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1 May 1962

MEMORANDUM FOR: Director of Central Intelligence

SUBJECT : Inspector General's Survey of Civil Air Transport (CAT)

REFERENCE : Memo dtd 10 Jan 62 to DD/S fr Actg IG, subj: "Survey of the Civil Air Transport Complex", w/att

1. Subject survey contains twelve specific recommendations directed to the Deputy Director (Support). As set forth in detail below, I have concurred in all except two of these recommendations and part of a third. In several cases the necessary steps have already been taken and the desired results accomplished. However, I should point out that concurrence in some instances is to a certain extent qualified by our interpretation of what is intended by the recommendation and our understanding of the results that are expected to be obtained. In addition to these twelve recommendations, the text of the report contains a number of comments concerning the management of CAT, which I feel do not take into consideration the problems involved in operating a venture of this size and complexity, nor do they indicate sufficient appreciation for the accomplishments of the management in meeting the many requirements that have been laid upon them. In the latter pages of this response, I would like to define certain of these problems and bring into focus the management's approach to their solution.

2. With regard to the specific recommendations, our comments and report of action taken are as follows:

Recommendation No. 23:

That the Deputy Director (Support) make no immediate change in the system of DD/S management of CAT.

Comment: CONCUR

In order to make the best use of this system of management of CAT, we believe that the operational requirements of the Agency will best be served by developing the closest working arrangement between the operating divisions who are the ultimate users of CAT's facilities and the officials of the company who are responsible for directing the company's participation in covert air operations as well as its overt activities. In providing direction for the allocation and the movement of the company's fleet and personnel, overt and covert activities are inseparable.

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Recommendation No. 24:

That the Deputy Director (Support) designate a senior officer to serve on his own Staff as a full-time project officer.

Comment: NON-CONCUR

It is felt that the project can be run best by the continued use of a committee composed of representatives of the Agency components concerned. This committee's principal function is to coordinate the air support requirements of the Clandestine Services with the company's requirement for maintaining its overt posture. The decisions of this committee for the execution of current air operations, the building of capability, and forward planning are carried out by the Managing Director of the company who is the case officer and maintains liaison with the using elements of the Agency. We do not believe that another senior full-time staff officer added to the Office of the DD/S will contribute to providing a bridge between operations and administrative requirements. The bridge will still have to be provided by the coordinated efforts of the committee.

Recommendation No. 25:

Comment: CONCUR

Also, individuals who are making their careers with CAT should have indoctrination and training at Headquarters in specialized courses which the Agency makes available.

The President of CAT, as General Manager, must continue to have over-all supervision and responsibility for all activities being carried out by his subordinates.

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Recommendation No. 26:

That the Deputy Director (Support) direct CAT management to take immediate steps to improve and organize housing, messing, PX, and recreational facilities for its personnel in Udorn.

Comment: CONCUR

Temporary company quarters are now provided for new arrivals until they can find private housing in the community, which has been done satisfactorily by the employees already there and which they prefer to living on base. Construction has begun on a recreation building which will provide a dining room and kitchen, lounge, bar, PX, showers and toilets and two bedrooms for overnight visitors. The building, which will be completely air-conditioned, will cost about [ ] and will be completed during the next 90 days, at which time the temporary facilities now being used will be closed down.

Recommendation No. 27:

a. The Deputy Director (Support) direct [ ] to consider the assignment of a [ ] as security officer to Udorn (or Bangkok) for CAT operations.

b. That the selection and assignment of this individual be within the cover, security, and tradecraft limitations imposed by the nonofficial nature of the operation. [ ]

Comment: CONCUR

An experienced security officer [ ] has been assigned to Bangkok and has already entered on duty. A second security officer was posted to Udorn, but his services have been found unnecessary and his assignment was terminated in March 1962 [ ]

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*In view of current problems at Udorn, maybe this decision was premature - 2014*

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Recommendation No. 28:

That the Deputy Director (Support) direct CAT to appoint a senior task force commander for covert operations in Southeast Asia and assure that he is given local authority.

