised to continue growing well into the future. In addition to the fact that it has a ten-year agreement with Northwest, the prospects for Pinnacle's continued growth are rooted in (a) Northwest's relatively thin route structure that makes using smaller aircraft economically attractive on many routes, (b) the fact that Northwest currently deploys proportionally fewer regional jets than virtually all of its network peers despite its thin route structure, and (c) the fact that Pinnacle's fleet of aircraft consists entirely of new and modern regional jets which are typically more cost effective to operate and have both greater range and a much higher level

of customer acceptance than do turboprop aircraft. Moreover, Pinnacle's share of Northwest's regional-to-mainline connecting passengers has grown rapidly over the past 4 years, as shown in Exhibit 18.

EXHIBIT 18: PINNACLE'S SHARE OF NORTHWEST AIRLINK REGIONAL-MAINLINE CONNECTING PASSENGERS



Source: U.S. DOT DB1A Database.
Note: Data for 2002 from first and second quarters. Domestic passengers only.

31. Like other large network carriers, Northwest relies upon its regional affiliates (Pinnacle and Mesaba) to provide cost effective feeder service from smaller communities to its connecting hubs.[15] During the first six months of 2002, for example, 18% of all domestic passengers taking a Northwest Airlines' mainline flight connected to or from a Northwest Airlink (Pinnacle or Mesaba) flight.[16] In short, nearly two of every ten passengers on a Northwest mainline flight connect to or from an Airlink regional flight. Thus, it is clear

[15] Northwest also has a codeshare agreement with a third regional carrier marketed under its *Northwest Airlink* brand, Pacific Island Aviation, for flights to and from Saipan.
[16] Source: U.S. DOT DB1A Database.

that Northwest's ability to maintain its overall network depends critically on the kind of cost-effective service provided by Pinnacle because without it, Northwest would lose the important "flow" traffic these routes generate for Northwest's mainline flights.

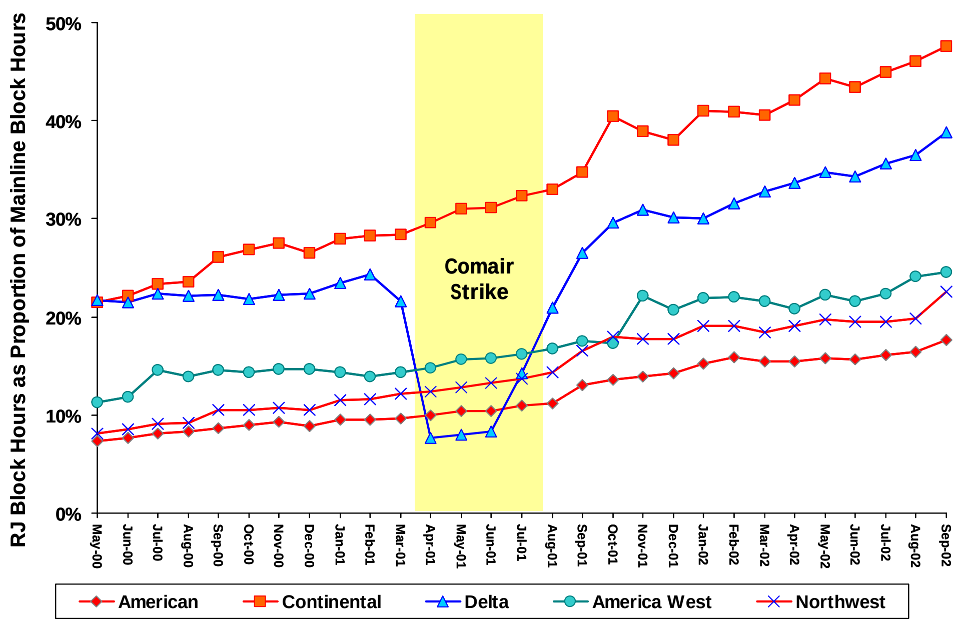
32. In addition to providing connecting feed to its mainline service, Northwest Airlink carriers are often the only economically viable means of providing air service for passengers traveling from small communities to Northwest's three domestic hub cities (i.e., local service from Lincoln, Nebraska to Minneapolis). During the twelve months ending June 2002, Northwest Airlink affiliates carried over seven hundred thousand local passengers between small communities and its three hub cities of Detroit, Minneapolis and Memphis.[17]

