

Background AFO

AOR 1990-10

TEXAS AIR
CORPORATION

1989
ANNUAL
REPORT

Financial Highlights*(Dollars in thousands, except per share data)*

	1989		1988	
	Texas Air Consolidated	Texas Air*	Texas Air Consolidated	Texas Air*
Total Operating Revenues	\$6,684,875	\$ 351,448	\$8,572,928	\$ 160,458
Total Operating Expenses	7,322,170	123,177	8,810,004	114,473
Operating Income (Loss)	(637,295)	28,271	(237,076)	45,985
Net Loss	(885,628)	(885,628)	(718,638)	(718,638)
Net Loss per Common and Common Equivalent Share	(22.71)	-	(18.88)	-
Total Assets	7,556,144	963,892	8,210,901	1,032,887
Cash, Marketable Securities and Restricted Investments	1,271,475	370,965	889,027	399,781
Net Worth, including Redeemable Preferred Stock	(622,840)	(1,026,730)	240,590	(144,144)

*Financial highlights of parent company's operations.

Business Profile

Texas Air Corporation is a holding company that owns all of the common stock of Continental Airlines, Inc., Eastern Air Lines, Inc. and System One Holdings, Inc.

Continental is a major U.S. certificated air carrier with headquarters in Houston which provides service to 149 destinations in the U.S. as well as 56 destinations in Europe, the Pacific, South America, the Caribbean and Central America. System One manages and coordinates the marketing of airline reservations and computer processing systems and telecommunications facilities. Eastern Air Lines, Inc., which was previously controlled by Texas Air, is currently being operated by a court-appointed trustee under protection of bankruptcy laws.

As of year-end 1989, Texas Air and its subsidiaries had substantial liquidity in the form of cash and marketable securities. In addition, Texas Air owned certain assets including aircraft and air transportation related facilities which are leased to Continental. Texas Air is headquartered in Houston and its securities are traded on the American Stock Exchange and the Pacific Stock Exchange.

To Our Shareholders:

During 1989, Texas Air Corporation took a number of important steps to strengthen and protect the basic air transportation franchise we have built during the past decade.

At Continental Airlines, which ended 1989 with a modest profit after capital gains, we can point to continued success in building the carrier's market position and economic viability.

Perhaps most importantly, the continuing dedication of Continental's 33,000 employees to service has resulted in dramatic improvements in operating performance. Measured by U.S. Department of Transportation standards, for instance, Continental had the third best rate of on-time arrivals among major U.S. airlines last year. In addition, the Department of Transportation indicator of customer satisfaction, the carrier "complaint rate," continued its steady improvement.

As a result of this progress, Continental is reaching further into the important business travel marketplace. The mix of more price-sensitive leisure, and higher-yielding business travel on the carrier has continued to show marked improvement.

We also have underway an aggressive program to improve Continental's service by making significant capital investments. In 1989, Continental placed orders for \$4 billion of new aircraft. New Boeing 737-400 and Airbus A330 and A340 aircraft will give the fleet added efficiency and keep Continental competitive in terms of operating economics and maintenance costs. Continental today has a very competitive fleet in terms of its average age, and these new orders will significantly enhance our position as the aircraft are delivered beginning in 1992.

In addition, last year Continental committed to substantial investments at its principal hub locations of Houston, Cleveland, and Newark, as well as at its key airports at LaGuardia and Seattle/Tacoma. More than \$325 million will be spent for terminal, catering and air freight facilities at these locations.

A recently announced agreement with the City of Denver, Continental's other principal domestic hub, permits the carrier to enjoy a lead position in the building of the first new international airport in the United States since 1974. Included are major safeguards to assure cost protection as well as provide Continental with distinct competitive advantages and heightened customer convenience.

Strong domestic hubs and new aircraft will allow Continental to continue capitalizing on growth objectives, which in 1989 were centered in the Caribbean, Central America and the Pacific.

During the year, Continental made major progress in developing the Caribbean and Central American portions of its route system. Continental recently announced service to the 67th city from its growing Houston hub, making it the largest Central American—U.S. carrier.

In mid-1989, Continental was awarded the much sought after Seattle-Tokyo route. This service is being augmented by new flights between Houston and Tokyo, via Honolulu, and flights from Guam to Sendai and Sapporo, Japan. Continental is pursuing still further growth in the Pacific Rim, including flights from Seattle/Tacoma to Nagoya, Japan, and other cities in the Far East.

Continental has made great progress in positioning itself as a truly global carrier.

Our progress on all these projects ultimately depends upon the attitude and productivity of Continental employees, and we continue to institute programs which are designed to strengthen these areas. In 1989, more than 20,000 Continental employees

attended our Quality Service Institute—a joint Continental and SAS project; as productivity has remained high, Continental has also been able to provide competitive compensation and benefit programs without losing its unit-cost advantage.

At Eastern Air Lines, the unresolved conflict between marketplace economic realities and reactionary union leadership, which for years plagued the carrier, forced the filing of a petition to reorganize the company. This followed a strike by machinists, pilots and flight attendants. In less than a year's time, the company returned to approximately two-thirds of its former size.

But the process of rebuilding Eastern was significantly altered by the appointment in April 1990 of a special trustee to lead the reorganization effort. While Texas Air does not believe that this step was warranted, we plan to support the airline, consistent with our overall interests.

Since Texas Air no longer controls Eastern, our financial statements in the future will no longer reflect the results of this entity. As a result of this deconsolidation, Eastern's assets and liabilities will no longer appear on our balance sheet, and we will no longer absorb losses being incurred by Eastern.

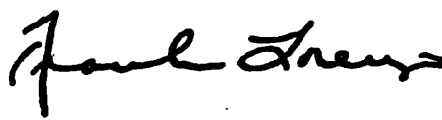
Texas Air's third principal subsidiary, System One, has also moved into a new stage of development through our recently announced joint venture agreement with EDS (Electronic Data Systems, Inc., a subsidiary of General Motors, Inc.). The computer reservations system, telecommunications and data processing operations, which will be transferred, will benefit from EDS's substantial resources and expertise. We expect that Continental and Eastern will remain the principal customers of this partnership and will gain the benefit of cost-efficient service contracts and a strengthened presence in the highly competitive and capital intensive computer reservations environment.

The decision to share the ownership of System One stemmed from our desire to have a partner to share in the development of this business. In addition, this transaction allows Texas Air to realize substantial value without compromising our ability to carry out primary airline-related objectives, and at the same time achieve substantial cost savings in the operation of our computer systems.

Approximately two-thirds of System One's 3,000 employees will become EDS employees as a result of this agreement; we look forward to continuing to work with them, as well as those who will remain as members of the partnership staff. Their relationship with Texas Air, while changed, will remain strong.

The decade ahead promises to provide new opportunities to develop our business and enhance shareholder value. Your management is committed to these goals and to dealing with the unique challenges that face us. We maintain our confidence.

Thank you for your continuing support.



Frank Lorenzo
Chairman of the Board
and Chief Executive Officer

May 1, 1990

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1989

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 No. 1-7969

TEXAS AIR CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

74-2102822

(I.R.S. Employer Identification No.)

333 Clay Street, Suite 4040, Houston, Texas
(Address of principal executive offices)

77002
(Zip Code)

Registrant's telephone number, including area code: (713) 658-9588

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$.01 par value	American Stock Exchange
6.34% Cumulative Convertible Junior Preferred Stock, \$.10 par value	Pacific Stock Exchange
6.50% Depositary Preferred Shares	Pacific Stock Exchange
12% Depositary Preferred Shares	Pacific Stock Exchange
Preferred Stock Purchase Rights	Pacific Stock Exchange
15.34% Senior Notes due 1992	American Stock Exchange
15.34% Senior Notes, Series B, due 1992	American Stock Exchange
10% Exchangeable Subordinated Debentures due 2005	American Stock Exchange
14.375% Senior Notes due 1990	American Stock Exchange
14.900% Senior Notes due 1995	American Stock Exchange
14.14% Senior Notes due 1993	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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

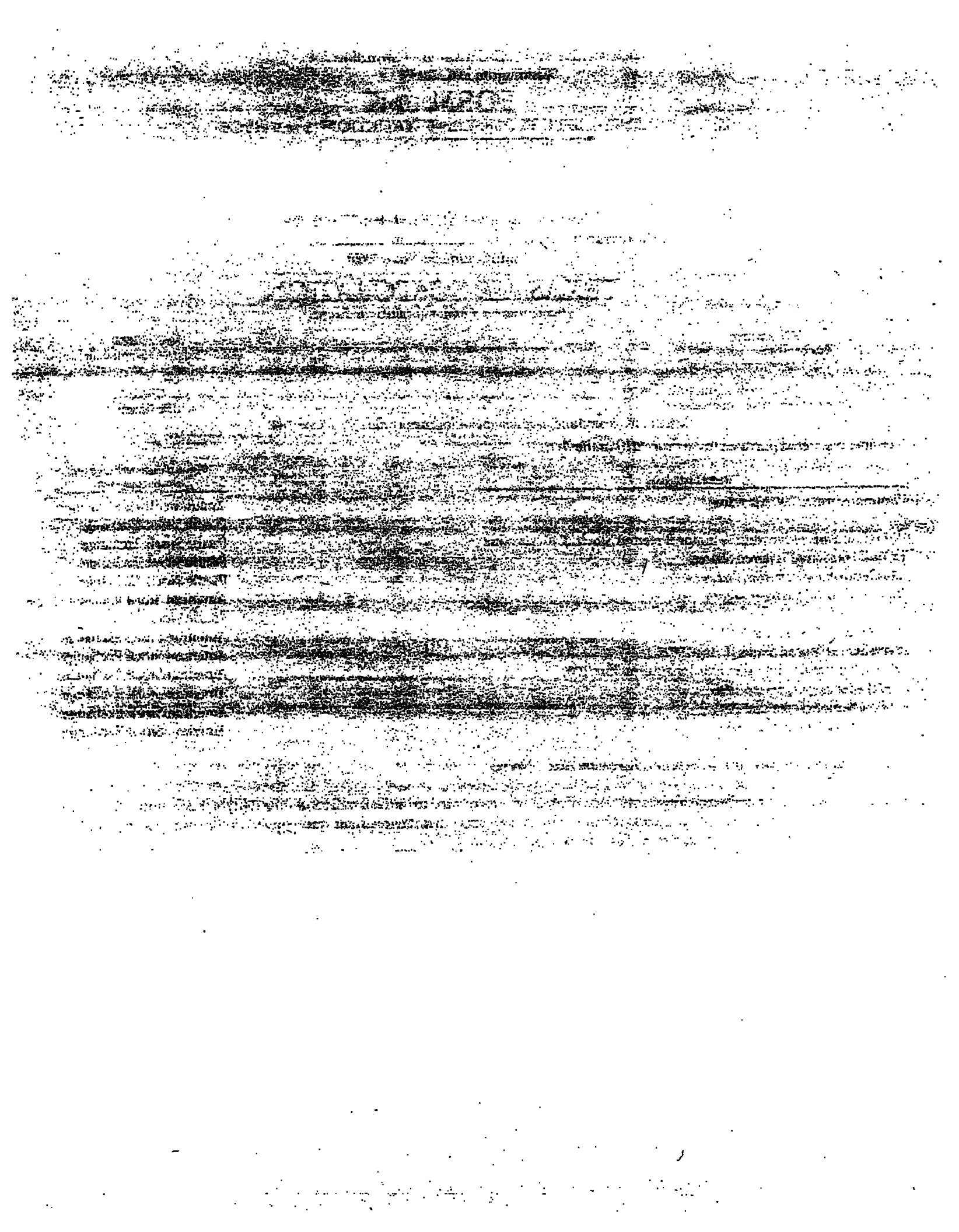
The aggregate market value of the voting stock held by nonaffiliates of the registrant was \$331,571,000 as of February 28, 1990. (For these purposes, "affiliates" have been defined as Jet Capital Corporation and all directors, although the Company does not acknowledge that any such person is actually an "affiliate" within the meaning of the federal securities laws.)

As of February 28, 1990, 40,268,798 shares of the common stock, \$.01 par value, and 2,040,000 shares of the Class A common stock, \$.10 par value, of Texas Air Corporation were outstanding.

The following document(s) are incorporated by reference herein:

Document:
Texas Air Corporation Proxy Statement for 1990

Part of Form 10-K
Part III



PART I

Item 1. Business.

General

Texas Air Corporation ("Texas Air") is a holding company that owns all of the common stock of Continental Airlines, Inc. ("Continental"), Eastern Air Lines, Inc. ("Eastern") and System One Holdings, Inc. ("System One"), as well as certain airline-related assets and aircraft which are leased to subsidiaries, cash and marketable securities. Continental and Eastern were, in 1989, the fifth and ninth largest airlines in the United States, respectively (measured in terms of revenue passenger miles). System One provides computer reservations systems and other products to the airline and travel related services industry. Continental, Eastern and System One are operated as independent companies.

On March 9, 1989, Eastern filed a voluntary petition for reorganization under Chapter 11 of the Federal Bankruptcy Code (the "Code") and currently is operating as a debtor-in-possession under the Code. See Item 1. "Business. Eastern-Chapter 11 Reorganization of Eastern."

In February 1990, Texas Air, System One and Electronic Data Systems Corporation ("EDS") entered into a preliminary agreement providing for the acquisition by EDS of substantially all of the assets of System One and the formation by System One and EDS of an equally owned partnership to operate and market System One's computer reservations systems business.

Texas Air, a Delaware corporation, was incorporated in 1980. Its principal place of business is 333 Clay Street, Suite 4040, Houston, Texas 77002; telephone number (713) 658-9588.

Continental

Continental, together with its subsidiaries, was the nation's fifth largest air carrier in 1989, measured in terms of revenue passenger miles. As of December 31, 1989, Continental and its subsidiaries operated 329 jet aircraft and 101 commuter aircraft and served 143 cities throughout the United States and 48 international destinations.

Continental experienced significant growth in recent years, primarily through its acquisition of a substantial number of aircraft and of People Express Airlines, Inc. ("People Express"), New York Airlines, Inc. ("New York Air"), Frontier Holdings, Inc. (together with its subsidiary Frontier Airlines, Inc., "Frontier") and commuter airline subsidiaries Rocky Mountain Airways, Inc. ("Rocky Mountain"), Britt Airways, Inc. ("Britt"), and Bar Harbor Airways, Incorporated ("Bar Harbor") (which is owned jointly by Continental and Eastern). Substantial funds were and continue to be expended to integrate the acquired operations and divergent fleet types and to provide a consistent and high level of service. During the same period, Continental developed two new hubs, Newark and Cleveland, shifted resources to maximize flying on its most successful routes and significantly expanded its international route system.

On July 11, 1989, the corporate predecessor to Continental merged with its wholly-owned subsidiary People Express and the surviving entity in the merger was renamed Continental Airlines, Inc. All references herein to Continental include, where applicable, the corporate predecessors to Continental.

Background and Ownership. In September 1983, the predecessor corporations to Continental temporarily suspended domestic operations and filed voluntary petitions for reorganization under Chapter 11 of the Code in the United States Bankruptcy Court for the Southern District of Texas (the "Continental Bankruptcy Court"). Continental's Plan of Reorganization (the "Continental Plan") became effective on September 2, 1986, at which point the predecessor corporations were consolidated.

On February 6, 1987, Texas Air acquired the outstanding publicly held shares of common stock of Continental by merger (the "Continental Merger"). A prior holder of Continental securities is contesting the terms of the Continental Merger. See Item 3. "Legal Proceedings. Litigation Contesting the Continental Merger."

Routes. Continental provides service to its domestic markets principally through a system of hub airports at Houston Intercontinental, Newark, Denver and Cleveland. The hub system allows Continental to transport passengers between a large number of destinations with substantially more frequent service than if each route were served directly. This allows substantially more effective use of aircraft resources by enabling Continental to add service to a new destination from a large number of cities using only one or a limited number of aircraft. In addition to accommodating different traffic flows, the use of multiple hubs enhances Continental's ability to reaccommodate passengers when travel through a particular hub city is restricted by weather or other delays.

Continental's jet service at each of its hub cities is complemented by and coordinated with the operations of its commuter airline subsidiaries. The commuter subsidiaries operate turbo-prop aircraft that seat from 15 to 48 passengers and operate under the name "Continental Express."

In recent years, Continental has been the dominant carrier at Houston Intercontinental, where it has consistently expanded service to accommodate traffic growth. As a result of the acquisition of People Express in December 1986, Continental became the dominant carrier at Newark International Airport and, in May 1988, Continental opened Terminal C at Newark. Continental has substantially increased its operations at Terminal C, with the result that Continental currently has more domestic flights to or from the New York City area than any other carrier. Continental began developing its Cleveland hub in 1987 and currently is one of the dominant carriers at the airport. Continental also is one of the dominant carriers at Denver's Stapleton International Airport.

Continental's international operations include the Pacific, where it serves destinations such as Australia, New Zealand, Japan, Guam and Micronesia through gateways in Los Angeles, San Francisco, Seattle and Honolulu. Continental also provides service to, among other destinations, England, France, Central America and Mexico from one or more of its hub cities. During 1989, Continental commenced nonstop service to Japan from Seattle and expanded its Caribbean service from Newark. Continental was recently selected to receive authority to fly from Houston to Tokyo via Honolulu and intends to commence this service later this year, subject to final Department of Transportation ("DOT") and other governmental regulatory approvals.

Certain service, primarily between Hawaii, Micronesia and Guam, and from these points on to other locations in the Pacific, including Japan and the Philippines, is provided pursuant to Continental's joint venture agreement with Air Micronesia. Continental manages the operations and receives at least 99% of the revenues from such service. Air Micronesia receives up to 1% of the revenues provided by such operations.

Employees. As of December 31, 1989, Continental had approximately 31,400 employees, approximately 83% of whom are nonunion. Continental's flight attendants are represented by the Union of Flight Attendants (the "UFA"), and Continental's dispatchers, who number less than 400 employees, are represented by the Transport Workers Union (the "TWU"). Since September 1983, Continental has not had a contract with the UFA. Continental has been bargaining with the UFA over a new contract but no agreement has been reached and, effective January 1, 1989, Continental amended its flight attendant work rules to provide a pay increase and other changes.

In early 1988, the International Association of Machinists and Aerospace Workers (the "IAM"), which represents Eastern's machinists, the TWU, which represents Eastern's flight attendants, and the Air Line Pilots Association ("ALPA"), which represents Eastern's pilots, requested that the National Mediation Board (the "NMB") declare that Continental (whose employees such unions do not represent) and Eastern constitute a "single carrier" for labor relations purposes and certify such unions as the bargaining agents for certain crafts or classes of the combined system. Continental believes that these assertions are not supported by NMB precedent and is contesting them vigorously. No decision has been issued by the NMB, but Continental believes that the NMB proceeding is subject to the automatic stay relating to Eastern's Chapter 11 filing. If the union requests were granted, it is possible that an election could be held among employees of both companies in the applicable job classes to determine whether a particular union would be certified as the bargaining representative or that, as the unions have requested, the NMB could declare them the union representatives of Continental employees. Continental anticipates that unions will continue to seek to be certified as bargaining representatives for certain of its employee groups.

If any Continental employee group which is not presently represented by a union were to select a union as its representative, Continental would be obligated to bargain with the union toward an agreement covering wages and working conditions and, depending on its relationship with the union, Continental's flexibility in dealing with changed circumstances in the industry or in its own operations could be significantly limited and Continental could be adversely affected.

See Item 1. "Business. Effect of Eastern's Chapter 11 Case on Texas Air and Affiliates" for a discussion of possible effects of Eastern's filing for reorganization on Continental.

Eastern

Eastern is one of the nation's original four trunk carriers and was, in 1989, the ninth largest airline in the United States, measured in terms of revenue passenger miles. Texas Air acquired the outstanding common stock of Eastern by merger (the "Eastern Merger") on November 25, 1986.

Chapter 11 Reorganization of Eastern. On March 9, 1989, Eastern and its wholly owned subsidiary, Ionosphere Clubs, Inc., filed voluntary petitions in the United States Bankruptcy Court for the Southern District of New York (the "Eastern Bankruptcy Court") seeking to reorganize under Chapter 11 of the Code. The filing for protection under the Code was necessary due to Eastern's inability to continue substantial operations as a result of the refusal by most of Eastern's pilots, represented by ALPA, to report to work since the commencement on March 4, 1989 of a strike against Eastern by employees of Eastern represented by the IAM. During 1989, Eastern steadily rebuilt its operations. As part of such rebuilding efforts, Eastern sold substantial assets in 1989 and it expects to sell substantial additional assets in 1990 and to emerge from Chapter 11 as a smaller U.S. airline with one primary hub in Atlanta. See "Asset Dispositions."

Eastern is being operated as a debtor-in-possession under the Code. As a debtor-in-possession, Eastern is authorized to operate its business, but may not engage in transactions outside of the ordinary course of business without approval, after notice and hearing, of the Eastern Bankruptcy Court. The committee of unsecured creditors appointed by the Eastern Bankruptcy Court (the "Creditors Committee"), as well as the committee of preferred stockholders appointed by the Eastern Bankruptcy Court (the "Preferred Stockholders Committee"), have been reviewing and making recommendations to the Eastern Bankruptcy Court with respect to any proposed business transactions that are out of the ordinary course of business.

Eastern estimates that as of December 31, 1989, it had approximately \$3.2 billion of prepetition liabilities, including \$2.3 billion of long-term debt and capitalized lease obligations. In addition, other claims have been submitted that are several times greater than Eastern's estimates and may require significant litigation to resolve. See Item 3. "Legal Proceedings. Litigation Relating to Eastern's Prepetition Claims." Under the Code, Eastern is required to pay substantial expenses associated with the Chapter 11 proceedings, which amounted to \$36.9 million through December 31, 1989.

The filing by Eastern of its voluntary petition for reorganization operated as an automatic stay against the commencement or continuation of any judicial, administrative or other proceedings against Eastern, any act to obtain possession of property of or from Eastern, or any act to create, perfect or enforce any lien against property of Eastern, with certain exceptions under the Code. Consequently, Eastern's creditors are prohibited from attempting to collect prepetition debts without the consent of the Eastern Bankruptcy Court. Any creditor may seek relief from the automatic stay and, if applicable, enforce a lien against any security if authorized to do so by the Eastern Bankruptcy Court. Notwithstanding the automatic stay, Eastern has paid certain prepetition liabilities, with approval from the Eastern Bankruptcy Court, including certain payments to foreign vendors and governmental

agencies, wages and salaries for active employees, insurance benefits, pension payments, interest payments, insurance claims, travel agency commissions and certain ticket refunds. In addition, payments are being made on certain debt relating directly to aircraft financing under the provisions of Section 1110 of the Code (which provides special treatment for certain aircraft lenders and lessors permitting them otherwise to obtain possession of such aircraft) and lease rentals for airport properties and certain items of ground equipment.

Certain parties to executory contracts, including leases, with Eastern may file motions with the Eastern Bankruptcy Court seeking to require Eastern to affirm or reject those contracts. Assumption of a contract requires Eastern, among other things, to cure defaults under such contract. Rejection of a contract, which may be done if the contract is found to be onerous and burdensome, constitutes a breach of that contract as of the moment immediately preceding the bankruptcy filing, giving the other party the right to assert a general unsecured claim against the bankruptcy estate for damages arising out of the breach. Eastern has been reviewing its executory contracts and has from time to time assumed or rejected specific contracts.

Eastern had the exclusive right for 120 days after the filing of its Chapter 11 petition to file a plan of reorganization and, in July 1989, Eastern filed a plan with the Eastern Bankruptcy Court. In order to allow Eastern time to negotiate revisions to its proposed plan with its creditors, including the Creditors Committee, the exclusivity period was extended on several occasions, but expired on February 20, 1990. Accordingly, any creditor or equity holder currently is free to file a plan of reorganization with the Eastern Bankruptcy Court and to solicit acceptances of creditors and equity holders with respect thereto. Acceptance of any reorganization plan generally will require the affirmative vote of those classes of Eastern creditors and equity holders whose claims are impaired thereby (subject to certain exceptions in the Code), as well as formal approval thereof by the Eastern Bankruptcy Court.

In February 1990, Eastern and the Creditors Committee agreed, subject to a number of conditions, to a plan of reorganization pursuant to which unsecured creditors would be paid 50% of their claims. The proposed plan was premised upon Eastern's ability to meet feasibility standards set forth in Section 1129(a)(11) of the Code, which standards were included in Eastern's January 1990 business plan.

Since February 1990, Eastern's business and, most importantly, its efforts to attract business passengers have continued to be negatively affected by the uncertainties generated by the bankruptcy proceeding, including questions that have arisen about Eastern's continued viability, continuing delay in achieving satisfactory resolution of its labor contracts and negative and disruptive media accounts about the results of the Examiner's report described below. As a result of these and other factors, Eastern's actual revenues and results have fallen short of projections. Accordingly, in late March 1990, Eastern proposed revisions to the January business plan and informed the Creditors Committee that it would not be able to go forward with the reorganization plan due to its inability to meet such feasibility standards discussed above.

Eastern's revised business plan will reflect a significant short-fall in revenue. Eastern has proposed to revise its business plan to reduce further its postpetition fleet size (from 160 to 148 aircraft), to reduce by 12% the level of flying projected in the January business plan for the period after July 1, 1990 and to reflect the effect of "Y-Not" fares. See Item 1: "Business, Industry Conditions-Competition." In addition, Eastern has stated its intention to seek Eastern Bankruptcy Court approval under Section 1113 of the Code to reject the expired ALPA and TWU labor contracts, which rejection could lead to substantial cost savings, unless negotiations with ALPA and the TWU are successful or assured to come to a definite end. Eastern also intends to seek Eastern Bankruptcy Court approval under Section 1114 of the Code to reduce the cost of health benefits for early retirees and those below age 65, which will also result in significant cost savings to Eastern. In an effort to counter negative publicity and recapture business passengers, Eastern expects to substantially increase its marketing efforts. In addition, the agreement with the Examiner, described below, would remain in place, subject to Eastern Bankruptcy Court approval, thereby providing essential assistance to Eastern following its emergence from Chapter 11. Eastern expects to begin negotiations in the near future with the Creditors Committee with respect to revisions to its business plan and the treatment of claims of unsecured creditors.

In discussions to date, Eastern has proposed that secured debt holders have their claims reinstated, with certain portions of some instruments prepaid on confirmation to reflect the sale of aircraft pledged thereunder and the balance of the outstanding indebtedness rescheduled. Holders of prepetition tickets would be given the choice of payment in full upon plan confirmation or new tickets worth 35% more than the face value of their original tickets. A new series of preferred stock with a liquidation value of \$34.9 million would be issued for all existing outstanding preferred stock, except the 11.36% Cumulative Junior Preferred Stock (the "11.36% Preferred"), which would be cancelled, subject to Texas Air's guaranty of dividend payments, redemption price and liquidation preference when due. Texas Air has been making dividend payments on the 11.36% Preferred since Eastern filed for protection under Chapter 11. Texas Air would waive any rights it has against Eastern arising from such guaranty. Eastern is negotiating with the Preferred Stockholders Committee with respect to this proposal, but no agreement has been reached.

In connection with the proposals described above, Texas Air would retain its equity in Eastern and Eastern would waive any and all potential claims against Texas Air and Continental.

Eastern's unions have been seeking appointment of a trustee in Eastern's Chapter 11 case. A hearing on this motion is currently scheduled for April 2, 1990, but may be adjourned to a later date. Management of Eastern cannot predict when or whether any revised reorganization plan will be formally accepted by creditors and equity holders entitled to vote thereon or approved by the

Eastern Bankruptcy Court or whether any other equity holders or creditors will submit a competing plan of reorganization to the Eastern Bankruptcy Court. If no plan of reorganization is accepted, and approved by the Eastern Bankruptcy Court, it is possible that Eastern will be unable to continue in existence and will be liquidated.

On April 5, 1989, the Eastern Bankruptcy Court, at Eastern's request, appointed an examiner in Eastern's Chapter 11 case (the "Examiner"). The Examiner was given authority, among other things, to review transactions between Eastern and its affiliates. On March 1, 1990, the Examiner filed with the Eastern Bankruptcy Court a report on his review of a number of affiliated transactions. The report contained the Examiner's determination that Eastern could assert possible claims against its affiliates, but in light of the agreement described below, recommended against making such claims. Eastern management does not believe that Eastern has valid claims against any of its affiliates with respect to the intercompany transactions discussed in the report. In a letter to Speaker of the House Thomas S. Foley dated after the report was filed, the Examiner explained the nature of his report and stated that the report "did not make a judgment as to the validity of [any such claims] or [the] likelihood of success. In short, [the Examiner] did not find on the merits against Eastern, Continental or Texas Air."

In connection with the Examiner's review, an agreement was reached among Eastern, Texas Air (for itself and Continental) and the Examiner on certain matters designed to improve the economic viability of Eastern. The agreement provides for, among other things, the payment by Texas Air to Eastern of \$107 million at confirmation and the payment by Texas Air of \$26.3 million of Eastern's deferred pension obligation. In addition, all prepetition obligations (including notes) of Texas Air, Continental and System One to Eastern would be offset against all prepetition obligations of Eastern to such companies. All postpetition obligations among the companies would be offset against each other and the net claim would be paid in cash by the appropriate party. Also pursuant to the agreement, among other things, the management fee charged to Eastern by Texas Air, which was reduced to \$250 thousand per month following Eastern's filing of its Chapter 11 petition, would remain at the reduced level for two years following confirmation. The agreement also provides for certain reductions for five years in the mileage rate for disproportionate usage in connection with the OnePass frequent flyer program. Eastern also would obtain certain purchase options on delivery to Continental of 40 new B737-300 aircraft and a 25% ownership interest in the computer reservations system partnership expected to be formed with EDS. The agreement is subject to Eastern Bankruptcy Court approval and confirmation of a plan of reorganization satisfactory to Eastern. Eastern has moved that the Eastern Bankruptcy Court approve the agreement. Eastern anticipates that in the course of the hearing on such motion, the Eastern Bankruptcy Court itself will analyze the validity of the claims that the Examiner contends could be asserted.

Asset Dispositions. Eastern needs substantial liquidity to rebuild its business and, as a result, has been selling and leasing assets surplus to its needs, including routes, gates and slots, with Eastern Bankruptcy Court approval. In June 1989, Eastern sold its Air Shuttle division, including gates, slots, 13 B727-200 and eight B727-100 aircraft, engines, spare parts and spare engines, to Trump Shuttle, Inc. ("Trump Shuttle") for \$365 million in cash. In 1989, Eastern sold other assets, including 41 aircraft, certain gates, routes, slots and facilities for gross proceeds of approximately \$497.2 million before related debt repayments, of which \$32.5 million have been paid and \$163.5 million remain subject to approval of a final plan of reorganization. Eastern also has leased 14 B727-200 aircraft to Pan American World Airways, Inc. for a term of three years at an aggregate rental of approximately \$58 million over the three year period.

During the first quarter of 1990, Eastern sold to an unrelated party five A300 aircraft, which were immediately leased to Continental, for gross proceeds to Eastern of approximately \$132.5 million. Also during the first quarter of 1990, Eastern sold to and leased back from an unrelated party six A300 aircraft for approximately \$168 million and sold to unrelated third parties one L-1011 aircraft for \$13.5 million, two DC-9-30 aircraft for \$13 million, and two B757 aircraft for \$74 million.

In December 1989, Eastern agreed to sell to American Airlines, Inc. ("American") its 14 Central and South American routes and other assets for aggregate proceeds of approximately \$349 million, subject to adjustment. See "Routes."

Eastern also has agreed in principle to assign to Continental its leasehold interest in two DC-10-30 aircraft and to sell to Continental its DC-10-30 spare parts inventory for \$11 million. In addition, Eastern is negotiating to sell or assign its fleet of 13 L-1011 aircraft. These transactions are subject to Eastern Bankruptcy Court approval.

Eastern needs substantial liquidity to implement its business plan and expects that it will continue to sell assets to provide such liquidity. Consummation of further sales of assets outside the ordinary course of business will require approval of the Eastern Bankruptcy Court. The net proceeds from asset sales by Eastern have been held in restricted accounts for the benefit of its creditors. Eastern has obtained the release of \$320 million from these restricted accounts (of which \$110 million was released during the first quarter of 1990) to meet its obligations and implement its business plan.

Routes. In the period immediately following the strikes commenced on March 4, 1989, Eastern's operations were reduced to approximately 10% of their pre-strike level (measured in terms of available seat miles). During 1989, Eastern steadily increased its operations using management and nonstriking employees, subcontractors and replacement employees to perform the work of striking employees. As of December 31, 1989, Eastern was operating at approximately 70% of its pre-strike level (measured in terms of available seat miles), providing scheduled air transportation between approximately 62 metropolitan areas in the United States and Canada, 13 cities in the Caribbean and 18 cities in Central and South America, as compared to 68, 16 and 18, respectively, as of March 1, 1989, which was immediately prior to the strikes. In January 1990, Eastern presented a revised business

plan to the Creditors Committee pursuant to which Eastern would rebuild an airline serving 68 cities in the United States and Canada and five cities in the Caribbean. Such plan reflects Eastern's agreement to sell its Central and South American routes, as more fully described below. Under this plan, Eastern would operate at approximately 68% of its pre-strike level by July 1990. Eastern has proposed certain revisions to its business plan that would, among other things, further reduce its operations. See "Chapter 11 Reorganization of Eastern."

Pursuant to its business plan, Eastern expects to be in a transitional period through at least the end of June 1990 when the sale of its Central and South American operations is expected to be consummated, its Caribbean operations reduced and excess gates and facilities eliminated. The first half of 1990 also will be marked by the "de-hubbing" of Miami and San Juan. Following the transition, Eastern expects that it will operate as a smaller airline with one primary hub in Atlanta, supplemented with northeast to Florida flying.

In December 1989, Eastern agreed to sell to American, among other things, its 14 Central and South American routes, its route authority for Miami-Madrid, Miami-Toronto and Tampa-Toronto, hangar and cargo facilities at New York's John F. Kennedy International Airport, cargo centers at Miami and San Juan airports, a reservations office building and a former terminal at San Juan, and various takeoff and landing slots at Kennedy, LaGuardia, O'Hare and Washington, D.C. National airports. In addition, Continental agreed to relocate certain of its gates and transfer to American a net of two gates at Dallas-Fort Worth and will sell to American its Miami-London route and certain slots at John F. Kennedy airport. System One will transfer telecommunication lines and equipment related to Eastern's Central and South American operations. Pursuant to the agreements, certain claims will be settled, including various antitrust and racketeering claims in excess of \$225 billion (after trebling, as required by the relevant antitrust and racketeering statutes) brought by Continental and other Texas Air subsidiaries against American relating to American's use of its computer reservations system ("CRS") and certain claims brought by American against Eastern, Texas Air, System One and Continental relating to the conversion of certain travel agencies from American's CRS to System One's CRS. The transactions, which are subject to certain conditions, provide for payments of \$349 million to Eastern, \$102.5 million to Continental and \$19.5 million to System One. The transactions also remain subject to approval by the DOT; approvals by the Eastern Bankruptcy Court and the Department of Justice have been obtained. Currently, Eastern and American are engaged in a dispute as to whether certain conditions have been met relating to the sale of certain assets in San Juan. Eastern and American have been negotiating a resolution to this dispute but if no satisfactory resolution can be reached, the issue will be submitted to the Eastern Bankruptcy Court.

In October 1989, Eastern sold certain assets used in its Philadelphia operations, including 16 DC-9-30 aircraft (two of which were delivered in the first quarter of 1990) and one pair of landing slots at each of New York's LaGuardia Airport and Washington, D.C.'s National Airport. In June 1989, Eastern sold its Air Shuttle division to Trump Shuttle. Until June 2004, neither Eastern nor any of its affiliates may schedule flights (other than "tag-end"

segments of international flights) between New York and Washington, D.C. or New York and Boston (other than to or from Newark) during specified hours of the day.

Employees. Eastern had the equivalent of 18,455 full-time employees as of December 31, 1989, of whom 9,200 were represented by three unions: the IAM, which represented the machinists, baggage handlers, cabin cleaners and other employees in related job categories; ALPA, which represented the pilots; and the TWU, which represented the flight attendants. As of March 1, 1989, immediately prior to the strikes, Eastern had the equivalent of 28,525 full-time employees. In December 1989, Eastern announced that it would eliminate approximately 600 positions during the first few months of 1990 and institute temporary wage reductions from 10% to 20% for certain of its employees, including management.

The IAM, ALPA and TWU contracts expired on December 31, 1987, July 2, 1988 and December 31, 1988, respectively. Under the Railway Labor Act (the "RLA"), which governs certain aspects of an airline's relations with its union employees, the terms of a contract ordinarily may not be changed upon expiration until the parties have exhausted the mandatory collective bargaining and mediation procedures of the RLA. In February 1989, the NMB determined that mediation between Eastern and the IAM had been unsuccessful, thereby triggering under the RLA a 30-day "cooling-off" period that expired at midnight on March 3, 1989. On March 4, 1989, as permitted by the RLA, the IAM called a strike at Eastern and Eastern replaced the IAM contract with new terms and conditions of employment, which substantially reduced the costs for services that had been provided by its IAM-represented employees. ALPA and the TWU also established strikes. As a result, Eastern was unable to maintain substantial operations and filed for protection under Chapter 11 of the Code.

Employees represented by the IAM are continuing their strike against Eastern and Eastern has arranged for management or nonstriking employees, subcontractors or replacement employees to undertake work formerly performed by IAM-represented employees. In late November 1989, ALPA and the TWU terminated their strikes and offered on behalf of their members to return to work. Because the number of pilots and flight attendants who either never went on strike, elected to abandon the strikes prior to November or were hired by Eastern as permanent replacements after commencement of the strikes was sufficient to fill all positions currently available at Eastern, none of the pilots and only some of the flight attendants still on strike when the unions' offers to return to work were made have been reinstated.

After disputes arose over whether returning strikers could displace pilots and flight attendants hired as replacements by Eastern, in August and November 1989, Eastern filed actions in the United States District Court for the Southern District of Florida (the "Florida District Court") seeking declaratory judgments, among other things, that pilots and flight attendants who had been promised permanent status when hired during the

strike and who were flying or in training at the time offers to return to work were received may not be deprived of employment in order to reinstate returning strikers. If such replacements were required, the new hires in training would lose their jobs, potentially giving rise to substantial claims against Eastern for breach of its promises to the new hires of permanent employment. Additionally, Eastern would incur substantial additional training expense and its flight schedules could be disrupted.

Eastern subsequently reached a settlement agreement with the TWU pursuant to which approximately 250 striking flight attendants have been reinstated. Eastern and ALPA have filed cross motions for summary judgment in their dispute over this issue, which motions are pending. In addition, Eastern and ALPA are engaged in other grievance proceedings, including a proceeding relating to the pursuit by ALPA of certain bid grievances of striking or formerly striking pilots. See Item 3: "Legal Proceedings, Litigation Relating to Eastern Labor Matters."

Eastern has been and intends to continue negotiating with each of the IAM, ALPA and the TWU with a view to reaching reasonable replacement contracts. Eastern believes that a successful reorganization is possible only if there are fundamental changes in its business. In Eastern's view this requires significant labor cost concessions from ALPA and the TWU. If these reductions cannot be achieved through negotiation, Eastern intends to seek Eastern Bankruptcy Court relief with respect to these contracts pursuant to Section 1113 of the Code. See "Chapter 11 Reorganization of Eastern." In addition, since the strikes, Eastern has taken steps to reduce its labor costs by imposing new terms and conditions of employment on hourly workers.

In August 1989, the Eastern Bankruptcy Court granted ALPA's request to lift the automatic stay imposed by the Code in order for arbitration hearings to commence on a dispute between Eastern and ALPA over the interpretation of a certain "pay parity" provision in the February 1986 collective bargaining agreement between Eastern and ALPA. ALPA contended that the phrase in question required Eastern to grant pilots wage increases totaling 8% that previously had been scheduled to be granted to employees represented by the IAM. In December 1989, the Eastern Airlines Pilot System Board of Adjustment (the "System Board") issued a final decision and award in favor of ALPA and directed Eastern to pay its pilots back pay comparable to a 3% wage increase on June 1, 1986, a 2% increase on January 1, 1987 and a 3% increase on July 1, 1987. Eastern recorded its estimated prepetition and postpetition exposure under this award of approximately \$65.5 million as of December 31, 1989. Eastern has sought review of the award in the Eastern Bankruptcy Court. Eastern has argued that the System Board exceeded its jurisdiction in awarding to pilots back pay comparable to the 2% increase and the 3% increase received by IAM-represented employees on January 1, 1987 and July 1, 1987, respectively, and that the grievance filed by ALPA concerning these two raises was untimely filed. ALPA has filed a counterclaim with the Eastern Bankruptcy Court contending that

the Eastern Bankruptcy Court has no jurisdiction to review the award. ALPA has sought to enforce the grievance award in an action filed in the Florida District Court. ALPA has agreed that pending a hearing on Eastern's motion before the Eastern Bankruptcy Court, ALPA will not proceed with this action.

ALPA also has filed a grievance seeking a pay increase as a result of a wage increase that it claims was given to certain supervisory employees and has filed a claim in the Eastern Bankruptcy Court of approximately \$252.0 million with respect to this grievance. On January 8, 1990 the System Board denied ALPA's grievance and, accordingly, Eastern has moved to have ALPA's bankruptcy claim arising out of this grievance disallowed.

See Item 1: "Business, Continental-Employees" for a discussion as to the attempts by Eastern's unions to organize Continental employees for the purpose of collective bargaining.

Eastern's unions have engaged in public relations, lobbying and litigation campaigns attacking Eastern since the strikes, as well as various pre-strike actions including "sick-out" and "slow-down" campaigns that have adversely affected Eastern's operations. Eastern believes that the damage to its reputation with the traveling public caused by these actions of, and investigations precipitated by, Eastern's unions have had a significant adverse effect on the level of its revenues.

Certain of Eastern's unions have in the past sought to acquire or sought a purchaser to acquire Eastern. Texas Air believes that certain union actions (including those referred to in the previous paragraph) have been undertaken to depress Eastern's value so that any such acquisition might be accomplished at a bargain price. Eastern and Texas Air have brought a lawsuit asserting this claim against ALPA, the IAM and certain others in the Florida District Court under federal and state racketeering statutes and various state common law grounds. See Item 3: "Legal Proceedings, Litigation Relating to Eastern Labor Matters" for a discussion of this case and of the counterclaims asserted by the unions and others.

System One

System One provides airline reservations and computer processing systems services to the airline and travel related industry, including to Continental and Eastern. Approximately 95% of all travel agencies in the United States have acquired computer reservations systems which provide travel agents with flight availability and other information relating to, among other things, flights, fares, hotels, car rentals, currency exchange rates and tourist information. As of December 31, 1989, the System One CRS was in place in approximately 7,700 travel agencies, making it the third largest CRS in the industry (based on travel agency locations), and was the dominant CRS in Houston, Miami and throughout the State of Florida. The two largest systems are offered by competing airlines. The System One CRS relies to some extent on the market strength of Eastern and Continental.

Airlines that provide competing computer reservations systems have in the past maintained preferential schedule displays, charged widely varying user fees to competitors and engaged in certain other practices with respect to these systems, which placed Texas Air's subsidiaries at a competitive disadvantage. Certain rules of the DOT were intended to eliminate these practices; however, these rules did not achieve the intended result. There has been a significant increase in the fees charged to airlines and a continuation of alleged anticompetitive practices by vendors.

Since September 1989, the DOT has been reviewing the efficacy of the existing CRS rules and it is expected to complete this review by the end of 1990.

Certain U.S. air carriers have entered into agreements with other carriers providing for the shared ownership and joint marketing of each carriers' CRS. United Air Lines, Inc. ("United") has entered into an agreement with USAir, Inc. and certain European carriers and Trans World Airlines, Inc. ("TWA") has entered into an agreement with Northwest Airlines, Inc. ("NWA"). In addition, in early 1990, TWA, Delta Air Lines, Inc. and NWA merged their computer reservation systems. These agreements may adversely affect System One's ability to market its CRS and may enhance the competitive position of the contracting carriers.