Comment: CONCUR

Effective 15 January 1962, the position of Regional Director for Southeast Asia was established with Headquarters in Bangkok [redacted]

[redacted] This position has been temporarily filled by the appointment of Mr. Ronald E. Lewis, who has been with CAT since December 1946, and who most recently has been General Manager for Air America at Tachikawa, Japan, in charge of the [redacted] Operation. The total Regional Staff for Southeast Asia is:

Mr. Ronald E. Lewis	Regional Director
Capt. Fred Walker	Regional Chief Pilot
Mr. Ajor Brigada	Regional Operations Manager
Mr. Jackson L. Forney	Regional Technical Services Manager
Mr. William P. Cagney	Regional Traffic Manager
Mr. William D. Barrus	Regional Security Chief
Mr. C. Y. Wong	Regional Communications Supervisor
	and in charge of Flight Following Network

Additionally, there is assigned a project chief pilot for each special type of aircraft.

As a permanent replacement for Mr. Lewis as Regional Director for Southeast Asia, the company has contracted to employ Colonel John P. McMahon, who will retire from the Marine Corps at the end of April after more than 20 years of service. He will assume his duties at Bangkok as soon as possible after the necessary indoctrination at the Taipei Office of the company.

Recommendation No. 29:

That the Deputy Director (Support) direct the management of CAT to develop for the corporation's American employees a pension plan with benefits which would be equitable by the standards of American air lines.

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Comment: CONCUR

Effective 31 March, a Thrift Plan was adopted under which participating employees will contribute [ ] of their earnings to a trust fund at the Manufacturers Hanover Trust Company. The Company will contribute matching amounts and, upon retirement, each employee's share in the trust fund can be converted into lifetime income. As presently written, the plan remains subject to modification through about the middle of June 1962, by which time Internal Revenue Service approval will need to have been obtained. Past service costs are expected to be slightly over [ ] which will be paid by the company into the trust fund in equal installments over a ten-year period, the shortest span of time the Internal Revenue Service will approve. The retirement arrangements are to be carried out in the name of Air America, Inc., and all non-Chinese employees in Air America, Inc., Air Asia Co., Ltd., and Southern Air Transport, Inc., are to have the opportunity to join the plan.

The development of a Retirement Program such as this, involving foreign exchange, several nationalities of employees, and the personal finances of many individuals has taken longer than was originally anticipated. The chronology of this endeavor is as follows. In 1957, an insured plan was proposed by field management, and the idea of a retirement plan was approved in principle by the Board of Directors, but nearly two years were required to get the insurance company to produce an estimate of the cost of their proposal. Meanwhile, many employees took a position against an insured plan and argued effectively for a funded plan which would afford the contributors better protection against inflation. Late in 1959, a funded plan was prepared in the field and proposed to Headquarters, but had to be rewritten to exclude Chinese Nationals, who were, by a law recently reaffirmed by the Government of China, already provided statutory retirement benefits. The redrafted plan was turned over to Wyatt & Company, actuaries and employee benefit consultants, during 1960. The plan now adopted is an outgrowth of Wyatt's reworking of the field's original draft of a funded plan.

Recommendation No. 30:

The Deputy Director (Support) arrange to have the present treasurer-comptroller relocated in a suitable job in the United States, and that he be succeeded by his present deputy.

Comment: NON-CONCUR

A suitable individual to eventually succeed the present Treasurer-Comptroller, who at 62 is nearing the company's retirement age of 65, is being sought and will be employed when found. [ ]

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Regarding his successor, the company's independent auditors, who have worked for several years with his Assistant (not Deputy) have recommended against the advancement of this Assistant to the position of Chief Financial Officer. Length of service, hard work and faithfulness, they counsel, should not be confused with the need for importantly greater skill and talent in this responsible position. However, the President states that the Assistant is gaining experience and, in his opinion, may eventually qualify for the top job.

Recommendation No. 31:

The Deputy Director (Support) direct the Chief, Audit Staff, to coordinate the audit of the CAT Complex, and place an Agency auditor on the audit team as an observer if possible.