33. Northwest Airlink carriers also make it possible for Northwest to provide air service (on a connecting basis) *between* many small communities (i.e., Sioux Falls, South Dakota to Appleton, Wisconsin, via Minneapolis). During the twelve months ending June 2002, nearly 320,000 O&D passengers making connections flew solely on flights operated by Northwest Airlink (i.e., their journeys did not include a mainline segment.) In sum, regional carriers such as Pinnacle are essential to the network breadth of major carriers generally, and Northwest Airlines, in particular, because of its relatively high proportion of thin routes in its route system.

[17] Source: U.S. DOT DB1A Database.

34. Since Northwest deploys proportionally fewer RJs that any of its large network peers, Northwest's RJ block hour flying as a proportion of its mainline block hour flying lags far behind that of most other major carriers, as demonstrated in Exhibit 19 below.

EXHIBIT 19: RJ BLOCK HOURS AS A % OF MAINLINE BLOCK HOURS

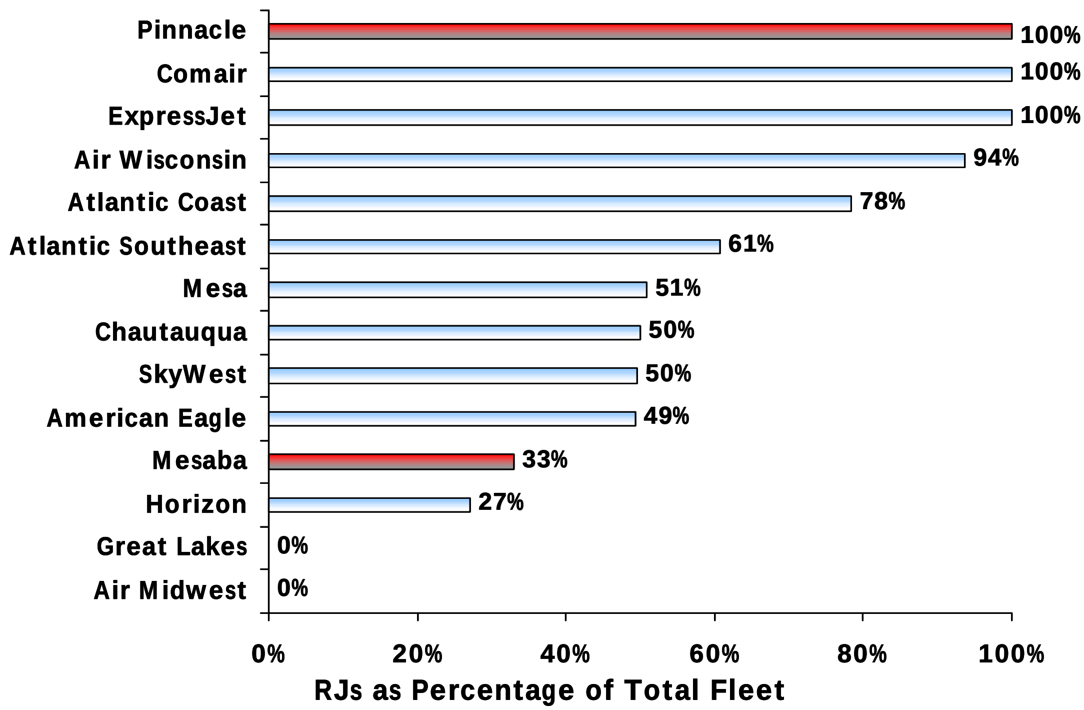


Notes: RJ block hours for Delta are for Comair and Atlantic Southeast only (I.e., exclude SkyWest and Atlantic Coast.) RJ block hours for American include American Eagle only (I.e., exclude Chautauqua and Trans States.) Domestic Operations.
Source: U.S. DOT T100 Database.

