

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

**FORM 10-Q**

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2005.

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-8957

**ALASKA AIR GROUP, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**91-1292054**  
(I.R.S. Employer  
Identification No.)

**19300 International Boulevard, Seattle, Washington 98188**  
(Address of principal executive offices)

Registrant's telephone number, including area code: (206) 392-5040

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.): Yes ☐ No ☒

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

The registrant has 27,603,113 common shares, par value \$1.00, outstanding at September 30, 2005.

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[Table of Contents](#)

**TABLE OF CONTENTS**

<b>PART I. FINANCIAL INFORMATION</b>		
Item 1.	<a href="#">Condensed Consolidated Financial Statements</a>	3
Item 2.	<a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a>	24
Item 3.	<a href="#">Quantitative and Qualitative Disclosures About Market Risk</a>	43
Item 4.	<a href="#">Controls and Procedures</a>	44
<b>PART II. OTHER INFORMATION</b>		
Item 1.	<a href="#">Legal Proceedings</a>	45
Item 2.	<a href="#">Unregistered Sales of Equity Securities and Use of Proceeds</a>	45
Item 3.	<a href="#">Default on Senior Securities</a>	45
Item 4.	<a href="#">Submission of Matters to a Vote of Security Holders</a>	45
Item 5.	<a href="#">Other Information</a>	45
	<a href="#">Signatures</a>	46
	<a href="#">Exhibits</a>	47

**Cautionary Note regarding Forward-Looking Statements**

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words “believe,” “expect,” “will,” “anticipate,” “intend,” “estimate,” “project,” “assume” or other similar expressions, although not all forward-looking statements contain these identifying words. Some of the things that could cause our actual results to differ from our expectations are: changes in our operating costs including fuel, which can be volatile; the competitive environment and other trends in our industry; our ability to meet our cost reduction goals; labor disputes; economic conditions; our reliance on automated systems; increases in government fees and taxes; actual or threatened terrorist attacks, global instability and potential U.S. military actions or activities; insurance costs; changes in laws and regulations; liability and other claims asserted against us; operational disruptions; compliance with financial covenants; our ability to attract and retain qualified personnel; third-party vendors and partners; our significant indebtedness; and downgrades of our credit ratings and availability of financing. For a discussion of these and other risk factors, see Item 7 of the Company’s Annual Report for the year ended December 31, 2004 on Form 10-K under the caption “Risk Factors.” All of the forward-looking statements are qualified in their entirety by reference to the risk factors discussed therein. These risk factors may not be exhaustive. We operate in a continually changing business environment, and new risk factors emerge from time to time. Management cannot predict such new risk factors, nor can it assess the impact, if any, of such new risk factors on our business or events described in any forward-looking statements. We disclaim any obligation to publicly update or revise any forward-looking statements after the date of this report to conform them to actual results. Over time, our actual results, performance or achievements will likely differ from the anticipated results, performance or achievements that are expressed or implied by our forward-looking statements, and such differences might be significant and materially adverse.

[Table of Contents](#)

**PART I. FINANCIAL INFORMATION**

**ITEM 1. Condensed Consolidated Financial Statements**

**CONSOLIDATED BALANCE SHEETS (unaudited)**

Alaska Air Group, Inc.

(In Millions)	September 30, 2005	December 31, 2004
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 26.7	\$ 28.0
Marketable securities	719.0	845.9
Restricted securities lending collateral	76.5	—
Receivables - net	130.1	99.4
Inventories and supplies - net	48.1	42.0
Deferred income taxes	61.8	74.7
Fuel hedge contracts	140.7	65.7
Prepaid expenses and other current assets	105.2	86.6
<b>Total Current Assets</b>	<b>1,308.1</b>	<b>1,242.3</b>
<b>Property and Equipment</b>		
Aircraft and other flight equipment	2,258.8	2,294.3
Other property and equipment	473.5	471.8
Aircraft purchase deposits	214.3	67.1
	<b>2,946.6</b>	<b>2,833.2</b>
Less accumulated depreciation and amortization	988.0	924.9
<b>Total Property and Equipment - Net</b>	<b>1,958.6</b>	<b>1,908.3</b>
<b>Intangible Assets</b>	<b>38.6</b>	<b>38.6</b>
<b>Fuel Hedge Contracts</b>	<b>71.1</b>	<b>30.3</b>
<b>Other Assets</b>	<b>133.3</b>	<b>115.5</b>
<b>Total Assets</b>	<b>\$ 3,509.7</b>	<b>\$ 3,335.0</b>

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)
**CONSOLIDATED BALANCE SHEETS (unaudited)**

Alaska Air Group, Inc.

(In Millions)	September 30, 2005	December 31, 2004
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 138.4	\$ 143.8
Accrued aircraft rent	64.0	75.3
Accrued wages, vacation and payroll taxes	93.9	133.0
Other accrued liabilities	350.7	301.6
Air traffic liability	320.5	250.2
Securities lending obligation	76.5	—
Current portion of long-term debt and capital lease obligations	57.6	53.4
<b>Total Current Liabilities</b>	<b>1,101.6</b>	<b>957.3</b>
<b>Long-Term Debt and Capital Lease Obligations</b>	<b>970.0</b>	<b>989.6</b>
<b>Other Liabilities and Credits</b>		
Deferred income taxes	176.3	173.6
Deferred revenue	276.5	264.8
Other liabilities	285.7	284.9
	<b>738.5</b>	<b>723.3</b>
<b>Commitments and Contingencies</b>		
<b>Shareholders' Equity</b>		
Preferred stock, \$1 par value		
Authorized: 5,000,000 shares, none issued or outstanding	—	—
Common stock, \$1 par value		
Authorized: 100,000,000 shares		
Issued: 2005 -30,130,917 shares		
2004 - 29,777,388 shares	30.1	29.8
Capital in excess of par value	513.0	496.5
Treasury stock, at cost: 2005 - 2,527,804 shares		
2004 - 2,651,368 shares	(57.7)	(60.5)
Deferred stock-based compensation	(9.2)	(3.4)
Accumulated other comprehensive loss	(87.7)	(81.6)
Retained earnings	311.1	284.0
	<b>699.6</b>	<b>664.8</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 3,509.7</b>	<b>\$ 3,335.0</b>

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)**

Alaska Air Group, Inc.

 Three Months Ended September 30  
 (In Millions Except Per Share Amounts)

	2005	2004
<b>Operating Revenues</b>		
Passenger	\$ 777.4	\$ 706.0
Freight and mail	26.1	25.5
Other - net	42.2	36.7
<b>Total Operating Revenues</b>	<b>845.7</b>	<b>768.2</b>
<b>Operating Expenses</b>		
Wages and benefits	221.5	248.9
Contracted services	30.8	19.7
Aircraft fuel	204.1	148.4
Aircraft maintenance	55.2	37.0
Aircraft rent	46.9	46.7
Food and beverage service	13.5	14.3
Selling expenses	44.3	37.5
Depreciation and amortization	36.3	35.7
Landing fees and other rentals	52.4	49.3
Other	51.9	46.4
Restructuring charges	(1.4)	27.5
<b>Total Operating Expenses</b>	<b>755.5</b>	<b>711.4</b>
<b>Operating Income</b>	<b>90.2</b>	<b>56.8</b>
<b>Nonoperating Income (Expense)</b>		
Interest income	8.6	7.9
Interest expense	(16.1)	(13.6)
Interest capitalized	2.8	0.5
Fuel hedging gains	62.9	66.9
Other - net	(1.6)	0.7
	<b>56.6</b>	<b>62.4</b>
Income before income tax	146.8	119.2
Income tax expense	56.6	45.2
<b>Net Income</b>	<b>\$ 90.2</b>	<b>\$ 74.0</b>
<b>Basic Earnings Per Share</b>	<b>\$ 3.28</b>	<b>\$ 2.75</b>
<b>Diluted Earnings Per Share</b>	<b>\$ 2.71</b>	<b>\$ 2.29</b>
<b>Pro Forma Results</b> (assuming change in method of accounting was applied retrospectively):		
Pro Forma Net Income	NA	\$ 84.1
Pro Forma Basic Earnings Per Share	NA	\$ 3.13
Pro Forma Diluted Earnings Per Share	NA	\$ 2.61
Shares used for computation:		
Basic	27.502	26.862
Diluted	33.857	32.631

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)**

Alaska Air Group, Inc.

Nine Months Ended September 30

(In Millions Except Per Share Amounts)

	2005	2004
<b>Operating Revenues</b>		
Passenger	\$2,061.9	\$1,896.7
Freight and mail	71.3	68.3
Other - net	111.5	102.5
<b>Total Operating Revenues</b>	<b>2,244.7</b>	<b>2,067.5</b>
<b>Operating Expenses</b>		
Wages and benefits	693.5	737.1
Contracted services	96.2	79.1
Aircraft fuel	526.0	384.8
Aircraft maintenance	174.6	137.9
Aircraft rent	140.0	141.5
Food and beverage service	37.1	39.5
Selling expenses	119.5	111.5
Depreciation and amortization	105.8	105.8
Landing fees and other rentals	156.5	138.5
Other	156.4	147.0
Restructuring charges	20.7	27.5
Impairment of aircraft and related spare parts	—	39.6
<b>Total Operating Expenses</b>	<b>2,226.3</b>	<b>2,089.8</b>
<b>Operating Income (Loss)</b>	<b>18.4</b>	<b>(22.3)</b>
<b>Nonoperating Income (Expense)</b>		
Interest income	21.6	18.6
Interest expense	(45.5)	(38.9)
Interest capitalized	4.9	1.1
Fuel hedging gains	198.6	93.3
Other - net	(4.5)	0.5
	175.1	74.6
Income before income tax and accounting change	193.5	52.3
Income tax expense	76.0	22.7
Income before accounting change	117.5	29.6
Cumulative effect of accounting change, net of tax	(90.4)	—
<b>Net Income</b>	<b>\$ 27.1</b>	<b>\$ 29.6</b>
<b>Basic Earnings Per Share:</b>		
Income before accounting change	\$ 4.31	\$ 1.10
Cumulative effect of accounting change	(3.32)	NA
Net Income Per Share	\$ 0.99	\$ 1.10
<b>Diluted Earnings Per Share:</b>		
Income before accounting change	\$ 3.62	\$ 0.98
Cumulative effect of accounting change	(2.69)	NA
Net Income Per Share	\$ 0.93	\$ 0.98
<b>Pro Forma Results</b> (assuming change in method of accounting was applied retrospectively):		
Pro Forma Net Income	NA	\$ 45.8
Pro Forma Basic Earnings Per Share	NA	\$ 1.71
Pro Forma Diluted Earnings Per Share	NA	\$ 1.48
Shares used for computation:		
Basic	27.274	26.820
Diluted	33.523	32.691

See accompanying notes to condensed consolidated financial statements.



[Table of Contents](#)
**CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (unaudited)**

Alaska Air Group, Inc.

<b>(In Millions)</b>	<b><i>Common Shares Outstanding</i></b>	<b><i>Common Stock</i></b>	<b><i>Capital in Excess of Par Value</i></b>	<b><i>Treasury Stock, at Cost</i></b>	<b><i>Deferred Stock-Based Compensation</i></b>	<b><i>Accumulated Other Comprehensive Income (Loss)</i></b>	<b><i>Retained Earnings</i></b>	<b><i>Total</i></b>
Balances at December 31, 2004:	27.126	\$ 29.8	\$ 496.5	\$ (60.5)	\$ (3.4)	\$ (81.6)	\$ 284.0	\$664.8
Net income for the nine months ended September 30, 2005							27.1	27.1
Other comprehensive income (loss):								
Related to marketable securities:								
Change in fair value						(2.2)		
Reclassification to earnings						3.3		
Income tax effect						(0.4)		
						0.7		0.7
Related to fuel hedges:								
Reclassification to earnings						(10.8)		
Income tax effect						4.0		
						(6.8)		(6.8)
Total comprehensive loss								21.0
Deferred stock-based compensation			6.9		(6.9)			—
Amortization of deferred stock-based compensation					1.1			1.1
Treasury stock sales, including \$0.3 tax benefit	0.123	—	—	2.8				2.8
Stock issued for employee stock purchase plan	0.094	0.1	6.5	—				6.6
Stock issued under stock plans, including \$0.9 tax benefit	0.260	0.2	3.1	—				3.3
<b>Balances at September 30, 2005</b>	<b>27.603</b>	<b>\$ 30.1</b>	<b>\$ 513.0</b>	<b>\$ (57.7)</b>	<b>\$ (9.2)</b>	<b>\$ (87.7)</b>	<b>\$ 311.1</b>	<b>\$699.6</b>

See accompanying notes to condensed consolidated financial statements.



[Table of Contents](#)
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

Alaska Air Group, Inc.

Nine Months Ended September 30 (In Millions)

	2005	2004
<b>Cash flows from operating activities:</b>		
Net income	\$ 27.1	\$ 29.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Cumulative effect of accounting change, net of tax effect	90.4	—
Restructuring charges	20.7	27.5
Impairment of aircraft and related spare parts	—	39.6
Depreciation and amortization	105.8	105.8
Amortization of airframe and engine overhauls	—	48.3
Stock-based compensation	1.1	—
Changes in fair values of open fuel hedge contracts	(126.6)	(80.4)
Loss (gain) on sale of assets	1.4	(1.4)
Changes in deferred income taxes	68.7	28.4
(Increase) decrease in receivables - net	(30.7)	0.2
Increase in prepaid expenses and other current assets	(28.4)	(13.8)
Increase in air traffic liability	70.3	42.2
Increase (decrease) in other current liabilities	(12.8)	31.4
Increase (decrease) in deferred revenue and other-net	(6.8)	26.1
Net cash provided by operating activities	180.2	283.5
<b>Cash flows from investing activities:</b>		
Proceeds from disposition of assets	5.4	11.1
Purchases of marketable securities	(908.7)	(717.0)
Sales and maturities of marketable securities	1,036.7	615.9
Securities lending collateral	(76.5)	—
Securities lending obligation	76.5	—
Property and equipment additions:		
Aircraft and aircraft purchase deposits	(253.6)	(52.0)
Capitalized overhauls	—	(44.1)
Other flight equipment	(39.6)	(22.0)
Other property and equipment	(24.1)	(25.7)
Aircraft deposits returned	7.5	19.2
Restricted deposits and other	(3.6)	(4.5)
Net cash used in investing activities	(180.0)	(219.1)
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of long-term debt, net	20.0	94.6
Long-term debt and capital lease payments	(35.4)	(193.2)
Proceeds from issuance of common stock	13.9	2.3
Net cash used in financing activities	(1.5)	(96.3)
Net change in cash and cash equivalents	(1.3)	(31.9)
Cash and cash equivalents at beginning of period	28.0	158.8
<b>Cash and cash equivalents at end of period</b>	<b>\$ 26.7</b>	<b>\$ 126.9</b>
Supplemental disclosure of cash paid (refunded) during the period for:		
Interest (net of amount capitalized)	\$ 35.5	\$ 34.8
Income taxes	(1.8)	(39.6)
Noncash investing and financing activities:		
Assets acquired under long-term debt and capital leases	—	44.7
Credit received for flight deposits deferred in other liabilities	9.7	—

See accompanying notes to condensed consolidated financial statements.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)**

Alaska Air Group, Inc.

**Note 1. Basis of Presentation and Significant Accounting Policies**

*Organization and Basis of Presentation*

The accompanying unaudited condensed consolidated financial statements of Alaska Air Group, Inc. (Air Group or the Company) include the accounts of the parent company, Alaska Air Group, Inc., and its principal subsidiaries, Alaska Airlines, Inc. (Alaska) and Horizon Air Industries, Inc. (Horizon), through which the Company conducts substantially all of its operations. These interim condensed consolidated financial statements are unaudited and should be read in conjunction with the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2004. In the opinion of management, all adjustments have been made which are necessary to present fairly the Company's financial position as of September 30, 2005, as well as the results of operations for the three and nine months ended September 30, 2004 and 2005. The adjustments made were of a normal recurring nature.

The Company's condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). In preparing these condensed consolidated financial statements, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities, as well as the reported amounts of revenues and expenses. Significant estimates made include assumptions used to record liabilities, expenses and revenues associated with the Company's Mileage Plan, amounts paid to lessors upon aircraft lease terminations, the fair market value of surplus or impaired aircraft, engines and parts, assumptions used in the calculations of pension expense in the Company's defined benefit plans, and the amounts of certain accrued liabilities. Actual results may differ from the Company's estimates.

*Reclassifications*

Certain reclassifications have been made to conform the prior year's data to the current format.

*Securities Lending*

From time to time, the Company lends certain marketable securities to third parties for a time period of less than one year. During the time period in which these securities are loaned to the third parties, the Company requires cash collateral for 102% of the daily market value of the loaned securities. This cash collateral is restricted and is deposited with a lending agent and invested by that agent in accordance with the Company's guidelines to generate additional income, which is shared with the lending agent. As of September 30, 2005, the Company had \$74.8 million of securities on loan under the program. These affected securities are included as marketable securities and included in current assets. The Company maintains full ownership rights to the securities loaned and continues to earn interest and appreciation on them. The Company has an indemnification agreement with the lending agent in the event a borrower becomes insolvent or fails to return securities. The cash collateral is classified in current assets as restricted securities lending collateral in our consolidated balance sheets and the related liability is classified in current liabilities as securities lending obligation.

[Table of Contents](#)

### Stock Options

The Company applies the intrinsic value method in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations in accounting for stock options.

The following table represents the pro forma net income before accounting change and pro forma net income per share (EPS) had compensation cost for the Company's stock options been determined in accordance with Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation." In accordance with SFAS No. 123, the fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model and then amortized ratably over the vesting period (in millions, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Income before accounting change as reported	\$ 90.2	\$ 74.0	\$ 117.5	\$ 29.6
Add: Total stock-based compensation expense recognized under the intrinsic value-based method, net of related tax	0.3	—	0.7	—
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of related tax effects	(1.2)	(1.1)	(3.5)	(3.4)
Pro forma income before accounting change	\$ 89.3	\$ 72.9	\$ 114.7	\$ 26.2
Net income as reported	\$ 90.2	\$ 74.0	\$ 27.1	\$ 29.6
Add: Total stock-based compensation expense recognized under the intrinsic value-based method, net of related tax	0.3	—	0.7	—
Deduct: Total stock-based compensation expense determined under fair value-based methods for all awards, net of related tax	(1.2)	(1.1)	(3.5)	(3.4)
Pro forma net income	\$ 89.3	\$ 72.9	\$ 24.3	\$ 26.2
Basic EPS before accounting change:				
As reported	\$ 3.28	\$ 2.75	\$ 4.31	\$ 1.10
Pro forma	3.25	2.71	4.21	0.98
Basic EPS:				
As reported	\$ 3.28	\$ 2.75	\$ 0.99	\$ 1.10
Pro forma	3.25	2.71	0.89	0.98
Diluted EPS before accounting change:				
As reported	\$ 2.71	\$ 2.29	\$ 3.62	\$ 0.98
Pro forma	2.68	2.26	3.54	0.88
Diluted EPS:				
As reported	\$ 2.71	\$ 2.29	\$ 0.93	\$ 0.98
Pro forma	2.68	2.26	0.85	0.88

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## [Table of Contents](#)

During the fourth quarter of 2004, the Financial Accounting Standards Board issued SFAS 123R, “Share Based Payment: An Amendment of SFAS Nos. 123 and 95”. The new standard requires companies to recognize as expense the fair value of stock options and other equity-based compensation issued to employees as of the grant date. This new standard will apply to both stock options that the Company grants to employees and the Employee Stock Purchase Plan, which features a look-back provision and allows employees to purchase stock at a 15% discount. Implementation of SFAS 123R will be effective January 1, 2006. Options are typically granted with ratable vesting provisions, and the Company intends to amortize compensation cost over the service period using the straight line method. The Company intends to use the “modified prospective method” upon adoption whereby previously awarded but unvested equity awards are accounted for in accordance with SFAS 123R and prospective amounts are recognized in the income statement instead of simply being disclosed. Once adopted, the Company expects that stock-based compensation expense, as measured under SFAS 123R, will be approximately \$6 million to \$10 million per year on a pre-tax basis.

### **Note 2. Change in Accounting Principle**

Effective January 1, 2005, the Company changed its method of accounting for major airframe and engine overhauls from the *capitalize and amortize* method to the *direct expense* method. Under the former method, these costs were capitalized and amortized to maintenance expense over the shorter of the life of the overhaul or the remaining lease term. Under the *direct expense* method, overhaul costs are expensed as incurred. The Company believes that the *direct expense* method is preferable because it eliminates the judgment and estimation needed to determine overhaul versus repair allocations in maintenance activities. Additionally, the Company’s approved maintenance program for the majority of its airframes now focuses more on shorter, but more frequent, maintenance visits. Management also believes that the *direct expense* method is the predominant method used in the airline industry. Accordingly, effective January 1, 2005, the Company wrote off the net book value of its previously capitalized airframe and engine overhauls for all aircraft in a charge totaling \$144.7 million pre-tax (\$90.4 million after tax). The Company does not believe disclosing the effect of adopting the *direct expense* method on net income for the period ended September 30, 2005 provides meaningful information because of changes in the Company’s maintenance program, including the execution of a “power by the hour” engine maintenance agreement with a third party in late 2004.

### **Note 3. Restructuring Charges**

During the second quarter of 2005, Alaska contracted out ramp services at the Seattle-Tacoma International Airport. This event resulted in a reduction of approximately 475 employees in Seattle. Severance and related costs associated with this restructuring were originally estimated at \$16.1 million, which was recorded in the second quarter.

During the third quarter of 2004, Alaska announced a management reorganization and the closure of its Oakland heavy maintenance base, contracting out of the Company’s fleet service and ground support

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## [Table of Contents](#)

equipment and facility maintenance functions, as well as other initiatives. Restructuring charges totaling \$53.4 million were recorded in 2004, with \$38.7 million remaining accrued at December 31, 2004.

The following table displays the activity and balance of the severance and related costs components of the Company's restructuring accrual as of and for the nine months ended September 30, 2005. The restructuring charge adjustment relates to our changes in estimated costs of medical coverage extended to impacted employees and a change in the number of employees affected since the original accrual was recorded. The Company expects to record additional adjustments in future quarters as the number of impacted employees that select the extended medical coverage becomes known.

### *Accrual for Severance and Related Costs*

	Nine Months Ended September 30,	
	2005	2004
Balance at December 31, 2004 and 2003, respectively	\$ 38.7	\$ —
Restructuring charges	16.1	27.5
Restructuring charge adjustments	(3.4)	—
Cash payments	(44.3)	(1.2)
Balance at September 30, 2005 and 2004, respectively	\$ 7.1	\$ 26.3

The Company will make the majority of the remaining cash payments in the fourth quarter of 2005. The accrual for severance and related costs at September 30, 2005 is included in accrued wages, vacation and payroll taxes in the consolidated balance sheets.

During March 2005, the Company notified the Port of Oakland of its decision to terminate the lease for the Oakland hangar as part of its ongoing restructuring efforts. Accordingly, the Company recorded an impairment charge of \$7.7 million in the first quarter of 2005 for the leasehold improvements that will be abandoned as a result of the lease termination. Additionally, the Company recorded a charge of \$0.3 million for certain costs associated with the lease termination, which has been paid.

### **Note 4. Derivative Financial Instruments**

The Company records all derivative instruments, all of which are currently fuel hedge contracts, on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in earnings.

The Company's operations are inherently dependent upon the price and availability of aircraft fuel, which accounted for approximately 20% of all of 2004 and 24% of year-to-date 2005 operating expenses (excluding impairment and restructuring charges). To manage economic risks associated with fluctuations in aircraft fuel prices, the Company periodically enters into swap agreements and call options for crude oil.

## Table of Contents

Because of historical variations in the spread between the prices of West Texas Intermediate crude oil and jet fuel since the second quarter of 2004, the Company's hedge contracts are not "highly correlated" to changes in prices of aircraft fuel, as defined in SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The impacts on the Company's reported results are as follows:

- All changes in the fair value of fuel hedge contracts since March 31, 2004 are reported in other non-operating income (expense).
- Reported fuel expense includes only the effective portion of gains associated with hedge positions that settled during the current period on contracts that existed at March 31, 2004 to the extent that mark-to-market gains were already included in Accumulated Other Comprehensive Loss at March 31, 2004.

The following table summarizes realized fuel hedging gains and changes in fair value of hedging contracts outstanding as of September 30, 2005 and 2004 (in millions):

	Three Months Ended September 30			
	Alaska Airlines		Horizon Air	
	2005	2004	2005	2004
Fuel expense before hedge activities ("raw" or "into-plane" fuel cost)	\$179.5	\$133.7	\$ 28.0	\$18.7
Less: gains on settled hedges included in fuel expense	(2.9)	(3.5)	(0.5)	(0.5)
GAAP fuel expense	\$176.6	\$130.2	\$ 27.5	\$18.2
Less: gains on settled hedges included in nonoperating income (expense)	(34.9)	(8.5)	(5.2)	(1.2)
Economic fuel expense	\$141.7	\$121.7	\$ 22.3	\$17.0
Mark-to-market hedging gains included in nonoperating income (expense) related to hedges that settle in future periods, net of the reclassification of previously recorded mark-to-market gains to <i>gains on settled hedges included in nonoperating income (expense)</i>	\$ 19.9	\$ 50.3	\$ 2.9	\$ 6.9
	Nine Months Ended September 30			
	Alaska Airlines		Horizon Air	
	2005	2004	2005	2004
Fuel expense before hedge activities ("raw" or "into-plane" fuel cost)	\$465.2	\$347.4	\$ 71.6	\$49.9
Less: gains on settled hedges included in fuel expense	(9.5)	(11.0)	(1.3)	(1.5)
GAAP fuel expense	\$455.7	\$336.4	\$ 70.3	\$48.4
Less: gains on settled hedges included in nonoperating income (expense)	(71.9)	(11.7)	(10.9)	(1.6)
Economic fuel expense	\$383.8	\$324.7	\$ 59.4	\$46.8
Mark-to-market hedging gains included in nonoperating income (expense) related to hedges that settle in future periods, net of the reclassification of previously recorded mark-to-market gains to <i>gains on settled hedges included in nonoperating income (expense)</i>	\$100.2	\$ 70.4	\$ 15.6	\$ 9.6

[Table of Contents](#)

Outstanding fuel hedge positions as of September 30, 2005 are as follows:

	Approximate % of Expected Fuel Requirements	Gallons Hedged (in millions)	Approximate Crude Oil Price per Barrel
Fourth Quarter 2005	50%	50.4	\$ 31.85
First Quarter 2006	50%	50.8	\$ 35.70
Second Quarter 2006	50%	53.5	\$ 39.76
Third Quarter 2006	40%	45.9	\$ 41.58
Fourth Quarter 2006	30%	31.2	\$ 42.70
First Quarter 2007	20%	20.9	\$ 43.09
Second Quarter 2007	19%	21.3	\$ 45.11
Third Quarter 2007	22%	26.0	\$ 45.27
Fourth Quarter 2007	17%	17.8	\$ 47.89
First Quarter 2008	11%	12.3	\$ 50.44
Second Quarter 2008	6%	7.1	\$ 49.26
Third Quarter 2008	6%	6.8	\$ 48.97
Fourth Quarter 2008	5%	5.5	\$ 48.68

The fair values of the Company's fuel hedge positions for the period ended September 30, 2005 and December 31, 2004 were \$211.8 million and \$96.0 million, respectively, and are presented as fuel hedge contracts as both current and non-current assets in the consolidated balance sheets.

**Note 5. Other Assets**

At September 30, 2005 and December 31, 2004, other assets consisted of the following (in millions):

	September 30, 2005	December 31, 2004
Restricted deposits (primarily restricted investments)	\$ 95.1	\$ 84.2
Deferred costs and other	38.2	27.7
Restricted cash for senior convertible notes	—	3.6
	<u>\$ 133.3</u>	<u>\$ 115.5</u>

**Note 6. Mileage Plan**

Alaska's Mileage Plan liabilities are included under the following balance sheet captions (in millions):

	September 30, 2005	December 31, 2004
<b>Current Liabilities:</b>		
Other accrued liabilities	\$ 159.0	\$ 136.6
<b>Other Liabilities and Credits (non-current):</b>		
Deferred revenue	265.9	252.9
Other liabilities	20.5	19.8
Total	<u>\$ 445.4</u>	<u>\$ 409.3</u>

[Table of Contents](#)

**Note 7. Employee Benefit Plans**

*Pension Plans-Qualified Defined Benefit*

Net pension expense for the three and nine months ended September 30 included the following components (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Service cost	\$ 13.3	\$ 13.5	\$ 38.8	\$ 40.9
Interest cost	12.9	11.8	38.7	35.8
Expected return on assets	(12.5)	(10.9)	(37.5)	(32.3)
Amortization of prior service cost	1.2	1.1	3.6	3.7
Actuarial loss	3.6	3.6	10.8	11.0
SFAS No. 88 curtailment charge*	—	1.0	—	1.0
<b>Net pension expense</b>	<b>\$ 18.5</b>	<b>\$ 20.1</b>	<b>\$ 54.4</b>	<b>\$ 60.1</b>

\* In connection with the restructuring charges and the reductions in force as discussed in Note 3, the Company recorded curtailment charges pursuant to SFAS No.88 in 2004. These charges are included in restructuring charges in the condensed consolidated financial statements.

The Company made \$30.7 million and \$69.3 million in contributions during the three and nine months ended September 30, 2005, respectively. The Company made \$16.5 million and \$49.4 million in contributions to its defined benefit pension plans during the three and nine months ended September 30, 2004, respectively.

*Pension Plans-Nonqualified Defined Benefit*

Net pension expense for the unfunded, noncontributory defined benefit plans for certain elected officers of the Company for the three and nine months ended September 30 included the following components (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Service cost	\$ 0.6	\$ 0.2	\$ 1.2	\$ 0.8
Interest cost	0.4	0.4	1.2	1.4
Actuarial loss	0.1	0.1	0.3	0.5
<b>Net pension expense</b>	<b>\$ 1.1</b>	<b>\$ 0.7</b>	<b>\$ 2.7</b>	<b>\$ 2.7</b>

*Postretirement Medical Benefits*

Net periodic benefit cost for the postretirement medical plans for the three and nine months ended September 30 included the following components (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Service cost	\$ 1.1	\$ 0.6	\$ 3.1	\$ 3.0
Interest cost	1.1	0.7	3.3	3.3
Amortization of prior service cost	(0.1)	(0.1)	(0.3)	(0.3)
Actuarial loss	0.5	0.4	1.5	1.8
<b>Net periodic benefit cost</b>	<b>\$ 2.6</b>	<b>\$ 1.6</b>	<b>\$ 7.6</b>	<b>\$ 7.8</b>



[Table of Contents](#)
**Note 8. Earnings Per Share**

Income per share was calculated as follows (in millions except per share amounts).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<b>Basic Earnings Per Share</b>				
Income before accounting change	\$ 90.2	\$ 74.0	\$ 117.5	\$ 29.6
Weighted average shares outstanding	27.502	26.862	27.274	26.820
Income per share before accounting change	\$ 3.28	\$ 2.75	\$ 4.31	\$ 1.10
Cumulative effect of accounting change, net of tax	NA	NA	\$ (90.4)	NA
Weighted average shares outstanding	NA	NA	27.274	NA
Per share cumulative effect of accounting change	NA	NA	\$ (3.32)	NA
Net income	\$ 90.2	\$ 74.0	\$ 27.1	\$ 29.6
Weighted average shares outstanding	27.502	26.862	27.274	26.820
Net income per share	\$ 3.28	\$ 2.75	\$ 0.99	\$ 1.10
<b>Diluted Earnings Per Share</b>				
Income before accounting change	\$ 90.2	\$ 74.0	\$ 117.5	\$ 29.6
Interest on convertible notes, net of tax	1.5	1.0	4.0	2.6
Diluted income before accounting change	\$ 91.7	\$ 75.0	\$ 121.5	\$ 32.2
Weighted average diluted shares outstanding	33.857	32.631	33.523	32.691
Income per share before accounting change	\$ 2.71	\$ 2.29	\$ 3.62	\$ 0.98
Cumulative effect of accounting change, net of tax	NA	NA	\$ (90.4)	NA
Weighted average shares outstanding	NA	NA	33.523	NA
Per share cumulative effect of accounting change	NA	NA	\$ (2.69)	NA
Net income	\$ 90.2	\$ 74.0	\$ 27.1	\$ 29.6
Interest on convertible notes, net of tax	1.5	1.0	4.0	2.6
Diluted net income	\$ 91.7	\$ 75.0	\$ 31.1	\$ 32.2
Weighted average shares outstanding	33.857	32.631	33.523	32.691
Net income per share	\$ 2.71	\$ 2.29	\$ 0.93	\$ 0.98

For the quarter and nine months ended September 30, 2005 and 2004, the dilutive impact of common stock options and 5.8 million common shares that would have been outstanding upon conversion of the senior convertible notes were included in the calculations. Outstanding options to purchase 0.9 million and 1.8

## [Table of Contents](#)

million common shares were excluded from the calculation for the quarter and nine months ended September 30, 2005, respectively, as the impact of those options would have been antidilutive. For the quarter and nine months ended September 30, 2004, options to purchase 3.3 million and 3.2 million common shares, respectively, were excluded from the computation of diluted loss per share in 2004 because the impact would have been antidilutive.

### Note 9. Operating Segment Information

Operating segment information for Alaska and Horizon for the three and nine month periods ended September 30 was as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Operating revenues:				
Alaska	\$689.3	\$632.8	\$1,828.9	\$1,701.7
Horizon	153.7	139.3	415.5	374.3
Other*	0.3	0.2	0.8	0.5
Elimination of intercompany revenues	2.4	(4.1)	(0.5)	(9.0)
Consolidated	\$845.7	\$768.2	\$2,244.7	\$2,067.5
Income (loss) before income tax and accounting change:				
Alaska	\$133.0	\$ 97.9	\$ 170.5	\$ 41.9
Horizon	17.3	24.4	33.0	18.7
Other*	(3.5)	(3.1)	(10.0)	(8.3)
Consolidated	\$146.8	\$119.2	\$ 193.5	\$ 52.3
Total assets at end of period:				
Alaska			\$3,226.6	\$3,161.1
Horizon			325.6	304.1
Other*			872.2	882.2
Elimination of intercompany accounts			(914.7)	(935.9)
Consolidated			\$3,509.7	\$3,411.5

\* Includes the parent company, Alaska Air Group, Inc, including its investments in Alaska and Horizon, which are eliminated in consolidation.

### Note 10. Long-Term Debt and Capital Lease Obligations

At September 30, 2005 and December 31, 2004, long-term debt and capital lease obligations were as follows (in millions):

	September 30, 2005	December 31, 2004
Fixed rate notes payable due through 2020	\$ 589.5	\$ 361.3
Variable rate notes payable due through 2018	287.8	531.2
Senior convertible notes due through 2023	150.0	150.0
Long-term debt	1,027.3	1,042.5
Capital lease obligations	0.3	0.5
Less current portion	(57.6)	(53.4)
	\$ 970.0	\$ 989.6

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## [Table of Contents](#)

During the first nine months of 2005, Horizon issued \$20.0 million of debt secured by flight equipment, having a fixed interest rate of 6.07% and a fifteen-year term.

During 2004, Alaska repaid its \$150 million credit facility and, on December 23, 2004, that facility expired. On March 25, 2005, Alaska finalized a \$160 million variable rate credit facility with a syndicate of financial institutions that will expire in March 2008. The interest rate on the credit facility varies depending on certain financial ratios specified in the agreement with a minimum interest rate of LIBOR plus 200 basis points. Any borrowings will be secured by either aircraft or cash collateral. This credit facility contains contractual restrictions and requires maintenance of specific levels of net worth, maintenance of certain debt and leases to net worth, leverage and fixed charge coverage ratios, and limits on liens, asset dispositions, dividends, and certain other expenditures. Such provisions restrict Alaska Airlines from distributing any funds to Alaska Air Group in the form of dividends and limit the amount of funds Alaska Airlines can loan to Alaska Air Group. As of September 30, 2005, Alaska could loan up to \$300.0 million to Air Group without violating the covenants in the credit facility. As of September 30, 2005, there are no outstanding borrowings on this credit facility.

In the second and third quarters of 2005, the Company exercised its option under several of its existing variable rate long-term debt arrangements to fix the interest rates through maturity. The fixed rates on these affected debt arrangements range from 5.2% to 6.5%. These changes did not result in any gain or loss in the consolidated statements of operations.

Subsequent to the end of the third quarter of 2005, Alaska finalized a pre-delivery payment facility to assist in its pre-delivery funding requirements on the purchase of B737-800 aircraft. See Note 13.

### **Note 11. Aircraft Commitments**

Alaska entered into an aircraft purchase agreement during the second quarter of 2005 to acquire 35 B737-800 aircraft with deliveries beginning in January 2006 and continuing through April 2011. The purchase agreement also includes options to purchase an additional 15 aircraft. Concurrent with the execution of this purchase agreement, Alaska paid \$110.9 million in aircraft purchase and option deposits using cash and a credit of \$9.7 million received from the manufacturer. The \$9.7 million credit has been deferred as other liabilities in the Company's balance sheet and will be applied to the purchase price of future aircraft upon delivery.

As of Sep 30, 2005, the Company has firm purchase commitments for 43 aircraft requiring aggregate future payments of approximately \$1.3 billion. In addition to the 15 options noted above, Horizon had options to purchase 11 Q400's and 19 CRJ 700's. However, these commitments and number of options for Horizon changed subsequent to the end of the quarter (See Note 13). Alaska and Horizon expect to finance the firm orders and, to the extent exercised, the option aircraft with leases, long-term debt or internally generated cash.

**Note 12. Contingencies**

The Company is a party to routine litigation incidental to its business and with respect to which no material liability is expected. Management believes the ultimate disposition of these matters is not likely to materially affect the Company's financial position or results of operations. However, this belief is based on management's current understanding of the relevant law and facts; it is subject to various contingencies, including the potential costs and risks associated with litigation and the actions of judges and juries.

In May 2005, the Air Line Pilots Association filed a lawsuit in federal district court in Seattle to overturn the current labor contract covering Alaska's pilots as established by an arbitrator, which was effective May 1, 2005. On July 21, 2005, the Company filed a motion to dismiss the lawsuit. On October 28, 2005, the district court granted the Company's motion to dismiss. This decision is subject to appeal.

In March 2005, the Company filed a claim against the International Association of Machinists (IAM) seeking to compel arbitration of the dispute regarding the subcontracting of the Company's ramp service operation in Seattle. On May 10, 2005, the IAM filed a counter claim against the Company alleging that the Company violated the status quo and engaged in bad faith bargaining. On May 13, 2005, the Company announced that it had subcontracted the ramp service operation in Seattle, resulting in the immediate reduction of approximately 475 employees represented by the IAM. Shortly after this event, the IAM filed a motion for a preliminary injunction seeking to reverse the subcontracting by the Company. That motion was heard and denied by a federal court judge on June 2, 2005. The Company's lawsuit is still pending in federal court and a September 2006 trial date has been set for the IAM's counter claim. The Company has filed a motion to dismiss the IAM's counter claim. At this time, the Company is not certain as to what the outcome will be.

**Note 13. Subsequent Events**

On October 19, 2005, Alaska finalized a \$172 million variable rate revolving loan facility with a syndicate of lenders to provide a portion of the pre-delivery funding requirements of the Company's purchase of up to 38 new Boeing 737-800 aircraft (23 of which are firm orders) under the current aircraft purchase agreement. The facility will expire on August 31, 2009. The interest rate is based on one-month LIBOR plus a specified margin. Any borrowings will be secured by the Company's rights under the Boeing purchase agreement. The initial draw on the facility was \$61.3 million, which was used to reimburse Alaska for the facility's portion of the pre-delivery payments made to date.

Horizon entered into an aircraft purchase agreement in October 2005 to acquire 12 Q400 aircraft with deliveries beginning in December 2006 and continuing through July 2007. The purchase agreement also includes options to purchase an additional 20 aircraft. Concurrent with the execution of this purchase agreement, Bombardier agreed to provide certain remarketing assistance for up to 12 DHC-8 Series 200 aircraft previously leased by Horizon for a fee as set forth in the agreement. In association with the purchase of the 12 Q400 Aircraft, Horizon and the manufacturer have agreed to terminate firm orders for seven CRJ700 model aircraft.