Comment: CONCUR

Although it will not be possible, due to previous commitments by the Agency Audit Staff, to accomplish this during the current audit now in progress, arrangements have been worked out with the



Recommendation No. 32:

The Deputy Director (Support) direct CAT to submit to the Agency's General Counsel a thorough study of the tax problem, possible courses of action, and recommendations concerning the most desirable solution.

Comment: CONCUR

The Board of Directors, the Agency's General Counsel, the Executive Committee, and company management, as well as the independent auditors, have long been aware of the difficult tax problem which has grown up since the early confused period

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on the Mainland and immediately following the move to Taiwan. This is an issue which confronts every American company operating overseas in a soft currency area and endeavoring to employ American personnel. This problem has been discussed with the President who agrees that the situation must be corrected and has undertaken to develop and submit to Headquarters an orderly plan that will be both palatable to the individual employees and plausibly acceptable to the Chinese tax authorities. The timing of a change in the method of paying American salaries might be set to coincide with the granting of compensating advantages.

Recommendation No. 33:

a. The Deputy Director (Support) assign a [ ] secretary to CAT, or that CAT itself assign cleared secretarial help for the President, the appropriate Vice Presidents, and the Security Section.

b. [ ]

Comment: CONCUR in a.

There has never, at any time, been any prohibition placed on the President, appropriate Vice Presidents, or the Security Section against having cleared secretarial staff. [ ] secretaries have been used in the past and have been satisfactory. Additionally, dependents of U.S. military personnel assigned in Taiwan have served as secretaries on a cleared and witting basis in an entirely satisfactory manner. Field management has been directed to remedy their present shortage in Taipei by local hire or by requesting what they need from Washington.

NON-CONCUR in b.

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Recommendation No. 34:

- a. The Deputy Director (Support) request the Development Project Division to provide in writing a set of requirements for light plane operation in Southeast Asia for the next year. Such a list should give appropriate recognition to the needs of other agencies with light plane requirements in Southeast Asia.
- b. The Deputy Director (Support) direct the project officer and CAT management to meet these requirements.

Comment: CONCUR

The development of such a set of requirements will be of great assistance to company management in their forward planning. Prior to issuing definitive instructions to CAT to proceed in accordance with part b., above, any necessary budget support will need to be programmed.

3. The critical comments contained in the text of the report which I feel should be answered fall into three general categories which can be summarized as follows:

- a. CAT has failed to meet the operational requirements of the Clandestine Services by providing a reserve of planes and pilots together with the necessary maintenance services.
- b. CAT management is over-emphasizing the commercial aspects of the business to the detriment of clandestine operations.
- c. CAT management's insistence on controlling all air operations and communications is wrong [redacted]

4. CAT's performance in meeting operational requirements of the Clandestine Services -- Operational requirements for air support consist generally of (1) providing airlift with CAT's own aircraft, crewed and maintained by CAT's personnel; (2) providing maintenance and/or flight crew personnel to go into the field to maintain and/or operate Agency-designated aircraft; and (3) maintaining Agency aircraft at CAT's main maintenance base at Tainan.

Two years ago, during the first quarter of 1960, CAT's flying with its own aircraft was slightly below 2,000 hours monthly. Discussions with DFD and FE Division indicated that flight equipment in the fleet and the maintenance and operating personnel then employed might be excessive. It appeared that the Agency would need to supplement

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CAT's income in order to avoid excessive losses. About this same time, DPD prepared a staff study of CAT which commented that the company was too large. Some excessive Chinese staff was separated to reduce the cash drain, but CAT maintained its fleet and its U.S. personnel position which represented a very substantial margin of reserve above 1960's needs.

During early 1960, a MATS contract was undertaken, thus keeping some of these specialists employed and trained. The MATS operation initially added two DC6A/B cargo aircraft to the fleet and utilized and trained the same crew complement as the [redacted] flights.

[redacted] and, a few months thereafter, requirements increased in Southeast Asia. Staff was added as promptly as capable people could be recruited, cleared and integrated.

With the substantial reserve which existed at the outset of this build-up, CAT was able to meet each requirement levied. We are not aware of any specific flying requirement which was permitted to go without response. As was appropriate, and as is part of CAT's plan, personnel were recalled from leave and overtime was utilized throughout the company. Flying hours increased to 4,000 per month by the end of 1960 and have continued to grow, until in March 1962, they were 9,264. During this same two-year period, "cockpit crew" personnel were increased from 80 to over 250.