In addition to its computer reservations system, System One sells a variety of other services and software to approximately 190 airlines, financial institutions and other businesses throughout the world, including passenger processing, baggage tracing services, flight planning, en route weather information, airport engineering analysis and time sharing services. System One also offers training and educational services, including a fully accredited travel academy.

System One is developing a worldwide computer reservation system with a consortium of European air carriers known as "Amadeus" (consisting of, among other airlines, Air France, Iberia, Lufthansa and Scandinavian Airlines System ("SAS")). System One has agreed to license software to Amadeus and to provide application development and technological and training support. The Amadeus agreement contemplates a significant investment by the consortium in the development of improvements in System One's computer software as well as a marketing arrangement between the consortium airlines and Eastern and Continental. Texas Air believes that Amadeus' affiliation with System One and the proposed marketing arrangements will significantly enhance traffic from foreign travelers on Eastern and Continental.

On February 20, 1990, Texas Air, System One and EDS entered into a preliminary agreement providing for the acquisition by EDS of substantially all of the assets of System One and the formation by System One and EDS of an equally owned partnership to operate and market System One's CRS business (the "EDS Transaction"). In consideration of the EDS Transaction, EDS will pay Texas Air \$250 million (net of certain implementation expenses) and assume certain liabilities.

Among the assets EDS will acquire are all of the software and substantially all of the other assets currently used by System One in providing data processing, telecommunications and application development services to Continental and Eastern. Contemporaneously with the asset acquisition, Continental and Eastern, as well as the CRS partnership, will enter into ten-year agreements with EDS to obtain such services from EDS. These agreements will provide for fixed prices (subject to inflationary adjustments under certain circumstances) over the ten-year term for a specified base package of resources. In addition, the fixed prices may be periodically adjusted upwards or downwards at the request of the airlines based on the cost of resources added to or deleted from the base package.

EDS also will acquire the assets and business of System One's Airline Services Division, previously owned by Continental. This business has historically been profitable for System One. Continental and Eastern have historically realized significant

benefits from association with the System One CRS that are expected to continue when the CRS business is operated by the partnership jointly owned with EDS.

The preliminary agreement is subject to various conditions, including approval by the Eastern Bankruptcy Court of the agreements relating to Eastern. Subject to approval of the agreement with the Examiner, upon confirmation of Eastern's plan of reorganization, Texas Air will transfer its 50% interest in the CRS partnership in equal portions to Continental and Eastern.

Certain of the services Continental and Eastern currently obtain from System One are essential to their businesses, including the operation of Continental's and Eastern's internal reservations systems. Upon consummation of the EDS Transaction, Continental and Eastern will obtain such services from EDS.

As of December 31, 1989, System One employed approximately 3,200 people at its corporate headquarters in Houston, Texas and at its various other locations, including Miami, Los Angeles, San Francisco and Chicago.

Effect of Eastern's Chapter 11 Case on Texas Air and Affiliates

Texas Air is not a party to Eastern's Chapter 11 case and believes there are no grounds for consolidating Texas Air or its assets with Eastern in the Eastern Bankruptcy Court.

Texas Air has guaranteed and may otherwise be liable for certain obligations of Eastern. See Item 7. "Management's Discussion and Analysis of Financial Conditions and Results of Operations" for additional discussion with respect to Texas Air guarantees of Eastern obligations. In addition, the agreement with the Examiner will involve the assumption of certain liabilities and require additional commitments of cash to Eastern from Texas Air or Continental. See Item 1. "Business. Eastern-Chapter 11 Reorganization of Eastern."

Certain transfers of assets from Eastern to Texas Air and other affiliates prior to the commencement of Eastern's Chapter 11 case could be reversed if the Eastern Bankruptcy Court determines that such transfers constituted "fraudulent conveyances" or "preferential transfers." Texas Air believes that the transactions between Eastern and its affiliates were proper and that there were no fraudulent conveyances or preferential transfers.

Pursuant to the agreement with the Examiner, any claims of Eastern relating to the transfers reviewed by the Examiner would be settled. In the event the proposed agreement with the Examiner is not approved by the Eastern Bankruptcy Court, the alleged claims described in the Examiner's report could be asserted against Texas Air and its affiliates. Management of Texas Air does not believe that such claims would prevail if asserted and believes that Texas Air and its affiliates have valid and substantial defenses to those claims. If such claims are asserted, Texas Air intends to defend itself vigorously and believes it will prevail, however final resolution of such claims in favor of Texas Air and its affiliates cannot be assured. There are other claims pending with respect to the examined transactions that are not presently before the Eastern Bankruptcy Court. See "Litigation Relating to the Eastern Merger" and "Litigation Relating to Eastern Labor Matters" under Item 3. "Legal Proceedings."

In the event there is no settlement with the Examiner, Continental will have a substantial unsecured claim against Eastern and certain creditors of Eastern may seek to prevent offset or to require subordination of Continental's claim, although Continental would vigorously oppose such attempt.

Each member of the Texas Air "controlled group" is jointly and severally liable for Eastern's periodic minimum pension plan funding obligations and could be jointly and severally liable for the full amount of the plans' underfundings if Eastern's pension plans were terminated (which may be done only if certain stringent criteria were met). Eastern's 1989 funding obligation, which includes payments due for prior years as to which Eastern received funding waivers, was approximately \$215.3 million. Of this amount, approximately \$117 million was paid by Eastern prior to its Chapter 11 filing. With respect to the remaining \$98.3 million, in September 1989, with Eastern Bankruptcy Court approval, Texas Air paid \$45 million (for which it has a claim against Eastern's bankruptcy estate) and Eastern paid \$27 million. The Internal Revenue Service (the "IRS") waived the payment of the remaining \$26.3 million until the earlier of June 30, 1990 or confirmation of a plan of reorganization. Pursuant to the agreement with the Examiner, Texas Air has agreed to make this payment when due and the amounts paid by Texas Air would be set-off against amounts owed by Texas Air to Eastern. Eastern estimates that its minimum pension plan funding obligations will be approximately \$168 million in 1990 (which includes \$26.3 million for contributions waived in prior years) and \$68 million in 1991, which amounts may vary based on the number of employees, benefit obligations and other circumstances at that time. Depending on the circumstances of a plan termination, the underfunded amount could be substantially higher than the ongoing minimum funding amounts.

Eastern believes that it is unlikely that the Pension Benefit Guaranty Corporation (the "PBGC") will terminate the Eastern plans and throughout Eastern's Chapter 11 proceeding, Eastern has maintained that under any plan of reorganization, the pension plans will not be terminated. However, if it were assumed that Eastern permanently ceased operations and it voluntarily terminated such pension plans, Eastern believes it could fully satisfy its obligations under the plans by purchasing annuity contracts covering each plan participant to pay all plan obligations as they matured, based on actuarial factors that Eastern believes are appropriate, at an estimated cost of approximately \$390 million based on an interest rate of 9.25% applicable to such annuity contracts. If the PBGC were to terminate the Eastern plans or if Eastern terminates the plans in a distress termination (which could be done only on certain conditions) and assume responsibility for the payment of plan benefits, Eastern's obligations to the PBGC for any unfunded liabilities could significantly exceed the costs of purchasing annuities, although Eastern would contend that the use by the PBGC of actuarial factors that produce a substantially higher amount is invalid. Further, current estimates of this liability indicate a potentially significant increase due to the number of employees electing to receive certain early retirement benefits resulting from the reduction in Eastern's workforce. If, upon a termination by the

PBGC, any person liable for such payments fails to pay the PBGC after notice and demand, a lien on all assets of any such person, up to 30% of the positive net worth of the "controlled group" arises in favor of the PBGC as of the date of the plan termination.

Eastern believes that it will be able to satisfy its own pension obligations following its emergence from Chapter 11.

Restructuring

Texas Air has from time to time considered and continues to consider certain restructuring possibilities designed to increase the value of Texas Air capital stock for its shareholders. Texas Air and its subsidiaries are continuing their review of possible restructuring steps, including sales or transfers of assets. Potential purchasers have conducted and continue to conduct discussions with Texas Air and its subsidiaries with respect to such transactions.

Industry Conditions

Competition. The airline industry is highly competitive. On most of their domestic routes, Continental and Eastern compete with at least one other major carrier and, on most major routes, they compete with two or more of such carriers. On shorter routes, they also compete with regional and commuter carriers, which have in some instances expanded into longer haul markets, and with surface carriers.

The airline industry has consolidated in recent years and, as a result, most major airports in the United States are now dominated by one or two large carriers. Competition is often intense at major airports between the dominant carriers. Since the availability of gates, take-off and landing rights ("slots") and other facilities is often limited at major airports, it is difficult in many cases for a nondominant carrier to provide significant new services at an airport dominated by other carriers. However, carriers often compete in such circumstances by providing connecting service through other airports to the same destinations as provided through the dominated airport.

Competition among air carriers in recent years has been primarily in the form of discount fares (which negatively affect revenues unless offset by higher load factors), quality of service and expansion into new markets. Discounting has been most prevalent in the first and fourth quarter of the year when overall travel demand is the weakest. There can be no assurance that periods of significant discounting will not continue. Eastern has been offering significantly discounted fares in an effort to regain passenger traffic. Although the discounted fares have resulted in higher load factors, Eastern's revenues have been and continue to be adversely affected because of Eastern's inability to attract sufficient numbers of full-fare business passengers. See Item 1. "Business. Eastern-Chapter 11 Reorganization of Eastern" and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations." Recently, Eastern introduced "Y-Not" fares that encourage business travelers to fly Eastern by offering first class travel for approximately 15% less than other airlines' unrestricted coach fares.

Eastern has faced increasing competition in its traditional eastern United States markets and certain of its Caribbean markets as other carriers seek to expand their operations. Competition on Eastern's routes intensified in 1988 as Eastern's financial position weakened. When its operations were substantially curtailed in March 1989, Eastern's market position suffered a further erosion

as its competitors accommodated Eastern's passengers on their regularly scheduled and, in some cases, expanded service. This competition, along with Eastern's need for liquidity, has resulted in the decision by Eastern's management to rebuild Eastern into a smaller airline operating principally out of Atlanta.

Cost. In any price competition, carriers with lower cost structures have an advantage over those with higher cost structures. Labor costs are a significant variable that can significantly impact airline results. For the year 1989, labor costs constituted approximately 30.9% of Eastern's total operating expenses and approximately 22.3% of Continental's total operating expenses. Eastern's labor expense has been governed largely by labor contracts which do not take into account free market labor rates. Since the strikes, Eastern has taken steps to reduce its labor costs by imposing new terms and conditions of employment on hourly workers. For a discussion of Eastern's efforts to reduce its labor costs under the ALPA and IAWU contracts, see Item 1 "Business, Eastern-Employees."

Fuel is another significant expense, with fuel costs constituting 15.2% of Continental's total operating expenses and 11.4% of Eastern's total operating expenses in 1989. Fuel prices increased significantly in 1989 and continued to rise in early 1990 as a result of strong winter demand and the destruction of a major refinery. Fuel prices are currently decreasing and are expected to level out in mid-1990. Any substantial increase in the cost of jet fuel which cannot be offset by increased revenues will have an adverse impact on earnings. In addition, in the event of fuel supply shortages due to disruption in petroleum imports or otherwise, curtailment of scheduled service or higher fuel prices might result.

Certain airlines have recently lowered their average costs through the acquisition of more efficient aircraft, in some cases at discounts granted by aircraft manufacturers for bulk purchases, and the hiring of employees at lower wage levels which may result in certain airlines becoming stronger competitors.

Continental's and Eastern's costs have also been affected by their high degrees of leverage. See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Marketing. As is the case with other carriers, a significant number of tickets for travel on Continental and Eastern are sold by travel agents. Travel agents generally receive commissions measured by the price of tickets sold. Recently, airlines have experienced increased commission expense because of, among other things, the payment of commission overrides in connection with special revenue programs. In an effort to encourage travel agents to book passengers on Eastern, Eastern has been offering travel agents significant incentive programs. It is anticipated that such special incentive programs will continue as Eastern implements its business plan.

In February 1990, Eastern established a "refund protection program" for travel agents and the flying public, guaranteeing full cash payment of potential refund claims during Eastern's Chapter 11 proceedings. See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations. Liquidity and Capital Resources - Eastern."

Due to the greater demand for air travel on Continental's routes during the summer months, revenues in the third quarter of the year are generally significantly greater than revenues in the first quarter of the year and moderately greater than revenues in the

second and fourth quarter of the year. Historically, Continental's results of operations have reflected this seasonality but have also depended on numerous other factors that are not necessarily seasonal, including the extent and nature of competition from other airlines, fare wars, changing levels of operation, fuel prices and general economic conditions. Eastern does not believe seasonal variations are material for an understanding of its business, although increased airline travel during traditional holiday and vacation periods produce increased revenue during those times.

Continental and Eastern operate a frequent flyer program known as OnePass. In recent years, airlines have expanded the scope and benefits available under their frequent flyer programs in an effort to attract and retain passengers, and the success of such programs has created intense competition among the airlines. Although Continental and Eastern believe that they have benefited from the OnePass program through increased traffic, substantial increases in the redemption of OnePass mileage credits could adversely affect their yields, although such risks are minimized by the structure of the program. Recognizing that Eastern's and Continental's proportional shares of mileage credits earned by participating frequent flyers may not equal their proportionate share of mileage credits redeemed by such participants, Eastern and Continental provided for, among other things, compensation between themselves in the event that award redemptions on one carrier exceed the mileage credits earned on that carrier. Pursuant to the agreement with the Examiner, these fees paid would, for the next five years, be reduced by approximately 50%. See Item 1 "Business, Eastern-Chapter 11 Reorganization of Eastern." As a result of Eastern's reduced level of operations, more frequent flyer awards have been redeemed for flights on Continental.

In October 1988, Texas Air, Eastern and Continental entered into agreements with SAS that provide for the creation of a comprehensive alliance with SAS. The agreements with Continental provide, among other things, for the leasing of airport facilities at Newark International Airport, the performance by Continental of ground handling services at Newark, joint marketing programs, joint sales representation and code sharing. In addition, Continental and SAS are operating a quality service training institute for employees. Also pursuant to the agreements, SAS paid Texas Air and Continental \$25 million and \$15 million, respectively, in 1989.

See Item 1 "Business, System One" for a discussion of computer reservations systems.

Airport Access. The Federal Aviation Administration (the "FAA") has designated John F. Kennedy, LaGuardia, O'Hare and Washington, D.C. National airports as "high density traffic airports" and has limited the number of slots at those airports. The FAA has in the past reallocated to other carriers by lottery certain slots previously owned by Texas Air's airline subsidiaries at LaGuardia, O'Hare and Washington, D.C. National airports. Currently, slots at the high density traffic airports may also be voluntarily sold or transferred among carriers. Various amendments to the slot system have been proposed from time to time by the FAA, Congress and others that could significantly affect

operations at the high density traffic airports. Certain of such proposals could have the effect of restricting the number of flights, limiting the transferability of slots, making it easier to have slots withdrawn, or decreasing the value of Eastern's and Continental's slots. Texas Air cannot predict whether any of such proposals will be adopted.

The DOT allows local airport authorities to implement procedures designed to abate special noise problems, provided such procedures do not unreasonably interfere with interstate or foreign commerce or the national transportation system. Accordingly, certain airports, including the major airports at Boston, New York, Washington, D.C., Chicago, Los Angeles and Denver, have established airport restrictions to limit noise, including restrictions on aircraft types to be used and limits on the number of hourly or daily operations or the time of such operations. In some instances these restrictions have caused curtailments in services or increases in operating costs and such restrictions could limit the ability of airlines to expand their operations at the affected airports. Local authorities at other airports are considering adopting similar noise regulations.

The ability of Continental and Eastern to service airports is also dependent on the availability of airport gates, which availability is restricted at certain of the airports served by Continental and Eastern because the demand for gates exceeds the existing supply.

Industry Regulations. Texas Air's airline subsidiaries operate under certificates of public convenience and necessity issued by the DOT. Such certificates may be altered, amended, modified or suspended by the DOT after notice and hearing if the public convenience and necessity so require, or may be revoked for intentional failure to comply with the terms and conditions of a certificate. The airlines are also regulated by the FAA, primarily in the areas of flight operations, maintenance, ground facilities and other technical matters. Pursuant to these regulations, Continental and Eastern have established, and the FAA has approved, a maintenance program for each type of aircraft operated by the carriers that provides for the ongoing maintenance of such aircraft ranging from frequent routine inspections to major overhauls. Recently, the FAA has issued a number of maintenance directives and other regulations in part to address concerns relating to the age of aircraft being flown by U.S. air carriers. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations. Liquidity and Capital Resources."

The award of international routes to U.S. carriers is regulated by agreements between the United States and foreign governments. In the past, the United States generally has followed the practice of encouraging foreign governments to accept multiple carrier designations on foreign routes, although certain countries have sought to limit the number of carriers.

International terrorist activity has resulted in the FAA and other governments requiring increased security measures at certain airports, the cost of which has been borne by the airlines. Such activity has already adversely affected the volume of international

air travel in general, although management believes the impact on Continental and Eastern has been less than on other airlines which have a greater focus on European and Middle Eastern routes.

On April 13, 1988, following substantial pressure on the U.S. Congress through the lobbying efforts of Eastern's unions, the DOT instituted an informal, nonadjudicatory preliminary investigation into the "fitness" of Texas Air and its subsidiaries. The investigation was conducted to determine, among other things, whether the operations of the air carriers owned by Texas Air were complying with all applicable requirements or whether a formal continuing fitness investigation or enforcement action was required. Simultaneously with the DOT investigation, the FAA instituted a comprehensive inspection of all aircraft in the Continental and Eastern fleets. In June 1988, the DOT reported that there was no basis to challenge the fitness of Texas Air and its airline subsidiaries. In addition, the FAA reported that Continental and Eastern were fully safe to fly. In December 1988, the DOT refused ALPA's request that it commence another fitness investigation at Eastern. Texas Air believes that the financial results of its airline subsidiaries have been significantly adversely affected by these investigations. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations. Results of Operations."

Item 2. Description of Properties.

Continental

Flight Equipment. As of December 31, 1989, Continental operated a fleet of 329 jet aircraft, as follows:

Type	Total(a)	Owled	Leased(b)	Seats in Standard Configuration	Average Age (in years)
Two Engine					
B747-200	6	6	-	408	18.0
B747-100	2	-	2	408	19.1
Three Engine					
DC-10-10	9	-	9	284	17.3
DC-10-30	8	2	6	258	13.4
B727-200	80	34	46	149	15.4
B727-100	14	4	10	119	23.8
Two Engine					
MD-80	65	11	54	146	5.0
DC-9-30	34	6	28	108	18.2
DC-9-10	7	-	7	83	23.8
B737-300	35	10	25	130	3.6
B737-200	25	8	17	108	20.4
B737-100	14	14	-	94	21.5
A300	12	2	10	260	8.1
Total	329	91	238		

- (a) Does not include 19 B727-200 and one MD-80 aircraft leased to unaffiliated air carriers and five DC-9-51 aircraft subleased to Eastern, all of which are under short-term operating leases. Includes certain DC-9-30 aircraft which Continental provided to Eastern under an agreement that was terminated in early 1990.
- (b) Includes the following aircraft which Continental leased from Texas Air: 14 MD-80, 29 B737-300 and seven DC-9-30 aircraft.

Virtually all the aircraft and engines owned by Continental are subject to mortgages. All aircraft leased from unrelated parties are leased on a long-term basis.

In 1989, Continental sold and leased back 21 aircraft and disposed of one aircraft which was being leased to an unrelated party.

In June 1989, Continental entered into an agreement with The Boeing Company to purchase 50 B737-300 narrow-body aircraft with an option to purchase an additional 50 such aircraft for an aggregate purchase price (including options) of \$2.8 billion, which price assumes an indexed price escalation factor. With certain notice, Continental has the right to convert its firm or option B737-300 aircraft to B737-400 series or B737-500 series aircraft. Prices may be higher or lower depending on the actual escalation factor at the time of delivery. Deliveries are scheduled from 1992 through 1995 on the firm aircraft and from 1995 through 1997 on the option aircraft. Pursuant to the agreement with the Examiner, Continental has agreed to provide to Eastern certain purchase options on delivery of up to 40 of such aircraft.

In November 1989, Continental agreed to purchase a total of 20 Airbus A330 and A340 wide-body aircraft, with an option to purchase 20 additional A330 or A340 aircraft for an aggregate purchase price, including option aircraft and spare engines, of approximately \$4.5 billion. Such price assumes an inflation-indexed escalation factor. The actual price per aircraft may vary depending on the escalation factor at the time of delivery. Deliveries on the firm aircraft are scheduled from 1993 through 1999. Pursuant to the terms of the agreement, Continental may assign its right to purchase up to approximately 25% of the firm and option aircraft to an affiliate, including to Eastern, although it has not agreed to do so.

While Continental has obtained substantial term and predelivery financing commitments from the respective manufacturers, subject to certain conditions, Continental expects to arrange specific asset financing for the Boeing and Airbus aircraft and related equipment closer to the time of each aircraft's delivery based on prevailing market conditions. There can be no assurance, however, that such third party financing will be available.

In March 1990, Continental agreed to lease from an unrelated third party, on a long-term basis, one B747-200 aircraft which is scheduled for delivery during the second quarter of 1990.

See "Eastern-Flight Equipment" for a discussion of certain aircraft-related transactions between Continental and Eastern.

As of December 31, 1989, Continental's commuter airline subsidiaries (Bar Harbor, Britt and Rocky Mountain) operated fleets consisting in the aggregate of 101 aircraft, as follows:

Type	Total(a)	Owned	Leased	Seats in Standard Configuration	Average Age (in years)
ATR-42	25	10	15	46	1.3
Beechcraft 1900	26	10	16	19	4.0
Beechcraft C99	14	10	4	15	4.4
Dash 7	6	2	4	48	10.2
EMB 120	20	14	6	30	1.2
Fairchild	2	2	-	46	30.8
Metro II	2	2	-	16	12.5
Saab 340	6	-	6	35	3.4
Total	101	50	51		

(a) Does not include 11 Beechcraft 99, seven DC-3, six YS-11, eight Fairchild and 12 Metro II aircraft having an aggregate net book and realizable value of approximately \$12 million, which aircraft have been deemed to be surplus to the commuter's operating needs as a result of Continental's substantial efforts to standardize its commuter fleets. Britt has a contract for the sale of the 12 Metro aircraft at net book value.

Owned aircraft in the above table include aircraft owned by Continental and leased to the commuter subsidiaries. Substantially all leased aircraft are leased on a long-term basis by either Continental or the subsidiary.

Continental is continuing to purchase commuter aircraft. As of December 31, 1989, 30 EMB 120 aircraft remained to be delivered at an aggregate cost of approximately \$168 million, with deliveries scheduled through the first quarter of 1991. In addition, 13 ATR-42 aircraft remain to be delivered at an aggregate cost of approximately \$100 million, with deliveries scheduled through 1990. Continental expects to lease all of these additional aircraft to its subsidiaries. Various forms of financing support are available in connection with these purchase agreements. At December 31, 1989, financing commitments had been secured for all of the aircraft scheduled for delivery other than the last 20 EMB 120 aircraft. Management of Continental believes that it will realize substantial operating efficiencies from the acquisition of these aircraft by virtue of standardized spare parts, centralized maintenance programs, standardized pilot training and operating procedures and the interchangeability of aircraft among the commuter carriers.

Continental continually reviews its jet and commuter flight equipment needs and may determine to acquire additional aircraft or to sell or lease certain of its existing aircraft.

Ground Facilities: Continental's principal facilities are located in Houston, Los Angeles, Denver, Cleveland, Honolulu and Newark. All such facilities, as well as substantially all of Continental's other facilities, are leased on a long-term, net rental basis, with the lessee responsible for maintenance, taxes, insurance and other facility-related expenses and services. In certain locations, Continental owns hangars and other facilities on land leased on a long-term basis, which facilities will become the property of the lessor on termination of the lease. At each of its hub cities and most other locations, Continental's passenger and baggage handling space is leased directly from the airport authority on varying terms dependent on prevailing practice at each airport. Continental also maintains administrative offices, airport and terminal facilities, training facilities and other facilities related to the airline business in the cities it serves.

The City of Denver is preparing to construct a new airport intended to replace Stapleton, which will significantly increase costs of operations at Denver. In March 1990, Continental entered into an agreement with the City of Denver to support the construction of the new airport which is scheduled to open in late 1993. Pursuant to the agreement, Continental will enter into a 20-year lease at the new airport, subject to Continental's cost per enplaned passenger not exceeding a specified amount. Also

pursuant to the agreement, Continental will be provided the gate concourse closest to the ticketing terminal, and Denver will issue airport revenue bonds in an amount up to \$100 million to finance the construction of Continental support facilities including a maintenance facility, flight kitchen and cargo facility. Denver has also agreed that all operations at Stapleton will terminate upon opening of the new airport which will be located approximately 10 miles northeast of Stapleton.

Eastern

Flight Equipment. As of December 31, 1989, Eastern's fleet consisted of 191 jet aircraft, as follows:

Type	Total	Owned	Leased	Seats in Standard Configuration	Average Age (in years)
Three Engine					
DC-10-30 (a)	2	-	2	240	15.4
L-1011 (b)	14	11	3	316	15.1
B727-200 (c) (d)	66	27	41	149	13.8
Two Engine					
A300 (e)	18	11	7	252	8.3
B737 (f)	24	17	7	185	5.7
DC-9-31	25	5	20	120	13.3
DC-9-31 (g)	40	39	1	99	21.9
Total	191	110	81		

- (a) Eastern has agreed in principle, subject to certain conditions including Eastern Bankruptcy Court approval, to assign its leasehold interest in these aircraft to Continental.
- (b) In the first quarter of 1990, Eastern sold one of these aircraft and is currently negotiating to sell or assign the balance of its L-1011 fleet.
- (c) Includes 18 aircraft on short-term leases to unaffiliated companies.
- (d) Includes three aircraft classified as nonoperating property at December 31, 1989.
- (e) Includes five aircraft that were sold to an unrelated third party and subsequently leased to Continental and six aircraft that were sold and leased back in the first quarter of 1990.
- (f) Includes two aircraft which have been sold during the first quarter of 1990. Such aircraft are classified as nonoperating property at December 31, 1989.
- (g) Includes two aircraft that were sold in the first quarter of 1990.

Virtually all the owned aircraft listed above are subject to mortgages. The aircraft shown as leased are leased from unrelated parties on a long-term basis with the exception of five DC-9-31 aircraft which are subleased from an affiliate on a short-term basis. During a portion of 1989 and the first quarter of 1990, Continental provided to Eastern up to 16 DC-9-31 aircraft and related crews, which are excluded from the table. Also excluded from the table are six DC-9-30 aircraft that Continental currently is providing to Eastern under short-term arrangements that the parties intend to finalize as a long-term lease.

As of December 31, 1989, Eastern had no firm orders to purchase aircraft. However, pursuant to an agreement with the Examiner, Eastern would obtain from Continental certain purchase options on delivery of 40 new B737-300 aircraft. See Item 1. "Business. Eastern-Chapter 11 Reorganization of Eastern."

Ground Facilities. Eastern leases substantially all of its hangars and ground facilities, including space occupied by its executive offices and its principal overhaul and maintenance bases in Miami, its bases in Atlanta, Boston, Newark and New York, and its local

ticket and administrative offices throughout its system. Eastern has agreed to sell its hangar, cargo, terminal and office spaces at John F. Kennedy and San Juan airports. See Item 1. "Business. Eastern-Routes."

Most of Eastern's principal facilities, or the land on which they are situated, are leased on a long-term net rental basis. The Dade County Aviation Department, which operates Miami International Airport, has asserted that Eastern's long-term lease at the airport for certain terminal facilities expired March 11, 1989. Eastern believes that its leasehold interest extends through March 1998 and that its leasehold interest is subject to the protection of the Eastern Bankruptcy Court.

Eastern and Continental have entered into a long-term lease with the Port Authority of New York and New Jersey providing for the construction of a new terminal at LaGuardia where current gate space is tightly restricted.

Item 3. Legal Proceedings.

General Litigation

In February 1987, a person who alleges he is a stockholder of Texas Air filed an action in the Court of Chancery for the State of Delaware in and for New Castle County (the "Chancery Court"), entitled *Scriber v. Bakes, et al*, naming as defendants Texas Air, Jet Capital Corporation ("Jet Capital") and certain present and former directors and officers of Texas Air (including Messrs. Carney, Garrett, Handmaker, Hickey, Lorenzo, McCormick, Pohlad, Snedeker and Wilson). The action challenges, among other things, (i) certain sales by Texas Air of shares it owned of capital stock of New York Air and Continental and certain sales by CCS Automation Systems, Inc., ("CCS") a wholly owned subsidiary of the Company at the time in question, to certain of the individual defendants, (ii) loans made by Texas Air in connection with these transactions and the subsequent repurchase of such shares of New York Air and CCS by Texas Air at a profit to such individuals, (iii) certain other loans from Texas Air to the other defendants, and (iv) certain arrangements pursuant to which Texas Air has made joint investments with Jet Capital. The action charges, among other things, that such transactions were improper and lacked a legitimate business purpose and seeks an accounting to Texas Air from the other defendants. The defendants have advised Texas Air that they have valid and substantial defenses to these charges.

Claims of Continental Employees

On September 24, 1983, the corporate predecessors to Continental temporarily suspended domestic operations and filed voluntary petitions for reorganization under Chapter 11 of the Code in the Continental Bankruptcy Court. The Continental Plan became effective on September 2, 1986 (the "Plan Effective Date"), at which point Continental emerged from the protection of the Continental Bankruptcy Court.

At the time the Chapter 11 petitions were filed, Continental unilaterally implemented new wage levels and work rules for all of its employees and rejected certain collective bargaining agreements. ALPA, the UFA and the IAM filed claims with the Continental Bankruptcy Court on behalf of Continental employees for alleged damages arising out of various actions taken by Continental, including the rejection of their executive contracts. Continental settled all union claims with ALPA, the

UFA and the IAM (with certain exceptions that are immaterial to its financial position), without prejudice to the rights of individual employees to seek to pursue their derivative share of such claims. In accordance with their individual right under the union settlements, individual pilots and flight attendants have applied to intervene in one or more of the claims filed by ALPA and the UFA, asserting claims aggregating approximately \$40 million. Continental has opposed approximately half of such claims on the ground that the claimants failed to comply with the intervention procedures prescribed by the Continental Bankruptcy Court. Because the Continental Bankruptcy Court has already entered orders disallowing the claims in which intervention is sought, any intervening employees will have to obtain rulings reversing the Continental Bankruptcy Court decisions in order to recover on their claims. In February 1989, the Texas District Court affirmed the Continental Bankruptcy Court's 1985 and 1986 orders, which denied claims for damages from Continental's rejection of union contracts. These orders have been appealed and argument was held before the Fifth Circuit Court of Appeals in January 1990. Continental believes it is likely that other claims will continue to be pursued on appeal. In January 1987, the Bankruptcy Court issued a Nunc Pro Tunc order that changed in certain respects its original order approving the settlement with ALPA, and issued three additional orders purporting to interpret the settlement, one of which could increase Continental's liability under the settlement for severance payments to pilots by approximately \$22 million. In July 1987, the three January orders were declared null and void by the District Court. In March 1989, the District Court reinstated and affirmed the three January 1987 orders. In April 1989, the District Court vacated the January 1987 Nunc Pro Tunc order except in so far as the order extended the period for pilots to accept recall and authorized the Bankruptcy Court to further modify and interpret the ALPA settlement. Continental has appealed the District Court's rulings affirming the three January orders and the April order. On June 26, 1989, the District Court granted Continental's motion to stay the March and April orders pending Continental's appeal of such order to the Fifth Circuit Court of Appeals. Individual pilots have also filed a lawsuit alleging that the back-to-work provisions of the ALPA settlement are unlawful and discriminate against former striking pilots. Continental intends to contest vigorously any efforts to amend the terms of the ALPA settlement in a manner adverse to it or its current employees.

In addition to derivative claims being pursued by employees, individual employees filed claims with respect to Continental's Chapter 11 filing, including claims for damages from the rejection of union contracts and for furlough pay, of which approximately \$28.6 million has not yet been resolved. The determination of the amount of disputed claims remains under the Continental Bankruptcy Court jurisdiction. The Plan does not require Continental to set aside funds for the payments of these claims or provide a limit on the amount of these claims.

Current and former Continental pilots have asserted claims that Continental's rejection of its ALPA collective bargaining agreement violated the terms of a side letter between Texas Air and ALPA executed in 1982. Three groups of pilots have brought suit against Texas Air seeking damages arising from Texas Air's alleged breach of the side letter. The *Maas, Sykes* group is composed of approximately 280 pilots who filed suit in Texas State District Court, Harris County, Texas. On January 10, 1990 the Texas State

District Court granted Texas Air's motion for summary judgment and entered a final judgment that the pilots take nothing by their suit. The pilots have filed an appeal. The *O'Neill* group intervened in *Texas Air v. ALPA* (a suit originally brought by Texas Air in the District Court, seeking a declaratory judgment that Texas Air had no liability under the side letter) seeking damages for the alleged breach of the side letter by Texas Air. The litigation was settled by the ALPA settlement and on that basis, the District Court entered an order and final judgment dismissing ALPA's claims and the *O'Neill* group intervention. The District Court, in an oral ruling from the bench, stated the side letter did not create individual rights in the intervenors. The *O'Neill* group appealed. An argument was heard before the Fifth Circuit Court of Appeals on March 6, 1990. The *Adair* group, 48 resigned and retired pilots, brought suit in 1986 in Colorado State District Court against Texas Air seeking damages for the alleged breach of the side letter. In the spring of 1989, the court submitted the fact issues in the case to a jury without ruling on Texas Air's legal defenses. On May 18, 1989, a jury determined that the side letter was intended to be a guaranty of Continental's collective bargaining agreement. Management of Texas Air and Continental believe that the pilots will not be entitled to any recovery because, among other legal defenses, (i) all claims under the side letter, if any, were settled and released by the ALPA settlement, (ii) the pilots are not entitled to damages because they were on strike, (iii) the Bankruptcy Court has already determined the pilots were not entitled to contract rejection damages and, (iv) the duration of the side letter was the same as the duration of the Continental/ALPA collective bargaining agreement, which was rejected September 23, 1983. Additional and substantial proceedings are necessary for the court to rule on Texas Air's legal defenses and another jury trial would be necessary on damages. Continental has agreed to indemnify Texas Air for any liability.

Litigation Concerning the Continental Merger

Pursuant to the settlement of certain class action lawsuits that contested the Continental Merger in February 1987, Continental agreed in March 1987 to pay \$3.75 per share of Continental common stock held by its former stockholders in addition to the merger consideration of \$16.50 per share. The settlement does not encompass the lawsuit brought by American General Corporation and American General Life Insurance Company (together, "American General") in the Delaware Chancery Court against Continental, Texas Air and certain directors of Continental and Texas Air. In its action, American General alleges, among other things, that the merger consideration is inadequate and that the Continental Merger is unfair and violated the terms of warrants to purchase up to approximately 5.1 million shares of Continental common stock, subject to adjustment, and an option agreement granting certain rights to subscribe to future issues of Continental common stock, which warrants and option were received by American General in June 1983 in connection with a \$40.0 million loan by American General to Continental. Pursuant to the terms of the Continental Merger, Continental believes that the warrants

were converted into the right to receive the merger consideration and that the option ceases to be applicable as a result of the Continental Merger.

In March 1987, American General moved for partial summary judgment asserting that its warrants are exercisable for a number of shares of Texas Air common stock equal to eight-tenths of the number of shares of Continental common stock previously subject to such warrants, on the grounds that similar options were offered by Texas Air to certain employees of Continental pursuant to the Texas Air 1987 Stock Option Plan (the "1987 Plan"). In January 1988, the Delaware Chancery Court held, among other things, that the Continental Merger did not breach the 1983 option agreement, and that upon exercise of its warrants, American General has the right to the same options to be granted to Continental employees under the 1987 Plan (in addition to American General's contractual right to the merger consideration). Continental and Texas Air appealed the Chancery Court's decision. Although a hearing on the appeal was held in late 1988, one of the judges subsequently disqualified himself, and a new hearing was held April 11, 1989. Thereafter the Chancery Court, on its own motion, set the appeal for the hearing *in banc*, which hearing was held in September 1989. A decision is pending. The 1987 Plan provides that the options granted to employee stockholders will be automatically suspended in certain events, including the award of similar options to American General. The validity and effect of these provisions is at issue in the appeal.

On May 11, 1988, American General attempted to exercise its warrants. Such exercise was rejected by Continental because of American General's refusal to accept the merger consideration as full payment of the warrants. Continental has extended the expiration date of the warrants to June 10, 1990, to allow an orderly determination of each party's rights.

Litigation Relating to Computer Reservations Services

In September and October 1985, Continental and New York Air filed antitrust lawsuits against American and United in the U.S. District Court for the Northern District of California seeking substantial damages. In the lawsuits, Continental and New York Air alleged, among other things, that preferential schedule displays on the American and United CRS caused travel agents to make reservations on these carriers even when Continental or New York Air would have more nearly corresponded to the customers' needs. The suit against United has been settled. The suit against American will be settled pursuant to the agreement to sell certain assets to American.

In October 1987, American filed an action in the District Court of Tarrant County, Texas against Continental, Texas Air, Eastern, System One and certain other affiliated companies. The action alleges that the defendants, in contracting with travel agents for the use of the System One CRS, wrongfully induced certain travel agent users of American's CRS to breach contracts relating to such use. The action seeks, among other things, direct and consequential damages amounting to unspecified millions of dollars and exemplary damages in the amount of \$100 million. Pursuant to the agreement with American, this suit also would be dismissed.

Litigation Relating to the Eastern Merger

In September 1986, a purported class action entitled *Weis v. Eastern Air Lines, Inc., et al* was commenced in the Chancery Court against Eastern, certain of its directors and Texas Air alleging, among other things, that the director defendants, aided and abetted by Texas Air, breached their fiduciary duties with respect to the negotiation of the agreement providing for the merger pursuant to which Texas Air acquired Eastern and the payment of allegedly grossly inadequate merger consideration. The action seeks damages, among other things. A second lawsuit, filed in October 1986 in the same court entitled *Kronfeld v. Eastern Air Lines, Inc., et al*, alleges the same grounds for relief.

In November 1986, a purported class action entitled *Kass, et al v. Eastern Air Lines, Inc.* was filed in the Chancery Court. Such action seeks, among other things, to require that each holder of any of the five series of Eastern's outstanding subordinated debentures in connection with which certain consents were sought and obtained in the merger, receive a cash payment or ticket vouchers, regardless of whether such holder gave his consent. Also in November 1986, a purported class action entitled *Louwensbus v. Eastern Air Lines, Inc.* was filed against Eastern in the Chancery Court. This lawsuit has been consolidated with the Kass lawsuit. A third lawsuit, entitled *Schulman v. Eastern Air Lines, Inc.*, was filed the same month, asserting the same claims as in the *Louwensbus* and *Kass* cases.

In November 1986, an action entitled *Hasinger-Murtagh, et al v. Texas Air Corporation, et al* was filed in the Florida District Court by, among others, the leaders of Eastern's three major unions against Eastern, members of Eastern's Board of Directors, and Texas Air. The suit alleges, among other things, that there were misstatements and omissions of material facts in the proxy materials relating to the Eastern Merger and that Eastern's directors breached certain fiduciary duties. Following the Eastern Merger, plaintiffs amended their complaint, among other things, to seek certification as a class action on behalf of all employee stockholders of Eastern, which class was certified in February 1988 on the issue of compensatory damages. The Florida District Court did not grant class certification on the remaining count, which alleges the wasting of corporate assets. Thereafter, Eastern conceded that this claim could proceed as a derivative claim.

Litigation Relating to Eastern Labor Matters

In February 1987, Eastern filed an action in the Florida District Court alleging that the IAM and certain of its individual officers had attempted to coerce and interfere with Eastern representatives and circumvent contract grievances and bargaining procedures, in violation of the RLA and common law. In March 1987, the IAM filed counterclaims alleging that Eastern had attempted to interfere with the IAM and its representatives and to frustrate the grievance resolution process, had made unilateral changes in the collective bargaining agreement, and had furloughed IAM-represented employees, in violation of the RLA and Florida law. In January 1988, all of the IAM's claims were dismissed, except those based on a theory of anti-union animus.

In July 1987, ALPA filed a complaint against Eastern in the U.S. District Court for the District of Columbia (the "D.C. District Court") alleging, among other things, that Eastern, acting in concert with Texas Air, has transferred routes, aircraft, and other assets to various other Texas Air subsidiaries in violation of the

RLA. The complaint seeks unspecified money damages and, among other things, an injunction directing Eastern to take all action necessary to restore the parties to their respective positions prior to the alleged unlawful conduct. In February and March 1988, the TWU and the IAM, respectively, filed similar actions in the D.C. District Court. These actions have been consolidated with the ALPA action described above. The action filed by the IAM also includes Eastern's directors, Texas Air, Jet Capital and System One as defendants. The defendants have filed a motion to dismiss the ALPA complaint or, in the alternative, for summary judgment with respect thereto and have filed a motion to dismiss the IAM complaint.

In response to Eastern's announcement that it would implement changes in its flight schedule effective August 31, 1988 and furlough employees, the IAM, ALPA and the TWU each filed motions in the respective above-referenced pending cases seeking to enjoin Eastern from implementing these schedule changes. The D.C. District Court issued a preliminary injunction prohibiting Eastern from furloughing its union-represented employees until Eastern and its unions exhausted the mandatory bargaining procedures of the RLA. In September 1988, the U.S. Court of Appeals for the District of Columbia Circuit (the "D.C. Court of Appeals") reversed the D.C. District Court's judgment and dissolved, without condition, the preliminary injunction. In January 1989, the D.C. Court of Appeals denied the union's petition for rehearing and suggestion for rehearing *en banc*. In February 1989, the unions filed a petition for writ of certiorari with the U.S. Supreme Court. The Supreme Court has extended the time for Eastern to respond to the petition until the automatic stay has expired or been lifted.

In November 1987, the IAM filed an action in the D.C. District Court claiming that Eastern was bargaining in bad faith and seeking a declaratory judgment and injunctive relief. In December 1987, Eastern filed a motion seeking summary judgment, which motion is pending. In February 1989, the IAM moved for leave to amend its complaint to allege additional claims of bad faith bargaining. In March 1989, the D.C. District Court indicated that it would grant the IAM's motion to amend its complaint, but would reserve any further action pending resolution by the Eastern Bankruptcy Court of the impact of the automatic stay.

A shareholder derivative action, entitled *Givis v. Texas Air Corporation, et al.*, was filed in the Chancery Court in December 1987 against, among others, Texas Air and certain officers and directors of Eastern. The lawsuit, brought by a holder of several series of Eastern preferred stock, including its 20% preferred, but funded by ALPA, alleges breach of fiduciary duty of loyalty, waste of corporate assets and breach of Eastern's Certificate of Incorporation. Plaintiff seeks (1) an order (i) temporarily restraining defendants from causing Eastern to transfer any assets to Texas Air or any of its subsidiaries; (ii) rescinding the sale by Eastern of two computer subsidiaries; and (iii) granting plaintiff the right to convert his 20% Preferred into Eastern common stock and the right to vote with respect to the sale of certain assets, and (2) unspecified damages and costs, including reasonable attorneys' fees. The defendants moved to dismiss the complaint and plaintiffs filed a motion for a preliminary injunction. In June 1989, the defendants removed the suit to the U.S. District Court for the District of Delaware.

