

How the CIA Molded the Charter Airline Industry

BY TOM REDBURN
Times Staff Writer

In 1960 Southern Air Transport was on the verge of bankruptcy. Down to its last two aging planes, Southern, like most of the other two dozen or so nonscheduled airlines then alive, faced a bleak future.

Of the few so-called nonskeds—or charter airlines—that remained, Southern was one of the weakest. Yet only a few months after it was sold in August, 1960 for a paltry \$300,000, the airline was thriving.

The reason? The actual buyer of Southern, a fact kept secret from most people for more than 13 years, was the Central Intelligence Agency. With the CIA's help, Southern quickly obtained new planes from another CIA company, Air America, and captured a key military contract to provide a "cover" for its operations.

In 1975, after two years of rumors and published news leaks, the CIA finally acknowledged that it had owned Southern Air from 1960 to 1973.

The story might have ended there. But now government documents and other information have surfaced indicating that the CIA's venture into the nonsked business had a profound impact, one that damaged the finances of a host of unsuspecting private businessmen and helped determine the shape of an entire industry for years to come.

By siphoning away a significant share of the military charter revenue that was the sustenance of these struggling airlines, the CIA played a big role in consigning some of these companies to oblivion. The few that survived became the nucleus of the modern U.S. charter airline industry.

Moreover, there is evidence that five other nonskeds that survived this period did so in part because they or their representatives learned of the CIA connection to Southern and were able to win favorable treatment from the Civil Aeronautics Administration and other government agen-

cies, which were eager to maintain the CIA's secret.

Today, many of the former nonsked operators who lost their flying rights when they ran out of money are trying to win those rights back from the CAB. The board, whose membership has changed completely in the intervening years, has set up a special proceeding to consider their requests.

Their efforts recently forced the release, under the Freedom of Information Act, of numerous previously secret government documents. Those, combined with interviews and previously ignored testimony, permit a close look at how the CIA wreaked its apparently unintended havoc on the nonsked industry.

That look reveals a complex pattern of

intrigue, with secret briefings by the CIA of CAB and military officials which won Southern crucial operating rights and contracts, along with desperate efforts by the competing nonskeds to gain a share of the government business that was not allotted to the CIA's airline.

Only six nonskeds were awarded, in the early 1960s, the lucrative overseas military contracts that became the difference between life and death. The losing airlines at the time were unaware that Southern was owned by the CIA. The other five—World Airways, AAIXCO (later Saturn Airlines), Overseas National Airlines, Capitol Airways and Trans International Airlines (which has recently acquired Saturn)—all were aware of the hidden CIA-Southern connection.

With the new evidence, a group of the former nonskeds charge that the favored airlines, which have since become the leaders of the U.S. charter airline industry,

agreed to keep their share of Southern's CIA ownership secret in return for the military contracts.

In recent testimony before a CAB hearing judge, Richard D. Neumann, president of a former nonsked, California Air Charter, alleged that at least one of the military charter airlines "used undue and improper influence in its economic rise to the top, or in less charitable words, blackmail and extortion. It is clear that several applicants (in a new route case) have engaged in activities of a very questionable nature."

The surviving carriers deny the charge.

In a letter to a Senate committee chairman, Edward J. Daly, chairman of World Airways wrote: "World has never resorted to coercion or relied upon favoritism to obtain military contract business."

Coates Lear, a lawyer connected to four of the surviving carriers, is now dead, but

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FACELIFT FOR MARINELAND—Large backhoe digs up front entrance to Marineland in major refurbishing of park. Taft Broadcasting Co., which bought Marineland last fall, hopes to pump new life into attraction which has been declining for the past decade.

IMF: A Long Road to New Economic Order

Progress Made at Mexico City Despite the Odds

BY ROGER SMITH
Times Staff Writer

The world monetary system staggered into a new era when the United States abandoned the gold standard in 1971. Fixed rates of currency exchange, which had become indefensible as national economies independently changed gears, quickly disappeared. But so did the order and stability which tends to foster growth in international trade.

Now the world's finance ministers are counting on the International Monetary Fund to lead the way toward a new world economic order. Their widely varying demands—free trade, aid for fledgling industries in developing countries, stable reserves, freedom to set national growth rates—could make an already monumental task impossible. In fact, the IMF is showing signs that it is making progress in spite of the odds.