[Table of Contents](#)
**Alaska Airlines Financial and Statistical Data (Unaudited)**

	Three Months Ended September 30			Nine Months Ended September 30		
	2005	2004	% Change	2005	2004	% Change
<b>Financial Data (in millions):</b>						
Operating Revenues:						
Passenger	\$624.1	\$ 576.6	8.2%	\$1,656.6	\$1,545.8	7.2%
Freight and mail	25.2	24.5	2.9%	68.4	65.3	4.7%
Other - net	40.0	31.7	26.2%	103.9	90.6	14.7%
Total Operating Revenues	689.3	632.8	8.9%	1,828.9	1,701.7	7.5%
Operating Expenses:						
Wages and benefits	174.5	207.3	-15.8%	556.2	611.8	-9.1%
Contracted services	27.6	17.8	55.1%	87.0	70.3	23.8%
Aircraft fuel	176.6	130.2	35.6%	455.7	336.4	35.5%
Aircraft maintenance	43.2	27.1	59.4%	143.5	111.3	28.9%
Aircraft rent	29.5	28.1	5.0%	87.2	85.5	2.0%
Food and beverage service	12.8	13.7	-6.6%	35.2	37.9	-7.1%
Selling expenses	34.0	35.9	-5.3%	97.9	101.1	-3.2%
Depreciation and amortization	31.9	32.0	-0.3%	92.9	95.2	-2.4%
Landing fees and other rentals	40.4	37.6	7.4%	121.5	106.1	14.5%
Other	39.8	34.6	15.0%	119.7	110.4	8.4%
Restructuring charges	(1.4)	27.5	NM	20.7	27.5	NM
Impairment of aircraft and related spare parts	—	—	NM	—	36.8	NM
Total Operating Expenses	608.9	591.8	2.9%	1,817.5	1,730.3	5.0%
Operating Income (Loss)	80.4	41.0	NM	11.4	(28.6)	NM
Interest income	9.2	8.4		23.1	20.0	
Interest expense	(13.0)	(11.6)		(36.9)	(33.1)	
Interest capitalized	2.6	0.4		4.5	0.7	
Fuel hedging gains	54.8	58.8		172.1	82.1	
Other - net	(1.0)	0.9		(3.7)	0.8	
	52.6	56.9		159.1	70.5	
Income Before Income Tax and Accounting Change	\$133.0	\$ 97.9	NM	\$ 170.5	\$ 41.9	NM
<b>Operating Statistics:</b>						
Revenue passengers (000)	4,632	4,589	0.9%	12,715	12,296	3.4%
RPMs (000,000)	4,598	4,571	0.6%	12,812	12,255	4.5%
ASMs (000,000)	5,822	6,012	-3.2%	16,735	16,825	-0.5%
Passenger load factor	79.0%	76.0%	3.0 pts	76.6%	72.8%	3.8 pts
Yield per passenger mile	13.57¢	12.62¢	7.4%	12.93¢	12.61¢	2.5%
Operating revenue per ASM	11.84¢	10.53¢	12.4%	10.93¢	10.11¢	8.1%
Operating expenses per ASM (a)	10.46¢	9.84¢	6.1%	10.86¢	10.28¢	5.6%
Operating expense per ASM excluding fuel, navigation fee refund, restructuring and impairment charges(a)	7.53¢	7.35¢	2.4%	8.04¢	7.95¢	1.2%
Raw fuel cost per gallon (a)	\$ 1.99	\$ 1.40	41.8%	\$ 1.78	\$ 1.30	37.4%
GAAP fuel cost per gallon (a)	\$ 1.95	\$ 1.36	43.3%	\$ 1.74	\$ 1.26	38.6%
Economic fuel cost per gallon (a)	\$ 1.56	\$ 1.27	23.0%	\$ 1.46	\$ 1.21	20.8%
Fuel gallons (000,000)	90.4	95.8	-5.7%	260.8	267.6	-2.5%
Average number of employees	8,961	10,201	-12.2%	9,108	10,147	-10.2%
Aircraft utilization (blk hrs/day)	10.9	11.8	-7.6%	10.8	11.1	-2.7%
Operating fleet at period-end	110	107	2.8%	110	107	2.8%

NM = Not Meaningful

(a) See Note A on Page 22.

### Horizon Air Financial and Statistical Data (Unaudited)

	Three Months Ended September 30			Nine Months Ended September 30		
	2005	2004	% Change	2005	2004	% Change
<b>Financial Data (in millions):</b>						
Operating Revenues:						
Passenger	\$151.2	\$134.5	12.4%	\$405.8	\$360.4	12.6%
Freight and mail	1.0	1.0	0.0%	2.9	3.0	-3.3%
Other - net	1.5	3.8	-60.5%	6.8	10.9	-37.6%
<b>Total Operating Revenues</b>	<b>153.7</b>	<b>139.3</b>	<b>10.3%</b>	<b>415.5</b>	<b>374.3</b>	<b>11.0%</b>
Operating Expenses:						
Wages and benefits	45.3	39.7	14.1%	131.6	122.1	7.8%
Contracted services	6.1	5.0	22.0%	17.7	15.4	14.9%
Aircraft fuel	27.5	18.2	51.1%	70.3	48.4	45.2%
Aircraft maintenance	11.9	9.9	20.2%	31.1	26.6	16.9%
Aircraft rent	17.5	18.6	-5.9%	52.8	56.0	-5.7%
Food and beverage service	0.7	0.6	16.7%	1.9	1.6	18.8%
Selling expenses	8.1	6.7	20.9%	22.1	19.9	11.1%
Depreciation and amortization	4.1	3.4	20.6%	12.0	9.7	23.7%
Landing fees and other rentals	12.2	11.0	10.9%	35.7	31.2	14.4%
Other	10.1	9.4	7.4%	31.0	31.2	-0.6%
Impairment of aircraft and spare parts	—	—	NM	—	2.8	NM
<b>Total Operating Expenses</b>	<b>143.5</b>	<b>122.5</b>	<b>17.1%</b>	<b>406.2</b>	<b>364.9</b>	<b>11.3%</b>
<b>Operating Income</b>	<b>10.2</b>	<b>16.8</b>	<b>NM</b>	<b>9.3</b>	<b>9.4</b>	<b>NM</b>
Interest income	0.3	0.3		1.0	0.9	
Interest expense	(1.6)	(0.9)		(4.3)	(3.2)	
Interest capitalized	0.2	0.1		0.4	0.4	
Fuel hedging gains	8.1	8.1		26.5	11.2	
Other - net	0.1	—		0.1	—	
	<b>7.1</b>	<b>7.6</b>		<b>23.7</b>	<b>9.3</b>	
<b>Income Before Income Tax and Accounting Change</b>	<b>\$ 17.3</b>	<b>\$ 24.4</b>	<b>NM</b>	<b>\$ 33.0</b>	<b>\$ 18.7</b>	<b>NM</b>
<b>Operating Statistics:</b>						
Revenue passengers (000)	1,755	1,641	6.9%	4,868	4,362	11.6%
RPMs (000,000)	683	601	13.6%	1,843	1,586	16.2%
ASMs (000,000)	911	830	9.8%	2,542	2,314	9.9%
Passenger load factor	75.0%	72.4%	2.6 pts	72.5%	68.5%	4.0 pts
Yield per passenger mile	22.14¢	22.38¢	-1.1%	22.02¢	22.73¢	-3.1%
Operating revenue per ASM	16.87¢	16.78¢	0.6%	16.35¢	16.18¢	1.0%
Operating expenses per ASM (a)	15.75¢	14.76¢	6.7%	15.98¢	15.77¢	1.3%
Operating expense per ASM excluding fuel and impairment charges(a)	12.73¢	12.57¢	1.3%	13.21¢	13.56¢	-2.6%
Raw fuel cost per gallon (a)	\$ 2.04	\$ 1.44	41.8%	\$ 1.85	\$ 1.34	38.4%
GAAP fuel cost per gallon (a)	\$ 2.00	\$ 1.40	43.1%	\$ 1.82	\$ 1.30	40.1%
Economic fuel cost per gallon (a)	\$ 1.62	\$ 1.31	23.9%	\$ 1.54	\$ 1.26	22.1%
Fuel gallons (000,000)	13.7	13.0	5.4%	38.6	37.2	3.8%
Average number of employees	3,508	3,439	2.0%	3,428	3,399	0.9%
Aircraft utilization (blk hrs/day)	9.0	8.7	3.4%	8.6	8.3	3.6%
Operating fleet at period-end	65	65	0.0%	65	65	0.0%

NM = Not Meaningful

(a) See Note A on Page 22.

[Table of Contents](#)
**Note A:**

Pursuant to Item 10 of Regulation S-K, we are providing disclosure of the reconciliation of reported non-GAAP financial measures to their most directly comparable financial measures reported on a GAAP basis. The non-GAAP financial measures provide management the ability to measure and monitor performance both with and without the cost of aircraft fuel (including the gains and losses associated with our fuel hedging program where appropriate), the navigation fee refund, restructuring charges, and aircraft impairment charges. Because the cost and availability of aircraft fuel are subject to many economic and political factors beyond our control and we record changes in the fair value of our hedge portfolio in our income statement, it is our view that the measurement and monitoring of performance without fuel is important. In addition, we believe the disclosure of financial performance without the navigation fee refund and impairment and restructuring charges is useful to investors. Finally, these non-GAAP financial measures are also more comparable to financial measures reported to the Department of Transportation by other major network airlines.

The following tables reconcile our non-GAAP financial measures to the most directly comparable GAAP financial measures for both Alaska Airlines, Inc. and Horizon Air Industries, Inc.:

**Alaska Airlines, Inc.:**

(\$ in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<b>Unit cost reconciliations:</b>				
Operating expenses	\$ 608.9	\$ 591.8	\$ 1,817.5	\$ 1,730.3
ASMs (000,000)	5,822	6,012	16,735	16,825
Operating expenses per ASM	10.46¢	9.84¢	10.86¢	10.28¢
Operating expenses	\$ 608.9	\$ 591.8	\$ 1,817.5	\$ 1,730.3
Less: aircraft fuel	(176.6)	(130.2)	(455.7)	(336.4)
Less: restructuring charges	1.4	(27.5)	(20.7)	(27.5)
Add: navigation fee refund	4.7	7.7	4.7	7.7
Less: impairment of aircraft and related spare parts	—	—	—	(36.8)
Operating expenses excluding fuel, navigation fee refund, restructuring and impairment charges	\$ 438.4	\$ 441.8	\$ 1,345.8	\$ 1,337.3
ASMs (000,000)	5,822	6,012	16,735	16,825
Operating expenses per ASM excluding fuel, navigation fee refund, restructuring and impairment charges	7.53¢	7.35¢	8.04¢	7.95¢
<b>Reconciliation to GAAP income before taxes and accounting change:</b>				
Income before taxes and accounting change, excluding mark-to-market hedging gains, navigation fee refund, restructuring and impairment charges	\$ 106.0	\$ 64.1	\$ 85.3	\$ 24.8
Add: mark-to-market hedging gains included in nonoperating income (expense)	19.9	50.3	100.2	70.4
Less: restructuring charges	1.4	(27.5)	(20.7)	(27.5)
Add: navigation fee refund and related interest received	5.7	11.0	5.7	11.0
Less: impairment of aircraft and related spare parts	—	—	—	(36.8)
GAAP income before taxes and accounting change as reported	\$ 133.0	\$ 97.9	\$ 170.5	\$ 41.9

**Aircraft fuel reconciliations:**

	Three Months Ended September 30,			
	2005		2004	
	(in millions)	Cost/Gal	(in millions)	Cost/Gal
Fuel expense before hedge activities ("raw" or "into-plane" fuel cost)	\$ 179.5	\$ 1.99	\$ 133.7	\$ 1.40
Less: gains on settled hedges included in fuel expense	(2.9)	(0.04)	(3.5)	(0.04)
GAAP fuel expense	\$ 176.6	\$ 1.95	\$ 130.2	\$ 1.36
Less: gains on settled hedges included in nonoperating income (expense)	(34.9)	(0.39)	(8.5)	(0.09)
Economic fuel expense	\$ 141.7	\$ 1.56	\$ 121.7	\$ 1.27
Fuel gallons (000,000)	90.4		95.8	
Mark-to-market gains included in non-operating income (expense) related to hedges that settle in future periods, net of the reclassification of previously recorded mark-to-market gains to gains on settled hedges included in nonoperating income (expense)	\$ 19.9		\$ 50.3	

	Nine Months Ended September 30,			
	2005		2004	
	(in millions)	Cost/Gal	(in millions)	Cost/Gal
Fuel expense before hedge activities (“raw” or “into-plane” fuel cost)	\$ 465.2	\$ 1.78	\$ 347.4	\$ 1.30
Less: gains on settled hedges included in fuel expense	(9.5)	(0.04)	(11.0)	(0.04)
GAAP fuel expense	\$ 455.7	\$ 1.74	\$ 336.4	\$ 1.26
Less: gains on settled hedges included in nonoperating income (expense)	(71.9)	(0.28)	(11.7)	(0.05)
Economic fuel expense	\$ 383.8	\$ 1.46	\$ 324.7	\$ 1.21
Fuel gallons (000,000)	260.8		267.6	
Mark-to-market gains included in non-operating income (expense) related to hedges that settle in future periods, net of the reclassification of previously recorded mark-to-market gains to gains on settled hedges included in nonoperating income (expense)	\$ 100.2		\$ 70.4	



[Table of Contents](#)
**Horizon Air Industries, Inc.**

(\$ in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<b>Unit cost reconciliations:</b>				
Operating expenses	\$ 143.5	\$122.5	\$ 406.2	\$364.9
ASMs (000,000)	911	830	2,542	2,314
Operating expenses per ASM	15.75¢	14.76¢	15.98¢	15.77¢
Operating expenses	\$ 143.5	\$122.5	\$ 406.2	\$364.9
Less: aircraft fuel	(27.5)	(18.2)	(70.3)	(48.4)
Less: impairment of aircraft	—	—	—	(2.8)
Operating expense excluding fuel and impairment charge	\$ 116.0	\$104.3	\$ 335.9	\$313.7
ASMs (000,000)	911	830	2,542	2,314
Operating expense per ASM excluding fuel and impairment charge	12.73¢	12.57¢	13.21¢	13.56¢
<b>Reconciliation to GAAP income before taxes and accounting change:</b>				
Income before taxes and accounting change, excluding mark-to-market hedging gains and impairment charge	\$ 14.4	\$ 17.5	\$ 17.4	\$ 11.9
Add: mark-to-market hedging gains included in nonoperating income (expense)	2.9	6.9	15.6	9.6
Less: impairment of aircraft and related spare parts	—	—	—	(2.8)
GAAP income before taxes and accounting change as reported	\$ 17.3	\$ 24.4	\$ 33.0	\$ 18.7

**Aircraft fuel reconciliations:**

	Three Months Ended September 30,			
	2005		2004	
	(in millions)	Cost/Gal	(in millions)	Cost/Gal
Fuel expense before hedge activities (“raw” or “into-plane” fuel cost)	\$ 28.0	\$ 2.04	\$ 18.7	\$ 1.44
Less: gains on settled hedges included in fuel expense	(0.5)	(0.04)	(0.5)	(0.04)
GAAP fuel expense	\$ 27.5	\$ 2.00	\$ 18.2	\$ 1.40
Less: gains on settled hedges included in nonoperating income (expense)	(5.2)	(0.38)	(1.2)	(0.09)
Economic fuel expense	\$ 22.3	\$ 1.62	\$ 17.0	\$ 1.31
Fuel gallons (000,000)	13.7		13.0	
Mark-to-market gains included in non-operating income (expense) related to hedges that settle in future periods, net of the reclassification of previously recorded mark-to-market gains to gains on settled hedges included in nonoperating income (expense)	\$ 2.9		\$ 6.9	

	Nine Months Ended September 30,			
	2005		2004	
	(in millions)	Cost/Gal	(in millions)	Cost/Gal
Fuel expense before hedge activities (“raw” or “into-plane” fuel cost)	\$ 71.6	\$ 1.85	\$ 49.9	\$ 1.34
Less: gains on settled hedges included in fuel expense	(1.3)	(0.03)	(1.5)	(0.04)
GAAP fuel expense	\$ 70.3	\$ 1.82	\$ 48.4	\$ 1.30
Less: gains on settled hedges included in nonoperating income (expense)	(10.9)	(0.28)	(1.6)	(0.04)
Economic fuel expense	\$ 59.4	\$ 1.54	\$ 46.8	\$ 1.26
Fuel gallons (000,000)	38.6		37.2	

Mark-to-market gains included in non-operating income (expense) related to hedges that settle in future periods, net of the reclassification of previously recorded mark-to-market gains to <i>gains on settled hedges included in nonoperating income (expense)</i>	\$ 15.6	\$ 9.6
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**ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read in conjunction with our condensed consolidated financial statements and the related notes contained elsewhere in this quarterly report on Form 10-Q. All statements in the following discussion that are not reports of historical information or descriptions of current accounting policy are forward-looking statements. Please consider our forward-looking statements in light of the risks referred to in this report's introductory cautionary note.

Air Group's filings with the Securities and Exchange Commission, including its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports are accessible free of charge at [www.alaskaair.com](http://www.alaskaair.com). The information contained on our website is not a part of this quarterly report on Form 10-Q. As used in this Form 10-Q, the terms "Air Group," "our," "we" and the "Company" refer to Alaska Air Group, Inc. and its subsidiaries, unless the context indicates otherwise.

**Third Quarter in Review and Current Events**

In the third quarter, despite relatively flat passenger traffic at Alaska, revenues continued to improve due to higher ticket yields resulting from industry wide fare increases. The flat passenger traffic resulted from reduced capacity, in light of the operational difficulties described below, despite record load factors during the quarter. Horizon continued to see significant increases in passenger traffic, resulting in increased revenues, offset by slightly lower yield. Operating expenses per available seat mile increased 6.1% at Alaska to 10.46 cents and 6.7% at Horizon to 15.75 cents compared to the third quarter of 2004. Fuel is a major component of our operating costs and fuel prices reached record highs once again during the quarter. At Alaska, our unit costs excluding fuel, a navigation fee refund and restructuring charges during the third quarter of 2005 increased by 2.4% to 7.53 cents compared to the third quarter of 2004. This is primarily due to the capacity reduction during the summer. Compared to the third quarter of 2004, Horizon had a 1.3% increase in unit costs excluding fuel to 12.73 cents.

Although revenues and pre-tax income at Alaska have improved over the prior year, we faced several operational difficulties during much of the third quarter due to the combined effects of the recent labor and operational changes across our company. The result was operational performance that was well below our goal during much of the third quarter. Our operational performance, measured by on-time arrivals and departures, declined from the third quarter of 2004. However, in September, we began to see improvement in these metrics and expect the positive trend to continue through the remainder of the year. In order to improve our operational performance, we reduced our 2005 summer capacity from our original expectations through schedule reductions and the elimination of certain flights.

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## [Table of Contents](#)

### *Labor Costs and Negotiations*

Subsequent to the end of the third quarter, Alaska reached an agreement with the Aircraft Mechanics Fraternal Association (AMFA) resulting in a new four year contract covering Alaska's approximately 700 aircraft technicians. This contract includes, among other items, a market-based wage increase of approximately 10% and a one-time \$1,000 bonus to each of the employees covered under the contract.

Also, in October 2005, Horizon reached an agreement with the Transport Workers Union for a new three-year contract covering 21 dispatchers at Horizon. Additionally, Horizon has reached a tentative agreement with AMFA on a three-year contract covering Horizon's more than 400 mechanics and fleet service agents. This tentative agreement is expected to be voted on by the union members in the fourth quarter of 2005.

We are pleased with the contracts that have been reached recently and we are continuing to negotiate with our other workgroups to reach agreement on contracts that would benefit both our employees and our shareholders. None of the contract negotiations is at an impasse or has reached the 30-day cooling off period required under the Railway Labor Act that would trigger self help. Therefore, we currently believe the risk of a work stoppage or other material service disruption in the near future is low.

### *Mark-to-Market Fuel Hedging Gains*

Beginning in the second quarter of 2004, we lost the ability to defer, as a component of comprehensive income, recognition of any unrealized gain or loss on our fuel hedge contracts until the hedged fuel is consumed. We lost this ability because the price correlation between crude oil, the commodity we use to hedge, and West Coast jet fuel fell below required thresholds. For more discussion, see Note 4 to our condensed consolidated financial statements.

The implications of this change are twofold: First, our earnings can be more volatile as we mark our entire hedge portfolio to market each quarter-end and report the gain or loss in other non-operating income or expense, even though the actual consumption could take place in a future period. In times of rising fuel prices such as the third quarter of 2005, this will have the effect of increasing our reported net income or decreasing our reported net loss. Our mark-to-market gains recorded in the third quarter of 2005 for contracts that settle in future periods, net of the reclassification of previously recorded mark-to-market gains for settled hedges, were \$22.8 million compared to \$57.2 million in the third quarter of 2004. Second, to a large extent, the impact of our fuel hedge program will not be reflected in fuel expense. In the third quarter of 2005, we recorded gains from settled fuel hedges totaling \$43.5 million, but only \$3.4 million of that gain is reflected as an offset to fuel expense with the balance reported in other non-operating income. In the third quarter of 2004, gains of \$4.0 million on settled hedges were recorded as an offset to fuel expense and gains of \$9.7 million were recorded in non-operating income related to settled hedges.

We have provided information on mark-to-market gains or losses, as well as calculations of our economic fuel cost per gallon on pages 22 and 23.

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## [Table of Contents](#)

We believe that our fuel hedge program is an important part of our strategy to reduce our exposure to volatile fuel prices.

### *Restructuring Charges*

During the third quarter of 2004, Alaska announced a management reorganization and the closure of its Oakland maintenance base, contracting out of the Alaska's fleet service and ground support equipment and facility maintenance functions, as well as other initiatives. Severance and related costs associated with this restructuring during the third quarter of 2004 were \$27.5 million. In the third quarter of 2005, we recorded a \$1.4 million (pre-tax) positive adjustment to the restructuring accrual related to this and other initiatives as discussed in Note 3 to our condensed consolidated financial statements.

### *Other Events*

In August 2005, Alaska recorded a net refund totaling \$5.7 million (\$3.6 million, net of tax) from the Mexican government related to navigation fees paid in 2004. Approximately \$4.7 million of the refund was recorded as a reduction to operating expenses and \$1.0 million was recorded as interest income in non-operating income. This is compared to an \$11.0 million refund (\$6.3 million, net of tax) recorded during the third quarter of 2004.

In October 2005, Horizon finalized an agreement to purchase twelve Bombardier Q400 aircraft with delivery dates beginning in December 2006 and continuing through July 2007. This agreement, in part, replaced firm orders for seven CRJ-700 aircraft that were to be delivered over the next several years. This agreement also provides for an option to purchase up to an additional 20 Q400 aircraft. In connection with the agreement, Bombardier agreed to provide certain remarketing assistance for up to twelve Q200 aircraft currently leased by Horizon for a fee as set forth in the agreement.

In October 2005, Alaska finalized a \$172 million variable rate revolving loan facility to provide a portion of the pre-delivery funding requirements of Alaska's purchase of up to 38 new Boeing 737-800 aircraft (23 of which are firm orders) under the current aircraft purchase agreement. The facility will expire on August 31, 2009 and the interest rate is based on one-month LIBOR plus a specified margin. Any borrowings will be secured by the Company's rights under the Boeing purchase agreement. Upon closing, we drew \$61.3 million on the facility.

We began daily non-stop service from Los Angeles to Mexico City in August 2005 and Seattle to Dallas/Fort Worth in September 2005.

### *Outlook*

For the fourth quarter of 2005, Alaska and Horizon expect capacity to be up approximately 2% and 8%, respectively, compared to 2004 capacity.

## **Results of Operations**

### **Comparison of Three Months Ended September 30, 2005 to Three Months Ended September 30, 2004**

Our consolidated net income for the third quarter of 2005 was \$90.2 million, or \$2.71 per diluted share, versus \$74.0 million, or \$2.29 per diluted share, in the third quarter of 2004.

Our consolidated pre-tax income for the quarter was \$146.8 million compared to \$119.2 million for the third quarter of 2004. Both the 2005 and 2004 results include certain notable items that impact the comparability of the quarters. These items are discussed in the “Third Quarter in Review and Current Events” section beginning on page 24. Excluding those items, the quarter over quarter improvement can be characterized by higher revenues and slightly lower non-fuel operating costs, offset by significantly higher fuel costs. Wages and benefits declined significantly due to some of the recent initiatives and the new pilot contract at Alaska. However, these declines were largely offset by higher operating expenses in other areas such as contracted services and aircraft maintenance.

Financial and statistical data comparisons for Alaska and Horizon are shown on pages 20 and 21, respectively. On pages 22 and 23, we have included a reconciliation of reported non-GAAP financial measures to the most directly comparable GAAP financial measures.

### **Alaska Airlines Revenues**

Operating revenues increased \$56.5 million, or 8.9%, during the third quarter of 2005 as compared to 2004 due to a 12.4% increase in operating revenue per available seat mile (RASM) offset by reduced ASMs. The increase in RASM was driven by a 7.4% increase in ticket yields that resulted from increases in ticket prices designed to offset higher fuel prices and higher load factors. The capacity decrease is primarily a direct result of the reduction in our flight schedule that was announced in June 2005, offset by the addition of three B737-800s in the first nine months of 2005

Load factor increased 3.0 percentage points to 79.0% for the third quarter of 2005 due primarily to the nearly flat passenger traffic combined with fewer departures. We expect that load factors will continue to improve and that yields and passenger unit revenues will be higher in the fourth quarter of 2005 compared to 2004, although not to the extent that we had in the third quarter.

Freight and mail revenues increased by \$0.7 million, or 2.9%, compared to the same period in 2004 as a result of a relatively new mail contract we have in the State of Alaska that began in the third quarter of 2004 and fuel surcharges added to our freight services during the third quarter of 2005, offset by lower freight volumes.

Other-net revenues increased \$8.3 million, or 26.2%, primarily due to increases in Mileage Plan revenues resulting from higher award redemption on our partner airlines and an increase in cash receipts from miles sold, of which a portion is recognized immediately as other revenue.

### **Alaska Airlines Expenses**

For the quarter, total operating expenses increased \$17.1 million, or 2.9%, as compared to the same period in 2004, although operating expenses excluding fuel, the navigation fee refund and restructuring charges, decreased by \$3.4 million, or 0.8%. Operating expenses per ASM increased 6.1% from 9.84 cents in the third quarter of 2004 to 10.46 cents in the third quarter of 2005. The increase in operating expenses is due largely to the significant increase in raw or “into-plane” fuel costs and increases in aircraft maintenance, contracted services, and landing fees and other rentals, offset by a decline in wages and benefits and selling expenses. Operating expenses per ASM excluding fuel, the navigation fee refund, and restructuring charges increased 2.4% as compared to the same period in 2004. Our estimates of costs per ASM, excluding the items noted above for the fourth quarter and full year of 2005, are 7.8 cents and 8.0 cents, respectively.

Explanations of significant period-over-period changes in the components of operating expenses are as follows:

- Wages and benefits decreased \$32.8 million, or 15.8%, during the third quarter. Wages have been favorably impacted by the restructuring initiatives announced in the third quarter of the prior year, subcontracting our ramp services operation in Seattle in the second quarter of 2005, and the reduction in pilot wages resulting from the new contract that took effect in May 2005. We expect to continue to see a year-over-year decline in wages in the fourth quarter of 2005, although to a lesser extent than the third quarter as we begin to anniversary the initiatives from 2004 and due to the increased wages for our aircraft technicians resulting from the recent contract agreement. We estimate a decline of approximately \$8 million, or 4% in the fourth quarter as compared to the same periods in 2004. The period over period decline in wages and benefits is partially offset by increases in contracted services and maintenance expense due to the subcontracting of certain operations.
- Contracted services increased \$9.8 million, or 55.1%, largely due to the contracting out of the Company’s fleet service and ground support equipment and facility maintenance functions in the fourth quarter of 2004, and the Seattle ramp operations in the second quarter of 2005. Additionally, the navigation fee refund recorded in contracted services was \$5.1 million in the third quarter of 2005 compared to \$7.7 million in the third quarter of 2004.
- Aircraft fuel increased \$46.4 million, or 35.6%, due to a 43.3% increase in the GAAP fuel cost per gallon, offset by a 5.7% decrease in fuel gallons consumed. During the third quarter of 2005, Alaska realized \$37.8 million of gains from settled hedges, the majority of which are recorded in other non-operating income (expense). The total gains from settled hedges of \$37.8 million represents 28.4% of Alaska’s pre-tax income. After including all gains on settled hedges recorded during the quarter, our “economic,” or net, fuel expense increased \$20.0 million, or 16.4%, over the same period in 2004. Our economic fuel cost per gallon increased 23.0% over the third quarter of 2004 from \$1.27 to \$1.56. At current market prices, we expect that the cost per gallon in the fourth quarter will exceed third quarter levels.

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## [Table of Contents](#)

During the second quarter of 2005, we entered into a fuel contract whereby the spread between crude oil prices and jet fuel prices is fixed for approximately one-third of our fuel consumption. This contract has resulted in approximately \$6.0 million in savings for Air Group during the third quarter of 2005.

See page 22 for a table summarizing fuel cost per gallon realized by Alaska (the economic cost per gallon), the cost per gallon on a GAAP basis (including hedging gains recorded in aircraft fuel) and fuel cost per gallon excluding all hedging activities.

- Aircraft maintenance increased \$16.1 million, or 59.4%, due largely to more airframe work and engine events in 2005 compared to 2004, and the contracting out of related heavy maintenance to third parties, which resulted in a shift of costs from wages and benefits into aircraft maintenance. Other factors causing the increase were our power-by-the-hour maintenance agreement, whereby we expense B737-400 engine maintenance on a flight-hour basis, regardless of whether the work was actually performed during the period, the change in our accounting policy regarding engine and airframe overhauls (see Note 2 to our condensed consolidated financial statements), as well as certain enhancements to aircraft interiors, systems and cockpits to assist with reliability improvement. We expect that maintenance expense will be higher by \$8.5 million in the fourth quarter of 2005 compared to the same period in 2004 as a result of the factors above and our decision to move the timing of some maintenance activities up from 2006.
- Aircraft rent increased \$1.4 million, or 5.0%, primarily due to the additional operating lease on a B737-800 that was delivered in March 2005 and more engine rentals in 2005 compared to 2004.
- Selling expenses decreased by \$1.9 million, or 5.3%, primarily due to a decline in the incentive payment to Horizon for harmonization flying, offset by increases in advertising expense and commissions and codeshare fees.
- Landing fees and other rentals increased \$2.8 million, or 7.4% despite a decrease in the number of departures. The higher rates reflect increased rental costs, primarily in Seattle, Portland and Los Angeles. We expect landing fees and other rentals to continue to increase by 10% to 15% in the fourth quarter compared to 2004 as a result of airport facility expansions and higher costs related to airport security along with anticipated capacity increase.
- Other expense increased \$5.2 million, or 15.0%, primarily reflecting increases in passenger remuneration costs and legal settlement costs. Additionally, in 2004, there was a \$2.5 million gain on the disposal of assets that offset other operating expenses.



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## [Table of Contents](#)

### **Horizon Air Revenues**

For the third quarter, operating revenues increased \$14.4 million, or 10.3% as compared to 2004. This increase is due largely to increased traffic, partially offset by a 1.1% decline in ticket yields.

For the three months ending September 30, 2005, capacity increased 9.8% and traffic was up 13.6%, compared to the same period in 2004 due primarily to the addition of one CRJ-700, four additional seats on each of our Q400's and an increase in the average trip length. Passenger yield decreased 1.1% to 22.14 cents per passenger mile due primarily to an increase in average trip lengths across the native network, partially as a result of increased harmonization flying with Alaska. Passenger revenues increased by \$16.7 million, or 12.4%, due primarily to the increase in traffic resulting from increased harmonization flying with Alaska and in our native network.

### **Horizon Air Expenses**

Operating expenses for the third quarter of 2005 increased \$21.0 million, or 17.1%, as compared to the same period in 2004 primarily due to increases in raw or "into-plane" fuel costs, wages and benefits and aircraft maintenance. Operating expenses per ASM increased 6.7% as compared to 2004. Operating expenses per ASM excluding fuel increased 1.3% as compared to the same period in 2004. Our estimates of costs per ASM, excluding fuel and any special charges, for the fourth quarter and full year of 2005 are 13.8 cents, and 13.4 cents, respectively.

Explanations of other significant period-over-period changes in the components of operating expenses are as follows:

- Wages and benefits increased \$5.6 million, or 14.1%, reflecting a slight increase in the number of employees and the average wage per employee, along with a move to a new paid time off program resulting in a one time charge related to this transition.
- Aircraft fuel increased \$9.3 million, or 51.1%, due to a 43.1% increase in the GAAP fuel cost per gallon from \$1.40 in 2004 to \$2.00 in 2005 and a 5.4% increase in fuel gallons consumed. During the quarter, Horizon realized \$5.7 million of gains from settled hedges, the majority of which are recorded in other non-operating income (expense). The total gains from settled hedges of \$5.7 million represents 32.9% of Horizon's pre-tax income. After including all gains on settled hedges recorded during the quarter, our "economic," or net, fuel expense increased \$5.3 million, or 31.1%, compared to the same period in 2004. Our economic fuel cost per gallon increased 23.9% from \$1.31 in 2004 to \$1.62 in 2005. At current market prices, we expect that the cost per gallon in the fourth quarter will meet or exceed third quarter levels.

During the second quarter of 2005, we entered into a fuel contract whereby the spread between crude oil prices and jet fuel prices is fixed for approximately one-third of our fuel consumption. This contract has resulted in approximately \$6.0 million in savings for Air Group during the third quarter of 2005.

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## [Table of Contents](#)

See page 23 for a table summarizing fuel cost per gallon realized by Horizon (the economic cost per gallon), the cost per gallon on a GAAP basis (including hedging gains recorded in aircraft fuel) and fuel cost per gallon excluding all hedging activities.

- Aircraft maintenance expense increased \$2.0 million, or 20.2%, primarily due to the timing of our airframe and engine events and accelerated inspection intervals on the Q400 engines along with the change in our accounting policy regarding engine and airframe overhauls (see Note 2 to our condensed consolidated financial statements).
- Aircraft rent decreased \$1.1 million, or 5.9%, due primarily to lower rents on extended leases, return of one aircraft on a short-term lease and fewer leased engines.
- Landing fees and other rentals increased \$1.2 million, or 10.9%. Higher landing fees are a result of significant rate increases in several of our key airports, modest growth and new markets being served. We expect landing fees and other rentals to continue to increase as a result of airport facility expansions and increased departures.

### **Consolidated Nonoperating Income (Expense)**

Net nonoperating income was \$56.6 million in the third quarter of 2005 compared to \$62.4 million during the same period of 2004. Interest income increased \$0.7 million due to a larger average marketable securities portfolio in the third quarter of 2005, offset by a larger interest payment in 2004 related to the navigation fee refund. Interest expense increased \$2.5 million primarily due to interest rate increases on our variable rate debt and the changes to some of our variable rate debt agreements to slightly higher fixed rate arrangements. Capitalized interest increased \$2.3 million from \$0.5 million in the third quarter of 2004 to \$2.8 million in the third quarter of 2005. This increase is due to the significant increase in deposits for future flight equipment resulting from our new aircraft purchase agreement for B737-800 aircraft.

Fuel hedging gains include \$40.1 million in gains from fuel hedging contracts settled in the third quarter of 2005 compared to \$9.7 million in 2004. In addition, fuel hedging gains include net mark-to-market gains on unsettled hedge contracts, net of the reclassification of previously recorded mark-to-market gains for settled hedges, of \$22.8 million in 2005 and \$57.2 million in 2004.

### **Comparison of Nine Months Ended September 30, 2005 to Nine Months Ended September 30, 2004**

Our consolidated net income for the nine months ended September 30, 2005 was \$27.1 million, or \$0.93 per diluted share, versus \$29.6 million, or \$0.98 per diluted share, during the same period of 2004.

Our consolidated income before income tax and the accounting change for the nine months of 2005 was \$193.5 million compared to \$52.3 million for the first nine months of 2004. Both the 2005 and

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## [Table of Contents](#)

2004 results include certain notable items as stated below that impact the comparability of the nine-month periods:

- Our 2005 consolidated net income includes a \$144.7 million pre-tax (\$90.4 million after tax) charge resulting from the change in the method of accounting for major airframe and engine overhauls as discussed in Note 2 to the condensed consolidated financial statements.
- We recorded restructuring charges of \$20.7 million (\$12.9 million, net of tax) in the first nine months of 2005 related primarily to the termination of the lease at our Oakland heavy maintenance base and severance and related costs resulting from the subcontracting of the ramp services operation in Seattle, compared to a charge of \$27.5 million (\$15.8 million, net of tax) during the first nine months of 2004.
- Results include mark-to-market fuel hedging gains on contracts that settle in future periods, net of the reclassification of previously recorded mark-to-market gains for settled hedges, of \$115.8 million (\$72.4 million, net of tax) during the first nine months of 2005 compared to \$80.0 million (\$45.9 million, net of tax) in the same prior year period.
- We received a refund of Mexico navigation fees originally paid in prior years of \$5.7 million (\$3.6 million, net of tax) during the first nine months of 2005 compared to \$11.0 million (\$6.3 million, net of tax) during the same period of 2004.
- 2004 results include an impairment charge of \$39.6 million (\$26.3 million, net of tax), substantially all of which was associated with a decision to accelerate the retirement of our Boeing 737-200C fleet.

Financial and statistical data comparisons for Alaska and Horizon are shown on pages 20 and 21, respectively. On pages 22 and 23, we have included a reconciliation of reported non-GAAP financial measures to the most directly comparable GAAP financial measures. A discussion of the nine-month data follows.

### **Alaska Airlines Revenues**

Operating revenues increased \$127.2 million, or 7.5%, during 2005 as compared to 2004.

Yield per passenger mile increased 2.5% to 12.93 cents and passenger load factor increased 3.8 points during the first nine months of 2005 as compared to the same period in 2004. Increases in traffic and yield resulted in a 7.2% increase in passenger revenues in 2005.

Freight and mail revenues increased \$3.1 million, or 4.7%, compared to the same period in 2004 because of a relatively new mail contract we have in the State of Alaska that began during the third quarter of 2004 and fuel surcharges added to our freight services during the third quarter of 2005, offset by lower freight volumes.

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## [Table of Contents](#)

Other-net revenues increased \$13.3 million, or 14.7%, due largely to an increase in Mileage Plan revenues, resulting from higher award redemption on our partner airlines and an increase in cash receipts from miles sold, of which a portion is recognized immediately as other revenue, offset by the termination of contract maintenance work that we were performing for third parties in the second quarter of 2004 and are no longer performing.

### **Alaska Airlines Expenses**

For the nine months ended September 30, 2005, total operating expenses increased \$87.2 million, or 5.0%, as compared to the same period in 2004. Operating expenses per ASM increased 5.6% in 2005 as compared to 2004. The increase in operating expenses is due largely to the significant increases in raw or “into-plane” fuel costs, aircraft maintenance, contracted services, and landing fees and other rentals, offset by a decline in wages and benefits, food and beverage service, selling expenses, depreciation and amortization and an impairment charge in 2004 related to our Boeing 737-200 fleet. Operating expense per ASM excluding fuel, the navigation fee refund, restructuring and impairment charges increased 1.2% as compared to the same period in 2004. As noted above, operating expenses per ASM was also negatively impacted by the summer capacity reductions.

Explanations of significant period-over-period changes in the components of operating expenses are as follows:

- Wages and benefits decreased \$55.6 million, or 9.1%, during the first nine months of 2005 compared to the same period in 2004. Wages have been favorably impacted by the restructuring initiatives announced in August and September of 2004 and the reduction in pilot wages resulting from the new pilot contract that took effect in May 2005. Additionally, during the second quarter of 2005, we subcontracted our ramp services operation in Seattle. During the first nine months of 2005, there were 9,108 full-time equivalents (FTEs), which is down by 1,039 FTEs from 2004. The period over period decline in wages and benefits is partially offset by increases in contracted services and maintenance expense due to the subcontracting of certain operations.
- Contracted services increased \$16.7 million, or 23.8%, due largely to contracting out of the Company’s fleet service and ground support equipment and facility maintenance functions in the fourth quarter of 2004, and the Seattle ramp operations in May 2005. Additionally, the navigation fee refund recorded in contracted services was \$5.1 million in the third quarter of 2005 compared to \$7.7 million in the third quarter of 2004.
- Aircraft fuel increased \$119.3 million, or 35.5%, due to a 38.6% increase in the GAAP fuel cost per gallon, offset by a 2.5% decrease in fuel gallons consumed. During the first nine months of 2005, Alaska also realized \$81.4 million of gains from settled hedges, the majority of which are recorded in other non-operating income (expense). The total gains from settled hedges of \$81.4 million represents 47.7% of Alaska’s income before taxes and the accounting change.

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## [Table of Contents](#)

After including all gains from settled hedges recorded during the period, our “economic,” or net, fuel expense increased \$59.1 million, or 18.2%, over the same period in 2004. Our economic fuel cost per gallon increased 20.8% over the first nine months of 2004 from \$1.21 to \$1.46.

See page 22 for a table summarizing fuel cost per gallon realized by Alaska (the economic cost per gallon), the cost per gallon on a GAAP basis (including hedging gains recorded in aircraft fuel) and fuel cost per gallon excluding all hedging activities.

- Aircraft maintenance increased \$32.2 million, or 28.9%, due largely to our power-by-the-hour maintenance agreement, whereby we expense B737-400 engine maintenance on a flight-hour basis, regardless of whether the work was actually performed during the period. Other factors causing the increase were more airframe work and engine overhauls in 2005 compared to 2004, the contracting out of related heavy maintenance to third parties, which resulted in a shift of costs from wages and benefits into aircraft maintenance, the change in our accounting policy regarding engine and airframe overhauls (see Note 2 to our condensed consolidated financial statements), as well as certain enhancements to aircraft interiors, systems and cockpits to assist with reliability improvement.
- Aircraft rent increased \$1.7 million, or 2.0%, due to the additional operating lease on a B737-800 that was delivered in March 2005, offset by lower rates on extended leases.
- Food and beverage service expense decreased \$2.7 million, or 7.1%, due primarily to a reduction in on-board services provided.
- Selling expenses decreased \$3.2 million, or 3.2% primarily due to a decline in the incentive payment to Horizon for harmonization flying, offset by increases in advertising expense and commissions and codeshare fees.
- Depreciation and amortization decreased \$2.3 million, or 2.4%. In the second quarter of 2004, we recorded an impairment charge of \$36.8 million to reduce the carrying value of the Boeing 737-200C fleet, which results in lower depreciation expense in future periods. This is offset by the increased depreciation on two new owned aircraft delivered during the first nine months of 2005.
- Landing fees and other rentals increased \$15.4 million, or 14.5%. The higher rates reflect increased rental costs, primarily in Seattle, Portland and Los Angeles.
- Other expenses increased \$9.3 million, or 8.4%, primarily reflecting increases in passenger remuneration costs and legal settlement costs, partly offset by lower passenger insurance premiums. Additionally, in 2004 there were \$0.6 million in gains on disposal of assets compared to a \$2.3 million loss on disposal in the current year.

