

March 24, 1998

Via Hand Delivery

Federal Trade Commission  
Premerger Notification Office  
Bureau of Competition  
(Attn: Richard Smith, Esq.)  
7th & Pennsylvania Avenue, N.W.  
Room 303  
Washington, D.C. 20580

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FEDERAL TRADE COMMISSION  
BUREAU OF COMPETITION  
7TH & PENNSYLVANIA AVENUE, N.W.  
WASHINGTON, D.C. 20580

Re: Application of the Hart-Scott-Rodino Antitrust Improvements Act of 1976,  
Pub. L. 94-435, 90 Stat. 1390 (1976) (codified as amended at 15 U.S.C.  
Sec. 18A) (the "HSR Act") to Pending Transaction \_\_\_\_\_

Dear Mr. Smith:

On behalf of our client, a party to a pending transaction (as described in this letter, the "Transaction"), we are writing to ascertain whether the Federal Trade Commission ("FTC") concurs with our analysis that the Transaction is exempt from the filing requirements of the HSR Act under 16 C.F.R. §802.1. The current §802.1 was adopted in 1996 as a clarification and expansion of the prior "ordinary course of business" exemption. Within the revised section, however, certain terms are not defined and there is presently little publicly available guidance on how that section should be applied in various instances other than what may be discerned from reading the various examples which are provided following the text of the regulation.

A. The Parties: The following parties are participating in the Transaction:

"Airline A", which is an "ultimate parent entity," as defined by 16 C.F.R. §801.1(b)(3), and has total assets exceeding \$100 million. Airline A will be the "acquired person" in the Transaction. The core business of Airline A is to run a commercial passenger airline and as a necessary part of that business, Airline A regularly and continually acquires, maintains, operates and disposes of aircraft. In its operations, it carries passengers between designations within the continental United States and elsewhere worldwide. Its business is somewhat seasonal, peaking during the summer months and, to a lesser degree, during various vacation periods, with lower passenger traffic during other periods of the year.

Leasing Company B ("LeaseCo B"), is an "ultimate parent entity," as defined by 16 C.F.R. §801.1(b)(3), and has total assets exceeding \$100 million. LeaseCo B is primarily engaged in the financing and management of commercial jet aircraft engines, components and spare parts for both airlines and overhaul/repair facilities, worldwide. As a vendor, LeaseCo B leases and sells jet engines, and sells components and spare parts, within the aircraft industry, including to Airline A. LeaseCo B has purchased used aircraft on prior occasions to be "cannibalized" for their engines, components and other parts for use in its business. LeaseCo B does not carry passengers or freight, and it has no revenues in the SIC code related thereto.

B. The Transaction. Airline A and LeaseCo B have entered into a letter of intent under which LeaseCo B shall acquire from Airline A 12 [REDACTED] commercial aircraft, each with 4 aircraft engines of a specific type. The aggregate purchase price for the 12 aircraft will be approximately \$35 million. The 12 aircraft being acquired by LeaseCo B do not comprise "all or substantially all of the assets of an operating unit" of Airline A under § 802.1(a) of the FTC's rules.

Each aircraft will be delivered "as-is" with a certificate of airworthiness or airframe dataplate except that, following delivery of each aircraft, LeaseCo B will promptly remove and return each certificate of airworthiness or airframe dataplate to Airline A. Each engine will be delivered "as-is" with the engine dataplate, without any specified remaining useful life for the most limiting life-limited internal engine component. Each aircraft will be delivered to LeaseCo B on a date following the specified retirement date for such aircraft, provided that Airline A can adjust the retirement date for the purpose of its use of the aircraft in its passenger-carrying operations. The first two aircraft are scheduled for delivery in April 1998, and the last aircraft, in December 2000.

Airline A shall have the option to retain 2 of the 12 aircraft by providing written notice to LeaseCo B no later than 2 months prior to the respective aircraft's retirement date, and with the purchase price being reduced in that event by approximately \$3 million per aircraft, with Airline A having the option to sell to LeaseCo B either or both of the retained aircraft at a reduced purchase price, depending upon the date of Airline A's exercise of its option to require LeaseCo B to buy such aircraft.

The 12 [REDACTED] aircraft being sold to LeaseCo B were built during the 1970's. Airline A has contracted to acquire a fleet of new [REDACTED] aircraft, which are bigger and more reliable than the older [REDACTED]. Airline A has already begun taking delivery of the [REDACTED] aircraft. After each new aircraft is delivered to Airline A, such aircraft will be put through appropriate testing by Airline A prior to being placed in service in passenger operations. As those aircraft are brought on-line, the aircraft being sold to LeaseCo B will be retired, with retirement dates being adjusted, if necessary, due to the passenger-load requirements of the season. During the time period beginning six months prior to the delivery of the first [REDACTED] to LeaseCo B and ending six months after the delivery of the

last, Airline A expects to take possession of 11 new [REDACTED] Airline A took possession of a 12th [REDACTED] seven months prior to the delivery of the first [REDACTED] to LeaseCo B.

Airline A will not cancel any of its scheduled flights or discontinue service to any destinations because the replacement aircraft are being acquired prior to the retirement of the old aircraft. Airline A will not incur any reduction in its "productive capacity" as such term is used in §802.1 of the FTC's rules.