Clearly, that progress is coming at a painfully slow rate. Like all international organizations, the IMF can easily become bogged down in petty wrangling or be stymied by the de-

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Japan last year because we don't believe in criticizing efficiency," said Manfred Lahnstein, undersecretary to the West German finance ministry. But the Germans did not miss the lesson the Japanese had learned: to keep the trading doors open, concessions may be necessary.

The IMF was created in 1944 as an adjunct to the United Nations to secure international monetary cooperation, stabilize exchange rates and expand international liquidity. In the past seven years those goals have become increasingly important to the West as inflationary pressures have mounted. Only the Communist bloc countries have declined to participate in the effort to build a new monetary order.

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his close friend Clayton Burwell, president of the Independent Airlines Assn. in 1960 and 1961 and soon thereafter counsel for Trans International Airlines, disputes the contention of the former nonskeds that there was, in his words, "an insiders club" that was the beneficiary of favoritism in military airlift contracts.

Although he confirms that he and a few other carriers' lawyers and executives knew about the CIA ownership as early as 1961, Burwell says it is "ridiculous" to believe they took advantage of that information to influence military contracting.

Whatever the factors that determined which nonskeds survived this period of travail for their industry in the 1960s, it is beyond dispute that the CIA's purchase of Southern contributed to the demise of those that succumbed.

The CIA's entry into the business, of course, wasn't the only factor. The CAB, which regulates all air carriers, had been giving the nonskeds short shrift for years in order to help protect the large scheduled airlines.

The CIA didn't intend, apparently, to harm other airlines. Immediately after the purchase, however, Southern captured an important military contract in the Pacific, even though it was based in Miami and had previously restricted its operations to that area. The carrier grew quickly, fed by military contracts and CIA operations.

The CIA did not want Southern to become too visible, and it never became exceedingly large. Southern bought planes from the CIA's largest proprietary company, Air America, which operated mostly in Southeast Asia. The money came from Air America loans and loans from Manufacturer's Hanover Bank in New York, which handled the banking for many of the CIA's companies.

But by the time Southern, which has no connection to Southern Airways, was sold in 1973 to Stanley Williams, the man who had operated it for the CIA, the line was doing millions of dollars of business annually.

Without that sale, for \$5.1 million, it might never have been possible to tell the history of the CIA's effect on the nonsked industry. For, before the deal could go through, a number of airlines protested the retention of key CAB operating rights by the new owner. The CAB held secret hearings on this issue, and it is through testimony recorded at those hearings and only recently released that much of the CIA's role can be documented.

The principal witness was Lawrence Houston, then the general counsel of the CIA, and the principal questioners were the lawyers for the five military supplemental airlines and a lawyer for Pan American World Airways, also representing eight major carriers.

According to Houston's testimony, the CIA decided to purchase Southern because Air America wouldn't be able to receive a CAB certificate without risking disclosure of its real owners and because the agency wanted an airline that would be able to operate in Latin America.

Houston claimed that the agency didn't ask for any special favors for Southern. "Southern bid on the MATS (Military Air Transport Service), later MACS (Military Airlift Command) contracts, which it performed in ordinary commercial fashion with no intercession by us, although we informed the top command of MATS, that we did have the beneficial ownership but we asked no special consideration."

However, Houston acknowledged that he had disclosed the CIA's ownership of Southern to key officials at the CAB. "The CAB was in the process of determining



DOWN BUT NOT OUT—Dick Neumann, a former nonsked operator, has been trying for years to win back from the government the right to fly. Times photo by Chris Hardy

service with the legal staff of the Bureau of Operating Rights, Southern was an applicant in several proceedings, including requests for exemptions and renewal and expansion of its supplemental certificate rights. The director of the Bureau of Operating Rights and a number of my staff colleagues informed me that it was the policy of the staff and the board to approve without investigation requests for exemptions or authority by Southern, because it was a CIA operation."

As early at 1960, the award of a Pacific islands charter contract to Southern by the military aroused the suspicion of at least one airline in the area, World Airways. In a sworn affidavit for the 1973 hearings, Clayton Burwell said he raised questions about the contract award.