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## [Table of Contents](#)

### **Horizon Air Revenues**

For the first nine months of 2005, operating revenues increased \$41.2 million, or 11.0% as compared to 2004. This increase is due largely to increased traffic in the native network and the contract flying for Frontier Airlines, which began in January 2004, partially offset by a 3.1% decline in ticket yields.

For the nine months ended September 30, 2005, capacity increased 9.9% and traffic was up 16.2%, compared to the same period in 2004, due to an increase in contract flying with Frontier and harmonization flying with Alaska, the addition of one CRJ-700 in March 2005 and four additional seats on each of our Q400's. Contract flying with Frontier represented approximately 9.1% of passenger revenues and 22.3% of capacity, during the first nine months of 2005 compared to 8.8% and 20.8%, respectively, in the first nine months of 2004. Passenger load factor increased 4.0 percentage points to 72.5%. Passenger yield decreased 3.1% to 22.02 cents, reflecting the inclusion of the Frontier contract flying, the yield for which is significantly lower than native network flying and an increase in average trip lengths across the native network, partially due to an increase in harmonization flying with Alaska. Passenger revenues increased by \$45.4 million, or 12.6%, due primarily to the increase in traffic resulting from increased harmonization flying with Alaska and the increase in Frontier contract flying.

### **Horizon Air Expenses**

Operating expenses for the first nine months of 2005 increased \$41.3 million, or 11.3%, as compared to the same period in 2004, primarily due to increases in fuel costs, wages and benefits, aircraft maintenance and landing fees and other rentals, partially offset by a decline in aircraft rent. Operating expenses per ASM increased 1.3% as compared to 2004. Operating expenses per ASM excluding fuel and impairment charges decreased 2.6% as compared to the same period in 2004.

Explanations of other significant period-over-period changes in the components of operating expenses are as follows:

- Wages and benefits increased \$9.5 million, or 7.8%, reflecting a slight increase in the average number of employees, wages per employee, a new performance-based incentive program for all employees, and the move to a new paid time off program resulting in a one time charge related to the transition.
- Contracted services increased \$2.3 million, or 14.9%, due primarily to the increase in harmonization flying with Alaska that results in higher payments to non-Horizon employees for ground handling services.
- Aircraft fuel increased \$21.9 million, or 45.2%, due to a 40.1% increase in the GAAP fuel cost per gallon from \$1.30 in 2004 to \$1.82 in 2005. During the first nine months of 2005, Horizon also realized \$12.2 million of gains from settled hedges, the majority of which are recorded in other non-operating income (expense). The total gains from settled hedges of \$12.2 million represents 37.0% of Horizon's pre-tax income. After including all gains from settled hedges

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## [Table of Contents](#)

recorded during the period, our “economic,” or net, fuel expense increased \$12.6 million, or 26.9%, over 2004. Our economic fuel cost per gallon increased 22.1% from \$1.26 in 2004 to \$1.54 in 2005.

See page 23 for a table summarizing fuel cost per gallon realized by Horizon (the economic cost per gallon), the cost per gallon on a GAAP basis (including hedging gains recorded in aircraft fuel) and fuel cost per gallon excluding all hedging activities.

- Aircraft maintenance expense increased \$4.5 million, or 16.9%, primarily due to a higher number of engine overhauls and propeller work for the Q400 fleet and fewer aircraft covered by warranty.
- Aircraft rent decreased \$3.2 million, or 5.7%, primarily due to lower rents on extended leases, return of one aircraft on a short-term lease and fewer leased engines.
- Selling expenses are up \$2.2 million, or 11.1%, from 2004 due primarily to an increase in credit card and other commissions as a result of higher rates and increased revenues.
- Depreciation and amortization increased \$2.3 million, or 23.7%, primarily due to the addition of one CRJ-700 at the end of the first quarter of 2005 and a Q400 in the third quarter of 2004.
- Landing fees and other rentals increased \$4.5 million, or 14.4%. Higher landing fees are a result of significant rate increases in several of our key airports, modest growth and new markets being served.

### **Consolidated Nonoperating Income (Expense)**

Net nonoperating income was \$175.1 million in 2005 compared to \$74.6 million in 2004. Interest income increased \$3.0 million due to a larger average marketable securities portfolio in 2005, offset by a larger interest payment in 2004 related to the navigation fee refund. Interest expense increased \$6.6 million due to interest rate increases on our variable rate debt and the changes to some of our variable rate debt agreements to slightly higher fixed rate agreements. Capitalized interest increased \$3.8 million from \$1.1 million in the first nine months of 2004 to \$4.9 million in the first nine months of 2005. This increase is due to the significant increase in deposits for future flight equipment resulting from our new aircraft purchase agreement for B737-800 aircraft.

Fuel hedging gains include \$82.8 million in gains from fuel hedging contracts settled in the first nine months of 2005 compared to \$13.3 million in 2004. In addition, fuel hedging gains include net mark-to-market gains on unsettled hedge contracts, net of the reclassification of previously recorded mark-to-market gains for settled hedges, of \$115.8 million in 2005 and \$80.0 million in 2004.

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[Table of Contents](#)

**Consolidated Income Tax Benefit**

Accounting standards require us to provide for income taxes each quarter based on either our estimate of the effective tax rate for the full year or the actual year-to-date effective tax rate if it is our best estimate of our annual expectation. As the volatility of airfares and fuel prices and the seasonality of our business make it difficult to accurately forecast full-year pre-tax results, we use the actual year-to-date effective tax rate to provide for income taxes. In addition, a relatively small change in pre-tax results can cause a significant change in the effective tax rate due to the magnitude of nondeductible expenses, such as employee per diem costs, relative to pre-tax profit or loss. Our effective income tax rate on pre-tax income before the accounting change for the third quarter and first nine months of 2005 is 38.6% and 39.3%, respectively. We applied our 2005 year-to-date marginal rate of 37.5% for the cumulative effect of the accounting change. In arriving at these rates, we considered a variety of factors, including year-to-date pre-tax results, the U.S. federal rate of 35%, estimated year-to-date nondeductible expenses and estimated state income taxes. We evaluate our tax rate each quarter and make adjustments when necessary.

**Change in Accounting Policy**

Effective January 1, 2005, we changed our method of accounting for major airframe and engine overhauls from the *capitalize and amortize* method to the *direct expense* method. Under the former method, these costs were capitalized and amortized to maintenance expense over the shorter of the life of the overhaul or the remaining lease term. Under the *direct expense* method, overhaul costs are expensed as incurred. We believe that the *direct expense* method is preferable because it eliminates the judgment and estimation needed to determine overhaul versus repair allocations in maintenance activities. Additionally, our approved maintenance program for the majority of our airframes now focuses more on shorter, but more frequent, maintenance visits. We also believe that the *direct expense* method is the predominant method used in the airline industry. Accordingly, effective January 1, 2005, we wrote off the net book value of our previously capitalized airframe and engine overhauls for all aircraft in a charge totaling \$144.7 million pre-tax (\$90.4 million after tax). We do not believe disclosing the effect of adopting the *direct expense* method on net income for the period ended September 30, 2005 provides meaningful information because of changes in our maintenance program, including the execution of a “power by the hour” engine maintenance agreement with a third party in late 2004.

**Critical Accounting Policies**

For information on additional critical accounting policies, see Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2004.



[Table of Contents](#)

## Liquidity and Capital Resources

The table below presents the major indicators of financial condition and liquidity.

	September 30, 2005	December 31, 2004	Change
	(In millions, except per share and debt-to-capital amounts)		
Cash and marketable securities	\$ 745.7	\$ 873.9	\$(128.2)
Working capital	206.5	285.0	(78.5)
Long-term debt and long-term capital lease obligations	970.0	989.6	(19.6)
Shareholders' equity	699.6	664.8	34.8
Book value per common share	\$ 25.34	\$ 24.51	\$ 0.83
Long-term debt-to-capital	58%:42%	60%:40%	NA
Long-term debt-to-capital assuming aircraft operating leases are capitalized at seven times annualized rent	76%:24%	78%:22%	NA

During the nine months ended September 30, 2005, our cash and marketable securities decreased \$128.2 million to \$745.7 million at September 30, 2005. This decrease reflects cash used for property and equipment additions, net of aircraft deposit returns and proceeds from asset dispositions, of \$304.4 million and cash used in financing activities of \$1.5 million, partially offset by cash provided by operating activities of \$180.2 million.

### *Cash Provided by Operating Activities*

During the first nine months of 2005, net cash provided by operating activities was \$180.2 million compared to \$283.5 million during the first nine months of 2004. The decrease is due largely to the significant increases in the cost of fuel in the current year, cash payments made for severance, and a \$42.7 million tax refund in 2004.

### *Cash Used in Investing Activities*

Cash used in investing activities was \$180.0 million during the first nine months of 2005, compared to \$219.1 million in 2004. We had net sales of \$128.0 million of marketable securities and net purchases of \$304.4 million for property and equipment additions, net of aircraft deposit returns and proceeds from asset dispositions. During the first nine months of 2005, our aircraft related capital expenditures net of aircraft deposit returns and proceeds from asset dispositions, increased \$190.9 million as compared to 2004, primarily reflecting the net payment of \$101.2 million related to the aircraft purchase commitment entered into during the second quarter of 2005 to acquire 35 B737-800 aircraft, as well as additional scheduled pre-delivery payments. As of January 1, 2005, we no longer have capital expenditures related to overhauls as those maintenance activities are expensed as incurred under our maintenance accounting policy adopted on that date. We expect capital expenditures to be approximately \$450.0 million for the full year of 2005 and approximately \$430 million (of which \$400 million is expected to be aircraft related) in 2006 as we begin to take delivery of several aircraft.

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## [Table of Contents](#)

### *Cash Provided by (Used in) Financing Activities*

Net cash used in financing activities was \$1.5 million during the first nine months of 2005 compared to \$96.3 million during the same period in 2004. There was one debt issuance during the first nine months of 2005 of \$20.0 million, which is secured by flight equipment. This note has a fixed interest rate of 6.07% and the payment term is 15 years. Additionally, we received \$13.9 million in proceeds from issuances of common stock during the first nine months of 2005 compared to \$2.3 million in the same period of 2004. Debt issuances and proceeds from common stock issuance during the period were offset by normal long-term debt payments of \$35.4 million.

We plan to meet our capital and operating commitments through internally generated funds from operations and cash and marketable securities on hand at September 30, 2005 totaling \$745.7 million, along with proceeds from our new pre-delivery payment facility used to provide assistance with our pre-delivery funding requirements on the purchase of new B737-800 aircraft, and additional debt financing. We also have restricted cash of \$6.5 million, which is intended to collateralize interest payments due through March 2006 on our \$150 million floating rate senior convertible notes due 2023 issued in 2003.

### *Bank Line of Credit Facility*

During 2004, Alaska repaid its \$150 million credit facility and, on December 23, 2004, that facility expired. On March 25, 2005, Alaska finalized a \$160 million variable rate credit facility with a syndicate of financial institutions that will expire in March 2008. The interest rate on the credit facility varies depending on certain financial ratios specified in the agreement with a minimum interest rate of LIBOR plus 200 basis points. Any borrowings will be secured by either aircraft or cash collateral. This credit facility contains contractual restrictions and requires maintenance of specific levels of net worth, maintenance of certain debt and leases to net worth, leverage and fixed charge coverage ratios, and limits on liens, asset dispositions, dividends, and certain other expenditures. Such provisions restrict Alaska from distributing any funds to Air Group in the form of dividends and limit the amount of funds Alaska can loan to Air Group. As of September 30, 2005, Alaska could loan up to \$300.0 million to Air Group without violating the covenants in the credit facility. As of September 30, 2005, there are no outstanding borrowings on this credit facility and the Company has no immediate plans to borrow using this credit facility.

### *Pre-delivery Payment Facility*

On October 19, 2005, Alaska finalized a \$172 million variable rate revolving loan facility with a syndicate of lenders to provide a portion of the pre-delivery funding requirements of Alaska's purchase of up to 38 new Boeing 737-800 aircraft (23 of which are firm orders) under the current aircraft purchase agreement. The facility will expire on August 31, 2009. The interest rate is based on one-month LIBOR plus a specified margin. Any borrowings will be secured by Alaska's rights under the Boeing purchase agreement. The initial draw on the facility was \$61.3 million, which was used to reimburse Alaska for the facility's portion of the pre-delivery payments made to date.

[Table of Contents](#)

*Supplemental Disclosure of Noncash Investing and Financing Activities*

We received a \$9.7 million credit toward our purchase deposits related to the aircraft purchase agreement entered into during the second quarter of 2005. This credit was recorded as additional purchase deposits and is included in other liabilities on our consolidated balance sheet and will be applied to future aircraft upon delivery.

**Contractual Obligations, Commitments and Off-Balance Sheet Arrangements**

*Aircraft Purchase Commitments*

In addition to the commitments below, Alaska has options to acquire 15 B737's and purchase rights for 50 more. In October 2005, Horizon entered into a purchase agreement to acquire 12 Q400 aircraft with deliveries beginning in December 2006 and continuing through July 2007. The purchase agreement also includes options to purchase an additional 20 aircraft. Concurrent with the execution of this purchase agreement, Bombardier has agreed to provide certain remarketing assistance for up to 12 DHC-8 Series 200 aircraft previously leased by Horizon for a fee as set forth in the agreement. In association with the purchase of the 12 Q400 Aircraft, Horizon and the manufacturer have agreed to terminate firm orders for 7 CRJ700 model aircraft.

Alaska and Horizon expect to finance the firm orders and to the extent exercised, the option aircraft with leases, long-term debt or internally generated cash. We are currently negotiating agreements for debt financing for 14 Boeing 737-800 aircraft to be delivered through May 2007. The following table summarizes aircraft commitments and payments by year as of September 30, 2005, adjusted for the subsequent Horizon agreement as discussed above:

Aircraft	Delivery Period - Firm Orders						Total
	October 1-December 31, 2005	2006	2007	2008	2009	Beyond 2009	
Boeing 737-800	—	10	8	5	3	9	35
Bombardier Q-400	—	2	10	—	—	—	12
Bombardier CRJ700	—	1	—	—	—	—	1
<b>Total</b>	<b>—</b>	<b>13</b>	<b>18</b>	<b>5</b>	<b>3</b>	<b>9</b>	<b>48</b>
Payments (Millions)	\$ 28.3	\$397.2	\$364.0	\$169.5	\$119.9	\$261.2	\$1,340.1

## [Table of Contents](#)

### *Contractual Obligations*

The following table provides a summary of our principal payments under current and long-term debt obligations, capital lease obligations, operating lease commitments, aircraft purchase commitments and other obligations as of September 30, 2005, adjusted for the subsequent Horizon agreement as discussed above. This table excludes contributions to our various pension plans, which we expect to be approximately \$60 million to \$70 million per year through 2008.

(in millions)	October 1-December 31, 2005	2006	2007	2008	2009	Beyond 2009*	Total
Current and long-term debt and capital lease obligations*	\$ 20.4	\$ 58.5	\$ 61.6	\$ 64.9	\$ 68.2	\$ 754.0	\$1,027.6
Operating lease commitments	47.3	247.0	219.8	210.4	193.7	986.0	1,904.2
Aircraft purchase commitments	28.3	397.2	364.0	169.5	119.9	261.2	1,340.1
Interest obligations (1)	16.3	52.7	51.5	49.7	47.2	159.9	377.3
Other purchase obligations (2)	6.1	29.1	29.4	29.7	30.0	154.5	278.8
<b>Total</b>	<b>\$ 118.4</b>	<b>\$784.5</b>	<b>\$726.3</b>	<b>\$524.2</b>	<b>\$459.0</b>	<b>\$2,315.6</b>	<b>\$4,928.0</b>

\* Includes \$150 million related to the Company's senior convertible notes due in 2023. Holders of these Notes may require the Company to purchase all or a portion of their Notes, for a purchase price equal to principal plus accrued interest, on the 5<sup>th</sup>, 10<sup>th</sup>, and 15<sup>th</sup> anniversaries of the issuance of the Notes, or upon the occurrence of a change in control or tax event. See Note 10 in the condensed consolidated financial statements.

(1) For variable rate debt, future obligations are shown above using interest rates in effect as of September 30, 2005.

(2) Includes obligations under our long-term power-by-the-hour engine maintenance agreement.

### **New Accounting Standards**

During the fourth quarter of 2004, the Financial Accounting Standards Board (FASB) issued SFAS 123R, "Share Based Payment: An Amendment of SFAS Nos. 123 and 95". The new standard requires companies to recognize as expense the fair value of stock options and other equity based compensation issued to employees as of the grant date. This new standard will apply to both stock options that we grant to employees and our Employee Stock Purchase Plan, which features a look-back provision and allows employees to purchase stock at a 15% discount. Our options are typically granted with ratable vesting provisions, and we intend to amortize compensation cost over the service period using the straight-line method. Due to a recent decision by the Securities and Exchange Commission, implementation of SFAS 123R will be effective January 1, 2006. We intend to use the "modified prospective method" upon adoption whereby previously awarded but unvested equity awards are accounted for in accordance with SFAS 123R and prospective amounts are recognized in the income statement instead of simply being disclosed. Once adopted, we expect our stock-based compensation expense, as measured under SFAS 123R, will be approximately \$6 million to \$10 million per year on a pre-tax basis.

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## [Table of Contents](#)

In March 2005, the FASB issued Interpretation No. 47 (FIN 47), “Accounting for Conditional Asset Retirement Obligations - an interpretation of FASB Statement No. 143.” FIN 47 clarifies that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability’s fair value can be reasonably estimated. The FIN also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of our fiscal year ending December 31, 2005. FIN 47 is not expected to have a significant impact on our financial position, results of operations or cash flows.

In May 2005, the FASB issued SFAS No. 154, “Accounting Changes and Error Corrections – a replacement of APB Opinion No. 20 and FASB Statement No. 3” (“SFAS No. 154”). SFAS No. 154 requires retrospective application as the required method for reporting a change in accounting principle, unless impracticable or a pronouncement includes specific transition provisions. SFAS No. 154 also requires that a change in depreciation, amortization or depletion method for long-lived, nonfinancial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. This statement carries forward the guidance in APB Opinion No. 20, “Accounting Changes,” for the reporting of the correction of an error and a change in accounting estimate. SFAS No. 154 is effective beginning January 1, 2006. SFAS No. 154 is not expected to have a significant impact on our financial position, results of operations or cash flows.

In June 2005, the Emerging Issues Task Force (“EITF”) reached a consensus on EITF Issue No. 05-6, “Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination” (“EITF 05-6”). EITF 05-6 requires that leasehold improvements that are placed in service significantly after and not contemplated at or near the beginning of the lease term be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date the leasehold improvements are purchased. EITF 05-6 is effective for our fourth quarter. We are currently evaluating the impact, if any, that EITF 05-6 will have on our financial position, results of operations or cash flows.

### **Effect of Inflation and Price Changes**

Inflation and price changes other than for aircraft fuel do not have a significant effect on our operating revenues, operating expenses and operating income.

### **Risk Factors**

Alaska and Horizon are parties to marketing agreements with certain domestic air carriers, including Northwest Airlines and Delta Air Lines. These agreements provide that certain flight segments operated by Alaska or Horizon are held out for sale as Northwest or Delta as “codeshare” flights. In addition, the agreements provide that members of Alaska’s Mileage Plan program can redeem miles for flights on Northwest or Delta.

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## [Table of Contents](#)

In September 2005, Northwest and Delta filed for protection under Chapter 11 of the Bankruptcy Code. Either carrier could propose plans of reorganization that would seek to modify or terminate some or all of these agreements. However, the nature and extent of risk cannot be quantified at this time.

For a discussion of our other risk factors, see Item 7 of the Company's Annual Report for the year ended December 31, 2004 on Form 10-K under the caption "Risk Factors."

### **ITEM 3. Quantitative and Qualitative Disclosures about Market Risk**

There have been no material changes in market risk from the information provided in Item 7A "Quantitative and Qualitative Disclosure About Market Risk" in our 2004 10K except as follows:

#### *Fuel Prices*

We purchase jet fuel at prevailing market prices, and seek to manage the risk of price fluctuations through execution of structured pricing purchase agreements and a documented hedging strategy. We utilize derivative financial instruments as hedges to decrease our exposure to the volatility of jet fuel prices. At September 30, 2005, we had fuel hedge contracts in place to hedge 50.4 million gallons of our expected jet fuel usage during the remainder of 2005, 181.4 million gallons in 2006, 86.0 million gallons in 2007 and 31.7 million gallons in 2008. This represents 50%, 42%, 20% and 7% of our anticipated fuel consumption in 2005, 2006, 2007 and 2008, respectively. Prices of these agreements range from \$32 to \$50 per crude oil barrel. We estimate that a 10% increase or decrease in crude oil prices as of September 30, 2005 would impact hedging positions by approximately \$41.0 million and \$40.1 million, respectively.

As of September 30, 2005 and December 31, 2004, the fair values of our fuel hedge positions were \$211.8 million and \$96.0 million, respectively. Of these amounts, \$140.7 million of the 2005 fair value amounts and \$65.7 million of the 2004 fair value amounts were included in current assets in the consolidated balance sheets based on the settlement dates for the underlying contracts. The remaining \$71.1 million 2005 fair value and \$30.3 million 2004 fair value is reflected as a non-current asset in the consolidated balance sheets.

During the second quarter of 2005, we entered into a fuel contract whereby the spread between crude oil prices and jet fuel prices is fixed for approximately one-third of our fuel consumption. This contract has resulted in approximately \$6.0 million in savings for Air Group during the third quarter of 2005.

Please refer to pages 22 and 23, as well as to Note 4 in the condensed consolidated financial statements, for company specific data on the results of our fuel hedging program.

#### *Financial Market Risk*

During the first nine months of 2005, we issued \$20.0 million of debt secured by flight equipment, having an interest rate of 6.07% and a payment term of 15 years.

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[Table of Contents](#)

In the second and third quarters of 2005, the Company exercised its option under several of its existing variable rate long-term debt arrangements to fix the interest rates through maturity. The fixed rates on these recently affected debt arrangements range from 5.2% to 6.5%. These changes did not result in any gain or loss in the consolidated statements of operations.

Subsequent to the end of the third quarter, as noted above, we finalized a \$172 million purchase deposit facility to assist with our pre-delivery funding requirements on the firm B737-800 aircraft. The initial draw on the facility was \$61.3 million.

Our pension obligation is highly sensitive to changes in the interest rate environment and our estimated return on assets. Our preliminary assessment of our projected pension benefit obligation, accumulated benefit obligation, and expected return on plan assets, assuming a consistent discount rate from the prior year, would result in a tax effected charge to equity as of December 31, 2005 of approximately \$20 million. However, due to the sensitivity of the obligation to changes in the discount rate used, a 25-basis point downward shift in the discount rate used to value our pension obligation would result in an additional tax affected charge to equity of approximately \$20 million.

**ITEM 4. Controls and Procedures**

As of September 30, 2005, an evaluation was performed under the supervision and with the participation of our management, including our chief executive officer and chief financial officer (collectively, our “certifying officers”), of the effectiveness of the design and operation of our disclosure controls and procedures. These disclosure controls and procedures are designed to ensure that the information required to be disclosed by us in our periodic reports filed with the Securities and Exchange Commission (the SEC) is recorded, processed, summarized and reported within the time periods specified by the SEC’s rules and forms, and that the information is communicated to our certifying officers on a timely basis.

Our certifying officers concluded, based on their evaluation, that disclosure controls and procedures were effective.

We made no changes in our internal controls over financial reporting during the fiscal quarter ended September 30, 2005, that our certifying officers concluded materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We intend to regularly review and evaluate the design and effectiveness of our disclosure controls and procedures and internal controls over financial reporting on an ongoing basis and to improve these controls and procedures over time and to correct any deficiencies that we may discover in the future. While we believe the present design of our disclosure controls and procedures and internal controls over financial reporting are effective, future events affecting our business may cause us to modify our these controls and procedures in the future.

## **PART II. OTHER INFORMATION**

### **ITEM 1. Legal Proceedings**

In May 2005, the Air Line Pilots Association filed a lawsuit in federal district court in Seattle to overturn the current labor contract covering Alaska's pilots as established by an arbitrator, which was effective May 1, 2005. On July 21, 2005, the Company filed a motion to dismiss the lawsuit. On October 28, 2005, the district court granted the Company's motion to dismiss. This decision is subject to appeal.

In March 2005, the Company filed a claim against the International Association of Machinists (IAM) seeking to compel arbitration of the dispute regarding the subcontracting of the Company's ramp service operation in Seattle. On May 10, 2005, the IAM filed a counter claim against the Company alleging that the Company violated the status quo and engaged in bad faith bargaining. On May 13, 2005, the Company announced that it had subcontracted the ramp service operation in Seattle, resulting in the immediate reduction of approximately 475 employees represented by the IAM. Shortly after this event, the IAM filed a motion for a preliminary injunction seeking to reverse the subcontracting by the Company. That motion was heard and denied by a federal court judge on June 2, 2005. The Company's lawsuit is still pending in federal court and a September 2006 trial date has been set for the IAM's counterclaim. The Company has filed a motion to dismiss the IAM's counterclaim. At this time, the Company is not certain as to what the outcome will be.

We are a party to ordinary routine litigation incidental to our business and with respect to which no material liability is expected. Management believes the ultimate disposition of these matters is not likely to materially affect our financial position or results of operations. This forward-looking statement is based on management's current understanding of the relevant law and facts; it is subject to various contingencies, including the potential costs and risks associated with litigation and the actions of judges and juries.

### **ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None

### **ITEM 3. Default on Senior Securities**

None

### **ITEM 4. Submission of Matters to a Vote of Security Holders**

None

### **ITEM 5. Other Information**

No changes have been made to the procedures by which security holders may recommend nominees to our Board of Directors since the filing of our definitive proxy statement for our 2005 annual meeting of shareholders.

### **ITEM 6. Exhibits**

See Exhibit Index on page 47.



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[Table of Contents](#)

**Signatures**

Pursuant to the requirements of the Securities Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ALASKA AIR GROUP, INC.  
Registrant

Date: November 9, 2005

By: /s/ Brandon S. Pedersen  
Brandon S. Pedersen  
Staff Vice President/Finance and Controller

By: /s/ Bradley D. Tilden  
Bradley D. Tilden  
Executive Vice President/Finance and Chief Financial Officer

## EXHIBIT INDEX

Pursuant to Item 601(a)(2) of Regulation S-K, this Exhibit Index immediately precedes the exhibits.

The following exhibits are numbered in accordance with Item 601 of Regulation S-K.

<u>Exhibit No.</u>	<u>Description</u>
10**	Retirement and Non-Compete Agreement by and between George D. Bagley and Alaska Airlines, Inc. (Exhibit 10.1 to September 14, 2005 8-K)
10.1*	Supplement to Master Purchase Agreement dated October 18, 2005 by and between Horizon Air Industries, Inc. and Bombardier, Inc.***
10.2*	Credit Agreement dated October 19, 2005 between Alaska Airlines, Inc. and HSH Nordbank AG New York Branch, as security agent, Norddeutsche Landesbank Girozentrale, and DekaBank Deutsche Girozentrale***
31.1*	Section 302 Certification of Chief Executive Officer Pursuant to 15 U.S.C. Section 7241
31.2*	Section 302 Certification of Chief Financial Officer Pursuant to 15 U.S.C. Section 7241
32.1*	Section 906 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
32.2*	Section 906 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350
*	Filed herewith.
**	Previously filed.
***	Pursuant to 17 CFR 240.24b-2, confidential information has been omitted and has been filed separately with the Securities and Exchange Commission pursuant to a Confidential Treatment Application filed with the Commission.

**SUPPLEMENT NO. PA-0436-5**  
**TO**  
**MASTER PURCHASE AGREEMENT NO. PA-0436**  
**BETWEEN**  
**BOMBARDIER INC.**  
**AND**  
**HORIZON AIR INDUSTRIES, INC.**

This Supplement is part of the Master Purchase Agreement No. PA-436 entered into between BOMBARDIER INC., a Canadian corporation represented by Bombardier Aerospace, Regional Aircraft having offices at 123 Garratt Boulevard, Downsview, Ontario, Canada ("Bombardier") and Horizon Air Industries, Inc. ("Buyer") dated the 21st day of December, 1998 (the "Agreement") and evidences our further agreement with respect to the matters set forth below.

The provisions of the Agreement shall apply to the Bombardier products purchased and sold in accordance with this Supplement PA 0436-5. All capitalized terms herein, unless defined herein, shall have the same respective meanings as in the Agreement. This Supplement PA 0436-5 is subject to the provisions of the Agreement, all of which are incorporated herein, provided that in the event of any inconsistency between the provision of the Agreement and the provisions of this Supplement PA 0436-5, the latter shall take precedence.

**Article 1 below supplements Article 2 of the Agreement.**

**ARTICLE 1                      SUBJECT MATTER OF SALE**

*1.1* Subject to the provisions of the Agreement and this Supplement PA 0436-5, Bombardier will sell and Buyer will purchase twelve (12) additional Bombardier DHC-8Q Series 400 model DHC-8-402 aircraft manufactured pursuant to Detail Specification number DS8-400 Rev. 1 Amend NC, Detail Specification for the DHC-8-402 dated April 2002, listed in Schedule 1 attached hereto, as same may be modified from time to time in accordance with the Agreement and this Supplement PA 0436-5 (the "Specification") as supplemented to reflect the incorporation of the Buyer selected optional features ("Buyer Selected Optional Features") set forth in Schedule 2 hereto (individually or collectively the "Aircraft").

Supplement No. PA-0436-5

-1-

Initials

Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

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**Article 2 below supplements Article 4 of the Agreement.**

**ARTICLE 2.0                      PRICE**

- 2.1 (a) The base price for each of the Aircraft (excluding the Buyer Selected Optional Features) for delivery in accordance with Article 4 hereof Ex Works (Incoterms 1990) Bombardier's facilities in Downsview, Ontario is [\*\*\*]\* expressed in [\*\*\*] US Dollars; and
- (b) The base price of the Buyer Selected Optional Features (Schedule 2) for the Aircraft is [\*\*\*] expressed in November 1, 2006 US Dollars.

The Aircraft base price shall be the base price for the Aircraft as stated in paragraph (a), plus the base price of the Buyer Selected Optional Features as stated in paragraph (b) (the "Base Price"). The price of the Aircraft shall be adjusted to the Delivery Date to reflect economic fluctuations during the period from November 1, 2006 to the Delivery Date of each Aircraft ("Aircraft Purchase Price"). Such adjustments shall be based on the economic adjustment formula attached hereto as Schedule 3 ("Economic Adjustment Formula") but when adjusted, the Aircraft Purchase Price shall in no case be lower than the Aircraft Purchase Price, as stipulated in Article 2.1 herein, and starting from the [\*\*\*] base year, escalated [\*\*\*].

**Article 3.0 below supplements Article 5.0 of the Agreement.**

**ARTICLE 3.0                      PAYMENT**

3.1 Bombardier has previously received a deposit for certain of the Aircraft, as set forth in Article 3.2.2 to this Supplement.

3.2 Payment Terms:

3.2.1 Buyer shall make payment or cause payment to be made for each of the Aircraft as follows:

- (a) [\*\*\*] of the net Aircraft Purchase Price upon execution of this Supplement PA 0436-5;
- (b) [\*\*\*] of the net Aircraft Purchase Price fifteen (15) months prior to its Scheduled Delivery Date;
- (c) [\*\*\*] of the net Aircraft Purchase Price twelve (12) months prior to its Scheduled Delivery Date;

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

- 
- (d) [\*\*\*]\* of the net Aircraft Purchase Price nine (9) months prior to its Scheduled Delivery Date;
  - (e) [\*\*\*] of the net Aircraft Purchase Price six (6) months prior to its Scheduled Delivery Date; and
  - (f) the balance of the Aircraft Purchase Price shall be received on or before the Delivery Date of such Aircraft to Buyer.

All payments referred to in paragraphs (c) through (f) above are to be made on the first day of the applicable month.

3.2.2 The sum of [\*\*\*] United States Dollars paid by Buyer pursuant to Supplement No. PA 0436-1, as amended, and currently held by Bombardier against the current [\*\*\*] in Supplement No. MPA0436-1 and [\*\*\*] in Supplement No. MPA0436-3 thereunder, (the "Transfer Deposit"), shall be transferred and retained by Bombardier against the Aircraft purchased pursuant to this Supplement No. MPA 0436-5. The Transfer Deposit shall be applied against Buyer's obligations as they become due under this Agreement.

3.3 For the sole purpose of the calculations set forth in Article 3.2.1 (a) through (f) above, the Aircraft Purchase Price shall be the Aircraft Purchase Price [\*\*\*].

3.4 Buyer shall make all payments due under this Agreement in electronic funds transfer by deposit on or before the due date to Bombardier's account in the following manner:

(a) Transfer to:	[***]
Account Name:	[***]
Account #:	[***]
Bank Name:	[***]
ABA#:	[***]
Please reference:	Invoice # and/or Aircraft Serial #

**Article 4.0 below supplements Article 6.0 of the Agreement.**

**ARTICLE 4.0 DELIVERY PROGRAM**

4.1 The Aircraft shall be offered for inspection and acceptance to Buyer at Bombardier's facility in Downsview, Ontario during the months set forth below: (the "Scheduled Delivery Dates").

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

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**DELIVERY SCHEDULE**

First Aircraft	December 2006
Second Aircraft	December 2006
Third Aircraft	January 2007
Fourth Aircraft	February 2007
Fifth Aircraft	February 2007
Sixth Aircraft	March 2007
Seventh Aircraft	April 2007
Eighth Aircraft	April 2007
Ninth Aircraft	May 2007
Tenth Aircraft	June 2007
Eleventh Aircraft	June 2007
Twelfth Aircraft	July 2007

**Article 5.0 below supplements Article 7.0 of the Agreement.**

**ARTICLE 5.0 BUYER INFORMATION**

5.1 Pursuant to Article 7.1 of the Agreement, Buyer will provide the information set forth in Article 7.1 of the Agreement as soon as practicable following execution of this Supplement PA 0436-5.

**ARTICLE 6.0 NON-EXCUSABLE DELAY**

**Article 6.1 below supplements Article 14.1 of the Agreement.**

6.1 If delivery of the Aircraft is delayed by causes not excused under Article 13.1 of the Agreement (a "Non-Excusable Delay"), Bombardier shall pay Buyer [\*\*\*] for any such delayed Aircraft.

**Article 6.2 below supplements Article 14.3 of the Agreement.**

6.2 The period of days referred to in Article 14.3 of the Agreement is sixty (60) days.

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

Article 8.0 below supplements Annex A, Article 4 of the Agreement.

## ARTICLE 8.0 - TECHNICAL DATA

### 8.1 Technical Data Provided

With each additional Aircraft purchased hereunder, Bombardier will provide, at no additional charge, one (1) copy of the Airplane Flight Manual, Quick Reference Handbook, Airplane Operating Manual ("AOM") and Weight and Balance Manual. Such technical manuals/documents will be prepared generally in accordance with revision 34 of ATA Specification 100 and 2100.

The Technical Data and the additional manuals provided with each Aircraft shall be in the English language and shall provide information on items manufactured according to Bombardier's detailed design and in those units of measure used in the Specification or as may otherwise be required to reflect Aircraft instrumentation, as may be mutually agreed.

### 8.2 List Of Technical Data

ITEM	DOC	CONF	MEDIUM	QTY	REV	DEL	ATA	REMARKS
1	Airplane Flight Manual PSM 1-84-1A	G	1	***]*	N	ATD	N	
2	Quick Reference Handbook PSM 1-84-1B	G	1	***]	N	ATD	N	
3	Weight and Balance Manual PSM 1-84-8	G	1	***]	Y	ATD	Y	
4	Airplane Operating Manual (AOM) PSM 1-84-1	C	1	***]	N	ATD	N	
5	*Aircraft Illustrated Parts Catalog PSM 1-84-4	G	1	***]	Y	PTD	Y	
6	*Aircraft Maintenance Manual PSM 1-84-2	G	1	***]	Y	PTD	Y	
7	*Wiring Diagrams Manual PSM 1-84-2W	G	1	***]	Y	PTD	Y	

\* Note: for items 5, 6, and 7, Bombardier may provide in electronic format, if available at the time of delivery.

#### Legend:

**CONF** G = Generic manual (contains information for all aircraft configurations).

C = Contains information to for the operator fleet configuration.

**MED** 1 = Paper, printed 2-sides.

2 = Dynaweb on DVD.

3 = CD ROM.

4 = Laminated Card.

Optional ATA specification 2100 (where applicable).

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

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**QTY** (number) = Quantity per contract.  
(number) PER = Quantity per delivered aircraft.  
A/R = As Required.

**REV** Y = Quarterly Revision service (if purchased).  
N = Revisions as required (if purchased).

**DEL** ATD = Document delivered at time of first aircraft delivery or subsequent aircraft delivery (when (number) PER).  
PTD = Document delivered 90 days prior to first aircraft delivery.

**ATA** Y = Generally in compliance with ATA 100 Revision 34.  
N = Bombardier Standard.

### 8.3 Shipment

Except for the Airplane Flight Manual, Quick Reference Handbook, Flight Crew Operating Manual, and Weight and Balance Manual, which will be provided with each Aircraft at time of delivery, all Technical Data provided hereunder shall be shipped to Buyer Free Carrier (Incoterms) Bombardier's designated facilities.

### 8.4 Revision Service

Bombardier will provide Buyer with a revision service, [\*\*\*]\* following the Delivery Date of Buyer's first Aircraft under this Supplement PA 0436-5. This revision service shall apply to the Technical Data for the Aircraft only. Subsequent to this [\*\*\*] period, Buyer shall be responsible for any revision services provided by Bombardier, at Bombardier's then current list prices.

Revisions to the Technical Data to reflect the Aircraft configuration at delivery shall be provided to Buyer within six (6) months following the Delivery Date of each respective Aircraft.

Provided the revision service is being supplied under the terms of this Agreement and applicable Supplement or by subsequent purchase order, Bombardier shall incorporate all applicable Bombardier originated Service Bulletins into the appropriate Technical Data documents (in a regular revision cycle), following formal notification by Buyer that such Service Bulletins have been or shall be incorporated on Buyer's Aircraft. The Technical Data shall then contain both the original and revised Aircraft configuration until Buyer advises Bombardier in writing that one configuration is no longer required.

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.



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**8.5 Vendor Manuals**

Bombardier will, at no additional charge, arrange to have one (1) set of the following manuals shipped directly to Buyer from the applicable vendor:

- (a) Engine Maintenance Manual;
- (b) Engine Illustrated Parts Catalogue; and
- (c) Propeller Maintenance Manual.

In addition, Bombardier will ensure that vendors ship directly to Buyer, all applicable vendor Component Maintenance Manual information not contained in the Bombardier issued Component Maintenance Manual.

The supply of revisions and amendments to vendor manuals will be the subject of separate agreements directly between Buyer and Bombardier's vendors.

**Article 9.0 below supplements Annex B, Article 1.0 of the Agreement.**

**ARTICLE 9.0                      WARRANTY**

- 9.1    The period of months referred to in Annex B, Article 1.2.1 (a) of the Agreement is forty-eight (48) months.
- 9.2    The period of months referred to in Annex B, Article 1.2.1 (b) of the Agreement is forty-eight (48) months.
- 9.3    The period of months referred to in Annex B, Article 1.2.1 (c) of the Agreement is forty-eight (48) months.
- 9.4    The period of months referred to in Annex B, Article 1.2.1 (d) of the Agreement is forty-eight (48) months.

Supplement No. PA-0436-5

-7-

Initials  
Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

**Article 10.0 below supplements Annex B, Article 3.7 of the Agreement.**

**ARTICLE 10.0 COVERED COMPONENTS**

**10.1 WING**

- (a) Upper and lower wing skins and stringers between front to rear spars;
- (b) Wing spar caps, webs and uprights;
- (c) Main box (front spar to rear spar) wing ribs;
- (d) Main box splice plates, fittings;
- (e) Wing to nacelle structural attachments;
- (f) Wing to fuselage structural attachments;
- (g) Support structure in the wing to spoilers, spoiler actuators and ailerons;
- (h) Main gear support structure; and
- (i) Engine support fittings.

**10.2 FUSELAGE**

- (a) External surface skins and doublers, stringers, circumferential frames between forward pressure bulkhead and aft pressure dome, excluding all systems, insulation, lining and decorative clips and brackets;
- (b) Window and windshield structure but excluding the windows and windshields;
- (c) Primary structure frames around body openings for passenger doors, cargo/baggage doors and emergency exits;
- (d) Nose gear support structure;
- (e) Floor beams and supporting structure in the flight compartment and cabin including the lavatory, excluding seat tracks in both areas;
- (f) Forward pressure bulkhead and aft pressure dome; and
- (g) Floor beams and supporting structure in the baggage compartment providing same is not damaged through abusive handling of baggage or cargo.

**10.3 VERTICAL TAIL (including fuselage aft of aft pressure dome)**

- (a) Fuselage external surface skins, stringers and frames between aft pressure dome and rear fin spar frame;
- (b) Fin skins and stiffeners between front and rear spars;
- (c) Fin front, centre and rear spar caps, webs and uprights;
- (d) Main box (front spar to rear spar) fin ribs;
- (e) Fin hinge and actuator support structure for rudder and elevator;
- (f) Fore rudder structure and hinge and actuator brackets; and
- (g) Aft rudder forward cell structure and hinge and radius rod brackets.