In May 1988, Eastern and Texas Air filed a suit in the Florida District Court against, among others, ALPA and the IAM alleging that the defendants violated the Racketeer Influenced and Corrupt Organizations Act ("RICO"), the comparable Florida state statute, and various aspects of Florida common law by engaging in a concerted plan to so damage Eastern that Texas Air would be forced to sell Eastern to ALPA and the IAM at a bargain price. The damaging conduct alleged includes a defamation campaign and the "slow-down" and "sick-out" discussed under Item 1. "Business Eastern- Employees." The suit seeks, among other things, \$1.5 billion in damages and an injunction against certain conduct. In July 1989, the Florida District Court denied the defendants' motion to dismiss, although the defendants subsequently filed a renewed motion to dismiss based in part on constitutional grounds. In September 1989, the defendants filed their answers and asserted counterclaims against Texas Air and Eastern and named Continental, Jet Capital and Messrs. Lorenzo and Bakes as additional counterclaim defendants. The counterclaim alleges that the named parties participated in acts of mail and wire fraud, extortion and securities fraud and defamed them through statements made to Continental and Eastern employees and others. These claims include class action allegations on behalf of employee owners of Eastern common and 20% convertible preferred stock that Texas Air and other counterclaim defendants omitted to disclose the existence of an alleged plan to acquire Eastern for less than fair value and to transfer Eastern assets to Texas Air subsidiaries and other third parties at artificially low prices. The counterclaims seek unspecified compensatory and consequential damages, treble damages pursuant to RICO and Florida state law, punitive damages and attorneys fees. Texas Air and the other defendants, except Eastern, which has not been served, filed motions to dismiss the counterclaims, which motions are pending. In October 1989, ALPA and the IAM filed motions in the Eastern Bankruptcy Court to lift the automatic stay as to their counterclaims against Eastern. In November 1989, Eastern opposed these motions and filed an adversary complaint in the Eastern Bankruptcy Court to enter a stay to enjoin prosecution of the unions' counterclaims against Eastern's counterclaim codefendants. All motions are pending.

In March 1989, a case entitled *Copeland v. Eastern Air Lines, Inc., et al.* was filed in the New York State Supreme Court, County of New York, against Eastern, Texas Air, Jet Capital, System One and Continental. The complaint alleges that various transactions between Eastern and its affiliates constitute avoidable conveyances under the New York Debtor and Creditor law. Plaintiffs request (i) setting aside such conveyances and transfers and appointing a receiver to take charge of such property, (ii) an injunction restraining Eastern from engaging further in such transfers, (iii) an injunction restraining the non-Eastern defendants from further conveyances of such property acquired from Eastern, and (iv) damages and costs. In May 1989, the case was removed to the Eastern Bankruptcy Court. In November 1989,

the Eastern Bankruptcy Court, with the consent of the parties, permitted the plaintiff to amend his complaint, among other things, to add ALPA as a plaintiff. In December 1989, Eastern filed a motion to dismiss the complaint. In January 1990, the Eastern Bankruptcy Court, without deciding Eastern's motion, enjoined further prosecution of the case until April 30, 1990.

Also, in March 1989, ALPA sent a demand letter to Eastern, Continental and Texas Air seeking to initiate seniority integration procedures pursuant to certain labor protective provisions contained in the last Eastern-ALPA collective bargaining agreement. ALPA sought through its demand to require integration of the Eastern and Continental pilots. After Eastern objected to ALPA's demand on the grounds that the arbitration award on which ALPA's demand was based does not require the integration that ALPA sought and violated the automatic stay, ALPA filed a motion in the Eastern Bankruptcy Court to lift the stay in order to permit the seniority integration to proceed. In September 1989, the Eastern Bankruptcy Court entered an order allowing the arbitration award to become final, but staying any action by ALPA purporting to enforce that award. ALPA has appealed that order to the U.S. District Court for the Southern District of New York (the "New York District Court").

In September 1989, ALPA filed a complaint with the Florida District Court seeking injunctive and monetary relief under the RLA's status quo, collective bargaining and nondiscrimination provisions based upon Eastern's agreement to "wet lease" Continental aircraft and pilots to fly Eastern revenue flights. Eastern then filed an adversary complaint in the Eastern Bankruptcy Court seeking to enjoin ALPA's "wet lease" litigation on the grounds that ALPA's complaint violated the Code's automatic stay provision. In October 1989, the Eastern Bankruptcy Court entered an order directing ALPA to dismiss its wet lease lawsuit, which ALPA then did. ALPA has appealed the October order to the New York District Court.

In December 1989, Eastern filed an adversary complaint and a motion to enjoin ALPA from pursuing pilot bid grievances challenging Eastern's practice of not accepting bids submitted by striking pilots because such pilots were on strike, or by formerly striking pilots when Eastern had no available vacancies because replacements had already been hired to fill such vacancies. ALPA had filed grievances after each bid contending that Eastern's conduct violated the Eastern-ALPA collective bargaining agreement. Eastern's adversary complaint also sought a ruling that it could continue for a reasonable period the use of temporary work rules it had implemented at the commencement of ALPA's strike. After the Eastern Bankruptcy Court issued a temporary restraining order, ALPA moved to withdraw the reference of Eastern's adversary complaint from the Eastern Bankruptcy Court to the New York District Court and in that court sought a transfer to the Florida District Court. In January 1990, the New York District Court entered an order referring Eastern's adversary complaint back to the Eastern Bankruptcy Court for trial. Included in the New York District Court's order was a ruling that Eastern had the legal right to continue to use the temporary work rules for a

reasonable period after the strike had ended. In February 1990, ALPA filed a motion for reconsideration of its motion to withdraw the reference, which motion is pending. A trial on the bid-related portion of Eastern's complaint is scheduled for March 27, 1990. A trial on the remainder of Eastern's complaint, relating to Eastern's continued use of its temporary work rules, will be scheduled after completion of the trial on the bid-related portion. ALPA has agreed not to litigate in any other forum any arbitration or judicial complaint on any of the issues presented by Eastern's complaint.

In February 1990, a group of 18 formerly striking pilots filed a complaint, purportedly on behalf of a class of approximately 1,800 un reinstated former strikers, against Eastern, Texas Air, Jet Capital and the Administrative Committee of the Eastern Pilot Pension "B" Plan, alleging that Eastern violated the RLA by improperly denying them the right to return to work in seniority order after ALPA made an unconditional offer to return to work on their behalf on November 22, 1989 and that Eastern violated its legal obligations to the Eastern pilots' pension plans, in violation of the RLA, RICO and the civil rights act. In March 1990, the Eastern Bankruptcy Court enjoined this action as a violation of the automatic stay.

Litigation Relating to Eastern's Prepetition Claims

Eastern has prepared a list of its creditors and the amount of their claims, which list was filed with the Eastern Bankruptcy Court (the "Schedule"). Section 501 of the Code allows any creditor to file a proof of claim with the Eastern Bankruptcy Court, which claim is deemed an allowed claim unless a party in interest objects thereto. If an objection is made to the allowance of a claim, the Eastern Bankruptcy Court, after notice and hearing, will determine the amount, validity and priority of such claim. August 31, 1989 was the last date for filing against Eastern's Chapter 11 estate all claims arising before the date of Eastern's Chapter 11 petition. The aggregate amount of prepetition claims filed against Eastern is several times greater than Eastern's estimate of such liability. Eastern believes that many of these claims are invalid, duplicative or based upon contingencies that have not occurred.

Unless otherwise noted, all of the proceedings relating to litigation against Eastern described above were automatically stayed upon the filing by Eastern of a petition for reorganization under Chapter 11 of the Code. Leave to lift the stay and allow the actions to proceed may be sought by Eastern or by other affected parties from the Bankruptcy Court. In the various asset transfer cases described above, Texas Air and the other codefendant affiliates may seek from the Eastern Bankruptcy Court and the other relevant courts extension of the stay with respect to themselves. Pursuant to the agreement with the Examiner, certain of the proceedings described above, or portions thereof, would be dismissed.

Management believes that the discussion under Item 1. "Business. Effect of Eastern's Chapter 11 Case on Texas Air and Affiliates" accurately states the effect, if any, that the litigation of Eastern described above will have on Texas Air and its affiliates.

In addition to the above lawsuits, Texas Air and/or its subsidiaries are involved in various matters of litigation, antitrust proceedings, personal injury and other civil actions, as well as other claims and disputes that could result in additional litigation.

Item 4. Submission of Matters to a Vote of Security Holders.

Not applicable.

Executive Officers of the Registrant

The following table sets forth certain information regarding the executive officers of Texas Air.

<u>Name, Age and Position</u>	<u>Business Experience</u>
Francisco A. Lorenzo, age 49 <i>Chairman of the Board, Chief Executive Officer, President and Director</i>	Chairman of the Board (since December 1985), Chief Executive Officer (since June 1980), President (June 1980 to December 1985 and since June 1986) and Director (since 1972) of Texas Air; Chairman of the Board and Chief Executive Officer (March 1982 to December 1988 and since October 1989) and President (September 1983 to April 1984 and July 1987 to January 1988) and Director (since November 1981) of Continental; Chairman of the Board and Director (since October 1986) of Eastern; Chairman of the Board and Director (since 1969) of Jet Capital.
Robert D. Snedeker, age 47 <i>Executive Vice President, Treasurer and Director</i>	Executive Vice President and Treasurer (since June 1989), Senior Vice President and Treasurer (June 1980 to December 1981 and July 1982 to May 1989) and Director (since July 1982) of Texas Air; Director of Eastern (since January 1987); Secretary and Treasurer and Director (since 1971) of Jet Capital.
John B. Adams, age 43 <i>Senior Vice President</i>	Senior Vice President (since January 1989) of Texas Air; Senior Vice President-Human Resources (June 1987 to January 1989) of Continental; Vice President-Human Resources (October 1986 to June 1987) of Eastern; Vice President-Personnel (September 1985 to October 1986) of Continental; Senior Vice President-Human Resources (July to September 1985) of Trans World Airlines, Inc.; Senior Vice President-Personnel (1982 to 1985) of Continental.
James W. Arpey, age 57 <i>Senior Vice President</i>	Senior Vice President (since June 1986) of Texas Air; Senior Vice President-Operations and Technical Services (June 1984 to June 1986), Vice President-Technical Services (January 1983 to June 1984) of Continental.
Charles T. Goolsbee, age 55 <i>Senior Vice President, General Counsel and Secretary</i>	Senior Vice President, General Counsel and Secretary (since February 1982).
Clark H. Onstad, age 44 <i>Senior Vice President</i>	Senior Vice President (since November 1989), Vice President (October 1982 to October 1989) of Texas Air.
Cynthia R. Greager, age 43 <i>Vice President</i>	Vice President (since September 1984) of Texas Air.
Robert R. Ferguson, III, age 41 <i>Vice President</i>	Vice President (since December 1985) of Texas Air; Senior Vice President (October, November 1985) of Dalfort Corporation (airline holding company), Dallas, Texas; similar positions (January 1981 to September 1985) with Braniff, Inc., Dalfort and affiliated companies.
J. David Grizzle, age 35 <i>Vice President and Associate General Counsel</i>	Vice President and Associate General Counsel (since July 1989) and Associate General Counsel (January 1987 to June 1989) of Texas Air; Vice President-Administration, General Counsel and Secretary of New York Air (November 1984 to December 1986).
Elliott M. Seiden, age 44 <i>Vice President and Associate General Counsel</i>	Vice President and Associate General Counsel (since July 1989), Associate General Counsel (April 1986 to June 1989) of Texas Air; Associate General Counsel-International and Regulatory Affairs (December 1985 to March 1986) of Continental; Section Chief-Transportation, Energy and Agriculture Section, Antitrust Division, U.S. Dept. of Justice (October 1977 to November 1985).

There is no family relationship between any of the above executive officers. There are no known arrangements or understandings between any executive officer and any other person pursuant to which any of the above-named executive officers was selected as an officer. All executive officers are elected annually by the Board of Directors to serve until the next annual Board of Directors' meeting, which follows the annual stockholders' meeting.

Item 6. Market Price of and Dividends on the Registrant's Common Equity and Related Security Holder Matters.

The common stock of Texas Air is listed on the American Stock Exchange and the Pacific Stock Exchange. The following table gives the high and low sales prices for the stock as reported on the American Stock Exchange for each quarterly period during the past two years:

	High	Low
1989 - First Quarter	15 1/4	11 1/4
Second Quarter	16 1/4	12
Third Quarter	23 1/4	15
Fourth Quarter	18 1/4	11 1/4
1988 - First Quarter	15 1/4	8 3/4
Second Quarter	14 3/4	9 1/2
Third Quarter	15 1/4	10
Fourth Quarter	17 1/4	10 1/4

As of February 28, 1990, there were approximately 32,627 holders of record of Texas Air's common stock.

Dividends

Dividends may be paid on the common stock of Texas Air out of any funds legally available therefore when, as and if declared by the Board of Directors, but subject (except in the case of dividends payable in common stock) to the payment of annual dividends on Texas Air's outstanding preferred stock and subject to the right of holders of Class A common stock, described below, to participate in most dividends. In addition, certain indentures of Texas Air contain restrictions on the payment of dividends by Texas Air, pursuant to which the Company has not paid dividends on three of its four preferred issues since the third quarter of 1988. Texas Air has not paid a dividend on its common stock since the second quarter of 1989.

In deciding whether to recommend the payment of dividends, management of Texas Air will consider Texas Air's earnings and financial condition and other factors. Texas Air's ability to pay dividends over the long term will depend on the earnings, if any, of Continental, Eastern and Texas Air's other subsidiaries, and such subsidiaries' ability to pay dividends to Texas Air. Certain of Continental's and Eastern's indentures restrict the payment of dividends based upon certain financial tests, including each such company's respective net income. In addition, dividends must be paid on Eastern's publicly-held preferred stock before dividends may be paid on the Eastern common stock held by Texas Air. Payment of dividends on Eastern's common stock and on Continental's common and preferred stock was not permitted by each company's indentures based on its respective net income through December 31, 1989. As a result of the Chapter 11 reorganization, payment of dividends by Eastern is subject to approval by the Eastern Bankruptcy Court. Pursuant to certain guaranties by Texas Air of Eastern's 11.36% Preferred, Texas Air has paid the quarterly cash dividends on such stock beginning in the second quarter of 1989.

As of March 30, 1990, 2,040,000 shares of Texas Air's Class A common stock are issued and outstanding, all of which are held by Jet Capital. Each share of Class A common stock entitles the holder thereof to ten votes on all matters submitted to the vote of shareholders, except with respect to the election of one-fourth of Texas Air's Board of Directors, and the right to participate in most dividends on common stock as if each such share had been converted into one-half of a share of common stock immediately prior to the record date for such dividend. However, in the case of distributions payable in common stock (including pursuant to stock splits), the holders of Class A common stock are not entitled to participate with the common stock but instead are entitled to receive shares of Class A common stock in the same ratio as shares of common stock are distributed. Each share of Class A common stock is convertible, at the option of the holder, into one-half of a share of common stock.

Item 6. Selected Financial Data.

The following table sets forth certain consolidated financial data of Texas Air as of and for the years ended December 31 (in thousands, except per share data and ratios):

	1989	1988	1987	1986	1985
Operating revenues	\$6,684,875	\$8,572,928	\$8,626,031	\$4,406,897	\$1,944,190
Operating income (loss)	(637,295)	(237,076)	128,323	237,378	164,703
Net income (loss) (a)	(885,628)	(718,638)	(466,146)	72,703	90,981
Primary earnings (loss) per common share:					
Before extraordinary credit	(22.71)	(18.88)	(12.58)	.65	2.49
Extraordinary credit	-	-	-	1.10	2.54
Net income (loss)	(22.71)	(18.88)	(12.58)	1.75	5.03
Fully diluted earnings (loss) per common share:					
Before extraordinary credit	(22.71)	(18.88)	(12.58)	.68	1.81
Extraordinary credit	-	-	-	.99	-1.78
Net income (loss)	(22.71)	(18.88)	(12.58)	1.67	3.39
Total assets	7,656,144	8,210,901	8,549,437	8,194,611	1,936,338
Long-term obligations, including current maturities (b)	5,145,672	5,344,955	5,397,957	4,943,648	1,109,183
Redeemable preferred stock	482,882	462,902	448,728	380,862	22,012
Cash dividends declared per common share					
Ratio of earnings to fixed charges (c)				1.16	1.65

(a) Net income for 1986 and 1985 includes extraordinary credits of \$30,466,000 and \$42,366,000, respectively, representing utilization of net operating loss carryforwards which offset the provision for income taxes.

(b) Includes long-term obligations included in estimated liabilities subject to Chapter 11 reorganization proceedings in 1989 and 1985.

(c) On a consolidated basis, earnings were insufficient to cover fixed charges by \$933,772,000, \$771,099,000 and \$516,964,000 for the years ended December 31, 1989, 1988 and 1987, respectively. Earnings, as used to compute such ratios, are the sum of pretax income (adjusted

as appropriate for minority interests) and fixed charges excluding allowance for interest capitalized. Fixed charges are total interest expense (before deducting allowance for interest capitalized) and related amortization of debt expense and one-third of rental expense (which is representative of the interest factors included therein) charged to income (loss). For purposes of these ratios, the preferred stock dividend requirements of subsidiaries have been increased to an amount representing the pre-tax earnings (at Texas Air's effective tax rate) which would be required to cover such dividend requirements.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

In 1986, Texas Air more than tripled the size of its airline operations through the acquisitions of Eastern, People Express, substantially all the assets of Frontier, several regional carriers, and a substantial number of additional aircraft. Results of operations of Texas Air in the years subsequent to 1986 have been significantly affected by this growth. Texas Air's financial results have also been significantly adversely affected by the labor difficulties at Eastern and Eastern's filing for Chapter 11 reorganization in March 1989.

Any comparison of year-to-year results should also take into account the fact that airline results are highly sensitive to industry conditions, and that industry conditions may vary dramatically from year to year in response to, among other things, changing levels of passenger traffic and fares. In part as a result of airline industry over-capacity, the airline industry has experienced periods of intense competition which have adversely affected financial results. In addition, the airline industry has consolidated, which has resulted in certain airlines becoming stronger competitors.

In December 1987, the Financial Accounting Standards Board issued a new statement on accounting for income taxes. See Note 9 of Notes to Consolidated Financial Statements.

Liquidity and Capital Resources

As discussed in Notes 1 and 3 of the Notes to Consolidated Financial Statements, Texas Air's consolidated financial statements include the financial statements of its wholly owned subsidiaries, Eastern, Continental and System One, all of which are impacted

by significant uncertainties including primarily the bankruptcy proceedings of Eastern and its potential impact on Texas Air, Continental and System One, and liquidity concerns resulting from continuing losses, capital expenditure requirements and substantial financial leverage. Eastern has taken steps to size down the scope of its operations, reduce operating costs and sell certain of its assets not required for its reduced level of operations. In addition, System One decreased, although to a more limited degree, its level of operations to reflect the reduced size of Eastern. In February 1990, Texas Air announced that it would sell 50% of its interest in System One to EDS. See Item 1. "Business. System One." Eastern will continue to be required to dispose of substantial assets in order to generate liquidity and continue its operations, and Texas Air and Continental could also be required to take such steps in order to maintain levels of liquidity required for their continued operations, although there can be no assurance that such liquidity can be generated. For a discussion of possible effects of Eastern's filing for reorganization on Texas Air, Continental and System One, see Item 1. "Business. Effect of Eastern's Chapter 11 Case on Texas Air and Affiliates."

Texas Air has from time to time considered and continues to consider certain restructuring possibilities designed to increase the value of Texas Air capital stock for its shareholders. Texas Air

and its subsidiaries are continuing their review of possible restructuring steps, including sales or transfers of assets. Potential purchasers have conducted and continue to conduct discussions with Texas Air and its subsidiaries with respect to such transactions.

As of December 31, 1989, Texas Air and its consolidated subsidiaries had total cash, temporary cash investments and marketable securities of \$1.3 billion, including \$333.0 million held by Texas Air (parent company only), \$257.4 million held by Continental and \$661.7 million held by Eastern (of which amount \$574.9 million was restricted and held in segregated accounts for the benefit of Eastern's creditors). See "Eastern." This position compares to a consolidated cash and marketable securities balance of \$889.0 million as of December 31, 1988. These consolidated amounts do not include approximately \$37.9 million and \$20.6 million of affiliates' marketable debt instruments held by Texas Air and Eastern, respectively, which for financial reporting purposes are eliminated in consolidation.

The \$382.4 million increase in the consolidated cash position during 1989 was largely the result of net proceeds aggregating approximately \$1.6 billion from the disposition of property, equipment and other assets, issuance of long-term debt, sale of marketable securities and refunds of cash deposited in escrow accounts, which amounts were substantially offset by a cash loss from operations of approximately \$403.0 million, debt repayments aggregating approximately \$45.1 million, capital expenditures of approximately \$245.7 million and dividend payments on preferred stock of approximately \$26.9 million.

Texas Air and its subsidiaries are highly leveraged. Such substantial levels of debt, combined with the high level of fixed costs in the airline industry, make Texas Air and its subsidiaries vulnerable to declines in revenue which could arise from general economic conditions, increasing competition and job actions by employees. In addition, such leverage may also affect Texas Air's and its subsidiaries' access to capital markets and the cost of obtaining borrowed funds.

Texas Air (Parent Company Only). As a holding company, Texas Air conducts most of its operations through or with its subsidiaries. With the exception of the receipt of approximately \$6.4 million in dividends from Eastern during 1987, Texas Air has not received significant dividends from its subsidiaries in recent years, although it has received substantial income from its subsidiaries. In addition, Texas Air receives material income from its cash investments and from lease payments and fees from its subsidiaries. See Item 1. "Business. Eastern—Chapter 11 Reorganization of Eastern" for a discussion of the effect of Eastern's filing for reorganization on payment of fees to Texas Air.

In October 1989, Texas Air sold to third parties \$60.4 million of Continental's debt securities that it held for net proceeds of approximately \$59.6 million.

Texas Air has in recent years received substantial funds through the issuance of debt and equity securities. Accordingly, its cash requirements relate primarily to its outstanding indebtedness and preferred stock. As of December 31, 1989, the scheduled debt

service requirements (including interest) on Texas Air's currently outstanding debt and capitalized lease obligations, net of any corresponding payments from its subsidiaries and the redemption of indebtedness discussed below, are estimated to approximate \$56.8 million in 1990. In addition, Texas Air's publicly-held debt securities have scheduled maturities of \$0, \$74.2 million, \$94.4 million and \$0 in 1991, 1992, 1993 and 1994, respectively, which amounts are net of the debt securities repurchased in open market transactions as discussed below.

Certain of Texas Air's indentures contain covenants requiring maintenance, on a consolidated basis, of a defined level of tangible net equity. Due to the substantial losses recorded during 1988 and 1989, Texas Air failed to meet such maintenance requirements in late 1988 and was required to redeem approximately \$61.6 million of indebtedness during 1989 and January 1990. During December 1989 and the first quarter of 1990, Texas Air purchased in open market transactions approximately \$158.4 million of its public debt securities, thereby satisfying all mandatory redemption requirements associated with said securities which might be required during 1990 and, in some cases, into 1991 and 1992. In addition, certain indentures of Texas Air contain restrictions on the payment of dividends by Texas Air, pursuant to which the Company has not paid dividends on three of its four preferred issues since the third quarter of 1988. Texas Air has not paid a dividend on its common stock since the second quarter of 1983.

Texas Air has guaranteed substantial obligations of its subsidiaries and has in the past provided financing directly to its subsidiaries. During 1988, Texas Air advanced \$150.0 million to Continental, of which amount \$100.0 million was repaid in December 1989. See "Continental." During 1988 and the first quarter of 1989, Texas Air advanced \$39.0 million to System One under a \$40.0 million revolving credit facility. During the first quarter of 1989, the \$39.0 million advanced to System One was converted to a term loan bearing interest at 10% per annum, repayable in six equal semiannual installments.

Texas Air has guaranteed and may otherwise be liable for certain obligations of Eastern including, among others, two years of interest (or \$69 million) on certain Eastern indebtedness (for such guaranty Eastern deposited \$40 million in cash with Texas Air), certain Eastern pension obligations and the payment of dividends, redemption price and liquidation value of Eastern's 11.36% Preferred. As of December 31, 1989, Eastern's 11.36% Preferred's annual dividend requirements were approximately \$27.1 million with a liquidation preference of approximately \$238.8 million. Pursuant to Texas Air's agreement with the Examiner, Texas Air has agreed to pay to Eastern \$107 million on confirmation of its plan of reorganization and will pay on Eastern's behalf in the second quarter of 1990 \$26.3 million of Eastern's deferred pension obligations. In addition, each member of the Texas Air "controlled group" is jointly and severally liable for Eastern's periodic minimum pension plan funding obligations and could be jointly and severally liable for the full amount of the plan's underfunding if an Eastern pension plan were terminated. See "Eastern—Chapter 11 Reorganization of Eastern" and "Effect of Eastern's Chapter 11 Case on Texas Air and Affiliates" under Item 1. "Business."

Continental. As of December 31, 1989, Continental had approximately \$257.4 million in cash and cash equivalents compared to approximately \$185.1 million at December 31, 1988. The

\$72.3 million increase was the result of \$220.0 million of net cash provided by investing activities (including \$406.1 million of proceeds from the disposition of property and equipment offset by \$186.1 million of capital expenditures) and \$97.9 million of cash generated from operations offset by \$245.5 million of net cash used by financing activities (including \$140.6 million of net repayments of loans from affiliates and \$104.9 million of net repayments of long-term debt and capital leases).

Continental had working capital deficits at December 31, 1989, 1988 and 1987 of approximately \$167 million, \$274 million and \$212 million, respectively. Because airlines typically have no product inventories and have substantial service performance liabilities due to advance ticket sales, Continental believes minimal or negative working capital balances are not unusual in the airline industry.

During 1989, Continental sold and leased back 21 aircraft, generating approximately \$252 million in cash, of which amount \$115 million was used to retire existing debt on the aircraft. These sale/leaseback transactions resulted in deferred gains of approximately \$147 million, which amounts will be amortized as a reduction in lease expense over the term of the respective leases. In early 1990, Continental sold and leased back four aircraft, realizing net proceeds of approximately \$80.1 million after repayment of \$75.9 million of long-term debt.

During 1989, Continental agreed to lease certain terminal improvements and flight kitchens in Houston, Newark and Cleveland. Such facilities were financed with the proceeds from the issuance of approximately \$127 million of tax-exempt industrial revenue bonds issued by governmental agencies with principal and interest payments paid through long-term lease agreements. Also during 1989, Continental expended approximately \$91 million for the purchase of new commuter aircraft, certain aircraft spare parts and made aircraft purchase deposits, which amount was financed with internally generated funds or specific asset financings.

Other than expenditures for the acquisition of aircraft and expenditures funded through the issuance of industrial revenue bonds, Continental's capital expenditures during 1989 aggregated approximately \$97 million, a significant portion of which related to the standardization of the fleets of Continental and its subsidiaries, the acquisition of spare parts inventories and improvements to passenger terminal facilities. Continental expects its non-aircraft capital commitments for 1990 to aggregate approximately \$100 million to \$150 million, largely for the same purposes, which expenditures Continental expects to finance with internally generated funds or specific asset financings.

Continental has firm commitments to acquire 50 B737-300 aircraft with deliveries scheduled from 1992 through 1995, for an aggregate purchase price of approximately \$1.4 billion, 20 A330 and A340 aircraft with deliveries scheduled from 1993 through 1999 for an aggregate purchase price of approximately \$2.0 billion, and an aggregate of 43 EMB and ATR aircraft with deliveries scheduled through the first quarter of 1991 for an aggregate purchase price of \$268 million. While significant term and predelivery financing commitments have been provided to Continental by the respective manufacturers, subject to certain conditions, Continental expects to obtain specific asset financing closer to the time of delivery based on prevailing market conditions, although there can be no assurance that such third-party

financing will be available. In March 1990, Continental agreed to lease from an unrelated third party, on a long-term basis, one B747-200 aircraft, which is scheduled for delivery in the second quarter of 1990. See Item 2. "Description of Properties. Continental-Flight Equipment."

Pursuant to certain legislation and FAA regulations relating to, among other things, collision avoidance systems, airborne windshear avoidance systems, and increased inspections and maintenance procedures to be conducted on older aircraft, Continental estimates, based on its current fleet, that it may incur costs through the 1990's of up to approximately \$205 million. However, this estimate is subject to revision based upon finalization of certain regulations as well as possible changes in Continental's fleet composition. Continental expects that the costs of compliance with such legislation and regulations will be funded through internally generated funds and modification of cost sharing provisions under certain lease agreements.

Continental remains obligated to pay approximately \$84.5 million upon the exercise of certain outstanding warrants (against receipt of \$42.5 million in consideration, which may be satisfied upon cancellation of substantially all of a Continental promissory note), all of which are held by American General. American General is contesting the terms on which Continental merged with a wholly owned subsidiary of Texas Air in February 1987 alleging, among other things, that the terms of the merger were unfair and that it is entitled to additional merger consideration. See Item 3. "Legal Proceedings. Litigation Contesting the Continental Merger."

Since December 31, 1989, Continental has sold certain assets pursuant to sale/leaseback transactions and settle certain litigation generating an aggregate of \$143 million of net proceeds, which either has been received or is not subject to significant conditions. Also, as of March 29, 1990, Continental had arrangements, subject to contingencies, which could generate an additional approximately \$134 million of net proceeds, related to sale/leaseback transactions, sales of surplus assets and settlement of certain litigation.

See "Eastern-Chapter 11 Reorganization of Eastern" and "Effect of Eastern's Chapter 11 Case on Texas Air and Affiliates" under Item 1. "Business." for a discussion relating to Continental's potential liability related to the Eastern reorganization and pension funding obligations.

Certain of Continental's debt agreements contain certain restrictive provisions relating to payments of dividends and maintenance of a minimum consolidated net worth. According to the terms of certain debt agreements, as of December 31, 1989, Continental was unable to pay dividends on its common stock or preferred stock.

As of December 31, 1989, Continental had approximately \$2.4 billion of long-term indebtedness and capitalized lease obligations. Continental generated liquidity during 1989 primarily through the refinancing of certain of its secured obligations, proceeds from the disposition of certain surplus assets, new third-party borrowings and cash generated from operating activities.

Continental believes that its internally generated funds, third-party borrowings and other financings, without the use of any new borrowing under the Texas Air \$50 million credit line described below, will be sufficient to meet its cash requirements although there can be no assurance that such liquidity can be generated.

As a wholly owned subsidiary of Texas Air, Continental has from time to time sought funding from Texas Air to provide liquidity, with the understanding that replacement funds would be sought when obtainable from other sources on commercially reasonable terms. In the first half of 1988, Texas Air advanced Continental an aggregate of \$193.5 million for working capital purposes, of which amount \$43.5 million was repaid in July 1988 and \$150 million was converted into a fixed rate note due July 1, 1991, bearing interest at 10%. In 1989, Continental's \$150 million term note was repaid and cancelled through the issuance of a new floating rate note to Texas Air due July 1, 1991, and Texas Air made available to Continental an additional \$50 million credit line, which may be borrowed at any time prior to July 1, 1991. In December 1989, Continental obtained a \$175 million secured revolving credit line from an unrelated third party, drew down the full \$175 million and repaid \$100 million of the floating rate note due to Texas Air.

Eastern: Eastern needs substantial liquidity to rebuild its business and recapture its passenger base. As a result, during 1989, Eastern generated substantial liquidity by disposing of or leasing surplus assets and has presented to the Creditors Committee a five-year business plan that provides for the generation of substantial additional liquidity from the sale of its South American routes and other assets surplus to its needs. Pursuant to such business plan, Eastern expects to emerge from its Chapter 11 proceeding as a smaller U.S. airline, with a significantly improved capital structure.

Eastern's January 1990 business plan calls for an aggregate of \$1.7 billion in proceeds from asset dispositions during its Chapter 11 proceedings. These asset sales are expected to generate approximately \$1.2 billion in net cash after repayment of related debt, of which approximately \$485.3 million in net cash is expected to be received in 1990. In addition, pursuant to the agreement with the Examiner, Eastern would receive \$107 million in cash from Texas Air upon confirmation of its plan of reorganization, subject to certain conditions. The cash generation portion of the January 1990 business plan was intended to provide Eastern with sufficient funds to facilitate implementation of its business plan and to provide a significant level of liquidity reserves, based on certain projected revenue. Eastern has proposed revisions to this plan. See Item 1. "Business. Eastern-Chapter 11 Reorganization of Eastern."

For a description of Eastern's asset sales in 1989 and 1990 and its agreement to sell additional assets, see Item 1. "Business. Eastern-Asset Dispositions."

Proceeds from the sale of assets and the rental income from aircraft leased out have been held in restricted accounts for

the benefit of creditors. Eastern has obtained the release of \$320 million from these restricted accounts (of which amount, \$110 million was released during the first quarter of 1990) to meet its obligations and implement its business plan. Eastern believes that additional restricted funds will be required in future periods, however there can be no assurance that such funds will be released.

At December 31, 1989, Eastern had cash, temporary cash investments and marketable securities of \$682.2 million, of which amount \$574.9 million was restricted and held in segregated accounts for the benefit of Eastern's creditors, as compared to \$402.3 million as of December 31, 1988. The \$279.9 million increase was primarily the result of \$862.2 million in proceeds from the disposition of assets and other net cash proceeds of approximately \$80.8 million, which amounts were substantially offset by a cash loss from operations of \$491.5 million, capital expenditures of approximately \$41.4 million, and the payment of \$130.2 million in debt and capital lease obligations and dividends on preferred stock issues.

Eastern estimates that as of December 31, 1989, it had prepetition liabilities of approximately \$3.2 billion, which included approximately \$2.3 billion of long-term indebtedness and capitalized lease obligations. The aggregate amount of claims filed with the Eastern Bankruptcy Court in connection with Eastern's Chapter 11 proceeding is several times greater than Eastern's estimates of such claims. Eastern believes that many of these claims are duplicative, invalid, or based upon contingencies that have not occurred. The resolution of these claims, certain litigation and other matters adverse to Eastern could have a material adverse effect on Eastern's financial condition; however, principally because of the ongoing nature of the Chapter 11 proceeding, the outcome thereof and ultimate liability resulting therefrom currently cannot be determined.

Although generally no payments can be made with respect to outstanding debt issues until the bankruptcy court has approved a plan of reorganization, Section 1110 of the Code provides special treatment for aircraft lenders and lessors with certain purchase money security interests in the aircraft, permitting them to obtain possession of such aircraft. In May 1989, Eastern paid approximately \$24 million to cover principal and interest on such debt and lease rentals without affirming the related contracts. Until these Section 1110 contracts are either affirmed or rejected, Eastern expects to continue meeting its related debt service obligations on an ongoing basis under the pre-filing terms and conditions. Also, pursuant to Section 365(d)(3) of the Code, a debtor must assume all leases of nonresidential real property within 60 days of the filing or, absent an extension from the bankruptcy court, such leases are deemed to be rejected. Prior to the 60-day deadline, Eastern paid approximately \$13 million to bring its obligations related to these properties current and is continuing to pay on an ongoing basis its obligations with respect thereto and with respect to certain ground equipment leases until such obligations are assumed or rejected. Eastern has until the earlier of confirmation of a plan of reorganization or September 6, 1990 to assume or reject these property leases, other than its leases

with the Greater Orlando Port Authority and the City of Atlanta. The Code includes various other provisions that may impose limitations or constraints on Eastern's operations and, as such, the foregoing discussion of Sections 1110 and 365(d)(3) is not intended to be all-inclusive as to such potential limitations and restrictions.

In February 1990, Eastern established a "refund protection program" for travel agents and the flying public guaranteeing full cash payment of potential refund claims during Eastern's Chapter 11 proceedings. Under the refund program, Eastern has dedicated ticket receivables and cash equal to 110% of potential transportation and travel-related refund claims from the sale of such transportation during the bankruptcy proceeding, which amount was estimated at \$105 million as of December 31, 1989. Eastern expects that any cash needed for the program would be generated from operations, enabling Eastern to avoid using amounts in its restricted investment accounts. However, the Eastern Bankruptcy Court authorized Eastern, if necessary, to use up to \$50 million from its restricted investment accounts.

Pursuant to certain legislation and FAA regulations relating to, among other things, collision avoidance systems, airborne windshear avoidance systems, and increased inspections and maintenance procedures to be conducted on older aircraft, Eastern estimates, based on its postreorganization fleet, that it may incur costs through the 1990's of approximately \$38.9 million. However, this estimate is subject to revision based upon finalization of certain regulations as well as possible changes in Eastern's fleet composition. Eastern expects that the costs of compliance with such legislation and regulations will be funded through internally generated funds and modification of cost sharing provisions under certain lease agreements.

Eastern had no firm cash commitments as of December 31, 1989, for aircraft capital expenditures. However, pursuant to the agreement with the Examiner, Continental would provide Eastern with certain purchase options on delivery of 40 B737-300 aircraft. See Item 2, "Description of Properties-Eastern Flight Equipment."

Each member of the Texas Air "controlled group" is jointly and severally liable for Eastern's periodic minimum pension plan funding obligations and could be jointly and severally liable for the full amount of the plans' underfundings if Eastern pension plans were terminated. See Item 1, "Business, Effect of Eastern's Chapter 11 Case on Texas Air and Affiliates" for a discussion with respect to Eastern's pension funding obligations.

Results of Operations

In addition to the substantial reduction in Eastern's operations in 1989 and its Chapter 11 filing, any comparison of Texas Air's year to year results should take into account the fact that its subsidiaries' results are highly sensitive to industry conditions and that industry conditions may vary dramatically from year to year in response to, among other things, changing levels of passenger traffic and fares. The airline industry has recently experienced periods of intense competition and has continued to undergo a period of consolidation.

Texas Air recorded a net loss of \$885.6 million for the year ended December 31, 1989, as compared to net losses of \$718.6 million and \$466.1 million in 1988 and 1987, respectively. Consolidated results reflect the substantial losses recorded by Eastern in

each of the three years and Continental in 1988 and 1987, which in turn reflect, in the case of Eastern, the effects of its labor difficulties and resultant Chapter 11 filing and, in the case of Continental, the additional expenses associated with the ongoing integration of the operations of People Express and New York Air as well as a charge of \$131.0 million recorded in the second quarter of 1988 in connection with its reestimation of its air traffic liability. Both carriers' results were adversely affected, from both a revenue and operational performance standpoint, by the investigations of Texas Air, Continental and Eastern conducted by the DOT and FAA during the second quarter of 1988. Eastern's results were also negatively impacted by the intense competition on certain routes in the eastern United States, in particular the new competitive pressures from several carriers that have established new hubs in the southeastern United States and the Caribbean, which new hubs have increased capacity on competing routes.

Total consolidated revenues declined by \$1.9 billion, from \$8.6 billion in 1988 to \$6.7 billion in 1989, reflecting the reduced level of operations implemented by Eastern in the latter part of 1988, its strike and the Chapter 11 filing. Eastern's revenues declined by \$2.3 billion between the two periods while Continental's revenues increased by \$378.2 million.

Total operating expenses decreased by \$1.5 billion, from \$8.8 billion in 1988 to \$7.3 billion in 1989, reflecting the effects of the strike and Chapter 11 filing by Eastern. From 1987 to 1988, total operating expenses increased by \$312.3 million, a substantial portion of which increase is attributable to a \$131.0 million noncash charge recorded by Continental in the second quarter of 1988 in connection with the reestimation of its air traffic liability.

Texas Air's net nonoperating expense declined by \$234.1 million from 1988 to 1989 and by \$111.8 million from 1987 to 1988, substantially the result of increases in gains on the disposition of property, equipment and other assets between the periods. Eastern recorded an increase of \$432.7 million in such gains from 1988 to 1989, which increase was partially offset by nonoperating expenses aggregating \$275.4 million for charges associated with pension curtailment, expenses associated with its Chapter 11 proceedings, the pilot back pay award and asset impairment.

Continental. Continental recorded net income of \$3.1 million in 1989, a substantial improvement over 1988 and 1987 when it recorded net losses of \$315.5 million and \$258.1 million, respectively.

Continental's revenues have increased during each of the years from 1987 to 1989, from \$4.1 billion in 1987 to \$4.7 billion in 1988 and \$5.1 billion in 1989. The \$378.2 million increase from 1988 to 1989 was largely the result of higher yields, improved scheduling of aircraft, a slight increase in load factor and increases in revenues associated with its charter and commuter operations and its alliance with SAS.

As a percentage of total operating costs, Continental's labor costs were 22.3% in 1989, 21.2% in 1988 (excluding the \$131.0 million one-time charge referred to above) and 20.7% in 1987. Continental's labor costs increased in 1989 as a result of increases in the wage levels for all employee groups. Continental's labor costs are among the lowest in the industry as a result of greater employee productivity resulting in part from flexible work rules, its lower average wage structure and the lower average seniority of its workforce. The number of employees decreased to approximately 31,400 at December 31, 1989 as compared to approximately 35,600 at December 31, 1988 and approximately 33,600 at December 31, 1987. Continental reduced its workforce in 1989 in response to its decreased level of operations and improved productivity of its workforce. Continental increased its employee workforce from 1987 to 1988 in order to reduce its utilization of outside services, including maintenance, and to eliminate workforce shortages resulting from the substantial increase in its operations during 1987. For a description of the efforts of Eastern's three principal unions to become the bargaining representatives of certain of Continental's employees, which efforts, if successful, could increase Continental's labor costs significantly, see Item 1. "Business. Continental Employees."

Continental recorded a \$52.7 million increase in aircraft fuel expense during 1989 as compared to 1988. Although the number of gallons used decreased to 1,226 million in 1989 as compared to 1,299 million in 1988, the average price per gallon increased by more than 14%. During 1988, Continental recorded a \$2.48 million decrease in aircraft fuel expense as compared to 1987 due to a decrease of 3.34 in its average price of fuel per gallon. See Item 1. "Business. Industry Conditions—Costs."

Rentals and landing fees have increased each year from 1987 to 1989 primarily due to added lease costs associated with aircraft refinanced in sale/leaseback transactions in 1988 and 1989 and from increases in fees levied by certain airport operators.

Continental's commissions expense increased 15.8% in 1989 over 1988 and 17.1% in 1988 over 1987 as the result of an increase in the number of Continental tickets purchased through travel agents as well as increased incentive and override commission rates as a result of intensified competition for travel agent bookings and the increase in passenger revenues.

Depreciation and amortization expense decreased 3.2% in 1989 over 1988 and increased 10.4% in 1988 as compared to 1987. The decrease in 1989 was the result of the adoption as of April 1, 1989 of a standard depreciable life for all of Continental's jet and certain commuter aircraft and by decreases resulting from sales and sale/leaseback transactions in 1988 and 1989, offset partially by the acquisition of new commuter aircraft and of certain airport facilities. The increase in 1988 was primarily the result of increased depreciation on aircraft and ground equipment acquired during 1987 and 1988 and additional amortization associated with amounts "pushed down" to Continental's financial statements in connection with Texas Air's acquisition of Continental's minority interest in March 1987.

Continental revised its estimate of air traffic liability during the second quarter of 1988 which resulted in a one-time charge to earnings of \$131.0 million. This charge, which had no impact on cash flow, is reflected as a separate line item on the consolidated statement of operations. The charge consisted of an estimated \$66.0 million for reaccommodation of passengers on other airlines and an estimated \$65.0 million for revisions of revenue recognition estimates including those related to ticketing errors, foreign currency fluctuations and revenue capture methodology. The change in estimates that required this charge related primarily to activity in late 1987 and, to a more limited degree, the first quarter of 1988. Continental has revised a number of its procedures used to estimate its advance ticket liability on a current basis.

Other operating expenses decreased 2.9% in 1989 over 1988 and increased 15.3% in 1988 over 1987. The decrease in other operating expenses in 1989 was primarily the result of reduced maintenance costs as compared to 1988 as a result of the transfer of certain maintenance on Continental's aircraft from outside services to the internal maintenance department. The increase in 1988 over 1987 was largely the result of increased maintenance expenses associated with the conversion of the People Express fleet to the Continental maintenance program during late 1987 and 1988, the additional costs relating to the FAA ramp inspection in 1988 and increased advertising associated with special programs and the marketing of Continental as a single integrated airline.

