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THE DECLINE OF SUPPLEMENTAL
AIR CARRIERS IN THE UNITED STATES

HEARINGS
BEFORE THE
SUBCOMMITTEE ON MONOPOLY
OF THE
SELECT COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
NINETY-FOURTH CONGRESS
SECOND SESSION
ON
THE DECLINE OF SUPPLEMENTAL AIR CARRIERS
IN THE UNITED STATES

PART 1

OCTOBER 6, 7, AND 8, 1976



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flights during the next 6 months began to delay making scheduled cash deposits and firm commitments for charters. Normally, from February through May is a time of substantial customer deposit buildup against future passenger charters. These deposit monies were relied upon in Universal's forecasts to provide for repayment of current obligations.

As President of Universal I found it necessary to spend virtually the latter half of February and first half of March in Washington seeking to explain Universal's delicate position to Federal agencies, the White House, and interested members of Congress in the desperate hope that our appeal would be given favorable consideration from what can only be described as a death dealing decision by the C. A. B.

Unfortunately, the above efforts took time and Universal simply did not have the liquidity to survive the rapidly escalating and compounding events which led the company to suspend operations on May 4, 1972. One day later the C. A. B., as a result of the President directing that Universal be given renewed transatlantic authority, announced that all 6 transatlantic supplemental carriers would have their transatlantic certificates renewed.

Senator ABOUREZK. The next witness is Mr. Robert Rousselot, Grey Oaks Ranch, Wagoner, Okla., formerly vice president of Civil Air Transport, formerly president of Continental Air Services, and formerly assistant to the president of Continental Airlines.

Is Mr. Rousselot here?

If Mr. Rousselot is not here, I know Mr. Fletcher Prouty is probably here.

We will take your testimony now, Mr. Prouty.

Mr. Prouty, you have been sworn, and I see you have quite a long statement.

Are you able to summarize that, or is it necessary to read the statement?

Mr. PROUTY. I think I would like to read it. I will move right through with it.

Senator ABOUREZK. All right.

You may proceed.

TESTIMONY OF FLETCHER PROUTY, 4201 PEACHTREE PLACE, ALEXANDRIA, VA. 22304, FORMERLY MILITARY OFFICER, RESPONSIBLE FOR LIAISON AND SUPPORT ARRANGEMENTS BETWEEN THE AIR FORCE, LATER THE DEPARTMENT OF DEFENSE, AND THE CENTRAL INTELLIGENCE AGENCY

Mr. PROUTY. Thank you, Mr. Chairman.

I would like to explain too that this is a summary more or less of a certain period of experiences I had with the Defense Department for over 20 years.

The last 9 years of those I was in the Pentagon, essentially the responsible officer for the duties I am talking about.

Primarily they were in connection with the military support of certain activities of the CIA.

It is important to keep in mind, during all of those years, and I presume it is true today, that clandestine activities of the U.S. Government must always be carried out in such a way that the Government may disclaim plausibly its actions.

When anyone carries anything out with that purpose ahead of time that he may have to explain plausibly what he is doing. This becomes a euphemism for what you and I might call "being prepared to tell a lie." So many of the things done in this period were done in such a way that they have become rather obscure. It would be my attempt today to speak about this area of operation, which affects many small airlines, many large airlines, and as a matter of fact, manufacturing companies as well as airlines. It was done in this manner, so they need a bit of explanation.

An understanding of the role of the CIA and of its numerous proprietary companies cannot be obtained from a simple study of those proprietaries alone.

The CIA's proprietaries are deeply involved with the Department of Defense. They are involved with other departments of the Government, and they are involved with many other governments.

In some cases the relationship is very complex. The CIA may have a military unit which is a cover unit and that unit may deal

with a proprietary which in turn will deal with some legitimate company. The legitimate company will think that it is dealing with a private firm or with the DOD directly where a military contract is involved.

In another case a CIA proprietary may gain a contract from the DOD and will utilize that contract to service the military and at the same time to service other companies. In so doing the private companies will not know that they are dealing with the CIA and not the DOD.

In another case a CIA proprietary may use its CIA connection to get something from the DOD which other companies could not get, thereby gaining a competitive advantage over the others. In so doing this device may be used intentionally or unintentionally to destroy the competition.

And then in certain rare cases, but in some most important cases, an outside company may learn that it has been outbid by a proprietary. It may learn this through its own devices and contacts or it may acquire such knowledge from a lawyer who has had special knowledge of such activity. In that case it may inform the DOD that if it does not get an equal or better contract it will blow the whistle. This type of "national security" blackmail is most effective. The outside company will get a contract and then may continue to use that kind of blackmail year after year.

CIA's proprietary business is very large. Some of its proprietaries' activities are concealed deeply within major companies, which cover for the CIA and in return get favors and inside assistance.

This could well be the subject of a complete study. Even beyond the search into proprietaries the study could look at what the CIA does with the rather large sums of money which it earns from these proprietaries.

The CIA uses a "street" name and buys and sells as other big investors do to manage these vast funds. The street name most commonly associated with the CIA is "Suydam."

Funds of this nature are of course not Federal funds and are not subject to the usual controls. Huge sums arise from the sale of proprietaries. We do not know where they go, nor do we know if the sale means a bona fide separation from the CIA or just another cover arrangement.

The CIA depends upon some of these funds for "laundered" money. Few people have ever had a real opportunity to understand how the CIA utilizes money. The CIA gets "what money will buy" many times without the actual expenditure of funds. It makes liberal use of the provisions of the National Economy Act of 1932 as amended in order to acquire goods and services from other agencies at no cost or at nominal cost. The "horizontal" movement of money where the CIA is involved is a little known specialty.

In order to provide some background for all of this it may be well worthwhile to provide some background about the DOD/CIA relationship and its role within the Government, industry and foreign affairs. It is a rather formal arrangement.

Before 1955, the U.S. Air Force had a policy for providing support of the clandestine activities of the CIA; but it was relatively informal. It was based upon a policy of providing support to each

In August of 1955, I was directed by the director of plans, Headquarters USAF to assemble all pertinent files and records and to draft a formal set of policy papers for the special support of the clandestine activity of the CIA. I had participated in clandestine activities, of a minor nature, during World War II and was involved in certain activities in Saudi Arabia, Russia, Turkey and had been at the Cairo and Teheran Conference. During the Korean war period I was the commander of the air transport unit which was responsible for certain operations throughout South Asia among them providing support for the CIA in India, Thailand, Vietnam, the Philippines, and Okinawa. I had background for this special work before 1955.

I was able to assemble a rather voluminous file dating from 1946 and 1947 through 1955. Some of these papers were in the handwriting of General Vandenberg who had been Chief of Staff of the Air Force and who had been the Director of the Central Intelligence Group before the creation of the CIA. In other words, there is a lot of this that was done with personal papers, because there were rarely many copies. Other papers were the original NSCID's dating back to the forties and by far the most important paper was the report to President Truman on the CIA, dated January 1, 1949, made by Allen W. Dulles, William H. Jackson, and Mathias Correa. Later directives were some in the handwriting of President Eisenhower.

One of the most pertinent of these papers was a long letter directive signed by the then Secretary of Defense Louis Johnson, in 1949 which established DOD policy for the operational and logistics support of the clandestine activity of the CIA.

Please note this use of words is to differentiate the clandestine operations of the CIA from its Intelligence mission which was not given this special status. The principal point of the Johnson directive was the DOD would do everything possible to support the CIA, but only after it has been ascertained without doubt that approval for each project had been granted by the NSC, and then only after the CIA had agreed to reimburse the DOD for all out-of-pocket costs incident to such support. It also authorized elaborate personnel support of the CIA on an assigned and attached basis.

National policy required that no clandestine operation would ever be undertaken which could not be plausibly disclaimed by the U.S. Government in the event of failure or compromise. As a result all clandestine operations were designed to be small, very closely held and whenever possible, one-time.

Needless to say, although my visible role was to provide military support for the clandestine operations of the CIA, my real role was to keep the military informed of what was being done in this rarified atmosphere, its cost and to emphasize this requirement for the ability to plausibly disclaim any operation which involved military support—at all times.

With all of this material and with the assistance of selected officials I was able to prepare a draft for support activities which was ready for air staff coordination. The report was about 50- to 60-pages in length and was coded TAB-6. It was coordinated throughout the Air Force in the States and overseas and, in addition to each

TAB-6 matters. Gen. Thomas D. White was Chief of Staff of the USAF at that time and my boss was Gen. Richard Lindsay.

When the Air Force policy had been made official, it was arranged for me to meet with Allen Dulles and his deputy, Gen. C. P. Cabell. They arranged for me to have a very thorough and continuing briefing on all CIA matters involved. The CIA was pleased with this policy and Mr. Dulles suggested that there be a single focal point office on the air staff. This was my office, and I was its chief from 1955 through 1960.

In 1956, Allen Dulles arranged for me to travel around the world to visit a considerable number of his overseas offices in the company of one of his officials. This was my first official visit to a number of these places, and I went back to many of them during the next 8 years.

In 1960, at the request of the Secretary of Defense, Thomas Gates, I was transferred from the Air Force to the Office of Special Operations. This senior office was responsible for all contact between the CIA and DOD, among other things. At that level I performed much the same duties and functions there as I had done in the Air Force, only then it was for all services.

After the Kennedy inauguration I continued to work in the office of the Secretary of Defense, Bob McNumara, for about a year until Gen. Earle Wheeler, who was then the Director of the Joint Staff, suggested that the military support of the CIA might best be placed on the Joint Staff level. This request was granted and in 1962, I was transferred to the Joint Staff and provided with a Navy and Army counterpart along with secretarial assistance. My first duty there was to draw up a Joint Staff policy paper very much like the one which I had created for the Air Force. This was done, and it was approved by the Chiefs of Staff and officially "Red Striped". An office similar to mine in the Joint Staff was established in most major commands overseas and in the Army, Navy, and Air Force.

In the 9 years which this period spanned many of the things which have now become quite well known as "CIA activities", meaning clandestine operations rather than intelligence chores, took place. For example, the very first meeting which I attended with CIA officials in 1955, involved the origins of the vast P2V-7 program which became a worldwide ELINT, radar and surveillance project. The Indonesian project, Tibetan programs, and the Bay of Pigs program and many others all got their first military support from my office.