35. Given Northwest's thin route system, the economic advantages of RJs in serving such routes, and the competitive pressures on Northwest as a result of expanded RJ use by its competitors, it is likely that Northwest will have to close its "RJ gap" with other large network carriers. As a result, it seems likely that Pinnacle (whose current fleet is comprised entirely of modern regional jets) will continue to have strong growth prospects.

36. As shown in Exhibit 20, Pinnacle is one of only three large U.S. regional carriers whose fleet is comprised entirely of regional jets. Thus, Pinnacle appears to be solidly positioned to provide RJ feeder service to Northwest and possibly other major carriers in the future.[18]

EXHIBIT 20: REGIONAL JETS AS A PROPORTION OF TOTAL FLEET



Sources: Regional airline websites and news releases; 2002 airline 10-Ks.

37. Moreover, since regional carriers primarily serve thin routes that typically cannot support service by the larger jets operated by major carriers, they are significantly less susceptible to LCC incursions than their major carrier counterparts. LCCs typically target dense (i.e., heavily traveled) routes, which

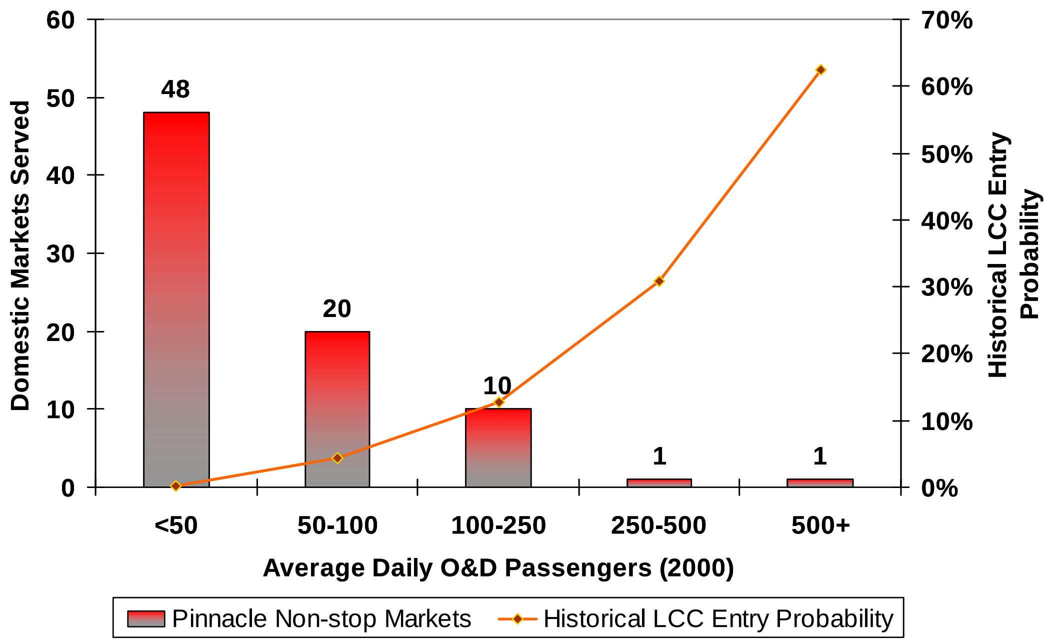
[18] Section 2.15 of the *Airline Services Agreement* between Pinnacle and Northwest permits Pinnacle to operate services for other carriers after the earlier of January 1, 2005 and the date on which Pinnacle has ninety-five CRJ-200/440 aircraft in its fleet.

rely less on connecting traffic, and thus allow LCCs to exploit their comparative advantage at offering quick turn, high frequency, point-to-point service.[19] Between 1992 and 2002, for example, LCCs entered only 0.2% of the city-pair markets with 100 or fewer O&D passengers per day. In contrast, during the same period, LCCs entered 75.3% of the markets generating over 1,000 passengers per day and 53.3% of the markets generating between 500 and 1,000 daily passengers.[20]

38. Exhibit 21 shows that the overwhelming majority of non-stop markets served by Pinnacle have passenger densities that are well below those that have attracted entry by LCCs.