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10.4 HORIZONTAL TAIL

- (a) Tailplane skins and stringers;
- (b) Tailplane spar caps, webs and uprights;
- (c) Tailplane main box (front spar to rear spar) ribs;
- (d) Tailplane hinge support structure for elevator;
- (e) Elevator forward cell structure and hinge and actuator brackets; and
- (f) Horizontal tail structure attachments.

In witness whereof this Supplement PA 0436-5 is signed on the date written below:

For and on behalf of

**HORIZON AIR INDUSTRIES, INC.**

---

Rudi Schmidt  
Vice President and Treasurer

Date: \_\_\_\_\_

For and on behalf of

**BOMBARDIER INC.**  
Bombardier Aerospace

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David MacNeil  
Senior Account Executive, Contracts  
**Regional Aircraft**  
Date: \_\_\_\_\_

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Ross Gray  
Director, Contracts  
**Regional Aircraft**  
Date: \_\_\_\_\_

Supplement No. PA-0436-5

-9-

Initials  
Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

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**SCHEDULE 1 TO SUPPLEMENT NO. PA-0436-5**

**DETAIL SPECIFICATION**

**DS8-400 Rev. 1. Amend NC,  
for the DHC-8-402**

**April 16, 2002**

Supplement No. PA-0436-5

-10-

Initials

Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

**SCHEDULE 2 TO SUPPLEMENT NO. PA-0436-5**

**BUYER SELECTED OPTIONAL FEATURES**  
**PRICES AND DESCRIPTIONS**

**CS: HRZ842207504**

<u>CR Ref.#</u>	<u>Option Descriptions</u>	<u>Price in Nov-06 U.S.</u>
803SO90021	Increased Tailwind Operation to 20 Knots (AFM Supplement #3)	[***]*
803SO90027	High Gross Weight (64,500 lb / 29,257 kg MTOW)	[***]
803SO90030	Reduced Propeller RPM Landing (AFM Supplement #39)	[***]
803SO90036	2 X Max.Take-Off Power (AFM Supplement #46)	[***]
803SO90037	AFM Supplement - Cat 1 Coupled Flap 35 Approach (#75)	[***]
803SO90038	AFM Supplement Take-off with bleed on - All flap settings (#61)	[***]
811CH00628	Exterior Paint Scheme - S400 - Horizon Air	[***]
811CH00657	Max Load Labels for Galleys, Baggage compartment and wardrobe inset - Horizon	[***]
811CH00717	Exterior Paint Scheme - Aluminized Paint Applied To Belly Of Aircraft	[***]
821SO90061	Ground Air Conditioning Cart Connection	[***]
822SO90387	AFCs - Heading Knobs Coupled Left & Right	[***]
823SO90100	Datalink - UNILINK (UASC UL-701) with integral VHF comm and Half-size Printer (Honeywell)	[***]
824CH00091	Batteries - Three 40 Amp Configuration - Forward Fuse	[***]
825CH01366	Detail Specification G2 Galley - Left Hand Aft Facing Galley - S400	[***]
825CH01461	PAX Seats - Deletion Of Ashtrays (Includes 'No Smoking' On)	[***]
825CH01596	G1 Galley - Stowage Compartments and Two Driessen Hot Jugs - Horizon	[***]
825CH01624	Cabin - Soft Materials Spec - Horizon	[***]
825CH01639	FWD Baggage Compartment - Removable Shelf in Upper Aft Portion	[***]
825CH01644	PAX Seats - Improved Seat Pan Cushions - Horizon	[***]

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

Supplement No. PA-0436-5

-11-

Initials

Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

825CH01829	Cockpit - Removal Of The Cockpit Door From Production Definition	***]
825CH02299	LOPA - Horizon Air (74 PAX, 3 F/A, G1 modified, G2,91 CU FT and 411 CU FT baggage compartments)	***]
825CH02336	AFT Staggered bulkhead with 2 F/A seats and without AFT stairs- Q400	***]
825SO90115-03	Flight Attendant Seats - Leather Dress Covers	***]
825SO90150-74	Passenger Seats - Leather Dress Covers	***]
825SO90157	Flight Attendant - 3rd Seat Installation	***]
825SO90290	Passenger Seats - In-Arm Meal Trays	***]
825SO90302-74	Passenger Seats - Additional Economy Passenger Seating (B/E Aero Model 925)	***]
825SO90389	Galley - Wardrobe Insert (Provisions for 1 Half Trolley and 1 S.U.)	***]
831SO70185	FAR 121.344 Requirement - Q400 - 88 Parameter Installation	***]
831SO90180	Enhanced GPWS (Honeywell)	***]
832CH00028	Cockpit - Nose Gear Lock Indicator	***]
833SO90188	Tail Logo Lights	***]
834CH00441	Single Cue Command on EADI	***]
834CH00559	VHF Comm - Provisions for 3rd VHF Radio (With Level "A" Certified Software)	***]
834SO70216	Radio Altimeter – Dual Collins ALT-4000	***]
834SO90209	HGS - CAT IIIa Partial Provisions For RCFDI STC	***]
834SO90926	FMS - Dual with GPS and TCAS II (Universal UNS-1E, SCN 802.2))	***]
835CH00937	Emergency Equipment - Increased Capacity Crew Fixed O2 Cylinder With Onboard Charging	***]
839SO90316	Alternate Symbolology Indication, Imperial (PFD & MFD Displays)	***]
849SO90266	APU (Hamilton Sundstrand APS-1000)	***]
853CH00128	Cockpit - Center Console Extension	***]
	<b>Total Buyer Selected Optional Features</b>	***]
	<b>Discounts and Allowances</b>	***]
***]	***]	***]
***]	***]	***]
	<b>Total including Discounts and Allowances</b>	***]

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

ANAC - At No Additional Cost

STD - Standard

(Buyer may amend the Buyer Selected Optional Features List via contract change order, subject to Bombardier required lead times.)

Supplement No. PA-0436-5

-12-

Initials

Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

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**SCHEDULE 3 TO SUPPLEMENT NO. PA-0436-5**

**AIRCRAFT**  
**ECONOMIC ADJUSTMENT FORMULA**

1. Economic adjustment will be calculated using the following Economic Adjustment Formula:

$$P_p = [***]^*$$

Where:

$P_p$  = Aircraft Purchase Price;

$P_o$  = Base Price;

$LD$  = the Canadian labour index based upon arithmetic the average of the indices for the fourth, fifth and sixth months prior to the month of delivery of the relevant Aircraft;

$LO$  = Being the arithmetic average of the Canadian labour index for the months of May, June and July 2006;

$ED$  = the U.S. labour index based upon the average of the indices for the fourth, fifth and sixth months prior to the month of delivery of the relevant Aircraft;

$EO$  = Being the arithmetic average of the U.S. labor index for the months of May, June and July 2006;

$MD$  = the Material index based upon the average of the arithmetic indices for the fourth, fifth and sixth months prior to the month of delivery of the relevant Aircraft; and

$MO$  = Being the arithmetic average of the Material index which for the months of May, June and July 2006;

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

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2. For the purpose of the Economic Adjustment Formula and the calculation of the economic adjustment:
- (a) the Canadian labour index shall be the North American Industrial Classification System (N.A.I.C.S.) Code 3364 for Average Hourly Earnings (including overtime) for Aerospace Products and Parts manufacturing (Canada) published by Statistics Canada in Catalogue 72-002 "Employment Earnings and Hours", Table 6;
  - (b) the U.S. labour index shall be the index published by the U.S. Department of Labor, Bureau of Labor Statistics in the North American Industrial Classification System (N.A.I.C.S.) Code 3364 for Average Hourly Earnings of Production Workers for Manufacturing, Aerospace products and parts (US); (The U.S. labour index provided in the Bureau of Labor Statistics (B.L.S.) Code 372 for Average Hourly Earnings for Aircraft and Parts as published by the U.S. Department of Labor, Bureau of Labor Statistics in "Employment and Earnings" Table B-15, has been discontinued)
  - (c) the material index shall be the index provided in the Producer Price Index for Code 10 Metals and Metals Products as published by the U.S. Department of Labor, Bureau of Labor Statistics in "Producer Prices and Price Indexes" Table 6;
  - (d) the indices used for the calculation of the Aircraft Purchase Price of each Aircraft shall be the last indices received by Bombardier in the month prior to the delivery of the relevant Aircraft; and
  - (e) in the event that Bombardier shall be prevented from calculating the Aircraft Purchase Price of each Aircraft due to any delay in the publication of the required indices, Bombardier shall use the last provisionally published indices, and in the event that provisional indices are not available, Bombardier shall extrapolate from the last three (3) months of published indices.
3. In the calculation of the Aircraft Purchase Price the following guidelines in respect of decimal places shall apply:
- (a) All average indices in the Economic Adjustment Formula shall be calculated to the applicable one or two decimal places;
  - (b) The Economic Adjustment Formula shall be calculated to four decimal places; and
  - (c) The Aircraft Purchase Price resulting from the Economic Adjustment Formula shall be corrected to the nearest dollar.
4. In the event that any index referred to be discontinued or restated, or if the methodology employed by the relevant authority in determining the index is substantially revised, then a mutually agreed to index will be substituted prior to delivery of the Aircraft.



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5. Pursuant to Article 4.2 of the Agreement, the Base Price of each Aircraft shall be adjusted for economic fluctuations. Such adjustment shall be based on the Economic Adjustment Formula (the “Formula”) as defined in Article 4.2, and more particularly set forth in this Schedule above.

Supplement No. PA-0436-5

-15-

Initials

Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

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**SCHEDULE 4 TO SUPPLEMENT NO. PA-0436-5**

**CREDIT MEMORANDUM**

- 1.0 Upon delivery of and payment in full for each Aircraft, Bombardier will issue to Buyer a credit memorandum in the amount of [\*\*\*]\*. Each credit memorandum shall be subject to escalation to the date of delivery in accordance with the Economic Adjustment Formula provided in Schedule 3 to this supplement [\*\*\*] and shall be used by Buyer to reduce the balance of the Aircraft Purchase Price payable on delivery of each such Aircraft.
- 2.0 Buyer acknowledges that the amount of the credit memorandum referenced in Article 1.0 above has been offered to Buyer [\*\*\*].
- 3.0 In the event of the termination of the Agreement, this Schedule shall become automatically null and void.
- 4.0 The provisions of this Schedule are personal to Buyer and shall not be assigned or otherwise disposed of by Buyer without the prior written consent of Bombardier.
- 5.0 This Schedule constitutes an integral part of the Agreement and subject to the terms and conditions contained therein.

**HORIZON AIR INDUSTRIES, INC.**

**BOMBARDIER INC.**  
Bombardier Aerospace

---

Rudi Schmidt  
Vice President and Treasurer

Date: October \_\_, 2005

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David MacNeil  
Senior Account Executive, Contracts  
**Regional Aircraft**  
Date: October \_\_, 2005

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Ross Gray  
Director, Contracts, Americas  
**Regional Aircraft**  
Date: October \_\_, 2005

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

Supplement No. PA-0436-5

-16-

Initials  
Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

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**SCHEDULE 5 TO SUPPLEMENT NO. PA-0436-5**

**PERFORMANCE GUARANTEE**

**1.0 AIRCRAFT CONFIGURATION**

The guarantees contained in this document are applicable to the DHC-8-402 aircraft to Detail Specification No. DS8-400 Rev. 1, Amend. NC, dated April 16, 2002, equipped with 34-inch tires per ECR no. 4Q24060, with an optional Maximum Take-off Weight of 64,500 pounds (29,257 kg) and equipped with Pratt and Whitney Canada PW150A engines with sea level static rating of 4580 SHP (Normal Take-off Power) and 5071 SHP (Maximum Take-off Power).

**2.0 PERFORMANCE GUARANTEES**

**2.1 Airfield Performance at [\*\*\*]\***

The take-off weight shall not be less than the guarantee value of [\*\*\*] pounds ([\*\*\*] kg) at the start of ground roll. The guarantee is based on the following conditions and operating conditions listed below:

Operational procedure:  
[\*\*\*]

Approved Aircraft Flight Manual

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Supplement No. PA-0436-5

-17-

Initials  
Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

**Table 1:**

***]*	***]	***]
***]	***]	***]

Published Special Procedure: Right turn at 5600 ft to heading 160 deg

**2.2 Landing Performance at Destination Airport [\*\*\*]**

The landing weight shall not be less than the guarantee values of [\*\*\*] pounds ([\*\*\*] kg) based on the following conditions and operating conditions listed below:

Operational procedure:

Approved Aircraft Flight Manual

[\*\*\*]

**2.3 Mission Payload from [\*\*\*]**

With an assumed Operational Weight Empty (OWE) of [\*\*\*] pounds ([\*\*\*] kg.), the resulting payload shall not be less than the guarantee value of [\*\*\*] pounds ([\*\*\*]kg.) The above guarantee is based on the following conditions and operating rules:

Operational Procedures:

Approved Aircraft Flight Manual [\*\*\*]

[\*\*\*]

**\*\*\* Note: ref. CS HRZ842207504, Issue 4, Sept.15, 2005.**

Fixed Time Allowances:

[\*\*\*]

Start & Taxi out [\*\*\*]

[\*\*\*]

Fuel Allowances:

Consistent with the fixed time allowances.

Reserve Fuel:

(a) Flight to Diversion, plus

[\*\*\*]\*

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### 3.0 GUARANTEE CONDITIONS

- 3.1 All guaranteed performance data are based on the ICAO International Standard Atmosphere (ISA) and specified variations therefrom. Altitudes are pressure altitudes.
- 3.2 In the event a change is made to any law, governmental regulation, requirement or in the interpretation of any such law, regulation or requirement that affects the certification basis for the aircraft as described and as a result thereof a change is made to the configuration and/or performance of the aircraft in order to obtain TC/FAA/JAA certification, the guarantees set forth in this document shall be appropriately modified to reflect the effect of any such change.
- 3.3 The take-off and landing guarantees are based on a paved, dry runway surface, and with automatic anti-skid operative. The take-off performance is based on use of the automatic take-off power control system, engine bleed selected off and a nominal line up allowance. All guarantee performance data are based on an aerodynamically clean wing, with REF SPEEDS switch selected OFF.
- 3.4 The mission payload guarantee is based on a new aircraft and engines, at the time of delivery, on cruise for optimum range and the optimum propeller speed and includes allowances for normal engine bleed and power extraction. Normal engine bleed shall be defined as that amount required to maintain a cabin pressure altitude not exceeding 8,000 feet during cruise at altitudes up to 25,000 feet, with a nominal aircraft ventilation rate including re-circulation of 40% and a cabin temperature of 75 degrees Fahrenheit.

### 4.0 GUARANTEE COMPLIANCE

- 4.1 Compliance with the guarantees of 2.0 shall be based on the conditions specified in those sections and the guarantee conditions of 3.0 unless otherwise noted.
- 4.2 Compliance with the take-off and landing guarantees shall be established by the approved AFM for the aircraft defined in 1.0 of this document.
- 4.3 Compliance with the mission payload guarantees shall be established by aircraft industry standard methodology calculations, based on flight test data obtained for aircraft configurations similar to that defined by the Detail Specification of 1.0, and an assumed Operational Weight Empty (OWE) of [\*\*\*]pounds ([\*\*\*] kg).

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4.4 The data derived from tests shall be adjusted as required by conventional methods of correction, interpolation or extrapolation in accordance with established aeronautical practices to show compliance with provisions of 2.0.

## 5.0 REMEDIES

In the event of a shortfall in the guarantees contained in this Schedule, Bombardier shall endeavor and shall use its reasonable efforts to develop corrective measures. Such measures shall be developed within a period of [\*\*\*]\* from the delivery of the first Aircraft under the Agreement (or such other longer period as is required in view of the corrective measures involved. [\*\*\*])

## 6.0 LIMITATION OF LIABILITY

[\*\*\*]

7.0 In the event of the termination of the Agreement, this Schedule shall become automatically null and void.

8.0 The provisions of this Schedule are personal to Buyer and shall not be assigned or otherwise disposed of by Buyer without the prior written consent of Bombardier.

9.0 This Schedule constitutes an integral part of the Agreement and subject to the terms and conditions contained therein.

**HORIZON AIR INDUSTRIES, INC.**

**BOMBARDIER INC.**  
Bombardier Aerospace

\_\_\_\_\_  
Rudi Schmidt  
Vice President and Treasurer

Date: October \_\_, 2005

\_\_\_\_\_  
David MacNeil  
Senior Account Executive, Contracts  
**Regional Aircraft**  
Date: October \_\_, 2005

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Ross Gray  
Director, Contracts, Americas  
**Regional Aircraft**  
Date: October \_\_, 2005

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**SCHEDULE 6 TO SUPPLEMENT NO. PA-0436-5**  
**DELAYS, LOSS OR DAMAGE AND TERMINATION**

- 1.0 In the event an Aircraft is not delivered on its respective Scheduled Delivery Date as a result of a Non-Excusable Delay, [\*\*\*]\*.
- 2.0 In the event of loss or damage to any Aircraft, pursuant to Article 15 of the Agreement, [\*\*\*].
- 3.0 In the event of termination of the Agreement by Bombardier in accordance with Article 16, of the Agreement, Bombardier [\*\*\*].
- 4.0 In the event of termination of the Agreement by Buyer in accordance with Article 16, of the Agreement Bombardier shall pay Buyer [\*\*\*].
- 5.0 In the event of any other termination of the Agreement, this Schedule shall become automatically null and void.
- 6.0 The provisions of this Schedule are personal to Buyer and shall not be assigned or otherwise disposed of by Buyer without the prior written consent of Bombardier.
- 7.0 This Schedule constitutes an integral part of the Agreement and subject to the terms and conditions contained therein.

**HORIZON AIR INDUSTRIES, INC.**

**BOMBARDIER INC.**  
Bombardier Aerospace

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Rudi Schmidt  
Vice President and Treasurer

Date: October \_\_, 2005

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Supplement No. PA-0436-5

-21-

Initials  
Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

AIRFRAME DIRECT MAINTENANCE COST GUARANTEE

1.0 Intent

- 1.1 The intent of the Airframe direct maintenance cost guarantee is to achieve the full potential of the maintainability of the Aircraft through the joint efforts of Bombardier and Buyer. To that end, Bombardier agrees to provide credits under the terms and conditions hereof and Buyer agrees to provide data defined below.
- 1.2 The "Airframe" shall mean the Aircraft excluding Power Plant Parts, related maintenance activities (such as overhaul, hot section inspection, basic unscheduled repair, LCF components, scheduled and unscheduled line replaceable unit repair and overhaul), Buyer Furnished Equipment (BFE), Ground Support Equipment (GSE) and Auxiliary Power Unit (APU).

2.0 Airframe Direct Maintenance Cost Guarantee

- 2.1 Bombardier guarantees that for the fleet of Aircraft operated by Buyer during the term of this Schedule 7 the cumulative average Airframe direct maintenance cost per flight hour shall not exceed a constant cumulative dollar value average of [\*\*\*]\* ("ADMCG") expressed in January 1st, 2005 dollars (subject to escalation) subject to escalation in accordance with the Attachment No. 2 of this Schedule 7 and subject to the following terms and conditions:
  - 2.1.1 The term of this Schedule 7 shall commence on the expiration of the Warranty Period of the first Aircraft and expire [\*\*\*] thereafter.
  - 2.1.2 Appropriate reductions shall be made in labour man-hours per flight hour and material costs per flight hour for the following:
    - a) Labour and material costs resulting from maintenance not performed in accordance with approved written procedures or from configuration changes made by Buyer without Bombardier's written agreement, or because recommended Service Bulletins which cause a reduction in direct maintenance cost have not been incorporated, provided Buyer has had sufficient time to incorporate said Service Bulletins consistent with Buyer's maintenance program. Bombardier shall not make reductions when Buyer has demonstrated that such change is not cost effective for Buyer. In the event of a

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disagreement between Bombardier and Buyer as to the cost-effectiveness of a recommended Service Bulletin change proposed by Bombardier, Buyer will explain its financial analysis used to evaluate the implementation of such Service Bulletin change;

- b) Labour and material costs incurred to repair damages resulting from accidents or negligence in maintaining the Aircraft, or for modification of the Aircraft, which may be capitalized by Buyer (except for actions on Airworthiness Directives);
- c) Credits, warranty payments, guarantee payments or other payments such as parts or services at reduced cost that Bombardier or vendors have made that compensate Buyer for or reduce Buyer's direct maintenance cost;
- d) Aircraft that have not been maintained in accordance with Buyer's regulatory agency approved initial maintenance program unless mutually agreed to by Buyer and Bombardier; and
- e) Scheduled maintenance checks which are not accomplished consistent with Buyer's standard maintenance practices.

### 3.0 Calculation of Cost

#### 3.1 Airframe Direct Maintenance Labour Cost ("ADML")

The ADML man-hours shall be defined as the annual man-hours in Buyer cost allocation system assigned to collect direct labour charges, without burden, expended in direct maintenance of the Aircraft. Notwithstanding Buyer's internal cost allocation system all elements of indirect labour such as shop cleaning, workplace maintenance, material handling, overtime premium, idle time, access time and inventory control shall be excluded from the calculation of Airframe direct maintenance man-hours.

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3.2 Airframe Direct Maintenance Material Cost (“ADMMC”)

The ADMMC is defined as the annual cost of material consumed, which excludes initial provisioning purchases, for the direct airframe maintenance of the aircraft, less any transportation, duties, taxes or license fees. Notwithstanding Buyer’s internal cost allocation system all elements of indirect material such as cleaning supplies, consumable tools, hydraulic fluids, oils and greases, welding supplies and adhesives are excluded from the calculation of ADMMC.

3.3 Airframe Direct Outside Service Cost (“ADOSC”)

The ADOSC is defined as the annual cost expended in outside services for direct airframe maintenance of the aircraft. The ADOSC shall include the total outside service charges of both labour and material costs, but excluding transportation and taxes.

3.4 Hourly Airframe Direct Maintenance Cost (“ADMC”)

The following formula shall be used to calculate the annual hourly ADMC:

$$\text{ADMC} = \text{[***]}^*$$

Where:

ADML = Airframe Direct Maintenance Labour in man-hours,

LC = Labour cost from Attachment A, item 4,

ADMMC = Airframe Direct Maintenance Material Service Cost,

ADOSC = Airframe Direct Outside Service Cost,

T = Total flight hours for the Aircraft recorded for the applicable year.

4.0 Credit Calculation

4.1 The actual hourly Airframe Direct Maintenance Cost (ADMC) shall be compared by Bombardier against the ADMCG on an annual basis.

4.2 [\*\*\*]

4.3 [\*\*\*]

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5.0 Credit Payment

5.1 [\*\*\*]\*

5.2 [\*\*\*]

5.3 If the credit due to Buyer is negative, Buyer will be under no obligation to compensate Bombardier, nor shall Bombardier owe any compensation to Buyer.

6.0 Audit

Upon five (5) business days prior written notification by Bombardier to Buyer and at Bombardier's expense, Bombardier shall have the right during normal business hours to audit all charges reported under this Schedule 7, Buyer's applicable maintenance practices and procedures, and applicable Aircraft records, where normally and customarily maintained, relative to maintenance, Service Bulletin incorporation and modification of the Aircraft. Such audit shall not interfere with the conduct of business by Buyer nor shall Buyer be required to undertake or incur additional liability or obligations with respect to the audit. Where a material disagreement exists between Bombardier and Buyer, a mutually agreed upon third party auditor will be engaged to resolve the discrepancy.

7.0 Reporting

7.1 Bombardier shall provide a quarterly report to Buyer on the status of the Airframe direct maintenance cost based on data submitted by Buyer and approved by Bombardier. Failure of Buyer to provide the required data, in spite of Bombardier's notice and within thirty (30) days thereof, shall void this Airframe direct maintenance cost guarantee.

7.2 The ADMCG was based upon the assumption outline in Attachment 1 to this Schedule 7. Any deviation from the assumptions outlined in Attachment shall cause a modification in the ADMCG by Bombardier.

8.0 Limitation of Liability

[\*\*\*]

9.0 In the event of the termination of the Agreement, this Schedule shall become automatically null and void.

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10.0 The provisions of this Schedule are personal to Buyer and shall not be assigned or otherwise disposed of by Buyer without the prior written consent of Bombardier.

11.0 This Schedule constitutes an integral part of the Agreement and subject to the terms and conditions contained therein.

**HORIZON AIR INDUSTRIES, INC.**

**BOMBARDIER INC.**

Bombardier Aerospace

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Rudi Schmidt  
Vice President and Treasurer

---

David MacNeil  
Senior Account Executive, Contracts

**Regional Aircraft**  
Date: October \_\_, 2005

Date: October \_\_, 2005

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Ross Gray  
Director, Contracts, Americas

**Regional Aircraft**  
Date: October \_\_, 2005

Supplement No. PA-0436-5

-26-

Initials  
Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

ADMCG

Guarantee Value Assumptions

The following is a listing of all assumptions used to determine the ADMCG per flight hour. It is understood by the parties that these assumptions may change in which case the parties, with mutual agreement, will adjust the ADMCG.

1. All costs are based upon Specification.
2. All costs are based on the maintenance inspection intervals in the Buyer's regulatory agency approved initial maintenance program.
3. All costs expressed in January 1, 2005 United States Dollars and are rounded to the nearest whole dollar subject to escalation as per the ADMCG Economic Adjustment Formula.
4. Buyer's in-house airframe labour rate per man-hour is [\*\*\*]\*.
5. Buyer's subcontract airframe labour rate per man-hour is [\*\*\*].
6. Annual average Aircraft utilization is [\*\*\*].
7. Buyer's average annual flight duration for the Aircraft will be [\*\*\*] per departure.

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Supplement No. PA-0436-5

-27-

Initials  
Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

**ADMCG ECONOMIC ADJUSTMENT FORMULA**

The ADMCG economic adjustment will be calculated using the following Guarantee Adjustment (GA) Formula. The ADMCG term is specified in Section 2.1.1 of Schedule 7.

GA =  $G1 - G0$

[\*\*\*]\*

GA = ADMCG Value Adjustment

G0 = ADMCG Value

G1 = ADMCG Value adjusted to the final year

L1 = the current year index for labour obtained by calculating the arithmetic average of the labour indexes published by the United States Department of Labour Statistics - Employer and Earnings Index for the fourth, fifth and sixth months prior to the month in the current year which defines the ADMCG term.

L0 = TBD which equals the January 1, 2005 index for labour obtained by calculating the arithmetic average of the labour indexes published by the United States Department of Labour Statistics - Employment Cost Index (Series ID: ECU281221), for the fourth, fifth and sixth months prior to the date specified in Attachment 1, Article 3 of this Schedule 7.

M1 = the current year index for material obtained by calculating the arithmetic average of the material indexes published by the United States Department of Labour - Material Industrial Commodities, Producer Price Index, for the fourth, fifth and sixth months prior to the month in the current year which defines the ADMCG term.

M0 = TBD which equals the January 1, 2005 index for material obtained by calculating the arithmetic average of the material indexes published by the United States Department of Labour - Material Industrial Commodities, Producer Price Index (Series ID: WPU142), for the fourth, fifth and sixth months prior to the date specified in Attachment 1, Article 3 of this Schedule 7.

If, during any economic adjustment period, L1 is less than L0, L1 will be deemed to equal L0 and if M1 is less than M0, M1 will be deemed to equal M0.

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**SCHEDULE 8 TO SUPPLEMENT NO. PA-0436-5**

**CREDIT MEMORANDUM RECONCILIATION**

- 1.0 In consideration of Buyer having entered into the above referenced Agreement, Buyer and Bombardier hereby agree to review the Credit Memorandum [\*\*\*] between Bombardier and Buyer, [\*\*\*]\* commencing [\*\*\*] after the delivery of the first Aircraft.
- 2.0 [\*\*\*]
- 3.0 The provisions of this Schedule are personal to Buyer and shall not be assigned or otherwise disposed of by Buyer without the prior written consent of Bombardier.
- 4.0 This Schedule constitutes an integral part of the Agreement and subject to the terms and conditions contained therein.
- 5.0 In the event of termination of the Agreement or Supplement PA 0436-5 with respect to any undelivered Aircraft, this Schedule shall automatically become null and void with respect to such undelivered Aircraft.

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Supplement No. PA-0436-5

-29-

Initials  
Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

**HORIZON AIR INDUSTRIES, INC.**

\_\_\_\_\_  
Rudi Schmidt  
Vice President and Treasurer

Date: October \_\_, 2005

\_\_\_\_\_

Supplement No. PA-0436-5

**BOMBARDIER INC.**  
Bombardier Aerospace

\_\_\_\_\_  
David MacNeil  
Senior Account Executive, Contracts  
**Regional Aircraft**  
Date: October \_\_, 2005

\_\_\_\_\_  
Ross Gray  
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-30-  
Initials  
Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_



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**SCHEDULE 9 TO SUPPLEMENT NO. PA-0436-5**

**NEW Q400 OPTION AIRCRAFT**

- 1.0 Bombardier hereby agrees to grant Buyer an option to purchase up to twenty (20) additional Aircraft (the “New Q400 Option Aircraft”) under the following general conditions:
- a. The base price (subject to escalation from [\*\*\*]\*) for each of the New Q400 Option Aircraft (including Buyer Selected Optional Features) for delivery Ex Works (Incoterms 1990) Bombardier facilities in Downsview Ontario shall be the combined total of the prices listed Article 2.1 (a) and (b) to this Supplement No. MPA0436-5.
  - b. Buyer shall exercise its right to purchase the New Q400 Option Aircraft by providing to Bombardier a written notice together with the New Q400 Option Deposit no later than fifteen (15) months prior to the Scheduled Delivery Date of each New Q400 Option Aircraft (“Exercise Date”);
  - c. Buyer shall make or cause to be made a payment to Bombardier of a deposit of [\*\*\*] for each New Q400 Option Aircraft totaling [\*\*\*] (the “New Q400 Option Deposit”) on signing of this Schedule 9 to Supplement PA 0436-5:  
[\*\*\*]
  - d. Buyer shall make payment or cause payment to be made for each New Q400 Option Aircraft as follows:
    - (i) [\*\*\*], as set forth in Article 1 (c) to this Schedule 9 to Supplement No. MPA0436-5;
    - (ii) [\*\*\*] of the net Aircraft Purchase Price upon Buyer’s notice to exercise their option to purchase the new Q400 Option Aircraft;
    - (iii) [\*\*\*] of the net Aircraft Purchase Price fifteen (15) months prior to its Scheduled Delivery Date;
    - (iv) [\*\*\*] of the net Aircraft Purchase Price twelve (12) months prior to its Scheduled Delivery Date;
    - (v) [\*\*\*] of the net Aircraft Purchase Price nine (9) months prior to its Scheduled Delivery Date;

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- 
- (vi) [\*\*\*]\* of the net Aircraft Purchase Price six (6) months prior to its Scheduled Delivery Date; and
  - (vii) the balance of the Aircraft Purchase Price shall be received on or before the Delivery Date of such Aircraft to Buyer.

All payments referred to in paragraphs (i) through (vii) above are to be made on the first day of the applicable month.

**f. New Q400 Option Aircraft Pricing:**

- (i) For the sole purpose of the calculations set forth in Article 1.0 (a) above the estimated net Option Aircraft Purchase Price shall be the estimated Option Aircraft Purchase Price [\*\*\*] to this Supplement No. PA 0436-5;
- (ii) Once a New Q400 Option Aircraft has been exercised in accordance with Article 1.0 (b) above, the price of the New Q400 Option Aircraft shall be the Base Price adjusted for changes made pursuant to Article 11 of Section I of the Agreement and any Regulatory Changes pursuant to Article 8.5 of Section I of the Agreement, and further adjusted to the Delivery Date to reflect economic fluctuations during the period from [\*\*\*] to the Delivery Date of each Aircraft ("Aircraft Purchase Price"). Such adjustments shall be based on the economic adjustment formula attached hereto as Schedule 3 ("Economic Adjustment Formula") but when adjusted, [\*\*\*].

g. The Scheduled Delivery Dates of the Option Aircraft are as follows:

[\*\*\*]

Twentieth Option Aircraft                      May 2010

h. The exercise of one or more of the options under this Schedule shall not create an obligation of Bombardier, nor grant a right to Buyer, for any additional options.

2.0 Upon exercise of Buyer's right to purchase a New Q400 Option Aircraft, the terms and conditions of the Agreement and of this Supplement No. PA 0436-5 shall [\*\*\*] to the purchase of such New Q400 Option Aircraft. In consideration of Buyer purchasing a New Q400 Option Aircraft, the terms set forth in [\*\*\*] will be amended to include the additional firm Aircraft on a one-for-one basis. Notwithstanding the foregoing, [\*\*\*]. Furthermore, [\*\*\*] shall be amended to reflect the increased number of Aircraft in Buyer's fleet unless expressly noted otherwise.

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- 3.0 In the event of the termination of the Agreement, this Schedule shall become automatically null and void.
- 4.0 The provisions of this Schedule are personal to Buyer and shall not be assigned or otherwise disposed of by Buyer without the prior written consent of Bombardier.
- 5.0 This Schedule constitutes an integral part of the Agreement and subject to the terms and conditions contained therein.

**HORIZON AIR INDUSTRIES, INC.**

**BOMBARDIER INC.**  
Bombardier Aerospace

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Rudi Schmidt  
Vice President and Treasurer

Date: October \_\_, 2005

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David MacNeil  
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Supplement No. PA-0436-5

-33-

Initials  
Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

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**SCHEDULE 10 TO SUPPLEMENT NO. PA-0436-5**

**Q200 JOINT REMARKETING ASSISTANCE**

- 1.0 As a special consideration to Buyer, Bombardier agrees to provide remarketing support to Buyer ("Remarketing Support") for [\*\*\*]\*, in accordance with the terms hereof:  
[\*\*\*]
- 2.0 [\*\*\*]
- 3.0 [\*\*\*]
- 4.0 [\*\*\*]
- 5.0 The provisions of this Schedule are personal to Buyer and shall not be assigned or otherwise disposed of by Buyer without the prior written consent of Bombardier.
- 6.0 This Schedule constitutes an integral part of the Agreement and subject to the terms and conditions contained therein.

**HORIZON AIR INDUSTRIES, INC.**

**BOMBARDIER INC.**  
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Supplement No. PA-0436-5

-34-

Initials  
Buyer \_\_\_\_\_ Bombardier \_\_\_\_\_

**DISPATCH RELIABILITY GUARANTEE**

**1.0 Intent**

The intent of the Dispatch Reliability Guarantee (“DRG”) is to achieve the full potential of the inherent technical reliability of the Aircraft [\*\*\*]\*, through the joint efforts of Bombardier and Buyer. To that end, Bombardier agrees to take action as specified below and Buyer agrees to set its Aircraft fleet dispatch reliability target [\*\*\*] above the Guarantee Value so that both Buyer and Bombardier’s technical staff can pursue attainment of the Guarantee Value.

**2.0 Definition**

A chargeable dispatch interruption shall be defined as; any delay caused by malfunction of equipment in which the actual departure time exceeds the scheduled departure time by [\*\*\*] (“Chargeable Dispatch Interruption”) [\*\*\*].

**3.0 Guarantee Value**

Bombardier guarantees that the Aircraft dispatch reliability after taking into account Chargeable Aircraft Dispatch Interruptions shall, at the end of the period indicated below calculated from the beginning of the Guarantee Term, meet the guarantee value percentages specified below (“Guarantee Value”):

<u>Period</u>	<u>Guarantee Value (%)</u>
[***]	[***]

**4.0 Term of Guarantee**

The term of this DRG shall commence on the first day of the month following the first revenue service flight of Buyer’s first Aircraft and shall expire [\*\*\*] thereafter (the “Guarantee Term”).

**5.0 Formula**

The dispatch reliability shall be compiled as a [\*\*\*] moving average of numerical value (expressed as a percentage) which shall be calculated by application of the following formula:

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DR = [\*\*\*]\*

Where:

DR = Dispatch Reliability (expressed as percentage)

CD = Total Chargeable Aircraft Dispatch Interruptions

SD = Total Scheduled Revenue Departures

6.0 Assumptions

6.1 The Guarantee Value is predicated on an average yearly fleet utilization of [\*\*\*]. Bombardier reserves the right to re-calculate the Guarantee Value in the event of deviation of [\*\*\*] in the aforementioned assumptions.

7.0 Conditions and Limitations

7.1 A Dispatch Interruption due to any one or more of the following causes shall not be considered a Chargeable Aircraft Dispatch Interruption:

- (a) Dispatch Interruption due to operation or maintenance of equipment in the Aircraft not being in accordance with the approved Technical Data;
- (b) Dispatch Interruption due to acts or omissions of Buyer including but not limited to unavailability of serviceable spare parts (provided that availability of spares is not restricted by inability of Bombardier or its suppliers or subcontractors to supply such spares), ground support equipment or personnel, and not dispatching in accordance with the approved Minimum Equipment List;
- (c) Dispatch Interruption caused by problems that have had relevant recommended Service Bulletins or Airworthiness Directives issued against them, if Buyer has not incorporated the bulletin on the Aircraft in question, provided that Buyer has had reasonable time to incorporate said bulletin or directive and seventy (70%) percent of the world wide fleet has committed to incorporate the bulletin or directive;
- (d) Dispatch Interruption caused by BFE of Buyer or Buyer designated equipment (equipment designated by Buyer and purchased by Bombardier on behalf of Buyer);

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- (e) Dispatch Interruption due to any modifications to the Aircraft made by Buyer without Bombardier's written approval unless Buyer furnishes reasonable evidence that such modification was not a prime cause of the Dispatch Interruption ; or
  - (f) Any Dispatch Interruption due to acts of God or foreign object damage or acts of third parties or force majeure.

7.2 Reporting

Buyer shall provide to Bombardier not later than (30) days after the last day of each month the following datasets as a minimum as defined in the latest revisions of (Electronic Data Standard Exchange) EDSE Service Letter DH8-400-SL-00-001 and Out-Of-Service Data Collection Service Letter DH8-400-SL-00-013:

- Aircraft Utilization
- Flight Interruptions
- Component Removals
- Pireps / Mareps
- Performed Tasks
- Service Bulletins / Airworthiness Directives
- Out-of-Service Data

Bombardier will assist Buyer in establishing a data exchange mechanism to allow a more streamlined electronic exchange from Buyer's internal reliability data system.

7.3 Master Record

The master record of dispatch reliability will be maintained by Bombardier based upon information provided by Buyer's maintenance control program as requested herein.

Bombardier shall format the data into Bombardier's format.

8.0 Corrective Action

- 8.1 In the event the achieved dispatch reliability, as reported to Buyer by Bombardier and reconciled in six (6) month increments, fails to equal the Guarantee Value for the applicable period, Bombardier and Buyer will jointly review the performance for that period to identify improvement changes required. Bombardier shall also provide, at no charge unless otherwise indicated, if requested by Buyer:

- (a) Bombardier's Technical Service Support to analyze Buyer's operating procedures, maintenance practices, training programs, manuals and publications and related procedures, practices, policies and programs that can have an adverse effect on dispatch reliability and recommend any changes in such procedures, practices,

policies and programs reasonably indicated to improve the dispatch reliability. Bombardier will send the audit report to Buyer and Buyer will take the appropriate reasonable corrective action with:

- (i) its own internal resources; or
  - (ii) an external contracted consulting organization at its own cost or
  - (iii) a Bombardier recognized consulting organization at its own cost;
- (b) Review of data related to parts, material, components, accessories and equipment incorporated in, and used in connection with, the Aircraft and furnish technical advice and information to Buyer for the purpose of improving the dispatch reliability of the Aircraft;
- (c) Corrective Bombardier engineering design changes and modification kits of Bombardier Parts and material for the Aircraft, which will, in the joint opinion of Buyer and Bombardier, cause the performance of the Aircraft upon Buyer's installation, to meet or exceed the Guarantee Value. The modification kits and design changes supplied by Bombardier which provide added value to Buyer beyond that required to reach the specified Guarantee Value will be negotiated by Bombardier and Buyer to define the cost allocation of the "Added Value". Bombardier will pay for [\*\*\*]\*, whichever is less, for the percentage as determined above of the installation cost necessary to meet the Guarantee Value. Buyer and Bombardier agree that Buyer's obligations to install such modification kits shall be consistent with Buyer's maintenance program. Thereafter, failure by Buyer to install a Bombardier change shall result in the exclusion of the associated malfunction from the dispatch reliability computation, unless Buyer can demonstrate to Bombardier's reasonable satisfaction that the change would not have eliminated the malfunction; and
- (d) Bombardier shall use its reasonable efforts to require its suppliers to provide corrective action at no charge to Buyer to the extent required when Chargeable Aircraft Dispatch Interruptions exceed the Guarantee Value as a direct result of failure of equipment designed by such suppliers.

8.2 [\*\*\*]

8.3 Bombardier's liability to investigate and provide corrective action under the terms of this DRG shall be dependent upon the quality, extent and regularity of information and data reported to Bombardier by Buyer. However, should Bombardier recommend reasonable corrective actions and Buyer fails to act upon said recommendations and as a result the Aircraft dispatch reliability exceeds the Guarantee Value, then Bombardier shall not have any obligation under Article 8.2 above while the situation persists.