Gradually a system developed which resulted in the DOD being—in effect—a proprietary partner of the CIA. This became a particularly important activity. For example, private companies which did business with these "military" units thought they were dealing with the military when in reality they were dealing with the CIA. In some cases this led to major contracts and in certain cases these contracts were let without the customary and required bidding or amending procedures normal to the DOD system.

Of course, in keeping with the old directive promulgated by Secretary Johnson and updated thereafter, the military sought reimbursement for all funds expended. But in some cases due to security

precautions they did not know what had taken place and in others they could not take action without exposing the CIA. Some competitive, nonproprietary companies learned about this system and took advantage of it. They used this quiet undercover relationship for leverage. As small companies learned this, larger ones did and this got to be quite widespread and led to a most unique method of procurement.

In another twist of this process the CIA would put its own agents into "military" units and in some cases would have them recalled to active duty so that they could serve in uniform with rank. Then the CIA would ask the Defense Department to reassign these people to other jobs with other Federal departments and agencies or even out into industry. Obviously the gaining organization did not know that the DOD was serving as a proprietary of the CIA.

This led to many complicated situations especially when a CIA agent, wearing the uniform of the Armed Forces was given a responsible job in the FAA or other such policymaking organization. This got even more deep-rooted after the original deep cover assignee was replaced and another took his place. By that time no one would know that the original slot had been created for the CIA and the new incumbent would be completely unidentifiable to anyone as a CIA agent.

This required elaborate money arrangements which my office was responsible for arranging. The salary such persons drew from the military would be blanked and the man would turn in his military check. He would be paid by the CIA and the military would be reimbursed—on paper to keep the record clear. Then it became more complicated when the individual would travel on military orders and incur expenses against the DOD all over the world.

In many cases we would keep three files: The individual's, his CIA file and his military file. We would do our best to keep them all up to date and to plug the holes. With all this activity it was inevitable that my office would become increasingly involved in the CIA proprietary program. We handled hundreds of contacts with companies of all kinds, with aircraft companies, with airlines, with maintenance organizations, with brokers and universities, with subcontractors and with innumerable small deals of every kind.

Out of all this came the "Air America" enterprises. (Air America will be used here generically.) Actually there is a whole hierarchy of companies under the Pacific Corp. and other arrangements.

(I am speaking about 1964, when I was in this work actively. What happened after that, I only know from picking it up.)

Air America is not unknown, yet there are perhaps no more than two or three people who really know how extensive what we shall call "Air America" is and how far-reaching its activity. At one time we had records in my office, and I am sure they were not comprehensive, of more than 100 organizations which were in some way or other related to Air America. It may be said that Air America, in total was one of the largest airlines and air support organizations in the world. At one time Air America had two base facilities in the Far East which had more than 4,000 men on each one. Can any other airline say that?

There are Air America affiliates all over the world. Air America works in Europe, the Far East and the Middle East. Air America crews and aircraft played a significant role in the Bay of Pigs program and in such things as the Indonesian and Tibetan projects.

Air America had the capability to maintain aircraft of all kinds and more than that it could make aircraft parts for most of its own aircraft. It had the design drawings required to make all parts of such aircraft as DC-6's. It could build complete aircraft in order that it could create a totally sanitized airplane with no serial numbers, anywhere in its entire structure—not just the tail number, for operational purposes.

Air America was an elaborate corporation. The best in its business in the world. It would surprise this committee to have a listing of how Air America acquired all of its aircraft and then for this committee to be able to go over that sanitized list to find out how Air America actually obtained its aircraft and its other capital assets.

It is significant to point out that these advantages which accrued to Air America gave it an enviable competitive edge in the airline, air maintenance and even in the manufacturing and subcomponent business among its peers.

There came a time when the Pacific Corp., Air America's gilt-edged parent, was being formed that the CIA wanted to regularize and formalize many of its activities. One of the things they were greatly interested in was the process of bidding for military contracts both airlift and maintenance. The president of Air America and I worked together for quite a period of time on the draft of an important letter which was to be signed by Allen Dulles and addressed to the Secretary of the Air Force with the suggestion that Air America be informed of every request for bid for either airlift or air maintenance contracts and that Air America be carefully considered when such bids were being awarded. We were careful, on both sides, to see that the letter was not a firm commitment and the Air Force was careful to see that no explicit commitment was informed.

After careful preparation the letter was signed by Allen Dulles and delivered to the Secretary via the Office of the Deputy Assistant Secretary for Civil Aviation. It should be noted that the Office of that official was Pentagon room number 4E871, and that the Office of the Secretary of the Air Force is also listed as 4E871. No other such official had the same room number as the Secretary. Actually that room was the Office of the Secretary's receptionist and was physically across the hall from the Secretary. It is interesting to note it had the same number. It also happened that the incumbent of that office at that time was an official of the CIA.

Because I had worked on the development of this letter I was directed to prepare a reply for the Secretary's signature. In general the Secretary agreed with the suggestion from Allen Dulles and agreed that the Air Force would provide the CIA's proprietaries with ontime information requisite to bidding on such contracts.

Air America and other proprietaries received many important airlift and aircraft maintenance contracts even at a time when this

meant omitting other small carriers from contracts which they might otherwise have expected to win. With the fulfillment of these contracts the CIA was able to make use of such flights for its own operational purposes and more importantly to give the appearance that Air America was a healthy and normal hard-working airline among its competition. In the Far East this close relationship blossomed into the period of the Vietnam war when Air America and its numberless affiliates received tremendous contracts involving them in all aspects of the war.

But it was not always that way and on one conspicuous occasion our letter of agreement with Allen Dulles caused the Air Force some grief. During that particular period airlift contracts had reached a low ebb and there were very few up for bid in the Far East. In spite of this Air America won its bid. This caused some bitter complaints from the others. One in particular came to the Pentagon and requested a discussion with the Secretary. Failing success with that ploy the next step was to visit the law offices of a prominent firm across the river. Not long after that they both returned and some sort of agreement was reached. The nonwinner obtained a contract for some airlift. This success did not go unnoticed nor did that device see its last implementation in the Pentagon. Like blackmail, it was so good it had to be repeated. Such were the vagaries of this type of under-the-cloak dealing.

I continued this unusual work which had begun in 1955 until December 31, 1963.

I had served through these formative years of the CIA under Allen Dulles and John McCone. I worked rather closely with Tom Gates and Bob McNamara and their immediate staffs. Many of the imponderables which we are trying to unravel and to understand today had their beginnings during that period. It is quite futile to attempt such probing around in the quagmire of that period, especially since it was a major part of the profession to obfuscate everything and everywhere as a matter of expertise. Men who might truthfully swear that they took part in such and such a mission might be wrong because they would have had no way of knowing that the part of the mission they worked with was only the umbrella portion and that the men they trained and launched never were intended to go anywhere anyhow. Even some who served with military units never knew that their units were really false, and they were simply maintaining helicopters or keeping records for the CIA.

But there is a way to get to a full understanding of all of these things. The law of this country spells out in fine detail the duties and responsibilities of the CIA. All that is necessary is to ask the CIA what it has done in accordance with the law—a law which is ultimately uncomplicated for one who reads it with skill and care. And next it is simple to arrange with the CIA that it will be funded explicitly each year to do certain things of importance for this Government and its welfare and that there will be money for those things and nothing else. That is the way these things can be operated. We did that in the DOD for those 9 years, and we knew what was going on. We ate a little crow from time to time; but at least we knew where the crow came from and whose it was.

I thank you.

Senator ABOUREZK. Thank you.

I understand from your testimony that a major part of Air America was CIA activity, and that the airline industry was faced with this airline being in existence for whatever purpose they wanted it for. But Air America also expanded into the bidding on what would otherwise have been competitive contracts for both airlift and maintenance, in competition with privately owned airlines. Is that correct?

Mr. PROUTY. That is correct.

Senator ABOUREZK. Where did this competition take place? Was it within the United States or externally?

Mr. PROUTY. During the period of time I can speak for, it was generally within the Pacific.

For instance, contracts for flights between Tokyo and Guam with a probable landing at Saipan, Okinawa, Korea, Thailand, the Philippines, that area, maybe into Bangkok.

Senator ABOUREZK. Well, did those particular routes have anything to do with what is now very famously known as national security interests, or were they just plain flights the CIA wanted to be in and kind of control the route structure?

Mr. PROUTY. The primary purpose of these flights was to provide support of military units, but the Agency had units in some of these places. Thus they could move people and move equipment there on their own, because the flight was there. The contract, to go back to the basic question, was to support military requirements, but the Agency would use the contract for the flights of the planes for its own cover.

For example, if there was a flight every other day between Tokyo and Guam, there was nothing to preclude the Agency from adding a flight of its own that would stop at Saipan, so that it would appear to be a regular airlift flight, but they would get their own operations taken care of.

Senator ABOUREZK. At that time the ostensible policy of the U.S. Government was to let bids to private air carriers on those kinds of flights?

Mr. PROUTY. Yes, sir; they were all listed for bid.

Senator ABOUREZK. And in spite of that policy, the Department of Defense—and presumably the CAB—was not involved at all in that?

Mr. PROUTY. Sir, I can only speak for the Defense Department.

Senator ABOUREZK. Then presumably the Department of Defense thwarted its own policy of competitive bidding to hand over a bid to the CIA-operated airline in opposition to the principles of competition that they espoused?

Mr. PROUTY. They tried to the fullest extent to go right ahead with the normal process, but Air America would always get a contract.

Senator ABOUREZK. That was because of a private arrangement between the CIA and the military people who were letting those bids?

Mr. PROUTY. Yes.

Senator ABOUREZK. Now, you spoke at one point in your testimony of the losers in a bidding operation of that type, in a loss to Air America, complaining, and then coming back and getting some kind of an award?

Mr. PROUTY. Most of the operators knew that Air America had more than a commercial life, and there was a period I would estimate, 1958 or 1959 (I might miss by a few months or so), when there were few contracts, the Defense Department had cut things back, and competition got pretty heavy.

As a result, when the awards were made, the feelings ran pretty high, and one of the losers, I know in particular, came immediately to the Pentagon.

Senator ABOUREZK. Which loser was that?

Mr. PROUTY. World Airways.

Senator ABOUREZK. And that was in what year?

Mr. PROUTY. I wish I could put my finger on it.