Continental's interest and debt expense decreased by 2.8% in 1989 as compared to 1988 as the result of a decrease in average debt levels during 1989 due to debt repayments for aircraft used in sale/leaseback transactions. Interest and debt expense increased by 4.4% in 1988 as compared to 1987 as the result of the inclusion of a full year's interest on the public debt issued in late March 1987 and slightly higher interest rates in 1988. Interest income increased 114.4% in 1989 from 1988 and decreased 53.9% in 1988 from 1987 primarily due to the changes in amounts of funds available for investment.

Continental recorded net gains on the disposition of property, equipment and other assets of approximately \$61.3 million, \$22.9 million and \$12.3 million for the years ended December 31, 1989, 1988 and 1987, respectively. The assets involved in these transactions were determined to be surplus to Continental's operating needs.

Continental's other nonoperating income (expense) during 1989, 1988, and 1987 included foreign exchange gains (losses) of \$8.1 million, \$3.0 million and (\$17.1 million), respectively, principally related to the revaluation of yen-denominated debt. Continental also recorded, in connection with sale/leaseback transactions, gains on early retirement of debt of \$19.9 million and \$9.7 million in 1989 and 1988, respectively. In 1988, Continental recorded gains of \$8.0 million related to the recognition of an allowed claim by the Frontier Bankruptcy Court, which amount was offset by an \$8.9 million charge for the settlement of certain securities litigation.

Eastern. Eastern recorded a net loss of \$852.3 million for the year ended December 31, 1989, as compared to net losses of \$335.4 million and \$181.7 million for the comparable 1988 and 1987 periods, respectively. Eastern's operating loss for the year

ended December 31, 1989 was \$864.7 million, as compared with an operating loss of \$209.4 million for the comparable period in 1988 and operating income of \$58.9 million for the comparable 1987 period. Eastern management believes that Eastern's financial results during 1988 and the beginning of 1989 were adversely affected by intense competition, the negative publicity surrounding the DOT and FAA investigations in 1988 and the negative public perception generated from its labor disputes. Operations for the year 1989 were affected further by the strike and continuing uncertainties created by the Chapter 11 filing.

In January 1990, Eastern presented to the Creditors Committee a business plan that was based on certain assumptions, such as the number of tickets sold to full-fare business passengers. The business plan is highly sensitive to differences between actual results and such assumptions. Since February 1990, Eastern's actual revenues and results have fallen short of its projections and, as a result, in March 1990, Eastern proposed to the Creditors Committee revisions to its business plan. See Item 1. "Business. Eastern- Chapter 11 Reorganization of Eastern."

Eastern does not believe that seasonal variations are material for an understanding of its business although increased airline travel during traditional holiday and vacation periods produce increased revenues during those times.

The substantial reduction in operations resulting from the strike and Eastern's Chapter 11 filing does not allow a meaningful analysis of the financial and operating data for the year 1989 over years 1988 and 1987. Accordingly, the following discussions have been abbreviated to address only those areas deemed to be of significance to current or future operations.

Passenger revenues for 1989 decreased \$2.1 billion or 60.9% from 1988 as compared to a decrease in 1988 of \$562.0 million or 13.8% from 1987. The substantial decrease in 1989 revenues is due primarily to the business disruptions resulting from the strike and Chapter 11 filing. In 1989, revenue passenger miles decreased 59.7% and yield decreased 3.1%. The decrease in yield reflects an increase in discount fares resulting from Eastern's efforts to recoup lost passenger traffic. Discount traffic was 92% of total volume in 1989 compared with 87% of total volume in 1988 and 90% in 1987.

As a result of the strike and subsequent filing for protection under Chapter 11, Eastern's workforce was substantially reduced. As Eastern's level of operations has increased, it has been recalling employees from "no work" status and hiring new employees to replace those in "strike" status. Eastern has taken steps to reduce its labor costs by imposing new terms and conditions of employment on hourly workers, proposing contractual changes to the ALPA and TWU contracts and by instituting temporary wage reductions from 10% to 20% for certain of its other employee groups. For the year 1989, labor costs constituted approximately 30.9% of Eastern's total operating expenses as compared to approximately 36.8% for the year 1988 and 36.6% for the year 1987. Labor costs decreased to 27.8% of total operating expenses during the last quarter of 1989. At December 31, 1989, Eastern had the equivalent of 18,455 full-time employees as compared to 28,688 and 32,481 at year-end 1988 and 1987, respectively.

Under the requirements of the Statement of Financial Accounting Standards ("SFAS") No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension

Plans and for Termination of Benefits," Eastern recorded a minimum pension curtailment expense of \$118.0 million for the year ended December 31, 1989. The curtailment expense principally reflects the recognition of unamortized pension costs related to employees who have retired or whose period of employment has otherwise terminated or for whom benefit accruals have been or are expected to be frozen.

The average cost per gallon of fuel increased by 15.2% from 1988 to 1989 and decreased by 3.7% from 1987 to 1988. A significant part of the 1989 increase in fuel prices occurred in the fourth quarter and fuel prices have continued to rise in 1990. See Item 1. "Business. Industry Conditions-Costs."

Eastern's annual maintenance expenditures generally do not vary significantly from year to year as a result of major maintenance overhauls because Eastern regularly rotates its fleet through such procedures. However, during 1989, Eastern experienced a significant decrease in its maintenance expense primarily as a result of reduction in its fleet size. Eastern is converting to an improved corrosion prevention program, which will schedule major checks at a greater frequency.

Depreciation and amortization expense decreased 20% in 1989 from 1988 to \$254.6 million, which decrease reflects continuing asset sales. In addition, in June 1989, Eastern reclassified to Nonoperating Property and Equipment, certain aircraft scheduled for sale and discontinued accruing depreciation relating to these aircraft, resulting in a reduction in depreciation expense of approximately \$19.4 million for the year ended December 31, 1989. Depreciation and amortization expense decreased 1.4% in 1988 from 1987 to \$318.3 million.

Interest and debt expense for 1989 increased \$22.2 million, or 7.4% from 1988; interest and debt expense for 1988 decreased \$7.3 million, or 2.4% from 1987.

Interest income in 1989 increased \$14.3 million, or 23.9%, to \$74.3 million from the comparable period in 1988, primarily reflecting an increase in interest income on restricted investments and notes receivable from affiliates. Interest income in 1988 increased \$5.2 million or 5.6% from 1987.

Gains from asset dispositions for 1989 of \$559.4 million include the sale of Eastern's Air Shuttle division (including 21 aircraft), two A300, 14 DC-9-31, 10 B727-100, 14 B727-200, one B757 aircraft and the sale of certain gates, routes and slots. Gains for 1988 and 1987 were \$126.7 and \$12.3 million respectively.

In December 1989, Eastern expensed \$65.5 million representing its estimated prepetition and postpetition exposure through December 31, 1989 from the award issued by the System Board in connection with an ALPA grievance concerning the interpretation of a pay parity provision contained in the February 1986 collective bargaining agreement between Eastern and ALPA. However, Eastern has sought review of the award by the Eastern Bankruptcy Court. See Item 1. "Business. Eastern-Employees."

In December 1989, Eastern expensed \$55.0 million to recognize an impairment in gate value at certain airports. Additionally, during 1989, Eastern recorded \$36.9 million of expenses relating to its Chapter 11 proceedings, primarily for professional and technical fees.

Analysis of Results of Operations

	1989	Net Change 1989-1988	1988	Net Change 1988-1987	1987
Continental (b)					
Revenues (a)	\$5,076.5	8.1%	\$4,698.3	13.9%	\$4,124.3
Operating expenses (a)	4,900.6	2.8	4,767.2	15.9	4,113.3
Operating income (loss) (a)	175.9	-	(68.9)	-	11.0
Net income (loss) (a)	3.1	-	(315.5)	-	(258.1)
Available seat miles (a)	62,891	(5.4)	66,487	3.6	64,176
Revenue passenger miles (a)	38,772	(4.3)	40,498	2.2	39,637
Cost per available seat mile	8.25¢	8.3	7.62¢	11.2	6.85¢
Passenger load factor	61.7%	1.3	60.9%	(1.5)	61.8%
Break-even passenger load factor	62.8%	(5.1)	66.2%	0.2	66.1%
Average yield per revenue passenger mile	11.18¢	11.1	10.06¢	9.9	9.15¢
Average length of passenger trip (miles)	1,097	2.0	1,076	8.5	992
Average length of aircraft flight (miles)	806	1.9	791	5.7	748
Average daily utilization of each aircraft (hours:minutes)	9:11	0.7	9:07	(2.5)	9:21
Eastern					
Revenues (a)	\$1,498.1	(60.6)%	\$3,806.1	(14.4)%	\$4,447.6
Operating expenses (a)	2,362.8	(41.2)	4,015.5	(8.5)	4,388.7
Operating income (loss) (a)	(864.7)	-	(209.4)	-	58.9
Net loss (a)	(852.3)	-	(335.4)	-	(181.7)
Available seat miles (a)	19,898	(59.1)	46,725	(16.6)	56,036
Revenue passenger miles (a)	11,592	(59.7)	28,793	(20.2)	36,104
Cost per available seat mile	(c)	-	9.24¢	10.1	8.39¢
Passenger load factor	60.7%	(1.5)	61.6%	(4.4)	64.4%
Break-even passenger load factor	(c)	-	67.6%	0.4	67.3%
Average yield per revenue passenger mile	11.72¢	(3.1)	12.09¢	7.8	11.22¢
Average length of passenger trip (miles)	801	(1.2)	811	-	811
Average length of aircraft flight (miles)	620	(0.6)	624	(1.1)	631
Average daily utilization of each aircraft (hours:minutes)	7:46	(5.7)	8:14	(9.7)	9:07

(a) In millions.

(b) Continental's statistical data does not include statistical data of its commuter airline subsidiaries. Commuter operating results are included in Continental's consolidated financial statements in other operating revenues and other operating expenses. During 1989, each of Bar Harbor, Britt and Rocky Mountain realized a net loss. However, to a large degree, commuter operations are structured and marketed to provide feed traffic to Continental Airlines; accordingly, management does not believe such airlines' separate results have been a true indicator of their contribution to the Company. Results at the commuter airlines also have been affected by changing operating philosophies and realignment of route structures incident to each airline's acquisition by Texas Air.

(c) For the year ended December 31, 1989, this statistic is not representative due to the business disruption resulting from the strike and Chapter 11 filing.

"Available seat miles" represents the number of seats available for passengers multiplied by the number of scheduled miles those seats are flown. "Revenue passenger miles" represents the number of scheduled miles flown by revenue passengers. "Cost per available seat mile" represents operating expense and interest expense divided by available seat miles. "Passenger load factor" represents revenue passenger miles divided by available seat miles. "Break-even passenger load factor" represents the percentage of seats which must be occupied by revenue passengers in order for the airline to break-even on a fully-allocated basis. "Average yield per revenue passenger mile" represents the average revenue received for each mile a revenue passenger is carried. "Average daily utilization of each aircraft" means the average revenue block hours flown in service per day per aircraft for the total fleet of aircraft.

Experts

The consolidated financial statements of Texas Air Corporation and subsidiaries included in this 1989 Annual Report on Form 10-K of Texas Air Corporation have been audited by Arthur Andersen & Co., independent public accountants, as indicated in their report with respect thereto, and are included herein in reliance upon the authority of said firm as experts in accounting and auditing in giving said reports. Reference is made to the

report on the consolidated financial statements of Texas Air Corporation and subsidiaries which includes explanatory paragraphs that describe the significant uncertainties impacting Texas Air Corporation and its subsidiaries, as discussed in Notes 1, 2 and 12 of Notes to Consolidated Financial Statements and, additionally, the change to a statement of cash flows as required by generally accepted accounting principles, as discussed in Note 3 of Notes to Consolidated Financial Statements.

Item 8. Financial Statements and Supplementary Data.

UNITED AIR HOLDINGS, INC. (Successor to United Air Lines, Inc.)

Index to Texas Air Consolidated Financial Statements

2013-2014 United Air Holdings, Inc.

	<i>Page</i>
Report of Independent Public Accountants	32
Consolidated Statement of Operations	33
Consolidated Balance Sheet	34
Consolidated Statement of Cash Flows	36
Consolidated Statement of Changes in Financial Position	37
Consolidated Statement of Redeemable and Nonredeemable Preferred Stock and Common Stockholders' Equity	38
Notes to Consolidated Financial Statements	39

Report of Independent Public Accountants

**To the Stockholders and Board of Directors,
Texas Air Corporation:**

We have audited the accompanying consolidated balance sheets of Texas Air Corporation (Texas Air) (a Delaware corporation) and subsidiaries as of December 31, 1989 and 1988, and the related consolidated statements of operations, redeemable and non-redeemable preferred stock and common stockholders' equity for each of the three years in the period ended December 31, 1989, and the statements of cash flows for each of the two years in the period then ended and the statement of changes in financial position for the year ended December 31, 1987. These financial statements are the responsibility of Texas Air's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Texas Air and subsidiaries, as of December 31, 1989 and 1988 and the results of their operations for each of the three years in the period ended December 31, 1989, and their cash flows for each of the two years in the period then ended and the changes in their financial position for the year ended December 31, 1987, in conformity with generally accepted accounting principles.

Texas Air's consolidated financial statements include the accounts of its wholly owned subsidiaries—Eastern Air Lines, Inc. (Eastern), Continental Airlines, Inc. (Continental) and System One Holdings, Inc. (System One). As discussed in Notes 1 and 2, there are significant uncertainties impacting Texas Air and each of its subsidiaries including primarily the bankruptcy proceedings of

Eastern, and its potential impact on Texas Air, Continental and System One, and liquidity concerns resulting from continuing losses, capital expenditure requirements and substantial leverage. As a result of these uncertainties, Eastern has taken steps to size down the scope of its operations, reduce operating costs and sell substantial assets. Additionally, Continental has generated liquidity through the refinancing of certain of its secured obligations, proceeds from disposition of certain surplus assets, new third-party borrowings and cash generated from operating activities. Eastern will continue to be required to dispose of substantial assets in order to generate liquidity and continue its operations, and Texas Air and Continental could also be required to take such steps in order to maintain levels of liquidity required for their continued operations, although there can be no assurance that such liquidity can be generated. In addition, as discussed in Note 12, there are various claims and lawsuits against Eastern the outcome of which could materially affect the financial statements of Texas Air; however, the ultimate liability resulting from such claims and lawsuits cannot presently be determined. The accompanying financial statements have been prepared assuming the companies continue as going concerns and do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amount and classification of liabilities or any other adjustments that might be necessary as a result of the outcome of the uncertainties described above.

As discussed in Note 14, subsequent to March 29, 1990, the date of our original report, the Bankruptcy Judge in Eastern's Chapter 11 case appointed a trustee to manage Eastern's reorganization efforts, and as a result, Texas Air will deconsolidate Eastern for financial reporting purposes effective April 19, 1990. Texas Air management is currently evaluating the impact of the trustee's appointment on Texas Air's financial condition and future operations.

As discussed in Note 3, Texas Air, as required by generally accepted accounting principles, has presented statements of cash flows for each of the two years in the period ended December 31, 1989, in place of statements of changes in financial position.

ARTHUR ANDERSEN & CO.

Houston, Texas
March 29, 1990
(except with respect to the
matter discussed in Note 14,
as to which the date
is April 19, 1990)

Texas Air Corporation and Subsidiaries
Consolidated Statement of Operations

(Dollars in thousands, except per share data)

	For the Years Ended December 31,		
	1989	1988	1987
Operating Revenues:			
Passenger	\$5,705,125	\$7,584,109	\$7,699,071
Cargo, mail and other	979,750	988,819	926,960
	<u>6,684,875</u>	<u>8,572,928</u>	<u>8,626,031</u>
Operating Expenses:			
Wages, salaries and related costs	1,982,424	2,613,288	2,556,913
Aircraft fuel	996,034	1,244,553	1,406,058
Rentals and landing fees	882,258	838,716	719,179
Commissions	593,364	695,934	679,756
Depreciation and amortization	552,430	622,951	575,691
Adjustment of air traffic liability related accounts	-	131,000	-
Other	2,315,660	2,663,562	2,360,111
	<u>7,322,170</u>	<u>8,810,004</u>	<u>8,497,708</u>
Operating Income (Loss)	<u>(637,295)</u>	<u>(237,076)</u>	<u>128,323</u>
Other Income (Expense):			
Interest and debt expense	(664,356)	(639,241)	(637,143)
Interest income	83,786	64,856	85,220
Gain on disposition of property, equipment and other assets, net	612,280	154,776	18,050
Preferred stock dividends of Eastern Air Lines, Inc.	(46,082)	(51,030)	(49,636)
Provision for pension curtailment	(117,967)	-	-
Expenses relating to Eastern's Chapter 11 proceedings	(36,931)	-	-
Asset impairment write-down	(54,969)	-	-
Provision for pilot back pay award	(65,514)	-	-
Other, net	42,066	8,881	(10,047)
	<u>(247,687)</u>	<u>(481,758)</u>	<u>(593,556)</u>
Loss before Provision for Income Taxes	<u>(884,982)</u>	<u>(718,834)</u>	<u>(465,233)</u>
Income Tax Provision (Credit)	646	(196)	913
Net Loss	<u>\$ (885,628)</u>	<u>\$ (718,638)</u>	<u>\$ (466,146)</u>
Net Loss per Common and Common Equivalent Share	<u>\$ (22.71)</u>	<u>\$ (18.88)</u>	<u>\$ (12.58)</u>

The accompanying notes to consolidated financial statements are an integral part of this statement.

Texas Air Corporation and Subsidiaries
Consolidated Balance Sheet
(Dollars in thousands)

	December 31,	
	1989	1988
Assets		
Current Assets:		
Cash	\$ 40,358	\$ 76,905
Temporary cash investments, at cost which approximates market	601,103	729,769
Subtotal—Cash and cash equivalents	641,461	806,674
Marketable securities, at lower of cost or market	55,111	82,353
Restricted investments, at cost which approximates market	574,903	-
Accounts receivable, less allowance for doubtful receivables (\$27,013 and \$30,270)	745,046	862,377
Inventories of spare parts and supplies, less allowance for obsolescence (\$72,963 and \$53,583)	444,548	446,868
Prepayments and other	99,041	104,373
Total current assets	2,560,110	2,302,645
Property and Equipment:		
Flight equipment	3,271,311	3,803,085
Other	1,334,941	1,443,249
	4,606,252	5,246,334
Less: Accumulated depreciation	(1,102,575)	(1,005,309)
	3,503,677	4,241,025
Property and Equipment Under Capital Leases:		
Flight equipment	1,088,695	1,120,139
Other	81,717	94,092
	1,170,412	1,214,231
Less: Accumulated amortization	(351,075)	(278,979)
	819,337	935,252
Nonoperating Property and Equipment:		
Flight equipment	86,986	-
Less: Accumulated depreciation and amortization	(17,189)	-
	69,797	-
Total property and equipment	4,392,811	5,176,277
Other Assets	703,223	731,979
	\$7,656,144	\$8,210,901

The accompanying notes to consolidated financial statements are an integral part of this statement.

Liabilities and Stockholders' Equity

	December 31,	
	1989	1988
Current Liabilities:		
Current maturities of long-term debt	\$ 250,650	\$ 256,830
Current obligations under capital leases	32,328	108,909
Long-term debt classified as current	-	1,554,064
Capital leases classified as current	-	676,616
Accounts payable	769,617	779,465
Air traffic liability	426,518	657,594
Accrued payroll and pension costs	267,614	425,238
Accrued interest	63,825	137,574
Accrued taxes	64,621	45,586
Other accrued liabilities	150,470	141,394
Total current liabilities	2,025,643	4,783,270
Estimated Liabilities Subject to Chapter 11 Proceedings	3,024,424	-
Long-term Debt, net	2,229,404	2,346,996
Obligations Under Capital Leases, net	366,534	401,540
Deferred Credits and Other Liabilities	624,434	429,958
Minority Stockholders' Equity in Subsidiary Companies (aggregate liquidation value: \$206,394 and \$206,639)	8,545	8,547
Commitments and Contingencies		
Redeemable Preferred Stock (aggregate liquidation value \$586,706 and \$558,404)	482,882	462,902
Nonredeemable Preferred Stock and Common Stockholders' Equity:		
6 3/4% Cumulative Junior Preferred Stock - \$10 par value; 6,000,000 shares outstanding (liquidation value - \$150,000)	600	600
Class A common stock - \$10 par value; 4,080,000 shares authorized; 2,040,000 shares outstanding	204	204
Common stock - \$.01 par value; 200,000,000 shares authorized; 41,304,734 and 40,621,308 shares issued	413	406
Additional paid-in capital	1,085,577	1,076,325
Retained deficit	(2,171,437)	(1,282,788)
Common treasury stock, 1,047,539 and 922,338 shares, at cost	(21,079)	(17,059)
Total nonredeemable preferred stock and common stockholders' equity	(1,105,722)	(222,312)
	\$7,656,144	\$8,210,901

The accompanying notes to consolidated financial statements are an integral part of this statement.

Texas Air Corporation and Subsidiaries
Consolidated Statement of Cash Flows
(Dollars in thousands)

	For the Years Ended December 31,	
	1989	1988
Cash Flows From Operating Activities:		
Net loss	\$ (885,628)	\$(718,638)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	552,430	622,951
Provision for uncollectible accounts receivable	17,611	10,338
Gain on disposition of property, equipment and other assets, net	(612,280)	(154,776)
Adjustment of air traffic liability-related accounts	-	131,000
Provision for pension curtailment	117,967	-
Asset impairment write-down	54,969	-
Provision for pilot back pay award	65,514	-
Preferred dividends of Eastern Air Lines, Inc.	46,082	51,030
Changes in operating assets and liabilities:		
Increase in accounts receivable	(47,599)	(23,460)
Increase in inventories	(21,820)	(101,786)
(Increase) decrease in prepayments and other assets	7,159	(24,463)
Increase in accounts payable	246,250	36,122
Decrease in air traffic liability	(16,530)	(42,740)
Increase in interest and taxes payable	138,753	33,288
Increase (decrease) in other liabilities	(55,880)	94,905
Increase (decrease) in deferred credits	(4,529)	23,021
Other, net	(5,444)	39,692
Net cash used by operating activities	<u>(402,995)</u>	<u>(23,516)</u>
Cash Flows From Investing Activities:		
Proceeds from disposition of property, equipment and other assets	1,266,830	768,559
Acquisition of property and equipment	(245,739)	(448,924)
Increase in restricted investments, net	(574,903)	-
Decrease in marketable securities, net	77,242	233,380
Cash refunded from (deposited in) escrow accounts	32,807	(44,876)
Net cash provided by investing activities	<u>506,237</u>	<u>508,139</u>
Cash Flows From Financing Activities:		
Proceeds from issuance of long-term debt, net	303,530	466,995
Payments on long-term debt and capital lease obligations	(545,066)	(560,239)
Payment of dividends on preferred stock	(26,919)	(55,636)
Net cash used by financing activities	<u>(268,455)</u>	<u>(148,880)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(165,213)	335,743
Cash and Cash Equivalents—Beginning of Period	806,674	470,931
Cash and Cash Equivalents—End of Period	<u>\$ 641,461</u>	<u>\$ 806,674</u>
Supplemental Cash Flow Information:		
Interest paid	\$ 496,900	\$ 582,271
Financing and Investing Activities Not Affecting Cash:		
Capital lease obligations incurred	\$ 15,821	\$ 69,985
Installment purchase agreements incurred	3,586	15,390

The accompanying notes to consolidated financial statements are an integral part of this statement.

Texas Air Corporation and Subsidiaries
Consolidated Statement of Changes in Financial Position
(Dollars in thousands)

**For the Year Ended
December 31, 1987**

Working capital was provided by:

Net loss	\$ (466,146)
Items not requiring (providing) working capital:	
Depreciation and amortization	565,746
Gain on disposition of property, equipment and other assets, net	(24,273)
Increase in long-term obligations due to exchange fluctuations and amortization of debt face value over carrying value	44,669
Other, net	15,523
Total from operations	135,519
Issuance of common and preferred stock	279,486
Issuance of treasury stock	11,247
Proceeds from disposition of property and equipment	323,647
Increase in long-term obligations due to new borrowings	1,385,659
Decrease in minority interest	(2,245)
Increase in deferred credits, net	7,754
Other, net	1,065
Total working capital provided	2,142,132

Working capital was applied to:

Reduction of long-term debt, net of current maturities	920,981
Acquisition of property and equipment	1,042,865
Purchase of treasury stock	25,822
Redemption of preferred stock	26,724
Dividends	21,087
Acquisition of minority interest in Continental	168,979
Purchase of other assets and increase in deferred charges and notes receivable from affiliates	65,891
Total working capital applied	2,272,349

Decrease in working capital	\$ (130,217)
Working capital—beginning of period	(15,222)
Working capital—end of period	<u>\$ (145,439)</u>

Increase (decrease) in working capital by component:

Cash and marketable securities	\$ (428,716)
Accounts receivable	136,593
Inventories	74,274
Prepayments and other	(1,369)
Current portion of long-term debt and capital lease obligations	80,204
Accounts payable and air traffic liability	(54,405)
Accrued liabilities	63,202
	<u>\$ (130,217)</u>

The accompanying notes to consolidated financial statements are an integral part of this statement.

Texas Air Corporation and Subsidiaries
Consolidated Statement of Redeemable and Nonredeemable
Preferred Stock and Common Stockholders' Equity
For the Three Years Ended December 31, 1989

(Dollars in thousands)

	Redeemable Preferred Stock	Nonredeemable Preferred Stock	Class A Common Stock	Common Stock		Additional Paid-In Capital	Retained Deficit	Common Treasury Stock	
				Shares	Amount			Shares	Amount
Balance, December 31, 1986	\$ 380,862	\$ 600	\$ 204	35,659,856	\$ 357	\$ 860,198	\$ (55,399)	161,105	\$ (2,091)
Issuance of stock-									
Exercise of stock options	-	-	-	211,149	2	1,475	-	-	-
Conversion of notes and debentures	562	-	-	87,724	1	3,926	-	-	-
Public offering-common stock	-	-	-	4,000,000	40	188,320	-	-	-
Subsidiary's profit sharing plan	-	-	-	-	-	3,180	-	(271,657)	8,067
Sale of subsidiary's preferred stock	84,386	-	-	-	-	-	-	-	-
Purchase of treasury stock	(168)	-	-	-	-	-	-	1,236,694	(23,654)
Redemption of preferred stock	(23,168)	-	-	-	-	(3,556)	-	-	-
Net loss	-	-	-	-	-	-	(466,146)	-	-
Dividends-									
15% \$20.00 Preferred	-	-	-	-	-	-	(35)	-	-
6 3/4% Cumulative Convertible Junior Preferred	-	-	-	-	-	-	(10,125)	-	-
6.50% Redeemable Cumulative Junior Preferred	-	-	-	-	-	-	(4,122)	-	-
12% Redeemable Cumulative Junior Preferred	-	-	-	-	-	-	(6,785)	-	-
Reduction in notes receivable from affiliates	-	-	-	-	-	143	-	-	-
Other	6,234	-	-	68,020	-	11,073	(3,034)	-	-
Balance, December 31, 1987	448,728	600	204	40,026,749	400	1,064,759	(545,666)	1,126,162	(19,678)
Issuance of stock-									
Exercise of stock options	-	-	-	266,146	2	2,323	-	(11,700)	206
Conversion of notes and debentures	1	-	-	38	-	3	-	-	-
Subsidiary's profit sharing plan	-	-	-	-	-	(2,157)	-	(293,705)	5,423
Purchase of treasury stock	-	-	-	-	-	-	-	10,245	(133)
Net loss	-	-	-	-	-	-	(718,638)	-	-
Dividends-									
15% \$20.00 Preferred	-	-	-	-	-	-	(45)	-	-
6 3/4% Cumulative Convertible Junior Preferred	-	-	-	-	-	-	(7,594)	-	-
6.50% Redeemable Cumulative Junior Preferred	-	-	-	-	-	-	(2,894)	-	-
12% Redeemable Cumulative Junior Preferred	-	-	-	-	-	-	(5,089)	-	-
Reduction in notes receivable from affiliates	-	-	-	-	-	432	-	-	-
Other	14,173	-	-	328,355	4	10,945	(2,864)	91,336	(2,877)
Balance, December 31, 1988	462,902	600	204	40,621,308	406	1,076,325	(1,282,788)	922,338	(17,059)
Issuance of stock-									
Exercise of stock options	-	-	-	438,357	5	3,669	-	(15,700)	305
Purchase of treasury stock	-	-	-	-	-	-	-	62,489	(1,855)
Net loss	-	-	-	-	-	-	(885,628)	-	-
Dividends-									
15% \$20.00 Preferred	-	-	-	-	-	-	(73)	-	-
Increase in notes receivable from affiliates	-	-	-	-	-	(1,294)	-	-	-
Other	19,980	-	-	245,069	2	6,877	(2,948)	78,412	(2,470)
Balance, December 31, 1989	\$ 482,882	\$ 600	\$ 204	41,304,734	\$ 413	\$ 1,085,577	\$ (2,171,437)	1,047,539	\$ (21,079)

The accompanying notes to consolidated financial statements are an integral part of this statement.

Texas Air Corporation and Subsidiaries
Notes to Consolidated Financial Statements

Note 1—Business, Liquidity and Risk Factors

The consolidated financial statements include the accounts of Texas Air Corporation (the "Company" or "Texas Air") and its subsidiaries, Continental Airlines, Inc. ("Continental"), Eastern Air Lines, Inc. ("Eastern") and System One Holdings, Inc. ("System One"). The companies operate principally within the air transportation industry. The airline industry is highly competitive and the Company's airline subsidiaries, Continental and Eastern, compete on most major routes with two or more other major carriers. The industry consolidated in recent years and Texas Air has grown substantially through the acquisition of Eastern in 1986 and Continental's acquisition of several carriers during 1986 and 1987. System One furnishes computer reservations systems ("CRS") and computer processing services to airlines, including Eastern and Continental, and travel-related businesses. Texas Air, Eastern and Continental have reported substantial losses in recent years, although Continental achieved an approximate break-even level of net income in 1989.

Summarized condensed financial information of Eastern and Continental as of and for the year ended December 31, 1989 is as follows (in thousands):

	Eastern	Continental
Current assets	\$ 1,785,364	\$ 1,333,333
Current liabilities	959,984	1,510,536
Working capital (deficit)	\$ 825,380	\$(177,203)
Noncurrent assets	2,110,113	2,789,664
Estimated liabilities subject to Chapter 11 proceedings	\$ 1,157,510	\$ 1,730,100
Long-term obligations	759,381	2,536,290
Net equity	\$ (832,313)	\$ - 3,079
Operating revenues	\$ 1,498,106	\$ 1,076,489
Operating expenses	2,362,827	1,900,622
Operating income (loss)	\$(864,721)	\$(824,133)
Other income (expense), net	12,408	(172,450)
Income tax provision		318
Net income (loss)	\$ (852,313)	\$ - 3,079

As discussed in greater detail below and in Notes 2 and 12, there are significant uncertainties impacting Texas Air and each of its subsidiaries including primarily the bankruptcy proceedings of Eastern, and its potential impact on Texas Air, Continental and System One, and liquidity concerns resulting from continuing losses, capital expenditure requirements and substantial leverage. As a result of these uncertainties, Eastern has taken steps to size down the scope of its operations, reduce operating costs and sell substantial assets. In addition, System One decreased, although to a more limited degree, its level of operations to reflect the reduced size of Eastern. In February 1990 Texas Air, System One and Electronic Data Systems Corporation ("EDS") entered into a preliminary agreement providing for the acquisition by EDS of an equally owned partnership to operate and market System One's CRS (see Note 12). Additionally, Continental has generated liquidity through the refinancing of certain of its secured obligations, proceeds from disposition of certain surplus assets, new third-party borrowings and cash generated from operating activities. Eastern will continue to be required to dispose of substantial assets in order to generate liquidity and continue its operations,

and Texas Air and Continental could also be required to take such steps in order to maintain levels of liquidity required for their continued operations, although there can be no assurance that such liquidity can be generated.

Texas Air and its subsidiaries are highly leveraged. Such substantial levels of debt, combined with the high level of fixed costs in the airline industry, make Texas Air and its subsidiaries vulnerable to declines in revenue which could arise from general economic conditions, increasing competition and job actions by employees. In addition, such leverage may also affect Texas Air's access to capital markets and the cost of obtaining borrowed funds.

The following provides a more detailed discussion of operations and liquidity relating to Texas Air, Continental and Eastern:

Texas Air. As a holding company, Texas Air conducts most of its operations through or with its subsidiaries. Texas Air has no lines of credit from outside sources and relies principally on income from its cash investments and lease payments and fees from its subsidiaries to supply the funds necessary for the payment of its obligations, including principal of and interest on its outstanding indebtedness and leases and for the payment of dividends. Management fees charged to Eastern during 1989 were reduced as a result of Eastern's reduction in operations. Texas Air does not expect to receive substantial dividends in the foreseeable future from either Eastern, Continental or System One. See Note 4.

Texas Air has in recent years received substantial funds through the issuance of debt and equity securities. Accordingly, its cash requirements relate primarily to its outstanding indebtedness and preferred stock. As of December 31, 1989, the scheduled debt service requirements on Texas Air's currently outstanding debt and capitalized lease obligations, net of any corresponding payments from its subsidiaries and the redemption of indebtedness discussed in Note 4, are estimated to approximate \$56,800,000 in 1990. In addition, Texas Air's publicly-held securities have scheduled maturities of \$0, \$74,200,000, \$0 and \$94,400,000 in 1991, 1992, 1993 and 1994, respectively, which amounts are net of the debt securities repurchased in open market transactions as discussed below. See Notes 4 and 7.

Texas Air has guaranteed substantial obligations of its subsidiaries and has in the past provided financing directly to its subsidiaries. During 1988, Texas Air advanced \$150,000,000 to Continental, of which amount \$100,000,000 was repaid in December 1989. During 1988 and the first quarter of 1989, Texas Air advanced \$39,000,000 to System One under a \$40,000,000 revolving credit facility. During the first quarter of 1989, the \$39,000,000 advanced to System One was converted to a term loan bearing interest at 10% per annum, repayable in six equal semiannual installments.

Texas Air has guaranteed and may otherwise be liable for certain obligations of Eastern including, among others, two years of interest (or \$69,000,000) on certain Eastern indebtedness (for which guaranty Eastern deposited \$40,000,000 in cash with Texas Air), certain Eastern pension obligations and the payment of dividends, redemption price and liquidation value of Eastern's 11.36% Cumulative Junior Preferred Stock (the "11.36% Preferred"). As of December 31, 1989, Eastern's 11.36% Preferred's

annual dividend requirements were approximately \$27,100,000 with a liquidation preference of approximately \$238,800,000. Pursuant to Texas Air's agreement with the Examiner (see Note 2) on certain matters designed to improve the economic viability of Eastern, Texas Air has agreed to pay to Eastern \$107,000,000 on confirmation of its plan of reorganization and will pay on Eastern's behalf in the second quarter of 1990 \$26,300,000 of Eastern's deferred pension obligations. In addition, each member of the Texas Air "controlled group" is jointly and severally liable for Eastern's periodic minimum pension plan funding obligations and could be jointly and severally liable for the full amount of the plans' underfunding if Eastern pension plans were terminated. See Notes 2, 4, 7 and 12.

Continental. Continental's operations and financial results were severely impacted during 1987 and 1988 by the integration of People Express Airlines, Inc. ("People Express"), Frontier Airlines, Inc. and New York Air, Inc. ("New York Air") with Continental. This problem, compounded by, among others, labor unions hostile to the management of Eastern who have also demonstrated against Continental, and negative publicity surrounding the Department of Transportation (the "DOT") and Federal Aviation Administration (the "FAA") investigations of Continental in 1988, resulted in significant net losses during 1987 and 1988. During late 1988, Continental committed to implement a service-based marketing strategy and during 1989 was able to achieve improved operating performance and higher yields as compared to 1988. Continental achieved operating income during 1989 of approximately \$176,000,000; however, net income was at an approximate break-even level after approximately \$81,000,000 in net nonrecurring gains from the disposition of property and equipment and early retirement of debt.

Continental generated liquidity during 1989 primarily through the refinancing of certain of its secured obligations, proceeds from the disposition of certain surplus assets, new third-party borrowings and cash generated from operating activities. Continental believes that its internally generated funds, third-party borrowings and other financings will be sufficient to meet its cash requirements, although there can be no assurance that such liquidity can be generated.

Although Continental is operated as a separate company, as a member of a consolidated group with Texas Air, Eastern and System One, Continental may be affected by the financial and operating condition of such companies. See Note 2 for discussion of Eastern's bankruptcy proceedings.

Eastern. Competition, the negative publicity surrounding the DOT and FAA investigations in 1988 and negative public perception generated from labor disputes against Eastern contributed to the substantial net losses during 1988 and 1989. Losses for 1989 were affected further by the strikes, the Chapter 11 filing and the continuing uncertainties created by the Chapter 11 proceedings. See Note 2.

Since February 1990, Eastern's business and, most importantly, its efforts to attract business passengers have continued to be negatively affected by the uncertainties generated by the bankruptcy proceeding, including questions that have arisen about Eastern's continued viability, continuing delay in achieving satisfactory resolution of its labor contracts and negative and disruptive media accounts about the results of the Examiner's

report. As a result of these factors, Eastern's actual revenues and results have fallen short of projections. Accordingly, in late March 1990, Eastern proposed revisions to the January business plan and informed the committee of unsecured creditors appointed by the Bankruptcy Court (the "Creditors Committee") that it would not be able to go forward with the tentative reorganization plan it had proposed. See Note 2.

Eastern needs substantial liquidity to rebuild its business and recapture its passenger base. As a result, during 1989, Eastern generated substantial liquidity by disposing or leasing of surplus assets. Eastern plans to generate, in 1990, additional liquidity from the sale of its South American routes and other assets surplus to its needs.

Proceeds from the sale of assets and the rental income from aircraft leased out have been held in restricted accounts administered by the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") for the benefit of creditors. At December 31, 1989, \$574,903,000 was held in such restricted accounts. Eastern has obtained the release of \$320,000,000 from these restricted accounts (of which, \$110,000,000 was released during the first quarter of 1990) to meet its obligations and implement its business plan. Eastern believes that additional restricted funds will be required in future periods, however there can be no assurance that such funds will be released.

The accompanying financial statements have been prepared assuming the companies continue as going concerns and do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amount and classification of liabilities or any other adjustments that might be necessary as a result of the outcome of the uncertainties discussed herein.

Note 2—Chapter 11 Reorganization of Eastern

On March 9, 1989, Eastern filed a voluntary petition in the Bankruptcy Court seeking to reorganize under Chapter 11 of the Federal Bankruptcy Code (the "Code"). The filing for protection under the Code was necessary due to Eastern's inability to continue substantial operations as a result of the refusal by most of Eastern's pilots, represented by the Air Line Pilots Association ("ALPA"), to report to work since the commencement on March 4, 1989 of the strike against Eastern by employees of Eastern represented by the International Association of Machinists and Aerospace Workers (the "IAM").

The filing by Eastern of its voluntary petition for reorganization operated as an automatic stay against the commencement or continuation of any judicial, administrative or other proceedings against Eastern, any act to obtain possession of property of or from Eastern, or any act to create, perfect or enforce any lien against property of Eastern, with certain exceptions under the Code. Consequently, Eastern's creditors are prohibited from attempting to collect prepetition debts without the consent of the Bankruptcy Court. Any creditor may seek relief from the automatic stay and, if applicable, enforce a lien against any security if authorized to do so by the Bankruptcy Court. Notwithstanding the automatic stay, Eastern has paid certain prepetition liabilities, with approval from the Bankruptcy Court, including certain payments to foreign vendors and governmental agencies, wages and salaries for active employees, insurance benefits, pension payments, interest payments, insurance claims, travel agency commissions and certain ticket refunds. In addition, payments

are being made on certain debt relating directly to aircraft financing under the provisions of Section 1110 of the Code (which provides special treatment for certain aircraft lenders and lessors permitting them otherwise to obtain possession of such aircraft) and lease rentals for airport properties and certain items of ground equipment. See Note 5. Under the Code, Eastern is required to pay substantial expenses associated with the Chapter 11 proceedings, which amounted to \$36,900,000 through December 31, 1989.

The following table summarizes, as of December 31, 1989, Estimated Liabilities Subject to Chapter 11 Reorganization Proceedings (in thousands):

Long-term debt	\$1,592,991
Capital lease obligations	673,765
Accounts payable	218,685
Air traffic liability	110,024
Accrued payroll and pension costs	203,946
Accrued interest	194,950
Accrued taxes	13,799
Other accrued liabilities	16,264
	<u>\$3,024,424</u>

Eastern expects that a portion of its receivables may be subject to set off against an equal amount of estimated unsecured payables. The issue of set off ultimately will be resolved by the Bankruptcy Court.

Eastern had the exclusive right for 120 days after the filing of its Chapter 11 petition to file a plan of reorganization and, in July 1989, Eastern filed a plan with the Bankruptcy Court. The exclusivity period was extended on several occasions, but expired on February 20, 1990. Accordingly, any creditor or equity holder is currently free to file a plan of reorganization with the Bankruptcy Court and to solicit acceptances of creditors and equity holders with respect thereto. Acceptance of any reorganization plan generally will require the affirmative vote of those classes of Eastern creditors and equity holders whose claims are impaired thereby (subject to certain exceptions in the Code) as well as formal approval thereof by the Bankruptcy Court.

In February 1990, Eastern and the Creditors Committee agreed, subject to a number of conditions, to a plan of reorganization pursuant to which the unsecured creditors would be paid 50% of their claims. The proposed plan was premised upon Eastern's ability to meet feasibility standards set forth in Section 1129(a)(11) of the Code, which standards were included in Eastern's January 1990 business plan.

Since February 1990, Eastern's business and, most importantly, its efforts to attract business passengers have continued to be negatively affected by the uncertainties generated by the bankruptcy proceeding, including questions that have arisen about Eastern's continued viability, continuing delay in achieving satisfactory resolution of its labor contracts and negative and disruptive media accounts about the results of the Examiner's report described below. As a result of these and other factors, Eastern's actual revenues and results have fallen short of projections. Accordingly, in late March 1990, Eastern proposed revisions to the January business plan and informed the Creditors Committee that it would not be able to go forward with the reorganization plan due to its inability to meet such feasibility standards discussed above.

Eastern has proposed to revise its business plan to reduce further its postpetition fleet size (from 160 to 148 aircraft) and to

reduce by 12% the level of flying projected in the January business plan for the period after July 1, 1990 and to reflect the effect of "Y-Not" fares that encourage business travelers to fly Eastern by offering first class travel for approximately 15% less than other airlines' unrestricted coach fares. In addition, Eastern has stated its intention to seek Eastern Bankruptcy Court approval under Section 1113 of the Code to reject the expired ALPA and Transport Workers Union of America (the "TWU") labor contracts, which rejection could lead to substantial cost savings, unless negotiations with ALPA and the TWU are successful or assured to come to a definite end. Eastern also intends to seek Bankruptcy Court approval under Section 1114 of the Code to reduce the cost of health benefits for early retirees and those below age 65, which will also result in significant cost savings to Eastern. In an effort to counter negative publicity and recapture business passengers, Eastern expects to substantially increase its marketing efforts. In addition, the agreement with the Examiner, described below, would remain in place, subject to Bankruptcy Court approval, thereby providing essential assistance to Eastern following its emergence from Chapter 11. Eastern expects to begin negotiations in the near future with the Creditors Committee with respect to revisions to its business plan and the treatment of claims of unsecured creditors.