"One of the carrier members of the association (the Independent Airlines Assn.) operated, under contract with the government, the inter-island contract between Japan, the Philippines and Taiwan. (Actually there were several operators of inter-island contracts. In a recent telephone interview, Burwell explained that the carrier he referred to was World Airways.) During 1960 or 1961 or thereabout, this contract was awarded by the government for the first time to Southern Air Transport (SAT) under circumstances that appeared to favor Southern over other supplementals seeking the inter-island contracts, some of which were better equipped and more experienced in the performance of that contract than Southern.

"One or more of the disappointed supplemental carriers sought my assistance in investigating and protesting the apparent favoritism in the contract award. During an investigation I learned from sources on Capitol Hill that the Central Intelligence Agency owned or controlled SAT and, accordingly, we could expect no help in securing a review of the award."

Burwell said he and the protesting airlines abandoned further efforts to have the award overturned.

But Houston testified that a few airlines knew of the CIA-SAT connection and did complain to the CIA. Houston testified that in those cases, the CIA tried to work out its differences with the protesting airline.

Burwell's affidavit acknowledged that some supplemental airlines knew of the secret ownership. "From 1960 or 1961 to date . . . I have been continuously and intimately involved with most of the officers and counsel of the leading supplemental airlines. On numerous occasions they have indicated to me their knowledge that Southern was owned and subsidized by the CIA."

In a recent interview, Burwell said he was referring to the airlines that became, in 1962, the National Air Carriers Assn. These were the airlines that won the military contracts, while the remaining members of the Independent Airlines Assn. tried to survive offering irregularly scheduled service.

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How CIA Actions Helped to Mold the Charter Airline Industry

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A year later, under new legislation, the board abolished individually ticketed nonscheduled service and created a smaller class of supplemental carriers.

Burwell represented TIA, while Coates Lear, at various times, represented World, Saturn, ONA, and Capitol. But Burwell insisted there was no favoritism based on their knowledge of the ownership of Southern.

What happened to the other nonskeds? In 1961, Ralph Cox, president of United States Overseas Airlines, then one of the largest nonskeds, went to speak to Lear. Cox, according to sworn testimony he delivered in late 1976 to a Senate committee, asked Lear for help in securing new flying contracts from the military. MATS had just changed its policy, under direction from the CAB, from accepting the lowest qualified bid to a closed allocation system at minimum rates.

Cox testified: "I went to Coates and I said, 'Coates, we did good business for 15 years, we are one of the pioneers, we did the Korean airlift, the Berlin airlift, how about taking us under your wing and helping us?'"

"I said, 'You have the key to the business. He said, 'That is right, I would like to take your carrier, because I think you have got the means of performing, you have got a good record!'"

"Two weeks later, he came back, he said, 'I am sorry Ralph, the rest of the boys do not want you. They do not want me to represent you. I cannot do it.' And USOA," Cox testified, "never got any more MATS business."

Today, representatives of the former nonskeds argue that the key to the business was the knowledge about the CIA and Southern. According to Houston's 1973 testimony, "some years back, I think very few knew about" the CIA's involvement with Southern. As he explained, the CIA sometimes dealt with individual

airlines when they complained of the unfair advantage Southern and Air America had. The only airlines, of course, that complained were those that were aware of the connection.

"We didn't make a practice of briefing the industry," Houston said. "But," he explained, "when particular complaints arose from an airline the CIA would talk to them and explain our problem as well as take into consideration theirs."

Soon thereafter, Houston was asked, "Were there ever any representations made to your knowledge that failure to accede to an objection might lead to some unfavorable publicity, or perhaps a letter to a congressman?"

He replied: "I believe there were occasions where this was indicated as a possibility." A few sentences later, Houston said, "I won't say there weren't difficulties; because some of the other airlines had quite strong feelings on this. On the other hand, to a considerable extent, many of them were cooperative in the sense that they realized what our mission was. In some cases, I believe they just thought they should lodge the protest and let it go. In other cases, there was some fairly strenuous give and take."

In a recent telephone interview, Houston would not describe the nature of the disputes or what action the CIA took to accommodate the protesting airlines.

The new military contracting policy which reduced the number of MATS carriers in the early 1960s was designed to encourage airlines to branch out of military business and to enable them to acquire jets. Representatives of nonskeds that lost out contend that the six chosen airlines were no more qualified than a dozen other carriers.

For instance, according to testimony in 1973 before the monopoly subcommittee of the Senate Select Small Business committee, Ralph Cox's airline, USOA, grossed almost \$12 million the year before the new MATS policy went into effect, most of it

from commercial sources, while Southern only grossed a few hundred thousand dollars and some of the other carriers had revenues of less than \$1 million.