I will have to say in the general area of 1959, sir, came into the Pentagon, and asked for a meeting with the Secretary of the Air Force.

I believe he had a meeting, but it was brief, and he did not seem satisfied.

Senator ABOUREZK. Who represented World Airways?

Mr. PROUTY. Well, the person representing World Airways was a man named Daly.¹

Senator ABOUREZK. He is in fact the owner of World Airways?

Mr. PROUTY. I have learned that since.

Senator ABOUREZK. Who was the Secretary of the Air Force then?

Mr. PROUTY. Mr. Talbot.²

Senator ABOUREZK. All right.

So they had a meeting?

Mr. PROUTY. It is a matter of record.

Senator ABOUREZK. We will not hold you to that. It has been a long time ago.

Mr. PROUTY. I have a record here if I could be of help to you.

Senator ABOUREZK. Go ahead about the meeting.

Mr. PROUTY. Well, the man came out and figured he needed a lawyer, went into town, and employed a lawyer, Mr. Zuckert.³ The lawyer that worked for him was Coates Lear.

Senator ABOUREZK. Mr. Zuckert was in a private law firm at that time?

Mr. PROUTY. Yes, sir.

Senator ABOUREZK. Had he ever been an official in the Defense Department?

Mr. PROUTY. I believe in prior years Mr. Zuckert had been an Assistant Secretary, U.S. Air Force.

Senator ABOUREZK. And then what happened?

Mr. PROUTY. He got a contract.

¹ On Nov. 5, 1976, Mr. Edward J. Daly, chairman of the board and president of World Airways, Inc., responded to this testimony by letter and attachments, which will be found at page 381, *infra*.—Committee editor.

² Mr. Prouty subsequently submitted the following notation in his edited testimony: "Note.—This is incorrect. The correct name may be Dudley Sharp or James Douglas."—Committee editor.

³ On Nov. 4, 1976, Mr. Eugene M. Zuckert responded to this testimony by letter. —which will be found at page 379, *infra*.—Committee editor.

Senator ABUREZK. After he hired Zuckert's law firm?

Mr. PROUTY. He came back, and he had a meeting, again with the Secretary of the Air Force, and shortly after that we learned that World Airways had a contract, and World Airways continued to get contracts. They did not get the contract at a loss to anybody else. They got a contract that was awarded to them. Not being with the procurement business, and since World Airways was not with the CIA, this is something that I learned about. We were concerned about this agreement with the Agency, and the effect it would have on Air Force contracts, so we were advised to be extremely careful about contracting after that. The general working knowledge was that the World Airways case broke the system that had been going on for years.

Senator ABUREZK. Now, to your knowledge did any other losers in the CIA bidding process get contracts in a similar manner?

Mr. PROUTY. You know, to my general knowledge, yes, because they did it either in a similar manner, or by beginning to employ the services of people who were familiar with Air America's activities, and they, therefore, had a little more knowledge about how this was done.

There again, would have to be developed further than I would know, because I was not on the procurement side of things, but other companies did get contracts, and especially toward the Vietnam period, many of them.

Senator ABUREZK. Now, do you have personal knowledge of what took place in that 1959 meeting, between Mr. Daly and the Secretary of the Air Force?

Mr. PROUTY. I do, but I did not sit in on the meeting.

My everyday work, frequent work, was with the people from Air America, with the deputy for Civil Air, who was in the Air Force Headquarters, a man who worked in the office across the hall, and from the daily, everyday work which I had been in for years, and remained in for years, that is the kind of knowledge I had. I did not participate in the meeting, because the meeting did not involve the agency directly.

Senator ABUREZK. And do you have personal knowledge of what Mr. Zuckert's law firm, or the representations from that law firm said or did to the Department of Defense to be able to obtain a contract for Mr. Daly?

Mr. PROUTY. Not in the sense I was at the meeting.

What I learned and was told, was that because Mr. Zuckert knew of these special arrangements, he was a little more knowledgeable than other people, or another way to put it was, that Mr. Daly was very fortunate in the lawyer he selected.

Senator ABUREZK. Would you say that the Defense Department was almost forced because of that knowledge into giving Mr. Daly the contract?

Mr. PROUTY. That is a good way to put it.

Senator ABUREZK. Is not that the same World Airways, and the same Mr. Daly that was in the news quite a bit during the evacuation of Vietnam last year?

Mr. PROUTY. Yes, it is.

Senator ABUREZK. And he has been operating routes over in the Far East and Southeast Asia since that time?

Mr. PROUTY. Yes, sir.

Senator ABUREZK. Is that to your knowledge?

Mr. PROUTY. Yes, sir.

At that time, as we knew him, he had an extremely small airline. Since then it has grown to a tremendous size.

Senator ABUREZK. You do not know if he has any connection at all with the CIA at this point, or whether he did have during the Vietnam evacuation?

Mr. PROUTY. Now, when I speak up to the period of 1963, I know of no definite arrangement between Daly, or his airline, and the Agency. Whether he had knowledge of those special things, I think he would have had to have. He was not in any way a proprietary airline.

After 1963, I cannot account for that.

Mr. ROSEN. One comment, and a couple of questions. I just want to make the record clear that we have discussed this matter with the relevant people involved. The committee has neither been able to confirm nor disconfirm the relationship of World Airways in this contract.

We will continue to pursue the matter, and we will provide an opportunity for World Airways and Mr. Zuckert to respond.

One question on Air America. We have requested and been denied information on the size of Air America's operations. The testimony that you have given today, indicating the number of employees, seems to confirm the testimony before the Church Committee, that Air America at one time had \$50 million in assets; however, we do not know how much yearly revenue they had.

Do you have any idea of approximately how much revenue they had?

Mr. PROUTY. Well, on many occasions, I either worked there in their offices in Washington, or at their bases in Taiwan and in Southeast Asia, and so forth. I was reasonably familiar with the airline business at the time. I used to be the officer that paid the contract airlines during the Korean war. Air America was so much bigger than any of them, that in terms of size, Air America would seem to be as large as Pan American.

I have been in Teheran to meet with Air America officials. I have seen their maintenance base on Taiwan. A lot of work done on that maintenance base was for Air Force aircraft in Taipei, and Taiwan. They had a huge facility that big airlines would like to have had.

Air America bid and won air maintenance contracts that were, as I recall, the biggest such contracts awarded in Southeast Asia, and at that time they were maintaining large numbers of helicopters, which is an extremely costly maintenance process. I used to maintain the cost records, listing employees, all of that. And they involved a tremendous amount of money. Compare that with what you would call an ordinary airline, and Air America's size increases. As I stated earlier, Air America is in a sense a generic term covering so many types of aircraft, and so many peripheral activities, that might not even involve an aircraft, but would involve aircraft sup-

port, or aircraft-related businesses, that considered on a worldwide basis, it was very large. I had maintenance work done on Air Force aircraft in Germany by Air America. In the Bay of Pigs, we needed pilots to fly C-46's, to be instructors for Cuban pilots. They had to be trained in the C-46 and Air America did this. So there was no end of what they could do. If you needed something, you would go to Air America. They were a tremendous company.

Mr. ROSEN. Well, what was the CIA's interest? I take it they were a company comparable to a major scheduled airline?

Mr. PROUTY. Yes.

Mr. ROSEN. Why did the CIA feel a need for a company with revenues that substantial and capacities that large?

Mr. PROUTY. That is a real good question.

First of all, CIA had a need for the great capacity, and the capability to be in lots of parts of the world for their own business, but you cannot establish an operation with two or three rather large transport aircraft, and perhaps converted amphibious airplane, which is quite unusual, you could not just put something that size anywhere. They would appear to have no business; so you would have to generate business for Air America to make the CIA's operation look legitimate, or you would not keep the CIA operation there.

They had an operation in Panama that began to grow larger than they could cover, and so they transferred it to the military sector. Later they were compelled to increase the size of Air America, and its peripheral, in order to cover their various demands which were worldwide.

In a sense, they got entrapped by the success of their activities which they covered by this airline. In turn this made the airline and the demand for covering it boundless.

That is the reason for the letter Allen Dulles sent to the Secretary, saying we have got to provide the semblance of being an airline, and when you have to do it all over the world, you have to have an awfully big organization.

Mr. ROSEN. If I understand it correctly, they were building up this very large organization to make it appear to be a regular organization, but at the same time it was common knowledge to many people in the airline industry, that it was all cover anyway.

Mr. PROUTY. Well, hindsight is dangerous sometimes.

Now, people know it, but if you go back to 1958 or 1959, when we were working in very important programs in Southeast Asia, and we had to get airlift, and we had to get planes and pilots that knew what they were doing, people did not know then what they know about Air America today.

The Vietnam war changed a lot of that, and when you put a little airline into Laos, that looked like it only had two or three little airplanes, and barely getting along, people did not know that airline was supported by a big organization, including the U.S. military. Hindsight is a little dangerous in the question you asked, but they were very professional about hiding the identity of the organization. Even if it meant the exposure of a larger organization somewhere else.

You could read Dun & Bradstreet and read about Air America, it was carefully placed in journals like Dun & Bradstreet, but you would never read about one of the little fly-by-night ones that was making landing in the Himalaya Mountains.

It is an extremely professional organization, and it is a huge one.

Senator ABOUREZK. Did you get any pressure of any kind from the CIA not to testify at these hearings today?

Mr. PROUTY. Sir, I have lived in this atmosphere for so long, and have had pressure from so many places, it is an occupation.

I had none any different from anything else, no.

Mr. WATTS. Your testimony, so far as it is from personal knowledge, is based entirely on the time period from 1955 through December 31, 1963, as you state on page 9 of your statement.

During that period of time, you were a uniformed military officer. Is that correct?

Mr. PROUTY. That is correct.

I was first a Lieutenant Colonel, and later a Colonel.

Mr. WATTS. On pages 2 and 7 of your testimony, you refer to the CIA's "proprietary business" in the present rather than in the past tense.

Presumably that would not be based on official information, since you are referring to sometime after 1963, and in fact the present time.

Mr. PROUTY. I would have to look carefully. I must admit, that since I am quite busy in my own occupation, I wrote this rather fast, most of it last night.

On December 31, 1963, I left the military, and I left this work. Due to a coincidence, this morning's Post carries a story of an activity that I went to work with the day I left the military, the Helio Corp.