Following its acquisition of each aircraft, LeaseCo B will "cannibalize" the aircraft to recover the engines, components and other parts for use in its business. Some of the engines will be refurbished and leased or sold by LeaseCo B or a subsidiary to airlines and overhaul/repair facilities. More than half of the engines are not expected to be in acceptable condition for refurbishment. These engines will be cannibalized as spare parts and components for installation in the engines being refurbished or for sale in the aircraft-parts market. The remaining parts of the aircraft will generally be cannibalized as spare parts and components for sale by LeaseCo B subsidiaries to overhaul/repair facilities and other customers in the aircraft-parts market. Any remaining portions of the aircraft will be disposed of by LeaseCo B or its subsidiaries for further salvage or recycling.

The refurbished engines, spare parts and components will not be sold or leased by LeaseCo B to any entity included within LeaseCo B for "use" by such entity except for subsequent lease or sale by such entity to third parties. Both LeaseCo B and a subsidiary engage in the leasing business, and some of the refurbished engines may be transferred to that subsidiary for lease or sale to third parties. Except for the spare engine parts and components installed in refurbished engines, the spare parts and components will be transferred by LeaseCo B to other subsidiaries that sell spare parts and components on the aircraft-parts market.

C. Application of the HSR Act. During my telephone conversation with you on March 11, 1998, we explored various aspects of the "ordinary course of business" exemption in §802.1. Our discussions did not include many of the details regarding the Transaction set forth above, including any of the facts relating to Airline A's purchase of replacement aircraft. You explained in our telephone conference that you had reservations regarding whether any of the §802.1 exemptions would apply and invited me to provide a detailed description of the Transaction that you might circulate for internal FTC discussion.

Based upon the facts as set forth above and our review of §802.1, we believe that exemptions under §802.1 are available on the bases set forth below.

1. Exemption under §802.1(c), "Current Supplies". The acquisition of the aircraft by LeaseCo B is an acquisition of current supplies in the ordinary course of business. The aircraft being acquired do not comprise an "operating unit" of Airline A. Under §802.1(c), the term "current supplies" includes both new or used assets, including,

specifically "goods acquired and held solely for the purpose of resale or leasing to an entity not within the acquiring person (e.g., inventory), and "goods acquired to be incorporated in the final product (e.g. raw materials and components)." The aircraft engines, depending upon their condition, comprise "goods acquired and held solely for the purpose of resale and leasing," or goods to be cannibalized as components and spare parts that may be sold in LeaseCo B's spare parts business or that may be installed in another engine to be leased in LeaseCo B's leasing business. The remaining parts of the aircraft will be generally cannibalized as spare parts and components, with the remaining portions of the aircraft being disposed of by LeaseCo B for further salvage or recycling. The refurbished engines, spare parts and components will not be sold or leased to any entity included within LeaseCo B for "use" by such entity.

Consequently, the exemption available in §802.1(c), which focuses on the "acquiring person," LeaseCo B, is available to LeaseCo B with respect to its purchase of aircraft from Airline A for use in LeaseCo B's jet aircraft engines, components and spare parts business.

2. Exemption under §802.1(d), "Used Durable Goods". As mentioned above, the aircraft being acquired by LeaseCo B do not comprise an "operating unit" of Airline A. The aircraft do not, as operating aircraft, comprise "durable goods" because the certificates of airworthiness and airframe dataplates shall, following delivery, be returned by LeaseCo B to Airline A. However, each engine will be delivered with the engine dataplate, and with the replacement of any particular engine parts near the end of their useful lives, the useful life of the refurbished engines will be expected to exceed one year, thereby qualifying as "durable" goods under §802.1(d). Other components and parts of the aircraft will also comprise "durable goods" with a useful life of greater than one year. The engines, components and parts are being acquired by LeaseCo B for the purpose of resale or leasing to entities not included in LeaseCo as the acquiring person, thereby qualifying the Transaction for exemption under §802.1(d)(1).

Furthermore, as explained above, Airline A has already contracted to replace, and is replacing, the aircraft being sold to LeaseCo B. It is not canceling flights nor discontinuing services to particular locations because, with prudent corporate planning, the new replacement aircraft will be received, flight-checked and placed in service prior to or at the time the old aircraft are retired from service. Under §802.1(d)(3) the acquired person must have replaced "all or substantially all of the productive capacity of the goods being sold within six months of that sale . . ." Based on example 9 following §802.1, the phrase "within six months" appears to mean that the replacement property must be received by the acquired person and placed in service during the period beginning six months prior to the retirement of the old property and ending six-months following such retirement. In the present instance, there is a time period during which the old aircraft are being retired, and a longer time period that has already started during which a replacement fleet of aircraft will be received. As mentioned above, during the time period beginning six months prior to the delivery of the first [REDACTED] to LeaseCo B and ending six months after the delivery of the

last, Airline A expects to take possession of 11 new [redacted] Although Airline A took possession of a 12th [redacted] seven months prior to the delivery of the first [redacted] to LeaseCo B, during the sale period and the six-month "window" before and after such period, there is not a one-for-one matching between the replacement aircraft and the retired aircraft. However, the new aircraft carry more passengers and are more reliable than the old ones and thus have a higher "productive capacity." Because Airline A has maintained its "productive capacity" so that no diminishment shall occur, the Transaction qualifies for exemption under §802.1(d)(3).

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We will telephone you soon to confirm that you received this letter and to inquire whether you need any additional facts to ascertain whether the Premerger Notification Office agrees with our conclusion that the Transaction is exempt under §802.1. In the meantime, if you have any questions, please telephone me at my number set forth above. Thank you for your assistance in this matter.

Very truly yours,  
[redacted]  
[redacted]

3/26/98 Advised writer that rule 802.1(c) is applicable to the purchase of used airplanes and the transaction is exempt under that rule. However, we do not think that the technical requirements of 802.1(d) have been met. (TH and ME concur in this result).

RTB:smh