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9.0 Implementation of Changes

Buyer may, at its option, decline to implement any change proposed by Bombardier under Article 8.0 above. If Buyer so declines, Bombardier may adjust the number of Chargeable Aircraft Dispatch Interruptions by an amount consistent with the expected reduction in Chargeable Aircraft Dispatch Interruptions based on reasonable substantiation to Buyer and on other operator experience, if any, as if such change has been incorporated. Bombardier shall not make adjustments when Buyer has demonstrated to Bombardier's reasonable satisfaction that such change is not cost effective to Buyer.

10.0 Duplicate Remedies

It is agreed that Bombardier shall not be obligated to provide to Buyer any remedy which is a duplicate of any other remedy which has been provided to Buyer elsewhere under the Agreement, by the Power Plant manufacturer or by any vendor.

11.0 Limitation of Liability

[\*\*\*]\*

12.0 In the event of the termination of the Agreement, this Schedule shall become automatically null and void.

13.0 The provisions of this Schedule are personal to Buyer and shall not be assigned or otherwise disposed of by Buyer without the prior written consent of Bombardier.

14.0 This Schedule constitutes an integral part of the Agreement and subject to the terms and conditions contained therein.

**HORIZON AIR INDUSTRIES, INC.**

**BOMBARDIER INC.**  
Bombardier Aerospace

\_\_\_\_\_  
Rudi Schmidt  
Vice President and Treasurer

Date: October \_\_, 2005

\_\_\_\_\_  
David MacNeil  
Senior Account Executive, Contracts  
**Regional Aircraft**  
Date: October \_\_, 2005

\_\_\_\_\_  
Ross Gray  
Director, Contracts, Americas  
**Regional Aircraft**  
Date: October \_\_, 2005

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SCHEDULE 12 TO SUPPLEMENT NO. PA-0436-5

\*\*\*]\*

1.0 \*\*\*]

2.0 \*\*\*]

3.0 \*\*\*]

4.0 Confidentiality

Each of Buyer and Bombardier (including its employees, agents and professional advisors) agrees to keep the terms and conditions of the \*\*\*] strictly confidential. Any information related to the form and amount of the \*\*\*] which may be provided by any third party support provider(s) is to be treated as confidential and, except as may be required by law or legal process, is not to be provided to any third party without the express written consent of the other party and then only subject to the third party agreeing to the third party support provider(s), or Buyer's, as appropriate, confidentiality agreement. It is the disclosing party's responsibility to have such agreement executed with any third party prior to disclosure of any such information and to provide such to the other party for approval.

5.0 In the event of the termination of the Agreement, this Schedule shall become automatically null and void.

6.0 The provisions of this Schedule are personal to Buyer and shall not be assigned or otherwise disposed of by Buyer without the prior written consent of Bombardier.

7.0 This Schedule constitutes an integral part of the Agreement and subject to the terms and conditions contained therein.

**HORIZON AIR INDUSTRIES, INC.**

**BOMBARDIER INC.**  
Bombardier Aerospace

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Date: October \_\_, 2005

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**Regional Aircraft**  
Date: October \_\_, 2005

\_\_\_\_\_  
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**FOIA CONFIDENTIAL  
TREATMENT REQUESTED**

**CREDIT AGREEMENT [HSH/AS B737-800]**

dated as of October 19, 2005

among

**ALASKA AIRLINES, INC.**  
as Borrower

**EACH SENIOR LOAN PARTICIPANT  
IDENTIFIED ON SCHEDULE I HERETO**  
Loan Participants,

and

**HSH NORDBANK AG NEW YORK BRANCH**  
Security Agent

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*Vedder, Price, Kaufman & Kammholz, P.C.*

*SkyBlue Capital LLC*

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## TABLE OF CONTENTS

	<b>Page</b>
	<hr/>
Section 1.	Certain Definitions
	1
Section 2.	Commitments; Borrower's Notice of Payment Dates; Closing Procedure
	1
Section 3.	Terms of Loan Certificates; Fees; Cancellation of Facility Amount and Renewal Options
	4
Section 4.	Conditions
	4
Section 5.	The Certificates
	7
Section 6.	Extent of Interest of Holders
	23
Section 7.	Borrower's Representations and Warranties
	23
Section 8.	Indemnities
	27
Section 9.	Covenants of the Borrower
	28
Section 10.	Notices
	32
Section 11.	Governing Law; Consent to Jurisdiction; Waiver of Jury Trial
	32
Section 12.	Invoices and Payment of Expenses
	33
Section 13.	Confidentiality
	33
Section 14.	Miscellaneous
	34
 <u>Schedules:</u>	
Schedule I	- Notice and Account Information
Schedule II	- Participations
Schedule III	- Advances
 <u>Exhibits:</u>	
Exhibit A	- Form of Funding Notice
Exhibit B	- Form of Assignment Agreement
Exhibit C	- Consent and Agreement to Mortgage and Security Agreement
Exhibit D	- Consent and Agreement of CFM International, Inc.
Exhibit E	- Aircraft Mortgage
Annex A	- Definitions

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**CREDIT AGREEMENT [HSH/AS B737-800]**

**THIS CREDIT AGREEMENT [HSH/AS B737-800]** dated as of October 19, 2005 is among (i) **ALASKA AIRLINES, INC.**, an Alaska corporation (the “**Borrower**”), (ii) **EACH LOAN PARTICIPANT IDENTIFIED ON SCHEDULE I HERETO**, and (iv) **HSH NORDBANK AG NEW YORK BRANCH**, as the Security Agent acting on behalf of the Loan Participants.

**W I T N E S S E T H:**

**WHEREAS**, concurrently with the execution and delivery of this Agreement, the Borrower and the Security Agent are entering into the Mortgage and Security Agreement [HSH/AS B737-800] dated as of the date hereof (the “**Mortgage**”) pursuant to which the Borrower agrees, among other things, that Loan Certificates issued hereunder and all other obligations hereunder or under any other Operative Document will be secured by the mortgage and security interest created by the Borrower in favor of the Security Agent.

**NOW, THEREFORE**, in consideration of the mutual agreements herein contained, the parties hereto agree as follows:

**Section 1. Certain Definitions.** Except as otherwise defined in this Agreement, including its annexes, schedules and exhibits, terms used herein in capitalized form shall have the meanings attributed thereto in Annex A.

Unless the context otherwise requires, any reference herein to any of the Operative Documents refers to such document as it may be modified, amended or supplemented from time to time in accordance with its terms and the terms of each other agreement restricting the modification, amendment or supplement thereof.

**Section 2. Commitments; Borrower’s Notice of Payment Dates; Closing Procedure.**

2.1 Subject to the terms and conditions of this Agreement, each Loan Participant agrees to make a secured loan to the Borrower in respect of each Advance (herein called, for such Advance, a “**Drawing**”) on a Borrowing Date to be designated pursuant to Section 2.2, but in no event later than the Commitment Termination Date. In the case of each Loan Participant, such Drawing shall be equal to the lesser of (i) such Loan Participant’s Maximum Commitment minus the aggregate amount of outstanding Drawings made by such Loan Participant prior to such Borrowing Date and (ii) such Loan Participant’s Participation Percentage set forth opposite such Loan Participant’s name in Schedule II hereto [\*\*\*] multiplied by the amount of such Advance (for each Loan Participant, such Loan Participant’s “**Commitment**” with respect to such Advance); provided that at no time shall the aggregate amount of Drawings made by the Loan Participants in respect of any Aircraft be more than

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\*\*\* of the Advance Payment Base Price for such Aircraft. The Drawings shall be made in separate series (each, a “**Series**”) with respect to each Aircraft.

If any Loan Participant shall default in its obligation to make the amount of its Commitment available pursuant to this Section 2.1 in respect of any Advance, no other Loan Participant shall have an obligation to increase the amount of its Commitment for such Advance and the obligations of the non-defaulting Loan Participants shall remain subject to the terms and conditions set forth in this Agreement. Without limiting the above, if the Security Agent disburses a Loan Participant’s Commitment in relation to an Advance without first having received funds from a Loan Participant, then the Loan Participant hereby indemnifies the Security Agent against any loss it may incur as a result of such failure to fund by the Loan Participant.

As more particularly set forth in Section 5, Borrower shall execute and deliver to each Loan Participant with appropriate insertions a Loan Certificate to evidence such Loan Participant’s Maximum Commitment. The Loan Certificates shall be issued such that each Loan Participant receives a Loan Certificate. Each Drawing shall be evidenced by this Agreement, the Loan Certificate with respect thereto, and notations made from time to time by each Loan Participant in its books and records, including computer records. Each Loan Participant shall record in its books and records, including computer records, the principal amount of the Drawings owing to it from time to time. Absent evidence to the contrary, each Loan Participant’s books and records shall constitute presumptive evidence of the accuracy of the information contained therein. Failure by any Loan Participant to make any such notation or record shall not affect the obligations of Borrower to such Loan Participant with respect to the repayment of its Drawings.

2.2 (a) The Borrower agrees to give the Security Agent at least five (5) Business Days’ prior written notice (the “**Funding Notice**”) of the Effective Date and the Borrowing Date for each Advance, which Borrowing Date shall be a Business Day not later than the Commitment Termination Date and shall not be a date before the scheduled date set forth in Schedule III for such Advance, which notice shall specify any funding instructions and shall be in substantially the form of Exhibit A. On the date of the execution and delivery of this Agreement and the satisfaction of the conditions precedent in Section 4.1 (the “**Effective Date**”), the Loan Participants shall make Drawings (subject to the limitations set forth in Section 2.1) in respect of certain Advances which were paid by Borrower prior to the Effective Date. The proceeds of such Drawings shall be paid to Borrower; provided, however, that Borrower shall remain responsible for, and shall have paid, its Cash Contribution for each Aircraft for which such Advances have been paid.

(b) In the event that any Drawing shall not be consummated in accordance with the terms hereof on the Effective Date or the Borrowing Date specified in a Funding Notice, the Loan Participants and the Borrower shall cooperate with each other to arrange a mutually acceptable postponement of such date provided that such date may not be more than 90 days

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after the Borrowing Date anticipated in Schedule III (the “**Delayed Borrowing Date**”). In the event that the Drawing shall not be consummated in accordance with the terms by 11:00 a.m. (New York time) on the Delayed Borrowing Date or, if earlier, the date on which the Borrower notifies the Loan Participants that the Drawing will not occur, the Loan Participants may cancel or terminate any funding arrangements that they may have made to enable them to fund their Commitments and the Borrower shall pay to each Loan Participant on demand their Break Amount (as reasonably determined by such Loan Participants and certified to the Borrower). In consideration of making their funds available on the Effective Date or the specified Borrowing Date, the Borrower shall compensate the Loan Participants for their net loss of earnings on such funds, by paying the Loan Participants’ interest on the aggregate amount thereof (calculated on the basis of a 360-day year and actual days elapsed) at a rate equal to the Loan Participants’ cost of funds for the period from and including the Effective Date or the specified Borrowing Date to but excluding the earlier of (x) the Business Day on which the Borrowing shall actually occur, (y) the Business Day on which the Borrower shall notify the Loan Participants that the Borrowing will not occur prior to the Delayed Borrowing Date (if such notice is given prior to 10:00 a.m. (New York time) or if later, until the Business Day subsequent to such notice date), or (z) the Delayed Borrowing Date.

2.3 On the Effective Date, each Loan Participant, through or on behalf of the Security Agent, agrees to pay the amount of its Commitment for the initial Advance to the Manufacturer by wire transferring (or by making other arrangements reasonably satisfactory to the Security Agent and the Manufacturer) such amounts to account or accounts specified in the applicable Funding Notice, subject to continued compliance with the limitations set forth in Section 2.1, to such other account as the Borrower shall direct the Security Agent in writing, from time to time to reimburse Borrower for previously funded Advances. On the Borrowing Date for each subsequent Drawing specified in a Borrower’s notice referred to in Section 2.2, subject to the terms and conditions of this Agreement, each Loan Participant, through or on behalf of the Security Agent, agrees to pay the amount of its Commitment for each such Advance directly to the Manufacturer by wiring such amounts to the account or accounts specified in the applicable Funding Notice.

2.4 The Borrower agrees that the actual transfer of the proceeds of Drawings to the bank designated by the Borrower for credit to the Manufacturer’s or the Borrower’s account (as applicable) maintained at such bank shall constitute conclusive evidence that the Drawings were made, and neither the failure of any Holder to endorse on the schedule attached to any Loan Certificate the amount of its Drawing, nor any failure of the bank designated by the Borrower to credit proceeds of a Drawing to the Manufacturer’s or the Borrower’s account (as applicable) maintained at such bank, nor any failure of the Manufacturer to credit proceeds of a Drawing to the account of the Borrower maintained on the books and records of the Manufacturer, shall affect the Borrower’s obligations hereunder.

The closing with respect to each Drawing shall take place at the offices of Vedder Price Kaufman & Kammholz, P.C., 805 Third Avenue, New York, New York 10022.

**Section 3. Terms of Loan Certificates; Fees; Cancellation of Facility Amount and Renewal Options.**

3.1 Each Loan Certificate shall bear interest and be repaid in accordance with the applicable terms of this Agreement and the Mortgage.

3.2 In consideration of the Loan Participants' Commitments hereunder, the Borrower shall pay to the Security Agent for the account of each Loan Participant on the Effective Date the front end fee specified in the Fee Letter, based on the amount of US\$172,000,000.

3.3 The Borrower shall pay to the Security Agent the Agency Fee specified in the Fee Letter [\*\*\*].

3.4 The Borrower shall pay to the Security Agent for the account of each Loan Participant, the Commitment Fee [\*\*\*]\*

3.5 The Borrower may at any time permanently and irrevocably cancel or reduce some or all of the Facility Amount provided that such Facility Amount is not the subject of a Drawing or a Funding Notice, and further provided that such cancellation or reduction shall be a minimum of \$5,000,000 and in \$500,000 multiples thereof, and the amount thereof shall be specified in a written notice to the Security Agent five (5) Business Days before the effective date of such cancellation. A notice of cancellation under this Section 3.5 is irrevocable.\*

3.6 [\*\*\*]\*

**Section 4. Conditions.**

4.1 Conditions Precedent to the Effectiveness of the Commitments. It is agreed that the Commitments of each Loan Participant and the effectiveness of this Agreement are subject to the satisfaction prior to or on the Effective Date of the following conditions precedent:

(a) The following documents shall have been duly authorized, executed and delivered by the party or parties thereto, shall each be satisfactory in form and substance to the Security Agent and (except for the [\*\*\*]) shall be in full force and effect and executed counterparts shall have been delivered to the Security Agent and its counsel:

(i) the Mortgage;

(ii) a copy of the Boeing Purchase Agreement certified by the Secretary or an Assistant Secretary of the Borrower as being a true and accurate copy of the same, provided that such copy may be redacted and shall not include any pricing

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information therein or any provisions thereof not assigned, and also provided that, receipt of such document will be strictly subject to Section 13;

- (iii) the Consent and Agreement;
- (iv) such Loan Participant's Loan Certificate; and
- (v) [\*\*\*]\*

(b) The Security Agent (with sufficient copies for each Loan Participant) shall have received the following, in each case in form and substance satisfactory to it:

(i) a certificate of good standing and certified copy of the Articles of Incorporation and By-laws of the Borrower and a copy of resolutions of the board of directors of the Borrower or the executive committee thereof, certified by the Secretary or an Assistant Secretary of the Borrower, duly authorizing the execution, delivery and performance by the Borrower of this Agreement, the Mortgage and each other document required to be executed and delivered by the Borrower on each Delivery Date in accordance with the provisions hereof and thereof; and

(ii) a certificate of the Borrower as to the Person or Persons authorized to execute and deliver this Agreement, the other Operative Documents, and any other documents to be executed on behalf of the Borrower in connection with the transactions contemplated hereby and as to the signature of such person or persons.

(c) The Security Agent (with sufficient copies for each Loan Participant) shall have received opinions addressed to such Loan Participant and the Security Agent from the Legal Department for the Borrower in form and substance reasonably satisfactory to the addressees thereof.

(d) The Security Agent (with sufficient copies for each Loan Participant) shall have received an opinion addressed to such Loan Participant and the Security Agent from counsel to Manufacturer, in respect of the Boeing Purchase Agreement and the Consent and Agreement, in form and substance reasonably satisfactory to the addressees thereof.

(e) The Security Agent (with sufficient copies for each Loan Participant) shall have received a certificate of the Borrower that the aggregate amount of Advances in connection with each Aircraft shall be sufficient when paid to the Manufacturer in accordance with this Agreement to satisfy the obligation of the Borrower with respect to all advance payments due and payable for each such Aircraft (including payments by the Borrower specified in Section 4.1(f)) under the Boeing Purchase Agreement.

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(f) Such Loan Participant shall have received evidence in form and substance reasonably satisfactory to such Loan Participant that Borrower shall have paid to Manufacturer its Cash Contribution in respect of the applicable Aircraft.

(g) In respect of Advances paid prior to the Effective Date, any liens over the Mortgage Estate granted by the Borrower to finance such Advances shall be released and terminated.

(h) A Uniform Commercial Code financing statement or statements covering all the security interests created by or pursuant to the granting clause of the Mortgage shall have been executed and delivered by the Borrower, and such financing statement or statements shall have been duly filed in all places deemed necessary or advisable in the opinion of counsel for the Loan Participants, and any additional Uniform Commercial Code financing statements deemed advisable by any Loan Participant or its counsel shall have been executed and delivered by the Borrower and duly filed and all other action shall have been taken as is deemed necessary or advisable, in the opinion of counsel for the Loan Participants, to establish and perfect the Security Agent's security interest in the Boeing Purchase Agreement.

(i) Each Loan Participant shall have received from Vedder, Price, Kaufman & Kammholz, P.C., special counsel for the Loan Participants, an opinion satisfactory in substance and form to such Loan Participant, as to such matters incident to the transactions contemplated hereby as such Loan Participant may reasonably request.

(j) The Security Agent shall have received for the account of the Loan Participants the front end fee specified in Section 3.2 and, for its own account, the Agency Fee specified in Section 3.3. The Security Agent shall disburse to each Loan Participant such front end fee upon receipt thereof in the amounts due and payable to each Loan Participant as separately agreed.

(k) Since December 31, 2004, there shall have been no material and adverse change in the financial or operational condition of the Borrower and no event or circumstance shall have occurred which in the reasonable judgment of any Loan Participant had or would be reasonably likely to have a Material Adverse Effect.

**4.2 Conditions Precedent to the Loan Participants' Participation in each Advance.** It is agreed that the obligations of each Loan Participant to lend all or any portion of its Commitment to the Borrower in respect of each Advance (including Advances made by Borrower or a third-party financier prior to the Effective Date) is subject to the satisfaction prior to or on the Borrowing Date for such Advance of the following conditions precedent:

(a) The Security Agent shall have received due notice with respect to the Borrowing Date for such Advance pursuant to Section 2 (or shall have waived such notice either in writing or as provided in Section 2).

(b) After the date of the execution and delivery of this Agreement, (A) no change shall have occurred in applicable law or regulations thereunder which would make it a violation of law or regulations for such Loan Participant to make such Advance, to acquire its Loan Certificate(s) or to realize the benefits of the security afforded by the Mortgage, and (B)

there shall have been no material and adverse change in the LIBO market which would materially impair the ability of a Loan Participant to make an Advance hereunder.

(c) The Borrower shall have paid to the Manufacturer its Cash Contribution in respect of the applicable Aircraft.

(d) On such Borrowing Date, (A) the representations and warranties of the Borrower contained in Section 7 shall be true and accurate as though made on and as of such date except to the extent that such representations and warranties relate solely to an earlier date (in which case such representations and warranties shall be true and accurate on and as of such earlier date), (B) no event shall have occurred and be continuing which constitutes (or would, with the passage of time or the giving of notice or both, constitute) an Event of Default, (C) since December 31, 2004, there shall have been no change in the Borrower and its Subsidiaries which would amount to a Material Adverse Effect, and (D) no event or circumstance shall have occurred which in the reasonable judgment of any Holder had or would be reasonably likely to have a Material Adverse Effect.

(e) The Security Agent shall have received for the account of the Loan Participants all fees specified in Sections 3.2, 3.3 and 3.4 that are due and payable on or prior to such Borrowing Date. The Security Agent shall distribute to each Loan Participant such fees as separately agreed.

**Section 5. The Certificates.**

5.1 Form of Loan Certificates. The Loan Certificates shall each be substantially in the form set forth below, as follows:

ALASKA AIRLINES, INC.

LOAN CERTIFICATE

No. \_\_\_\_\_ New York, New York  
Series: \_\_\_\_\_  
\$ \_\_\_\_\_ [Effective Date]

Alaska Airlines, Inc. (the "**Borrower**") hereby promises to pay to \_\_\_\_\_ ("**Lender**"), or registered transferees, the principal sum of \_\_\_\_\_ (\$ \_\_\_\_\_), or, if less, the aggregate unpaid principal amount of all Drawings made by Lender to Borrower pursuant to that certain Credit Agreement [HSH/AS B737-800] of even date herewith among Borrower, Lender, HSH Nordbank AG New York Branch, as Security Agent thereunder and certain other lenders named therein, payable in full on the Final Repayment Date, together with interest on the unpaid principal amount hereof from time to time outstanding from and including the date hereof until such principal amount is paid in full. The Interest Periods for the Series of Drawings evidenced by this Note (and accordingly the Applicable Rates) can vary in accordance with the definition of Interest Period in the Credit Agreement. Interest shall accrue with respect to each Interest Period at the Applicable Rate in effect for such Interest Period and shall be payable in arrears on each Interest Payment Date and on the date this Loan Certificate is paid in full. This Loan Certificate shall bear interest at the applicable Past Due Rate on any principal hereof, and, to the extent permitted by applicable law, interest and other amounts due hereunder, not paid when due (whether at stated maturity, by acceleration or otherwise), for any period during which the same shall be overdue, payable on demand by the Holder hereof.

Interest shall be payable with respect to the first but not the last day of each Interest Period. Interest shall be calculated on the basis of a year of 360 days and actual number of days elapsed. If any sum payable hereunder falls due on a day which is not a Business Day, then such sum shall be payable on the next succeeding Business Day; provided that, in the case of principal of and interest hereon payable on an Interest Payment Date, if by virtue of such extension such payment would fall in the next succeeding month, such sum shall be payable on the next preceding Business Day.

Borrower hereby acknowledges and agrees that this note is one of the Loan Certificates referred to in, evidences indebtedness incurred under, and is subject to the terms and provisions of, the Credit Agreement including, without limitation, the repayment in full of a Series of Drawings made in respect of an Aircraft upon the Delivery Date of such Aircraft. The Credit Agreement, to which reference is hereby explicitly made, sets forth said terms and provisions, including those under which this Loan Certificate may or must be paid prior to its due date or may have its due date accelerated.

All payments of principal, Break Amount, if any, and interest and other amounts to be made to the Holder hereof or under the Mortgage and Security Agreement [HSH/AS B737-800] dated as of October 19, 2005 (as amended or supplemented from time to time, herein called the "**Mortgage**", the terms defined therein and not otherwise defined herein being used herein with the same meanings) between the Borrower and HSH Nordbank AG New York Branch, as

Security Agent thereunder, shall be made in accordance with the terms of the Credit Agreement and the Mortgage.

Principal and interest and other amounts due hereon shall be payable in Dollars in immediately available funds prior to 1:00 p.m., New York, New York time, on the due date thereof, to the Security Agent at the Payment Office and the Security Agent shall, subject to the terms and conditions of the Mortgage, remit all such amounts so received by it to the Holder hereof in accordance with the terms of the Mortgage at such account or accounts at such financial institution or institutions as the Holder hereof shall have designated to the Security Agent in writing, in immediately available funds, such payment to be made, in the case of any such designated account in New York, New York, prior to 3:00 p.m., New York time, on the due date thereof. In the event the Security Agent shall fail to make any such payment as provided in the immediately foregoing sentence after its receipt of funds at the place and prior to the time specified above, the Security Agent agrees to compensate the Holder hereof for loss of use of funds in a commercially reasonable manner. All such payments by the Borrower and the Security Agent shall be made free and clear of and without reduction for or on account of all wire or other like charges.

Each Holder hereof, by its acceptance of this Loan Certificate, agrees that, except as otherwise expressly provided in the Mortgage, each payment received by it in respect hereof shall be applied, first, to the payment of any amount (other than the principal of or interest on this Loan Certificate) due in respect of this Loan Certificate, second, to the payment of interest hereon (as well as any interest on overdue principal and, to the extent permitted by law, interest and other amounts payable hereunder) due and payable hereunder, third, to the payment of the principal of this Loan Certificate then due, fourth, the balance, if any, remaining thereafter, to the payment of the principal of this Loan Certificate remaining unpaid, and fifth, in the manner set forth in clause "fifth" of Section 5.4(e) of the Credit Agreement.

This Loan Certificate is one of the Loan Certificates referred to in the Mortgage which have been or are to be issued by the Borrower pursuant to the terms of the Mortgage. The Mortgage Estate is held by the Security Agent as security, in part, for the Loan Certificates. Reference is hereby made to the Mortgage and the Credit Agreement referred to therein for a statement of the rights and obligations of the Holder hereof, and the nature and extent of the security for this Loan Certificate and of the rights and obligations of the other Holders, and the nature and extent of the security for the other Loan Certificates, as well as for a statement of the terms and conditions of the trusts created by the Mortgage, to all of which terms and conditions in the Mortgage and such Credit Agreement each Holder hereof agrees by its acceptance of this Loan Certificate.

There shall be maintained a Certificate Register for the purpose of registering transfers and exchanges of Loan Certificates at the office of the Security Agent set forth in the Credit Agreement or at the office of any successor security agent in the manner provided in Section 5.8 of the Credit Agreement. As provided in the Credit Agreement and the Mortgage and subject to certain limitations set forth therein, this Loan Certificate or any interest herein may, subject to the next following paragraph, be assigned or transferred, and the Loan Certificates are exchangeable for a like aggregate original principal amount of Loan Certificates of a like Series of any authorized denomination, as requested by the Holder surrendering the same.

Prior to the due presentment for registration of transfer of this Loan Certificate, the Borrower and the Security Agent shall deem and treat the person in whose name this Loan Certificate is registered on the Certificate Register as the absolute owner of this Loan Certificate and the Holder for the purpose of receiving payment of all amounts payable with respect to this Loan Certificate and for all other purposes whether or not this Loan Certificate is overdue, and neither the Borrower nor the Security Agent shall be affected by notice to the contrary.

This Loan Certificate is subject to prepayment as permitted by Sections 5.10 and 5.11 of the Credit Agreement and to acceleration by the Security Agent as provided in Section 3.1 of the Mortgage, and the Holder hereof, by its acceptance of this Loan Certificate, agrees to be bound by said provisions.

This Loan Certificate is subject to purchase by the Manufacturer following an Event of Default pursuant to the Consent and Agreement.

This Loan Certificate shall be governed by and construed in accordance with the law of the State of New York.

**IN WITNESS WHEREOF**, the Borrower has caused this Loan Certificate to be executed in its corporate name by its officer thereunto duly authorized, as of the date hereof.

**ALASKA AIRLINES, INC.**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

5.2 Terms of Loan Certificates; Drawings. (a) On the Effective Date, the Borrower shall issue a Loan Certificate to each Loan Participant in an aggregate original principal amount equal to such Loan Participant's Maximum Commitment (or their respective nominees). The Borrower shall be entitled to make Drawings against each Loan Certificate in accordance with Sections 2.1 and 4.

(b) Each Loan Certificate shall bear interest on the unpaid principal amount thereof from time to time outstanding from and including the date thereof until such principal amount is paid in full. Such interest shall accrue with respect to each Interest Period at the Applicable Rate in effect for such Interest Period and shall be payable in arrears on each Interest Payment Date and on the date such Loan Certificate is paid in full. The Interest Periods for the Series of Drawings can vary in accordance with the definition of Interest Period. Interest shall be payable with respect to the first but not the last day of each Interest Period. Interest hereunder and under the Loan Certificates shall be calculated on the basis of a year of 360 days and actual number of days elapsed.

(c) If any sum payable under the Loan Certificates or under the Mortgage falls due on a day which is not a Business Day, then such sum shall be payable on the next succeeding Business Day; provided that, in the case of principal of and interest hereon payable on an Interest Payment Date, if by virtue of such extension such payment would fall in the next succeeding month, such sum shall be payable on the next preceding Business Day.

(d) The principal of the Drawings of each Series shall be due and payable in full upon the earlier of (i) the first Business Day of the month (being an Interest Payment Date) in which the Delivery Date of the Aircraft related to such Series shall occur, as notified by the Borrower to the Security Agent five (5) Business Days prior to such day; and (ii) the Final Repayment Date.

(e) Each Loan Certificate shall bear interest at the Past Due Rate on any principal thereof and, to the extent permitted by applicable law, interest (other than interest accrued at the Past Due Rate) and other amounts due thereunder and hereunder, not paid when due (whether at stated maturity, by acceleration or otherwise), for any period during which the same shall be overdue, payable on demand by the respective Holder given through the Security Agent.

(f) The Loan Certificates shall be executed on behalf of the Borrower by one of its authorized officers. Loan Certificates bearing the signatures of individuals who were at any time the proper officers of the Borrower shall bind the Borrower, notwithstanding that such individuals or any of them have ceased to hold such offices prior to the delivery of such Loan Certificates or did not hold such offices at the respective dates of such Loan Certificates. No Loan Certificates shall be issued hereunder except those provided for in Section 5.2(a) and any Loan Certificates issued in exchange or replacement therefor pursuant to the terms of this Agreement.

5.3 Tax Forms. (a) The Security Agent agrees, to the extent required by applicable law, to withhold from each payment due hereunder or under any Loan Certificate United States



federal withholding taxes at the appropriate rate, and, on a timely basis, to deposit such amounts with an authorized depository and make such reports, filings and other reports in connection therewith, and in the manner, required under applicable law.

(b) The Security Agent shall furnish no later than March 15 of each year to each Holder a U.S. Treasury Form 1042-S (or similar forms as at any relevant time in effect), if applicable, indicating payment in full of any Taxes withheld from any payments by the Security Agent to such Holder together with all such other information and documents reasonably requested by such Holder and necessary or appropriate to enable such Person to substantiate a claim for credit or deduction with respect thereto for income tax purposes of any jurisdiction with respect to which such Person is required to file a tax return.

(c) The Security Agent need only perform its obligations under Sections 5.3(a) and (b) for a Holder which is a Non-U.S. Person, if such Holder has furnished to the Security Agent (and the Security Agent has furnished to the Borrower a copy of) either:

(i) a properly completed and currently effective U.S. Treasury Form W-8BEN (or such substitute or successor form as may be required by the United States Treasury Department) during the calendar year in which the payment is made (or at such other times as applicable law may require), and has not notified the Security Agent of the withdrawal of such Form prior to the date of each interest payment; or

(ii) a properly completed and currently effective U.S. Treasury Form W-8 ECI or other certificate or form establishing exemption from withholding of United States federal income tax during each calendar year in which the payment is made (or at such other times as applicable law may require), and has not notified the Security Agent of the withdrawal of such Form or certificate prior to the date of each interest payment, then no amount shall be withheld from payments under the Loan Certificates held by such Holder in respect of United States federal income tax.

(d) Each Holder shall indemnify and hold harmless the Security Agent and the Borrower against any claim for United States federal withholding taxes which the Security Agent improperly fails to withhold on payments to such Holder, except that, [\*\*\*] with respect to such payment and withholding, the indemnification required by this Section shall apply only if such failure to withhold is a direct result of the failure by such Holder to provide the required certificate or Form or the invalidity of any certificate or Form provided by such Holder pursuant to this Section 5.3 (it being understood that the provision of such certificate or form shall constitute a representation by the relevant Holder as to such Holder's qualification for complete exemption from United States federal gross income tax withholding or, in the event of a change in law or regulation for which the Borrower is obligated to hold harmless the Holder pursuant to Section 8, for partial exemption from such withholding).

5.4 Distribution of Funds Received. (a) The Security Agent shall establish and maintain an account (the "**Payment Account**"), into which all amounts payable hereunder shall be paid.

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

(b) Provided that no Event of Default has occurred and is then continuing, each installment of interest payable on the Loan Certificates shall be distributed as promptly as possible on or after the date that such amount is deposited in the Payment Account and becomes immediately available to the Security Agent:

First, to the Loan Participants ratably, without priority of one over the other, to the payment in full of the aggregate amount of interest due under the Loan Certificates in an amount equal to (i) accrued interest at the rate provided in each Loan Certificate, (ii) any overdue interest thereon, and (iii) Break Amount, if any;

Second, the balance, if any, thereof thereafter remaining to the Borrower or such other Person(s) as may then lawfully be entitled thereto.

(c) Provided that no Event of Default has occurred and is then continuing, upon the first Business Day of the month in which the Delivery Date of the related Aircraft occurs, each payment made by the Borrower as repayment of the relevant Series of Drawings shall be distributed as promptly as possible on or after the date that such amount is deposited in the Payment Account and becomes immediately available to the Security Agent:

First, to the Loan Participants ratably, without priority of one over the other, to the payment in full of the aggregate amount of interest due under the Loan Certificates in respect of the Series of Drawings being repaid in an amount equal to (i) accrued interest at the rate provided in each Loan Certificate, and (ii) any overdue interest thereon plus the Break Amount, if any, due to the Loan Participants in respect of such payment;

Second, to the Loan Participants ratably, without priority of one over the other, to the payment in full of the outstanding principal amount of the Series of Drawings made by the Loan Participants which is being repaid;

Third, the balance, if any, thereof thereafter remaining to the Borrower or such other Person(s) as may then lawfully be entitled thereto.

(d) Upon any partial optional repayment of the Loan Certificates pursuant to Section 5.11(a) hereof, the amount paid by Borrower shall be applied against the amounts which Borrower is obligated to pay in connection with such prepayment pursuant to Section 5.11(a) (it being understood that no prepayment shall be permitted under Section 5.11(a) unless the Borrower pays a sufficient amount to satisfy the amounts owed by it under Section 5.11(a) in connection with such prepayment).

(e) After an Event of Default shall have occurred, and so long as such Event of Default shall be continuing, all amounts deposited in the Payment Account and all proceeds resulting from a sale of any of the Mortgage Estate shall be applied in the following order of priority:

First, to the extent not theretofore paid by or on behalf of the Borrower, to pay all costs and expenses of the Security Agent incurred in connection with the performance of its duties hereunder or under any other Operative Document, including reasonable attorneys' fees and expenses and all costs and expenses incurred by the Security Agent in connection with its

entering upon, taking possession of, holding, operating, managing, selling or otherwise disposing of the Mortgage Estate or any part thereof, any and all Taxes, assessments or other charges of any kind prior to the Lien of any Operative Document that the Security Agent determined in good faith to pay or be paid, and all amounts payable to the Security Agent hereunder or under any of the Operative Documents in respect of any indemnities or other obligations of the Borrower;

Second, to the Loan Participants ratably, without priority of one over the other, to the payment of all accrued and unpaid interest (including Break Amount, if any, and interest on account of overdue payments of principal and interest) then due the Loan Participants under this Agreement or any of Loan Certificates;

Third, to the Loan Participants ratably, without priority of one over the other, to the payment of any other amount, indebtedness or obligations (other than principal) due and payable to the Loan Participants under any Operative Documents;

Fourth, to the Loan Participants ratably, without priority of one over the other, to the payment in full of the principal amount of the Loan Certificates;

Fifth, the balance, if any, thereof thereafter remaining, to the Borrower or such other Person(s) as may then lawfully be entitled thereto.

If the Security Agent purchases and subsequently sells the Aircraft to a third party, any net sale proceeds (after deduction of all relevant costs, including maintenance, storage and insurance) which exceed the debt advances for such Aircraft shall be deposited in the Payment Account and distributed under this Section 5.4.

5.5 Method of Payment. Principal and interest and other amounts due hereunder or under the Loan Certificates or in respect hereof or thereof shall be payable in Dollars in immediately available funds prior to 1:00 p.m., New York, New York time, on the due date thereof, to the Security Agent at the Payment Office and the Security Agent shall, subject to the terms and conditions of Section 5.4, remit all such amounts so received by it to the Holders at such account or accounts at such financial institution or institutions as the Holders shall have designated to the Security Agent in writing, in immediately available funds for distribution to the relevant Holders, such payment to be made, in the case of any such designated account in New York, New York, prior to 3:00 p.m., New York time, on the due date thereof.

In the event the Security Agent shall fail to make any such payment as provided in the immediately foregoing sentence after its receipt of funds at the place and prior to the time specified above, the Security Agent agrees to compensate the Holders for loss of use of funds in a commercially reasonable manner.

All such payments by the Borrower and the Security Agent shall be made free and clear of and without reduction on account of all wire and other like charges. Prior to the due presentment for registration of transfer of any Loan Certificate, the Borrower and the Security Agent may deem and treat the Person in whose name any Loan Certificate is registered on the Certificate Register as the absolute owner of such Loan Certificate for the purpose of receiving payment of all amounts payable with respect to such Loan Certificate and for all other purposes

whether or not such Loan Certificate shall be overdue, and neither the Borrower nor the Security Agent shall be affected by any notice to the contrary.

If the Security Agent disburses funds on a payment date without first having received funds from the Borrower and if the Borrower subsequently fails to make such payment before the end of the day, then on the next Business Day on demand from the Security Agent, each Loan Participant which has received such funds will refund to the Security Agent the amount advanced by the Security Agent which such Loan Participant received.

**5.6 Termination of Interest in Mortgage Estate.** None of the Security Agent, any Loan Participant and any Holder shall, as such, have any further interest in, or other right with respect to, the Mortgage Estate with respect to any Aircraft when and if the principal amount of, Break Amount on, if any, interest on and other amounts due under all Drawings of the related Series held by such Holder and all other sums due to such Holder hereunder and under the other Operative Documents in respect of such Aircraft shall have been paid in full; provided, however, that the interests and rights of the Loan Participants in and with respect to the mortgage and security interests created by the Mortgage shall continue (except with respect to any Aircraft as to which the related Series of Drawings has been repaid) after all such amounts have been paid in full so long as the Commitments have not terminated. Upon payment in full of any Series of Drawings, the Security Agent shall release that portion of the Mortgage Estate which relates solely to the applicable Aircraft from the Lien of the Mortgage.

**5.7 Registration, Transfer and Exchange of Loan Certificates.** The Security Agent agrees with the Borrower that the Security Agent shall keep a register (herein sometimes referred to as the “**Certificate Register**”) in which provision shall be made for the registration of Loan Certificates of each Series and the registration of transfers of Loan Certificates of such Series.

Prior to the due presentment for registration of the transfer of any Loan Certificate, the Borrower and the Security Agent shall deem and treat the person in whose name such Loan Certificate is registered on the Certificate Register as the absolute owner of such Loan Certificate, and the Holder for the purpose of receiving payment of all amounts payable with respect to such Loan Certificate, and for all other purposes whether or not such Loan Certificate is overdue, and neither the Borrower nor the Security Agent shall be affected by notice to the contrary.

The Certificate Register shall be kept at the office of the Security Agent set forth in this Agreement or at the office of any successor Security Agent, and the Security Agent is hereby appointed “Certificate Registrar” for the purpose of registering Loan Certificates and transfers of Loan Certificates as herein provided.

Upon surrender for registration of transfer of any Loan Certificate at the office of the Security Agent set forth in this Agreement and upon delivery by the Security Agent to the Borrower of such surrendered Loan Certificate, the Borrower shall execute, and the Security Agent shall deliver, in the name of the designated transferee or transferees, one or more new Loan Certificates of a like aggregate principal amount.

At the option of the Holder, its Loan Certificates may be exchanged for other Loan Certificates of any authorized denominations, of a like aggregate principal amount, upon surrender of the Loan Certificates to be exchanged at the office of the Security Agent specified in the Credit Agreement. Each new Loan Certificate issued upon transfer or exchange shall be in a principal amount of at least [\*\*\*]\* (except as may be necessary to evidence the entire outstanding principal amount of a Loan Certificate) and dated the Effective Date. Whenever any Loan Certificates are so surrendered for exchange, the Borrower shall execute and deliver the Loan Certificates which the Holder making the exchange is entitled to receive.

Each Holder may also assign to any assignee an interest in any Loan Certificate held by it and the Security Agent shall, upon receipt of a written request of such assignee, accompanied by such proof of such assignment as the Security Agent may reasonably require, register in the name of such assignee such interest in such Loan Certificate and thereafter such assignee shall be a Holder for all purposes of the Operative Documents (subject to any limitations in the instrument of assignment).

All Loan Certificates issued upon any registration of transfer or exchange of Loan Certificates shall be the valid obligations of the Borrower evidencing the same obligations, and entitled to the same security and benefits under the Mortgage and this Agreement, as the Loan Certificates surrendered upon such registration of transfer or exchange.

Every Loan Certificate presented or surrendered for registration of transfer or exchange, shall (if so required by the Security Agent) be duly endorsed, or be accompanied by a written instrument of transfer in form satisfactory to the Security Agent duly executed by the Holder thereof or his attorney duly authorized in writing, and the Security Agent may require evidence satisfactory to it as to the compliance of any such transfer with the Securities Act and the securities laws of any applicable state.

The Security Agent shall make a notation on each new Loan Certificate or Loan Certificates of the then available Commitment on the old Loan Certificate or Loan Certificates with respect to which such new Loan Certificate is issued, the current outstanding principal and the date to which interest accrued on such old Loan Certificate or Loan Certificates has been paid and the extent, if any, to which any interest therein has been subject to a registered assignment.

The Security Agent shall not be required to register the transfer of or exchange any surrendered Loan Certificates as above provided during the five calendar day period preceding the due date of any payment on such Loan Certificates.

Any Holder may transfer any or all of its Loan Certificates to any Person. The Borrower and the Security Agent shall treat the Person in whose name each Loan Certificate is

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

registered on the Certificate Register as the Holder with respect thereto for all purposes hereof until due presentment for registration of transfer as provided in this Section 5.7.