At this flying-hour level, four and a half times early 1960, it may be said that little reserve exists; however, on this base CAT's expansion has continued and added future requirements can be met. Currently, capacity equivalent to about three C-46s and two DC6A/Bs is available in reserve and reserve flight crew capability is available for the use of these aircraft. During CAT's build-up, the greatest strain has been on top management, and talent is being added as it can be found.

The high level of specialized and experienced talent required in the top management in a company of the complexity of CAT is not easy to find, especially since such personnel must be willing to live in the Far East. Six corporations operating in twelve, sometimes more, different political jurisdictions, employing directly about 3,500 people, and equipped and qualified to maintain and operate 21 types of aircraft present a challenge not paralleled in many civil aviation organizations.

Independent and skilled observers from various segments of the aviation industry have volunteered comments to the effect that CAT has done an unusually good job in meeting this challenge. It is not contended that perfection in all things has been accomplished, but within the possibilities available to CAT, building on its early 1960 base which was considered adequate, possibly excessive, I find that CAT has met its requirements, and the record will show that no specific Agency request for airlift has gone unfilled.

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In the past two years, ten new types of aircraft have been added to the CAT fleet, thus enhancing its capability. The most modern is the four-engine jet CV-880. The most demanding undertaking has been the organizing and staffing of an H-34 helicopter unit of twenty machines based in Northeastern Thailand. This operation, performed for MAAG, has, during recent weeks, been highly commended by MAAG Commander General Boyle, U.S. Army, for its dependability and otherwise good performance. Boyle has cited its performance as being superior to that of the helicopter operation in Vietnam conducted by U.S. military organizations.

5. Emphasis on commercial aspects -- As the report points out, during the first four or five years that the Agency owned the CAT Complex, there was great need for administrative improvement. The development of proper accounting procedures, the training of competent personnel and the establishment of proper corporate records and practices had to be of primary concern to the management, although the continued development of both flying and maintenance capabilities for covert missions were not neglected during this period. The corporate structure was revamped in 1954, and, during the succeeding years, the required administrative improvements have been successfully introduced. The books of account since 1956 have properly reflected the financial condition of the company and statistical reports are prepared at regular intervals to show in detail company air fleet utilization and availability and how maintenance hours of skilled labor are allocated. Forecasts of expected activity are also prepared every six months.

All of these "tools of management" are those normally supplied to the officers and directors of a commercial company interested in making a profit, and that is exactly what CAT has to be if it is going to maintain its overt aspect of a civil air line operating scheduled international and domestic services, repairing and overhauling its equipment in its own maintenance shops and, at the same time, selling to outside customers charter or contract flying services as well as maintenance work.

It should be realized that Air Asia Co., Ltd., the principle operating subsidiary of the CAT Complex, is a Chinese company, incorporated in Formosa, and is subject to all the rules and regulations of the Government of the Republic of China. As a corporation formed under the Foreign Investment Law, it owes its very existence to the Ministry of Economic Affairs. As a civil air line, the company comes under the jurisdiction of the Ministry of Communications which directly controls all civil air line operations through the Civil Aeronautics Administration. The Ministry of National Defense, through the Chinese Air Force, controls the air fields at Taipei and Tainan and through the Taiwan Garrison Headquarters regulates entry and exit permits for workers at the air fields, including CAT's maintenance shops. The Ministry of Internal Affairs has administrative jurisdiction over all labor relations with the employees. The Ministry of Justice has jurisdiction over allotment and control of foreign exchange as well as

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import or export permits. The Ministry of Finance, through the Taipei Municipal Tax Bureau (roughly equivalent to our District Director of Internal Revenue), is continuously checking on the company's tax returns, methods of bookkeeping, and foreign currency transactions. The Bureau examines the company's tax returns in great detail and audits the corporate records supporting these returns. It also enforces the Customs Regulations concerning all imports and exports. To all of these supervisory authorities, the company must present the facade of an orthodox business venture, seeking profitable ways to provide flying and maintenance service to its customers, and properly recording all transactions on its books.