I did not know the Helio Corp. was involved in what I read in the Post this morning. I have maintained contact with a lot of people whom I had known earlier. I have kept up with a lot of these things. I have tried very carefully in my written comments, to keep the context from 1955 to 1963.

Mr. WATTS. If I were to tell you I have heard from persons employed by the CIA, that they are out of the air proprietary business now, and that references in the present tense in your statement should be corrected to read the past tense, would you agree with that?

Mr. PROUTY. Well, I would like a chance to edit this thing for a lot of reasons.

I will have to go through some of that. Such statements from the CIA need interpretation.

Mr. WATTS. Referring to the period after 1963, then, your testimony is based on the same kind of knowledge we all have: That is, from the papers and surmised?

Mr. PROUTY. And additionally, from my old friends. From people whom I lived with and worked with for 20 years. You do not leave them the day you retire from the service.

Mr. WATTS. On page 8 of your testimony, you say, "There came a time when the Pacific Corp. * * *," and then you go on to describe

your collaboration with the president of Air America to prepare a letter. What was that time?

Mr. PROUTY. That is a good point.

Before that time Air America was called CAT, Civil Air Transport and some other names.

There came a time about 1958 when the agency had outgrown its air operations business. They came up with a plan to concentrate aircraft, and aircraft maintenance on one huge facility within the military establishment, and we worked on that and got it done.

At the same time they took all of these airlines, some of which had grown like topsy, grown from the bottom up, and they decided to put them in one management area. Air America became part of this organization. It was well ordered and well organized. Before that they had been rather scattered. They did get organized. They organized this big company to cover the whole world and to get it all under manageable business-like control. There were several changes taking place at the same time.

Mr. WATTS. As part of your official duties in and about 1958, you sat down with the president of Air America to compose this letter to the Secretary of the Air Force?

Mr. PROUTY. Right.

We wanted to be sure that it was properly coordinated.

Mr. WATTS. Who was the president of Air America? *PERSONALLY Hired March 1962*

Mr. PROUTY. A gentleman named George Doole.

Mr. WATTS. It was signed by the Director of Central Intelligence, Allen Dulles?

Mr. PROUTY. Oh, yes.

We knew that it was being prepared for him when we started, and we knew it was going back to him when the letter was returned.

Mr. WATTS. The very existence of that letter was at the time top secret, classified information, I suppose?

Mr. PROUTY. I am not sure that I would say that. The file records would show that. Because it involved Mr. Doole's office, which was downtown, was not top secret, there was an area things were kept private, but not stamped top secret. I would have to see the letter again to answer your question. That is important in any consideration of these things. It is very difficult to get to these records. The privacy with which we treated the open activities of that company on the other hand, and then the way the secrecy would be applied to something like a military support activity were technically different things.

They are hard to unravel.

Mr. WATTS. Is the text of that letter now in the public domain?

Mr. PROUTY. In the sense that military records are maintained, I am sure it is, especially that kind of letter.

Mr. WATTS. It is no longer under any classification?

Mr. PROUTY. I see what you mean. That you may have access to it?

Mr. WATTS. Yes.

Mr. PROUTY. I have no idea what its status is. I have not seen it or even talked about it for 20 years, 18 years or so.

Mr. WATTS. Well, the existence of this letter is the portion of your testimony that is most relevant to our inquiry, so that is why I

pressed you to some extent to elaborate. Do you think it would be possible for us to obtain a copy of that letter for this record?

Mr. PROUTY. In the sense that the records of the Secretary of the Air Force are maintained complete, I am sure it is there.

You might have to look in a special file, but I would say it is there.

Mr. WATTS. We would have to inquire of the Secretary whether it could be released for this record?

Mr. PROUTY. I suppose so.

Mr. WATTS. I have no further questions.

Senator ABOUREZK. We thank you very much for your testimony and for your appearance and in giving of your testimony.

[The prepared statement of Mr. Prouty follows:]

STATEMENT OF FLETCHER PROUTY, 4201 PEACHTREE PLACE, ALEXANDRIA, VA. 22304, FORMERLY MILITARY OFFICER, RESPONSIBLE FOR LIAISON AND SUPPORT ARRANGEMENTS BETWEEN THE AIR FORCE, LATER THE DEPARTMENT OF DEFENSE, AND THE CENTRAL INTELLIGENCE AGENCY

THE CIA AND ITS PROPRIETARY NETWORKS

An understanding of the role of the CIA and of its numerous proprietary companies can not be obtained from a simple study of those proprietaries alone. The CIA's proprietaries are deeply involved with the Department of Defense. They are involved with other departments of the Government and they are involved with many other governments. In some cases the relationship is very complex. The CIA may have a military unit which is a cover unit and that unit may deal with a proprietary which in turn will deal with some legitimate company. The legitimate company will think that it is dealing with a private firm or with the DOD directly where a military contract is involved. In another case a CIA proprietary may gain a contract from the DOD and will utilize that contract to service the military and at the same time to service other companies. In so doing the private companies will not know that they are dealing with the CIA and not the DOD.

In another case a CIA proprietary may use its CIA connection to get something from the DOD which other companies could not get, thereby gaining a competitive advantage over the others. In so doing this device may be used—intentionally or unintentionally—to destroy the competition.

And then in certain rare cases, but in some most important cases, an outside company may learn that it has been outbid by a proprietary. It may learn this through its own devices and contacts or it may acquire such knowledge from a lawyer who has had special knowledge of such activity. In that case it may inform the DOD that if it does not get an equal or better contract it will blow the whistle. This type of "National Security" blackmail is most effective. The outside company will get a contract and then may continue to use that kind of blackmail year after year. [Page 2] CIA's proprietary business is very large. Some of its proprietaries' activities are concealed deeply within major companies, which cover for the CIA and in return get favors and inside assistance. This could well be the subject of a complete study. Even beyond the search into proprietaries the study could look at what the CIA does with the rather large sums of money which it earns from these proprietaries. The CIA uses a "street" name and buys and sells as other big investors do to manage these vast funds. The street name most commonly associated with the CIA is "Suydam". Funds of this nature are of course not Federal Funds and are not subject to the usual controls. Huge sums arise from the sale of proprietaries. We do not know where they go, nor do we know if the sale means a bona fide separation from the CIA or just another cover arrangement. The CIA depends upon some of these funds for "laundered" money.

Few people have ever had a real opportunity to understand how the CIA utilizes money. The CIA gets "what money will buy" many times without the actual expenditure of funds. It makes liberal use of the provisions of the National Economy Act of 1932 as amended in order to acquire goods and

services from other agencies at no cost or at nominal cost. The "horizontal" movement of money where the CIA is involved is a little known specialty.

In order to provide some background for all of this it may be well worth while to provide some background about the DOD/CIA relationship and its role within the government, industry and foreign affairs.

Before 1955 the U.S. Air Force had a policy for providing support of the clandestine activities of the CIA; but it was relatively informal. It was based upon a letter: coded DAF 53. In August of 1955 I was directed by the Director of Plans, Hq USAF to assemble all pertinent files and records and to draft a formal set of policy papers for the special support of the clandestine activity of the CIA. I had participated in clandestine activities, of a minor nature, during WW II and was involved in [Page 3] certain activities in Saudi Arabia, Russia, Turkey and had been at the Cairo and Teheran Conferences. During the Korean War period I was the Commander of an Air Transport unit which was responsible for certain operations throughout South Asia among them providing support for the CIA in India, Thailand, Vietnam, the Philippines and Okinawa. I had background for this special work before 1955.

I was able to assemble a rather voluminous file dating from 1946 and 1947 through 1955. Some of these papers were in the handwriting of General Vandenberg who had been Chief of Staff of the Air Force and who had been the Director of the Central Intelligence Group before the creation of the CIA. Other papers were the original NSCID's dating back to the forties and by far the most important papers were the Report to President Truman on the CIA, dated Jan 1, 1949, made by Allen W. Dulles, William H. Jackson and Mathias Correa. Later directives were some in the handwriting of President Eisenhower.

One of the most pertinent of these papers was a long letter directive signed by the then Secretary of Defense Louis Johnson, in 1949 which established DOD policy for the operational and logistics support of the clandestine activity of the CIA. (NOTE: This use of words is to differentiate the clandestine operations of the CIA from its Intelligence mission which was not given this special status.) The principle point of the Johnson directive was the DOD would do everything possible to support the CIA but only after it has been ascertained without doubt that approval for each project had been granted by the NSO and then only after the CIA had agreed to reimburse the DOD for all out-of-pocket costs incidents to such support. It also authorized elaborate personnel support of the CIA on an assigned and attached basis.

National policy required that no clandestine operation would ever be undertaken which could not be plausibly disclaimed by the U.S. government in the event of failure or compromise. As a result all clandestine operations were designed to be small [Page 4] very closely held and whenever possible, one-time.

Needless to say, although my visible role was to provide military support for the clandestine operations of the CIA, my real role was to keep the military informed of what was being done in this rarified atmosphere, its cost and to emphasize this requirement for the ability to plausibly disclaim any operation which involved military support—at all times.

With all of this material and with the assistance of selected officials I was able to prepare a draft for support activities which was ready for Air Staff coordination. The report was about 50-60 pages in length and was coded: TAB-6. It was coordinated throughout the Air Force in the States and overseas and in addition to each Commanding General one other officer was designate to handle "TAB-6" matters. General Thomas D. White was Chief of Staff of the USAF at that time and my boss was Gen. Richard Lindsay.

When the Air Force policy had been made official, it was arranged for me to meet with Allen Dulles and his Deputy, General C. P. Cabell. They arranged for me to have a very thorough and continuing briefing on all CIA matters involved. The CIA was pleased with this policy and Mr. Dulles suggested that there be a single "Focal Point" office on the Air Staff. This was my office and I was its chief from 1955 through 1960.

In 1956 Allen Dulles arranged for me to travel around the world to visit a considerable number of his overseas offices in the company of one of his officials. This was my first official visit to a number of these places and I went back to many of them during the next eight years.

In 1960, at the request of the Secretary of Defense, Thomas Gates I was transferred from the Air Force to the Office of Special Operations. This office

office was responsible for all contact between the CIA and DOD, among other things. At this level I performed much the same duties and functions there as I had done in the Air Force only then it was for all services. [Page 5] After the Kennedy inauguration I continued to work in the office of the Secretary of Defense, Bob McNamara for about a year until General Earle Wheeler, who was then the Director of the Joint Staff suggested that the military support of the CIA might best be placed on the Joint Staff level. This request was granted and in 1962 I was transferred to the Joint Staff and provided with a Navy and Army counterpart along with secretarial assistance.