The Security Agent shall give the Borrower and each Holder notice of such transfer of a Loan Certificate under this Section 5.7.

**5.8 Mutilated, Destroyed, Lost or Stolen Loan Certificates.** If any Loan Certificate shall become mutilated, destroyed, lost or stolen, the Borrower shall, upon the written request of the affected Holder, execute and deliver in replacement thereof, a new Loan Certificate, in the same principal amount, dated the date of such Loan Certificate and designated as issued under the Mortgage.

If the Loan Certificate being replaced has become mutilated, such Loan Certificate shall be surrendered to the Security Agent and the original thereof shall be furnished to the Borrower by the Security Agent.

If the Loan Certificate being replaced has been destroyed, lost or stolen, the affected Holder shall furnish to the Borrower and the Security Agent such security or indemnity as may be reasonably required by them to hold the Borrower and the Security Agent harmless and evidence satisfactory to the Borrower and the Security Agent of the destruction, loss or theft of such Loan Certificate and of the ownership thereof, provided, however, that if the affected Holder is an original party to this Agreement or an Affiliate thereof, the written notice of such destruction, loss or theft and such ownership and the written undertaking of such Holder delivered to the Borrower and the Security Agent to hold harmless the Borrower and the Security Agent in respect of the execution and delivery of such new Loan Certificate shall be sufficient evidence, security and indemnity.

**5.9 Payment of Expenses on Transfer.** Upon the issuance of a new Loan Certificate or new Loan Certificates pursuant to Section 5.7 or 5.8, the Borrower and/or the Security Agent may require from the party requesting such new Loan Certificate or Loan Certificates payment of a sum sufficient to reimburse the Borrower and/or the Security Agent for, or to provide funds for, the payment of any tax or other governmental charge in connection therewith or any charges and expenses connected with such tax or other governmental charge paid or payable by the Borrower or the Security Agent, and any out of pocket expenses, including legal fees (for external counsel) incurred, of the Borrower or the Security Agent.

**5.10 Prepayment.** (a) On at least five Business Days prior written notice, the Borrower may prepay on the date specified in such notice of prepayment, in whole or in part, the Loan Certificates then outstanding at the principal amount thereof (or portion thereof to be repaid), and provided that any partial prepayment shall be in an aggregate original principal amount of at least \$5,000,000 and in \$500,000 multiples thereof, and the amount thereof shall be specified in such written notice. The Security Agent will give prompt notice of the Borrower's intent to prepay to the Holders.

(b) Upon the occurrence of a cancellation of the Boeing Purchase Agreement with respect to any Aircraft for any reason whatsoever, the aggregate outstanding principal amount of all Drawings relating to such Aircraft shall become due and payable in 10 days, and

the Borrower shall prepay the Loan Certificates to the extent of such Drawings, together with accrued interest thereon to the date of prepayment plus any Break Amount and all other amounts due thereunder and hereunder and under the other Operative Documents with respect to such Aircraft to the Holders. The Security Agent will give notice of prepayment to the Holders under this Section 5.10(b) promptly.

(c) In the event that a Loan Participant is entitled to a payment under Section 5.13 or Section 8.2 (an “**Affected Loan Participant**”), the Borrower, the Security Agent and the Affected Loan Participant shall cooperate for a period of sixty (60) days to:

(i) first, restructure the Loan for the Affected Loan Participant so as to eliminate the need for any such payment (it being agreed that the Affected Loan Participant shall have no obligation to proceed with such restructuring to the extent such restructuring would:

- (1) result in an adverse regulatory consequence for the Affected Loan Participant; or
- (2) involve any unreimbursed or unindemnified cost for the Affected Loan Participant; or
- (3) be inconsistent with the Affected Loan Participant’s internal policies); or

(ii) if no restructuring can be arranged, attempt, with the Borrower acting as marketing agent, to find an entity reasonably satisfactory to the Security Agent to purchase the Affected Loan Participant’s Loan Certificate and assume the Affected Loan Participant’s Commitment.

The Affected Loan Participant shall be paid (by the purchasing entity or the Borrower) the outstanding principal balance of its Loan Certificate, all accrued and unpaid interest thereon, any Break Amount incurred (calculated as if such purchase were a prepayment of such Affected Loan Participant’s Loan Certificate) and all other amounts owed to the Affected Loan Participant hereunder, thereunder or under any other Operative Document as a condition precedent to such purchase.

In the event the Borrower is unable to find a purchaser of the Affected Loan Participant’s Loan Certificate, then, so long as no Default or Event of Default shall have occurred and be continuing on at least five (5) Business Days’ prior written notice, the Borrower may prepay on the date specified in its notice of prepayment, in whole the Affected Loan Participant’s Loan Certificate at the principal amount thereof together with accrued and unpaid interest thereon to the date of prepayment plus the Break Amount, if any, and all other amounts due to the Affected Loan Participant hereunder, thereunder and under the other Operative Documents.

(d) In the event that the Manufacturer refunds any amounts under the Boeing Purchase Agreement relating to payments made thereunder for which proceeds of any Drawing were used to pay (or to reimburse the Borrower) or otherwise relating to any Aircraft, a principal

amount of the Drawings (and any Break Amount related thereto) relating to such Aircraft equal to such refund shall become immediately due and payable.

(e) Any notice of prepayment delivered pursuant to Sections 5.10(a), (b) or (c) shall be irrevocable and shall identify the amount to be prepaid and the Series of Drawings (if applicable) subject to prepayment.

5.11 Provisions Relating to Prepayment. (a) Notice of prepayment having been given, the principal amount of the Loan Certificates so to be prepaid, plus accrued interest thereon to the date of prepayment, together with the Break Amount, if any, shall become due and payable on the prepayment date.

(b) On the date fixed for prepayment under Section 5.10, immediately available funds in Dollars shall be deposited by the Borrower in the account of the Security Agent at the place and by the time and otherwise in the manner provided in Section 5.5, in an amount equal to the principal amount of Loan Certificates to be prepaid together with accrued and unpaid interest thereon to the date fixed for such prepayment, all Break Amounts, if any, and all other amounts due to the Holders of the Loan Certificates hereunder, thereunder and under the other Operative Documents.

(c) Each Holder of a Loan Certificate shall furnish to the Borrower, with a copy to the Security Agent, a certificate setting forth in reasonable detail the calculation of the Break Amount due to such Holder, which certificate shall be presumptively correct, absent manifest error.

5.12 Increased Costs. (a) The Borrower shall pay directly to each Holder from time to time such amounts as such Holder may determine to be necessary to compensate such Holder for any increase in actual costs that such Holder determines are attributable to its making or maintaining of its Commitment or the loans evidenced by its Loan Certificates or funding arrangements utilized in connection with such loans, or any reduction in any amount receivable by such Holder hereunder in respect of any of Commitments, such loans or such arrangements (such increases in costs and reductions in amounts receivable being herein called "**Additional Costs**"), resulting from any Regulatory Change that:

(i) imposes any tax that is the functional equivalent of any reserve, special deposit or similar requirement of the sort covered by Section 5.12(a)(ii); or

(ii) imposes or modifies any reserve, special deposit or similar requirements (including any Reserve Requirement) relating to any extensions of credit or other assets of, or any deposits with or other liabilities of, such Holder (including, without limitation, any of such loans or any deposits referred to in the definition of "LIBO Rate" in Annex A), or any such obligations; or

(iii) imposes any other condition affecting this Agreement or the Loan Certificates (or any of such extensions of credit or liabilities) or any such obligation.

(b) Without limiting the effect of the foregoing provisions of this Section 5.12 (but without duplication), the Borrower shall pay directly to each Holder of a Loan Certificate



from time to time on request such amounts as such Holder may determine to be necessary to compensate such Holder (or, without duplication, the holding company of which such Holder is a subsidiary) for any increase in actual costs that it determines are attributable to the maintenance by such Holder (or any lending office or such holding company), pursuant to any law or regulation or any interpretation, directive or request (whether or not having the force of law and whether or not failure to comply therewith would be unlawful so long as compliance therewith is standard banking practice in the relevant jurisdiction) of any court or governmental or monetary authority following:

(i) any Regulatory Change; or

(ii) implementing any risk-based capital guideline or other similar requirement hereafter issued by any government or governmental or supervisory authority, of capital in respect of its Commitments or Loan Certificates or funding arrangements utilized in connection with the Loan Certificates; such compensation to include, without limitation, an amount equal to any reduction of the rate of return on assets or equity of such Holder (or any lending office or such bank holding company) could have achieved but for such law, regulation, interpretation, directive or request.

(c) Each Holder shall notify the Borrower of any event occurring after the date of this Agreement entitling such Holder to compensation under Sections 5.12(a) or (b) as promptly as practicable, but in any event within 30 days, after such Holder obtains actual knowledge thereof, provided that:

(i) such Holder shall, with respect to compensation payable pursuant to this Section 5.12 in respect of any Additional Costs resulting from such event, only be entitled to payment under this Section 5.12 for Additional Costs incurred from and after the date such Holder does give such notice; and

(ii) each Holder will use commercially reasonable efforts (at the Borrower's expense) to mitigate the amount of the Additional Costs associated with such event, including designating a different lending office for the Loan Certificates of such Holder affected by such event if such designation will avoid the need for, or reduce the amount of, such compensation and will not, in the sole opinion of such Holder, result in any economic, legal or regulatory disadvantage to such Holder (other than economic disadvantages for which the Borrower agrees to indemnify such Holder and which indemnity is acceptable to such Holder in its discretion acting reasonably based on its credit assessment of the Borrower).

(d) Each Holder will furnish to the Borrower an officer's certificate setting forth in reasonable detail:

(i) the events giving rise to such Additional Costs;

(ii) the basis for determining and allocating such Additional Costs; and

(iii) the amount of each request by such Holder for compensation under Sections 5.12(a) or (b) (subject, however, to any limitations such Holder may require in

respect of disclosure of confidential information relating to its capital structure), together with a statement that the determinations and allocations made in respect of the Additional Costs comply with the provisions of this Section 5.12 including as provided in the last proviso of this Section 5.12(c).

Determinations and allocations by any Holder for purposes of this Section 5.12 of the effect of any Regulatory Change pursuant to Section 5.12(a), or of the effect of capital maintained pursuant to Section 5.12(b), on its costs or rate of return of maintaining its Commitment or Loan Certificate or its funding, or on amounts receivable by it in respect of Loan Certificates, and of the amounts required to compensate such Holder under this Section 5.12, shall be conclusive absent manifest error, provided that such determinations and allocations are made on a reasonable basis and, in the case of allocations, are made fairly.

(e) The Borrower shall not be required to make payments under this Section to any Holder if (i) a claim hereunder arises through circumstances peculiar to such Holder and which do not affect commercial lenders in the same jurisdiction generally; (ii) such Holder is required by Section 5.12(f) to sell its Loan Certificates to a designated purchaser (which may be the Borrower) but fails to do so (other than as a result of such designated Person failing to purchase such Loan Certificates; (iii) such Holder is not also seeking indemnification against similar increased costs, to the extent it is entitled to do so, in transactions with substantial borrowers (it being agreed that an officer's certificate to the contrary from any such Holder shall constitute conclusive evidence of such fact); or (iv) the claim arises out of a voluntary relocation by such Holder of its lending office (it being understood that any such relocation effected pursuant to Section 5.12(c)(ii) is not "voluntary").

(f) If any Holder gives notice of a claim against the Borrower under Section 5.12(c), the Borrower shall have the right by notice to such Holder to request such Holder to sell, without representation or warranty (except for its own acts), its Loan Certificates on a Business Day not fewer than ten days after the giving of such notice (the "**Purchase Date**") to a Person (which may be the Borrower) designated by the Borrower (the "**Purchaser**") at a purchase price equal to either (A) the sum of (i) the aggregate outstanding principal amount of the Loan Certificates held by such Holder, plus (ii) accrued interest to the Purchase Date, plus (iii) any Break Amount as if such Loan Certificates were being prepaid pursuant to Section 5.10 plus (iv) all other amounts owing to such Holder under the Operative Documents, or (B) a lesser amount than the preceding clause (A), so long as the Borrower pays an additional amount sufficient to cover the amount of such shortfall (as compared to such clause (A)).

5.13 Illegality. Notwithstanding any other provision of this Agreement or the Mortgage, if any Holder (an "**Illegal Holder**") shall notify the Security Agent that the introduction after the date of this Agreement of or any change after the date of this Agreement or any other Operative Document in or in the interpretation of any law or regulation makes it unlawful, or any central bank or other governmental authority asserts that it is unlawful, for such Holder to make, fund or allow to remain outstanding its Loan Certificate, then such Holder shall, promptly after becoming aware of the same, deliver to the Borrower through the Security Agent a certificate to that effect, and, if the Security Agent on behalf of such Holder so requires, the Borrower shall attempt to cure such illegality or otherwise, within 10 days of such notification, the Borrower shall prepay the aggregate outstanding principal amount of the Loan Certificate

held by such Illegal Holder in full, together with accrued interest thereon to the date of prepayment plus all Break Amount, if any, and all other amounts due thereunder and hereunder and under the other Operative Documents to such Illegal Holder.

**Section 6. Extent of Interest of Holders.** No Holder shall have any further interest in, or other right with respect to, the mortgage and security interests created by the Mortgage when and if the principal and interest on the Loan Certificate held by such Holder and all other sums payable to such Holder hereunder, under the Mortgage and under such Loan Certificate shall have been paid in full, provided, however, that the interests and rights of the Loan Participants in and with respect to the mortgage and security interests created by the Mortgage shall continue after all such amounts have been paid in full so long as the Commitments have not terminated.

**Section 7. Borrower's Representations and Warranties.** The Borrower represents and warrants that on the date hereof and on each Borrowing Date:

(a) the Borrower is a corporation duly organized and validly existing in good standing pursuant to the laws of the State of Alaska; is duly qualified to do business as a foreign corporation in each jurisdiction in which its operations or the nature of its business requires, except where the failure to be so qualified would not have a Material Adverse Effect; is a U.S. Air Carrier; has its "location" (as such term is defined in Article 9 of the Uniform Commercial Code) in the State of Alaska; and has the corporate power and authority to engage in air transport and to carry on scheduled passenger service as presently conducted, to purchase the Aircraft under the Boeing Purchase Agreement and to enter into and perform its obligations under the Operative Documents;

(b) the execution, delivery and performance by the Borrower of the Operative Documents to which it is a party have been duly authorized by all necessary corporate action on the part of the Borrower, do not require any stockholder approval, or approval or consent of any trustee or holders of any indebtedness or obligations of the Borrower except such as have been duly obtained and are in full force and effect, and none of the execution, delivery or performance by Borrower of such Operative Documents contravenes any law, judgment, government rule, regulation or order binding on the Borrower or the Articles of Incorporation or By-laws of the Borrower or contravenes the provisions of, or constitutes a default under, or results in the creation of any Lien (other than Permitted Liens) upon the property of the Borrower under, any indenture, mortgage, contract or other agreement to which the Borrower is a party or by which it or its properties may be bound or affected;

(c) neither the execution and delivery by the Borrower of the Operative Documents nor the performance by the Borrower of its obligations thereunder requires the consent or approval of, the giving of notice to, or the registration with, or the taking of any other action in respect of any Federal, state or foreign government authority or agency, except for (A) the orders, permits, waivers, exemptions, authorizations and approvals of the regulatory authorities having jurisdiction over the operation of the Aircraft by the Borrower, which orders, permits, waivers, exemptions, authorizations and approvals, if any, concurrently required to be obtained and in full force and effect have been duly obtained and are in full force and effect except for those orders, permits, waivers, exemptions, authorizations and approvals the failure to obtain which would not have a Material Adverse Effect, and (B) any filings, registrations or

applications specifically described in this Agreement (the items referred to in (A) and (B) collectively referred to as “**Permits**”);

(d) the Operative Documents to which the Borrower is a party each constitute legal, valid and binding obligations of the Borrower enforceable against the Borrower in accordance with the terms thereof except as such enforceability may be limited by equitable principles or applicable bankruptcy, insolvency, reorganization, moratorium or other similar laws affecting creditors’ rights generally;

(e) there is no pending or (to the best of Borrower’s knowledge) threatened action or proceeding before any court, arbitrator or administrative agency that individually (or in the aggregate in the case of any group of related lawsuits) is expected by the Borrower to have a Material Adverse Effect;

(f) except for the filing of financing statements (and continuation statements at periodic intervals) with respect to the interests created by such documents under the Uniform Commercial Code of Alaska and such other states as may be specified in the opinion furnished pursuant to Section 4.1(i) hereof, no further action, including any filing or recording of any document (including any financing statement in respect thereof under Article 9 of the Uniform Commercial Code of any applicable jurisdiction), is necessary or advisable in order to establish and perfect the first mortgage Lien on the Boeing Purchase Agreement (and, from the date of any Engine Warranty Substitution, the CFM Purchase Agreement) and the rest of the Mortgage Estate in favor of the Security Agent pursuant to the Mortgage in any applicable jurisdiction in the United States;

(g) there has not occurred any event which constitutes a Default or an Event of Default under the Mortgage which is presently continuing;

(h) the statements of financial position of the Borrower as of December 31 of the year prior to the Borrowing Date, and the related statements of earnings and cash flow of the Borrower in all material respects for the year and fiscal quarter, as the case may be, then ended, copies of which have been furnished to each Loan Participant, fairly present the financial condition of the Borrower at such date and the results of operations and cash flow of the Borrower for the period ended on such dates, in accordance with generally accepted accounting principles consistently applied, and subject, to normal year-end adjustments, and since December 31 of the year prior to the Borrowing Date, there has been no material and adverse change in such condition or operations;

(i) the Boeing Purchase Agreement (and, from the date of any Engine Warranty Substitution, the CFM Purchase Agreement) is in full force and effect and neither the Borrower nor, to the knowledge of the Borrower, the Manufacturer (or, from the date of any Engine Warranty Substitution, the Engine Manufacturer) is in default of any of its material obligations thereunder. Except as contemplated by the Mortgage and Liens granted to third-party financiers and released and terminated prior to the Effective Date, the Borrower has neither assigned nor granted any Lien in its rights under either Purchase Agreement in respect of any of the Aircraft or the Engines;

(j) assuming the Loan Participants are acquiring their Loan Certificates in the ordinary course of their normal business operations for their own accounts, the issuance of the Loan Certificates to the initial Loan Participants will not require registration of the Loan Certificates pursuant to the Securities Act;

(k) the Borrower has filed or caused to be filed all Federal, state, local and (in the Borrower's opinion) foreign tax returns which are required to be filed and has paid or caused to be paid or provided adequate reserves for the payment of all taxes shown to be due and payable on such returns or (except to the extent being contested in good faith and by appropriate proceedings and for the payment of which adequate reserves have been provided in accordance with generally accepted accounting principles) on any assessment received by the Borrower, to the extent that such taxes have become due and payable, except such returns or taxes as to which the failure to file or pay, as the case may be, could not be reasonably expected to materially and adversely affect the assets, operations or financial condition, of the Borrower;

(l) the Borrower is not:

(i) to the best of its knowledge, in default under any indenture, mortgage, lease or credit agreement or under any other agreement or instrument of a material nature to which the Borrower is now a party or by which it is bound, and no event has occurred and is continuing which, under the provisions of any such indenture, mortgage, credit agreement or other material agreement or instrument, with the lapse of time or the giving of notice, or both, would constitute a default thereunder (it being understood that maintenance issues concerning leased or mortgaged aircraft that create technical defaults in relation to which no action has been taken by the relevant lessor or mortgagor are not, for the purposes of this representation, "defaults"); or

(ii) in violation of any law, order, injunction, decree, rule or regulation applicable to the Borrower of any court or administrative body, which default or violation would reasonably be expected to materially and adversely affect the operations or financial condition of the Borrower or the Borrower's ability to execute, deliver and perform its obligations under the Operative Documents;

(m) (i) no material liability to the Pension Benefit Guaranty Corporation (other than liability for premiums) which would reasonably be expected to have a Material Adverse Effect has been incurred by the Borrower with respect to any Plan;

(ii) there has been no event or condition which presents a material risk of termination of any Plan by the Pension Benefit Guaranty Corporation which would reasonably be expected to have a Material Adverse Effect;

(iii) no accumulated funding deficiency (as defined in Section 302 of ERISA and Section 412 of the Code), whether or not waived, exists with respect to any Plan which would reasonably be expected to have a Material Adverse Effect; and

(iv) no amount of "withdrawal liability," as that term is used in Section 4201 of ERISA, which would reasonably be expected to have a Material Adverse Effect has been or is expected to be incurred by the Borrower nor has the Borrower or

any affiliate of the Borrower been notified by any multi-employer plan (within the meaning of Section 3(37)(A) of ERISA) that such multi-employer plan is in reorganization or insolvency within the meaning of Section 4241 or Section 4245 of ERISA or that such multi-employer plan intends to terminate or has been terminated under Section 4041A of ERISA where such reorganization, insolvency or termination which would reasonably be expected to have a Material Adverse Effect (for purposes of this subclause (m), the term "affiliate" shall mean any corporation or person which is a member of the same controlled group of corporations (within the meaning of Section 414(b) of the Code) as the Borrower or is under common control (within the meaning of Section 414(c) of the Code) with the Borrower);

(n) the Borrower is not an "investment company" as defined in, or subject to regulation under, the Investment Company Act of 1940 and the Borrower is not a "holding company" as defined in, or subject to regulation under, the Public Utility Holding Company Act of 1935;

(o) none of the information relating to any Aircraft, its price and/or any Delivery Date furnished by or on behalf of the Borrower to the Security Agent or any Loan Participant in connection with the negotiation of this Agreement or delivered hereunder (as modified or supplemented by other information so furnished) contains any material misstatement of fact or omits any material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading;

(p) no part of the proceeds of any Drawing hereunder will be used, whether directly or indirectly, for any purpose that entails a violation of any of the Regulations of the Board of Governors of the Federal Reserve, including Regulations U and X;

(q) the Security Agent has, or will have upon the filing of a UCC-1 in Alaska, a duly perfected first priority security interest in the Boeing Purchase Agreement and, from the date of any Engine Warranty Substitution, the CFM Purchase Agreement (subject to Permitted Liens);

(r) the Mortgage Estate is free and clear of all Liens (except Liens contemplated by the Mortgage and Permitted Liens);

(s) (i) there are no pre-delivery deposit payments or other advances with respect to any Aircraft other than the Advances listed on Schedule III (including, for the avoidance of doubt, the Engine Substitution Contribution);

(ii) the Borrower has paid in full all Advances which have become due and owing with respect to any Aircraft (including, without limitation, the Advances due and payable upon the execution of the Boeing Purchase Agreement) and has not received, directly or indirectly, any refund or credit from the Manufacturer with respect to any portion thereof;

(iii) Schedule III sets forth in full and accurate detail, with respect to each Aircraft:

(1) the aggregate amount of Advances made by the Borrower prior to the date hereof (net of any and all refunds and credits received from the Manufacturer prior to the date hereof) with respect to such Aircraft;

(2) the scheduled dates and amounts of each Advance due with respect to such Aircraft after the date hereof; and

(3) the scheduled delivery date for such Aircraft;

(iv) assuming that each Aircraft is delivered on its Delivery Date in the condition required by the terms of the Boeing Purchase Agreement, each of the Aircraft shall be in such condition as is necessary to be certified by the Federal Aviation Administration as to type and airworthiness and to meet the requirements necessary to obtain an airworthiness certificate under the Federal Aviation Act; and

(v) [\*\*\*]\*

(t) the Borrower has no financings with either the Manufacturer or the Engine Manufacturer which contain an event of default triggered by the failure of the Borrower to meet financial performance standards; and

(u) the value of the Security Agent's Lien over the Purchase Agreements and its other rights in relation to the Purchase Agreements under the Operative Documents (with Purchase Agreements for the purpose of this Section 7(u) only to include all Excluded Provisions) is not adversely affected by the omission of the Excluded Provisions from the Purchase Agreements for the purposes of the Operative Documents, such that, the Security Agent would receive a higher price than the [\*\*\*]\* Price (as defined in the Consent and Agreement) were it not for the Security Agent's rights over the Purchase Agreements excluding the Excluded Provisions, provided however, that the parties acknowledge that the Engine Substitution will affect the value of the Security Agent's Lien, and that the representation in this Section 7(u) does not apply in relation to any Engine Substitution.

## **Section 8. Indemnities.**

8.1 [\*\*\*]\*

### **8.2 Withholding Taxes.**

(a) Except as provided in this Section 8.2, the Borrower shall have no liability to any Holder in the event any withholding Tax is imposed on payments made to holders of the Loan Certificate(s).

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

(b) [\*\*\*]\*

8.3 Interest. The Borrower will pay to each Indemnitee on demand, to the extent permitted by applicable law, interest on any amount of indemnity not paid when due pursuant to this Section 8 until the same shall be paid, at the Past Due Rate.

**Section 9. Covenants of the Borrower**. The Borrower hereby covenants for the benefit of all Loan Participants, as follows:

(a) Borrower Merger. For so long as the Mortgage remains in force, the Borrower shall not enter into any merger or consolidation, or sell, transfer, lease or convey all or a substantial part of its assets, unless, only in the case of such merger or consolidation:

(i) no Default or Event of Default shall have occurred and be continuing or would result therefrom;

(ii) the Borrower is the surviving corporation or, if otherwise, such other Person or continuing corporation (herein called “**Successor Corporation**”) shall be a corporation incorporated under the laws of a state of the United States, shall be a U.S. Air Carrier, and after giving effect to such merger, consolidation, sale, transfer, lease or conveyance, the net worth of the Successor Corporation is not less than the greater of (1) the lesser of Borrower’s tangible net worth immediately before the Merger and Borrower’s tangible net worth on December 31, 2004 and (2) 75% of Borrower’s tangible net worth immediately before the Merger;

(iii) in the case of a Successor Corporation, such Successor Corporation shall:

(1) execute, prior to or contemporaneously with the consummation of such transaction, such agreements, if any, as are in the reasonable opinion of the Security Agent necessary or advisable to evidence the assumption by the Successor Corporation of liability for all of the obligations of the Borrower under the Mortgage and the other Operative Documents;

(2) make such recordings and filings, and take such other action with respect to the Operative Documents, as shall be necessary or advisable in the reasonable opinion of the Loan Participants to protect their security interest in the Aircraft and obtain all consents of Manufacturers to the extent necessary; and

(3) cause to be delivered to the Security Agent and the Loan Participants such legal opinions (which may be from in-house counsel) as any of

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them may reasonably request in connection with the matters specified in the preceding clauses (1) and (2).

Upon any consolidation or merger in accordance with this Section 9(a), the Successor Corporation shall succeed to, and be substituted for, and may exercise every right and power of, the Borrower under this Agreement with the same effect as if such Successor Corporation had been named as the Borrower herein.

(b) U.S. Air Carrier. The Borrower covenants and agrees that at all times it will be U.S. Air Carrier.

(c) Purchase Agreements. The Borrower shall:

(i) duly perform all of its obligations under each of the Purchase Agreements and take all actions necessary to keep the Purchase Agreements in full force and effect;

(ii) immediately notify the Security Agent of any material default (whether by the Borrower or the Manufacturer or the Engine Manufacturer) under or cancellation, termination or rescission or purported cancellation, termination or rescission of either Purchase Agreement of which it has notice specifying in reasonable detail the nature of such default, cancellation, rescission or termination;

(iii) not, without the Security Agent's prior written consent, in any way modify, cancel, terminate or amend either Purchase Agreement in respect of the Aircraft against which Drawings are made (other than executing change notices as provided in Section 9(h) below), except as expressly permitted by the Mortgage or this Agreement;

(iv) notify the Security Agent of each Aircraft's manufacturer's serial number not less than six (6) months before the scheduled delivery date of that Aircraft, and notify the Security Agent of each Aircraft's Engines' manufacturer's serial numbers no later than (A) thirty (30) days before the scheduled delivery date of that Aircraft; or (B) within five (5) Business Days of being advised of the Engines' manufacturer's serial numbers if the Borrower has not been informed of such serial numbers thirty (30) or more days prior to the scheduled delivery date of that Aircraft;

(v) not accept delivery of any Aircraft from the Manufacturer before either (A) repaying to the Loan Participants all amounts owing in respect of the Drawings relating to that Aircraft, or [\*\*\*]\* and

(vi) not effect an Engine Warranty Substitution unless: (A) the Engine Warranty Substitution shall in no way reduce the rights of, increase the obligations of, or

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increase risk to the Loan Participants under the Operative Documents, (B) the Security Agent shall have first received the Engine Consent and Agreement, duly authorized, executed and delivered by the parties thereto, provided that, if any amendment is required to be made to the form of the Engine Consent and Agreement annexed in Exhibit D, the Loan Participants' unanimous consent shall be obtained, (C) the Security Agent shall have received a copy of the CFM Purchase Agreement certified by the Secretary or an Assistant Secretary of the Borrower as being a true and accurate copy of the same, provided that such copy may be redacted and shall not include any pricing information thereon or any provisions thereof not assigned, and also provided that, receipt of such document shall be strictly subject to Section 13, (D) the Security Agent (with sufficient copies for each Loan Participant) shall have received opinions addressed to such Loan Participant and the Security Agent from the Borrower in relation to the Engine Substitution in form and substance reasonably satisfactory to the addressees thereof, and (E) if necessary, a Uniform Commercial Code financing statement shall have been filed to perfect the Security Agent's interest in the CFM Purchase Agreement.

(d) Further Assurances. The Borrower covenants and agrees with each party hereto as follows:

(i) The Borrower will cause to be done, executed, acknowledged and delivered all and every such further acts, conveyances and assurances as any Holder shall reasonably require for accomplishing the purposes of this Agreement and the other Operative Documents; provided that any instrument or other document so executed by the Borrower will not expand any obligations or limit any rights of the Borrower in respect of the transactions contemplated by any Operative Documents.

(ii) The Borrower, at its expense, will take all actions (including the filing of financing statements under the Uniform Commercial Code in all applicable jurisdictions) to (A) cause the lien of the Mortgage to at all times be and remain a perfected Lien, and (B) establish the priority of the Mortgage with respect to the Mortgage Estate.

(iii) The Borrower shall pay all reasonable costs and expenses (including costs and disbursements of counsel) incurred by the Security Agent and the Holders after the date hereof in connection with (A) any supplements or amendments of the Operative Documents (including, without limitation, any related recording costs) (other than any supplement or amendment associated with the syndication or transfer of the Loan Certificates or the sale of participation interests therein), (B) any Default and any enforcement or collection proceedings resulting therefrom or in connection with the negotiation of any restructuring or "work-out" (whether or not consummated), (C) the enforcement of this Section 9, or (D) the registration of an Aircraft Mortgage or a breach of Section 9(c)(iv).

(e) Conduct of Business, Maintenance of Existence. The Borrower shall and shall cause its subsidiaries to (i) continue to engage in business of the same general type as conducted by the Borrower and its subsidiaries on the date hereof and (ii) except as expressly permitted by Section 9(a), preserve, renew and keep in full force and effect its respective

corporate existence and take all reasonable action to maintain all rights, privileges and franchises necessary or desirable in the normal conduct of business of the Borrower and any of its subsidiaries; provided that the Borrower shall not be required to maintain, and shall not be required to cause any of its subsidiaries to maintain, any such rights, privileges or franchises, if the failure to do so could not reasonably be expected to result in a Material Adverse Effect; comply with all contractual obligations and requirements of law, except to the extent that failure to comply therewith could not reasonably be expected to result in a Material Adverse Effect; and comply with the provisions of their respective certificates of incorporation, by-laws and other organizational documents.

(f) Maintenance of Property; Insurance. The Borrower shall, and shall cause its subsidiaries to, keep all property useful and necessary in the respective businesses of the Borrower and its subsidiaries in good working order and condition, normal wear and tear excepted; maintain with financially sound and reputable insurance companies insurance on all property material to the business of the Borrower and its subsidiaries in at least such amounts and against at least such risks (but including in any event public liability and product liability) as are usually insured against in the same general area by companies engaged in the same or a similar business; and furnish to any Holder, upon written request, information in reasonable detail as to the insurance carried, together with copies of certificates of insurance and other evidence of such insurance, if any.

(g) Inspection of Property; Books and Records; Discussions. The Borrower shall, and shall cause its subsidiaries to, keep proper books of records and account in which full, complete and correct entries in conformity with GAAP and all Requirements of Law shall be made of all dealings and transactions in relation to the Borrower's and its subsidiaries' respective business and activities; and permit representatives of any Holder to visit and inspect any of the Borrower's properties and examine and, to the extent reasonable, make abstracts from any of the Borrower's non-confidential books and records and to discuss the business, operations, properties and financial and other condition of the Borrower and its subsidiaries with officers and employees of the Borrower, in each case at any reasonable time during normal business hours, upon reasonable notice to a responsible officer of the Borrower, and as often as may reasonably be desired at reasonable intervals, provided that non-disclosure agreements are executed or no non-public information is divulged other than to employees or advisers of the Holder who agree to hold the information confidential or regulatory agencies which oversee the Holder, it being understood that the Borrower is the principal subsidiary of a publicly traded company.

(h) Increase in [\*\*\*]\* Price. The Borrower shall not amend the detail specification for an Aircraft that would increase the [\*\*\*]\* Price by more than [\*\*\*]\*, unless the Borrower shall pay to the Manufacturer within 60 days of entering into such agreement the aggregate amount by which the increased [\*\*\*]\* Price exceeds [\*\*\*]\*.

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

**Section 10. Notices.** All notices, demands, instructions and other communications required or permitted to be given to or made upon any party hereto shall be in writing and shall be personally delivered or sent by registered or certified mail, postage prepaid, or by facsimile, or by prepaid courier service, and shall be effective upon receipt.

Unless otherwise specified in a notice sent or delivered in accordance with the foregoing provisions of this Section 10, notices, demands, instructions and other communications in writing shall be given to or made upon the respective parties hereto at their respective addresses (or to their respective telex address or facsimile numbers) as follows: (a) if to the Borrower or the Security Agent, to the addresses set forth in Section 7.6 of the Mortgage, (b) if to a Loan Participant, to the address set forth on Schedule I, or (c) if to any subsequent Holder, addressed to such Holder at its address set forth in the Certificate Register maintained pursuant to the Mortgage.

**Section 11. Governing Law; Consent to Jurisdiction; Waiver of Jury Trial.**

11.1 This Agreement shall in all respects be governed by, and construed in accordance with, the law of the State of New York.

11.2 Each party hereby irrevocably and unconditionally submits, for itself and its property, to the nonexclusive jurisdiction of the Supreme Court of the State of New York sitting in New York County and of the United States District Court of the Southern District of New York, and any appellate court from any thereof, in any action or proceeding arising out of or relating to this Agreement, or for recognition or enforcement of any judgment, and each of the parties hereto hereby irrevocably and unconditionally agrees that all claims in respect of any such action or proceeding may be heard and determined in such New York State or, to the extent permitted by law, in such Federal court. Each of the parties hereto agrees that a final judgment in any such action or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law. Nothing in this Agreement shall affect any right that any party may otherwise have to bring any action or proceeding relating to this Agreement against another party or its properties in the courts of any jurisdiction.

11.3 Each party hereby irrevocably and unconditionally waives, to the fullest extent it may legally and effectively do so, any objection which it may now or hereafter have to the laying of venue of any suit, action or proceeding arising out of or relating to this Agreement in any court referred to in Section 11.2. Each of the parties hereto hereby irrevocably waives, to the fullest extent permitted by law, the defense of an inconvenient forum to the maintenance of such action or proceeding in any such court.

11.4 Each party to this Agreement irrevocably consents to service of process in the manner provided for notices in Section 10. Nothing in this Agreement will affect the right of any party to this Agreement to serve process in any other manner permitted by law.

11.5 EACH PARTY HERETO HEREBY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY IN ANY LEGAL PROCEEDING DIRECTLY OR INDIRECTLY ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED

HEREBY (WHETHER BASED ON CONTRACT, TORT OR ANY OTHER THEORY). EACH PARTY HERETO (A) CERTIFIES THAT NO REPRESENTATIVE, AGENT OR ATTORNEY OF ANY OTHER PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT SUCH OTHER PARTY WOULD NOT, IN THE EVENT OF LITIGATION, SEEK TO ENFORCE THE FOREGOING WAIVER AND (B) ACKNOWLEDGES THAT IT AND THE OTHER PARTIES HERETO HAVE BEEN INDUCED TO ENTER INTO THIS AGREEMENT BY, AMONG OTHER THINGS, THE MUTUAL WAIVERS AND CERTIFICATIONS IN THIS SECTION.

**Section 12. Invoices and Payment of Expenses.** Each of the Security Agent and the Loan Participants shall promptly submit to the Borrower for its prompt approval copies of invoices of the Transaction Expenses (as defined below) as they are received. The Borrower agrees to pay Transaction Expenses promptly upon receipt of invoices of such Transaction Expenses. For the purposes hereof, "Transaction Expenses" means:

- (a) with respect to the preparation, negotiation, execution and delivery of this Agreement and the payment or anticipated payment of each Advance on each Borrowing Date, the reasonable fees, expenses and disbursements of Vedder, Price, Kaufman & Kammholz, P.C., special counsel to the Loan Participants;
- (b) all fees, taxes (including license, documentary, stamp, excise and property taxes) and other charges payable in connection with the recording or filing of instruments and financing statements; and
- (c) each Loan Participant's reasonable out-of-pocket costs and expenses relating to the negotiation and closing of this transaction.

**Section 13. Confidentiality.** Each of the Loan Participants and the Security Agent covenants and agrees to keep confidential, and not to disclose to any third parties, the Operative Documents and all non-public information received by it from the Borrower pursuant to the Operative Documents, provided that such information may be made available:

- (a) to prospective and permitted transferees of a Loan Participant's Loan Certificates or the Security Agent's respective interest in the Mortgage Estate, who agree to hold such information confidential on the terms provided herein;
- (b) to any Holder's counsel or independent certified public accountants, independent insurance advisors or other agents who agree to hold such information confidential;
- (c) as may be required by applicable law or by any statute, court or administrative order or decree or governmental ruling or regulation (or, in the case of any Holder, to any bank examiner or other regulatory personnel); or
- (d) as may be necessary for purposes of enforcement of any Operative Document.

**Section 14. Miscellaneous.**

14.1 The representations, warranties, indemnities and agreements of the Borrower provided for in this Agreement and each party's obligations under any and all thereof, shall survive the expiration or other termination of this Agreement or any other Operative Document, except as expressly provided herein or therein.

14.2 This Agreement may be executed by the parties hereto in separate counterparts, each of which when so executed and delivered shall be an original, but all such counterparts shall together constitute but one and the same instrument. Neither this Agreement nor any of the terms hereof may be terminated, amended, supplemented, waived or modified, except by an instrument in writing signed by the party or parties thereto.

14.3 (a) This Agreement shall be binding upon and shall inure to the benefit of, and shall be enforceable by, the parties hereto and their respective successors and permitted assigns including each successive holder of any Loan Certificate(s) issued and delivered pursuant to this Agreement or the Mortgage whether or not an express assignment to any such holder of rights under the Agreement has been made.

(b) The Borrower may not assign any of its rights or obligations under this Agreement or the other Operative Documents except to the extent expressly provided thereby.

(i) Each Loan Participant may assign its Loan Certificate, in whole or in part, as provided in Section 5.7, which assignment shall be effected pursuant to an agreement substantially in the form of Exhibit B.

(ii) In addition, a Loan Participant may assign, in whole or in part (provided that each full or partial assignment shall be no less than [\*\*\*]\* and the result of any transfer does not increase the total number of Holders beyond [\*\*\*]\*), its Commitment in respect of any Advance to any other financial institution (so long as Borrower has no obligations under Sections 5.12 or 8 that result from such transfer that are higher than the obligations that would be payable to the transferor) having a net worth which demonstrates that such financial institution is capable of meeting its funding obligation in respect of the assigned Commitment, which assignment shall be effected pursuant to an agreement substantially in the form of Exhibit B hereto, appropriately modified to relate to the assignment of a Commitment.

(iii) Effective upon the assignment of any Commitment, the assigning Loan Participant shall be relieved of its obligations in respect of such Commitment to the extent the assignee thereof shall have become obligated in respect thereof.

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

(iv) Notwithstanding the above, a Holder may not transfer any Loan Certificate or interest therein in violation of the Securities Act or applicable foreign or state securities laws.

(v) No Loan Participant shall have any obligation or duty to the Borrower, or to other Persons with respect to the transactions contemplated hereby except those obligations or duties of such Loan Participant expressly set forth in this Agreement and the other Operative Documents and no Loan Participant shall be liable for performance by any other party hereto of such other party's obligations or duties hereunder. Without limitation of the generality of the foregoing, under no circumstances whatsoever shall any Loan Participant be liable to the Borrower for any action or inaction on the part of the Security Agent in connection with the transactions contemplated herein, whether or not such action or inaction is caused by willful misconduct or gross negligence of the Security Agent.

\* \* \*

**IN WITNESS WHEREOF**, the parties hereto have caused this Agreement to be duly executed by their respective officers thereunto duly authorized as of the day and year first above written.

**ALASKA AIRLINES, INC., Borrower**

By: [\*\*\*]  
Name: [\*\*\*]  
Title: [\*\*\*]

**HSH NORDBANK AG NEW YORK BRANCH, Security Agent**

By: [\*\*\*]  
Name: [\*\*\*]  
Title: [\*\*\*]

By: [\*\*\*]  
Name: [\*\*\*]  
Title: [\*\*\*]

**LOAN PARTICIPANTS:**

**HSH NORDBANK AG NEW YORK BRANCH**

By: [\*\*\*]  
Name: [\*\*\*]  
Title: [\*\*\*]

By: [\*\*\*]  
Name: [\*\*\*]  
Title: [\*\*\*]

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.