The foregoing relates only to Air Asia Co., Ltd., but it should also be noted that Air America, Inc., which is a Delaware Corporation and the most important element of the CAT corporate complex, is subject to audit by the Internal Revenue Service and must maintain its commercial posture before the United States authorities.

In connection with this overt posture that CAT must maintain vis-a-vis the Chinese authorities, it must always be kept in mind that most of the personnel employed in the offices at Taipei and Tainan are unwitting Chinese Nationals. The extent to which the Chinese employees become aware of the details of operational activities can be illustrated by the following summary of the back-up that is required to fly a plane from, say, Taipei to Kadann. Chinese Air Force approval must first be obtained, and the exact time and altitude established at which the plane will pass through the CAF air defense radar screen. The Operations Office assigns the crew from available flight personnel and the Personnel Office is advised that they will be in flight pay status. The plane to be used is checked, fueled and released by maintenance personnel. Flight Planners prepare details of the route to be followed and the Weather Section

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supplies route forecast data. Finally, all pertinent data is fed into the Statistical Office of the Treasurer-Comptroller for entry on the books. Practically all of these tasks are handled by Chinese employees and while there is no reason to question their loyalty to the company, we must assume that any deviation from normal procedures or any attempt to alter the books with unsupported "notional" entries would probably be reported to the Government in due course. A more professional approach is to make our overt accounting good enough and complete enough to withstand any scrutiny, and this CAT has done.

One of the important skills needed in company management is the capability to build viable commercial cover, and CAT should be given credit for having carried out this task well. Company management has also demonstrated that it considers its primary assignment and profession to be the conducting of covert air lifts and other air operations under the commercial cover it creates.

Attached hereto (Tab A) is a breakdown of CAT's activities (including Southern Air Transport) for the ten months ended 31 January 1962. The commercial air line accounts for [ ] of revenue and [ ] of flying hours. Add to these figures the two overt flying operations performed for the U. S. Air Force [ ] and for MATS (Southern Air Transport) and the percentages total [ ] of revenue and [ ] of flying hours. This is CAT's overt business cover and its basic reason for having flying crews and planes and maintenance facilities. On top of this "flying floor", the company has flown under contract to CIA, USOM and MAAG a total of 47,367 hours or [ ] of its total flying hours. Revenues from these contracts are [ ] of gross revenue. Any comparison of the ratio of dollar revenue to flying hours in overt and covert categories would be meaningless, since the flying equipment involved is not comparable. The hours flown by the Convair 880 Jet in the international scheduled service cannot be equated with the hours flown by a single-engine Helio Courier. However, it is worth noting that more than twice as many "plane in the air" hours were devoted to covert operations than to so-called overt commercial operations.

The report does state that the operational components of the Agency have not always been objective about the building of cover and have ignored the limitations imposed on civilian organizations by foreign Governments. However, it goes on to underline the point that the senior company officials are criticized for over-emphasizing commercial activities to the detriment of clandestine operations. It would appear that better liaison between the operating elements of the Agency and company management would lead to a better understanding of the needs and problems of each. Company management has, we feel, through the Executive Committee and otherwise, effectively offered the mechanism for closer liaison and better understanding.

6. Control of air operations and communications -- Our response to Recommendation No. 25 above states our position regarding the [ ]  
However, this point needs to be given particular attention since the Inspector General's

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Survey (Paragraph 13 of Section C) describes a system of management which experience has proven will not result in proper control of the Agency's assets and effective direction of the exploitation of CAT's capabilities. As already stated, more operational talent can be used in CAT, [redacted]

[redacted] However, in providing airlift and in conducting air operations for the Agency, direction and control within CAT must come from the top of the company.