My first duty there was to draw up a Joint Staff policy paper very much like the one which I had created for the Air Force. This was done and it was approved by the Chiefs of Staff and officially "Red Striped". An office similar to mine in the Joint Staff was established in most major commands overseas and in the Army, Navy and Air Force.

In the nine years which this period spanned many of the things which have now become quite well known as "CIA activities," meaning clandestine operations rather than intelligence chores, took place. For example, the very first meeting which I attended with CIA officials in 1955 involved the origins of the vast P2V-7 program which became a world wide ELINT, radar and surveillance project. The Indonesian project, Tibetan programs, the Bay of Pigs program and many others all got their first military support from my office. Gradually a system developed which resulted in the DOD being—in effect—a proprietary partner of the CIA.

My office processed and supported the assignment or attachment of thousands of military personnel to the agency and in support of the agency. It established and supported more than one thousand military cover units which were created for the sole purpose of providing cover for the CIA.

This became a particularly important activity. For example: private companies which did business with these "military" units thought they were dealing with the military when in reality they were dealing with the CIA. In some cases this led to major contracts and in certain cases these contracts were let without the customary and required bidding or amending procedures normal to the DOD system. Of course, in keeping with the old directive promulgated by Sec. Johnson and up-dated thereafter, the military [Page 6] sought reimbursement for all funds expended. But in some cases due to security precautions they did not know what had taken place and in others they could not take action without exposing the CIA. Some competitive, non-proprietary companies learned about this system and took advantage of it. They used this quiet undercover relationship for leverage. As small companies learned this, larger ones did and this got to be quite widespread and led to a most unique method of procurement.

In another twist of this process the CIA would put its own agents into "military" units and in some cases would have them recalled to active duty so that they could serve in uniform with rank. Then the CIA would ask the Defense Dept. to reassign these people to other jobs with other federal departments and agencies or even out into industry. Obviously the gaining organization did not know that the DOD was serving as a proprietary of the CIA. This led to many complicated situations especially when a CIA agent, wearing the uniform of the armed forces was given a responsible job in the FAA or other such policy making organization.

This got even more deep-rooted after the original "deep cover" assignee was replaced and another took his place. By that time no one would know that the original "slot" had been created for the CIA and the new incumbent would be completely unidentifiable to anyone as a CIA agent.

This required elaborate money arrangements which my office was responsible for arranging. The salary such persons drew from the military would be blanked and the man would turn in his military check. He would be paid by the CIA and the military would be reimbursed—on paper to keep the record clear. Then it became more complicated when the individual would travel on military orders and incur expenses against the DOD all over the world.

In many cases we would keep three files: the individual's, his CIA file and his military file. We would do our best to keep them all up to date and to plug the holes.

[Page 7] With all this activity it was inevitable that my office would become increasingly involved in the CIA proprietary program. We handled hundreds of contacts with companies of all kinds, with aircraft companies, with airlines, with

maintenance organizations, with brokers and universities, with sub-contractors and with innumerable small deals of every kind. Out of all this came the "Air America" enterprises. (Air America will be used here generically. Actually there is a whole hierarchy of companies under the Pacific Corp. and other arrangements.)

Air America is not unknown; yet there are perhaps no more than two or three people who really know how extensive what we shall call "Air America" is and how far reaching its activity. At one time we had records in my office, and I am sure they were not comprehensive, of more than 100 organizations which were in some way or other related to Air America. It may be said that Air America, in total was one of the largest airlines and air support organizations in the world. At one time Air America had two base facilities in the Far East which had more than 4,000 men on each one. Can any other airline say that?

There are Air America affiliates all over the world. Air America works in Europe, the Far East and the Middle East. Air America crews and aircraft played a significant role in the Bay of Pigs program and in such things as the Indonesian and Tibetan projects.

Air America had the capability to maintain aircraft of all kinds and more than that it could make aircraft parts for most of its own aircraft. It had the design drawings required to make all parts of such aircraft as DC-C's. It could build complete aircraft in order that it could create a totally sanitized airplane with no serial numbers, anywhere in its entire structure—not just the tail number, for operational purposes. Air America was an elaborate corporation. The best in its business in the world. It would surprise this committee to have a listing [Page 8] of how Air America acquired all of its aircraft and then for this committee to be able to go over that "sanitized" list to find out how Air America actually obtained its aircraft and its other capital assets. It is significant to point out that these advantages which accrued to Air America gave it an enviable competitive edge in the airline, air maintenance and even in the manufacturing and sub-component business among its peers.

There came a time when the Pacific Corporation, Air America's gilt-edged parent, was being formed that the CIA wanted to regularize and formalize many of its activities. One of the things they were greatly interested in was the process of bidding for military contracts both airlift and maintenance. The president of Air America and I worked together for quite a period of time on the draft of an important letter which was to be signed by Allen Dulles and addressed to the Secretary of the Air Force with the suggestion that Air America be informed of every request for bid for either airlift or air maintenance contracts and that Air America be carefully considered when such bids were being awarded. We were careful, on both sides, to see that the letter was not a firm commitment and the Air Force was careful to see that no explicit commitment was inferred.

After careful preparation the letter was signed by Allen Dulles and delivered to the Secretary via the office of the Deputy Assistant Secretary for Civil Aviation. (It should be noted that the office of that official was Pentagon Room number 4E871 and that the office of the Secretary of the Air Force is also listed as 4E871. No other such official had the same room number as the Secretary. Actually that room is the office of the Secretary's receptionist as was physically across the hall from the Secretary. It also happened that the incumbent of that office was an official of the CIA.)

Because I had worked on the development of this letter I was directed to prepare a reply for the Secretary's signature. In general the Secretary agreed with the suggestion from Allen Dulles and agreed that the Air Force would provide the CIA's [Page 9] proprietaries with on-time information requisite to bidding on such contracts. Air America and other proprietaries received many important airlift and aircraft maintenance contracts even at a time when this meant omitting other small carriers from contracts which they might otherwise have expected to win. With the fulfillment of these contracts the CIA was able to make use of such flights for its own operational purposes and more importantly to give the appearance that Air America was a healthy and normal hard working airline among its competition.

In the Far East this close relationship blossomed into the period of the Vietnam War when Air America and its numberless affiliates received tremendous contracts involving them in all aspects of the war. But it was not

always that way and on one conspicuous occasion our letter of agreement with Allen Dulles caused the Air Force some grief. During that particular period airlift contracts had reached a low ebb and there were very few up for bid in the Far East. In spite of this Air America won its bid. This caused some bitter complaints from the others. One in particular came to the Pentagon and requested a discussion with the Secretary. Failing success with that ploy the next step was to visit the law offices of a prominent firm across the river. Not long after that they both returned and some sort of agreement was reached. The "non-winner" obtained a contract for some airlift. This success did not go unnoticed nor did that device see its last implementation in the Pentagon. Like blackmail, it was so good it had to be repeated. Such were the vagaries of this type of under-the-cloak dealing.

I continued the unusual work which had begun in 1955 until December 31, 1963. I had served through those formative years of the CIA under Allen Dulles and John McCone. I worked rather closely with Tom Gates and Bob McNamara and their immediate staffs. Many of the imponderables which we are trying to unravel and to understand today had their beginnings during that period.

It is quite futile to attempt such probing around in [Page 10] the quagmire of that period, especially since it was a major part of the profession to obfuscate everything and everywhere as a matter of expertise. Men who might truthfully swear that they took part in such and such a mission would be wrong because they would have no way of knowing that the part of the mission they worked with was only the umbrella portion and that the men they trained and launched never were intended to go anywhere anyhow.

Even some who served with military units never knew that their units were really false and they were simply maintaining helicopters or keeping records for the CIA.

But there is a way to get to a full understanding of all of these things. The law of this country spells out in fine detail the duties and responsibilities of the CIA. All that is necessary is to ask the CIA what it has done in accordance with the law—a law which is ultimately uncomplicated for one who reads it with skill and care. And next it is simple to arrange with the CIA that it will be funded explicitly each year to do certain things of importance for this government and its welfare and that there will be money for those things and nothing else. That is the way these things can be operated. We did that in the DOD for those nine years and we knew what was going on. We ate a little crow from time to time; but at least we knew where the crow came from and whose it was.

I thank you.

Senator ABUREZK. The staff counsel has an announcement he would like to make before we adjourn the hearings.

Mr. ROSEN. The last witness scheduled was Mr. Robert Rousselot. Mr. Rousselot in conversation with the staff had indicated that he would testify concerning his former occupation as head of Civil Air Transport, a CIA proprietary, his subsequent employment by Continental Airlines, and his efforts on their behalf to set up Continental Air Services, a subsidiary of Continental Airlines, which operated contract services for the CIA in Southeast Asia, and other contractors.

Mr. Rousselot, again in the conversation with the staff—this was not sworn testimony—indicated that he was hired for the purpose, in essence, of using his knowledge of the CIA's activities to get this arrangement for Continental Airlines that it would not otherwise have been able to achieve.

Mr. Rousselot has telegraphed the committee to say he will be unable to appear.

We have talked to his wife and he is not available to talk to the staff or anyone else right now.

That is all of the information we have.

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Senator ABOUREZK. The hearings are recessed until the call of the chairman.

I believe that after the Senate convenes in 1977, we intend to continue these hearings with more witnesses, those from the airline industry and the CAB. Those who wish to respond to any charges made will be given an opportunity to do so.

I want to thank all of the witnesses.

We stand adjourned.

[Whereupon, the subcommittee was adjourned at 12:05 p.m.]

APPENDIXES

APPENDIX I

CORRESPONDENCE SUPPLEMENTING THE TESTIMONY OF RALPH COX, JR.

(NOTE.—The following correspondence was supplied by Mr. Cox from his files for inclusion in the record.—Committee editor.)

1. Letter dated Jan. 31, 1962, to Hon. Joseph S. Imirie, Assistant Secretary of the Air Force, from Mr. Cox



United States Overseas Airlines, Inc.