**NORDDEUTSCHE LANDESBANK GIROZENTRALE**

By: [\*\*\*]  
Name: [\*\*\*]  
Title: [\*\*\*]

By: [\*\*\*]  
Name: [\*\*\*]  
Title: [\*\*\*]

**DEKABANK DEUTSCHE GIROZENTRALE**

By: [\*\*\*]  
Name: [\*\*\*]  
Title: [\*\*\*]

By: [\*\*\*]  
Name: [\*\*\*]  
Title: [\*\*\*]

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

**SCHEDULE I**

**NOTICE & ACCOUNT INFORMATION**

**Loan Participants**

**HSH Nordbank AG New York Branch**

230 Park Avenue  
New York, NY 10169-0005  
[\*\*\*]\*

Account Details:  
[\*\*\*]\*

**Norddeutsche Landesbank Girozentrale**

Aircraft Finance Department  
Friedrichswall 10  
31059 Hannover  
Germany [\*\*\*]\*

Account Details:  
[\*\*\*]\*

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

**DekaBank Deutsche Girozentrale**

For documentary matters:

Taunusanlage 10

60329 Frankfurt

[\*\*\*]\*

Account Details:

[\*\*\*]\*

**Security Agent**

**HSH Nordbank AG New York Branch**

230 Park Avenue

New York, NY 10169-0005

[\*\*\*]\*

Account Details:

[\*\*\*]\*

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

SCHEDULE I

Page 2

SCHEDULE II  
**PARTICIPATIONS\***

<u>Loan Participant</u>	<u>Participation Percentage</u>	<u>Maximum Commitment</u>
HSH Nordbank AG New York Branch	[***]*	[***]*
Norddeutsche Landesbank Girozentrale	[***]*	[***]*
DekaBank Deutsche Girozentrale	[***]*	[***]*
<b>Facility Amount</b>		<b>US\$172,000,000</b>
<u>[***]*</u>		

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

**SCHEDULE III**

**ADVANCES\***

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SCHEDULE III

Page 1

EXHIBIT A

FUNDING NOTICE [HSH/AS B737-800]

\_\_\_\_\_, 20\_\_

HSH Nordbank AG New York Branch

[

]

[

]

Attention: [                      ]

Fax: [                              ]

Re: Predelivery Deposit Payment Financing for Alaska Airlines, Inc.

Ladies and Gentlemen:

Reference is hereby made to that certain Credit Agreement [HSH/AS B737-800] dated as of October 19, 2005 (the “**Credit Agreement**”; capitalized terms used herein without definition shall have the definitions set forth in the Credit Agreement) entered into among Alaska Airlines, Inc., as borrower (the “**Borrower**”), the institutions listed on Schedule I thereto, as senior loan participants (the “**Loan Participants**”) and HSH Nordbank AG New York Branch, as security agent (the “**Security Agent**”).

1. Pursuant to Section 2.2(a) of the Credit Agreement, Borrower hereby requests a Drawing in accordance with the following parameters:

- (1) Aircraft MSN: \_\_\_\_\_
- (2) Borrowing/Effective Date: \_\_\_\_\_
- (3) Advance Payment Base Price (“**ABP**”): \$ \_\_\_\_\_
- (4) Additional payment for engines made by Borrower: [\*\*\*]\*
- (5) Advance Amount: US\$ \_\_\_\_\_; \_\_\_\_ % of ABP.

2. Please distribute the proceeds of the Drawing as follows: [Insert payment instructions]

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

3. Borrower hereby confirms that the representations and warranties of the Borrower in Section 7 of the Credit Agreement are true and accurate on the date hereof as though made on the date hereof except to the extent that such representations and warranties relate solely to an earlier date (in which case such representations and warranties were true and accurate on and as of such earlier date).

4. In consideration of the Loan Participants making their funds available on the Borrowing Date specified in this Funding Notice, in the event that the Drawing does not take place on the Borrowing Date specified in this Funding Notice or in the event the Drawing takes place on any Delayed Borrowing Date, the Borrower shall compensate the Loan Participants for their net loss on such funds, including any LIBO Rate Break Amounts, by paying the Loan Participants interest on the aggregate amount thereof (calculated on the basis of a 360-day year and actual days elapsed) at a rate equal to the Loan Participants' cost of funds for the period from and including the Borrowing Date specified in this Funding Notice to but excluding the earlier of (x) the Business Day on which the Borrowing Date shall actually occur, (y) the Business Day on which the Borrower shall notify the Loan Participants that the Borrowing will not occur prior to the Delayed Borrowing Date (if such notice is given prior to 10:00 a.m. (New York time) or if later, until the Business Day subsequent to such notice date), or (z) the Delayed Borrowing Date.

For the purposes of the first Drawing under this Funding Notice, the Credit Agreement shall be treated as executed and delivered even if it is yet to be executed and delivered.

The terms and provisions of this Funding Notice shall be binding upon and inure to the benefit of the Loan Participants and the Borrower and their successors and assigns.

This Funding Notice shall be governed by the internal laws of the State of New York.

Very truly yours,

**ALASKA AIRLINES, INC.**

By: \_\_\_\_\_

Name:

Title:

EXHIBIT A

Page 2

**EXHIBIT B**

**ASSIGNMENT AGREEMENT**

**ASSIGNMENT AGREEMENT [HSH/AS B737-800]** dated as of \_\_\_\_\_, \_\_\_\_ between \_\_\_\_\_ (the “**Assignee**”) and \_\_\_\_\_ (the “**Assignor**”).

**RECITALS**

**WHEREAS**, the Assignor is the holder of the Loan Certificate No. \_\_\_\_\_ dated as of \_\_\_\_\_, \_\_\_\_ (the “**Assignor’s Loan Certificate**”) issued under the Credit Agreement [HSH/AS B737-800], dated as of October 19, 2005 (the “**Credit Agreement**”) between Alaska Airlines, Inc. (“**Alaska**”), the Loan Participants party thereto and HSH Nordbank AG New York Branch, as Security Agent (the “**Security Agent**”);

**WHEREAS**, the Assignor proposes to assign to the Assignee \$\_\_\_\_\_ of the \$\_\_\_\_\_ Assignor’s Loan Certificate and a pro rata portion of all of the rights and obligations of the Assignor under the Credit Agreement and the other Operative Documents (as defined below) in respect thereof, on the terms and subject to the conditions set forth herein, and the Assignee proposes to accept the assignment of such rights and obligations from the Assignor on such terms and subject to such conditions;

**NOW, THEREFORE**, in consideration of the foregoing and the mutual agreements contained herein, the parties hereto agree as follows:

**Section 1. Definitions.** Unless otherwise defined herein, terms defined in the Credit Agreement are used herein as therein defined.

**Section 2. Assignment.**

(a) On \_\_\_\_\_, \_\_\_\_ (the “**Effective Date**”), and on the terms and subject to the conditions set forth herein, the Assignor will sell, assign and transfer to the Assignee, without recourse to or representation, express or implied, by the Assignor (except as expressly set forth in Section 5 hereof), a \$\_\_\_\_\_ portion of the Assignor’s Loan Certificate and a pro rata portion of the rights and obligations of the Assignor under the Credit Agreement and the other Operative Documents in respect thereof (but not with respect to any indemnity or other claim, interest thereon at the Past Due Rate and breakage amounts, if any, accrued and unpaid as of the Effective Date or thereafter payable to the Assignor in respect of the period prior to the Effective Date), and the Assignee shall accept such assignment from the Assignor and assume all of the obligations of the Assignor accruing from and after the Effective Date under the Credit Agreement and the other Operative Documents relating to the Assignor’s Loan Certificate on such terms and subject to such conditions.

(b) Upon the satisfaction of the conditions set forth in Section 4, (A) the Assignee shall, on the Effective Date, succeed to the rights and be obligated to perform the obligations of a Loan Participant and Holder under the Credit Agreement and the other Operative Documents, and (B) the Assignor shall be released from its obligations under the Credit



Agreement and the other Operative Documents accrued from and after the Effective Date, in each case to the extent such obligations have been assumed by the Assignee.

**Section 3. Payments.** As consideration for the sale, assignment and transfer contemplated in Section 2 hereof, the Assignee shall pay to the Assignor, on the Effective Date, in lawful currency of the United States and in immediately available funds, to the account specified below its signature on the signature pages hereof, an amount equal to \$\_\_\_\_\_.

**Section 4. Conditions.** This Assignment Agreement shall be effective upon the due execution and delivery of this Assignment Agreement by the Assignor and the Assignee and the effectiveness of the assignment contemplated by Section 2 hereof is subject to:

(a) the receipt by the Assignor of the payment provided for in Section 3 [and the receipt by the Assignee of a front end fee in the amount of \$\_\_\_\_\_] and

(b) the delivery to the Security Agent of the Assignor's Loan Certificate, duly endorsed for [partial] transfer to the Assignee, together with a request in the form attached hereto as Exhibit A that a new Loan Certificate be issued to the Assignee and Assignor.

**Section 5. Representations and Warranties of the Assignor.** The Assignor represents and warrants as follows:

(a) the Assignor has full power and authority, and has taken all action necessary to execute and deliver this Assignment Agreement and any other documents required or permitted to be executed or delivered by it in connection with this Assignment Agreement and to fulfill its obligations under, and to consummate the transactions contemplated by, this Assignment Agreement, and no governmental authorizations or other authorizations are required in connection therewith;

(b) the Assignor's interest in the Assignor's Loan Certificate is free and clear of any and all Liens created by or through the Assignor;

(c) this Assignment Agreement constitutes the legal, valid and binding obligation of the Assignor, enforceable against the Assignor in accordance with its terms; and

(d) the Assignor has received no written notice of any Default having occurred and continuing on the date of execution hereof.

**Section 6. Representations and Warranties of the Assignee.** The Assignee hereby represents and warrants to the Assignor and Borrower that:

(a) the Assignee has full power and authority, and has taken all action necessary to execute and deliver this Assignment Agreement and any and all other documents required or permitted to be executed or delivered by it in connection with this Assignment Agreement and to fulfill its obligations under, and to consummate the transactions contemplated by, this Assignment Agreement, and no governmental authorizations or other authorizations are required in connection therewith;

(b) this Assignment Agreement constitutes the legal, valid and binding obligation of the Assignee, enforceable against the Assignee in accordance with its terms; and

(c) the Assignee has fully reviewed the terms of the Operative Documents and has independently and without reliance upon the Assignor and based on such information as the Assignee has deemed appropriate, made its own credit analysis and decision to enter into this Assignment Agreement.

**Section 7. Further Assurances.** The Assignor and the Assignee hereby agree to execute and deliver such other instruments, and take such other action, as either party may reasonably request in connection with the transactions contemplated by this Assignment Agreement.

**Section 8. Governing Law.** This Assignment Agreement shall be governed by, and construed in accordance with, the law of the State of New York.

**Section 9. Notices.** All communications between the parties or notices in connection herewith shall be in writing, hand-delivered or sent by ordinary mail or facsimile, addressed as set forth on the signature pages hereof. All such communications and notices shall be effective upon receipt.

**Section 10. Binding Effect.** This Assignment Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

**Section 11. Integration of Terms.** This Assignment Agreement contains the entire agreement between the parties relating to the subject matter hereof and supersedes all oral statements and other writings with respect to the subject matter hereof.

**Section 12. Counterparts.** This Assignment Agreement may be executed in one or more counterparts, each of which shall be an original but all of which, taken together, shall constitute one and the same instrument.

**IN WITNESS WHEREOF**, the parties have caused this Assignment Agreement to be executed and delivered by their duly authorized officers as of the date first above written.

**[ASSIGNEE]**

By: \_\_\_\_\_  
Name:  
Title:

Address for Notices:

Wire Instructions:

**[ASSIGNOR]**

By: \_\_\_\_\_  
Name:  
Title:

Address for Notices:

Wire Instructions:

**EXHIBIT A TO ASSIGNMENT AGREEMENT**  
**REQUEST FOR LOAN CERTIFICATE AND REGISTRATION**

To: HSH Nordbank AG New York Branch,  
as Security Agent

Ladies and Gentlemen:

We refer to the assignment by \_\_\_\_\_ (the “**Assignor**”), of certain of its rights and obligations with respect to Loan Certificate No. \_\_\_\_\_ in the principal amount of \$ \_\_\_\_\_ (the “**Assignor’s Loan Certificate**”) to \_\_\_\_\_ (the “**Assignee**”), pursuant to an Assignment Agreement [HSH/AS B737-800] dated as of \_\_\_\_\_, \_\_\_\_\_ between the Assignor and the Assignee. Capitalized terms not otherwise defined herein shall have the meanings assigned thereto in such Assignment Agreement. The Assignor hereby delivers the Assignor’s Loan Certificate to HSH Nordbank AG New York Branch, in its capacity as Security Agent. The Assignor requests Alaska Airlines, Inc. to issue to (i) the Assignee a new Loan Certificate (the “**New Loan Certificate**”) in the principal amount of \$ \_\_\_\_\_ and (ii) to the Assignor a new Loan Certificate (the “**Assignor’s New Loan Certificate**”) in the principal amount of \$ \_\_\_\_\_, each, with a [Borrowing Date] issue date.

The Security Agent is hereby instructed to pay all interest on the portion of the Assignor’s Loan Certificate being assigned hereunder accrued through the date hereof directly to the Assignor on the date such interest is payable and paid.

The Assignor requests the Security Agent to deliver the New Loan Certificate to the Assignee at its address set forth below and to deliver the Assignor’s New Loan Certificate to the undersigned.

Very truly yours,

**[ASSIGNOR]**

By: \_\_\_\_\_  
Name:  
Title:

Address for Notices:

Wire Instructions:

**[ASSIGNEE]**

By: \_\_\_\_\_  
Name:  
Title:

Address for Notices:

Wire Instructions:

Accepted and Agreed:

**HSH NORDBANK AG NEW YORK  
BRANCH**, as Security Agent

By: \_\_\_\_\_  
Name:  
Title:

By: \_\_\_\_\_  
Name:  
Title:

EXHIBIT C

CONSENT AND AGREEMENT TO  
MORTGAGE AND SECURITY AGREEMENT [HSH/AS B737-800]

**THIS CONSENT AND AGREEMENT** (“**Consent**”) entered into as of October \_\_\_\_, 2005 is among Alaska Airlines, Inc. (“**Alaska**”), each Loan Participant identified on the signature pages hereto (together with their successors and assigns, “**Loan Participants**”), HSH Nordbank AG New York Branch, as Security Agent on behalf of each Loan Participant (“**Assignee**”) and The Boeing Company (“**Manufacturer**”).

RECITALS

A. Alaska and Assignee have heretofore entered into that certain Credit Agreement [HSH/AS B737-800] dated as of October 19, 2005 (“**Credit Agreement**”) among Alaska, the Loan Participants and Assignee, pursuant to which the Loan Participants have agreed to make certain funds available to Alaska in order to enable Alaska to meet certain of its deposit and advance payment obligations under the Boeing Purchase Agreement in respect of the Aircraft specified in the Mortgage (those aircraft that Alaska has agreed to purchase which the Loan Participants are funding are referred to hereinafter as the “**Aircraft**”).

B. Alaska and Assignee have entered into that certain Mortgage and Security Agreement [HSH/AS B737-800] dated as of October 19, 2005 (“**Mortgage**”), pursuant to which Alaska has granted to Assignee, on behalf of itself and the Loan Participants, a security interest in all of Alaska’s right and interest in and to the Boeing Purchase Agreement (for the avoidance of doubt excluding the Excluded Provisions, and subject to the Engine Substitution) with respect to the Aircraft to be delivered between June 2006 and April 2009, [\*\*\*]\* (the “**Aircraft**”) and its rights and interests, if any, in and to any and all equipment furnished by or on behalf of Alaska expressly designated to be placed on any of the Aircraft (the “**Buyer Furnished Equipment**”) in order to secure performance of Alaska under and in respect of the Operative Documents.

C. Alaska and Assignee wish to obtain Manufacturer’s consent to the Mortgage and Manufacturer is willing to grant such consent, all subject to and upon the terms and conditions provided herein.

**NOW THEREFORE**, in consideration of the mutual promises herein contained, the parties agree as follows:

1. Definitions. Capitalized terms used herein and not otherwise defined herein shall have the meanings assigned to such terms in the Mortgage.

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

2. Consent of Manufacturer.

a. Manufacturer hereby acknowledges notice of the Mortgage and consents, subject to the terms and conditions of this Consent, to the assignment to Assignee of all of Alaska's right and interest in and to the Boeing Purchase Agreement with respect to the Aircraft pursuant to the Mortgage.

b. Manufacturer agrees that this Consent constitutes the consent of Manufacturer as required by the Boeing Purchase Agreement.

c. Solely to the extent necessary to perfect Assignee's security interest therein (but without making any representation or warranty with respect thereto or being subject to any liability whatsoever to the Assignee with respect to the Buyer Furnished Equipment except as expressly provided in this Consent) and subject to the terms and conditions of this Consent and the Boeing Purchase Agreement, Manufacturer agrees to hold the Buyer Furnished Equipment on behalf of Assignee.

3. Assignee's Rights under the Mortgage.

a. Event of Default. Manufacturer acknowledges that, subject to the provisions of Paragraph 4 hereof, upon and after notice to Manufacturer by Assignee that an Event of Default under the Mortgage has occurred and is continuing and that Assignee is exercising its rights and remedies under the Mortgage, Assignee shall be entitled to make all demands, give all notices, take all actions and exercise all rights of "Customer" under and subject to the Boeing Purchase Agreement in respect of the Aircraft (and Alaska shall not be entitled to do so) including, if Assignee purchases an Aircraft, the right to all product support and warranties with respect thereto under the Boeing Purchase Agreement, to the extent assigned under the Mortgage. Manufacturer acknowledges that such rights of "Customer" include Assignee's right to purchase the Aircraft and agrees that in such event, the purchase price for an Aircraft shall be equal to the [\*\*\*]\* Price (as defined below).

b. Cancellation of Boeing Purchase Agreement. Manufacturer agrees that (i) upon deciding to cancel the Boeing Purchase Agreement with respect to the rights related to any one or more of the Aircraft and / or (ii) a rejection of the Boeing Purchase Agreement by Alaska in bankruptcy or otherwise:

(i) it shall give Assignee written notice of its intent to cancel the Boeing Purchase Agreement; and

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

(ii) the Assignee shall have the right, within [\*\*\*]\* Business Days of receipt of such notice, subject to the provisions of Paragraph 4 of this Consent, to give Manufacturer written notice of its irrevocable decision to assume all of the obligations of "Customer" under the cancelled Boeing Purchase Agreement insofar as it relates to any or all of the Aircraft by entering into a substitute purchase agreement with Manufacturer, relating to such Aircraft on terms and conditions substantially equivalent to those set out in the Boeing Purchase Agreement, as modified pursuant to an assignment agreement in the form of Annex 1 hereto.

If Assignee does so notify Manufacturer and enter into a substitute purchase agreement, then, subject to the terms of Paragraph 7 of this Consent, Assignee shall be entitled to make all demands, give all notices, take all actions and exercise all rights of "Customer" under and subject to the substitute purchase agreement and purchase the Aircraft for the [\*\*\*]\* Price (as defined below).

In such case, Assignee shall be entitled but not obliged to purchase from Alaska all buyer furnished equipment related to the cancelled Aircraft under the Boeing Purchase Agreement, in which Alaska has title or uncontested right to title on the same terms as a purchase by Manufacturer under the Boeing Purchase Agreement.

If no notice from Assignee is timely received, (i) Alaska and Assignee will be deemed to have waived all rights thereto, but Assignee may exercise its enforcement rights in and to the Aircraft under the Operative Documents, and (ii) immediately prior to the sale of any Aircraft by the Manufacturer, the Assignee shall release the Boeing Purchase Agreement to the extent relating to such Aircraft from the Lien of the Mortgage; provided, the Assignee shall retain its Lien to the extent necessary such that in connection with any such sale of the Aircraft by the Manufacturer, the purchase price received by the Manufacturer is to be distributed (A) first, to reimburse the Manufacturer for all costs, expenses and damages incurred by the Manufacturer as a result of the cancellation; (B) second, to the Manufacturer, for the payment of the final installment of the [\*\*\*]\* Price for the Aircraft; and (C) third, the balance to the Assignee for application and distribution in the manner set forth in the Credit Agreement and the Mortgage for payments received during the existence of an Event of Default.

In such case, Manufacturer shall be entitled but not obliged to purchase from Assignee or Alaska, as applicable, all Buyer Furnished Equipment related to the cancelled Aircraft under the Boeing Purchase Agreement, in which Assignee or Alaska, as appropriate, has title or an uncontested right to title.

To the extent Assignee exercises its right to be treated as "Customer" with respect to one or more Aircraft, Assignee shall be under no obligation to exercise such right with respect to any other Aircraft.

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Notwithstanding any other provisions of this Consent, the Assignee's obligations to the Manufacturer following an assignment hereunder shall be limited to complying with the terms of the Boeing Purchase Agreement, including, but not limited to (A) payment of the [\*\*\*]\* Price; (B) provision of an insurance certificate as required under Article 8.2.1 of the Aircraft General Terms Agreement; (C) the disclaimer and release under Exhibit C of the Aircraft General Terms Agreement; and (D) accepting delivery of the Aircraft.

c. Assignment. Manufacturer acknowledges that upon the occurrence of an Event of Default under the Mortgage and notice thereof by the Assignee to Manufacturer, subject to Section 4 hereof, the Assignee shall have the right to assign its rights in and to the Mortgage and this Consent (including the right to purchase Aircraft in accordance with Section 3 hereof), as a delivery assignment taking effect at or about delivery of the relevant Aircraft, pursuant to an assignment agreement in the form of Annex I hereto and any such permitted assignee shall be entitled to exercise the Assignee's rights thereunder and hereunder; provided, that Assignee shall not assign without the Manufacturer's prior written consent, [\*\*\*]\*. If there is any further assignment hereunder, the assignee shall be entitled to take delivery of the Aircraft including all assigned warranties by payment of the unpaid portion of the [\*\*\*]\* Price (as defined below), as assigned to the Assignee, but, unless otherwise agreed, without releasing the Assignor from its obligations to purchase the Aircraft under the Boeing Purchase Agreement. The Manufacturer further agrees that it will sell an appropriate support package to any further permitted assignee purchasing one or more Aircraft.

d. [\*\*\*]\*

4. Manufacturer's [\*\*\*]. At the time of exercise of its rights and remedies under Section 3 of the Mortgage and/or the exercise of Assignee's purchase right under Section 3.a or 3.b hereof in respect of any Aircraft as a result of the occurrence of an Event of Default under the Mortgage, Assignee shall notify Manufacturer in writing.

[\*\*\*]\*

5. Alaska's Waiver and Indemnity; No Release from Obligations.

a. Alaska hereby waives any rights which it may have pursuant to contract or law or otherwise against Manufacturer arising out of, or resulting from, the exercise by Assignee of its rights and remedies under the Mortgage or this Consent and agrees to indemnify and hold harmless Manufacturer, its successors and assigns, and their respective officers, directors and employees from and against any and all claims, losses or liabilities (including reasonable attorneys' fees) resulting therefrom.

b. Alaska hereby agrees, expressly for the benefit of Manufacturer that notwithstanding anything contained in the Mortgage to the contrary:

(i) Alaska shall at all times

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remain liable to Manufacturer under the Boeing Purchase Agreement to perform all duties and obligations of the "Customer" thereunder in respect of the Aircraft to the same extent as if the Mortgage and this Consent had not been executed, and (ii) the exercise by Assignee of any rights assigned under the Mortgage shall not release Alaska from any of its duties or obligations to Manufacturer under the Boeing Purchase Agreement except to the extent that such exercise by Assignee shall constitute performance of such duties or obligations.

6. Notices.

a. Alaska and Assignee agree, expressly for the benefit of Manufacturer, that for all purposes of the Mortgage, Manufacturer shall not be deemed to have knowledge of and need not recognize any event, condition, right, remedy or dispute affecting the interests of Alaska or Assignee under the Mortgage unless and until Manufacturer shall have received written notice thereof from Assignee addressed to its Vice President-Contracts, Boeing Commercial Airplanes, if by mail, at P.O. Box 3707, Mail Code 21-34, Seattle, Washington 98124 or to (425) 237-1706 if by fax. In acting in accordance with the Boeing Purchase Agreement and this Consent, Manufacturer may rely conclusively upon any such notice.

b. Manufacturer shall be entitled to rely conclusively upon any notice or instruction received by it from Assignee pursuant to the Mortgage or this Consent, and Manufacturer shall have no obligation to inquire as to the accuracy of such notice or instruction or as to the relative priority of rights of any person asserting rights in and to the Boeing Purchase Agreement and the Aircraft.

c. Except as provided in Paragraph 3 of this Consent, unless and until Assignee shall have notified Manufacturer that it is exercising its rights and remedies under the Mortgage, Alaska shall have all rights and obligations of "Customer" under the Boeing Purchase Agreement and Manufacturer shall have no duty to consult with or otherwise deal with Assignee concerning the Boeing Purchase Agreement or the Aircraft.

d. Without limiting the generality of the foregoing, prior to the receipt of Assignee's written notice that it is exercising its remedies under the Mortgage, as provided in Paragraph 3(a) hereof, Manufacturer shall have no obligation to inquire as to whether Alaska has complied with the provisions of the Mortgage and shall be entitled to rely upon any notice, consent, waiver or other action taken by Alaska in connection with the Boeing Purchase Agreement.

e. Notice to Assignee hereunder shall be given by hand, first class, certified or registered mail, by a recognized overnight courier service or by fax (confirmed by mail or overnight courier) at 230 Park Avenue, New York, New York 10169-0005.

7. Rights Subject to the Boeing Purchase Agreement.

a. Assignee and each Loan Participant hereby agrees, expressly for the benefit of Manufacturer, that, notwithstanding anything contained in the Mortgage to the contrary (and without in any way releasing Alaska from any of its duties or obligations under the Boeing Purchase Agreement), insofar as the provisions of the Boeing Purchase Agreement relate to the Aircraft, in exercising any rights under the Boeing Purchase Agreement, or in making any

claim with respect to the Aircraft or other things (including without limitation data, Materials (as defined in the Boeing Purchase Agreement), training and services) delivered or to be delivered pursuant to the Boeing Purchase Agreement, the terms and conditions of the Boeing Purchase Agreement, including without limitation, the DISCLAIMER AND RELEASE and EXCLUSION OF LIABILITIES in Article 11 of Part 2 of Exhibit C of the Aircraft General Terms Agreement, shall apply to and be binding upon Assignee to the same extent as if Assignee had been the original "Customer" thereunder. Assignee and each Loan Participant further agrees, expressly for the benefit of Manufacturer, that at any time and from time to time upon the written request of Manufacturer, it shall promptly and duly execute and deliver any and all such further assurances, instruments and documents and take all such further action as Manufacturer may reasonably request in order to obtain the full benefits of its agreements set forth in this paragraph.

b. Except as otherwise expressly provided in this Consent, the execution and delivery by Manufacturer of this Consent and the performance by Manufacturer of its obligations hereunder shall not be regarded as having created or imposed upon Manufacturer any increased or additional obligations or undertakings or any increased or additional limitations to the rights and duties on its part than are contained in the Boeing Purchase Agreement as a result of entering into this Consent. Manufacturer shall not be required to divest itself of title to or possession of the Aircraft or any other thing to be delivered under the Boeing Purchase Agreement until delivery and transfer thereof and payment therefor, as provided in the Boeing Purchase Agreement, or to take any action with respect to the Boeing Purchase Agreement or the Aircraft in any manner inconsistent with applicable law (including, without limitation, any bankruptcy or other court order, ruling or finding).

8. Application of Deposits and Advance Payments. The parties hereto acknowledge and agree that (i) in the event Assignee exercises its rights under the Mortgage and purchases any Aircraft, the deposits and advance payments made under the Boeing Purchase Agreement with respect to such Aircraft shall be applied toward the purchase price of such Aircraft and (ii) in the event the Boeing Purchase Agreement is cancelled with respect to any Aircraft, deposits, credits and advanced payments made (or deemed made) under the Boeing Purchase Agreement with respect to such Aircraft shall be dealt with in accordance with the terms of the cancelled Boeing Purchase Agreement and applicable law.

9. Indemnification of Manufacturer by the Assignee. Assignee agrees to indemnify, defend and hold harmless Manufacturer, its successors and assigns, and their respective officers, directors and employees (collectively, the "**Indemnitees**") and each an "**Indemnitee**") from and against any and all claims, losses, obligations, damages, penalties, actions, judgments, suits, costs, expenses and disbursements and liabilities of any kind whatsoever (including, without limitation, the reasonable fees and disbursements of counsel for such Indemnitees) which may be imposed on, incurred by, or asserted against such Indemnitees in any manner resulting from or arising out of the exercise by Assignee of its rights or remedies under the Mortgage or this Consent, if and only if it is determined by the final judgment of a court of competent jurisdiction that Assignee was not entitled to exercise such rights or remedies or that such rights or remedies were exercised contrary to the provisions of this Consent, the Mortgage or applicable law.

Notwithstanding the previous sentence, Assignee will not indemnify any Indemnitee who has been determined by the final judgment of a court of competent jurisdiction to have acted with gross negligence with regard to the matter for which indemnification is sought, provided that to the extent that any indemnity arises out of the terms of the Boeing Purchase Agreement, such indemnification will be available in accordance with the terms of the Boeing Purchase Agreement.

If any Indemnitee hereunder has knowledge of any liability hereby indemnified against, it shall give prompt written notice thereof to Assignee. Assignee shall have the right to investigate, defend or compromise any claim for which indemnification is sought and each Indemnitee hereunder shall cooperate with the reasonable requests of Assignee with respect thereto.

10. Manufacturer's Representations and Warranties. Manufacturer hereby represents and warrants to Alaska, Assignee and each Loan Participant that:

- a. Manufacturer is a corporation duly incorporated, validly existing and in good standing under the laws of the State of Delaware and is duly qualified to do business as a foreign corporation in the State of Washington.
- b. Manufacturer has all requisite corporate power and authority to execute, deliver and perform its obligations under this Consent and the execution, delivery and performance of this Consent have been duly authorized by all necessary corporate action on the part of Manufacturer.
- c. Each of the Boeing Purchase Agreement and this Consent has been duly executed and delivered by Manufacturer and constitutes the legally valid and binding obligation of Manufacturer, enforceable against Manufacturer in accordance with its terms except as enforceability may be limited by applicable bankruptcy, insolvency, moratorium and other similar laws affecting the enforcement of creditors' rights generally and general principles of equity (regardless of whether such enforceability is at issue in the proceeding in equity or at law).
- d. Set forth on Schedule I hereto, with respect to each Aircraft, is (1) the current Scheduled Delivery Date of such Aircraft, (2) the aggregate amount of Advances received by the Manufacturer prior to the date hereof with respect to such Aircraft, (3) the remaining scheduled dates and amounts of Advances with respect to such Aircraft due after the date hereof and (4) the estimated purchase price as of the currently Scheduled Delivery Date for such Aircraft.
- e. In the event the Manufacturer releases Alaska from its obligations under the Boeing Purchase Agreement to purchase an Aircraft prior to the expiration of the applicable period in Section 3.b hereof, the Manufacturer shall pay to the Assignee in full the Series of Drawings made by the Loan Participants with respect to such Aircraft, together with all interest accrued and unpaid thereon under the Loan Certificates (to a maximum of nine (9) months interest), and all other amounts due and payable in respect of such Drawings under the Operative Documents.

f. Manufacturer will not convey clear title to any of the Aircraft to Alaska without confirmation from the Security Agent that all amounts due and owing from Alaska to the Loan Participants with respect to such Aircraft have been paid in full (or arrangements are in place to repay the Loan Participants simultaneously with such conveyance), but may require Alaska to take delivery and convey title subject to the Lien of the Assignee, provided that, the Manufacturer must first furnish to the Assignee, at the same time as it is furnished to Alaska, a copy of monthly correspondence providing forecast target delivery date information relating to such Aircraft beginning six months prior to the delivery of the Aircraft and further provided that a report is issued one month prior to the Aircraft delivery month that includes notification of such Aircraft's Engine serial numbers and a specific target delivery date, and also provided that any change to the specific target delivery date shall be provided by the Manufacturer to the Assignee at the same time as such information is provided to Alaska.

11. Manufacturer's Covenants. Manufacturer hereby covenants to Alaska, Assignee and each Loan Participant that:

a. Manufacturer will remain liable to observe and perform all the conditions and obligations to be observed and performed by it under the Boeing Purchase Agreement in accordance with the terms and conditions thereof and, subject to the terms of the Boeing Purchase Agreement, the Mortgage and this Consent, all of Manufacturer's obligations under the Boeing Purchase Agreement will inure to the benefit of Assignee as though Assignee were named "Customer" thereunder;

b. [\*\*\*]\*

c. Manufacturer will not assert any lien or claim against any Aircraft after payment in full for that Aircraft under and in accordance with the Boeing Purchase Agreement.

12. GOVERNING LAW. THIS CONSENT WILL BE INTERPRETED UNDER AND GOVERNED BY THE LAWS OF THE STATE OF WASHINGTON, U.S.A., EXCEPT THAT WASHINGTON'S CHOICE OF LAW RULES SHALL NOT BE INVOKED FOR THE PURPOSE OF APPLYING THE LAW OF ANOTHER JURISDICTION.

13. Counterparts. This Consent may be executed by the parties in separate counterparts, each of which when so executed and delivered shall be an original, but all such counterparts shall together constitute but one and the same instrument.

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

**IN WITNESS WHEREOF**, the parties hereto have caused this Consent to be executed by their respective officers or agents as of the date first above written.

**ALASKA AIRLINES, INC.**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**ASSIGNEE:**

**HSH NORDBANK AG NEW YORK BRANCH, as Security Agent**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**MANUFACTURER:**

**THE BOEING COMPANY**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**SENIOR LOAN PARTICIPANTS:**

**HSH NORDBANK AG NEW YORK BRANCH**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**NORDDEUTSCHE LANDESBANK GIROZENTRALE**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**DEKABANK DEUTSCHE GIROZENTRALE**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**ANNEX I**

**PURCHASE AGREEMENT ASSIGNMENT**

Dated

[\_\_\_\_\_]

between

**HSH NORDBANK AG NEW YORK BRANCH,**  
not individually, but solely as Security Agent, on behalf  
of the Loan Participants,  
Assignor

and

\_\_\_\_\_  
Assignee  
\_\_\_\_\_

EXHIBIT C  
Page 11



**PURCHASE AGREEMENT ASSIGNMENT**

**THIS PURCHASE AGREEMENT ASSIGNMENT** dated \_\_\_\_\_, \_\_\_\_ between **HSH NORDBANK AG NEW YORK BRANCH**, not individually, but solely as Security Agent on behalf of the Loan Participants under the Credit Agreement (as defined below) ("**Assignor**"), and \_\_\_\_\_, ("**Assignee**").

**W I T N E S S E T H:**

**WHEREAS**, Alaska Airlines, Inc. ("**Alaska**") has entered into the Purchase Agreement (as hereinafter defined) with Manufacturer (as hereinafter defined) pursuant to which, among other things, Manufacturer has agreed to sell to Alaska, and Alaska has agreed to purchase from Manufacturer, the Aircraft (as hereinafter defined);

**WHEREAS**, Alaska has entered into a Credit Agreement [HSH/AS B737-800] dated as of October 19, 2005 ("**Credit Agreement**") among Alaska, Assignor, as Security Agent and HSH Nordbank AG New York Branch, Norddeutsche Landesbank Girozentrale and DekaBank Deutsche Girozentrale (together with their successors and assigns, the "**Loan Participants**");

**WHEREAS**, Alaska and Assignor have entered into a Mortgage and Security Agreement [HSH/AS B737-800] dated as of October 19, 2005 ("**Mortgage**"), pursuant to which Alaska has granted to Assignor a security interest in all of Alaska's right and interest in and to the Purchase Agreement with respect to the Aircraft in order to secure payment and performance by Alaska of its obligations under and in respect of the Operative Documents, including the Credit Agreement;

**WHEREAS**, pursuant to the Mortgage, and the Consent and Agreement to Mortgage and Security Agreement executed by the Manufacturer in connection with the Credit Agreement, Assignor has the right, following an Event of Default under the Mortgage, to purchase the Aircraft from the Manufacturer;

**WHEREAS**, an Event of Default under the Mortgage has occurred and is continuing; and

**WHEREAS**, Assignee wishes to acquire the Aircraft and Assignor, on the terms and conditions herein and in the Consent and Agreement of the Manufacturer attached hereto as Exhibit A, desires to assign to Assignee all of Assignor's rights and interests in and under the Purchase Agreement relating to the Aircraft, and Assignee desires to accept such assignment, as hereinafter set forth.

**NOW, THEREFORE**, in consideration of the mutual covenants herein contained and for other good and valuable consideration, the parties hereto agree as follows:

**Section 1. Definitions.** For all purposes of this Assignment, except as otherwise expressly provided for or unless the context otherwise requires, the following terms shall have the following meanings:

"Aircraft" means those certain Boeing Model B737-800 Aircraft, as the case may be, bearing manufacturer's serial numbers [Insert], including [Insert number] CFM International

Model 56-7B26 engines bearing manufacturer's serial numbers [Insert serial numbers] in the configuration (including all optional features and customer furnished equipment) specified in the Purchase Agreement, together with, as the context permits, the aircraft and engine manuals, records and other technical documents delivered therewith under each of the Purchase Agreements.

"Buyer Furnished Equipment" means the equipment purchased by Alaska and supplied to the Manufacturer to be incorporated into an Aircraft as contemplated by the Boeing Purchase Agreement.

"Consent and Agreement" means a consent and agreement substantially in the form of Exhibit A attached hereto.

"Engine Substitution" means [\*\*\*]\*

"Excluded Provisions" means, in relation to the Purchase Agreement, property, data, services, support and other rights of Alaska not expressly assigned pursuant to the Mortgage, including terms extended by the Manufacturer to Alaska based on (i) the overall business relationship of the parties, or (ii) the consideration to be received from Alaska under the Purchase Agreement (including without limitation the number of Aircraft purchased or to be purchased by Alaska under the Purchase Agreement), and including rights made available for the benefit of Alaska only during such time as Alaska is the owner or operator of the Aircraft.

"Manufacturer" shall mean The Boeing Company, a Delaware corporation, and its successors and assigns.

"Purchase Agreement" means that certain Purchase Agreement Number 2497 dated as of June 15, 2005 between Manufacturer and Alaska incorporated by reference with that certain Aircraft General Terms Agreement AGTA-ASA dated as of June 15, 2005 between Manufacturer and Alaska, in each case only to the extent relating to the Aircraft and including Exhibits A and B, Supplemental Exhibits AE1, BFE1, CS1, EE1 and SLP1 and Letter Agreements 2497-1 through 2497-6 (inclusive) [\*\*\*] but excluding any and all other Letter Agreements and the Excluded Provisions.

"Purchase Agreement Assignment", "this Agreement" or "this Assignment" shall mean this Purchase Agreement Assignment.

"Purchase Price" shall mean the full invoice price for the Aircraft as specified in the invoice for the Aircraft to be delivered by the Manufacturer pursuant to the Purchase Agreement (plus the Buyer Furnished Equipment if and to the extent that it has not been provided to the Manufacturer free of charge).

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

All other terms used herein in capitalized form which are defined in the Credit Agreement and not otherwise defined herein shall have the meanings set forth in the Credit Agreement.

**Section 2. Assignment.** Assignor does hereby assign, transfer and set over unto Assignee all of Assignor's right, title and interest in and to the Purchase Agreement, as and to the extent that such right, title and interest relate to the Aircraft and the purchase and operation thereof, including, without limitation:

(a) the right to purchase one or more Aircraft pursuant to and in accordance with the Purchase Agreement upon valid tender by the Manufacturer (provided that the Assignee may purchase one Aircraft without incurring an obligation to purchase any other Aircraft),

(b) the right to accept delivery of the Aircraft, such acceptance to be exercised by an authorized representative of Assignee (provided that Manufacturer shall have received the written notice in advance of the identity and authority of such authorized representative),

(c) the right to take title to the Aircraft and to be named as the purchaser in the bill of sale (the "**Bill of Sale**") to be delivered by the Manufacturer,

(d) all claims for damages in respect of the Aircraft arising as a result of any default by the Manufacturer under the Purchase Agreement or by any vendor or other supplier of aircraft engines or other parts or equipment installed on or in the Aircraft referred to therein, including, without limitation, all warranty, service life policy, aircraft performance guarantee and indemnity provisions contained in the Purchase Agreement and all claims thereunder and

(e) any and all rights of Assignor to compel performance of the terms of the Purchase Agreement in respect of the Aircraft; provided, however, notwithstanding anything contained herein to the contrary:

(i) Assignor shall at all times remain liable to Manufacturer under the Purchase Agreement as and to the extent relating to the Aircraft to perform all duties and obligations of the Customer thereunder to the same extent as if this Assignment had not been executed, and

(ii) the exercise by Assignee of any rights assigned hereunder shall not release Assignor from any of its duties or obligations to Manufacturer under the Purchase Agreement except to the extent that such exercise by Assignee shall constitute performance of such duties or obligations.

**Section 3. Representations, Warranties and Covenants of Assignor.** Assignor does hereby represent and warrant that Assignor has not sold, assigned or pledged or otherwise disposed of the whole or any part of the rights hereby assigned, and that such rights are free and clear of all liens, claims or encumbrances, except as provided in the Purchase Agreement.