In discussions to date, Eastern has proposed that secured debt holders have their claims reinstated, with certain portions of some instruments prepaid on confirmation to reflect the sale of aircraft pledged thereunder and the balance of the outstanding indebtedness rescheduled. Holders of prepetition tickets would be given the choice of payment in full upon plan confirmation or new tickets worth 35% more than the face value of their original tickets. A new series of preferred stock with a liquidation value of \$34,900,000 would be issued for all existing outstanding preferred stock, except the 11.36% Preferred, which would be cancelled, subject to Texas Air's guaranty of dividend payments, redemption price and liquidation preference when due. Texas Air has been making dividend payments on the 11.36% Preferred since Eastern filed for protection under Chapter 11. Texas Air would waive any rights it has against Eastern arising from such guaranty. Eastern is negotiating with the committee of Preferred Stockholders appointed by the Bankruptcy Court (the "Preferred Stockholders Committee") with respect to this proposal, but no agreement has been reached.

In connection with the proposals described above, Texas Air would retain its equity in Eastern and Eastern would waive any and all potential claims against Texas Air and Continental.

Management of Eastern cannot predict when or whether any revised reorganization plan will be formally accepted by creditors and equity holders entitled to vote thereon or approved by the Bankruptcy Court or whether any other equity holders or creditors will submit a competing plan of reorganization to the Bankruptcy Court. If no plan of reorganization is accepted, and approved by the Bankruptcy Court, it is possible that Eastern will be unable to continue in existence and will be liquidated.

On April 5, 1989, the Bankruptcy Court, at Eastern's request, appointed an examiner in Eastern's Chapter 11 case (the "Examiner"). The Examiner was given authority, among other things, to review transactions between Eastern and its affiliates. On March 1, 1990, the Examiner filed with the Bankruptcy Court

a report on his review of a number of affiliated transactions. The report contained the Examiner's determination that Eastern could assert possible claims against its affiliates, but in light of the agreement described below, recommended against making such claims. Eastern management does not believe that Eastern has valid claims against any of its affiliates with respect to the intercompany transactions discussed therein. The agreement among Eastern, Texas Air (for itself and Continental) and the Examiner, which was designed to improve the economic viability of Eastern, provides for, among other things, the payment by Texas Air to Eastern of \$107,000,000 at confirmation and the payment by Texas Air of \$26,300,000 of Eastern's deferred pension obligation. In addition, all prepetition obligations (including notes) of Texas Air, Continental and System One to Eastern would be offset against all prepetition obligations of Eastern to such companies. All postpetition obligations among the companies would be offset against each other and the net claim would be paid in cash by the appropriate party. Eastern also would obtain certain purchase options on delivery to Continental of 40 new B737-300 aircraft and a 25% ownership interest in the CRS partnership expected to be formed with EDS. The agreement is subject to Bankruptcy Court approval and confirmation of a plan of reorganization satisfactory to Eastern. Eastern has moved that the Bankruptcy Court approve the agreement. Eastern anticipates that in the course of the hearing on such motion, the Bankruptcy Court itself will analyze the validity of the claims that the Examiner contends could be asserted.

Eastern estimates that as of December 31, 1989, it had approximately \$3.2 billion of prepetition liabilities, including approximately \$2.3 billion of long-term indebtedness and capitalized lease obligations. The aggregate amount of claims filed with the Bankruptcy Court in connection with Eastern's Chapter 11 proceedings, however, is several times greater than Eastern's estimates of such claims. Eastern believes that many of these claims are duplicative, invalid or based upon contingencies that have not occurred. The resolution of these claims, certain litigation and other matters adverse to Eastern could have a material adverse effect on Eastern's financial condition; however, because of the ongoing nature of the Chapter 11 proceeding, the outcome thereof and Eastern's ultimate liability resulting therefrom currently cannot be determined.

In June 1989, Eastern sold its Air Shuttle division to Trump Shuttle, Inc., for \$365,000,000 in cash. In 1989, Eastern sold other assets consistent with its rebuilding plan, including 41 aircraft, certain gates, routes, slots and facilities for gross proceeds of approximately \$497,200,000 before related debt repayments, of which \$32,500,000 have been paid and \$163,500,000 remain subject to approval of a final plan of reorganization. Eastern also has leased 14 B727-200 aircraft to Pan American World Airways, Inc. for a term of three years at an aggregate rental of approximately \$58,000,000 over the three-year period.

In December 1989, Eastern, Continental and System One entered into separate agreements with American Airlines, Inc. ("American"). Pursuant to the agreements, Eastern will sell to American, among other things, its 14 Central and South American routes, certain hangar, cargo and office facilities, slots, and three

other route authorities; Continental will transfer to American certain gates and sell to American a route and certain slots and System One will transfer telecommunication lines and equipment related to Eastern's Central and South American operations. In addition, certain claims will be settled including various claims arising out of disputes involving the System One CRS and American's CRS. See Note 12. The transactions, which are subject to certain conditions, provide for payments of \$349,000,000 to Eastern, \$102,500,000 to Continental and \$19,500,000 to System One. The transactions also remain subject to approval by the DOT; approvals by the Bankruptcy Court and the Department of Justice have been obtained. Currently, Eastern and American are engaged in a dispute as to whether certain conditions have been met relating to the sale of certain assets in San Juan. Eastern and American have been negotiating a resolution to this dispute, but if no satisfactory resolution can be reached, the issue will be submitted to the Bankruptcy Court.

During the first quarter of 1990, Eastern sold to an unrelated third party five A300 aircraft which were immediately leased to Continental for gross proceeds to Eastern of approximately \$132,500,000. Also during the first quarter of 1990, Eastern sold to and leased back from an unrelated third party six A300 aircraft for approximately \$168,000,000, sold to unrelated third parties one L-1011 aircraft for \$13,500,000, two DC-9-30 aircraft for \$13,000,000 and two B757 aircraft for \$74,000,000. All of these transactions are or will be subject to Bankruptcy Court approval.

Note 3—Summary of Significant Accounting Policies

(a) Principles of consolidation—The consolidated financial statements include the accounts of Texas Air and its subsidiaries, Continental, Eastern and System One. All significant intercompany transactions have been eliminated.

(b) Marketable securities—Marketable securities are carried at the lower of cost or market value. As of December 31, 1989 and 1988, the cost of these securities was approximately \$60,581,000 and \$89,340,000, respectively.

(c) Restricted investments—At December 31, 1989, \$574,903,000 of Eastern's cash and investments were held in segregated accounts for the benefit of Eastern's creditors. These funds include cash generated from asset sales, rental income from aircraft leased out to third parties and accrued interest income on such restricted investments. Eastern obtained the release of \$320,000,000 (of which \$110,000,000 was released during the first quarter of 1990) from its restricted accounts to meet its obligations and implement its business plan.

(d) Traffic receivables—Certain of Eastern's traffic receivables were sold by Eastern to a bank under revolving agreements which expired in 1989. The agreements provided for 18 or 45 percent of the selling price to be withheld by the purchaser to cover uncollectible accounts and customer refunds, which have historically approximated nine to 11 percent of the face value of the receivables sold. The excess of amounts withheld were remitted to Eastern as receivables were collected. Eastern was also responsible for all related servicing costs. The balances withheld by the purchaser under these agreements amounted to zero and \$22,300,000 at December 31, 1989 and 1988, respectively. Proceeds from the sale of these receivables amounted to \$49,800,000 and \$313,800,000 in 1989 and 1988, respectively.

(e) Spare parts and supplies—Flight equipment expendable parts and supplies are valued at average cost. An allowance for obsolescence is accrued to allocate the costs of these assets over the useful lives of the related aircraft and engines to an estimated residual value.

(f) Property and equipment—Property and equipment are depreciated to estimated residual values over their estimated useful lives using the straight-line method. Estimated lives are eight to 21 years, depending on the lease period, for aircraft acquired under long-term capital leases; four to 28 years for owned aircraft; and two to 25 years for other property and equipment including airport facility improvements. Maintenance and repairs are expensed as incurred; major renewals and betterments are capitalized and depreciated over the remaining life of the asset.

Effective April 1, 1987, Continental extended the depreciable lives of its narrow-body aircraft to April 1, 1997 and its wide-body aircraft to April 1, 2002 for aircraft previously being depreciated over a shorter period. This change in depreciable lives resulted in a reduction of depreciation and amortization expense of approximately \$11,400,000 for 1987. Effective April 1, 1989, Continental standardized the depreciable lives of all its jet and certain of its commuter aircraft to 28 years from the date of manufacture for aircraft being depreciated over different lives. This change in depreciable lives resulted in a reduction of depreciation and amortization expense of approximately \$14,400,000 for 1989.

During 1989, Eastern reclassified certain of its aircraft scheduled for sale to Nonoperating Property and Equipment. Eastern discontinued accruing depreciation relating to these aircraft resulting in a reduction in depreciation expense of approximately \$19,400,000 for the year ended December 31, 1989.

The Company's aircraft fleet is regularly rotated through maintenance overhaul procedures. Costs associated with this maintenance and routine maintenance and repairs are expensed as incurred. Modifications which increase the usefulness of the aircraft are capitalized and depreciated over the remaining life of the asset.

(g) Goodwill—Cost in excess of fair value of net assets acquired (relating primarily to the acquisition of Continental) has been recorded as goodwill and is being amortized primarily over a 30-year period using the straight-line method. As of December 31, 1989 and 1988, goodwill comprised \$277,064,000 and \$286,651,000, respectively, of the balance in Other Assets, net of \$30,487,000 and \$19,460,000 of accumulated amortization, respectively. During 1989, 1988 and 1987, \$11,027,000, \$10,871,000 and \$8,248,000, respectively, of goodwill amortization was expensed in the consolidated statement of operations.

(h) Deferred credits—Deferred credits consist primarily of deferred gains from the sale/leaseback of aircraft. These credits are being amortized as a reduction of lease expense over the terms of the related leases.

(i) Revenue recognition—Passenger revenues are recognized when the transportation is provided rather than when the ticket is sold. The amount of passenger sales not yet recognized as revenue is reflected in the consolidated financial statements as air traffic liability. The companies perform a periodic verification of this estimated liability, and adjustments which result therefrom are included in the consolidated statements of operations.

Continental revised its estimate of air traffic liability during the second quarter of 1988 which resulted in a one-time charge to

earnings of \$131,000,000. This charge, which had no impact on cash flow, is reflected as a separate line item in the 1988 consolidated statement of operations. The charge consisted of an estimated \$66,000,000 for reaccommodation of passengers on other airlines and an estimated \$65,000,000 for revisions of revenue recognition estimates including those related to ticketing errors, foreign currency fluctuations and revenue capture methodology. The change in estimates that required this charge related primarily to activity in late 1987 and, to a more limited degree, the first quarter of 1988. Continental has revised a number of its procedures used to estimate its advance ticket liability on a current basis.

(j) Passenger traffic commissions—Passenger traffic commissions are recognized as expense when the transportation is provided and the related revenue is recognized. The amount of passenger traffic commissions not yet recognized as expense is classified in the consolidated financial statements as prepayments.

(k) Frequent traveler program—Eastern and Continental operate a combined frequent flyer program known as OnePass that provides a variety of awards to program members based on accumulated mileage. The estimated incremental cost of providing free travel is recognized as an estimated liability and charged to income when program members accumulate sufficient mileage to qualify for free travel awards. Such estimated liability is adjusted periodically based on awards earned and awards redeemed. As of December 31, 1989 and 1988, the airlines had recorded air traffic liabilities totaling \$40,500,000 and \$57,400,000, respectively, for the estimated liability under the OnePass program.

(l) Foreign currency transactions—Realized and unrealized foreign currency transaction adjustments are included in the consolidated statement of operations on a current basis. Financial results for 1989, 1988 and 1987 include gains (losses) of \$4,853,000, (\$5,418,000), and (\$22,209,000), respectively.

(m) Income taxes—A provision for income taxes is based upon income before income tax. Deferred federal income taxes arise when certain income or expense items are recognized in different time periods for federal income tax purposes than for financial reporting purposes. The benefits of net operating loss and investment tax credit carryforwards are recognized to the extent the benefit is realized or to the extent of existing deferred tax credits. See Note 9.

(n) Net loss per share—Loss per common and common equivalent share for 1989, 1988 and 1987 was computed using 40,030,000, 39,308,000 and 38,963,000 weighted average common shares outstanding during the year, respectively. Preferred stock dividend requirements and amortization of discount on preferred stock for 1989, 1988 and 1987 of \$23,260,000, \$23,635,000, and \$24,121,000, respectively, were added to net loss for this computation. Although certain preferred stock, warrants and stock options are considered common equivalent shares, they were not included in the computation since their inclusion would be antidilutive. Similarly, fully diluted loss per share is the same as primary loss per share since the assumed conversion of certain preferred stock and convertible debentures would be antidilutive.

(o) Statement of cash flows—As of December 31, 1988, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 95, "Statement of Cash Flows," which requires a

statement of cash flows in place of a statement of changes in financial position for fiscal years ending after July 15, 1988. Restatement of prior years' financial statements is not mandatory; accordingly, a consolidated statement of changes in financial position has been provided for the year ended December 31, 1987. Cash equivalents consist of short-term, highly liquid investments which are readily convertible into cash and have original maturities of three months or less.

(p) Reclassifications—Certain reclassifications have been made in the financial statements for prior years to conform to the 1989 presentation.

Note 4—Long-Term Debt
Long-term debt (net of indebtedness payable to affiliates) at December 31, 1989 and 1988 is summarized as follows (in thousands):

	1989	1988
Texas Air		
Senior Secured Indebtedness:		
Notes payable, 9.88% to 13.69% and LIBOR plus 1.5% to 1.75%, payable through 2002 (a)	\$ 175,225	\$ 186,833
Notes payable, 9%, payable to 1994	200	241
Senior Unsecured Indebtedness:		
Senior Notes, 14.25% to 15.75%, due 1990 to 1995	315,169	336,832
Senior Extendible Reset Notes (b)	80,200	100,000
Other	98	377
	<u>560,692</u>	<u>624,003</u>
Less: Current maturities	(92,799)	(21,422)
Total Texas Air	\$ 467,893	\$ 602,581

	1989	1988
Continental		
Senior Secured Indebtedness:		
Notes payable to banks, 11% to prime plus 1.5%, payable to 1997 (c)	110,728	17,408
Notes payable, 6% to 12.25%, payable to 2008 (d)	611,200	630,766
Notes payable, 8.5% to prime plus 1.5%, payable to 1998 (e)	230	215,000
Notes payable to institutions, 8.5% to 15.87%, payable to 1994 (d)	99,899	62,357
Notes payable, 11%, payable to 1998 (e)	14,435	46,188
Equipment Trust Certificates, 10% to 14.75%, payable to 1999 (f)	457,918	243,078
Aircraft deposit notes, prime plus 2% to LIBOR plus 2.5%, payable to 1998 (c)	99,363	—
Revolving notes, prime plus 2%, payable to 1995 (c)	181,100	10,000
Senior Unsecured Indebtedness:		
Notes payable, prime plus 2%, payable to 1991 (c)(g)	30,685	65,366
Notes payable, 8% to 16.5%, payable to 2006 (h)	328,724	332,513
Floating Rate Notes, LIBOR plus 1.75%, payable to 1996 (c)	38,106	38,106
Subordinated Indebtedness:		
Convertible Subordinated Debentures, 3.5%, payable to 1992 (i)	12,120	11,422
Subordinated debentures, 5.5% and 11%, payable to 1996 (j)	12,627	19,547
Subordinated obligation to People Express claimants, 15.75%, payable to 1999 (k)	5,000	5,000
	<u>1,838,175</u>	<u>1,828,627</u>
Less: Current maturities	(124,155)	(125,423)
Total Continental	\$ 1,714,020	\$ 1,703,204

	1989	1988
Eastern		
Senior Secured Indebtedness:		
Equipment Trust Certificates, 11.75%, 12.75% and 13.75%, payable through 2001	\$ 453,765	\$ 457,765
Second Priority Secured Equipment Notes, 17.25%, due 1993 (l)	200,000	200,000
Secured Equipment Certificates, 11.48%, due 2002	188,000	188,000
Promissory Notes, 8% to 10.06%, payable to 1996 (m)	200,879	193,946
Installment and Other Purchase Obligations, 8.625% to 17.25%, payable through 2002 (n)	120,207	154,675
Subordinated Indebtedness:		
Manufacturers Subordinated Notes, prime or Eastern's Leverage Ratio, due through 1995 (o)	79,124	84,016
Manufacturers Subordinated Notes, 9.25% to 13.25%, due through 1998 (p)	151,675	147,247
Convertible Subordinated Debentures, 4.75%, due 1993 (q)(r)	10,353	9,916
Convertible Subordinated Debentures, 5%, due 1992 (r)(s)	25,774	24,546
Convertible Subordinated Debentures, 3%, due 2008 (r)(t)	9,873	9,318
Convertible Subordinated Debentures, 11.5%, due 1999 (r)(u)	136,913	135,522
Convertible Subordinated Debentures, 11.75%, due 2005 (r)(v)	25,073	25,475
	<u>1,601,636</u>	<u>1,630,626</u>
Less:		
Current maturities:		
Original contractual maturities	(568)	(76,562)
Due to default	—	(1,554,064)
Prepetition amounts included in Estimated Liabilities Subject to Chapter 11 Proceedings	(1,592,991)	—
Total Eastern	\$ 8,077	\$ —
System One		
Secured Indebtedness:		
Notes payable to vendors, 6% to 17%, payable to 1998	\$ 64,388	\$ 74,694
Less: Current maturities	(33,128)	(33,423)
Total System One	\$ 31,260	\$ 41,271
Total Consolidated Long-Term Debt	\$ 4,073,045	\$ 4,157,890
Less:		
Current maturities:		
Original contractual maturities	(250,650)	(256,830)
Due to default	—	(1,554,064)
Prepetition amounts included in Estimated Liabilities Subject to Chapter 11 Proceedings	(1,592,991)	—
Total	\$ 2,229,404	\$ 2,346,996

- (a) The LIBOR rates related to this debt were 8.5625% and 9.4375% at December 31, 1989 and 1988, respectively.
- (b) These notes bore interest from August 18, 1988 to November 30, 1988 at the rate of 16% per annum. An additional 50 basis points was added to the stated interest rate of these notes from November 16 through December 5, 1988, in accordance with the terms of a registration rights agreement relating to the notes. On December 1, 1989, the interest rate was reset for a one-year period to 17.75% per annum which, pursuant to the terms of the notes, was the interest rate the notes should bear in order to have a market value of 101% of the principal amount thereof. Notwithstanding the foregoing, the interest rate on these notes shall not be less than 16% per annum nor greater than 20% per annum. The notes mature December 1, 1990, except that Texas Air may, at its sole option, extend the maturity of all or part of the notes for successive one-year periods with the final maturity date ending on August 15, 1993.

- (c) As of December 31, 1989 and 1988, the prime rate associated with this indebtedness approximated 10.5% at each date, while the LIBOR rate for the comparable dates approximated 8.4% and 9.3%, respectively.
- (d) Texas Air has guaranteed payments on approximately \$41,939,000 principal amount of these notes, plus interest, which notes are secured by two DC-9-80 aircraft and two 737-200 aircraft acquired by Continental and New York Air in 1986. In January 1990, the guaranties related to the two 737-200 aircraft were cancelled in conjunction with sale/leaseback transactions.
- (e) Warrants to purchase 5,100,000 shares of Continental's common stock at \$8.50 per share were issued in connection with these notes. These notes have annual mandatory redemptions and are secured by certain Continental leasehold interests. These notes are net of unamortized discount at December 31, 1989 and 1988 of \$2,895,000 and \$3,345,000, respectively. As a result of Texas Air's acquisition of the minority interest in Continental, the warrants, when exercised, are currently exercisable for approximately \$84,500,000 in cash. See Note 12.
- (f) Primarily in conjunction with sale/leaseback transactions in 1989 and 1988, respectively, \$134,000,000 and \$42,000,000 of the face value of these notes were retired. These notes are net of unamortized discount at December 31, 1989 and 1988 of \$13,304,000 and \$15,204,000, respectively. In October 1989, Texas Air sold \$60,400,000 of these debt instruments that it held (which previously for financial reporting purposes had been eliminated in consolidation) to third parties for net proceeds of approximately \$59,600,000.
- (g) This debt represents unsecured creditors' allowed claims under the Continental plan of reorganization and is guaranteed by Texas Air, along with the related accrued interest, in accordance with such plan.
- (h) In March 1987, Continental issued to the public \$171,000,000 of 11 1/4% Senior Notes due 1997 which are guaranteed by Texas Air. These notes are net of unamortized discount at December 31, 1989 and 1988 of \$44,251,000 and \$45,380,000, respectively.
- (i) These debentures are convertible into approximately 260,000 shares of Texas Air common stock and approximately 83,000 shares of Texas Air 15% \$20.00 Cumulative Preferred Stock, subject to certain adjustments. These debentures are net of unamortized discount at December 31, 1989 and 1988, of \$1,196,000 and \$1,947,000, respectively.
- (j) These debentures are net of unamortized discount at December 31, 1989 and 1988 of \$1,620,000 and \$1,892,000, respectively.
- (k) Continental agreed to issue this obligation pursuant to the settlement of certain litigation against People Express brought under the securities laws relating to claims arising before the acquisition of People Express by Texas Air. In March 1990, Continental agreed to purchase this obligation plus accrued interest from date of issue for approximately \$4,400,000, subject to court approval.
- (l) Texas Air agreed to guaranty up to two years of interest on these notes, for which guaranty Eastern agreed to provide partial security and to pay Texas Air a guaranty fee at the annual rate of 2% of the uncollateralized portion of the guaranty and .5% of the collateralized portion. In March 1988, Eastern deposited \$40,000,000 with Texas Air as partial security for the guaranty, which amount will be returned to Eastern with accrued interest if the guaranty is not utilized. Pursuant to such guaranty, Texas Air paid on behalf of Eastern \$17,250,000 on each of September 1, 1989 and March 1, 1990 for Eastern's semiannual interest payments, which payments were offset against the \$40,000,000 deposit.
- (m) These notes are net of unamortized discount of \$12,632,000 and \$19,566,000, at December 31, 1989 and 1988, respectively. The effective interest rate of this debt after revaluation was 15.2%.
- (n) These obligations are inclusive of unamortized premium of \$615,000 at both December 31, 1989 and 1988. The effective interest rate of this debt after revaluation was 14.95%.
- (o) The effective interest rates of this debt ranged from 12.75% to 13% at both December 31, 1989 and 1988.
- (p) These notes are net of unamortized discount of \$19,737,000 and \$24,165,000 at December 31, 1989 and 1988, respectively. The effective interest rate of this debt after revaluation was 16.83%. The interest rate is subject to upward or downward adjustments based on Eastern's profit margin for each year. For 1989, approximately \$75,500,000 was subject to an adjustment of plus or minus 1.25% and approximately \$95,900,000 was subject to an adjustment of plus .20% or minus .25%.
- (q) These debentures are convertible into approximately \$183.82 of cash and 4.41 depositary preferred shares representing Eastern's 11.36% Preferred (the "Depositary Preferred Shares") for each \$1,000 principal amount of debentures. These debentures are net of unamortized discount of \$2,406,000 and \$2,843,000 at December 31, 1989 and 1988, respectively. The effective interest rate of this debt after revaluation was 14.51%.
- (r) Due to Eastern's Chapter 11 filing the conversion features of this debt cannot be exercised.
- (s) These debentures are convertible into \$125.00 of cash and 3 Depositary Preferred Shares for each \$1,000 principal amount of debentures. These debentures are net of unamortized discount of \$4,460,000 and \$5,688,000 at December 31, 1989 and 1988, respectively. The effective interest rate of this debt after revaluation was 15%.
- (t) These debentures are convertible into approximately \$390.63 of cash and 9.88 Depositary Preferred Shares for each \$1,000 principal amount of debentures. These debentures are net of unamortized discount of \$9,646,000 and \$10,120,000 at December 31, 1989 and 1988, respectively. The effective interest rate of this debt after revaluation was 16.56%.
- (u) These debentures are convertible into approximately \$390.63 of cash and 9.88 Depositary Preferred Shares for each \$1,000 principal amount of debentures. These debentures are net of unamortized discount of \$13,058,000 and \$14,449,000 at December 31, 1989 and 1988, respectively. The effective interest rate of this debt after revaluation was 15%.
- (v) These debentures are convertible into approximately \$480.77 of cash and 11.54 Depositary Preferred Shares for each \$1,000 principal amount of debentures. These debentures are net of unamortized discount of \$3,436,000 and \$3,567,000 at December 31, 1989 and 1988, respectively. The effective interest rate of this debt after revaluation was 13.95%.

Certain of Texas Air's indentures contain covenants requiring maintenance, on a consolidated basis, of a defined level of tangible net equity. Due to the substantial losses recorded during 1989 and 1988, Texas Air failed to meet such maintenance requirements in late 1988 and was required to redeem approximately \$61,600,000 of indebtedness during 1989 and January 1990. During December 1989 and the first quarter of 1990, Texas Air purchased in open market transactions approximately \$158,400,000 of its

public debt securities, thereby satisfying all mandatory redemption requirements associated with said securities which might be required during 1990 and, in some cases, into 1991 and 1992. In addition, certain indentures of Texas Air contain restrictions on the payment of dividends by Texas Air, pursuant to which the Company has not paid dividends on three of its four preferred issues since the third quarter of 1988. Texas Air has not paid a dividend on its common stock since the second quarter of 1983.

Certain of Continental's debt agreements contain certain restrictive provisions relating to payments of dividends and maintenance of a minimum consolidated net worth. According to the terms of certain debt agreements, as of December 31, 1989, Continental was unable to pay dividends on its common stock or preferred stock.

Prior to Eastern's filing for Chapter 11 reorganization, certain of Eastern's mortgages and indentures imposed certain restrictions on the payment of dividends and provided for the maintenance of certain levels of net worth, financial leverage and collateral. As a result of the Chapter 11 filing, Eastern is in default under the terms of substantially all of its loan and lease agreements, notes, debentures and indentures; however, such defaults will be cured or waived before or concurrent with the effective date of a plan of reorganization. See Note 2.

Currently, Eastern is making principal and interest payments on postpetition and on certain prepetition debt pursuant to Section 1110 of the Code. No other principal or interest may be paid without the approval of the Bankruptcy Court. Eastern accrued interest on its unsecured obligations in 1989; however, due to the uncertainties relating to a final plan of reorganization, Eastern ceased accruing interest on unsecured obligations effective January 1990. See Note 2.

Continental has agreed with the seller of certain used aircraft purchased by Continental in 1987 to prepay in June 1990 approximately \$54,000,000 in secured debt assumed in connection with such purchase. Continental has reached a preliminary agreement with an unrelated party to refinance the aircraft securing such debt through a sale/leaseback transaction subject to certain conditions.

Scheduled maturities of long-term debt of Texas Air and its subsidiaries (excluding Eastern) reflected in the consolidated balance sheet as of December 31, 1989, due over the course of the next five years, are approximately \$250,082,000 in 1990, \$133,343,000 in 1991, \$375,170,000 in 1992, \$334,013,000 in 1993 and \$181,604,000 in 1994. As a result of the uncertainties relating to a final plan of reorganization, future minimum repayments of Eastern's long-term debt have not been presented.

A substantial portion of the subsidiaries' assets are subject to various chattel mortgages and trust agreements securing indebtedness of those subsidiaries.

Note 5—Leases

The companies lease certain aircraft and other assets under long-term leasing arrangements which are recorded as capital leases. Additionally, the companies lease, or have constructed as leasehold improvements on leased real property, facilities including airport and terminal facilities, sales offices, maintenance facilities, training centers and general offices. These leases are

generally on a long-term net rent basis, whereby the companies pay taxes, maintenance and certain other operating expenses applicable to the leased premises.

At December 31, 1989, the scheduled future minimum lease payments under capital leases and the scheduled future minimum lease rental payments, net of subleases, required under operating leases that have initial or remaining noncancellable lease terms in excess of one year and operating leases of aircraft are as follows (in thousands):

Year Ended December 31,	Capital	Operating Leases	
	Leases	Aircraft	Other
1990	\$ 208,617	\$ 453,327	\$ 352,494
1991	192,753	445,711	399,414
1992	183,219	438,928	327,364
1993	170,356	422,482	324,551
1994	159,815	374,185	320,384
Later years	773,466	2,429,182	2,533,699
Total minimum lease payments	1,688,226	\$4,563,815	\$4,197,906
Less: Amount representing interest	(615,599)		
Present value of obligations under capital leases	1,072,627		
Less:			
Current maturities per original contract			(32,328)
Prepetition amounts included in Estimated Liabilities Subject to Chapter 11			(673,765)
Long-term obligations under capital leases	\$ 366,534		

Total rental expense for all operating leases, net of sublease rentals, was \$738,796,000, \$662,749,000 and \$530,041,000 in 1989, 1988 and 1987, respectively. The above minimum rental payments and total rental expense do not include landing fees.

During 1989, Continental sold and leased back 21 aircraft. The terms of the leases ranged from six to ten years. These transactions generated approximately \$252,000,000 in cash, of which \$115,000,000 was used to retire existing debt on the aircraft, and resulted in deferred gains of approximately \$147,000,000. During 1989 and early 1990, Continental agreed to lease certain terminal improvements and flight kitchens in Houston, Newark and Cleveland. Such facilities were financed with the proceeds from the issuance of approximately \$127,000,000 of tax-exempt industrial revenue bonds issued by governmental agencies. Continental has agreed to fund the principal and interest payments related to such bonds through long-term lease agreements. In March 1990, Continental agreed to lease from an unrelated third party, on a long-term basis, one B747-200 aircraft, which is scheduled for delivery in the second quarter of 1990. Continental has agreed to enter into a 20 year lease at Denver's new airport, which is scheduled for completion in 1993. Continental expects that its cost of operations at Denver will increase as a result of the relocation to the new airport.

The Dade County Aviation Department, which operates Miami International Airport, has asserted that Eastern's long-term lease at the airport for certain terminal facilities expired March 11, 1989. Eastern believes that its leasehold interest extends through March 1998 and that its leasehold interest is subject to the protection of the Bankruptcy Court.

Future minimum lease payments under capital leases on nine aircraft with principal amounts aggregating \$114,946,000 and future minimum lease payments on 15 aircraft under operating leases aggregating \$111,395,000 are guaranteed by Texas Air. Texas Air has also provided back-up deficiency guaranties to certain aircraft and engine manufacturers on their deficiency guaranties related to three additional DC-9-80 aircraft leased by New York Air in 1984 under long-term operating leases and two B737-300 aircraft purchased by Texas Air in 1986. The guaranties provide that the manufacturers will pay up to a specified amount of any loss in the event of a default because of a shortfall in the value of the aircraft upon a disposition of the aircraft following default. Texas Air believes that currently the value of each aircraft is greater than any amounts that may be payable to the lenders and lessors in the event of a default.

Note 6—Minority Stockholders' Equity in Subsidiary Companies

Minority interest as of December 31, 1989 and 1988 included 2,383,687 and 2,384,205 shares, respectively, of Eastern's 20% Participating Noncumulative Convertible Preferred Stock (the "20% Participating Preferred") with a book value of \$8,545,000 and \$8,547,000 and a liquidation preference of \$206,594,000 and \$206,639,000, respectively. The 20% Participating Preferred was issued pursuant to Eastern's 1984 Wage Investment Program to employees' trusts (with the exception of issuances to certain pilots) with distribution and other terms subject to the various trust arrangements. These shares are entitled to a liquidation preference subordinate to other series of Eastern's preferred stock (other than the 11.36% Preferred, to which it is senior), with liquidation preference reduced by the amount of any dividends paid thereon and proportionately reduced for any further conversion of these preferred shares. Dividends on this series, as on all other series, are payable only when, as, and if declared by the Board of Directors. Before dividends may be paid on this series, all dividends and sinking fund payments then accrued or due on Eastern's other preferred series must be paid and such dividends may be paid only to the extent of 20% of Eastern's net income, as defined, subject to a maximum annual dividend of \$8.6667 per share. As a result of Eastern's Chapter 11 reorganization, payment of dividends on this issue is subject to approval by the Bankruptcy Court. For a discussion with respect to a new issue of preferred stock that has been proposed to be issued to Eastern preferred stockholders, see Note 7.

As proposed, Eastern's revised reorganization plan provides that holders of the 20% Participating Preferred would receive a new series of preferred stock with a liquidation value equal to 5% of the liquidation value of the stock currently outstanding (approximately \$10,300,000), a 10% annual dividend rate after a two-year grace period with annual redemptions of 10% in each of years 11 through 20. See Note 2.

Note 7—Preferred Stock

The Company has authorized 15,000,000 shares of preferred stock, \$.10 par. The unissued shares may be issued as either redeemable or nonredeemable. Texas Air's outstanding preferred stock ranks junior to all existing and future indebtedness of Texas Air and senior to the common stock. Certain indentures of Texas Air contain restrictions on the payment of dividends by Texas Air, pursuant to which the Company has not paid dividends on its

preferred issues (with the exception of the 15% \$20 Cumulative Preferred Stock, on which stock dividend payments have been made) since the third quarter of 1988. Accordingly, as of December 31, 1989, Texas Air had approximately \$25,299,000 of dividends on its preferred stock in arrears.

Redeemable Preferred Stock. As of December 31, 1989, the following series of redeemable preferred stock were outstanding:

Series	Shares Outstanding	Amount (\$000)	Liquidation Preference (\$000)(e)	Annual Dividends (per share)(f)
Texas Air:				
15% \$20.00 Cumulative Preferred	19,363(a)	\$ 386	\$ 387	\$3.00
6.50% Cumulative Junior Preferred (b)	3,121(a)	29,969	51,208	0.65
12% Cumulative Junior Preferred (b)	3,655	48,637	36,548	1.20
Eastern:				
\$2.72 Cumulative Preferred (c)	2,488,330	43,994	62,208	2.72
\$3.24 Cumulative Preferred (c)	3,607,690	109,219	121,266	3.24
\$3.12 Cumulative Preferred (c)	2,249,742(a)	42,132	56,244	3.12
11.36% Cumulative Junior Preferred (c)(d)	95,338	206,545	238,843	2.84
		<u>\$ 482,882</u>	<u>\$ 586,706</u>	

- (a) Shares outstanding are net of Texas Air's ownership.
- (b) Redeemable at the option of Texas Air in whole or in part at any time at \$10 per share plus accumulated and unpaid dividends.
- (c) Redeemable at Eastern's option at any time on 30 days' notice at redemption preference (which is equal to liquidation preference) plus accrued and unpaid dividends. The \$2.72 Cumulative Preferred and \$3.24 Cumulative Preferred rank in parity and are senior to all other classes and series of Eastern's stock with respect to payment of dividends and liquidation preference. During 1989 and 1988, respectively, Eastern issued 1,450,168 and 625,329 shares of its redeemable preferred stock, primarily as dividends in kind (net of 33,318 and 14,906 shares issued to Texas Air). As a result of Eastern's Chapter 11 reorganization, payment of dividends on these issues is subject to approval by the Bankruptcy Court. In the first quarter of 1990, Eastern did not declare dividends on these series.
- (d) Texas Air guaranties, on a subordinated basis, the payment of dividends, redemption preference and liquidation preference. Pursuant to such guaranties, Texas Air made dividend payments aggregating \$20,063,000 and \$6,688,000 during 1989 and the first quarter of 1990, respectively.
- (e) The carrying value of these series is being accreted to the liquidation value on the interest method over the periods the series are expected to be outstanding.
- (f) Annual dividend requirements of \$0.65, \$1.20 and \$2.84 (per share) are associated with depositary preferred shares, each depositary preferred share representing 1/1000th (in the case of the 6.50% and 12% series) and 1/100th (in the case of the 11.36% series) of a share of the underlying preferred stock.

Holders of the Eastern preferred issues are entitled to vote (only upon certain matters presented to a vote of Eastern stockholders), including the right to elect directors if dividends are in arrears equal to six full quarterly dividends. Holders of the 6.50% Depositary Preferred Stock ("6.50% Preferred") and 12% Cumulative Junior Preferred Stock ("12% Preferred") are entitled to one-twentieth and one-twelfth of a vote per share, respectively, voting together with the common stock as a single class, generally on all matters presented to a vote of stockholders. If dividends on the 6.50% Preferred and 12% Preferred are in arrears in an aggregate amount equal to six full quarterly dividends, the holders of the preferred issues may elect two additional directors (but not any other directors) to be added to Texas Air's Board of Directors.

Scheduled sinking fund requirements as of December 31, 1989 for the next five years for the four issues of Eastern redeemable preferred stock are \$7,996,000 in each of 1990 and 1991, and \$31,881,000 in each of 1992, 1993 and 1994. The 6.50% Preferred is required to be redeemed at the rate of 10% of the number of shares originally issued during each of the years 2003 through 2011 with the balance being redeemed in 2012. The 12% Preferred is required to be redeemed at the rate of 10% of the number of shares originally issued during each of the years 1998 through 2006 with the balance being redeemed in 2007.

Eastern has had discussions with the Preferred Stockholders Committee relating to a plan of reorganization that would provide that a new series of preferred stock with a liquidation value of \$34,900,000 would be issued for all existing outstanding preferred stock, except the 11.36% Preferred, which would be cancelled, subject to Texas Air's guaranty of dividend payments, redemption price and liquidation preference when due. Texas Air has been making dividend payments on the 11.36% Preferred since Eastern filed for protection under Chapter 11. Texas Air would waive any rights it has against Eastern arising from such guaranty. Eastern is negotiating with the Preferred Stockholders Committee with respect to this proposal, but no agreement has been reached.

Nonredeemable Preferred Stock. The 6¾% Cumulative Convertible Junior Preferred Stock (the "6¾% Preferred") is convertible into common stock at the ratio of two-thirds of a share of common stock for each share of 6¾% Preferred, subject to adjustment. The 6¾% Preferred has an aggregate liquidation preference of \$150,000,000, is entitled to cumulative cash dividends of \$1.6875 per share per annum and is redeemable at the option of Texas Air at specified redemption prices declining to \$25 per share on or after July 15, 1996, plus accumulated unpaid dividends. Except as required by law, the holders of the 6¾% Preferred are not entitled to vote except as a class with respect to certain matters relating to such class or in the event that dividends on the 6¾% Preferred are in arrears in an amount equal to six full quarterly dividends; in such case, holders of the series, voting as a class, may elect two additional members of Texas Air's Board of Directors.

Note 8—Common Stock

At December 31, 1989, 14,885,083 shares of common stock were reserved as follows: 2,563,205 shares for issuance upon conversion of convertible subordinated debt; 1,020,000 shares for issuance upon conversion of Class A common stock; 4,000,000 shares for issuance upon conversion of preferred stock; 1,020,000 shares for issuance upon conversion of Series C preferred stock; and 6,281,878 shares for issuance upon exercise of warrants and options.

Each share of Class A common stock (all of which is owned by Jet Capital Corporation ("Jet Capital")) entitles the holder thereof to ten votes on all matters submitted to the vote of shareholders, except with respect to the election of one-fourth of Texas Air's Board of Directors, and the right to participate in most dividends on common stock as if each such share had been converted into one-half of a share of common stock immediately prior to the record date for such dividend. Each share of Class A common stock is convertible, at the option of the holder, into one-half of a share of common stock.

During 1988, the Board of Directors of Texas Air adopted a Stockholder Rights Plan (the "Rights Plan") designed to protect the interests of its stockholders from stock accumulations and tactics designed to acquire control of the Company without an offer of fair value to all stockholders. Under the Rights Plan, each stockholder at the close of business on June 29, 1988 received a dividend distribution of one right for each share of common stock held and one-half right for each share of Class A common stock held. These rights entitle the holder, under certain conditions, to purchase shares of a new class of junior participating preferred stock or common stock of Texas Air at an exercise price of \$60, subject to adjustment. The rights are redeemable by Texas Air under certain conditions at a price of \$.01 per right and expire on June 29, 1998.

The Company has common stock option plans covering certain officers and key employees which include provisions for incentive stock options and stock appreciation rights. The Texas Air 1979 Stock Option Plan (the "1979 Plan") provides for the issuance of up to 6,000,000 shares at prices as much as 50% below market value. As of December 31, 1989, there were options outstanding under this plan for 3,797,221 shares, of which options for 1,985,691 shares were exercisable. No stock appreciation rights have been granted. On December 7, 1987, Texas Air, with the agreement of the option holders, terminated 1,518,900 options with an exercise price in excess of \$9.25 and reissued those options with an exercise price of \$9.25. Of options granted under the 1979 Plan, 2,309,000 shares (at prices ranging from \$9.25 to \$12.875) are subject to the optionee, upon full vesting and exercise of the options, receiving a bonus equal to one-half of the exercise price. Of these options, 10,000 shares were purchased by the Company in 1989, leaving a balance of 2,299,000 shares subject to the bonus. The receipt of the bonus is subject to the fulfillment of certain conditions, including continuity of employment. On February 8, 1990, the Texas Air Board of Directors approved the granting of options to purchase 902,000 shares with an exercise price of \$6.00 per share and an additional 505,585 shares with an exercise price

of \$6.00 per share, which grants are subject to the surrender of comparable options at higher prices by certain optionholders. Transactions under the 1979 Plan are summarized as follows:

	Number of Shares	Weighted Average Option Price Per Share
Outstanding, December 31, 1986	1,728,570	\$21.10
Granted	3,230,229	10.84
Exercised	(88,100)	6.45
Cancelled	(1,664,000)	24.14
Outstanding, December 31, 1987	3,206,699	9.52
Granted	288,500	10.61
Exercised	(121,500)	7.08
Cancelled	(133,813)	11.56
Outstanding, December 31, 1988	3,217,886	9.62
Granted	1,767,500	12.32
Exercised	(345,684)	10.16
Purchased	(90,134)	2.79
Cancelled	(732,347)	11.43
Outstanding, December 31, 1989	3,797,221	10.53

Pursuant to the terms of the merger agreements with Continental, New York Air, Eastern, CCS Automation Systems, Inc. and People Express, options outstanding under each of these companies' stock purchase or stock option plans were converted into options to purchase the number of whole shares of Texas Air common stock based on a formula which gives effect to the different values of Texas Air and the other companies' common stock at the time of the merger. As of December 31, 1989, options to purchase 199,393 shares were outstanding under these plans at prices ranging from \$2.00 to \$41.61 per share. It is not anticipated that any further stock options will be granted pursuant to these plans.

Pursuant to terms of the merger agreement with People Express and as an inducement to continued employment, the People Express Supplemental Plans were formed, whereby participants in the People Express Restricted Stock Purchase Plan were given the right to exchange, generally over a two-to-four year period, a portion of the merger consideration received in the People Express merger for .13445 of a share of Texas Air common stock per unit of common share merger consideration which had been received for each People Express common share. In addition, certain managing officers of People Express were given the right to exchange their merger consideration in the same manner under the 1986 Texas Air Corporation Stock Plan for People Express Managing Officers. Exchanges under these plans were made in 1989, 1988 and 1987 pursuant to which participants received 243,498, 328,355 and 68,020 shares of Texas Air common stock, respectively. The balance of the exchange rights under these plans terminated in 1989.

Also in connection with the People Express merger, Texas Air adopted the Special Option Plan for People Express Managing Officers, whereby participants were granted stock options to purchase shares of Texas Air common stock at the price of \$1.00 per share. During 1989, 24,630 shares were issued and at December 31, 1989, 5,844 shares were exercisable under this plan. No further grants are anticipated under this plan.

During 1989, upon recommendation by Texas Air management, the 1989 Stock Option Plan for Nonemployee Directors (the "Directors' Plan") was adopted. The Directors' Plan provides for

the grant of options to nonemployee directors, subject to certain conditions, at a price per share equal to 100% of the fair market value of a share of Texas Air common stock on the date the option is granted. The aggregate number of shares which may be issued pursuant to the Directors' Plan is 300,000, subject to certain adjustments. Options to purchase 225,000 shares at an exercise price of \$12.50 per share were granted in 1989, which options vest over five years.