DOMESTIC AND OVERSEAS OPERATIONS
PASSENGER AND CARGO • DC4'S AND DC6'S

MAINTENANCE & OPERATIONS BUREAU
CAPE MAY COUNTY AIRPORT
POST OFFICE BOX 234
WILDWOOD, NEW JERSEY
WILDWOOD 322-7716

January 31, 1962

Hon. Joseph S. Imirie
Assistant Secretary of the Air Force
The Pentagon
Washington 25, D.C.

Dear Mr. Imirie:

I submit for your consideration the following first hand observations. Without belaboring the fact that USOA has been an active and satisfactory MATS contractor for more than eleven years and we feel have done our share in developing low cost, efficient commercial air transportation for the government, we can certainly speak with conviction on this matter.

When the contracts were made last July, USOA took strong exception to awarding business to carriers which we felt were of the quick dollar philosophy, who had no true desire to build permanence, who didn't so much as own a screw driver or a spare spark plug, and consequently are of little value as a real national defense asset when the chips are down.

Within a few days after USOA was deprived of any MATS contracts fate, so to speak, in the form of the hated red dictator proved our point. The Berlin crisis caused a heavy demand for air lift and the military turned to USOA for day to day "call" business in the Atlantic and the Pacific. Had we not built our organization soundly over the last 15 years, we would not have been ready and able like volunteer firemen to do this job.

My point is that our defense policy does not recognize or reward the sound operator, in fact their very methods are destroying him, while encouraging the fly-by night fast buck operators who go in and out of business with rented airplanes, borrowed operations manuals, cash and carry maintenance purchased on a "drop in" basis from several different maintenance companies which may or may not be qualified to service long range overseas operations. These operators don't even own spare parts, they have no mechanics, they have no routes developed, they plan to be able to shut down on a day's notice. USOA has consistently participated in all phases of Military Airlift activity such as the Korean, Berlin, Congo, Hungarian and the DEW line airlift operations. We have consciously developed the Limited authority awarded by the CAB.

THE DECLINE OF SUPPLEMENTAL ^{21.491}
AIR CARRIERS IN THE UNITED STATES

3175-1

HEARINGS
BEFORE THE
SUBCOMMITTEE ON MONOPOLY AND
ANTICOMPETITIVE ACTIVITIES
OF THE
SELECT COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
NINETY-FIFTH CONGRESS
FIRST SESSION
ON
THE DECLINE OF SUPPLEMENTAL AIR CARRIERS
IN THE UNITED STATES

PART 2

PLA-94
FEBRUARY 24 AND 28, 1977



Printed for the use of the Select Committee on Small Business

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WASHINGTON : 1977

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AIR PROPRIETARIES

As the operations of Air America developed, problems arose involving large cargo carriers. In the early days of its operation the airline used C-54s, which had an extremely limited range, but were able to perform under demanding circumstances. Discussions proceeded during that period about modernizing the equipment and the Agency, through Air America, bought DC-6AB's. These aircraft were a conversion of the DC-6 with large cargo doors installed. Air America did not maintain any jet equipment at that point.

In the early 1950's Air America became deeply involved in a military Air Transport System. This system was originally known as MATS, and later as MAC.

They got MATS contracts, and Air America got these, and these were very good to keep a constant utilization at a good rate, the MATS rates were usually good, because the policy was not to do competitive bidding for the lowest bidder because then you got the poorest service, but give good rates to the carriers, and then require the carrier belong to the Civil Reserve Air Fleet.⁴⁵ CRAF

In 1956 MATS changed its policy and required that bidders on their contracts be certified. Because Air America could not become certified, the Agency decided to purchase Southern Air Transport. While this corporation was technically a separate entity, not involved with Air America; it was actually an integral part of the complex from a management perspective. All management decisions for Southern Air Transport were made by the same CIA consultant and advisory team that established Air America policy.

Eventually, MAC decided to require that bidders not only be certified, but that they also have equipment qualified for the Civil Reserve Air Fleet; i.e., jet aircraft. As a result, the Agency acquired Boeing 727's and convinced Boeing to modify the 727 by enlarging the ventral exit, enhancing its airdrop capability.

So the theory was that the 727's would be used on MAC contracts to be available on an overriding basis if needed for major national security operation. They were used, usually when they had spare time. To my recollection, they were only called off once, off the actual contract time, and this was for a possible use which didn't go through. But the White House asked if we had the capability to move something from here to there. I think from the Philippines to somewhere in Southeast Asia. I don't recall, and so they sent word to management that they wanted a plane available at the earliest opportunity at Clark Field. They pulled one of them off the MAC contract and had it available. I think ready to go, in twelve hours, all set for the operation. And the operation was never called. But it showed what the capability was. And what they had to do was get substitute service for the MAC contract.⁴⁶

During the late 1960s several Chinese airlines began operations on a limited scale. With the establishment of these indigenous airlines

⁴⁵ *Ibid.*, 89.
⁴⁶ *Ibid.*, p. 39.

flying Far East routes, the CIA considered reducing its international carriage work. The Agency decided to retain the MAC contracts because they did not compete with the native enterprises, but plans to reduce Air America's international common carriage were initiated.

Another CIA proprietary, Civil Air Transport Company, Ltd., which had been organized in 1954, had been the first Agency entity to engage in common carriage. Later, Air America did the American contracting, followed by Southern Air Transport which also performed MAC and MATS contracts with planes leased from Air America.⁴⁷

Houston noted that in the late 1960s an internal decision was made that:

... we probably couldn't justify this major airlift with the big jets, and so we started getting rid of them. See, they had no utilization to speak of down in Southeast Asia. A couple of supply flights went into [another area] and I think we used prop planes for that, to my recollection.^{47a}

So the Agency began to phase out the 727s, which contributed to the decision to divest itself of Southern Air Transport and Air America.

Internal management was streamlined in 1963 by the establishment of an executive committee consisting of the boards of directors of the Pacific Company, Air America and Air Asia. The overt board of directors in New York City passed a resolution organizing an overt executive committee, which consisted of the CIA consultant and two other directors. Covertly, the Agency added its own representatives to this committee, which allowed representatives of management, Agency and the operators to meet, consider policies, and give guidance to the company. Houston indicated that this mechanism was extremely effective in controlling the company:

So I think for the last, oh, fifteen, eighteen years, the proprietary management system was on the whole pretty effective from the Agency point of view. I think we knew what was going on. I think we were able to get things up for decisions, and if we couldn't resolve them at the staff level, we would take them up to the Director for decisions; quite different from the early days in the early 50's that I described, and the operators at least made the claim that they had the right to call the tune.⁴⁸

During this period of time Operations Directorate personnel

were getting themselves involved in the acquisition of aircraft and which were getting awfully damned expensive at this time, and separate projects were going after some of this expensive equipment without consideration of what might be available elsewhere to the Agency by contract or old aircraft. And so the Director of Central Intelligence set up EXCOMAIR, of which I was Chairman, and had representation from both the operation and management and fi-

⁴⁷ SAT actually owned one 727 and leased two from Air America.

^{47a} *Ibid.*, p. 42.

⁴⁸ *Ibid.*, pp. 46-47.

MACF WAS HIRED BY AIR ASIA 1962

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nance out of the Agency, to try and coordinate the overall control and acquisition and disposition of aircraft.⁴⁹

A February 5, 1963 memorandum entitled "Establishment of Executive Committee for Air Proprietary Operations," noted that the committee was "to provide general policy guidance for the management of air proprietary projects, and review and final recommendations for approval of air proprietary project actions." Houston indicated that this committee, dubbed EXCOMAIR, "was . . . an amorphous group" which worked on a very informal basis. He indicated that EXCOMAIR was an effective method of achieving overall coordination; it was responsible for conducting a thorough inventory of all the equipment that the Agency had in the aviation field and was generally able to keep track of who needed what.⁵⁰

According to Houston, a general shift in thinking at the Agency occurred between 1968 and 1972 as to the desirability of maintaining a substantial airlift capability. The records appear to indicate that Houston convinced the Director in the early 1970s that such a capacity was no longer necessary to retain. Houston commented on this assessment as follows:

Through what knowledge I had of the utilization of the various assets, it seemed to me that utilization, particularly of large assets, that is, heavy flight equipment, was going down to the point where there was very little of it. Consequently, we couldn't forecast a specific requirement. Such requirements as you could forecast were highly contingent. But I also remember a couple of times putting the caveat into the Director that with a changing world and with the complications in the aviation field, once you liquidate it, you could not rebuild, and so you ought to think very, very carefully before getting rid of an asset that did have a contingent capability.⁵¹

Our study revealed that during the indicated period, a large number of proprietaries were dissolved, sold, or otherwise disposed of, thus substantiating the Agency's claim that it had moved decisively to extricate itself from this area of activity. In a very real sense, it is nearly impossible to evaluate whether a "link" still exists between the Agency and a former asset related to a proprietary. In some cases, even though formal and informal Agency ties are discontinued, social and interpersonal relationships remain. The impact of such liaisons is difficult to assess.

At its peak, Air America, the Agency's largest proprietary, had total assets of some \$50 million and directly employed more than 5,600 individuals (the total number of employees for the Air America complex was in excess of 8,000). The company is in the process of being liquidated because it is no longer required. The Air America complex included a number of other companies with the Pacific Corporation as the holding company. The general plan for liquidation of Air America is for the Pacific Corporation to sell off Air America, Inc., and its affiliates. A private New York firm was engaged to estimate a fair market value for the complex. Although the Agency conducted an intensive search for competitive bidders, it was able to find buyers for only one of the affiliated companies. The sale of this company was closed on January 31, 1975. The remaining parts of Air America are being liquidated by sale of individual assets upon completion of existing contracts. Funds realized from the sales could be as much as \$25 million and will be returned to the Treasury.

Agency financial support for Radio Liberty and Radio Free Europe, both sizeable proprietaries, was terminated in FY 1971 and responsibility for their funding and operation was assumed by the Department of State.

Southern Air Transport was sold on December 31, 1973 because its contingency capability was no longer needed. The Agency realized \$8,470,000 from this sale, of which \$3,345,000 was in cash (including a \$1.2 million award in arbitration of a dispute over the proceeds of the sale of an aircraft by Southern Air Transport after the sale of the company by the Agency). The purchaser paid the balance to Air America to retire a debt owed by Southern Air Transport. A group of employees of Southern Air Transport filed a civil action disputing the propriety of the sale of the company by the Agency, but the case was dismissed with prejudice on July 17, 1974 by a Federal court.