At the same time, the MATS policy in distributing its more than \$80 million a year was that its carriers should have at least 50% of their business from commercial sources so that they would have a reserve of aircraft that could be used in a military emergency. Yet in 1964, according to Senate testimony, Southern Air received 84% of its revenues from the Defense Department, while Capitol got 79% of its revenues from that source, TIA obtained 100% of its business from the military, and World got 92%.

Southern's dependence on the military particularly galled the former nonskeds, because—despite the policy that jets should be used—Southern never acquired any jet aircraft.

In addition, MATS refused to deal with the airlines that did not receive its long-term contracts. For instance, in 1961 both Standard Airways and Trans International were flying nonscheduled passenger service from California to Hawaii. TIA left the market and began flying MATS contracts. In 1962, when the CAB clamped a limit on Standard's passenger service, Bud Kraft, the owner, tried to get a MATS contract by leasing a plane that was being used for military service by TIA. As soon as the plane was leased to Standard, MATS refused to allow it to be used for its contracts. When Kraft finally transferred it back to TIA, the plane was immediately allowed to resume MATS service.

At the same time that MATS was limiting the number of carriers on its service to Southern and the other five nonscheduled airlines, the CAB was in the process of limiting the number of carriers that would receive new supplemental certificates.

In 1962, the CIA's Houston held a

meeting with the CAB board that was apparently so secret that only a notation of it was kept in CAB files rather than any minutes, as was proper procedure.

Later, in 1965, after a CAB hearing examiner had recommended against granting Southern a supplemental certificate to operate in Latin America, the director of the CIA wrote a letter to the CAB chairman Charles Murphy asking that the decision be overturned. The letter said that "the Central Intelligence Agency is also very much interested in seeing Southern continue operations in the Central and South America area for covert reasons . . ." The denial of Central and South America authority to Southern would remove its presence and capability in a major area of

interest, curtail its present flexibility of operations in that area and render it a less useful asset from our standpoint."

Soon after, the CAB granted Southern the authority the CIA wanted.

In contrast to the treatment the board gave Southern, other nonskeds found themselves forced out of business by the CAB for the slightest infraction of the rules. One Senate staff member called these rules "a series of Catch-22 regulations that made it impossible for all but a few carriers to remain in business."

Today, Southern continues to operate out of Miami, but because of the protests of the supplemental airlines in 1973, it no longer holds a CAB supplemental certificate authorizing it to fly charter passenger service; nor

does the CIA own it, although a number of former CIA-affiliated men work for it.

Today, many of the former nonsked operators are old and frustrated. "This is one of the tragedies of aviation history," says one CAB staff member, "and the government carries the main burden of responsibility."

Some of the former operators, however, believe they finally have a real opportunity to get back in the aviation business. Dick Neumann, living in a modest, tiny home in Altadena, has led the protest of the former nonskeds. "I've spent the last three years of my life trying to convince anyone to listen to our case," he says. "All I want is a chance to show I know how to run an airline."

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Stein: Businessman Invades Bureaucracy

Continued from First Page

As a former general partner of Goldman Sachs & Co., Stein may re-embark at least a token effort by Gov. Brown to appease the business community and to try and undo some of the negative publicity about the state's business climate.

Stein in fact follows another businessman—Richard T. Silberman of San Diego—in this position.

Particularly in an election year, the governor cannot afford to ignore the huge financial resources that the

of arts degree from Columbia College (1952), masters degree in business administration from Harvard Business School in 1954. At Goldman Sachs he became a partner after about 10 years and was corporate finance manager for the West Coast when he left the firm at the end of 1976.

"It was time to do something different," Stein explained. "I was telling myself there must be more to life." First, he traveled for five months in Europe, the Middle East and Africa with his wife Ruth and three chil-

six-figures a Goldman Sachs partner can expect to earn.

Through a mutual friend, Stein met then-Business and Transportation Secretary Silberman and in January was appointed deputy director of the fledgling Department of Economic and Business Development. In March, Gov. Brown's chief of staff Gray Davis left to run the campaign and Silberman assumed that position. Stein was appointed to head the agency on an interim basis until after the November election, when Silberman is expected to return if Brown wins