[19] A recent study of LCC entry between 1992-2002 found that pre-entry density was the single most important factor in predicting LCC entry decisions. See "Low Cost Carrier Growth in the U.S. Airline Industry: Past, Present and Future," by Harumi Ito and Darin Lee, Brown University Department of Economics Working Paper, 2003.
[20] Ibid, page 23.

EXHIBIT 21: PINNACLE NON-STOP MARKET DENSITY VS. LCC ENTRY PROBABILITIES



Notes: Markets served by Pinnacle with at least 1 roundtrip per weekday during March 2003. Historical entry probability based on Entries by Southwest, Frontier, AirTran, ATA and Jetblue between 1992 and 2002. Markets defined as non-directional city-pairs. The Pinnacle market serving more than 500 passengers per day is Detroit to New York's Westchester County Airport and airports in the New York City area (LGA, JFK, EWR and HPN) are grouped together for purposes of computing daily passengers. Historical entry probabilities based on LCC entry patterns between 1992-2002 (see Ito and Lee (2003), op cit.)

Pinnacle's Profitability Is Also Likely to be Relatively Stable

39. Pinnacle's prospects are further enhanced by the fact that its agreement with Northwest covers a ten-year term. And since the contract also provides that Pinnacle is to be paid on a "cost plus" basis, the risk of unexpected traffic declines or fuel price increases are borne by Northwest, not by Pinnacle. Thus, Pinnacle's contract with Northwest substantially insulates Pinnacle from the economic risks of the airline business by providing that Pinnacle will be reimbursed for the costs—fuel, aircraft, labor, etc.—that it incurs in operating Northwest Airlink flights,[21] plus a specified profit margin. As a result,

[21] For some categories of cost (e.g., labor, corporate overhead), Pinnacle is responsible for increases above levels specified in the contract.

Pinnacle's profitability under the ASA contract is assured as long as it maintains labor and overhead costs within contractual limits. And the more predictable earnings stream made possible by similar agreements entered into by other regional airlines has no doubt contributed to the superior performance of regional airline stocks discussed previously.

Pinnacle Would Maintain Value Even in Northwest Filed For Chapter 11

40. The airline industry is currently facing the most challenging economic environment in the history of modern aviation. This situation has come about as the result of a number of factors, including: (a) the rapid decline in high-yielding business traffic associated with the "dot-com" bust and overall weakness in the economy, (b) the continuing impact of events of September 11th, (c) the proliferation of low cost carriers, (d) the Iraq war; (e) the "SARS" epidemic; (f) increased taxes and security-related costs; and (g) the widespread use of Internet booking channels, which has led to increased price-shopping and transparency in airline prices. Thus far, these unprecedented business conditions have forced two major carriers—United and US Airways—and several smaller ones to file for Chapter 11 bankruptcy, and few major airlines are immune from the threat of bankruptcy.

41. Since Northwest has thus far been able to maintain a relatively strong liquidity position, it is somewhat less vulnerable to the threat of bankruptcy than most other large, network airlines. And because the exemption permitting the use

of Pinnacle stock to fund Northwest's pension obligations would allow Northwest to conserve liquidity, it would thus lessen the likelihood Northwest will be forced to file for protection under Chapter 11.

42. But if such a filing by Northwest does become necessary, a strong liquidity position would increase the likelihood of a successful reorganization under Chapter 11. Hence, approval of the proposed exemption, permitting Northwest to contribute Pinnacle stock to help fund its pension obligations would increase the likelihood that the reorganization would be successful.

43. Moreover, if it were required to reorganize under Chapter 11, Northwest could expect to realize substantial labor, aircraft and other cost savings that would significantly strengthen its competitive position in the airline industry.