Most of the entities of which the Agency has divested itself were either sold or given to witting individuals (former officers, employees, managers, contractors, etc.). A handful were sold or given to witting individuals who had no formal relationship with the proprietary. In several cases, transfer of the entity was conditioned as an agreement that the proprietary would continue to provide goods or services to the CIA. Other methods which have occasionally been used to dispose of entities include: merger with another Agency proprietary; transfer or sale of a proprietary to another Government department; and liquidation, with the remaining assets of the proprietary being given to previously uncompensated participants in the venture, or to other Agency proprietaries.

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2. The Sale of Southern Air Transport, Inc.

Southern Air Transport Incorporated (SAT) is an American air carrier, incorporated in the State of Florida on October 31, 1949. From its inception until its purchase in 1960 by the Central Intelligence Agency, it was privately owned. It was purchased by the CIA on August 5, 1960, and owned by the CIA through December 31, 1973 when the Agency sold the firm back to one of its original owners.

The decision to acquire Southern Air Transport was triggered by a change in the regulations governing the award of Military Air Transport Service (MATS) contracts. On April 1, 1960, Air America had begun flying a seven month MATS contract operating out of Tachikawa Air Force Base in Japan, to other Pacific locations. In June of 1960, the Department of Defense and the Civil Aeronautics Board changed the regulations governing the awarding of MATS contracts to require that bidders hold at least a Supplemental Certificate of Convenience and Necessity for an air carrier and that they participate in the Civil Reserve Air Fleet Program. Air America did not meet either of these new criteria and could not obtain appropriate waivers.

The Air America heavy airlift capability represented an American asset for use in future operational contingencies throughout the Far East area. Loss of the MATS contract would result in underutilization of aircraft and air crews, and the revenues were needed to sustain these assets. Therefore, the CIA proposed that either Air America should obtain the necessary certification, or that the Agency should buy another commercial firm that already held these certifications. The October 1, 1960 contract date, the need for public hearings, and lengthy proceedings militated against Air America applying for the certificate. In order to avoid lengthy public hearings, which would be time-consuming and generate public exposure, it was decided that the ownership of the company to be acquired must be kept completely separate from Air America. This solution was concurred in by the CAB, DOD, the CIA, and Air America management.

It was anticipated that if the new company were awarded an ongoing MATS contract, it would actually perform the flying service but would use equipment under conditional sale from Air America and would employ personnel transferred from Air America. Under inter-company agreements Air America would provide all maintenance work, ground handling, and other services for which it would be reimbursed by the new company. In this way, Air America would share in the revenues generated by the MATS contracts. The proposal to purchase a supplemental carrier and operate it under the above arrangement was approved by Director of Central Intelligence Allen Dulles on July 15, 1960. Funds from the Clandestine Services budget for FY 1962 were made available for the purchase.

After World War II there had been over 200 supplemental carriers in existence. By 1960 only 18 were still operating. Air America management made a survey of the 18 and determined that Southern Air Transport in Miami, Florida, was the most attractive as a purchase possibility. It operated two C-46s—one owned, one leased—between

Miami and points in the Caribbean and South America. Its associated company owned the four acre property on which SAT was located. Moreover, it operated at a modest profit and had no long term debts.

Negotiations for the purchase of SAT were successful and on August 5, 1960, the CIA exchanged \$307,506.10 for all outstanding shares of capital stock of SAT and its real property owning affiliate. The Agency owned these shares in the name of a former board member of Air America.

Under CIA management Southern Air Transport operated with two semi-autonomous sections: the Pacific and Atlantic Divisions. The Pacific Division performed the MATS contract and supported Agency "heavylift" requirements in East Asia. The Atlantic Division continued to operate in the Caribbean and South America; doing the same sort of flying SAT had done prior to Agency acquisition. The Atlantic Division was also able to furnish support for certain sensitive operations. At the peak of its activities, the SAT fleet, comprised of both owned and leased aircraft, included Douglas DC-6, Boeing 727, and Lockheed L-100 Hercules aircraft.

The Sale

In 1972 it became apparent that the Agency's air capabilities exceeded its needs, and that political realities and future operational requirements in the post-war era of Southeast Asia would not require large air proprietary assets. On April 21, 1972, the Director of Central Intelligence authorized the divestiture of CIA ownership and control of the Air America complex and Southern Air Transport. He approved recommendations calling for: Air America to be retained until the end of the war in Southeast Asia; the immediate elimination of the Pacific Division of SAT; the sale of two 727 aircraft leased to SAT by Air America; and subsequent divestiture of Agency ownership and control of the remainder of SAT.⁸⁸ Specific note was made that conflict of interest should be avoided and that no employee should receive a windfall benefit as a result of these transactions.⁸⁹

In May 1972, two Agency officials met with the Chairman of the Civil Aeronautics Board and his Administrative Assistant to seek informal advice as to the best way to disengage from SAT. Three alternatives were discussed: (1) dissolve the company and sell the assets; (2) sell the assets to the current operators of the company; (3) sell SAT to, or merge SAT into, one of the other supplemental carriers.

The CAB chairman discouraged option (3) because it would involve public hearings and would be subject to criticism by the other supplementals: Option (1), although least troublesome from the legal

⁸⁸ The Director determined that "we no longer should retain air proprietaries purely for contingent requirements and that on the record, therefore, the Agency should divest itself of the Southern Air Transport complex entirely." He stated that the desirable course of action would be dissolution, although he realized that the problems were many and complex. Also, he did not rule out other solutions which might achieve the end and yet better satisfy the interests of all concerned.

⁸⁹ A condition imposed by the DCI was that "in the disposition of any of the assets involved nothing inure to the benefit of Agency employees or former employees or persons whose relationship with the Agency has been or is of such a nature as might raise a question of conflict of interest."

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and security standpoints, would further reduce the shrinking number of U.S. supplementals (by 1972, there were only eleven supplemental carriers left) and would be unfair to SAT employees. The CAB officials had no objections to option (2).

On May 5, 1972 the DCI was presented with the results of the meeting with the CAB chairman. He approved the recommendation to explore the sale of the equity in SAT to the current management. It was noted that SAT had been operating as a supplemental carrier for 25 years, that none of the employees of SAT had ever been an employee of the Agency, and that both the Department of Defense and the chairman of the CAB considered it in their best interests to keep SAT as a viable carrier. The rationale behind selling SAT intact to its management was:

(1) Liquidation would deprive the United States of a useful air carrier and would be unfair to the employees.

(2) Sale of SAT on the open market would generate an unacceptable level of public interest and scrutiny. A publicly advertised disposition would run contrary to the Director's statutory mandate to protect intelligence sources and methods.

(3) Although a potential for conflict of interest and windfall profit existed, the sale of SAT to its management would best satisfy the requirements of everyone involved.

The DCI was, apparently, allowed this flexibility in method of disposal by statute. 40 U.S.C. § 474(17) provides that nothing in the regulations relating to disposal of surplus government property shall affect any authority of the CIA. In addition, 50 U.S.C. § 403(d)(5) provides that the Director of Central Intelligence is responsible for protecting intelligence sources and methods from unauthorized disclosure. It was determined that sale of SAT stock to one of its former owners in a confidential manner would prevent damage which could result from disclosure of CIA ownership.

Agency officials began exploring ways in which SAT could be sold to its management, without permitting a windfall to accrue to the buyer, and in a way that could not be construed as a conflict of interest. To establish a reasonable selling price, the Agency asked a Certified Public Accounting firm to perform a valuation study. The accounting firm in turn engaged an aviation consultant firm to conduct an evaluation of the aircraft. The following values were established:

	Millions
(1) Book value of SAT.....	\$3.900
(2) Estimated total value of SAT capital stock on open market.....	2.045
(3) Disposal as going concern.....	2.100
(4) Liquidation value.....	1.250
(5) Agency investment.....	1.500

Based on these figures, the Executive Director-Comptroller on August 17, 1972, approved an asking price of \$2.7 million. Sale at this price to the management would require simultaneous payment in full of the \$3.2 million note payable to Air America through an associated land holding company, and would not include any equity in the lease purchase agreement between SAT and Air America for a Lockheed L 100-30 Hercules aircraft. Although this \$2.7 million price was less than the \$3.9 million book value, it did exceed the fair market value of the company as calculated by professional appraisers. The appraisals were based not on depreciated purchase prices for assets, as

reflected in book values, but on the earning power of the assets adjusted to "present value" and the current resale value for all assets.

On August 23, 1972, the former owner was advised that the asking price for SAT was \$5.9 million; \$2.7 million for the acquisition of stock and \$3.2 million for payment of debt to Air America. A deadline date of October 1, 1972 was established; otherwise the firm would be dissolved and the assets liquidated. Although the former owner contended the asking price should be reduced because the outstanding loan to Air America had been reduced since the date of the study, he stated that he would attempt to work out financing within the deadline date of October 1, 1972. This deadline was extended by the Agency to December 4, 1972.

On December 5, 1972, the former owner submitted an offer to buy SAT for \$5 million: \$1.875 million for the acquisition of SAT and \$3.125 million to pay off the debt to Air America. On December 26, 1972, the Executive Director-Comptroller approved the recommendation that the offer be rejected and that if the former owner was unable to raise by January 20, 1973, the additional funds required for the original purchase price of \$5.9 million, including the Air America debt, that the Agency proceed with liquidation plans and the dismissal of SAT employees not later than February 1, 1973.

On January 11, 1973, a new proposal was submitted to purchase SAT for a total price of \$5,605,000. The former owner cited a tentative commitment for a loan of \$4.0 million and his offer was contingent upon an additional loan. The offer called for a total payment of \$5,605,000 broken down as follows:

	In millions
Acquisition of SAT stock.....	\$2.145
Payment of debt to Air America.....	3.125
Credit for payments to Air America since 10 June 1972 in liquidation of long term debt.....	.335
Total payment.....	5.605

Prior to accepting the offer, CIA officers again discussed the sale of SAT with a CAB representative, who indicated that the board would be interested in seeing SAT continued. The CAB representative stated that it would not be necessary to surface the Agency's name as the true owner of SAT in the CAB proceedings, and that he did not anticipate any problems with other supplemental carriers as a result of the sale.