Note 9—Income Taxes

Texas Air files a consolidated federal income tax return with its domestic subsidiaries. Texas Air has entered into a tax sharing agreement with its affiliates (the "Texas Air Group") which requires profitable members of the Texas Air Group to compensate other members when losses have been utilized in consolidation to offset taxable income generated by other members of the group. If a member leaves the Texas Air Group, all deferred payments to or from Texas Air become currently due. The tax sharing agreement is subject to review by the Bankruptcy Court to the extent it applies to Eastern.

The provision (credit) for income taxes represents state taxes of \$646,000, \$(196,000) and \$913,000 in 1989, 1988 and 1987, respectively. Due to losses generated, there is no provision for federal income taxes at December 31, 1989, 1988 or 1987.

The tax benefits of net operating losses ("NOL") and investment tax credits ("ITC") are recognized when realized and as offsets to deferred federal income tax liability to the extent the liability reverses during the carryforward period; therefore, there is no deferred tax liability as of December 31, 1989 or 1988.

As a result of accounting for Texas Air's acquisitions of Eastern and People Express and the minority interests in Continental and New York Air as purchases, permanent differences of approximately \$1.2 billion were generated due to the step-up in basis of these entities' net assets for financial reporting purposes and the conversion of all timing differences at the acquisition dates into permanent differences. At December 31, 1989, the unamortized amount of these permanent differences was approximately \$646,000,000. These differences may increase income tax expense in future periods.

The NOL and ITC carryforwards as of December 31, 1989, are comprised of the following (in thousands):

	NOL Carryforwards		
	Financial Purposes	Tax Return Purposes	ITC Carryforwards
Amounts included in Texas Air consolidated tax return, not subject to separate company limitations (a)	\$1,424,000	\$1,221,000	\$ 56,000
Amounts subject to separate company limitations (b):			
Continental	447,000	449,000	19,000
New York Air	-	63,000	3,000
Eastern	731,000	731,000	97,000
	<u>\$2,602,000</u>	<u>\$2,464,000</u>	<u>\$175,000</u>

(a) At December 31, 1989, consolidated NOL carryforwards, which expire 1998-2004, are available to reduce future years' income for

financial statement and tax return purposes, and ITC carryforwards, which expire 1993-2002, are available to reduce future tax liability.

(b) The NOL and/or ITC carryforwards of Continental, New York Air and Eastern can be used to reduce the respective company's future tax liability for financial statement and tax return purposes only to the extent attributable to the separate company income of each company. The benefits of carryforwards utilized in future periods related to (i) the separate company income and liability of each company, excluding New York Air and Continental, and (ii) approximately 30% of the separate company income and liability of New York Air and Continental will be recorded for financial statement purposes as a reduction of property or goodwill as required under the purchase method of accounting until adoption of the new Financial Accounting Standards Board statement discussed below.

In December 1987, the Financial Accounting Standards Board issued SFAS No. 96, "Accounting for Income Taxes." In December 1989, the effective date of this statement was amended by SFAS No. 103 "Accounting for Income Taxes—Deferral of the Effective Date of FASB Statement No. 96," to allow for possible amendments to simplify SFAS No. 96. Texas Air is required to adopt the new statement by 1992, although earlier implementation is permitted. Texas Air does not plan early adoption at this time; however, Texas Air is still analyzing the effects of the new statement, including whether to retroactively restate prior periods or record a cumulative catch-up adjustment in the year of adoption.

The effect that adoption of SFAS No. 96 will have on Texas Air's consolidated financial position and results of operations cannot be determined since the statement is subject to change. If the statement is adopted by Texas Air in its current form, the tax benefits of NOL and ITC carryforwards generated prior to Texas Air's acquisition of Continental, New York Air and Eastern (when recognized) would be first applied to reduce noncurrent intangible assets related to the acquisition to zero and then to eliminate or reduce income tax expense. This would be reflected as a separate component of income taxes rather than as an extraordinary credit.

The Internal Revenue Service ("IRS") has examined the Company's federal income tax returns through 1981. In addition, the IRS has examined Eastern's and Continental's federal income tax returns through 1983 and 1982, respectively. As a result of those examinations, all material issues raised by the IRS have been satisfactorily resolved by the Company, Eastern, Continental and the IRS.

Note 10—Related Party Transactions

The following is a summary of material related party transactions that are not eliminated in the consolidated financial statements which have occurred during 1989 and 1988 other than those discussed elsewhere in the notes to consolidated financial statements.

As of December 31, 1989 and 1988, Texas Air and its subsidiaries had loans outstanding to certain executive officers and employees of Texas Air and its subsidiaries totaling approximately \$3,527,000 and \$2,182,000, respectively. Of such amounts, \$1,544,000 and \$250,000 as of December 31, 1989 and 1988, respectively, were related to the purchase of Texas Air common stock and have been reflected as a reduction of additional paid-in capital. Deferred compensation aggregating \$6,434,000 as of December 31, 1987, which related to the forgiveness of certain

indebtedness of People Express employees incurred in connection with the purchase of common stock, was credited to additional paid-in capital with an offsetting reduction charged to stockholders' equity. Such amount was expensed during 1988. The long-term portion of the remaining outstanding loans at December 31, 1989 and 1988 has been classified as an other asset. The loans principally bear interest between 3% and 11% per annum or are non-interest-bearing and are principally payable on demand or require annual principal payments plus accrued interest for a period not exceeding seven years from date of issuance. In addition, during the first quarter of 1990, Texas Air made loans aggregating approximately \$226,750 to certain members of its Board of Directors. During 1989 and 1988, Texas Air guaranteed loans of certain executive officers of Texas Air or its subsidiaries in amounts aggregating approximately \$575,000 in each year. All of these guaranties expired in 1989.

Prior to April 1, 1989, certain officers of Jet Capital who performed services for Texas Air were treated as Texas Air employees. Texas Air billed Jet Capital on a monthly basis for the salaries, employee benefits and certain overhead expenses for the portion of time spent by these employees on Jet Capital business as well as for services provided by Texas Air employees to Jet Capital. During 1989, 1988 and 1987, such charges from Texas Air to Jet Capital aggregated approximately \$146,000, \$242,000 and \$144,000, respectively. Beginning on February 1, 1989, Jet Capital agreed, at Texas Air's request, to provide financial advisory services to Texas Air for a monthly fee of \$35,000, including financial advice and assistance on purchase and sale transactions which Texas Air may propose or contemplate from time to time. Texas Air has agreed to pay Jet Capital an additional fee of up to $\frac{1}{4}$ of 1% of the consideration paid or received by Texas Air, contingent upon successful completion of the proposed purchase or sale transaction. Jet Capital acted as financial advisor and provided other assistance to Texas Air and Eastern in connection with Eastern's sale of its Air Shuttle division. For such services, Jet Capital was paid fees of \$1,050,000 and \$1,250,000 in 1989 and 1988, respectively. It is not contemplated that Jet Capital will be involved in any further transactions involving the disposition of Eastern assets.

Note 11—Employee Benefit Plans

The Company's subsidiaries have noncontributory defined benefit pension and incentive compensation (profit sharing) plans as well as defined contribution plans. Substantially all employees are covered by one or more of these plans. Total normal pension expense for the defined benefit plans was \$103,884,000, \$97,051,000 and \$110,916,000 and for the defined contribution plans was \$13,193,000, \$28,885,000 and \$28,892,000 for 1989, 1988 and 1987, respectively. In addition, under the requirements of SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination of Benefits," Eastern recorded a minimum pension curtailment expense of \$117,967,000 for the year ended December 31, 1989. The curtailment expense principally reflects the recognition of unamortized pension costs related to employees who have retired or whose period of employment has otherwise terminated or for whom benefit accruals have been or are expected to be frozen.

Effective May 1, 1989, Eastern's pension benefit accruals for employees represented by the IAM were suspended. Benefit

accruals for noncontract employees were suspended effective August 1, 1989 for 17 months. In 1988 Continental adopted a new defined benefit plan which covers substantially all full-time employees. Continental employees may also participate in a 401(k) savings plan in which the employer matches a portion of the employees' contributions.

Continental has incentive compensation plans for its employees in which contributions are based on a percentage of profits. A minimum of 30% of such contribution must be invested in Texas Air common stock for the benefit of the individual employee. The employee may elect to receive the balance currently or defer and invest it in Texas Air common stock or other investment funds. The Texas Air common stock may be newly issued or purchased on the open market.

Net periodic cost of the Company's defined benefit plans for 1989, 1988 and 1987 included the following components (in thousands):

	1989	1988	1987
Service cost—benefits earned during the year	\$ 30,564	\$ 32,300	\$ 49,800
Interest cost on projected benefit obligations	177,095	163,349	153,113
Return on plan assets	(221,720)	(199,849)	(49,388)
Net amortization and deferral	109,845	99,720	(47,610)
Net periodic costs	\$ 95,784	\$ 95,520	\$ 105,715

The following sets forth the plans' funded status and the related amounts as of December 31, 1989 and 1988 (in thousands):

	1989	1988
Accumulated benefit obligations, including vested benefits of \$1,936,542 and \$1,595,069	\$(1,979,368)	\$(1,691,569)
Effect of projected future salary increases	(51,345)	(65,700)
Projected benefit obligation	(2,030,713)	(1,757,269)
Plan assets at fair value	1,592,657	1,318,269
Projected benefit obligation in excess of plan assets	(438,056)	(439,000)
Unrecognized net gain	(10,574)	(119,166)
Unrecognized net obligation at transition	82,995	219,109
Unrecognized prior service cost	1,921	(2,900)
Additional minimum liability	(59,163)	-
Accrued pension cost	\$ (403,097)	\$ (342,456)

Plan assets consist primarily of government and corporate debt securities, marketable equity securities and money market instruments. The weighted average discount rate used in determining the actuarial present value of the projected benefit obligation was 9.27%, 10.0% and 10.5% for 1989, 1988 and 1987, respectively. The expected long-term rate of return on assets was 9.07% for 1989 and 9.0% for 1988 and 1987. The weighted average rate of salary increases was 5.19%, 4.5% and 4.0% for 1989, 1988 and 1987, respectively. Eastern's net obligations at transition arising in the year of adoption, unrecognized prior service costs and the unrecognized net gain are amortized on a straight-line basis over the average remaining service period of employees in the plans.

The Company's funding policy is to make contributions to its defined benefit plans annually equal to the minimum funding requirements of the Employee Retirement Income Security Act of 1974, although in certain years Eastern has funded less than the minimum amount. See Note 12 for a discussion of Eastern's pension plan funding obligation. Continental's funding is also in

accordance with settlement agreements and, to the extent applicable, provisions of its plan of reorganization.

Certain provisions of SFAS No. 87, "Employer's Accounting for Pensions," pertaining to the recognition of plan liabilities were adopted in 1989. The application of these provisions resulted in the recognition of an additional minimum liability and intangible asset of \$59,163,000 at December 31, 1989.

In addition to providing pension benefits, Eastern provides certain health care and life insurance benefits for retired employees. Substantially all of Eastern's employees may become eligible for those benefits if they retire while working for Eastern. Those and similar benefits for active employees are provided through an insurance company whose premiums are based on the benefits paid during the year. Eastern recognizes the cost of providing those benefits by expensing the annual insurance premiums. The costs of providing retiree health care and life insurance were \$27,211,000, \$25,800,000 and \$18,900,000 in 1989, 1988 and 1987, respectively.

Note 12—Commitments and Contingencies

Texas Air. Texas Air is not a party to Eastern's Chapter 11 case and believes there are no grounds for consolidating Texas Air or its assets with Eastern in the Bankruptcy Court. Texas Air has guaranteed and may otherwise be liable for certain obligations of Eastern including, among others, two years of interest (or \$69,000,000) on certain Eastern indebtedness (for such guaranty Eastern deposited \$40,000,000 in cash with Texas Air), certain Eastern pension obligations and the payment of dividends, redemption price and liquidation value of Eastern's 11.36% Preferred. See Notes 2, 4 and 7.

In addition, each member of the Texas Air Group is jointly and severally liable for Eastern's periodic minimum pension plan funding obligations and could be jointly and severally liable for the full amount of the plans' underfundings if Eastern's pension plans were terminated (which may be done only if certain stringent criteria were met). Eastern's 1989 funding obligation, which includes payments due for prior years as to which Eastern received funding waivers, was approximately \$215,300,000. Of this amount, approximately \$117,000,000 was paid by Eastern prior to its Chapter 11 filing. With respect to the remaining \$98,300,000, in September 1989, with Bankruptcy Court approval, Texas Air paid \$45,000,000 (for which it has a claim against Eastern's bankruptcy estate) and Eastern paid \$27,000,000. The IRS waived the payment of the remaining \$26,300,000 until the earlier of June 30, 1990 or confirmation of a plan of reorganization. Pursuant to the agreement with the Examiner, Texas Air has agreed to make this payment when due and the amounts paid by Texas Air would be set off against amounts owed by Texas Air to Eastern. Eastern estimates that its minimum pension plan funding obligations will be approximately \$168,000,000 in 1990 (which includes \$26,300,000 for contributions waived in prior years) and \$68,000,000 in 1991, which amounts may vary based on the number of employees, benefit obligations and other circumstances at that time. Depending on the circumstances of a plan termination, the underfunded amount could be substantially higher than the ongoing minimum funding amounts.

Eastern believes that it is unlikely that the Pension Benefit Guaranty Corporation ("PBGC") will terminate the Eastern plans and throughout Eastern's Chapter 11 proceeding, Eastern has maintained that under any plan of reorganization, the pension plans will not be terminated. However, if it were assumed that Eastern permanently ceased operations and it voluntarily terminated such pension plans, Eastern believes it could fully satisfy its obligations under the plans by purchasing annuity contracts covering each plan participant to pay all plan obligations as they matured, based on actuarial factors that Eastern believes are appropriate, at an estimated cost of approximately \$390,000,000 based on an interest rate of 9.25% applicable to such annuity contracts. If the PBGC were to terminate the Eastern plans or if Eastern terminates the plans in a distress termination (which could be done only on certain conditions) and assume responsibility for the payment of plan benefits, Eastern's obligations to the PBGC for any unfunded liabilities could significantly exceed the costs of purchasing annuities, although Eastern would contend that the use by the PBGC of actuarial factors that produce a substantially higher amount is invalid. Further, current estimates of this liability indicate a potentially significant increase due to the number of employees electing to receive certain early retirement benefits resulting from the reduction in Eastern's workforce. If, upon a termination by the PBGC, any person liable for such payments fails to pay the PBGC after notice and demand, a lien on all assets of any such person, up to 30% of the positive net worth of the "controlled group," arises in favor of the PBGC as of the date of the plan termination.

Eastern believes that it will be able to satisfy its own pension obligations following its emergence from Chapter 11.

Certain transfers of assets from Eastern to Texas Air and other affiliates prior to the commencement of Eastern's Chapter 11 case could be reversed if the Bankruptcy Court determines that such transfers constituted "fraudulent conveyances" or "preferential transfers." Texas Air believes that the transactions between Eastern and its affiliates were proper and that there were no fraudulent conveyances or preferential transfers.

In the event the proposed agreement with the Examiner is not approved by the Bankruptcy Court, the alleged claims set forth in the Examiner's report could be asserted against Texas Air and its affiliates. Management of Texas Air does not believe that such claims would prevail if asserted and believes that Texas Air and its affiliates have valid and substantial defenses to those claims. If such claims are asserted, Texas Air intends to defend itself vigorously and believes it will prevail, however final resolution of such claims in favor of Texas Air and its affiliates cannot be assured. There are other claims pending with respect to the disputed transactions that are not presently before the Bankruptcy Court. See "Legal Proceedings."

In October 1988, Texas Air, Eastern and Continental entered into agreements with Scandinavian Airlines System ("SAS") that provide for the creation of a comprehensive alliance with SAS. The agreements with Continental provide, among other things, for the leasing of airport facilities at Newark International Airport,

the performance by Continental of ground handling services at Newark, joint marketing programs, joint sales representation and code-sharing. In addition, Continental, and SAS are operating a quality service training institute for employees. Also pursuant to the agreements, SAS paid Texas Air and Continental \$25,000,000 and \$15,000,000, respectively, in 1989.

Continental. Continental has firm commitments to acquire 50 B737-300 aircraft with deliveries scheduled from 1992 through 1995, for an aggregate purchase price of approximately \$1.4 billion, 20 A330 and A340 aircraft with deliveries scheduled from 1993 through 1999 for an aggregate purchase price of approximately \$2.0 billion, and an aggregate of 43 EMB and ATR aircraft with deliveries scheduled through the first quarter of 1991 for an aggregate purchase price of \$268,000,000. While significant term and pre-delivery financing commitments have been provided to Continental by the respective manufacturers for substantially all of the aircraft, subject to certain conditions, Continental expects to obtain specific asset financing closer to the time of delivery based on prevailing market conditions.

Continental expects its nonaircraft capital commitments for 1990 to aggregate approximately \$100,000,000 to \$150,000,000. These expenditures relate primarily to the continuing standardization of the Continental fleet, acquisition of spare parts inventories and passenger terminal facility improvements. Continental expects to finance such expenditures with internally generated funds, borrowings and other financings.

Recently, the FAA issued a number of maintenance directives and other regulations relating to, among other things, collision avoidance systems, airborne windshear avoidance systems and increased inspections and maintenance procedures to be conducted on older aircraft. Continental estimates, based on its current fleet, that it may incur costs through the 1990's of up to approximately \$205,000,000 to comply with these regulations. However, this estimate is subject to revision based upon finalization of regulations as well as possible changes in Continental's fleet composition. Continental expects that the costs of compliance with such regulations will be funded through internally generated funds and modification of cost sharing provisions under certain lease agreements.

Continental remains obligated to pay approximately \$84,500,000 upon the exercise of certain outstanding warrants (against receipt of \$42,500,000 in consideration, which may be satisfied upon cancellation of substantially all of a Continental promissory note), all of which are held by American General Corporation and American General Life Insurance Company (together, "American General"). American General is contesting the terms on which Continental was acquired by Texas Air in February 1987, alleging, among other things, that the terms of the merger were unfair and that it is entitled to additional merger consideration. See "Legal Proceedings-Continental."

In the event there is no settlement with the Examiner, Continental will have a substantial unsecured claim against Eastern and certain creditors may seek to prevent offset or to require subordination of Continental's claim, although Continental would vigorously oppose such attempt.

System One. On February 20, 1990, Texas Air, System One and EDS entered into a preliminary agreement providing for the acquisition by EDS of substantially all of the assets of System One and

the formation by System One and EDS of an equally owned partnership to operate and market System One's CRS business (the EDS Transaction). In consideration of the EDS Transaction, EDS will pay Texas Air \$250,000,000 (net of certain implementation expenses) and assume certain liabilities.

Among the assets EDS will acquire are all of the software and substantially all of the other assets currently used by System One in providing data processing, telecommunications and application development services to Continental and Eastern. Contemporaneously with the asset acquisition, Continental and Eastern, as well as the CRS partnership, will enter into ten-year agreements with EDS to obtain such services from EDS. These agreements will provide for fixed prices (subject to inflationary adjustments under certain circumstances) over the ten-year term for a specified base package of resources. In addition, the fixed prices may be periodically adjusted upwards or downwards at the request of the airlines based on the cost of resources added to or deleted from the base package.

EDS also will acquire the assets and business of System One's Airline Services Division, previously owned by Continental. This business has historically been profitable for System One. Continental and Eastern have historically realized significant benefits from association with the System One CRS that are expected to continue when the CRS business is operated by the partnership jointly owned with EDS.

The preliminary agreement is subject to various conditions, including approval by the Bankruptcy Court of the agreements relating to Eastern. Subject to approval of the agreement with the Examiner, upon confirmation of Eastern's plan of reorganization, Texas Air will transfer its 50% interest in the CRS partnership in equal portions to Continental and Eastern.

Certain of the services Continental and Eastern currently obtain from System One are essential to their businesses, including the operation of Continental's and Eastern's internal reservations systems. Upon consummation of the EDS Transaction, Continental and Eastern will obtain such services from EDS.

Legal Proceedings

Continental. When Continental filed for Chapter 11 reorganization in September 1983, Continental unilaterally implemented new wage levels and work rules for all its employees and rejected certain collective bargaining agreements. Unions representing Continental employees brought various claims as a result of these actions, which claims have been settled, subject to the right of individual employees to intervene and pursue their derivative share of the respective union claim. Various employees, however, are attempting to amend the terms of a settlement agreement with ALPA and continue to assert (individually and derivatively) claims for damages for contract rejection and under a side letter agreement between certain unions and Texas Air. Approximately \$29,000,000 of individual claims, \$40,000,000 of claims originally asserted by unions (which continue to be asserted by employees) and claims that could increase Continental's liability for severance pay under its settlement with ALPA by approximately \$22,000,000 have not yet been resolved. Continental intends to continue to contest vigorously the contract rejection and side letter claims and any efforts to amend the terms of the ALPA settlement in a manner adverse to it or its current employees.

Continental is a party to lawsuits involving Eastern and certain of Eastern's unions. In September 1989, Continental became a named defendant in an action brought by certain of Eastern's unions alleging, among other things, that Continental participated in acts of securities fraud and defamation of the unions. The plaintiffs seek unspecified compensatory, consequential, punitive and treble damages pursuant to the federal Racketeering and Corrupt Organizations Act and the Florida Civil Remedies for Criminal Practices Act and attorney fees. Continental is also named in a case alleging that various transactions between Eastern and its affiliates constitute voidable conveyances under the New York debtor and creditor law. This action has been stayed by the Bankruptcy Court until April 30, 1990.

American General has a suit pending in the Delaware Chancery Court against Continental, Texas Air and certain directors of Continental and Texas Air. In its action, American General alleges, among other things, that the consideration paid pursuant to Texas Air's acquisition of the minority interest in Continental in 1987 is inadequate and that such merger violated the rights to subscribe to future issues of Continental common stock which warrants and rights were received by American General in June 1983 in connection with a \$40,000,000 loan by American General to Continental. Pursuant to the terms of the merger, Continental believes that the warrants were converted into the right to receive the merger consideration and that the option ceased to be applicable. In March 1987, American General asserted that its warrants are exercisable for approximately 4,000,000 shares of Texas Air common stock on the ground that similar options were offered by Texas Air to certain employees of Continental. In January 1988, the Delaware Chancery Court held, among other things, that the merger did not breach the 1983 option agreement, and that upon exercise of its warrants, American General has the right to the same employee options (in addition to American General's contractual right to the merger consideration). Continental and Texas Air appealed the court's decision. A decision is pending. On May 11, 1988, American General attempted to exercise its warrants. Such exercise was rejected by Continental because of American General's refusal to accept the merger consideration as full payment of the warrants. Continental has extended the expiration date of the warrants to June 10, 1990, to allow an orderly determination of each party's rights.

Eastern. Eastern's contingencies, including legal proceedings, are generally subject to the effects of its filing under Chapter 11, which are discussed in Note 2. The following discussion does not purport to reflect or provide for all the consequences of the ongoing Chapter 11 cases. Because of the ongoing nature of the Chapter 11 cases, these matters are subject to material uncertainties.

In December 1989, the Eastern Airlines Pilot System Board of Adjustment (the "System Board") issued a final decision and award in favor of ALPA in connection with a grievance filed by ALPA concerning the interpretation of a certain "pay parity" provision contained in the February 1986 collective bargaining

agreement between Eastern and ALPA and directed Eastern to pay its pilots back pay comparable to a 3% wage increase on June 1, 1986, a 2% increase on January 1, 1987 and a 3% increase on July 1, 1987. In December 1989, Eastern expended \$65,514,000 representing its estimated prepetition and postpetition exposure under this award through December 31, 1989. However, Eastern has sought review of the award in the Bankruptcy Court. Eastern has argued that the System Board exceeded its jurisdiction in awarding the pilots back pay comparable to the 2% increase and the 3% increase received by IAM-represented employees on January 1, 1987 and July 1, 1987, respectively, and that the grievance filed by ALPA concerning these two raises was untimely filed.

ALPA has also filed a grievance seeking a pay increase as a result of a wage increase that it claims was given to certain supervisory employees. ALPA has filed a claim in the Bankruptcy Court with respect to this grievance in the amount of approximately \$252,000,000. On January 3, 1990, the System Board denied ALPA's grievance and, accordingly, Eastern has moved to have ALPA's bankruptcy claim arising out of this grievance disallowed.

A number of lawsuits, including several purported class action suits, are pending against Eastern and its directors (and in certain cases, also against Texas Air) growing out of (i) the November 25, 1986 merger and related transactions pursuant to which, among other things, Texas Air acquired all the common stock equity interest of Eastern (the "Eastern Merger"); (ii) sales and proposed sales or other transfers of assets between Eastern and its affiliates occurring after such merger, and (iii) various other labor disputes. Such actions seek various damages and equitable relief including, among other things, to have the Eastern Merger rescinded, to rescind sales of assets that have occurred after such merger and to enforce certain alleged rights growing out of labor agreements, including alleged rights to reinstatement of pilots who Eastern contends have been permanently replaced and substantial retroactive pay increases. Additionally, in connection with Eastern's Chapter 11 proceedings, the aggregate amount of claims filed with the Bankruptcy Court is several times greater than Eastern's estimate of such liability. Eastern believes that many of these claims are duplicative, invalid, or based upon contingencies that have not occurred.

Various other claims and lawsuits against Texas Air and/or its subsidiaries are pending which could result in additional litigation, but are either covered by insurance, are not material, or are the type which are normally and reasonably foreseeable in view of the nature of their business, and the management of Texas Air and such subsidiaries believes the total amount of liability, if any, which may reasonably be expected to arise from such claims and lawsuits beyond that which is covered by insurance would not have a material effect on the financial condition of Texas Air and/or its subsidiaries or their ability to carry on their business.

With respect to Eastern, there are various claims and lawsuits, the outcome of which could materially affect the financial statements of Texas Air; however, principally because of the ongoing nature of the Eastern Chapter 11 proceedings, the outcome and ultimate liability resulting from such claims and lawsuits cannot presently be determined.

Note 13—Quarterly Financial Data (Unaudited)

Unaudited summarized financial data by quarter for 1989 and 1988 is as follows (in thousands, except per share data):

	Three Months Ended			
	March 31	June 30	September 30	December 31
1989				
Operating revenues	\$1,886,999	\$1,997,985	\$1,675,114	\$1,725,577
Operating loss	(174,045)	(164,331)	(68,676)	(230,243)
Net loss	(255,526)	(109,347)	(157,956)	(362,799)
Primary and fully diluted loss per common share (a)	(6.36)	(2.88)	(4.09)	(9.17)
1988				
Operating revenues	\$2,184,843	\$2,183,451	\$2,186,177	\$2,018,457
Operating income (loss)	(2,007)	(136,707)	6,489	(104,851)
Net loss	(124,275)	(255,836)	(114,145)	(224,362)
Primary and fully diluted loss per common share (a)	(3.34)	(6.67)	(3.05)	(5.78)

(a) Fully diluted loss per share for 1989 and 1988 are the same as primary loss per share since the assumed conversion of certain preferred stock and convertible debentures would be antidilutive.

Gains on disposition of property, equipment and other assets totaled \$38,866,000, \$284,333,000, \$108,384,000 and \$180,897,000 in the first through fourth quarters of 1989, respectively. Eastern recorded gains totaling \$559,381,000 from the sale of its Air Shuttle division (including 21 aircraft), 41 aircraft and certain routes, gates and slots. Continental recorded gains totaling \$61,300,000 during 1989, largely from the sales of slots at Chicago's O'Hare airport, real property located in Guam, and certain international routes.

Under the requirements of SFAS No. 88, Eastern recorded a minimum pension curtailment expense of \$65,700,000, \$34,100,000 and \$18,167,000 in the second, third and fourth quarters of 1989, respectively. See Note 11.

In the fourth quarter of 1989, Eastern expended \$54,969,000 to recognize an impairment in gate value at certain airports. Also in the fourth quarter of 1989, Eastern expended \$65,514,000 relating to back pay for pilots through December 31, 1989. See Note 12.

The Company recognized income in the first and second quarters of 1989, respectively, as a result of proceeds received from SAS totaling \$25,000,000 by Texas Air and \$15,000,000 by Continental. See Note 12.

The Company recorded gains totaling \$37,730,000, \$22,746,000, \$44,287,000 and \$47,347,000 during the first through fourth quarters of 1988, respectively, from the sale of aircraft, aircraft delivery positions and other assets.

In the second quarter of 1988, Continental revised its estimate of air traffic liability resulting in a one-time non-cash charge to earnings of \$131,000,000.

Note 14—Subsequent Event

On April 19, 1990, the Bankruptcy Judge in Eastern's Chapter 11 case appointed a trustee to manage Eastern's reorganization efforts. While Texas Air does not feel a trustee was warranted, Texas Air presently intends to continue to work with and support Eastern in all reasonable ways. Texas Air will deconsolidate Eastern for financial reporting purposes effective April 19, 1990. Texas Air management is currently evaluating the impact of the trustee's appointment on Texas Air's financial condition and future operations.

Item 9. Accounting and Financial Disclosure Practices.

There were no reported disagreements on any matters of accounting principles or financial statement disclosure between the Company and its independent public accountants, during the period covered by this report, nor during the preceding 24 months.

PART III

Item 10. Directors and Executive Officers of the Registrant.

Item 11. Management Remuneration and Transactions.

Item 12. Security Ownership of Certain Beneficial Owners and Management.

Item 13. Certain Relationships and Related Transactions.

The Company will file a definitive Proxy Statement which involves the election of directors within 120 days after the end of its fiscal year covered by this Form 10-K, and the information called for in these Items is incorporated by reference to said definitive Proxy Statement pursuant to Instruction G(3) of the General Instructions to Form 10-K.

PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

(a) Certain documents filed as part of the Form 10-K.

The index to financial statements provided in response to Item 8 is herein incorporated by reference.

(b) Report on Form 8-K.

None.

(c) Exhibits:

- 2.1 -Amended and Restated Agreement and Plan of Merger dated as of December 11, 1986, among Texas Air, Continental and CAC Mergerco, Inc.—incorporated by reference from Exhibit A to Exhibit 1 to Amendment No. 5 to the Schedule 13e-3 Transaction Statement filed by Texas Air with the Securities and Exchange Commission (the "Commission") on January 20, 1987.
- 2.2 -Order of the United States Bankruptcy Court dated June 30, 1986—incorporated by reference to Exhibit 2.2 to Continental's Current Report on Form 8-K, dated July 2, 1986.

- 2.3 -Continental's Third Amended Joint Plan of Reorganization under Chapter 11 of the United States Bankruptcy Code—incorporated by reference from Exhibit 2.2 to Continental's Annual Report on Form 10-K for the year ended December 31, 1985.
- 2.4 -Eastern's Plan of Reorganization under Chapter 11 of the United States Bankruptcy Code dated July 21, 1989—incorporated by reference to Exhibit 2.1 to Eastern's Quarterly Report on Form 10-Q for the quarter ended June 30, 1989.
- 3.1 -Composite Certificate of Incorporation of Texas Air as amended through May 1, 1986—incorporated by reference from Exhibit 3.1 to the Form S-1 Registration Statement (No. 33-4899) originally filed by Texas Air with the Commission on April 16, 1986 (the "April 1986 S-1").
- 3.2 -Amended Certificate of Incorporation of Texas Air as amended through May 22, 1987—incorporated by reference from Exhibit 4.1 to Texas Air's Form 10-Q for the quarter ended June 30, 1987.
- 3.3 -By-Laws of Texas Air, as amended through December 1, 1989 (filed herewith).
- 3.4 -Form of Certificate of Designations of 6 3/4% Cumulative Convertible Junior Preferred Stock of Texas Air—incorporated by reference from Exhibit 4.7 to the Form S-1 Registration Statement (No. 33-6865) filed by Texas Air with the Commission on July 22, 1986.
- 3.5 -Form of Certificate of Designations of 6.50% Redeemable Cumulative Preferred Stock of Texas Air—incorporated by reference to Annex D to the Proxy Statement/Prospectus included in the Form S-4 Registration Statement (No. 33-10483) filed by Texas Air with the Commission on December 5, 1986 (the "People Express S-4").
- 3.6 -Form of Certificate of Designations of 12% Redeemable Cumulative Preferred Stock of Texas Air—incorporated by reference to Annex E to the Proxy Statement/Prospectus included in the People Express S-4.
- 3.7 -Form of Certificate of Designations of Series A Junior Participating Preferred Stock of Texas Air—incorporated by reference from Exhibit A to Exhibit 1 of Form 8-A filed by Texas Air on June 20, 1988 (the "8-A").
- 4.1 -Agreement by Texas Air to furnish to the Commission, upon request, certain instruments defining the rights of holders of long-term debt—incorporated by reference from Exhibit 4.1 to Texas Air's Annual Report on Form 10-K for the year ended December 31, 1985 (the "Texas Air 1985 10-K").
- 4.2 -Form of 6.50% Deposit Agreement, among Texas Air, First Fidelity Bank National Association, New Jersey and the Holders of Receipts—incorporated by reference from Exhibit 4.2(b) to the People Express S-4.
- 4.3 -Form of 12% Deposit Agreement, among Texas Air, First Fidelity Bank National Association, New Jersey and the Holders of Receipts—incorporated by reference from Exhibit 4.3(b) to the People Express S-4.
- 4.4 -Rights Agreement, dated as of June 9, 1988, between Texas Air and MTrust Corp., N.A., as Rights Agents—incorporated by reference from Exhibit 1 of the 8-A.
- 10.1 -Option Agreement among Texas Air, Continental and American General Corporation dated June 10, 1988—incorporated by reference from Exhibit 10.9 of Continental's Annual Report on Form 10-K for the fiscal year ended December 31, 1983 (the "Continental 1983 10-K").
- 10.2 -Texas Air's 1979 Stock Option Plan, as amended—incorporated by reference from the Texas Air Proxy Statement dated August 11, 1989. (the "Texas Air 1989 Proxy").
- 10.3 -Texas Air 1987 Stock Option Plan—incorporated by reference from Exhibit 10.3 to Texas Air's Annual Report on Form 10-K for the year ended December 31, 1987 (the "Texas Air 1987 10-K").
- 10.4 -Texas Air 1983 Continental Stock Bonus Plan—incorporated by reference from Exhibit 10.18 of the Continental 1983 10-K.
- 10.5 -Texas Air 1983 Continental Stock Option Plan—incorporated by reference from Exhibit 10.19 of the Continental 1983 10-K.

- 10.6 -Form of Employment Contract between Texas Air and certain key officers-incorporated by reference from Exhibit 10.44 of Texas Air's Annual Report on Form 10-K for the year ended December 31, 1983 (the "Texas Air 1983 10-K").
- 10.7 -Form of Promissory Note between Texas Air and certain key officers-incorporated by reference from Exhibit 10.45 to Texas Air 1983 Form 10-K.
- 10.8 -Agreement between Texas Air and Continental dated October 10, 1984-incorporated by reference from Exhibit 10.57 to the Form S-1 Registration Statement (No. 2-93858) originally filed with the Commission by Texas Air on October 19, 1984.
- 10.9 -Exchange Agreement between Texas Air and Jet Capital dated as of May 20, 1985-incorporated by reference from Exhibit D to the Schedule 13D dated June 13, 1985 filed by Texas Air with the Commission with respect to the common stock of TWA.
- 10.10 -Indemnity Agreement dated as of May 21, 1985, among Texas Air and certain members of the Board of Directors of New York Air-incorporated by reference from Exhibit 10.104 to the Form S-1 Registration Statement (No. 2-99269) originally filed by Texas Air with the Commission on July 29, 1985.
- 10.11 -Form of Indemnity Agreement dated September 1, 1987, between Texas Air and the directors of Texas Air-incorporated by reference from Exhibit 10.11 to the Texas Air 1987 10-K.
- 10.12 -Term Sheet for Agreement dated August 21, 1985, and executed December 23, 1985, among Texas Air, the corporate predecessors to Continental and the unsecured creditors committee-incorporated by reference from Exhibit 10.60 to the Form S-1 Registration Statement (No. 33-2862) originally filed by Texas Air with the Commission on January 22, 1986 (the "January 1986 S-1").
- 10.13 -Guaranty Agreement dated as of September 5, 1985, among Texas Air, the corporate predecessors to Continental and the unsecured creditors committee-incorporated by reference from Exhibit 10.61 of the January 1986 S-1.
- 10.14 -Indemnity Agreement between Texas Air and certain directors of Eastern dated as of February 24, 1986-included as Exhibit C to the Schedule 13D dated March 6, 1986 filed by Texas Air with the Commission with respect to the common stock of Eastern.
- 10.15 -Indemnity Agreement dated as of April 27, 1985, among Texas Air and certain members of the Board of Directors of Continental-incorporated by reference from Exhibit 10.36 of the Texas Air 1985 10-K.
- 10.16 -Employment Agreement made effective January 1, 1986, by and between Texas Air and Francisco A. Lorenzo-incorporated by reference from Exhibit 10.38 to the Eastern Form S-4 Registration Statement/Proxy Statement (No. 33-8636) filed by Texas Air and Eastern with the Commission September 10, 1984.
- 10.17 -Indemnity Agreement dated as of September 15, 1986, among Texas Air and certain directors of People Express-included as Exhibit 10.1 to the People Express S-4.
- 10.18 -Copy of Letter of Agreement between Eastern and the Airline Pilots Association, International as approved by the ALPA Management Executive Council on January 31, 1984 and by the ALPA membership on February 19, 1984-incorporated by reference from Exhibit 4.11-A to Eastern's Registration Statement No. 2-88502.
- 10.19(a) -Copy of Letter of Agreement between Eastern and The Air Line Pilots in the service of Eastern as represented by ALPA executed October 14, 1985 (Document No. 105)-incorporated by reference from Exhibit 10.3A filed with Eastern's Quarterly Report on Form 10-Q for the quarter ended September 30, 1985 (the "Eastern September 1985 10-Q").
- 10.19(b) -Copy of Letter of Agreement between Eastern and The Air Line Pilots in the service of Eastern as represented by ALPA executed October 14, 1985 (Document No. 106)-incorporated by reference from Exhibit 10.3B filed with the Eastern September 1985 10-Q.
- 10.19(c) -Copy of Letter of Agreement between Eastern and the Air Lines Pilots Association, International, executed July 7, 1987-incorporated by reference to Exhibit 10.5-A2 to Eastern's Annual Report on Form 10-K for the year ended December 31, 1987 (the "Eastern 1987 10-K").
- 10.19(d) -Copy of Eastern's promulgated work rules for mechanic employees of the IAM, as imposed by Eastern on March 4, 1989-incorporated by reference to Exhibit 10.2-B2 to Eastern's Annual Report on Form 10-K for the year ended December 31, 1988 (the "Eastern 1988 10-K").
- 10.19(e) -Copy of Eastern's promulgated work rules for service workers on the IAM as imposed by Eastern on March 4, 1989-incorporated by reference to Exhibit 10.2-B2 to the Eastern 1988 10-K.
- 10.19(f) -Copy of 1986 Agreement between Eastern and the TWU covering Flight Attendants-incorporated by reference from Exhibit 10.2(c) to the Eastern 1987 10-K.
- 10.20 -Copy of Form of Fuel Service Agreement dated as of April 1, 1987 between TAC Fuel Management, Inc. and Continental and Eastern-incorporated by reference from Exhibit 10.23 to Texas Air's 1987 10-K.
- 10.21 -Copy of Stock Transfer Agreement dated as of March 15, 1987 between Eastern and System One-incorporated by reference from Exhibit 10.7 to the Eastern 1987 10-K.
- 10.22 -Copy of Purchase Agreement between Continental and Texas Air dated as of April 1, 1987-incorporated by reference from Exhibit 2.1 to Continental's report on Form 8-K filed with the Commission in April 1987.
- 10.23 -Stock Purchase Agreement by and among SAS, Texas Air, Eastern and Continental dated as of October 4, 1988-incorporated by reference from Exhibit 10.26 to Texas Air's Annual Report on Form 10-K for the year ended December 31, 1988.
- 10.24 -Tax Sharing Agreement by and between Texas Air and Continental Airlines, Eastern, System One Holdings and other subsidiaries of Texas Air dated January 1, 1988-incorporated by reference from Exhibit 10.10 to Continental's Annual Report on Form 10-K for the year ended December 31, 1988.
- 10.25 -Texas Air Corporation 1988 Stock Option Plan for Non-Employee Directors-incorporated by reference from the Texas Air 1989 Proxy.
- 10.26 -Basic Agreement dated February 20, 1990 among Electronic Data Systems Corporation, System One and Texas Air (filed herewith).
- 10.27 -Memorandum of Understanding among Texas Air, for itself and Continental, Eastern and David I. Shapiro dated February 28, 1990-incorporated by reference from Exhibit 10.9 to Eastern's Annual Report on Form 10-K for the year ended December 31, 1989.
- 10.28 -Purchase Agreement dated June 6, 1989, between The Boeing Company and Continental-incorporated by reference to Exhibit 10.14 to Amendment No. 3 to Continental's Form S-1 Registration Statement (No. 33-30305).
- 10.29 -Purchase Agreement dated November 16, 1989, between AVSA, S.A.R.L. and Continental-incorporated by reference to Exhibit 10.11 to Continental's Annual Report on Form 10-K for the year ended December 31, 1989.**
- 11.1 -Statement Regarding Computations of Per Share Earnings (Loss) (filed herewith).
- 11.2 -Statement Regarding Computations of Ratios of Earnings to Fixed Charges (filed herewith).
- 22.1 -List of Subsidiaries of Texas Air (filed herewith).
- 24.1 -Consent of Arthur Andersen & Co. (filed herewith).
- 25.1 -Powers of Attorney executed by certain directors and officers of Texas Air (filed herewith).

*Continental has received confidential treatment for a portion of this agreement.

**Continental has requested confidential treatment for a portion of this agreement.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Texas Air Corporation has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TEXAS AIR CORPORATION

By /s/Robert D. Snedeker March 29, 1990
Robert D. Snedeker Date
Executive Vice President
and Treasurer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of Texas Air Corporation and in the capacities and on the dates indicated.