**Section 4. Acceptance of Assignment.** Assignee hereby accepts the assignment contained in Section 2.

**Section 5. Rights of Assignee.**

(a) Effective upon the purchase of the Aircraft by Assignee, Assignee and its successors and permitted assigns shall, to the exclusion of Assignor, be entitled to assert and enforce such rights and claims as substitute party plaintiff or otherwise, and Assignor shall, at the request of Assignee or its successors or permitted assigns and at Assignor's expense, cooperate with and take such action as is reasonably necessary to enable Assignee and its successors and permitted assigns to enforce such rights and claims (including, without limitation, providing Assignee with a certified copy of the Purchase Agreement). In furtherance of the foregoing, Assignor hereby constitutes and appoints Assignee, its successors and permitted assigns, Assignor's true and lawful attorney, irrevocably (it being acknowledged that such appointment is coupled with an interest, namely Assignee's rights acquired and to be acquired hereunder) with full power (in the name of Assignor or otherwise) to ask, require, demand, receive, compromise, settle, compound and give acquittance for any and all monies and claims for monies due and to become due under, or arising out of, the Purchase Agreement in respect of the Aircraft, to the extent that the same have been assigned by this Assignment, and for such period as Assignee may exercise rights with respect thereto hereunder, to endorse any checks or other instruments or orders in connection therewith and to file any claims or take any action or institute (or, if previously commenced, assume control of) any proceedings and to obtain any recovery in connection therewith that Assignee may deem to be necessary or advisable in the premises.

(b) All amounts that the Manufacturer or subcontractor or vendor, as the case may be, is obligated to pay to Assignor under the Purchase Agreement with respect to the Aircraft, including, without limitation, in respect of refunds thereunder or resulting from the enforcement of any warranty, covenant, representation, service life policy, aircraft performance guarantee, indemnity or product support agreement thereunder or the enforcement or exercise of any right or power under the Purchase Agreement or hereunder (a "**Manufacturer Payment**"), will be payable and applicable directly to the Assignee.

**Section 6. Certain Rights and Obligations of the Parties.**

(a) Assignee confirms for the benefit of the Manufacturer and subcontractor and vendor, as the case may be, that, insofar as the provisions of the Purchase Agreement (and applicable vendor and subcontractor agreements) relate to the Aircraft, in exercising any rights under the Purchase Agreement (and applicable vendor and subcontractor agreements), or in making any claim with respect to the Aircraft or other goods and services delivered or to be delivered pursuant to the Purchase Agreement (and applicable vendor and subcontractor agreements), the terms and conditions of the Purchase Agreement (and applicable vendor and subcontractor agreements) (including, without limitation, the DISCLAIMER AND RELEASE and EXCLUSION OF LIABILITIES in Article 11 of Part 2 of Exhibit C of the Aircraft General Terms Agreement, and other warranty disclaimer, insurance and indemnity provisions in the Customer Support or Product Assurance Documents of Exhibits B and C to the Aircraft General Terms Agreement (and such similar provisions in the applicable Vendor and subcontractor agreements)) shall apply to, and be binding upon, Assignee to the same extent as if originally named "Customer" therein.

Assignee further confirms that it cannot further assign its rights under the Purchase Agreement without the written consent of Manufacturer and Assignor.

(b) Nothing contained herein shall:

(i) subject the Manufacturer or subcontractors and vendors, as the case may be, to any liability to which it would not otherwise be subject under the Purchase Agreement (and applicable vendor and subcontractor agreements), or

(ii) modify in any respect the Manufacturer's (or subcontractor's and vendor's, as the case may be) contract rights thereunder.

Without limiting the generality of the foregoing, nothing contained in this Assignment shall require Manufacturer (or subcontractors and vendors, as the case may be) to transfer title to or possession of the Aircraft or any other goods, property or services under the Purchase Agreement (and applicable vendor and subcontractor agreements) until delivery thereof and payment therefor pursuant to and in accordance with the terms of the Purchase Agreement (and applicable vendor and subcontractor agreements).

(c) Insofar as this Agreement purports to assign vendor and subcontractor agreements and to bind vendors and subcontractors, Assignee agrees that such assignments and binding are subject to the terms and conditions of such vendor and subcontractor agreements and any provision of this Agreement that would violate any such agreement shall be considered void to the extent relating to such agreement, and neither Assignor nor any other person has made any representations as to the assignability of such agreements or the binding effect of this Agreement on such vendors and subcontractors. For the avoidance of doubt, Assignee acknowledges that the Manufacturer makes no representations or warranties about, and does not consent to, the assignment of engine warranties or warranties, if any, provided by any vendor or subcontractor suppliers of parts or equipment installed on the Aircraft.

(d) Assignor and Assignee agree, expressly for the benefit of Manufacturer, that for all purposes of this Assignment, Manufacturer shall not be deemed to have knowledge of and need not recognize any event, condition, right, remedy or dispute affecting the interests of Assignor or Assignee unless and until Manufacturer shall have received written notice thereof addressed to its Vice President-Contracts at Boeing Commercial Airplanes, P.O. Box 3707, Mail Code 21-34, Seattle, Washington 98124, if by mail, or to (425) 234-1706 if by fax, and in acting in accordance with the Purchase Agreement and this Assignment, Manufacturer may conclusively rely upon such notice.

**Section 7. Further Assurances.** Assignor agrees that at any time and from time to time Assignor shall promptly and duly execute and deliver any and all such further instruments and documents and take such further action as Assignee may reasonably request in writing in order to obtain the full benefits of this Assignment and of the rights and powers herein granted; provided however, that the execution and delivery of any such instrument or document shall not in any way limit or restrict the rights or enlarge the obligations of Assignor in respect of any of the Operative Documents.

EXHIBIT C

Page 16

**Section 8. Nondisclosure.** Assignor and Assignee agree, expressly for the benefit of the Manufacturer, that they will not disclose the terms of the Purchase Agreement to any third party, except:

- (a) as required by applicable laws or governmental regulations,
- (b) with the prior written consent of the Manufacturer,
- (c) to the Loan Participants and to potential transferees thereof permitted by the Credit Agreement and Mortgage and their respective counsel or
- (d) to bona fide potential purchasers of the Aircraft or Assignee's interest therein permitted by the Credit Agreement or their respective counsel, independent auditors, insurance brokers or other agents.

Any disclosure contemplated by clause (c) or (d) of the preceding sentence shall include a requirement that the entity to whom such information is disclosed shall be subject to obligations of nondisclosure with respect to such information substantially the same as those contained herein.

**Section 9. Binding Effect.** This Assignment shall be binding upon and shall inure to the benefit of Assignor, Assignee and their respective successors and permitted assigns.

**Section 10. Notice.** Except as otherwise expressly provided herein, notice hereunder may be given, and shall be deemed to have been received when given. Notice shall be sent to:

Assignor

HSH Nordbank AG New York Branch

[ ]

Assignee

[ ]

**Section 11. Counterparts.** This Assignment may be executed by the parties hereto in separate counterparts, each of which when so executed and delivered shall be an original, but all such counterparts shall together constitute one and the same instrument.

**Section 12. Governing Law.** This Assignment shall be governed by and construed in accordance with the internal laws of the State of New York, including all matters of construction, validity and performance.

**Section 13. Delivery.** This Assignment is being delivered in the State of New York.

\* \* \*

EXHIBIT C

Page 17

**IN WITNESS WHEREOF**, the parties hereto have caused this Purchase Agreement Assignment to be duly executed the day and year first above written.

**HSH NORDBANK AG NEW YORK BRANCH**, as Assignor

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

\_\_\_\_\_, as Assignee

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**EXHIBIT A**

**CONSENT AND AGREEMENT**

The undersigned, **THE BOEING COMPANY**, a Delaware corporation, subject to the last paragraph hereof, hereby acknowledges notice of, and consents to all of the terms of, the Purchase Agreement Assignment dated \_\_\_\_\_, \_\_\_\_\_ by and between HSH Nordbank AG New York Branch, as Security Agent ("**Assignor**") and \_\_\_\_\_ ("**Assignee**") (herein called the "**Purchase Agreement Assignment**"; the terms defined therein or by reference therein being hereinafter used with the same meaning) and hereby confirms to the Assignor and the Assignee, and agrees, that:

(a) all representations, warranties, indemnities and agreements of the Manufacturer under the Aircraft Purchase Agreement No. 2497 dated as of June 15, 2005 between Manufacturer and Alaska, incorporated by reference with that certain Aircraft General Terms Agreement AGTA-ASA dated as of June 15, 2005 between Manufacturer and Alaska, in each case only to the extent relating to the Aircraft and including Exhibits A and B, Supplemental Exhibits AE1, BFE1, CS1, EE1 and SLP1 and Letter Agreements 2497-1 through 2497-6 (inclusive) [\*\*\*]\* but excluding any and all other Letter Agreements and the Excluded Provisions (as defined below) (the "**Purchase Agreement**") and subject to the Engine Substitution, with respect to the Aircraft, to the extent assigned by the Assignor to the Assignee, shall inure to the benefit of the Assignee to the same extent as if originally named the "Customer" therein, subject to the terms and conditions of the Purchase Agreement Assignment and the Purchase Agreement. "**Excluded Provisions**" means, in relation to the Purchase Agreement, property, data, services, support and other rights of Alaska not expressly assigned pursuant to the Mortgage, including terms extended by the Manufacturer to Alaska based on (i) the overall business relationship of the parties, or (ii) the consideration to be received from Alaska under the Purchase Agreement (including without limitation the number of Aircraft purchased or to be purchased by Alaska under the Purchase Agreement), and including rights made available for the benefit of Alaska only during such time as Alaska is the owner or operator of the Aircraft;

(b) the terms and conditions of the Purchase Agreement relating to the Aircraft (including, without limitation, the DISCLAIMER AND RELEASE and EXCLUSION OF LIABILITIES in Article 11 of Part 2 of Exhibit C of the Aircraft General Terms Agreement and other warranty disclaimer, insurance and indemnity provision in the Customer Support and Product Assurance Documents of Exhibits B and C to the Aircraft General Terms Agreement) shall apply to, and be binding upon, the Assignee to the same extent as if originally named "Customer" therein;

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions



(c) the Manufacturer will pay to the Assignee all payments and amounts owed which the Manufacturer may be required to make in respect to the Aircraft under the Purchase Agreement directly to the Assignee at its address at \_\_\_\_\_ Attention: \_\_\_\_\_;

(d) the Assignee cannot further assign its rights under the Purchase Agreement without the written consent of Manufacturer, such consent not to be unreasonably withheld or delayed (it being agreed that the Manufacturer's failure to consent based on (i) a prospective business relationship between the Manufacturer and a third party; or (ii) a current relationship between the Manufacturer and a third party (so long as such third party is not in default under any material agreement between itself and the Manufacturer) shall be unreasonable). If there is any further assignment hereunder, the assignee shall be entitled to take delivery of the Aircraft including all assigned warranties by payment of the unpaid portion of the [\*\*\*]\* Price at delivery that would have been made under the Purchase Agreement, as assigned to the Assignee, but without releasing the Assignor from its obligations to purchase the Aircraft under the Purchase Agreement. The Manufacturer further agrees that it will sell an appropriate support package to any further assignee purchasing one or more Aircraft;

(e) Assignor shall remain obligated to purchase the Aircraft, to the extent the Assignee fails to do so in accordance with the Purchase Agreement; and

(f) for all purposes of an Assignment under the Purchase Agreement Assignment, Manufacturer shall not be deemed to have knowledge of and need not recognize any event, condition, right, remedy or dispute affecting the interests of Assignor or Assignee unless and until Manufacturer shall have received written notice thereof from Assignor addressed to Boeing Commercial Airplanes; Attn: Vice-President- Contracts at P.O. Box 3707, Mail Code 21-34, Seattle, Washington 98124, if by mail, or to (425) 234-1706 if by fax, and in acting in accordance with the Purchase Agreement and the Purchase Agreement Assignment, Manufacturer may conclusively rely upon such notice.

The Manufacturer hereby represents and warrants that:

- (i) the Manufacturer is a corporation duly organized and existing in good standing under the laws of the State of Delaware,
- (ii) the making and performance of the Purchase Agreement, the Bills of Sale and this Consent and Agreement have been duly authorized by all necessary corporate action on the part of the Manufacturer, do not require any stockholder or other approval, do not contravene the Manufacturer's Restated Certificate of Incorporation or By-laws or any indenture, credit agreement or other contractual agreement to which the Manufacturer is a party or by which it is bound, and the making of the Purchase

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

Agreement, the Bills of Sale and this Consent and Agreement does not contravene, and to the best of the Manufacturer's knowledge, the Manufacturer's performance of the Bills of Sale and this Consent and Agreement, does not contravene, any law binding on the Manufacturer, and

(iii) each of the Purchase Agreement, the Bills of Sale and this Consent and Agreement constitutes a binding obligation of the Manufacturer enforceable against the Manufacturer in accordance with its respective terms, subject to (a) applicable bankruptcy, insolvency, moratorium and other similar laws affecting the enforcement of creditors' rights generally and (b) general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

Insofar as the Purchase Agreement Assignment purports to assign vendor and subcontractor agreements and to bind vendors and subcontractors, Manufacturer makes no representations or warranties about, and does not consent to, the assignment of engine warranties or warranties, if any, provided by any vendor or subcontractor suppliers of parts or equipment installed on the Aircraft.

\* \* \*

This Consent and Agreement shall be governed by and construed in accordance with the internal laws of the State of Washington, including all matters of construction, validity and performance.

Dated \_\_\_\_\_, \_\_\_\_

**THE BOEING COMPANY**

By: \_\_\_\_\_  
Name:  
Title:

MSN

EXHIBIT D

ENGINE CONSENT AND AGREEMENT [HSH/AS B737-800]

\_\_\_\_\_, 200\_\_

To: Alaska Airlines, Inc.  
HSH Nordbank AG New York Branch  
Norddeutsche Landesbank Girozentrale  
DekaBank Deutsche Girozentrale

The undersigned, CFM International, Inc. ("**CFM International**"), a corporation organized and existing under the laws of the State of Delaware, hereby acknowledges notice of:

(a) the Mortgage and Security Agreement [HSH/AS B737-800], dated October 19, 2005 (the "**Security Agreement**") between Alaska Airlines, Inc., an Alaska corporation (the "**Assignor**") and HSH Nordbank AG New York Branch, as security agent (the "**Assignee**") in respect of Boeing model B737-800 aircraft (each, an "**Aircraft**"), together with two (2) [\*\*\*] engines for each Aircraft (collectively, the "**Engines**") [\*\*\*]; and

(b) the sale by The Boeing Company to Assignee of the Engines pursuant to the terms of the Purchase Agreement.

CFM International hereby consents to the collateral assignment of certain of Assignor's rights in the CFM Purchase Agreement pursuant to the granting clauses of the Security Agreement. Any capitalized terms used but not defined herein shall have their respective meaning as set forth in the Security Agreement.

CFM International confirms to the Assignee that:

(i) the Warranties related to the Engines provided or otherwise extended to the Assignor pursuant to the CFM Purchase Agreement (namely, the New Engine Warranty, the New Parts Warranty, Ultimate Life Warranty and the Campaign Clause Warranty (the "**Warranties**") shall, subject to the terms and conditions thereof and of the Security Agreement, inure to the benefit of Assignee to the same extent as if originally named "Customer" or the "Airline" therein;

(ii) Assignee shall not be liable for any of the obligations or duties of the Assignor under or in respect of the Warranties, nor shall the Security Agreement give rise to any duties or obligations whatsoever on the part of Assignee owing to CFM International except for the agreement in the Security Agreement on the part of Assignee to the effect that in exercising any rights in respect of the Warranties, or in making any claim with respect to the Warranties pursuant to the CFM Purchase Agreement, the terms and conditions of the Warranties shall apply to and be binding upon Assignee to the same extent as Assignor, nothing contained herein shall subject CFM International to any liability to which it would not otherwise be subject under the Engine Purchase Agreement or modify in any respect CFM International's contract rights thereunder, and with respect to such agreement CFM International agrees that, anything contained in the CFM Purchase Agreement or the Security Agreement to the contrary

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

EXHIBIT D

Page 1

notwithstanding, so long as CFM International shall not have received notice from the Assignee that an Event of Default has occurred and is continuing, the Assignee shall not have any liability to CFM International for failure to comply with any of the terms of the CFM Purchase Agreement with respect to the Warranties; provided always that no person other than CFM International shall have any rights against Assignee with respect to the undertaking and agreement set forth in this paragraph (ii);

(iii) if, at such time as Assignee shall notify CFM International that an Event of Default has occurred and is continuing, Assignee desires to lease or sell any Aircraft to a person who is not then a party to a general terms agreement with CFM International, to the extent permitted under the laws of the United States of America, CFM International agrees that it will then offer to such lessee or purchaser, subject to execution of an agreement to lease or sell such Aircraft, a general terms agreement on CFM International's then standard terms and conditions for a person in the category in which CFM International reasonably determines such lessee or purchaser falls; provided that if such lessee or purchaser is then a party to a general terms agreement with CFM International, such general terms agreement shall apply to any purchase by such lessee or purchaser of such Aircraft provided however that nothing herein shall be deemed to constitute any consent by CFM International to any assignment by the Assignee of their rights in respect of the Warranties.

CFM International hereby represents and warrants that:

(a) CFM International is a corporation duly organized and validly existing under the laws of the State of Delaware;

(b) the making and performance of this Consent and Agreement has been duly authorized by all necessary corporate action on the part of CFM International, does not require any shareholder approval and does not contravene CFM International's certificate of incorporation or by-laws or any indenture, credit agreement or other contractual agreement to which CFM International is a party or by which it is bound or any law binding on CFM International;

(c) the making and performance of the Warranties in accordance with their terms have been duly authorized by all necessary corporate action on the part of CFM International, does not require any shareholder approval, does not contravene CFM International's certificate of incorporation or by-laws or any indenture, credit agreement or other contractual agreement to which CFM International is a party or by which it is bound, and does not, as to the making thereof, contravene any law binding on CFM International, and to the best knowledge of CFM International, does not, as to the performance thereof, contravene any law binding on CFM International;

(d) the Warranties constitute as of the date thereof and at all times thereafter to and including the date of this Consent and Agreement a binding obligation of CFM International enforceable against CFM International in accordance with its terms and this Consent and Agreement, when executed by CFM International, will be a binding obligation of CFM International enforceable against CFM International in accordance with its terms, subject to:

(i) the limitations of application bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the rights of creditors generally; and

(ii) general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

This Consent and Agreement shall be binding upon and shall inure to the benefit of the Assignee and its respective successors and permitted assigns.

This Consent and Agreement may be executed by the party hereto in separate counterparts, each of which when so executed and delivered shall be an original, but all such counterparts shall together constitute one and the same instrument.

This Consent and Agreement shall be governed by and construed in accordance with the internal laws of the State of New York, including all matters of construction, validity and performance.

This Consent and Agreement is being delivered in the State of New York.

\* \* \*

EXHIBIT D

Page 3

IN WITNESS WHEREOF, the party hereto has caused this Consent and Agreement to be duly executed the day and year first above written.

**HSH NORDBANK AG NEW YORK  
BRANCH**, as Assignee

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**CFM INTERNATIONAL, INC.**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

EXHIBIT D  
Page 4

**EXHIBIT E**

**AIRCRAFT MORTGAGE**

**NAME AND ADDRESS OF DEBTOR**

Alaska Airlines, Inc.  
19300 International Blvd  
Seattle, Washington, 98188

**NAME AND ADDRESS OF SECURED PARTY**

HSH Nordbank AG New York Branch  
230 Park Avenue  
New York, New York, 10169

**ABOVE SPACE  
FOR FAA USE ONLY**

Date:

Complete description of collateral being mortgaged:

**AIRCRAFT:**

Boeing 737-800  
U.S. Registration Number:  
Manufacturer's Serial Number:

**ENGINES:**

CFM International, Inc. 56-7B26  
Manufacturer's Serial Numbers:                      and

together with all equipment and accessories attached thereto or used in connection therewith, including engines of 750 or more horsepower, or the equivalent, described above, and all aircraft documents and maintenance records with respect thereto, all of which are included in the term aircraft as used herein.

The above described aircraft is hereby mortgaged to the secured party for the purpose of securing in the order named:

1. The payment of all indebtedness evidenced by and according to the terms of that certain Credit Agreement, hereinbelow described, and all renewals and extensions thereof and instruments delivered thereunder.

Credit Agreement [HSH/AS B737-800] bearing the date as of October \_\_, 2005 executed by the debtor and payable to the order of HSH Nordbank AG New York Branch and each

Senior Loan Participant (as defined therein) in the aggregate sum of up to \$172,000,000 due on or before the [\*\*\*]\*

2. The prompt and faithful discharge and performance of each agreement of the debtor herein contained made with or for the benefit of the secured party in connection with the indebtedness to secure which this instrument is executed, and the repayment of any sums expended or advanced by the secured party for the maintenance or preservation of the property mortgaged hereby or in enforcing its rights hereunder.

Said debtor hereby declares and hereby warrants to the said secured party that it is, and will remain the absolute owner of the legal title to the said aircraft and in possession thereof, and that the same is, and will remain free and clear of all liens of record, encumbrances, and adverse claims whatsoever (other than this mortgage).

It is the intention of the parties to deliver this instrument in the State of New York and that New York law shall be the governing law.

Provided, however, that if the debtor, its heirs, administrators, successors, or assigns shall pay all amounts owing under the Credit Agreement and the interest thereon in accordance with the terms thereof and shall keep and perform all and singular the terms, covenants, and agreements in this mortgage and the Credit Agreement, then this mortgage shall be null and void.

Time is of the essence of this mortgage. It is hereby agreed that, if default be made in the payment of any part of the principal or interest under the Credit Agreement secured hereby at the time and in the manner therein specified, or if any breach be made of any obligation or promise of the debtor herein contained or secured hereby, or if any or all of the property covered hereby be hereafter sold, leased, transferred, mortgaged, or otherwise encumbered without the written consent of the secured party first had and obtained, or in the event of the seizure of the aircraft under execution or other legal process, or if for any other reason the secured party may deem itself insecure, then the whole principal sum unpaid under the Credit Agreement, with the interest accrued thereon, shall immediately become due and payable at the option of the secured party.

Upon default, the secured party may at once proceed to foreclose this mortgage in any manner provided by law, or it may at its option, and it is hereby empowered so to do, with or without foreclosure action, enter upon the premises where the said aircraft may be and take possession thereof; and remove and sell and dispose of the same at public or private sale, and from the proceeds of such sale retain all costs and charges incurred by it in the taking or sale of said aircraft, including any reasonable attorney's fees incurred; also all sums due it under said Credit Agreement and interest thereon, or due or owing to the said secured party, under any provisions of this mortgage, or secured hereby, with the interest thereon, and any surplus of such proceeds

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions



remaining shall be paid to the debtor, or whoever may be lawfully entitled to receive the same. If a deficiency occurs, the debtor agrees to pay such deficiency forthwith.

Said secured party or its agent may bid and purchase at any sale made under this mortgage or herein authorized, or at any sale made upon foreclosure of this mortgage.

EXHIBIT E  
Page 3

IN WITNESS WHEREOF, the debtor has hereunto set its hand and seal on the day and year first above written.

**ALASKA AIRLINES, INC.**

By: \_\_\_\_\_  
Name:  
Title:

EXHIBIT E  
Page 4

ANNEX A  
DEFINITIONS

For all purposes of the Mortgage and Credit Agreement [HSH/AS B737-800] the following terms shall have the following meanings (such definitions to be equally applicable to both the singular and plural forms of the terms defined). Any agreement referred to below shall mean such agreement as amended, supplemented and modified from time to time in accordance with the applicable provisions thereof and of the other Operative Documents. Unless otherwise specified, Section references are to Sections of the Mortgage or the Credit Agreement.

“Advance” means each Advance Payment (as defined in the Boeing Purchase Agreement) payable by Borrower in respect of each Aircraft in accordance with the terms of the Boeing Purchase Agreement which, as of the Effective Date, is in the amount and payable on the date set forth in Schedule III to the Credit Agreement.

“Advance Payment Base Price” means, in respect of each Aircraft, the amount set forth in Schedule III to the Credit Agreement.

“Affiliate” means, with respect to any Person, any other Person which directly or indirectly controls, is controlled by, or under common control with, such Person. The term “control” means the possession, directly or indirectly of the power to direct or cause the direction of the management and policies of a Person, whether through the ownership of voting securities, by contract or otherwise.

“Aircraft” means each Airframe together with the Engines specified in Schedule III to the Credit Agreement in the configuration (including all optional features and Buyer Furnished Equipment) specified in the Boeing Purchase Agreement, together with, as the context permits, the aircraft and engine manuals, records and other technical documents delivered therewith.

“Aircraft Mortgage” means a mortgage in the form of Exhibit E to the Credit Agreement, signed by the Borrower, but undated, and with provisions describing applicable Aircraft and the Engines left blank.

“Airframe” means each Boeing 737-800 aircraft (excluding Engines or engines from time-to-time installed thereon).

“Applicable Margin” means [\*\*\*]\* per annum.

“Applicable Rate” means, for any Interest Period, a rate per annum equal to the LIBO Rate for such Interest Period plus the Applicable Margin.

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

“Boeing Purchase Agreement” means that certain Purchase Agreement Number 2497 dated as of June 15, 2005 between the Manufacturer and the Borrower, incorporated by reference with that certain Aircraft General Terms Agreement AGTA-ASA dated as of June 15, 2005 between Manufacturer and the Borrower, in each case only to the extent relating to the Aircraft and including Exhibits A and B, Supplemental Exhibits AE1, BFE1, CS1, EE1 and SLP1 and Letter Agreements 2497-1 through 2497-6 (inclusive) [\*\*\*]\*, but excluding any and all other Letter Agreements and the Excluded Provisions.

“Borrower” means Alaska Airlines Inc., an Alaska corporation, and its successors and permitted assigns.

“Borrowing Date” means the Effective Date and each date on which an Advance is payable in respect of an Aircraft under the Boeing Purchase Agreement as set forth in Schedule III to the Credit Agreement.

“Break Amount” means (A) where the Applicable Rate is not based on the LIBO Rate, the amount, if any, required to compensate each Holder for any losses, costs or expenses (excluding loss of profit) which it may incur as the result of the prepayment or acceleration (or the failure to make any such prepayment on the date irrevocably scheduled therefor) of any Loan Certificate held by it on a date other than the last day of the then current Interest Period therefor, including, without limitation, losses, costs or expenses incurred in connection with unwinding or liquidating any deposits or funding or financing arrangement with its funding sources, as reasonably determined by such Holder and (B) where the Applicable Rate is based on the LIBO Rate, an amount equal to the excess, if any, of (i) the amount of interest which otherwise would have accrued on the principal amount so prepaid or accelerated to the last day of such Interest Period (the “Break Period”) at the LIBO Rate therefor in excess of (ii) the interest component of the amount the affected Holder would have bid in the London interbank market for Dollar deposits of leading banks in amounts comparable to such principal amount and with maturities comparable to the Break Period (as reasonably determined by such Holder).

“Business Day” means any day other than a Saturday or Sunday or a day on which commercial banks are required or authorized to close in Seattle, Washington and, if such day relates to the giving of notices or quotes in connection with the LIBO Rate or a payment or prepayment of principal or interest on the Loan Certificates, the city in which the Security Agent’s office is located, New York, New York and London, England and, for the Effective Date and for the date on which any Drawing is to be made, Hannover, Germany.

“Buyer Furnished Equipment” means the equipment purchased by the Borrower and supplied to the Manufacturer to be incorporated into an Aircraft as contemplated by the Boeing Purchase Agreement.

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

“Cash Contribution” means, for each Aircraft, the Borrower’s advance payment for such Aircraft of [\*\*\*]\* of the Advance Payment Base Price plus the Engine Substitution Contribution, payable to the Manufacturer under the Boeing Purchase Agreement, and as initially reflected in Schedule III to the Credit Agreement.

“Certificate Register” has the meaning specified in Section 5.7 of the Credit Agreement.

“CFM Purchase Agreement” means that certain General Terms Agreement No. 6-7695 dated as of January 8, 1991, as amended from time to time by and between the Engine Manufacturer and the Borrower, to the extent relating to the Engines and if and only if an Engine Warranty Substitution has occurred, including all Exhibits, Appendices, Tables and Letter Agreements with respect thereto, but excluding Excluded Provisions.

“Code” means the Internal Revenue Code of 1986, as amended.

“Commitment” in respect of any Advance has the meaning specified in Section 2.1 of the Credit Agreement.

“Commitment Fee” means [\*\*\*]\* per annum of the outstanding unutilized Maximum Commitment of each Loan Participant, as cancelled or reduced under Section 3.5 of the Credit Agreement.

“Commitment Termination Date” means the date of the last Advance specified in Schedule III to the Credit Agreement, however, if an Excusable Delay (as defined in the Boeing Purchase Agreement) occurs, or if any other delay occurs which does not result in a termination of either Purchase Agreement or an Event of Default hereunder, then the Commitment Termination Date may be a date not more than 90 days after such date, or as extended by agreement of all Loan Participants.

“Consent and Agreement” means the Manufacturer Consent and Agreement [HSH/AS B737-800], dated as of October 19, 2005, among the Borrower, the Loan Participants, the Security Agent, as assignee, and the Manufacturer.

“Credit Agreement” means that certain Credit Agreement [HSH/AS B737-800], dated as of October 19, 2005, among the Borrower, the Loan Participants and the Security Agent as such Credit Agreement may be amended or supplemented from time to time pursuant to the applicable provisions thereof.

“Default” means any event which with the giving of notice or the lapse of time or both if not timely cured or remedied would become an Event of Default pursuant to Section 2 of the Mortgage.

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“Delivery Date” means, for any Aircraft, the date on which such Aircraft is delivered by Manufacturer and accepted by Borrower or its permitted assignee under the Boeing Purchase Agreement.

“Dollars”, “Dollar” and “\$” means the lawful currency of the United States of America.

“Drawing” in respect of any Advance means the borrowing made by the Borrower on the Borrowing Date with respect to such Advance from each Loan Participant.

“Effective Date” means the date as defined in Section 2.2 on which the initial Drawings are made under the Credit Agreement, being a date on or before October 30, 2005.

“Engine” means in respect of each Airframe, each of the CFM International, Inc. model 56-7B26 engines delivered with such Airframe under the Boeing Purchase Agreement, subject to any Engine Substitution.

“Engine Consent and Agreement” means the Engine Manufacturer Consent and Agreement [HSH/AS B737-800] executed by the Engine Manufacturer and the Security Agent, if and only if an Engine Warranty Substitution has occurred.

“Engine Manufacturer” means CFM International, Inc.

“Engine Substitution” means [\*\*\*]\*

“Engine Warranty Substitution” means the amendment of either or both of the Boeing Purchase Agreement and the CFM Purchase Agreement that results in substitution of the warranties in relation to the Engines given by the Manufacturer under the Boeing Purchase Agreement with warranties given by the Engine Manufacturer under the CFM Purchase Agreement.

“Engine Substitution Contribution” means, in respect of the Cash Contribution, an amount of [\*\*\*]\* payable by the Borrower to the Manufacturer under the Boeing Purchase Agreement.

“ERISA” means the Employee Retirement Income Security Act of 1974, as amended from time to time.

“Event of Default” has the meaning specified in Section 2 of the Mortgage.

“Excluded Provisions” means, in relation to the Boeing Purchase Agreement and the CFM Purchase Agreement, as applicable, property, data, services, support and other rights of the Borrower not expressly assigned pursuant to the Mortgage, including terms extended by the Manufacturer or the Engine Manufacturer to the Borrower (including confidential modifications)

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\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

to provisions of such agreements that have not been, and will not be, disclosed to the Security Agent or Holders) based on (i) the overall business relationship of the parties, or (ii) the consideration to be received from the Borrower under the Purchase Agreement (including without limitation the number of Aircraft or Engines purchased or to be purchased by the Borrower under the Purchase Agreement), and including rights made available for the benefit of the Borrower only during such time as the Borrower is the owner or operator of the Aircraft or the Engines.

“Expense” or “Expenses” means any and all liabilities, obligations, losses, damages, penalties, claims, actions, suits, out of pocket costs, expenses and disbursements (including reasonable legal fees and expenses) of whatever kind and nature but excluding Taxes, internal costs and expenses such as salaries, any amounts that would be included in Break Amounts, and overhead of whatsoever kind and nature.

“Facility Amount” means \$172,000,000, or such lesser amount as specified in Schedule III to the Credit Agreement, as cancelled or reduced by the Borrower under Section 3.5 of the Credit Agreement.

“Federal Aviation Act” means subtitle VII of Title 49 of the United States Code, or any successor provision.

“Fee Letter” means [\*\*\*]\*

“Final Repayment Date” means August 31, 2009 [\*\*\*]\*

“GAAP” means the United States’ generally accepted accounting principles, consistently applied.

“Holder” means, at any time, each Loan Participant and any holder of one or more Loan Certificates.

“Indemnitee” or “Indemnities” means the Security Agent, the Holders and each of their respective successors, permitted assigns, directors, officers, and employees.

“Interest Payment Date” means the first day of each month occurring after the Effective Date, provided that, if any such date shall not be a Business Day, then the relevant Interest Payment Date shall be the next succeeding Business Day.

“Interest Period” means, (i) initially, the period commencing on the Effective Date and ending on the first Interest Payment Date, and (ii) thereafter, the period commencing on the last day of the previous Interest Period and ending on the next Interest Payment Date or, if earlier, the Final Repayment Date.

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

“LIBO Rate” means, with respect to any Interest Period, a rate per annum (calculated on the basis of a 360-day year and actual days elapsed) equal to (x) for the first (if for a period of less than one month) Interest Period for a Series of Drawings, the rate certified by the Loan Participants as their cost of funds for such period and (y) otherwise, the rate determined by the Security Agent (with notice to the Loan Participants and the Borrower) by reference to Telerate Page 3750 as of 11:00 A.M. (London time) on the day two London business days prior to the first day of such Interest Period for a period comparable to such Interest Period.

“Lien” means any mortgage, pledge, lien, claim, encumbrance, lease, security interest or other lien of any kind on property.

“Loan Certificates” means the loan certificates issued pursuant to Section 5.2(a) of the Credit Agreement and any such certificates issued in exchange or replacement therefor pursuant to Section 5.7 or 5.8 of the Credit Agreement.

“Loan Participant” means those parties identified in Schedule I to the Credit Agreement, and its successors and assigns.

“Majority in Interest of Holders” means, as of any date of the determination thereof, the Holders of not less than [\*\*\*]\*% in aggregate outstanding principal amount of all Loan Certificates as of such date. For all purposes of the foregoing definition, in determining as of any date the then aggregate outstanding principal amount of Loan Certificates, there shall be excluded any Loan Certificates, if any, held by the Borrower or any of its Affiliates (unless the Borrower and/or its Affiliates, as the case may be, own all Loan Certificates then outstanding).

“Manufacturer” means The Boeing Company, in its capacity as manufacturer of the Aircraft, and its successors and assigns.

[\*\*\*]\*

“Material Adverse Effect” means [\*\*\*]\*

“Maximum Commitment” means with respect to each Loan Participant, such Loan Participant’s Participation Percentage multiplied by the Facility Amount, as cancelled or reduced under Section 3.5 of the Credit Agreement.

“Mortgage” means the Mortgage and Security Agreement [HSH/AS B737-800], dated as of October 19, 2005, between Borrower and Security Agent, including each supplement from time to time entered into pursuant hereto.

“Mortgage Estate” means the “Mortgage Estate” as defined in the Granting Clause of the Mortgage.

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions



“Non-U.S. Person” means any Person other than (i) a citizen or resident of the United States of America (for purposes of this definition, the “United States”), (ii) a corporation, partnership, limited liability company or other entity created or organized under the laws of the United States or any political subdivision thereof or therein or (iii) an estate or trust that is subject to United States federal income taxation regardless of the source of its income.

“Operative Documents” means the Credit Agreement, the Mortgage, the Loan Certificates, the Purchase Agreements, the Consent and Agreement, and the Engine Consent and Agreement, each Aircraft Mortgage and any amendments or supplements of any of the foregoing.

“Participation Percentage” in respect of each Loan Participant, the percentage set forth for such Loan Participant on Schedule II to the Credit Agreement.

“Past Due Rate” means a per annum rate equal to the Applicable Rate plus [\*\*\*]\* calculated on the basis of a year of 360 days and actual number of days elapsed.

“Payment Account” means the account established pursuant to Section 5.4(a) of the Credit Agreement.

“Payment Office” means the bank and account number of the Security Agent referred to in Schedule I to the Credit Agreement.

“Permitted Investments” means those investments described in Section 5.1 of the Mortgage.

“Permitted Lien” means any Lien permitted under Section 1.1 of the Mortgage.

“Person” means any individual, corporation, limited liability company, partnership, joint venture, association, joint-stock company, estate or trust, unincorporated organization or government or any agency or political subdivision thereof.

“Plan” means an “employee pension benefit plan” (as such term is defined in Section 3(2) of ERISA) or any “plan” (as such term is defined in Section 4975(e)(1) of the Code) which is maintained or contributed to by the Borrower or an Affiliate that, together with the Borrower, is treated as a single employer under Section 414(b), (c) or (m) of the Code or with respect to which Borrower has any direct or indirect material liability.

“Purchase Agreements” means, collectively, the Boeing Purchase Agreement and, from the date of any Engine Warranty Substitution, the CFM Purchase Agreement.

\* Indicates that certain information contained herein has been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions

“Regulation D” means Regulation D of the Board of Governors of the Federal Reserve System (or any successor), as the same may be modified and supplemented and in effect from time to time.

“Regulatory Change” means, with respect to any Holder, any change that occurs after the date of the Mortgage in Federal, state or foreign law or regulations (including Regulation D) or the adoption or making after such date of any interpretation, directive or request applying to a class of banks or financial institutions including such Holder of or under any Federal, state or foreign law or regulations (whether or not having the force of law and whether or not failure to comply therewith would be unlawful so long as compliance therewith is standard banking practice in the relevant jurisdiction) by any court or governmental or monetary authority charged with the interpretation or administration thereof. For the avoidance of doubt, the coming into effect of any applicable law or regulations, policies, orders, directives or guidelines issued by any governmental body, monetary authority or other regulatory organization (whether or not having the force of law) with respect to, arising out of, or in connection with the matters discussed and/or set forth in the proposals set forth in the June 1999 Consultative Paper issued by the Basle Committee on Banking Supervision (as modified, supplemented, revised and/or superseded by any subsequent proposal, consultative paper or other document) shall be deemed a Regulatory Change, except to the extent that compliance therewith has been made mandatory with respect to any Loan Participant on or prior to the Effective Date.

“Reserve Requirement” means, for any Loan Certificate, the average maximum rate at which reserves (including, without limitation, any marginal, supplemental or emergency reserves) are required to be maintained during the Interest Period in respect of such Loan Certificate under Regulation D by member banks of the Federal Reserve System in New York City with deposits exceeding one billion Dollars against “Eurocurrency liabilities” (as such term is used in Regulation D). Without limiting the effect of the foregoing, the Reserve Requirement includes any other reserves required to be maintained by such member banks by reason of any Regulatory Change with respect to (i) any category of liabilities that includes deposits by reference to which the LIBO Rate is to be determined or (ii) any category of extensions of credit or other assets that includes the Loan Certificates.

“Scheduled Delivery Date” means, for each Aircraft, the date specified in Schedule III to the Credit Agreement.

“Securities Act” means the Securities Act of 1933, as amended.

“Security Agent” means HSH Nordbank New York Branch, in its capacity as Security Agent hereunder, and any successor thereto in such capacity.

“Series” has the meaning specified in Section 2.1 of the Credit Agreement.

“Tax” or “Taxes” means any and all fees (including, without limitation, license, documentation and registration fees), taxes (including, without limitation, income, gross receipts, sales, rental, use, turnover, value added, property (tangible and intangible), excise and stamp taxes), licenses, levies, imposts, duties, recording charges or fees, charges, assessments, or

withholdings of any nature whatsoever, together with any assessments, penalties, fines, additions to tax and interest thereon.

“U.S. Air Carrier” means any United States air carrier as to which there is in force a certificate issued pursuant to Section 40102(a) of the Federal Aviation Act, and which is a citizen of the United States (as defined in Section 40102(a)(15) of the Federal Aviation Act) holding an air carrier operating certificate issued by the Secretary of Transportation pursuant to chapter 447 of title 49 (or the equivalent authority issued by the Civil Aeronautics Board under the predecessor regulatory laws, rules and regulations) for aircraft capable of carrying 10 or more individuals or 6,000 pounds or more of cargo or which may operate as an air carrier by certification or otherwise under any successor or substitute provisions therefor or in the absence thereof.

## CERTIFICATIONS

I, William S. Ayer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Alaska Air Group, Inc. for the period ended September 30, 2005;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 9, 2005

By /S/ William S. Ayer  
William S. Ayer  
Chairman, President & CEO

## CERTIFICATIONS

I, Bradley D. Tilden, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Alaska Air Group, Inc. for the period ended September 30, 2005;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 9, 2005

By /S/ Bradley D. Tilden  
Bradley D. Tilden  
Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED  
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Alaska Air Group, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William S. Ayer, Chairman, President & Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By /S/ William S. Ayer  
William S. Ayer  
Chairman, President & Chief Executive Officer  
November 9, 2005

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED  
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Alaska Air Group, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Bradley D. Tilden, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By /S/ Bradley D. Tilden  
Bradley D. Tilden  
Chief Financial Officer  
November 9, 2005