44. Further, based on the labor agreements negotiated under Chapter 11 by US Airways and United—that permit both of those carriers to dramatically *increase* their usage of regional jets—it is reasonable to anticipate that a bankruptcy filing by Northwest could result in an even greater increase in RJ flying opportunities for Pinnacle.[22]

[22] US Airways reorganization plan provides for up to 200 firm RJ orders (and 300 options). Source: US Airways Press Release, August 11, 2002. In addition, United's new "scope" clause provides the Company with the ability to increase substantially its usage of RJs. See, for example, Appendix B to *Memorandum in Support of Debtors' Motion to Reject Their Collective Bargaining Agreements Pursuant to Section 1113(c).*

45. The increase in RJ flying by reorganized large network carriers has been made possible by the fact that under Chapter 11, airlines can be relieved of labor contract terms that impose artificial limits on the use of RJs. Increased ability to use RJs has been a key component of recent airline reorganizations because major airlines clearly recognize that the importance of maintaining the scope of their route networks, perhaps their most significant competitive advantage vis-à-vis LCCs.[23] Due to the favorable economics of RJs, especially in thin markets, regional jets offer large network carriers a cost effective means of preserving and enhancing network breadth, even as they are forced to ground larger aircraft and reduce overall system capacity. Thus, even if Northwest finds it necessary to reorganize under Chapter 11, its demand for regional flying—the very service that Pinnacle provides—would continue to grow.

46. Finally, because major airlines incur significant switching costs if they change their regional carriers, regional affiliates, such as Pinnacle, that perform satisfactorily also enjoy an important measure of "job security."

E. CONCLUSIONS

47. Over the past decade, regional airlines have grown more rapidly and been more profitable than large network airlines. And since 1990, the stocks of publicly traded regional airlines have substantially outperformed those of

[23] See, for example, *Informational Brief of United Airlines*, In the United States Bankruptcy Court for the Northern District of Illinois Eastern Division, December 9, 2002.

large network carriers. Based on existing and foreseeable financial and competitive conditions in the airline industry, there is good reason to believe regional airlines will continue to play an essential role for large network airlines—including Northwest—for the foreseeable future.

48. Pinnacle has been one of the fastest growing regional airlines in recent years and is well positioned to experience continued growth. At a time when regional jets are being used to replace both turboprop and some large jet services, Pinnacle is the predominant Northwest Airlink operator of RJs and one of only three large regional airlines with an all-RJ fleet.

49. In addition, although Northwest has a large number of thin routes that are well suited for RJ service, it has been relatively slow in adding RJs. Thus, it appears that Pinnacle still has considerable opportunities to expand its services as a Northwest Airlink regional carrier.

50. Likewise, Pinnacle's long-term contract with Northwest insulates it from much of the risk normally borne by airlines. As long as Pinnacle continues to meet its performance obligations under the Airlink contract and to maintain a few costs (e.g., labor, corporate overhead) at or below specified levels, its profitability is assured.

51. Northwest's liquidity levels compare favorably to those of other large, network airlines, so even if circumstances do require it to seek protection under Chapter 11, it is likely that Northwest would be able to reorganize successfully. Moreover, the labor, aircraft and other cost reductions that are likely to result from reorganization would leave Northwest in a strong competitive position in the airline industry.

52. Moreover, if Northwest does file for protection under Chapter 11, it could easily result in an even greater increase in its use of RJs—and expanded service opportunities for Pinnacle—just as recent airline reorganizations have led to increased RJ flying opportunities at both US Airways and United.

53. Maintaining liquidity is critical—both for Northwest to avoid bankruptcy and, if that is not possible, to successfully reorganize under Chapter 11. Approval of Northwest's request for an exemption to use of Pinnacle stock to satisfy its pension funding requirements would help Northwest to preserve the liquidity so critical to its future prospects.

APPENDIX A: CURRICULUM VITAE OF DANIEL M. KASPER

DANIEL M. KASPER
LECG, LLC
350 Massachusetts Avenue, Suite 300
Cambridge, MA 02139

PRESENT POSITION

LECG November 1997-present
Managing Director & Head of the Transportation Practice

Since joining LECG, Mr. Kasper has concentrated his practice in the transportation industry. He has provided consulting services as well as expert economic analysis and testimony on aviation and other transportation-related matters for a variety of clients in both the private and public sectors.