On January 19, 1973, the DCI approved the sale of SAT. It was noted that the offer was within 5 percent of the original asking price, was above the independent evaluation for sale as a going concern, and was at a figure which would not seem to give the buyer windfall profit. The sale would constitute a clean break-away of SAT from the Agency with the exception of a one year extension on the lease/purchase agreement with Air America for an L 100-30 aircraft. This agreement for sale between the former owner and the Agency included a provision that any profit derived from the sale of assets within one year would constitute a windfall and would be added to the total sale price.

On February 28, 1973, the Board of Directors of SAT executed corporate action on the Agreement for Sale of SAT to the former owner. Closing date was established at not later than 30 days after CAB approval. On March 1, 1973 application for approval of acquisition

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tion of control of SAT by the former owner was filed with the CAB under Docket No. 252-64. It was anticipated that CAB approval would be forthcoming within 60 days.

Subsequent to the agreement for sale and application to CAB, several supplemental carriers generated a great deal of pressure to prevent SAT from being sold to the former owner and to prevent SAT from operating as a supplemental carrier. This pressure was applied through Congressional representatives, the General Accounting Office, and the General Services Administration. The various supplemental carriers objected to the sale of SAT for a variety of reasons. Basically each supplemental objected to the portions of SAT's operating authority which would allow SAT to compete with it. Specifically, representatives of one competitor indicated that it would not oppose the sale if the new owner would voluntarily renounce his rights to Trans-Pacific routes.

Two other companies objected to SAT operating any aircraft as large or larger than a 727 in the Far East. Another objected to SAT bidding on any domestic MAC contracts. Restricting SAT to satisfy all potential competitors could make SAT sufficiently unattractive as a profitable investment that financing would be unobtainable. With this in mind the Agency took the position that agreement for sale of SAT had been executed, subject to CAB approval. If the CAB ruled against the sale and ownership reverted to the Agency, the Agency would cease any bids or service under MAC contracts and dissolve SAT.

Two supplementals expressed interest in buying SAT. One did not make a cash offer, but on June 29, 1973, the other made a cash offer of about \$2 million in excess of what the former owner had offered. According to the Agency, there were compelling reasons not to pursue these offers. Agency officers had reason to believe that the supplementals were not interested in actually buying SAT as they were attempting to secure a commitment from the Agency which could be used to compromise the CIA's position in future CAB hearings. Three reasons for not accepting either offer were:

(1) Any merger with another supplemental carrier would necessitate a very difficult series of CAB hearings during which all other major supplementals would certainly voice loud and strenuous objections.

(2) To sell the firm on a sole source basis to either outside buyer without soliciting public bids would be contrary to sound business practice, and would attract even more adverse publicity.

(3) Both offers were made directly to officials of the CIA and not to the stockholders of record. Although the relationship between the CIA and SAT was the subject of much public speculation, the relationship was still classified and an acceptance of either offer would be a violation of security and cover.

Dissolution of the firm, or sale to the former owner, continued as the most acceptable method of divestiture, subject to CAB approval.

In view of the objections by other supplemental carriers to the sale of SAT to its former owner, and the award by the Air Force of a Logistics Air contract to SAT, the DCI directed on July 31, 1973,

that SAT be dissolved, that it withdraw from the LOGAIR contract and withdraw its application for renewal of supplemental certificate. The former owner was advised of this decision and made a counter offer to purchase the company under his previous offer. He also proposed that SAT return its supplemental certificate, withdraw application for acquisition for sale from CAB, and operate as a commercial carrier under Federal Aviation Regulation Part 121 authority. Such action would remove SAT from direct competition with the supplementals, but retain a worthwhile market in which to operate. Additionally, no CAB hearing would be necessary to obtain this type of operating authority. On October 1, 1973, the DCI agreed to entertain the proposal to continue the sale of SAT as a Part 121 operator, on the condition that the former owner obtain prompt financing. Otherwise, the firm would be dissolved.

On October 5, 1973, the SAT Board of Directors approved and executed a new agreement for sale including the following provisions:

- (1) The former owner to acquire stock of SAT and Aetus for \$2,145,000.
- (2) The former owner to pay off \$3,125,000 owed to Air America.
- (3) Agreement subject to the former owner obtaining \$1 million loan.
- (4) Agreement to be subject to SAT withdrawing application for renewal of its Certificate of Necessity and Convenience for an Air Carrier (Supplemental Certificate).
- (5) Lease/purchase agreement for L-100 between AAM and SAT to be extended one year.
- (6) Anti-windfall provision to be effective for one year from date of sale.

On November 29, 1973, the former owner received a commitment from The First National Bank of Chicago for a loan of \$4.5 million thereby making the October 5, 1973 agreement operative. On November 30, 1973, the DCI approved the sale of SAT in accordance with the October 5 agreement for sale. On the same day, the application to the CAB for acquisition of SAT under Docket No. 252-64 was withdrawn and petition for cancellation of certificate and termination of exemption authority was filed with an effective date of December 30, 1973. On December 31, 1973 the sale was closed, the note to Air America was paid off, and the former owner became the sole owner of SAT.

In early January 1974, CIA officials learned from Air America management that SAT had exercised the purchase option of the lease/purchase agreement between SAT and Air America for the Lockheed L 100-30 Hercules aircraft. The option sale price from Air America was \$3,150,000. SAT immediately resold the aircraft to Saturn Airways for \$4,350,000, for a profit of \$1.2 million. The Agency interpreted this sale as a violation of the anti-windfall provisions of its agreement with the owner. On January 25, 1974, Air America executed an Escrow and Arbitration Agreement on behalf of the CIA with SAT on the disputed \$1.2 million profit. The agreement called for \$750,000 to be placed in escrow with the American Security and Trust Company of Washington, D.C. The escrow funds were to be held as a Certificate of Deposit purchased at the prevailing market

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rate. It was further agreed that SAT would also place in escrow a Promissory Note to Air America for the remaining \$450,000 of the disputed amount. The note was to bear interest at the same rate currently being earned on the Certificate of Deposit in escrow. It was arranged that the escrow deposits plus accrued interest would be paid to the party deemed in favor by an arbitrator with each party to pay one-half of the costs of arbitration. On September 5, 1974 the arbitrator ruled in favor of Air America. This decision caused an additional \$1,304,243 to accrue to the Agency from the SAT sale. This was the sum of the \$1.2 million under arbitration plus accrued interest, less the Agency's share of arbitration costs.

3. Declassification of Relationship With CIA

In March 1974 the employees of SAT retained an attorney and brought a class action suit in U.S. District Court for Southern Florida against Southern Air Transport, Inc. and the Central Intelligence Agency. The employees as plaintiffs sued for injunctive relief and damages. In this suit the employees alleged:

- (1) That the CIA sold the stock of SAT to the former owner illegally,
- (2) That SAT had embarked on a program to sell off its assets, depriving the plaintiffs of employment,
- (3) That the plaintiffs were entitled to the benefits of the CIA Retirement and Disability System, and
- (4) That their civil rights had been violated.

In view of the publicity arising from the allegations made by the other supplemental carriers during the CAB proceedings and the publicity arising from this suit, it was determined that no useful purpose would be served by continuing to deny the true ownership relationship of SAT by CIA. The operational activities performed by SAT on behalf of CIA were and remain classified. As a part of the Agency's defense in this suit, an affidavit of the Deputy Director for Management and Services of the CIA was presented in court.

In the affidavit he delineated the relationship between the CIA and SAT and the authorities for purchasing and later selling the capital stock of SAT. He also defined the employment status of the plaintiffs as not being government employees and not being CIA employees, and therefore not being eligible for participation in the CIA Retirement and Disability System.

In the Order Granting Motion for Summary Judgment, the court found that the sale of SAT capital stock was not in violation of law; that the plaintiffs' claim to be U.S. Government employees and entitled to CIA retirement benefits was invalid; and that the SAT employees were not deprived of any civil right under any state law. As a result, the action was dismissed with prejudice as to the plaintiff. Although this suit did cause the relationship between the Agency and SAT to be officially disclosed, it did establish, in a court of law, two points favorable to the Agency:

- a. The sale of SAT violated no laws and was within the authority of the DCI; and
- b. The directly hired employees of CIA owned proprietary firms such as SAT do not necessarily enjoy the status of Federal Government employees.

4. Possible Conflict of Interest

In the SAT divestiture, the Agency took precautions to avoid conflict of interest. A retired staff agent who had been the Managing Director of Air America, Inc., made several offers to acquire SAT. In early 1972 he and some other members of Air America management made an informal offer to buy SAT. On August 7, 1972, the retired staff agent told the Agency official responsible for the management of SAT and Air America, that he, in association with two supplementals, wanted to offer "book value" for SAT. He stated that they were not interested in SAT's certificate, but rather in the equipment and that if allowed to make an offer, it would be one that would not require CAB hearings. In both cases, the CIA General Counsel determined that due to the offeror's close association with the Agency, the offer was unacceptable. In later discussions, the retired staff agent asked to be allowed to bid on SAT in open bidding. The General Counsel's position on this request was that open bids would not solve the conflict of interest problems. In any transaction this complex, selecting the bid is only a preliminary to the negotiated final sale.

Another potential conflict of interest involved another supplemental air carrier. From the time the Agency first decided to divest until the sale was consummated, this company expressed continuing interest in merging with SAT. Their representative was a former Director of Central Intelligence, who made literally dozens of phone calls to Agency officials and arranged many meetings; all for the purpose of pressing this company's case to purchase SAT. The company also proposed to arrange "shadow financing" for the former owner of SAT if he would agree to merge at some later time. These offers were all rejected because merger with another supplemental was not an acceptable solution and the apparent conflict of interest was too great.

The sale of SAT to its former owner was another area of possible conflict of interest. While the former owner was not an employee of the Federal Government during any period of association with SAT or CIA, he had been the owner prior to CIA acquisition, and had been nominal president of SAT during Agency ownership. This potential area of conflict had been recognized at the outset of sale proceedings, and the Agency obtained third party professional evaluation and restricted windfall profits to prevent such conflicts. The underlying philosophy for sale back to the former owner was to restore the *status quo ante*, i.e. return of the corporation to its previous ownership once the need for a Government-controlled entity had terminated.

ALL OF THESE OPERATIONS MENTIONED
WERE DIRECTED BY ROBERT ROUSELOT
FROM TAIPEI — CIVIL AIR TRANSPORT WAS
BASED THERE & ROUSELOT WAS VP
FLT OPS —