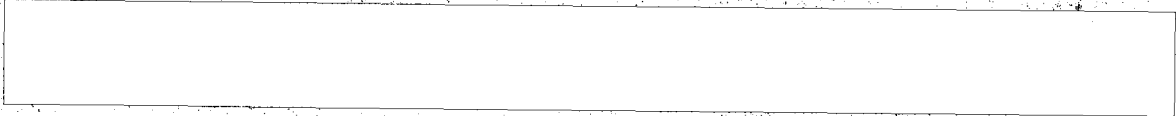
[redacted] Field employees of CAT, [redacted] or otherwise, appropriately respond to the next higher level in CAT, and through the President who is the General Manager in the field. Attempts at other arrangements have failed to provide the [redacted] organization which is essential. I am convinced that it would be absolutely unsound for the management of any organization of this size and complexity to be getting its orders from more than one source.

[redacted] We find no important difference in loyalty to the Agency between [redacted] and CAT employees who are non-staff, but witting. Both these individuals are afforded the same element of direct contact with the Agency. This is through CAT's supervisory chain. Their basic responsibilities to the Agency are essentially the same even though the [redacted] make him something of a temporary employee in the CAT organization. CAT recruits continuously for additional skilled supervisory personnel and would prefer to fill positions with [redacted] [redacted] should individuals with the necessary talents be willing to remain long enough in CAT to gain the required experience and background for responsible assignments within the CAT system. To acquire the skills which are so essential and to retain these people for extended periods of time in the Far East, the company has, so far, found it necessary to offer salaries which can only be paid to overt employees.

In December 1961, CAT prepared a document entitled "Contingency Force Plan", which provides for the organization of a "covert cell" within CAT. Selected individuals, [redacted] make up this group. It is visualized that the group must be augmented and re-shaped from time to time, depending upon the nature and size of covert projects undertaken. In any and all cases, the ex officio head of this field cell is the President and General Manager of CAT. He may delegate a large part of his covert duties to a Chief of Staff, but, in any case, he must remain knowledgeable and is responsible as the senior Agency representative in CAT in the field. It is planned that each of the eight senior individuals in the covert cell will rotate through tours of duty at Agency Headquarters in such a manner that one of these individuals is always in Washington. This Headquarters duty should serve to bring experienced long-term employees closer to the Agency.

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7. In conclusion I would like to say that while relations between the project and the operating components of the Agency have at times been less than satisfactory, I do not believe that these shortcomings can be attributed to the system of management which has been established and which I am convinced is the most workable and practical method of administering this complicated project. There is a basic conflict between any business proprietary and the operational demands that are levied upon it; the bigger the proprietary, the bigger the inherent conflict. Misunderstandings and personality conflicts have, in my opinion, been largely to blame for the friction that has developed between the operational elements of the Agency and company management. These can and must be eliminated through better coordination here at Headquarters between the originators of requirements for air support and the managers of the project. I intend to make every effort to develop a close working liaison between these two elements so that when requirements for air support are approved by Headquarters, there will be a mutual understanding of the methods to be employed to carry out each operations.



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L. K. White  
Deputy Director  
(Support)

Attachment:  
Tab A

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	<u>Flying Hours</u>	<u>Consolidated Gross Revenue</u>
<u>Services Under Contract to CIA:</u>		
CSG - Okinawa, Saipan	199	
NACC - Flying, Taiwan	90	
Maintenance		
BPF - Thailand	515	
USOM - (57-08) - Helio	4,365	
C-46	4,485	
C-47	635	
D@-28	92	
CEECO-Personnel, Taiwan, Takhli		
Maintenance		
<u>USOM and MAAG - Contract:</u>		
Southeast Asia - C-46	9,941	
C-47	6,954	
Apache	882	
Helio	288	
C-45	2,097	
Helicopter	16,823	
		30.1
<u>USAF</u>		
- Japan, Korea	6,320	8.9
<u>Airline Operations</u>		
International	4,482	
Domestic	1,469	
Agency Commissions		
Charter	1,065	
		21.2
<u>Contract Maintenance Engineering</u>		
USAF, USA, USN Aircraft		
Other Aircraft		
Equipment		
		12.0
<u>Ground Handling, Other</u>		
		4.5
<u>Non-Revenue Flying Hours</u>		
	1,459	
<u>Southern Air Transport, Inc.</u>		
Latin America C-46, Rar East DC6A/B,		
Net After Services from AAM and		
AACL	9,510	
		11.4
TOTAL	Hours 71,671	Gross Revenue 100.0%

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