PREVIOUS EXPERIENCE

COOPERS & LYBRAND, Consulting 1993-1997
Partner and Chairman Transportation Industry Program

As head of C&L's transportation industry program, Mr. Kasper directed numerous engagements involving domestic and international transportation clients in both the private and public sectors. He also appeared frequently as an expert witness before Federal courts, regulatory agencies, and the Congress.

UNITED STATES NATIONAL AIRLINE COMMISSION, 1993
Member

In 1993, Mr. Kasper was appointed and served as one of fifteen voting members of the US National Airline Commission. After conducting extensive public hearings and analyses, the Commission submitted its Report and recommendations to the President and Congress in September of 1993.

HARBRIDGE HOUSE, INC. 1983-1993
Vice President, Director and Head of the Transportation Practice

Until the firm was acquired by Coopers & Lybrand, Mr. Kasper managed the Harbridge House's transportation practice where he was responsible for a wide array of projects involving domestic and international transportation issues affecting every mode of transportation. He also served as an expert witness in numerous proceedings before Federal and state courts, regulatory agencies and legislative bodies.

UNITED STATES CIVIL AERONAUTICS BOARD, 1980-1983
Director of International Aviation

From January 1980 through September 1983, Mr. Kasper served as Director of International Aviation, the Board's primary advisor and chief line officer for all matters involving international aviation. During his tenure as Director, Mr. Kasper was instrumental in developing and implementing a pro-competitive U.S. international aviation policy. He was responsible, *inter alia*, for developing CAB positions and supervising Board participation in all U.S.-international air service negotiations and for advising the

Board on such major issues as the regulation of fares and rates, computerized reservation systems, mergers and inter-carrier agreements, and carrier selection decisions in cases where entry to international routes was limited. In addition, Mr. Kasper frequently represented the Board at sub-Cabinet meetings and on interagency working groups responsible for developing trade sanctions and other responses to international aviation disputes.

<u>Executive Assistant to Civil Aeronautics Board Member</u>

Previously, Mr. Kasper served as chief staff advisor to Board Member and Vice-Chairperson Elizabeth E. Bailey. In that capacity, he was responsible for reviewing all matters pending before the Board and advising Ms. Bailey on proper disposition of those matters. Matters dealt with by the Board during that period included a number of proposed airline mergers, the allocation of takeoff and landing slots, potential barriers to entry posed by control of gates at congested airport facilities, retail marketing of air transportation, pricing policy, and a request for antitrust immunity by the International Air Transport Association.

HARVARD UNIVERSITY, BUSINESS SCHOOL, 1976-1981
<u>Faculty</u>

At Harvard Business School, Mr. Kasper specialized in the impact of alternative forms of government regulation on the management and performance of business organizations. He also taught courses that focused on the effects and efficacy of various national economic policies and strategies. Mr. Kasper also authored a number of case studies on various aspects of the transportation and telecommunication industries.

While at Harvard, Mr. Kasper was a member and active participant in the Harvard Regulatory Reform Project conducted under the auspices of the Kennedy School of Government. He also consulted with firms in the telecommunications and computer industries to help them anticipate and prepare for the impact of telecommunications deregulation on their businesses.

UNIVERSITY OF SOUTHERN CALIFORNIA, SCHOOL OF BUSINESS ADMINISTRATION, 1971-1976

While on the faculty of USC, Mr. Kasper developed, administered and taught courses dealing with the control of business activities by means of direct government regulation, the enforcement of private contracts, and through the use of tort law. His research focused on the regulation of transportation, telecommunications industries and workplace safety. He also served as a member of the Faculty Senate.

BOOKS

1) *Deregulation and Globalization: Liberalizing International Trade in Air Services*, Ballinger Publishers, Cambridge, MA, 1988.
2) *The US Regional Airline Industry to 1996: Markets, Competition, and the Demand for Aircraft*, The Economist Publications, London & New York, 1987.

EDUCATION

BA, Political Science, UNIVERSITY OF KANSAS, 1967

Masters in Business Administration, UNIVERSITY OF CHICAGO, 1971

Juris Doctorate, UNIVERSITY OF CHICAGO, 1970

PROFESSIONAL AFFILIATIONS

Member of the Illinois Bar

Member of the California Bar

Member, American Bar Association