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~~JAPAN KOREA~~

Memorandum NO.WH-50-163

DATE: 18 October 1950

TO: Board of Directors

FROM: Whiting Willauer

SUBJECT: Problems which will arise in renewing CAT's operating franchise with the Chinese National Government for the calendar year 1951

CAT Incorporated operates its airline based on Formosa under the provision of an operating franchise which is contained in a contract between Major-General C. L. Chennault, U.S. Army (Retired) and Whiting Willauer, a partnership under the Chinese law doing business as Civil Air Transport (CAT) and the National Government of China. There are various companies now or in the past which are loosely described as "CAT". The history and relationship of all of these organizations is fully described in the attached memorandum (Appendix A). CAT's operating franchise has always been on a year to year basis since October 1946, and the 1950 version will expire on 31 December 1950.

2. Under the law and practice of all countries, operation of an airline requires that it be carried on under the flag of some country recognized in the countries where the operations occur. At present although CAT is an American corporation (CAT Incorporated) it operates under the Chinese National flag pursuant to a special provision in its 1950 operating franchise which is explained in Appendix A and which is intended for the purpose of protecting the operation from interference by the Chinese Communists. In addition to carrying the National flag, such matters as certificates of airworthiness and pilots' licences are all issued under the laws of Nationalist China and without them the planes could not be operated. Therefore the basic preliminary question for CAT's future is whether the National Government of China will continue to be recognized by the United States (for purposes of operations for the U.S. Forces in Japan) and by other countries such as French Indo-China (for purposes of operations there). In view of the probability of recognition of the Chinese Communists by the United States Government and others during 1951, immediate consideration must be given to the problem of how CAT would operate subsequent to such recognition. As an original question for which there is no precedent, it is submitted that since CAT is an American corporation, Japan or the U.S. Occupation Forces, or any United Nations operating agency in the Japan-Korea area could contract with CAT for operations under the circumstances and in the absence of any provision of law strictly limiting air operations to air carriers having certificates of convenience and necessity from the Civil Aeronautics Administration of the United States Government or of the governments of Japan and Korea. No such limiting provision of law is known to exist although I believe that the U.S. Army is required either by custom or law to give preference to American enterprises. I do not believe that in the case of airlines lack of U.S. CAA certification would control. In other words, it is believed that the situation in the Japan-Korea area is now similar to that in China so that anything is possible if the parties to the arrangement are in agreement. So far as I know, the operation in French Indo-China would be on the same basis. In case of Indonesia and Pakistan, and possibly in Korea, we would of course, in any event, operate through a corporation formed under the laws of Indonesia, etc.

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Another alternative possibility for the future might arise in the event that Formosa is put under a United Nations trusteeship. In this case it might be possible to continue operations as a company based on Formosa flying whatever flag was flown by the people of Formosa under the special arrangement prevailing during the trusteeship. However, it is anticipated that the countries who would be chosen as trustees for Formosa would be in general countries such as India who would not look with favor on an organization such as CAT which has stuck so faithfully to the Nationalist regime.

3. The problem of contract renewal must also be considered on the assumption that the question will arise prior to any change of status of Formosa. Under these circumstances, we would be negotiating with the present National Government of China for a straight renewal of our present contract.

Here the most difficult problem which would have to be faced would be the question of who are the stock holders of CAT Incorporated. A bit of history is needed here to fully understand the implications of this question.

Chennault and Willauer desired originally to form an airline corporation to carry on the CAT operations. It was the policy of the then Premier Dr. T. V. Soong to confine airline operations to one chosen instrument, CNAC. Before Chennault and Willauer's application was made, another Chinese airline organization, CATC, had applied for official permission to incorporate and function under the old rights of a pre-war airline called Eurasia, which was a Sino-German enterprise, similar in structure to the Sino-American CNAC. This permission was refused by Dr. Soong, but the operation commenced nevertheless because the political influence of the CATC backers was so great that they were virtually able to defy Dr. Soong's position and Dr. Soong did not feel strong enough to face the bitter issues which would have risen if he had taken affirmative steps to stop the operation. In addition, there were other groups of interests, notably Da Hwa Aviation Company, whose applications to operate were blocked by the same policy. It therefore would have been politically impossible to permit Chennault and Willauer to form an airline corporation and approve its license to operate. However, Dr. Soong appreciated that the Chennault-Willauer case was different, and above all he was confident that they would operate in a safe manner and be loyal to the Government - things which he feared with good reason would not be the case of the many other candidates. Also, UNRRA had found that existing Chinese air transport facilities were inadequate for their needs and had made a specific request for the formation of a service by Chennault and Willauer. Since it was obvious that the wishes of UNRRA had to be complied with, and furthermore since their needs could be classified as temporary, the Government sought a way to permit the operation and yet not be too inconsistent with their general "chosen instrument" policy. Obviously, General Chennault's war time record as the savior of China during the AVG days and later through the 14th Air Force, coupled with Willauer's extensive work in helping the Chinese during the war both as an official of the Chinese Government and later in the

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U.S. Government in the Foreign Economic Administration gave a personal exceptional flavor to the proposed temporary permission to operate, provided always the right to operate was given only on a personal and temporary basis. Accordingly, when the permission was granted it was carefully played up by the Chinese authorities as a temporary and personal one running to Chennault and Willauer and the language of the contract was almost redundant on these points. Coupled with the foregoing political considerations, there were also the intense nationalistic and anti-foreign feeling in China which prevailed in many influential quarters and were widely held among many of the literate people. This feeling was in part nullified by the fact that the Chennault and Willauer partnership had as silent partners a substantial group representing almost 40% of Chinese national ownership.