	<u>Signature</u>	<u>Capacity</u>	<u>Date</u>
(i)	<u>Principal Executive Officer:</u> <u>FRANCISCO A. LORENZO*</u> Francisco A. Lorenzo	Chairman of the Board and Chief Executive Officer	March 29, 1990
(ii)	<u>Principal Financial Officer:</u> <u>/s/Robert D. Snedeker</u> Robert D. Snedeker	Executive Vice President and Treasurer	March 29, 1990
(iii)	<u>/s/Janice E. Bryant</u> Janice E. Bryant	Controller	March 29, 1990
(iv)	<u>A Majority of the Directors:</u> <u>FRANK BORMAN*</u> Frank Borman	Director	March 29, 1990
	<u>JAN CARLZON*</u> Jan Carlzon	Director	March 29, 1990
	<u>ROBERT J. CARNEY*</u> Robert J. Carney	Director	March 29, 1990
	<u>ROBERT GARRETT*</u> Robert Garrett	Director	March 29, 1990

I. H. HANDMAKER*

I. H. Handmaker

Director

March 29, 1990

A. THOMAS HICKEY*

A. Thomas Hickey

Director

March 29, 1990

FRANCISCO A. LORENZO*

Francisco A. Lorenzo

Director

March 29, 1990

SANFORD E. MCCORMICK*

Sanford E. McCormick

Director

March 29, 1990

CARL R. POHLAD*

Carl R. Pohlrad

Director

March 29, 1990

ROBERT D. SNEDEKER*

Robert D. Snedeker

Director

March 29, 1990

JAMES W. WILSON*

James W. Wilson

Director

March 29, 1990

***By /s/ Charles J. Goolsbee**

Charles J. Goolsbee

Attorney-In-Fact

March 29, 1990

Officers and Directors**Directors of
Texas Air Corporation**

Frank Borman^{1,4}
Vice Chairman of the Board—
Texas Air Corporation

Jan Carlzon⁴
President and Chief
Executive Officer—
Scandinavian Airlines Group
Stockholm, Sweden

Robert J. Carney¹
Chairman of the Board
and Director—
Vacation Publications
Houston, Texas

Robert Garrett^{1,4}
President—
Robert Garrett & Sons Incorporated
New York, New York

L.H. Handmaker^{1,4}
Investor—
Tucson, Arizona

A. Thomas Hickey^{1,4}
Investor—
Los Angeles, California

Francisco A. Lorenzo^{1,5}
Chairman of the Board and
Chief Executive Officer—
Texas Air Corporation

Sanford E. McCormick²
Investor—
Houston, Texas

Carl R. Pohlad^{1,4}
President and Director—
Marquette Bank Minneapolis, N.A.
Minneapolis, Minnesota

Robert D. Smedeker²
Executive Vice President
and Treasurer—
Texas Air Corporation

James W. Wilson^{1,2,5}
Senior Vice President, General
Counsel and Director—
Brown & Root, Inc.
Houston, Texas

**Officers of
Texas Air Corporation**

Francisco A. Lorenzo
Chairman of the Board and
Chief Executive Officer

Robert D. Smedeker
Executive Vice President and
Treasurer

John B. Adams
Senior Vice President

James W. Arpey
Senior Vice President

Charles T. Goodshoe
Senior Vice President, General
Counsel and Secretary

Clark H. Onstad
Senior Vice President

Cynthia R. Creager
Vice President

Robert R. Ferguson, III
Vice President

J. David Grizzle
Vice President

Elliott M. Seiden
Vice President

Janice E. Bryant
Controller

Member of the Executive Committee

Member of the Compensation
Committee

Member of the Audit Committee

Member of the Affiliated Transactions
Committee

Member of the Aircraft Committee

**Directors of
Continental Airlines, Inc.**

Jose Carral
President—
Carral Rubin del Cuen
Mexico

Mickey P. Foret
President—
Continental Airlines, Inc.

Francisco A. Lorenzo
Chairman of the Board and
Chief Executive Officer—
Texas Air Corporation

James L. McKenney
Professor of Business Administration—
Harvard University Graduate
School of Business Administration
Boston, Massachusetts

Carl R. Pohlad
President and Director—
Marquette Bank Minneapolis, N.A.
Minneapolis, Minnesota

Robert T. Sakowitz
President and Chief Executive
Officer—
Sakowitz, Inc.
Houston, Texas

Robert D. Smedeker
Executive Vice President
and Treasurer—
Texas Air Corporation

James W. Wilson
Senior Vice President, General
Counsel and Director—
Brown & Root, Inc.
Houston, Texas

**Officers of
Continental Airlines, Inc.**

Francisco A. Lorenzo
Chairman of the Board and
Chief Executive Officer

Mickey P. Foret
President

Lewis H. Jordan
Executive Vice President
and Chief Operating Officer

John W. Nelson
Executive Vice President—
Marketing

Robert F. Allen
Senior Vice President—
Human Resources

Sam E. Ashmore
Senior Vice President
Crew and Airport Affairs

Donald J. Breeding
Senior Vice President—
Flight Operations

Raymond Valcika
Senior Vice President—
Technical Operations

James C. Bacon
Vice President—
Customer Service, Western Division

Gary L. Fishman
Vice President—
Planning

Richard J. Hillman
Vice President—
Flight Operations
Systems and Standards

Richard B. Hirst
Vice President, General
Counsel and Secretary

Stanley J. Hula
Vice President—
Schedule Development

Thomas Kalil
Vice President—
Customer Service

Armut Kent, Jr.
Vice President—
Corporate Communications

Gary H. Lantner
Vice President—
Properties and Purchasing

John E. Luth
Vice President and Treasurer

Samuel L. Perry
Vice President—
Inflight Services

C. W. Peter Ruhnette
Vice President—
International

Richard A. Schroeter
Vice President and Controller

Richard H. Shuyler
Vice President—
Finance and Chief
Financial Officer

**Senior Corporate Officers of
System One Holdings, Inc.**

Richard E. Murray
Chairman of the Board and
Chief Executive Officer

Frank M. Heinzmann
Executive Vice President and
Chief Technical Officer

William S. Diffenderffer
General Counsel and Secretary

Michael E. Higgins
Vice President—
Finance and Chief
Financial Officer

Judi Schafers
Vice President—
Distribution, Sales and Service

Brenda Woodsmall
Vice President—
Human Resources

Shareholder Information

Preferred Stock

Issue	Exchange	Trading Symbol	Quarterly Dividend (per share)	Payment Date
6 3/4% Cumulative Convertible Junior Preferred	Pacific	TexPr.G	.421875	15th day of January, April, July and October
6.50% Depositary Preferred	Pacific	TexPr.H	.1625	Last day of March, June, September and December
12% Depositary Preferred	Pacific	TexPr.I	.30	Last day of March, June, September and December

Preferred stock dividends have not been paid since the third quarter of 1988.

**Common and Preferred Stock
Transfer Agents and Registrars**

Ameritrust Texas N.A.
1900 Pacific Ave., 16th Floor
P.O. Box 2326
Dallas, Texas 75221-2326

Chase Manhattan Bank
One Chase Manhattan Plaza
New York, New York 10081

First Fidelity Bank N.A., New Jersey
10 Bank Street
P.O. Box 1380
Newark, New Jersey 07102

Common Stock, 6 3/4% Cumulative Convertible Junior Preferred Stock and 15% \$20.00 Cumulative Preferred Stock
6.50% Redeemable Cumulative Junior Preferred Stock and 12% Redeemable Cumulative Junior Preferred Stock

Debenture Information

Trustee and Escrow Agent

10% Exchangeable Subordinated Debentures due 2005

Listed on the American Stock Exchange

Trustee: Bank of New York
21 West Street
New York, New York 10015

15 3/4% Senior Notes due 1992

15 3/4% Senior Notes, Series B, due 1992

14.375% Senior Notes due 1990

14.900% Senior Notes due 1995

14 1/4% Senior Notes due 1993

Listed on the American Stock Exchange

Trustee: National Westminster Bank NJ
One Exchange Place
Jersey City, New Jersey 07302

Senior Extendible Reset Notes

Trustee: Ameritrust Texas N.A.
333 Clay Street, 5th Floor
P.O. Box 3285
Houston, TX 77253

SEC Form 10-K

A copy of the Texas Air Corporation Annual Report on Form 10-K for 1989 may be obtained by writing to Mr. Charles T. Goolsbee, Senior Vice President, General Counsel and Secretary, Texas Air Corporation, 333 Clay Street, Suite 4040, Houston, Texas 77002.

Investor Information

Stockholders and others desiring financial and additional information on Texas Air Corporation may do so by writing to Ms. Cynthia R. Creager, Vice President, Texas Air Corporation, 10 Rockefeller Plaza, 9th Floor, New York, New York 10020.

Common Stock

The common stock of Texas Air Corporation is listed on the American Stock Exchange and the Pacific Stock Exchange, stock trading symbol TEX. The following table gives the high and low sales prices for the stock as reported on the American Stock Exchange for each quarterly period during the past two years. No common stock dividend was paid during 1988 and 1989.

	High	Low
1989 First Quarter	15 3/4	11 3/8
Second Quarter	16 1/4	12
Third Quarter	23 1/4	15
Fourth Quarter	18 3/4	11 3/8
1988 First Quarter	15 1/4	8 7/8
Second Quarter	14 3/4	9 1/2
Third Quarter	15 3/4	10
Fourth Quarter	17 1/4	10 3/4

As February 28, 1990, there were 40,268,798 shares of common stock outstanding and approximately 32,600 shareholders of record.

TEXAS AIR CORPORATION

Three Allen Center
333 Clay Street, Suite 4040
Houston, Texas 77002
(713) 658-9588

PROXY STATEMENT*

1990 ANNUAL MEETING OF STOCKHOLDERS TO BE HELD JUNE 6, 1990

This statement is furnished in connection with the solicitation by and on behalf of the Board of Directors of Texas Air Corporation, a Delaware corporation (the "Company" or "Texas Air"), of proxies to be used at the 1990 Annual Meeting of Stockholders of the Company or any adjournment or adjournments thereof (the "Meeting"), to be held at the Wyndham Warwick, 5701 Main Street, Houston, Texas, on June 6, 1990, at 2:30 P.M. (Central Daylight Savings Time), for the purposes set forth in the accompanying Notice of 1990 Annual Meeting of Stockholders.

The Proxy

Stockholders giving proxies may revoke them at any time before they are voted by notifying the Secretary of the Company in writing of such revocation. Any such revocation must be received prior to the Meeting to be effective. If a stockholder who has signed a proxy attends the Meeting in person, such stockholder may withdraw his proxy by notifying the Secretary and may vote personally on all matters brought before the Meeting. If a proxy is signed properly by a holder of common stock, \$.01 par value per share (the "Common Stock"), a holder of 6.50% Redeemable Cumulative Junior Preferred Stock, \$.10 par value (the "6.50% Preferred Stock"), or 12% Redeemable Cumulative Junior Preferred Stock, \$.10 par value (the "12% Preferred Stock"), and is not revoked, it will be voted at the Meeting in the manner specified on the proxy or, if no manner is specified, it will be voted "FOR" the election of non-preferred stock directors (the "Non-Preferred Stock Directors") nominated by the Board of Directors (Proposal 1), "FOR" Proposal 4, and "AGAINST" Proposals 5 and 6. In addition, if a proxy is signed properly by a holder of 6.50% Preferred Stock or 12% Preferred Stock and is not revoked, it will be voted at the Meeting in the manner specified on the proxy, or, if no manner is specified, it will be voted "FOR" the election of the directors (the "6.50% and 12% Directors") nominated by the Board of Directors to represent the 6.50% Preferred Stock and 12% Preferred Stock together as a class (Proposal 2). If a proxy is signed properly by a holder of 6 $\frac{3}{4}$ % Cumulative Convertible Junior Preferred Stock, par value \$.10 per share (the "6 $\frac{3}{4}$ % Preferred Stock") and is not revoked, it will be voted at the Meeting in the manner specified on the proxy or, if no manner is specified, it will be voted "FOR" the election of directors (the "6 $\frac{3}{4}$ % Directors") nominated by the Board of Directors to represent the 6 $\frac{3}{4}$ % Preferred Stock (Proposal 3). Holders of Common Stock and Class A Common Stock are not entitled to vote on Proposals 2 or 3, holders of 6.50% Preferred Stock and 12% Preferred Stock are not entitled to vote on Proposal 3 and holders of 6 $\frac{3}{4}$ % Preferred Stock are only entitled to vote on Proposal 3.

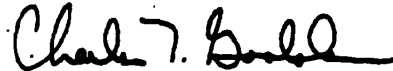
The Company will bear the costs of the solicitation of proxies. In addition to the solicitation of proxies by mail, proxies may also be solicited by telephone, telegram and personal interview by regular employees and directors of the Company, none of whom will receive additional compensation therefore and by Morrow & Co., which the Company has retained to assist in the solicitation of

* Unless otherwise indicated, the information set forth herein reflects information available up to and including January 31, 1990.

Stock") are entitled to notice of and to vote at the Annual Meeting with respect to all Proposals other than Proposal 3 and, with respect to Proposal 2 only, holders of 6.50% Preferred Stock and 12% Preferred Stock vote together as a class. Holders of record at the close of business on April 13, 1990 of the Company's 6¼% Cumulative Convertible Junior Preferred Stock are entitled to notice of and to vote as a class at the Annual Meeting with respect to Proposal 3 only.

The Proxy Statement and form of Proxy are enclosed.

By Order of the Board of Directors,



CHARLES T. GOOLSBEE
Secretary

Houston, Texas
May 7, 1990

We urge you to sign and date the enclosed Proxy and return it promptly by mail in the enclosed envelope, whether or not you attend the meeting in person. No postage is required if mailed in the United States. If you do attend the meeting in person, you may withdraw your Proxy and vote personally on all matters brought before the meeting.

proxies for a fee estimated not to exceed \$7,500 plus reasonable out-of-pocket expenses. Arrangements will be made with brokerage houses and with other custodians, nominees and fiduciaries to forward proxy soliciting material to beneficial owners. The Company may reimburse persons holding stock for others in their names or as nominees for their reasonable out-of-pocket expenses in sending proxy material to their principals and obtaining their proxies.

This Proxy Statement and the accompanying proxy, together with a copy of the Company's 1989 Annual Report, are being mailed to stockholders on or about May 9, 1990.

Record Date and Voting Securities

The Board of Directors has fixed the close of business on April 13, 1990 as the record date (the "Record Date") for the determination of stockholders entitled to notice of and to vote at the Meeting. At the close of business on the Record Date, the Company had outstanding and entitled to vote 40,271,539 shares of Common Stock, 2,040,000 shares of Class A common stock, par value \$.10 per share (the "Class A Common Stock"), 5,121 shares of 6.50% Preferred Stock, 5,655 shares of 12% Preferred Stock, and 6,000,000 shares of 6¾% Preferred Stock.

All of the shares of 6.50% Preferred Stock and 12% Preferred Stock are held by First Fidelity Bank, National Association ("First Fidelity"), as depositary, and First Fidelity has issued depositary preferred shares representing the 6.50% Preferred Stock (the "6.50% Depositary Preferred") and the 12% Preferred Stock (the "12% Depositary Preferred"). The 6.50% Depositary Preferred and the 12% Depositary Preferred are collectively referred to herein as the "Depositary Preferred Shares." Each share of 6.50% Depositary Preferred and 12% Depositary Preferred represents 1/1000 of a share of 6.50% Preferred Stock and 12% Preferred Stock, respectively.

By the terms of the deposit agreements with First Fidelity pursuant to which the Depositary Preferred Shares were issued, holders on the Record Date of Depositary Preferred Shares are entitled to receive notice of the Meeting and to instruct First Fidelity as to the exercise of the voting rights pertaining to the amount of 6.50% Preferred Stock and 12% Preferred Stock represented by such holder's Depositary Preferred Shares. First Fidelity must abstain from voting any of the 6.50% Preferred Stock and 12% Preferred Stock for which it receives no instructions from holders of the Depositary Preferred Shares. At the close of business on the Record Date, 5,120,756 shares of 6.50% Depositary Preferred and 5,654,788 shares of 12% Depositary Preferred were outstanding and entitled to direct the vote of the 6.50% Preferred Stock and 12% Preferred Stock on all matters on which the 6.50% Preferred Stock and 12% Preferred Stock are entitled to vote.

Each share of Common Stock and 6¾% Preferred Stock entitles the holder thereof to one vote on all matters on which holders of Common Stock or 6¾% Preferred Stock, as applicable, are entitled to vote and each share of Class A Common Stock entitles the holder thereof to ten votes on all matters on which holders of Class A Common Stock are entitled to vote. Each share of 6.50% Depositary Preferred entitles the holder to direct one-twentieth of a vote on all matters on which holders of 6.50% Preferred Stock are entitled to vote and each share of 12% Depositary Preferred entitles the holder to direct one-twentieth of a vote on all matters on which holders of 12% Preferred Stock are entitled to vote. The holders of Common Stock, 6.50% Preferred Stock and 12% Preferred Stock, voting together as a single class, are entitled to elect one-quarter of the number of Texas Air's directors (the "Common Stock Directors") to be elected at each meeting held for the election of directors (rounded, if necessary, to the next higher whole number, but excluding the 6.50% and 12% Directors and the 6¾% Directors), and the holders of Common Stock, Class A Common Stock, 6.50% Preferred Stock and 12% Preferred Stock entitled to vote, voting together as a single class, are entitled to elect the remaining Non-Preferred Stock Directors. In addition, each class of the Company's voting securities has certain rights to a class vote on matters particularly affecting such class, including election of additional directors, as described below. The Company's Certificate of Incorporation does not provide for cumulative voting.

The Company's Certificate of Incorporation provides that whenever dividends on the Company's 6.50% Preferred Stock and 12% Preferred Stock have not been paid in an amount equivalent to six full quarterly dividends thereon, the number of directors constituting the Board of Directors shall be increased automatically by two and the holders of the 6.50% Preferred Stock and 12% Preferred Stock, voting together as a class, shall be entitled to elect two directors to fill such positions. In addition, in the event that the Company fails to pay six quarterly dividends on the 6¼% Preferred Stock, the Certificate of Incorporation similarly provides for an additional increase by two in the number of directors constituting the Board of Directors and the exclusive right of the holders of 6¼% Preferred Stock to elect such directors. Effective April 15, 1990, the Board of Directors had not declared dividends on any of these series of preferred stock for six quarters and, accordingly, the size of the Board of Directors automatically increased by four. The Board of Directors has nominated for election to these positions two 6.50% and 12% Directors and two 6¼% Directors, to be voted upon by the 6.50% Preferred Stock and 12% Preferred Stock together as a class, and the 6¼% Preferred Stock as a class, respectively. The right of the holders of each of these series of preferred stock to elect such directors will continue until such time as all dividends on their respective series of preferred stock accumulated to the last dividend payment date are paid in full, or declared or set apart in trust for payment, at which time the right to elect such directors will terminate, the number of directors constituting the Board of Directors will be reduced accordingly and the term of office of such directors will terminate. Subject to such earlier termination, the 6.50% and 12% Directors and the 6¼% Directors will hold office until their successors are elected.

On June 9, 1988, the Board of Directors of the Company adopted a Stockholder Rights Plan (the "Rights Plan") designed to preserve long-term values and protect the interests of its stockholders from stock accumulations and other abusive tactics designed to acquire control of the Company without an offer of fair value to all stockholders. Under the Rights Plan, each stockholder at the close of business on June 29, 1988 received a dividend distribution of one right ("Right") for each share of Common Stock held and one-half Right for each share of Class A Common Stock held. Each Right entitles the holder, under certain conditions, to purchase from the Company a unit ("Unit") consisting of one two-hundredth of a share of a new class of Series A Junior Participating Preferred Stock, par value \$.10 per share, of Texas Air at an exercise price of \$60 per unit, subject to adjustment. The Rights are not exercisable at the present time and only become exercisable under certain limited circumstances. The Rights are redeemable by Texas Air under certain conditions at a price of \$.01 per Right and expire on June 29, 1998.

Each share of Class A Common Stock is convertible, at the option of the holder, into one-half of a share of Common Stock. In addition, the Company has the option to convert each share of Class A Common Stock into one share of Series C Convertible Preferred Stock (the "Series C Preferred Stock"), at seven year intervals, commencing in 1992, and in the event Francisco A. Lorenzo should reduce his ownership of Jet Capital Corporation ("Jet Capital") below 30% or should die. See "Principal Stockholders." The Class A Common Stock is not transferable, except under certain limited circumstances. In addition, in connection with the issuance of Class A Common Stock, Texas Air and Jet Capital entered into an exchange agreement (the "Exchange Agreement"), pursuant to which Jet Capital is prohibited from voting in favor of any mergers, acquisitions or similar transactions unless such transaction is approved by a majority of the directors of the Company unaffiliated with Jet Capital. See also, "Election of Directors."

The Series C Preferred Stock (which is reserved for issuance upon conversion of the Class A Common Stock and no shares of which are currently outstanding) would be entitled to one vote per share and would be convertible into one-half of a share of Common Stock. In addition, the affirmative vote of a majority of the outstanding shares of Series C Preferred Stock, voting as a separate class, would be required to approve any merger or consolidation involving the Company, any sale or conveyance of all or substantially all of the assets of the Company, any reorganization or reclassification of shares of the Company's capital stock or the liquidation of the Company.

PRINCIPAL STOCKHOLDERS

The following table sets forth certain information as of April 13, 1990, with respect to persons owning beneficially (to the knowledge of the Company) more than five percent of any class or series of the Company's voting securities. The table also sets forth the respective general voting power of such persons:

<u>Name and Address of Beneficial Holders</u>	<u>Title of Class</u>	<u>Amount and Nature of Beneficial Ownership(1)</u>	<u>Percent of Class(2)</u>	<u>General Voting Power(3)</u>
Jet Capital Corporation 10 Rockefeller Plaza New York, New York 10020	Class A Common	2,040,000 100,000(4)	100.0% * (4)	33.3% * (4)
Scandinavian Airlines System..... Frosundaviks Alle 1 Sola S-161 87 Stockholm, Sweden	Common	3,933,000	9.8%	6.4%
Massachusetts Financial Services Company 500 Boylston Street Boston, Massachusetts 02116	12% Depository Preferred	425,000	7.5%	(5)
PaineWebber Incorporated..... 1285 Avenue of the Americas New York, New York 10019	6¾% Preferred Stock	1,776,700	29.6%	(6)
J. P. Morgan & Co. Incorporated..... 23 Wall Street New York, New York 10015	6¾% Preferred Stock	1,255,920	20.9%	(6)
Mark Schwarzman, Inc. 475 Steamboat Road Greenwich, Connecticut 06830	6¾% Preferred Stock	406,200	6.8%	(6)

* Less than 1%.

- (1) Unless otherwise indicated, each entity has sole voting and dispositive power.
- (2) In the case of the Common Stock, the 12% Depository Preferred and the 6¾% Preferred Stock, these percentages are calculated by dividing the number of shares in the "Amount and Nature of Beneficial Ownership" column by 40,271,539, 471,232 and 6,000,000 shares, respectively, of the Common Stock, the 12% Depository Preferred and the 6¾% Preferred Stock outstanding on April 13, 1990 (excluding securities held by or for the account of Texas Air or its subsidiaries).
- (3) Computed on the basis of 40,271,539 shares of Common Stock, 256,038 votes for shares of 6.50% Depository Preferred, 471,232 votes for shares of 12% Depository Preferred and 20,400,000 votes for shares of Class A Common Stock outstanding on April 13, 1990. Does not include power to elect Common Stock Directors, as to which holders of Common Stock, 6.50% Preferred Stock and 12% Preferred Stock are entitled to vote together as a separate class.
- (4) Does not include 1,020,000 shares of Common Stock issuable upon conversion of the Class A Common Stock. If these shares were included, Jet Capital's percentage ownership of Common Stock and its general voting power would be 2.8%.
- (5) Entitled to less than 1% of the General Voting Power of shares of Common Stock, Class A Common Stock, 6.50% Depository Preferred and 12% Depository Preferred voting together and entitled to 4.87% of the voting power of the 6.50% Depository Preferred and the 12% Depository Preferred voting together as a single class for the election of the 6.50% and 12% Directors.
- (6) The 6¾% Preferred Stock does not vote generally with the Common Stock, the Class A Common Stock, the 6.50% Preferred Stock and the 12% Preferred Stock, and has one vote per share for all matters on which the 6¾% Preferred Stock is entitled to vote.

Jet Capital is a holding company whose principal assets are securities of the Company. Francisco A. Lorenzo, Chairman of the Board, Chief Executive Officer and President of the Company, is Chairman of Jet Capital and, as of April 13, 1990, owned 1,930,500 shares of Jet Capital Class A common stock (the "Jet Class A"), which has five votes per share, and 390,000 shares of Jet Capital common stock (the "Jet Common"), which has one vote per share. This ownership entitled Mr. Lorenzo to exercise 48.7% of the general voting power of such outstanding stock. The Jet Class A is subject to significant restrictions on transfer, but is convertible at the option of the holder on a share-for-share basis into Jet Common, which is freely transferable. The dividend and liquidation rights of both classes are comparable.

ELECTION OF DIRECTORS

For a description of the procedural provisions in the Company's Bylaws relating to the nomination of directors by stockholders, see "Other Matters." The nominees set forth in Proposals 1, 2 and 3 have been nominated by the Board of Directors. Pursuant to the Bylaws of the Company, the deadline for nominations by stockholders has passed.

It is the intention of the persons named in the enclosed form of proxy, unless otherwise instructed, to vote such proxy for the election of each nominee named in Proposals 1, 2 and 3, as applicable, to hold office until the next Annual Meeting of Stockholders and until his respective successor has been duly elected and has qualified (or, in the case of the 6.50% and 12% Directors and the 6¼% Directors, until their earlier termination as discussed under "Record Date and Voting Securities.") Management does not contemplate that any of the nominees will become unavailable for any reason, but if that should occur before the Meeting, proxies will be voted for another nominee or nominees to be selected by the Board of Directors of the Company.

The tables set forth in Proposals 1, 2 and 3 show, with respect to each nominee, (i) his name and age, (ii) the period, if applicable, that he has served as a director of the Company (and if service to the Company is indicated prior to June 1980, of its predecessor, Texas International Airlines, Inc.), (iii) all positions and offices with the Company and its two principal airline subsidiaries, Continental Airlines, Inc. (including its predecessors, "Continental") and Eastern Air Lines, Inc. ("Eastern"), currently held by each such nominee and his principal occupation over the last five years (including other directorships and business experience), and (iv) the standing committees, if any, of the Board of Directors of which he is a member.

There is no family relationship between any of the nominees for director or executive officers. Pursuant to the Exchange Agreement, Jet Capital has agreed to use its best efforts, to the extent permitted by Delaware law, including the use of its voting power, if necessary, to cause Texas Air to have at all times no less than three directors, each of whom is neither an officer or employee of Texas Air, nor an officer, director, employee or stockholder of Jet Capital.

Other than as set forth below, there are no other known arrangements or understandings between any nominees for director or executive officer and any other person pursuant to which any of the nominees for director or executive officers were selected as an officer or nominees for director.

Jan Carlzon is President and Chief Executive Officer of Scandinavian Airlines System ("SAS"). On October 4, 1988, SAS and the Company entered into a global air carrier agreement, providing for broad-based cooperation between SAS and the Company's air carrier subsidiaries. In connection with the foregoing, SAS and the Company also entered into a Stock Purchase Agreement, pursuant to which, among other things, the Company consented to the purchase by SAS of up to an aggregate of 9.9% of the outstanding shares of Common Stock and agreed, at least through the fifth anniversary of the date thereof, in the event that SAS acquired at least 7.5% of the outstanding shares of Common Stock, to appoint to the Board of Directors of the Company, a person selected by SAS. Pursuant to such agreement, Mr. Carlzon was elected to the Board of Directors in January 1989.

NON-PREFERRED STOCK DIRECTORS

(Proposal 1 on the Proxy Card)

At the meeting, 10 Non-Preferred Stock Directors are to be elected to hold office until the next Annual Meeting of Stockholders and until their respective successors have been duly elected and have qualified. Messrs. Handmaker, Hickey and McCormick have been designated as Common Stock Directors and are to be elected by the holders of the Common Stock, the 6.50% Preferred Stock and the 12% Preferred Stock, voting together as a class. The remaining seven Non-Preferred Stock Directors are to be elected by the holders of the Common Stock, the Class A Common Stock, the 6.50% Preferred Stock and the 12% Preferred Stock, voting together as a single class.

Prior to April 15, 1990, the number of members constituting the Board of Directors (the "Non-Preferred Stock Board") was fixed at 11. In accordance with the Certificate of Incorporation, on April 15, 1990, the size of the Board of Directors automatically increased by four to provide for two 6.50% and 12% Directors and two 6¼% Directors (collectively, the "Preferred Stock Directors"). (See "Record Date and Voting Securities".)

On May 7, 1990, the Board of Directors resolved to reduce the number of the Non-Preferred Stock Directors by one (from 11 to 10). Accordingly, a total of 14 directors will be elected at the Annual Meeting of Stockholders and will comprise the entire Board of Directors, including four Preferred Stock Directors and 10 Non-Preferred Stock Directors (including three Common Stock Directors).

<u>Name and Age</u>	<u>Position; Business Experience; Committee Memberships</u>
FRANK BORMAN, age 62	Director and Vice Chairman of the Board since 1986; Chairman of the Board and Chief Executive Officer (December 1976 to June 1986) and President (December 1976 to September 1985) of Eastern ¹ ; Director of the Home Depot, Inc. (retail building products), Atlanta, Georgia; Director of Outboard Marine Corporation (outboard motors), Waukegan, Illinois; Director of Thermo Instruments Systems, Inc. (a subsidiary of Thermo Electron Corporation); Chairman of the Board, President and Chief Executive Officer of Patlex Corporation (technology licensing), Las Cruces, New Mexico; Trustee of the National Geographic Society; Chairman of Audit Committee and member of Affiliated Transaction Committee.
JAN CARLZON, age 48	Director since 1989; President and Chief Executive Officer (since 1981) of Scandinavian Airlines Group (airline and related travel services), Stockholm, Sweden; Director of Linjeflyg (domestic Swedish airline, 50% owned by Scandinavian Airlines Group), Stockholm, Sweden; Director of Enator (computer and electronic systems), Stockholm, Sweden; Director of Pronator (real estate and finance), Stockholm, Sweden; Director of Fondkommission (stock brokerage), Stockholm, Sweden; member of Affiliated Transactions Committee.

<u>Name and Age</u>	<u>Position; Business Experience; Committee Memberships</u>
ROBERT J. CARNEY, age 49	Director since 1972; Chairman and Director (since 1984) of Vacation Publications, Inc. (travel magazines), Houston, Texas; Director and President of Jet Capital (1969 to March 1986); member of Audit Committee.
I. H. HANDMAKER, age 81	Director since 1967; Investor, Tucson, Arizona; Director of MEI Diversified Inc. (snack and health food distributor), Minneapolis, Minnesota; Consultant to General Trading Company, Lakeville, Minnesota; member of Audit Committee and Affiliated Transactions Committee.
A. THOMAS HICKEY, age 49	Director since 1972; Investor, Los Angeles, California; member of Audit Committee, Compensation Committee and Affiliated Transactions Committee.
FRANCISCO A. LORENZO, age 49	Director since 1972; Chairman of the Board (since December 1985), Chief Executive Officer (since June 1980) and President (June 1980 to December 1985 and since June 1986); Chairman of the Board and Chief Executive Officer (March 1982 to December 1988) and President (September 1983 to April 1984 and July 1987 to January 1988) and Director (since November 1981) of Continental; Chairman of the Board and Director (since October 1986) of Eastern; Chairman of the Board and Director (since 1969) of Jet Capital; member of Executive Committee.
SANFORD E. McCORMICK, age 58	Director since 1981; Investor, Houston, Texas; President (since November 1988) of MetFuel, Inc., Houston, Texas; President (since November 1987) of McCormick Resources, Inc., Houston, Texas; President and Chairman of the Board (January 1984 to June 1985) of McCormick Production Company, general partner of McCormick Oil & Gas Partnership (oil and gas production), Houston, Texas; President and Chairman of the Board (1969 to April 1984) of McCormick Oil & Gas Co. and its affiliates (oil and gas exploration and production), Houston, Texas; Director of Texas Medical Center (oversight of Medical Center properties and their operations), Houston, Texas; Director, Conterra Oil Co., Ft. Worth, Texas; Director, Menil Collection, Houston, Texas; member of Compensation Committee.

<u>Name and Age</u>	<u>Position; Business Experience; Committee Memberships</u>
CARL R. POHLAD, age 74.....	Director since 1967; President and Director (since prior to 1982) of the Marquette Bank Minneapolis, N.A., Minneapolis, Minnesota; Director (since March 1982) of Continental; Director (since March 1986) of Jet Capital; Director (since January 1987) of Eastern ¹ ; President and Director of Bank Shares Incorporated (bank holding company), Minneapolis, Minnesota; Chairman of the Board and Director of MEI Diversified Inc. (snack and health food distributor), Minneapolis, Minnesota; Director of TGI Friday's Inc. (restaurant chain), Dallas, Texas; Chairman of Executive Committee and Chairman of Compensation Committee.
ROBERT D. SNEDEKER, age 47.....	Director since 1982; Executive Vice President and Treasurer (since June 1989); Senior Vice President and Treasurer (June 1980 to December 1981 and July 1982 to June 1989); Director (since September 1989) of Continental; Director (since January 1987) of Eastern ¹ ; Secretary, Treasurer and Director (since 1971) of Jet Capital; member of Executive Committee.
JAMES W. WILSON, age 61.....	Director since 1976; Senior Vice President (since 1979) and General Counsel and Director (since 1980) of Brown & Root, Inc. (engineering and construction), Houston, Texas; Director (since March 1982) of Continental; Director (since January 1987) of Eastern ¹ ; Director (since March 1987) of Jet Capital; member of Executive Committee and Compensation Committee.

(1) On March 9, 1989, Eastern filed a petition for reorganization under Chapter 11 of the Federal Bankruptcy Code (the "Code") in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court"). From March 9, 1989 to April 18, 1990, Eastern operated as a debtor-in-possession under the Code. On April 19, 1990, Martin R. Shugrue was appointed by the Bankruptcy Court as Trustee over Eastern's Chapter 11 estate, and as such, Mr. Shugrue has all the powers of the officers and directors of Eastern to manage Eastern's business during the pendency of Eastern's Chapter 11 proceeding.

**THE DIRECTORS RECOMMEND A VOTE "FOR"
THE ELECTION OF THE NOMINEES NAMED ABOVE.**

Proxies will be so voted unless a contrary indication is made.

6.50% AND 12% DIRECTORS
(Proposal 2 on the Proxy Card)

At the meeting, two directors are to be elected to represent the 6.50% Preferred Stock and 12% Preferred Stock to hold office until the next Annual Meeting of Stockholders or until their earlier termination, all as described under "Record Date and Voting Securities." The 6.50% and 12% Directors are to be elected by the holders of 6.50% Preferred Stock and 12% Preferred Stock, voting together as a single class. Of the nominees named below, one is a current member of the Texas Air Board of Directors and the other is a former member of the Eastern Board of Directors.

<u>Name and Age</u>	<u>Position; Business Experience; Committee Memberships</u>
LINDSAY E. FOX, age 53	<p>Founder and Chairman of Linfox Group (since 1965) (transportation company), Melbourne, Australia; Director of Eastern¹ (June 1987 to April 1990); Chairman, Continental International Advisory Board (November 1984 to November 1987); Director of Coles Myer Limited (retail), Melbourne, Australia; York Trailer Holdings Plc. (trucking manufacturer), London, England; Premier Investments Limited (investment company), Melbourne, Australia.</p> <p>Mr. Fox is the owner of 15,000 shares of the 6 3/4% Preferred Stock.</p>
ROBERT GARRETT age 53.....	<p>Director from 1972 to 1974 and since 1979; President (since April 1986) of Robert Garrett & Sons Incorporated (financial services), New York, New York; Executive Vice President (1980 to December 1985) of Security Capital Corporation (real estate and finance), New York, New York; Senior Vice President of Smith Barney Real Estate Corporation (1978 to March 1984) (real property investment and management), New York, New York; Director of Mickelberry Corp. (advertising and printing), New York, New York; Director of C. R. Gibson Company (producer of g.l.s. stationery and memory items), Norwalk, Connecticut; Director of Reich & Tang, Inc. (investment management company), New York, New York; member of Executive Committee and Affiliated Transactions Committee.</p>

⁽¹⁾ See footnote under "Non-Preferred Stock Directors."

**THE DIRECTORS RECOMMEND A VOTE "FOR"
 THE ELECTION OF THE NOMINEES NAMED ABOVE.**

Proxies will be so voted unless a contrary indication is made.

6¼% DIRECTORS
(Proposal 3 on the Proxy Card)

At the meeting, two directors are to be elected to represent the 6¼% Preferred Stock to hold office until the next Annual Meeting of Stockholders or until their earlier termination, all as described under "Record Date and Voting Securities." The 6¼% Directors are to be elected by the holders of the 6¼% Preferred Stock.

<u>Name and Age</u>	<u>Position; Business Experience; Committee Memberships</u>
JAMES A. LAWRENCE, age 36	Chairman (since March 1983) of LEK Partnership (merger and acquisition advising business), Boston, Massachusetts; Director (since May 1989) of Southmark Corporation (banking and financial services), Dallas, Texas; Vice President and Partner (July 1977 to March 1983) of Bain & Company (management consulting firm), Boston, Massachusetts.
GERALD TSAI, JR., age 61	Director of Primerica Corporation (financial services) since 1982; Chairman of Executive Committee (since 1988) of Primerica Corporation; Chairman and Chief Executive Officer, Primerica Corporation (January 1987 to December 1988); Vice Chairman of Primerica Corporation (June 1983 to February 1987); Director, First Gibraltar Bank; Director, The Independent Investment Company; Director, Montleigh Group; Director, NAC Re Corporation; Director, National Cleaning Contractors, Inc.; Director, Rite Aid Corporation; Director, Sequa Corporation; Director, Universal Matchbox Group, Ltd.

Mr. Tsai is the owner of 8,000 shares of the 6¼% Preferred Stock and 23,500 shares of the Common Stock.

**THE DIRECTORS RECOMMEND A VOTE "FOR"
 THE ELECTION OF THE NOMINEE NAMED ABOVE.**

Proxies will be so voted unless a contrary indication is made.

Security Ownership

The following table sets forth, as to each nominee for director of Texas Air and as to all current and two former executive officers, as of January 31, 1990 (including the presidents of three principal subsidiaries of the Company who are named in the Cash Compensation Table herein), collectively, the "Security Ownership Executive Officer Group", and nominees for director of Texas Air as a group, such person's or group's beneficial ownership of equity securities of Texas Air and Jet Capital as of January 31, 1990. The information as to each person has been furnished by him and each person has sole voting power and sole investment power with respect to all shares beneficially owned by him, except as otherwise indicated.

	Texas Air Common Stock Owned Beneficially			Jet Capital Capital Stock Owned Beneficially					
	No. of Shares	% of Class(1)	General Voting Power(2)	No. of Class A Shares	% of Class(3)	No. of Common Shares	% of Class(4)	General Voting Power(5)	% of Capital Stock(6)
Frank Borman(7)(16).....	6,000	*	*	0	*	0	*	*	*
Jan Carlzon(16).....	5,000	*	*	0	*	0	*	*	*
Robert J. Carney(16).....	10,597	*	*	0	*	0	*	*	*
Lindsay E. Fox.....	0	0	0	0	0	0	0	0	0
Robert Garrett(16).....	7,984(8)	*	*	0	*	0	*	*	*
I. H. Handmaker(16).....	25,000	*	*	0	*	0	*	*	*
A. Thomas Hickey(16).....	13,600	*	*	0	*	0	*	*	*
James A. Lawrence.....	0	0	0	0	0	0	0	0	0
Francisco A. Lorenzo.....	2,362,545(9)	5.9%	35.4%	1,930,500(10)	48.0%	390,000	78.1%	48.7%	51.3%
Sanford E. McCormick(16).....	13,200	*	*	0	*	0	*	*	*
Carl R. Pohlad.....	52,000	*	*	563,750(11)	14.0%	0	*	13.7%(11)	12.5%
Robert D. Snedeker.....	113,252(12)	*	*	278,300	6.9%	55,000	11.0%	7.0%	7.4%
Gerald Tsai, Jr.....	0	*	*	0	*	0	*	*	*
James W. Wilson(13)(16).....	12,700	*	*	222,100	5.5%	0	*	5.6%	5.1%
All nominees and the Executive Officer Group (24 persons).....	2,973,414(14)	7.3%	36.3%(14)	3,082,650(15)	76.7%	445,000	89.2%	77.0%(15)	78.0%

* Less than 1%.

- (1) Computed on the basis of 40,267,643 shares of Common Stock outstanding on January 31, 1990, plus, in each case, the number of respective shares which the person had the right to acquire within 60 days of January 31, 1990, as indicated in the appropriate footnote.
- (2) Computed on the basis of 40,267,643 votes for shares of Common Stock, 256,037 votes for shares of 6.50% Depositary Preferred, 471,232 votes for shares of 12% Depositary Preferred and 20,400,000 votes for shares of Class A Common Stock outstanding on January 31, 1990. Does not include the power to elect (i) Common Stock Directors, as to which holders of Common Stock, 6.50% Preferred Stock and 12% Preferred Stock are entitled to vote together as a separate class, (ii) 6.50% and 12% Directors, as to which holders of 6.50% Preferred Stock and 12% Preferred Stock are entitled to vote together as a separate class or (iii) 6¾% Directors, as to which holders of 6¾% Preferred Stock are entitled to vote as a separate class.
- (3) Computed by dividing the number of shares in the "Jet Capital—Capital Stock Owned Beneficially—No. of Class A Shares" column by 4,020,713 shares of Jet Class A outstanding on January 31, 1990.
- (4) Computed by dividing the number of shares in the "Jet Capital—Capital Stock Owned Beneficially—No. of Common Shares" column by 499,220 shares of Jet Common outstanding on January 31, 1990.

- (5) Computed on the basis of 499,220 votes for shares of Jet Common and 20,103,565 votes for shares of Jet Class A outstanding on January 31, 1990.
- (6) Computed on the basis of 4,020,713 shares of Jet Class A and 499,220 shares of Jet Common outstanding on January 31, 1990.
- (7) Mr. Borman owns 1,008 shares of Eastern's 20% Participating Noncumulative Convertible Preferred Stock (held in an Eastern employee trust), which represents less than 1% of the class.
- (8) Includes 1,000 shares which are owned by Mr. Garrett's children and to which shares Mr. Garrett disclaims beneficial ownership and for which shares he has no voting power.
- (9) Includes 1,240,467 shares of Common Stock that Mr. Lorenzo had the right to acquire within 60 days upon exercise of stock options. Also includes 100,000 shares of Common Stock and 2,040,000 shares of Class A Common Stock (convertible into 1,020,000 shares of Common Stock) beneficially owned by Jet Capital, of which Mr. Lorenzo is a principal stockholder. Mr. Lorenzo disclaims beneficial ownership of shares held by Jet Capital. If the amounts of Common Stock and Class A Common Stock beneficially owned by Jet Capital are excluded from these calculations, Mr. Lorenzo owned 1,242,345 shares (including 400 shares held by members of his family and as to which shares Mr. Lorenzo disclaims beneficial ownership) (3.1% of the class). Also includes 1,335 shares of Common Stock held by an employee benefit plan for Mr. Lorenzo's benefit, none of which shares may be voted by Mr. Lorenzo and all of which shares may only be withdrawn under certain limited circumstances.
- (10) Includes 88,000 shares which are owned by Mr. Lorenzo's children and as to which shares Mr. Lorenzo disclaims beneficial ownership. If Mr. Lorenzo were to convert all his Jet Class A into Jet Common and assuming no other conversions of Jet Class A, Mr. Lorenzo would own beneficially 95.5% of the Jet Common and his Jet Capital voting power would be 18.0%.
- (11) Includes 530,750 shares owned, directly or indirectly, by members of Mr. Pohlads family and his affiliates and as to which shares Mr. Pohlads disclaims beneficial ownership.
- (12) Includes 99,333 shares of Common Stock that Mr. Snedeker had the right to acquire within 60 days upon exercise of stock options.
- (13) In addition, Mr. Wilson has 1,669 votes for shares of 6.50% Preferred Stock and 2,100 votes for shares of 6¼% Preferred Stock, which is less than 1% of the respective classes.
- (14) Includes 1,120,000 shares of Common Stock beneficially owned by Jet Capital and 1,621,281 shares of Common Stock that certain officers and directors had the right to acquire within 60 days upon exercise of stock options. If such shares held by Jet Capital are excluded, the nominees for director and the Security Ownership Executive Officer Group owned 1,808,414 shares of Common Stock (4.5% of the class) as of January 31, 1990. Also includes 5,673 shares held by employee benefit plans for the benefit of certain individuals in the Group (including 1,335 shares for Mr. Lorenzo), none of which shares may be voted by such individuals and all of which shares may be withdrawn only under certain limited circumstances.
- (15) If all nominees for director and the individuals in the Security Ownership Executive Officer Group as a group were to convert all their Jet Class A into Jet Common and assuming no other conversions of Jet Class A, all nominees for director and the Security Ownership Executive Officer Group as a group would beneficially own 98.5% of the Jet Common and their voting power would be 42.6%.
- (16) Includes 5,000 shares of Common Stock which Messrs. Borman, Carlzon, Carney, Handmaker, Hickey, McCormick, Pohlads and Wilson each had the right to acquire within 60 days upon exercise of stock options granted under the 1989 Stock Option Plan for Nonemployee Directors. (See "Texas Air Stock Option Plans—1989 Stock Option Plan for Nonemployee Directors.")

Texas Air Board of Directors and Committees

Meetings of the Board of Directors are held periodically, including an organizational meeting following the conclusion of the Annual Meeting of Stockholders. The Board may also hold special meetings on call. The Board held nine meetings in 1989.

Compensation of Directors

Directors who are not employees of the Company or any of its subsidiaries receive a monthly retainer of \$1,333.33 for serving as a member of the Board of Directors. The chairmen of the board committees also receive additional annual retainers of \$2,000 each. Nonemployee directors receive \$1,500 for each regular or special Board meeting and committee meeting (other than telephonic meetings) which they attend. In addition, nonemployee directors of the Company participate in the 1989 Stock Option Plan for Nonemployee Directors (see "Texas Air Stock Option Plan—1989 Stock Option Plan for Nonemployee Directors.")

Committees of the Board

The standing committees established by the Board of Directors to assist it in the discharge of its responsibilities are described below. The biographical information on the current directors, set forth above, identifies the committee memberships held by each director.

The Executive Committee consists of five members, three of whom are nonemployee directors. Its principal function is to exercise the powers of the Board of Directors in the direction of the business of the Company when action is required between Board meetings. The Executive Committee held four meetings in 1989.

The Audit Committee consists of four nonemployee directors. During the year, it consults with management and the independent public accountants on matters related to the annual audit, the published financial statements, and the accounting principles and auditing procedures being applied. It meets with the Company's independent public accountants after year-end to discuss the results of their audit and submits to the Board of Directors any recommendations requiring Board approval, including the appointment of an accounting firm for the upcoming year. The Audit Committee authorizes all audit and other professional services rendered by the accounting firm and periodically reviews its independence. It periodically reviews the Company's system of internal accounting controls and the Company's policies on business practices and reports on these matters to the Board of Directors annually. The Audit Committee held three meetings in 1989.

The Compensation Committee consists of four nonemployee directors. The principal functions of the Compensation Committee are establishment of compensation and all other matters relating to employment for corporate officers and the administration of the Company's 1979 Stock Option Plan and other stock option and purchase plans. The Compensation Committee held five meetings in 1989.

The Affiliated Transaction Committee consists of five nonemployee directors who are unaffiliated with Jet Capital. The principal function of the Affiliated Transaction Committee is to consider, authorize and approve any agreement, arrangement or transaction involving Texas Air and Jet Capital.

The Company does not have a standing nominating committee.

Attendance at Meetings

During 1989, each director of the Company attended more than 75% of the sum of the total number of meetings of the Board and each committee of which he was a member held during the period for 1989 during which he was a director or such a member.

Compensation of Executive Officers

The following table sets forth information for 1989 with respect to cash compensation (including cash bonuses) for services to the Company and its subsidiaries paid to (i) each of the five most highly compensated executive officers of the Company (including one current and two former executive officers of subsidiaries of the Company who are or were not officers of the Company but are listed in the table below) as to whom cash compensation exceeded \$60,000 and (ii) the 14 persons as a group who were executive officers of the Company at any time during 1989 (including the three officers of subsidiaries referred to above).

<u>Name of Individual or Number of Persons in Group</u>	<u>Principal Capacities in Which Served During 1989</u>	<u>Cash Compensation (1)</u>
D. Joseph Corr(2)	Chairman of the Board and Director of Continental	\$ 800,028(2)
Francisco A. Lorenzo.....	Chairman of the Board, Chief Executive Officer, President and Director of the Company; Chairman of the Board, Chief Executive Officer and Director of Continental; Chairman of the Board and Director of Eastern	698,200(4)
Phil Bakes(3).....	President, Chief Executive Officer and Director of Eastern	375,417(4)
Robert D. Snedeker	Executive Vice President, Treasurer and Director of the Company; Director of Continental and Eastern	345,837
Richard E. Murray.....	Chairman of the Board, Chief Executive Officer and Director of System One Holdings, Inc. ("System One")	261,325(4)
All executive officers as a group (14 persons) (the "Executive Officer Group").....		5,662,003(-)

(1) Does not include \$17,781, \$12,954 and \$200,382 of relocation-related expenses reimbursed to or paid on behalf of Messrs. Corr, Murray and the group, respectively; also does not include the purchase by the Company of certain stock options from Mr. Snedeker and the Executive Officer Group (see "Texas Air Stock Option Plans—1979 Stock Option Plan").

(2) Mr. Corr served as Chairman of the Board and Director of Continental from December 1988 to October 1989.

(3) Effective April 20, 1990, Mr. Bakes resigned as President and Chief Executive Officer of Eastern.

(4) Includes amounts paid by Continental, Eastern and System One, as applicable, for services rendered to such companies.

Mr. Bakes' employment contract with Texas Air runs through August 1993 at a minimum annual salary of \$425,000. Upon termination of his contract without cause (as defined), Mr. Bakes will be entitled to \$800,000, one-half of which is payable upon such termination and the balance in 12 installments commencing 13 months after termination. Effective April 20, 1990, Mr. Bakes resigned as President and Chief Executive Officer of Eastern, and is currently discussing his employment with Texas Air.

Mr. Snedeker renewed his employment contract during 1989 which currently runs through August 1993, at a minimum annual salary of \$250,000. Upon termination of his contract without cause (as defined) or upon the Company's failure to renew his contract, Mr. Snedeker will be entitled to (i) immediate payment of an amount equal to his salary and any bonus paid for the preceding year, and (ii) a similar amount paid in 12 installments commencing 13 months after termination. Mr. Snedeker

was appointed Executive Vice President of the Company in June 1989. Another member of the executive officer group renewed his employment contract during 1989 on terms and conditions similar to Mr. Snedeker's.

Effective January 1, 1986, Mr. Lorenzo and the Company entered into an employment agreement having an initial term of seven years. The agreement is automatically extendable so that the term will at all times be at least five years unless the Company or Mr. Lorenzo elects not to extend. The agreement provides for (i) a salary of \$365,000 per year, increased annually by a percentage not less than the average of the percentage salary increases received by the two next most highly paid officers of the Company, (ii) annual bonuses equal to 1% of the Company's consolidated net income to \$25,000,000 and 0.5% of the Company's consolidated net income from \$25,000,000 to \$100,000,000, and (iii) a \$1,000,000 life insurance policy payable to Mr. Lorenzo's beneficiaries. In most instances of termination of Mr. Lorenzo's employment, Mr. Lorenzo will be entitled to receive his salary and certain bonuses for the remainder of the term of the agreement. The agreement provides that following termination of his employment Mr. Lorenzo shall not compete with the Company during such period as he receives payments pursuant to the agreement. The agreement provides that it will be binding upon any corporation into which the Company merges or to which the Company sells all of its assets. In addition, Mr. Lorenzo has a Family Protection Agreement with Texas Air, which provides that upon the death of Mr. Lorenzo while employed, his beneficiary will be paid 50% of his salary for 10 years, adjusted for increases in the cost of living. Mr. Lorenzo is also covered under a deferred compensation arrangement approved by the Board of Directors pursuant to which approximately \$570,300 of deferred compensation has been accrued since inception of this arrangement in 1983 (\$152,615 of which deferred compensation was accrued in 1989). Under the arrangement, the deferred compensation would be paid to Mr. Lorenzo in the event of the termination of his employment or to his beneficiary in the event of Mr. Lorenzo's death.

Texas Air Stock Option Plans

Option Grants and Exercises. The following table shows, for those executive officers named in the table and the individuals in the Executive Officer Group, information with respect to stock options granted under the Texas Air Stock Option Plans during the periods indicated.

	<u>Francisco A. Lorenzo</u>	<u>Phil Baker(2)</u>	<u>D. Joseph Corr(3)</u>	<u>Robert D. Snedeker</u>	<u>Richard E. Murray</u>	<u>Executive Officer Group (14 persons)</u>
Granted January 1, 1989—						
January 31, 1990:						
Number of options (1).....	500,000	50,000	650,000	200,000	—	1,497,500
Weighted average per share exercise price.....	\$ 11.875	\$ 12.875	\$ 11.875	\$13.9375	—	\$ 12.25
Exercised January 1, 1989—						
January 31, 1990:						
Number of options	—	27,000	130,000	—	17,000	194,133
Net value realized of shares (market value less exercise price).....	—	\$282,875	\$162,500	—	\$59,500	\$ 721,380
Terminations and Cancellations						
January 1, 1989—						
January 31, 1990:						
Number of options	—	—	520,000	—	—	520,000

(1) Messrs. Lorenzo and Snedeker were granted options to purchase 500,000 and 200,000 shares, respectively, at prices ranging from \$11.875 to \$15.00 per share. Upon full vesting and exercise of these options, bonuses equal to one-half of the exercise price of the options will be paid to these individuals, the receipt of which is subject to the fulfillment of certain conditions, including continuity of employment.

- (2) Effective April 20, 1990, Mr. Bakes resigned as President and Chief Executive Officer of Eastern.
- (3) Mr. Corr served as Chairman of the Board and Chief Executive Officer of Continental from December 1988 to October 1989.

1979 Stock Option Plan. In June 1979, the Company adopted a stock option plan (the "1979 Plan") under which shares of Common Stock could be issued to key employees of the Company and its subsidiaries pursuant to options, including Incentive Stock Options ("ISO's") within the meaning of Section 422A of the Internal Revenue Code and options that do not qualify as ISO's ("Non-ISO's"), or stock appreciation rights ("SAR's"). Options granted under the 1979 Plan may be exercisable for a term of up to 10 years (11 years for Non-ISO's). In December 1985, the Compensation Committee decided that all then existing and future options under the 1979 Plan would become immediately exercisable in the event of a change in control (as defined) of the Company unless the specific option grant otherwise eliminated or modified the applicability of this provision. In all cases, however, options may not be exercised for at least six months from the date of grant. No SAR's have been granted pursuant to the 1979 Plan, and the Board of Directors of the Company does not intend to do so. The expiration date of the 1979 Plan is April 30, 1995.

The 1979 Plan, which originally provided for the issuance of 300,000 shares of Common Stock, has been amended several times since its adoption to, among other things, increase the number of shares of Common Stock available for issuance under the 1979 Plan. The number of shares of Common Stock currently permitted to be issued under the 1979 Plan is 6,000,000.

From January 1, 1989 to January 31, 1990, all employees other than the individuals in the Executive Officer Group were granted options to purchase 224,500 shares of Common Stock at a weighted average exercise price per share of \$13.33. From January 1, 1989 to January 31, 1990, options to purchase a total of 233,272 shares of Common Stock with a weighted average exercise price per share of \$10.22 were terminated or canceled and options to purchase a total of 167,017 shares of Common Stock were exercised at a weighted average exercise price per share of \$9.03 and an aggregate net value realized of \$902,298, with respect to all employees other than the individuals in the Executive Officer Group. On January 31, 1990, options to purchase a total of 3,794,221 shares of Common Stock were outstanding at a weighted average option exercise price per share of \$10.53. The options are exercisable through October 24, 1999. There are options for a total of 2,244,667 shares in the 1979 Plan which, when fully vested and exercised, entitle the optionees to bonuses equal to one-half the exercise price of the options. Messrs. Lorenzo, Bakes, Snedeker and certain members of the Executive Officer Group have options to purchase 1,525,000, 103,000, 315,000 and 123,000 shares, respectively, at prices ranging from \$9.25 to \$15.00 which are subject to such bonuses. Three employees who are not included in the Executive Officer Group have options to purchase 178,667 shares at prices ranging from \$9.25 to \$12.875, which are subject to the bonuses. Receipt of the bonus is subject to the fulfillment of certain conditions, including continuity of employment. On September 15, 1989, Texas Air purchased 53,300 options from Snedeker for \$772,037 and 106,934 options from the Executive Officer Group for \$1,343,452, in each case reflecting the spread between the exercise price of the purchased options and \$13.875 per share, the closing price of such shares on the American Stock Exchange on the trading day immediately preceding such purchase. As of January 31, 1990, approximately 200 employees were entitled to participate in the 1979 Plan. Nonemployee directors of the Company are not entitled to participate in the 1979 Plan.

Texas Air 1983 Continental Stock Option Plan. On September 30, 1983, the Board of Directors of the Company adopted, and in June 1984 the stockholders of the Company approved, the Texas Air 1983 Continental Stock Option Plan (the "1983 Plan"). The 1983 Plan provided for the grant to key employees of the Company and Continental of options to purchase up to 750,000 shares of the Common Stock of Continental. Options granted under the 1983 Plan become exercisable upon a change of control (as defined) of Texas Air. Nonemployee directors of the Company are not entitled to participate in the 1983 Plan.

On February 6, 1987, the effective date of the merger of Continental into a wholly-owned subsidiary of Texas Air (the "Continental Merger"), each outstanding option under the 1983 Plan was

converted into an option to purchase eight-tenths of a share of Common Stock for each share of Continental Common Stock subject to such option, at a per share exercise price equal to 125% of the option price of such option. The ratio of eight-tenths reflects the ratio of the closing prices of Texas Air Common Stock and Continental Common Stock on the last trading day prior to the date the Continental Merger was initially proposed. From January 1, 1989 through January 31, 1990, no options were granted pursuant to the 1983 Plan. During such period, options to purchase 36,500 shares of Common Stock were exercised by all employees other than the individuals in the Executive Officer Group at a net value realized (market value less exercise price) of \$445,170. As of January 31, 1990, options to purchase 101,430 shares of Common Stock were outstanding at a weighted average exercise price per share of \$3.98.

1989 Stock Option Plan for Nonemployee Directors. During 1989, upon recommendation by Texas Air management, the 1989 Stock Option Plan for Nonemployee Directors (the "Directors' Plan") was adopted and approved by stockholders of Texas Air. The Directors' Plan provides for the grant of options to nonemployee directors, subject to certain conditions, at a price per share equal to 100% of the fair market value of a share of Texas Air Common Stock on the date the option is granted. The aggregate number of shares which may be issued pursuant to the Directors' Plan is 300,000, subject to certain adjustments. Options to purchase 225,000 shares at an exercise price of \$12.50 per share were granted in 1989 to each of the Nonemployee Directors of Texas Air, which options vest in equal installments over five years.

Other Options

Texas Air and its subsidiaries also maintain a number of other benefit plans for employees of Texas Air and its subsidiaries. No individual in the Executive Officer Group participates in any of the plans described below. Under the 1982 Stock Option Plan of New York Airlines, Inc., as of January 31, 1990, there were outstanding options to purchase 34,915 shares of Common Stock, at exercise prices ranging from \$5.82 to \$18.22 per share (a weighted average exercise price per share of \$16.62) with expiration dates ranging from April 1, 1992 through May 21, 1994. Such options are held by 18 persons. Under the Eastern Air Lines, Inc. 1979 Stock Plan, as of January 31, 1990, there were outstanding options to purchase 4,548 shares of Common Stock, at exercise prices ranging from \$32.27 to \$41.61 per share (a weighted average exercise price of \$33.93 per share) with expiration dates ranging from May 20, 1990 through October 21, 1990. Such options are held by seven persons. Under the 1983 Continental Airlines Corporation Stock Option Plan, as of January 31, 1990, there were outstanding options to purchase 20,000 shares of Common Stock at exercise prices ranging from \$9.85 to \$16.25 per share (a weighted average exercise price per share of \$13.00) with expiration dates ranging from December 11, 1994 to December 11, 1995. Such options are held by three persons.

Continental Profit Sharing Plan

The Board of Directors of Continental in late 1983 adopted an incentive compensation plan for all employees of Continental. This plan is keyed to the profitability of Continental and provides that a certain percentage of Continental's net profits (as defined) on a sliding scale (up to 25%) be distributed to employees of Continental. Fifty percent of the profit sharing contribution is 100% vested when made and, at the option of the employee, may be taken in cash or invested in Texas Air Common Stock or several independently managed investment funds. The remaining 50% is invested in Texas Air Common Stock and vests over seven years. No contribution to the Profit Sharing Plan was made in 1989 and none is due in 1990 with respect to the 1989 year.

Continental Retirement Plan

The Continental Retirement Plan, which was adopted by Continental in 1988, subject to receipt of a determination by the Internal Revenue Service of the plan's qualification, is a noncontributory defined benefit pension plan. Substantially all domestic employees of Continental and certain designated subsidiaries, other than temporary employees, are eligible to participate in the plan. Employees hired on or after July 1, 1989 must have one year of service in order to participate.

A participant's annual benefit commencing at or after the normal retirement age of 65 (60 for pilots) is equal to 1.19% of the participant's final average compensation plus 0.45% of the participant's final average compensation in excess of the average Social Security wage base, multiplied by the participant's years of participation up to a maximum of 30 years. Final average compensation means the participant's highest five consecutive years of compensation during the last 10 calendar years with Continental after January 1, 1984. Compensation includes regular pay, shift differential and gainsharing, but excludes bonuses, overtime, profit sharing distributions, severance pay, incentive or other special forms of pay.

A participant who has attained age 50 and satisfied certain service requirements may elect to receive an early retirement benefit of equivalent actuarial value. Participants who terminate employment before they are eligible to retire will receive benefits as described above only if they have at least five years of service. Requirements of the Internal Revenue Code of 1986 (the "Internal Revenue Code") may in certain circumstances limit the benefits payable under the plan to an amount which is less than that described above. The plan permits participants to elect a reduced retirement benefit in return for the plan's providing a death benefit to the participant's spouse in the event of the participant's death prior to retirement. The plan also provides certain benefits in the event of a participant's disability.

The following table represents the estimated benefits payable per year for life to employees under the plan, assuming normal retirement in the current year, and the employee elects a single life annuity.

Final Average Compensation	Years of Participation					
	5	10	15	20	25	30
\$100,000.....	\$ 7.836	\$15.684	\$23.532	\$31.380	\$39.228	\$47.076
\$125,000.....	9.897	19.974	29.690	39.587	49.484	59.381
\$150,000.....	11.947	23.894	35.840	47.787	59.734	71.681
\$175,000.....	13.997	27.994	41.990	55.987	69.985	83.981
\$200,000 and above.....	16.047	32.094	48.140	64.187	80.234	96.281

The values reflected in the above table represent the application of the plan formula to the specified amounts of compensation and years of participation without regard to Internal Revenue Code maximums. Of all the executive officers in the Executive Officer Group, only Mr. Lorenzo is eligible to participate in the plan. The final average compensation under the plan for each of the individuals included in the compensation table set forth above is not substantially different than the amounts set forth in the table. Mr. Lorenzo has less than two years of participation.

Eastern Employee Benefit Plans

Officers of Eastern (with certain exceptions) are eligible to participate in Eastern's fixed benefit retirement plan that applies to all salaried non-contract employees (the "Non-Contract Fixed Benefit Plan"). Of all the individuals in the Executive Officer Group, only Mr. Bakes is eligible to participate in the Non-Contract Fixed Benefit Plan and as of December 31, 1989, Mr. Bakes had 2.2 years of credited service thereunder. Currently, participants in the Non-Contract Fixed Benefit Plan accrue benefits annually of 1.65% of the first \$14,200 in Annual Earnings (as defined) plus 2% of Annual Earnings over \$14,200, however, the Non-Contract Fixed Benefit Plan was amended effective August 1, 1989 to freeze benefit accruals through December 31, 1990.

Officers of Eastern generally are also eligible to participate in Eastern's variable benefit retirement plan that applies to all salaried Non-Contract Employees (the "Non-Contract Variable Benefit Plan"). Under this plan, participants are permitted to contribute up to 10% of after-tax salary to an investment fund and to withdraw, at any time, the value of their own contributions.

Officers of Eastern are also eligible to participate in Eastern's Non-Contract Investment Plan. Under this plan, participants can contribute to various investment vehicles up to 10% of salary on a pre-tax basis pursuant to Section 401(K) of the Internal Revenue Code.

In addition to the above, officers of Eastern who retire as active Eastern officers are eligible to receive pension benefits under the Supplemental Executive Retirement Plan ("SERP"). Annual benefits generally accrue under SERP at the rate of 2% of an officer's average Salary of Record in the highest three consecutive years of employment out of the final five years of employment ("Final Average Earnings") for each year of service as a staff officer and 3.5% of an officer's Final Average Earnings for each year of service as a corporate officer. The annual benefits are based on the above accruals, with SERP providing the annual benefits in excess of those provided by Eastern's Non-Contract Fixed Benefit Plan, but are limited to 55% of the staff officer's or 62% of the corporate officer's Final Average Earnings. SERP benefits are due and payable from Eastern on a current basis after the officer's retirement. Participants are permitted to receive SERP benefits following an early retirement, disability retirement or deferred retirement. Eastern stopped paying SERP benefits as a result of its filing under Chapter 11. Participants have an unsecured claim for pre-petition accrued but unpaid benefits.

The following table sets forth estimated total annual retirement benefits payable upon normal retirements under Eastern's Non-Contract Fixed Benefit Plan and SERP retirement plans to officers of Eastern in specified compensation and years-of-service classifications. These amounts are based on a single life annuity form of payment and exclude amounts resulting from payments under Eastern's Non-Contract Variable Benefit Plan. Officers may elect alternative annual payment methods, which affect the amount of such annual payments.

Final Average Earnings(1)	Years of Pension Service(2)		
	15	20	25+
\$ 50,000	\$ 20,625	\$ 27,500	\$ 31,000
\$125,000	51,563	68,750	77,500
\$200,000	82,500	110,000	124,000
\$275,000	113,438	151,250	170,500
\$350,000	144,375	192,500	217,000
\$425,000	175,313	233,750	263,500
\$500,000	206,250	275,000	300,000

(1) Final Average Earnings represents average Salary of Record in the highest three consecutive years of employment out of the last five years.

(2) Assumes that retiring officers served their entire employment as officers of Eastern, the first half as staff officers and the second half as corporate officers. The credited years of pension service, as of December 31, 1989, for Mr. Bakes was 2.2. Amounts shown in this chart are not subject to any Social Security offset.

Eastern has a compensation incentive program for the officers of Eastern, which program was suspended upon the filing by Eastern of its Chapter 11 petition. Under this compensation incentive program, officers of Eastern are eligible for annual incentive payments that are apportioned according to Eastern's profitability and performance against goals and the individual officer's performance against goals. There were no payments for 1989 under this compensation incentive program. Of the individuals in the Executive Officer Group, only Mr. Bakes is eligible to participate in this program.

Indebtedness of Management

The following table sets forth (i) the largest aggregate amount of indebtedness (by individual note) outstanding during the period from January 1, 1989 to January 31, 1990, and (ii) the outstanding indebtedness on each individual note as of January 31, 1990, of the members of the Executive Officer Group and directors of the Company who owe the Company or any of its subsidiaries in the aggregate in excess of \$60,000.

<u>Name and Position</u>	<u>Largest Amount of Indebtedness During Period 1/1/89 to 1/31/90</u>	<u>Amount of Indebtedness on 1/31/90</u>
Francisco A. Lorenzo Chairman of the Board, Chief Executive Officer, President and Director	\$ 350,000(1)	\$ 250,000
Robert D. Snedeker Executive Vice President, Treasurer and Director	69,350(2) 250,000(3)	— 200,000
Charles T. Goolsbee Senior Vice President, General Counsel and Secretary	1,610(2) 220,000(3) 25,000(4) 254,083(4)	— 185,000 — —
Robert R. Ferguson, III Vice President	103,500(5)	82,750
Phil Bakes President, Chief Executive Officer and Director of Eastern(a)	400,000(3) 108,000(6) 250,000(7) 200,000(8)	400,000 102,000 137,700 200,000
Richard E. Murray Chairman of the Board, Chief Executive Officer and Director of System One	25,000(9) 100,000(10)	5,000 100,000
D. Joseph Corr Chairman of the Board and Director of Continental(b)	1,543,750(11)	1,543,750

(a) Effective April 20, 1990, Mr. Bakes resigned as President and Chief Executive Officer of Eastern.

(b) Mr. Corr served as Chairman of the Board and Director of Continental from December 1988 to October 1989.

(1) This indebtedness was incurred in 1984 and 1985 principally in connection with the acquisition of stock and is evidenced by non-interest-bearing notes payable on demand.

(2) This indebtedness was incurred in connection with the exercise of stock options, bore interest at 9% per annum and was repaid in 1989.

(3) This indebtedness was incurred pursuant to the renewal of the executive's employment contract and is evidenced by a note bearing interest at 3% per annum maturing in 1995. Upon termination of employment (as defined), these notes must be collateralized. In addition, Mr. Bakes has the option, upon termination, to amend his note to bear interest at 12.5% per annum with a maturity date three years from such termination.

- (4) This indebtedness was incurred in 1989 in connection with relocation, was non-interest-bearing and was repaid upon the sale of his previous residence.
- (5) This indebtedness was incurred in 1986 in connection with the purchase from the Company of Jet Class A, bears interest at 7.32% per annum and matures in 1991.
- (6) This indebtedness was incurred in 1986 and 1987 in connection with relocation, bears interest at 6% per annum and matures in 1991.
- (7) This indebtedness was incurred in 1988, bears interest at 8.85% per annum and matures in 1993.
- (8) This indebtedness was incurred in 1989, bears interest at 8.85% and matures in 1993.
- (9) This indebtedness was incurred in 1988, is non-interest-bearing and will be forgiven upon involuntary termination or if he remains continuously employed by System One through March 1991.
- (10) This indebtedness was incurred in 1988 in connection with relocation, was non-interest-bearing through 1988, and at 9.01% thereafter, and is payable upon the sale of his previous residence.
- (11) This indebtedness was incurred in connection with the exercise of stock options, is secured by 130,000 shares of Common Stock purchased through the exercise of a stock option, is non-recourse, bears interest at 10.5% and matures in October 1990.

Certain Transactions

Prior to April 1, 1989, certain officers of Jet Capital (none of whom were officers of Texas Air) who performed services for Texas Air were treated as Texas Air employees. Texas Air billed Jet Capital on a monthly basis for the salaries, employee benefits and certain overhead expenses for the portion of time spent by these employees on Jet Capital business as well as for services provided by Texas Air employees to Jet Capital. During 1989, such charges from Texas Air to Jet Capital aggregated approximately \$146,000.

Beginning on February 1, 1989, Jet Capital agreed, at Texas Air's request, to provide financial advisory services to Texas Air for a monthly fee of \$35,000, including financial advice and assistance on purchase and sale transactions which Texas Air may propose or contemplate from time to time. If Jet Capital is retained for a specific transaction, Texas Air has agreed to pay Jet Capital an additional fee of up to 1% of the consideration paid or received by Texas Air, contingent upon successful completion of the proposed transaction and confirmation by the Affiliated Transactions Committee of the Texas Air Board of Directors.

Jet Capital acted as financial advisor and provided other assistance to Texas Air and Eastern in connection with Eastern's proposed sale of its Air Shuttle division. For such services, Jet Capital was paid fees aggregating \$1,050,000 in 1989. It is not contemplated that Jet Capital will be involved in any further transactions involving the disposition of Eastern assets.

During 1989, Texas Air guaranteed loans of certain executive officers of Texas Air or its subsidiaries in amounts aggregating approximately \$200,000, which guaranties expired in March 1989.

From time to time, the Company has made low or non-interest-bearing loans to various executive officers in the Executive Officer Group. Using Texas Air's average interest cost for borrowed money during 1989, Messrs. Carr, Lorenzo, Bakes, Snedeker, Murray and all individuals in the Executive Officer Group saved \$2,805, \$10,679, \$27,433, \$10,340, \$4,393, and \$75,149, respectively, with respect to such loans. (See "Indebtedness of Management.")

Certain Legal Proceedings

In February 1987, a person who alleges he is a stockholder of Texas Air filed an action in the Delaware Chancery Court, entitled Schreiber v. Bakes, et al., naming as defendants Texas Air, Jet Capital and certain present and former directors and officers of Texas Air (including Messrs. Carney, Garrett, Handmaker, Hickey, Lorenzo, McCormick, Pohlard, Snedeker and Wilson). The action

challenges, among other things, (i) certain sales by Texas Air of shares it owned of capital stock of Continental and New York Airlines, Inc. ("New York Air") (formerly a majority-owned subsidiary of Texas Air and now a wholly-owned subsidiary of Continental) and certain sales of shares by CCS Automation Systems, Inc. ("CCS"), a wholly-owned subsidiary of the Company at the time in question, to certain of the individual defendants, (ii) loans made by Texas Air in connection with the transactions described in clause (i) and the subsequent repurchase of such shares of New York Air and CCS by Texas Air at a profit to such individuals, (iii) certain other loans from Texas Air to the other defendants, and (iv) certain arrangements pursuant to which Texas Air made joint investments with Jet Capital. In August 1989, the plaintiff in this action amended his complaint to also challenge (i) Jet Capital's role as financial advisor to Texas Air and Eastern in connection with Eastern's sale of its Air Shuttle division, and (ii) an agreement between Jet Capital and Texas Air relating to general financial advisory services. The action charges, among other things, that such transactions were improper and lacked a legitimate business purpose and seeks an accounting to Texas Air from the other defendants. The defendants have advised Texas Air that they have valid and substantial defenses to these charges.

In July 1987, the Air Line Pilots Association ("ALPA") filed a complaint against Eastern in the United States District Court for the District of Columbia (the "D.C. District Court") alleging, among other things, that Eastern, acting in concert with Texas Air, has transferred routes, aircraft, and other assets to various other Texas Air subsidiaries in violation of the Railway Labor Act (the "RLA"). The complaint seeks unspecified money damages and, among other things, an injunction directing Eastern to take all action necessary to restore the parties to their respective positions prior to the alleged unlawful conduct. In February and March 1988, the Transport Workers Union of America (the "TWU") and the International Association of Machinists and Aerospace Workers (the "IAM"), respectively, filed similar actions in the D.C. District Court. These actions have been consolidated with the ALPA action described above. The action by the IAM also includes, among others, Messrs. Lorenzo, Pohlada, Snedeker and Wilson, Texas Air, Jet Capital and System One as defendants. The defendants have filed a motion to dismiss the ALPA complaint or, in the alternative, for summary judgment with respect thereto, and have filed a motion to dismiss the IAM complaint.

A shareholder derivative action, entitled Gioia v. Texas Air Corporation, et al., was filed in the Delaware Chancery Court in December 1987, against, among others, Texas Air, Jet Capital, Messrs. Lorenzo, Pohlada, Snedeker and Wilson. The lawsuit, brought by a holder of several series of Eastern preferred stock, but funded by ALPA, alleges breach of fiduciary duty of loyalty, waste of corporate assets and breach of Eastern's Certificate of Incorporation. Plaintiff seeks, among other things, (1) an order (i) temporarily restraining defendants from causing Eastern to transfer any assets to Texas Air or any of its subsidiaries; and (ii) rescinding the sale by Eastern of two computer subsidiaries, and (2) unspecified damages and costs, including reasonable attorneys' fees. The defendants moved to dismiss the complaint and plaintiffs filed a motion for a preliminary injunction. In June 1989, the defendants removed the suit to the United States District Court for the District of Delaware.

In May 1988, Eastern and Texas Air filed a suit in the United States District Court for the Southern District of Florida (the "Florida District Court") against, among others, ALPA and the IAM alleging that the defendants violated the Racketeer Influenced and Corrupt Organizations Act ("RICO"), the comparable Florida state statute, and various aspects of Florida common law by engaging in a concerted plan to so damage Eastern that Texas Air would be forced to sell Eastern to ALPA and the IAM at a bargain price. The suit seeks, among other things, \$1.5 billion in damages and an injunction against certain conduct. In July 1989, the Florida District Court denied the defendants' motion to dismiss, although the defendants subsequently filed a renewed motion to dismiss based in part on constitutional grounds. In September 1989, the defendants filed their answers and asserted counterclaims against Texas Air and Eastern and named Continental, Jet Capital and, among others, Mr. Lorenzo as additional counterclaim defendants. The counterclaim alleges that the named parties participated in acts of mail and wire fraud, extortion and securities fraud and defamed them through statements made to Continental and Eastern employees and others. The counterclaims seek unspecified compensatory and consequential damages, treble damages pursuant to RICO and Florida state law, punitive damages, and attorneys' fees. Texas Air and the other defendants, except Eastern,

which has not been served, filed motions to dismiss the counterclaims, which motions are pending. In October 1989, ALPA and the IAM filed motions in the Bankruptcy Court to lift the automatic stay as to their counterclaims against Eastern. In November 1989, Eastern opposed these motions and filed an adversary complaint in the Bankruptcy Court to enter a stay to enjoin prosecution of the Unions' counterclaims against Eastern's counterclaim co-defendants. All motions are pending.

In March 1989, a case entitled Copeland v. Eastern Air Lines, et al. was filed in the New York State Supreme Court, County of New York, against Eastern, Texas Air, Jet Capital, System One and Continental. The complaint alleges that various transactions between Eastern and its affiliates constitute avoidable conveyances under the New York Debtor and Creditor law. Plaintiffs request (i) setting aside such conveyances and transfers and appointing a receiver to take charge of such property, (ii) an injunction restraining Eastern from engaging further in such transfers, (iii) an injunction restraining the non-Eastern defendants from further conveyances of such property acquired from Eastern, and (iv) damages and costs. In May 1989, the case was removed to the Bankruptcy Court. In November 1989, the Bankruptcy Court, with the consent of the parties, permitted the plaintiff to amend his complaint, among other things, to add ALPA as a plaintiff. In December 1989, Eastern filed a motion to dismiss the complaint. In January 1990, the Bankruptcy Court, without deciding Eastern's motion, enjoined further prosecution of the case until April 30, 1990.

RATIFICATION OF APPOINTMENT OF ACCOUNTANTS

(Proposal 4 on the Proxy Card)

Subject to stockholder ratification, the Company's Board of Directors, upon recommendation of the Audit Committee, has reappointed the firm of Arthur Andersen & Co., independent public accountants, to make an audit of the consolidated financial statements of the Company for the year 1990. Arthur Andersen & Co. has served as independent public accountants for many years. The Board recommends that the Company's stockholders vote "FOR" said ratification. If the stockholders do not ratify this appointment, other certified public accountants will be appointed by the Board upon recommendations of the Audit Committee.

One or more members of Arthur Andersen & Co. are expected to be present at the Meeting with the opportunity to make a statement if they so desire and will be available to respond to appropriate questions.

Vote Required for Ratification of Appointment of Accountants

The favorable vote of a majority of the combined voting power of the Common Stock, Class A Common Stock, 6.50% Preferred Stock and 12% Preferred Stock, voted in person or by proxy at the Meeting, is necessary to ratify the appointment of the independent public accountants.

THE DIRECTORS RECOMMEND A VOTE "FOR" PROPOSAL 4.

Proxies will be so voted unless a contrary indication is made.

STOCKHOLDER'S PROPOSAL

(Proposal 5 on the Proxy Card)

Mr. Michael Schaefer, 1150 Silverado, Suite 111, La Jolla, CA 92037, owner of the required number of shares of both preferred and Common Stock, has informed the Company that he intends to introduce the following resolution at the meeting:

RESOLVED: "That shareholders assembled in person and by proxy urge the Board of Directors to take such action as necessary to establish as company policy the providing of roundtrip air transportation at the lowest fare rate quoted to the public for advance purchase with specified stayover to any shareholder wishing to attend the Annual Meeting of our Corporation, said tickets to be paid for by the shareholder by direct arrangements with the company or its subsidiaries, or through a travel agent, but the shareholder to be exempt from any stayover requirement and not be subject to advance purchase of more than 15 days."

Mr. Schaefer has submitted the following statement in support of his resolution:

"It is in our company's best interest that as many shareholders as possible be able to attend and participate or observe the conduct of our annual stockholders session. Unless meetings are scheduled for Friday or Sunday, the Saturday-night Stayover required for "supersaver" rates is an artificial burden to stockholders. Texas Air Corporation meetings are generally mid-week. Since proxy material forwarded by brokers arrive sometimes only 20 days prior to a meeting, a 15 day advance booking requirement is all that should be required.

The expense to the corporation would be nominal, and the travel by shareholders might prove profitable, if such additional business fills seats that would otherwise be unsold.

Without advance reservation and without weekend stayover, travel from the east or west coast to Houston, Texas, coach class, would cost almost \$1,000 total, roundtrip. Supersaver rates start at \$198 roundtrip. Shareholders should have access to the supersaver rate of \$198, or whatever is currently being marketed, on a space available basis. Such policy would encourage shareholder participation in their investment, and would attract many new investors to Texas Air Corporation. And permit current stockholders to get acquainted (sic) with our service."

"If you AGREE, please mark your proxy FOR this resolution."

Recommendation by the Board of Directors

The Board of Directors of the Company recommends that this stockholder's proposal not be approved. The Board believes that the administrative burden that would be required to effectuate such policy far outweighs any benefit to stockholders. Stockholders who are unable to attend the Annual Meeting are afforded an opportunity to exercise their full voting rights by virtue of this proxy solicitation. In addition, in an effort to enable stockholders to attend the Annual Meeting, the Company has endeavored to hold its Annual Meeting in different areas of the country each year, to the extent practicable. In the last five years, the meetings have been held in Houston, Texas, New York City, New York, Los Angeles, California and Denver, Colorado. The Company also notifies the American Stock Exchange (which notifies brokers) of the meeting date in advance of the date of the distribution of its Proxy Statement, and endeavors to send out its Proxy Statement as much in advance of the Annual Meeting as possible. Requiring the Company to provide such air transportation benefits to stockholders is unduly burdensome to administer, including problems in determining at the time of booking a reservation, whether a person is a stockholder of record and in verifying that only stockholders use the tickets and that such stockholders attend the meeting. Accordingly, the Board of Directors believes adoption of this stockholder's proposal is not necessary to afford stockholders an opportunity to attend the Annual Meeting, and would be unduly burdensome on the Company and its subsidiaries to administer.

THE DIRECTORS RECOMMEND A VOTE "AGAINST" PROPOSAL 5.

Proxies will be so voted unless a contrary indication is made.

STOCKHOLDER'S PROPOSAL

(Proposal 6 on the Proxy Card)

Mrs. Evelyn Y. Davis, The Watergate Office Building, Suite 215, 2600 Virginia Avenue, N.W., Washington, D.C. 20037, owner of 250 shares of Common Stock, has informed the Company that she intends to introduce the following resolution at the Meeting:

RESOLVED: "That the shareholders recommend that the Board take the necessary step that Texas Air Corporation specifically identify by name and corporate title in all future proxy statements those executive officers, not otherwise identified, who are contractually entitled to receive in excess of \$100,000 annually as a base salary, together with whatever other additional compensation bonuses and other cash payments were due them."

Mrs. Davis has submitted the following statement in support of her resolution:

"In support of such proposed Resolution it is clear that the shareholders have a right to comprehensively evaluate the management in the manner in which the Corporation is being operated and its resources utilized." "At present only a few of the most senior executive officers are so identified, and not the many other senior executive officers who should contribute to the ultimate success of the Corporation." "Through such additional identification the shareholders will then be provided an opportunity to better evaluate the soundness and efficacy of the overall management."

"If you AGREE, please mark your proxy FOR this resolution."

Recommendation by the Board of Directors

The Board of Directors of the Company recommends that this stockholder's proposal not be approved. The Board does not believe it is in the best interests of the Company to require management to disclose the information requested by Mrs. Davis. The Company already is subject to and fully complies with the comprehensive informational and reporting requirements of the Securities Exchange Act of 1934 and the rules and regulations thereunder, including disclosure with respect to the five most highly compensated executive officers and the aggregate compensation of all executive officers as a group. The Board believes that any benefit to stockholders from receiving information relating to the breakdown of salaries in the Executive Officer Group, other than for the five most highly compensated executive officers, is far outweighed by the potential harm to the Company and such executive officers of disclosure of this confidential and highly sensitive business information. The Board further believes that such disclosure would not be material to the Company's stockholders.

THE DIRECTORS RECOMMEND A VOTE "AGAINST" PROPOSAL 6.

Proxies will be so voted unless a contrary indication is made.

OTHER MATTERS

The Company is not aware that any matters other than those mentioned above will be presented for action at the Meeting. If any other matters do properly come before the Meeting, the persons named as proxies will vote upon such matters in accordance with their best judgment.

Pursuant to the Bylaws of the Company, nominations for the election of directors may be made by the Board of Directors. In addition, any stockholder entitled to vote for the election of directors may nominate person(s) for election to the Board of Directors if such stockholder delivers written notice of his intention to make such nomination. Such notice must be delivered to or mailed, postage prepaid, and received by the Secretary of the Company at 333 Clay Street, Suite 4040, Houston, Texas

77002, not later than 90 days prior to the anniversary date of the immediately preceding annual Meeting, provided, that if the Annual Meeting is to be held more than 30 days before or after the anniversary date of the immediately preceding Annual Meeting, or if a special meeting is to be held such notice must be delivered or received not later than the close of business on the 10th day following the first public disclosure by the Company of the date of such meeting. Each such notice shall state: (A) the name and address of the stockholder who intends to make the nomination and of the person(s) to be nominated; (B) a representation that the stockholder is a holder of record of stock entitled to vote at such meeting (or if the record date for such meeting is subsequent to the date required for notice, a representation that the stockholder is a holder of record at the time of such notice and intends to be a holder of record on the record date for such meeting), the number and class of shares so held, and that the stockholder intends to appear in person or by proxy at the meeting to nominate the person(s) specified in the notice; (C) a description of all arrangements or understandings between the stockholder and each nominee and any other person(s) (naming such person(s)) pursuant to which the nomination(s) are to be made; (D) such other information regarding each nominee as would have been required to be included in a proxy statement filed pursuant to the proxy rules of the Securities and Exchange Commission had each nominee been nominated, or intended to be nominated, by the Board of Directors; and (E) the consent of each nominee to serve as a director of the Company if so elected.

The Bylaws of the Company also provide that a stockholder entitled to vote thereon may bring business before any Annual Meeting if written notice of such stockholder's intention to bring such business before the Annual Meeting is delivered to, or mailed, postage prepaid, and received by, the Secretary of the Company at the address specified above within the time period described above. Each such notice shall state: (A) a brief description of the business desired to be brought before the meeting and the reasons for conducting such business at the meeting; (B) the name and address of the stockholder who intends to propose such business; (C) a representation that the stockholder is a holder of record of stock of the Company entitled to vote at such meeting (or if the record date for such meeting is subsequent to the date required for such stockholder notice, a representation that the stockholder is a holder of record at the time of such notice and intends to be a holder of record on the record date for such meeting), the number and class of shares so held, and that the stockholder intends to appear in person or by proxy at such meeting to propose such business; and (D) any material interest of the stockholder in such business.

A copy of the Bylaws of the Company is available by written request to the Secretary of the Company at the above address or by oral request at (713) 658-9588.

DATE FOR STOCKHOLDER PROPOSALS

Written proposals from stockholders must be received at the address of the Company set forth on the Notice of the Company's Annual Meeting of Stockholders by January 4, 1991, for consideration for inclusion in the proxy material for the Annual Meeting of Stockholders to be held in 1991.

AVAILABILITY OF THE COMPANY'S ANNUAL REPORT ON FORM 10-K

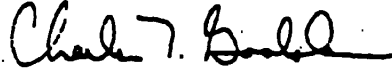
Upon receipt of written requests from holders of the Company's securities on the Record Date, the Company will furnish without charge to each such stockholder a copy of the Company's Annual Report on Form 10-K, including financial statements and any schedules thereto, required to be filed with the Securities and Exchange Commission for the year 1989. Such written requests should be addressed to:

Mr. Charles T. Goolsbee
Senior Vice President, General
Counsel and Secretary
Texas Air Corporation
333 Clay Street, Suite 4040
Houston, Texas 77002

Requests from beneficial owners of the Company's securities must include a good faith representation that, as of April 13, 1990, the person making the request was a beneficial owner of securities entitled to be voted at the Company's Annual Meeting of Stockholders.

If you do not plan to attend the Meeting in person, please complete, sign, date and return the enclosed proxy card promptly.

TEXAS AIR CORPORATION



CHARLES T. GOOLSBEE
Secretary

Houston, Texas
May 7, 1990