The situation today has changed politically somewhat, but it is still undoubtedly essential that the Chennault and Willauer partial ownership Chinese formula of ownership be preserved for the public record. Whereas the problem of a single chosen instrument has ceased to exist in great measure following upon the defection of CNAC and CATC, there is today an embryo airline called Fu Shing which appears to have some sort of official sanction and which is headed by Moon Chen, formerly Executive Vice President of CATC and Ange Tai, formerly Chief Engineer of that company. While Fu Shing is not yet operating, there is no doubt that they and their backers are carrying on an energetic propaganda campaign and aim towards operating China's future exclusive airline. They will certainly play up any issue that they can find against CAT. The chances of Fu Shing succeeding in harming CAT have been greatly increased by U.S. policy towards the National Government of China which has caused a bitter hatred of all things American in the clique close to the Generalissimo. While it seems improbable that the opposition to CAT could prevail to the point of preventing the renewal of the contract, there is no doubt there is going to be a very difficult set of negotiations. In order to come out of these negotiations successfully and without too many hampering provisions in the final form of the renewal agreement, it is essential that the best possible political front be presented by CAT from the outset of the negotiations.

There is another factor which must also be considered. In the days of CNAC and CATC, it was their custom to appoint as members of their Boards, or as Advisors, a number of influential Chinese officials such as the Minister and Vice-Minister of Communications and the Heads of other Bureaus in that Ministry. Pay and perquisites from these posts were purposely made high so that the Minister of Communications, for instance, has in the past lived exceedingly well solely on his earnings as Chairman of the Board of CNAC. We have already found out that these same officials are looking enviously towards the time when CAT applies for its renewal of contract to question the present lack of Chinese representation on the Board of Directors, obviously with a thought that they themselves may thus work their way into lucrative positions with CAT, similar to those which they formerly held with the other two airlines. It may be that in the final analysis it will be necessary to put up with a certain amount of this and to pass out a few directorships either in CAT, or in some subsidiary

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company designed specially for that purpose. It is believed that to forestall this pressure as far as possible serious consideration should be given at once to the election of Chinese Board members who are known to be friendly. They can be such people as Wang Wen-san, formerly Chairman of the Board of CAT and others that he might suggest and vouch for. One or more might be obtained from the staff of CAT in an ex-officio capacity. Such men as Arthur Fang and Henry Yuan suggest themselves in this connection. A further possibility is to elect Chinese of great personal prestige who would not be disposed to interfere and yet who would be of such great stature that smaller men who are simply looking for a good thing would be afraid to displace them. In this connection such figures as the two former Premiers Chang Chun and Yen Hsi-shan are possibilities. Indeed if they could be persuaded, a combination of Chang Chun, Yen Hsi-shan and Wang Wen-san would give sufficient numbers and I think would present an impregnable front. It is even possible that Wu Te-chen, representing the Kuo-Min-Tang, might be a desirable choice if he were willing. I think it would be safe to count on a very high degree of non-interference by men of this calibre and it also might be possible to amend the by-laws to vest very broad powers in me as Manager subject to check on most important things by the bankers as distinguished from the Board of Directors. In fact the idea would be to make myself and the bankers the real controllers of policy and the Board of Directors merely an advisory group.

Assuming that the Board of Directors problem can be straightened out, the next matter would be that of the ownership of stock. The previous 40% Chinese ownership has been drastically reduced not from choice by the American side but because the former Chinese partners feared to remain with CAT because their other business interests would be vulnerable to Chinese Communists confiscation by reason of the CAT connection. It seems clear, therefore, that it is going to be necessary first to vest a larger holding of stock on the record in the names of Chennault and Willauer to take the place of other Americans who have stepped out and secondly to vest an additional amount of approximately 30% in the names of friendly Chinese. These stock ownership could probably all be tied up with powers of attorney which pledged with the bankers as additional security for our indebtedness. Since in the case of any Chinese chosen as stockholders, it is not believed that they will be investing the value of the stock in cash, the stock might be further pledged for very substantial notes to be taken as consideration for the stock and which none of the individuals, as a practical matter, could pay off. One might even go further and impose additional conditions preventing the Chinese from acquiring unlimited ownership in the stock so that as a practical matter there will not be one chance in a thousand of their ever acquiring full rights.

4. Negotiations can not be commenced for renewal of the contract until the problems stated above had been settled in so far as we can do so. 15 November is the very latest date for commencing these negotiations. I have discussed this whole question fully with the person bearing this to you safehand and request immediate consideration and decision to be communicated also by safehand.

Whiting Willauer
President, CAT Incorporated