

MEMORANDUM

TO : MGDR (via President)

DATE : 17 March 1972

FROM : VP-L

REF. No. VP-L/72-91

SUBJECT : Relations Between Southern Air Transport and Air America, Inc.
and Air Asia Company Limited
Ref: TP1877 dated 17 December 1971
HOM211B

1. The corporate relations between Southern Air Transport and the two companies of Air America and Air Asia are based primarily on two written agreements, one being an agreement between Southern and Air Asia for maintenance and supply support and one being an agreement between Southern and Air America for aircraft ground handling and for mutual assistance within Japan. There are or have been a number of lesser agreements (such as aircraft leases) but in general the relations of Southern with these two companies are based on the two main agreements.
2. During the eleven years that Southern's Pacific Division has been operating, the business arrangements between these companies have expanded to cover many facets that are not provided for in the written agreements. Now that Southern's Pacific Division accounting function is to be centered at the main office in Miami it is desirable to examine these relationships since SAMIA will no doubt encounter many personnel, financial and operational arrangements that are not covered by written contracts.
3. The contract between Southern and Air America (No. 69-20, also inadvertently numbered 69-6) contains two main parts. One part provides for aircraft ground handling services at Yokota AB, Osan AB, and Clark AB. This part represents Air America's standard ground handling contract and is essentially the same as Air America's handling contracts with other carriers. The second main part provides for "Mutual Assistance" at Yokota AB and Tachikawa AB (but not elsewhere) and reads as follows:

"Section 7. Mutual Assistance

7.1. Services

Air America agrees to assist Southern with the ground handling of its air carrier operations and maintenance of its aircraft at both Yokota Air Base and Tachikawa Air Base, Japan and Southern agrees to reciprocate by similarly assisting Air America with its operations at Tachikawa performed pursuant to contract(s) with the United States Government. All work performed on aircraft of either Air America or Southern will be in accordance with applicable civil air regulations of the country of aircraft registry and officially approved Maintenance Manuals.

7.2. Personnel

Air America's and Southern's supervisors will consult and coordinate to make the personnel of each party available as necessary in a timely

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manner in order to maintain operations and maintenance schedules of both Southern and Air America at Tachikawa and Yokota Air Base. When Air America's personnel are assisting Southern pursuant to this Section 7 of Annex A they shall be subject to the direction and instruction of Southern's supervisors in charge of their activities and when Southern's personnel are assisting Air America they shall be subject to the direction and instruction of Air America's supervisors in charge of their activities.

7.3. Equipment and Parts

The parties hereto agree to make their respective tools, parts and equipment located at Tachikawa and Yokota available to the other in conjunction with the mutual assistance contemplated by this Section 7 of Annex A. Parts and materials provided in accordance with this agreement are subject to acceptance inspection by the receiving party and must meet Civil Air Regulations and/or industry standards as applicable. All parts obtained by one party from the other shall be replaced in kind.

7.4. Training

Southern Air Transport agrees to assist Air America in the required training of Air America crew members by making available to Air America Southern's facilities and personnel including the provisioning of a crew member training program to be conducted in accordance with the approved training program outlined in the pertinent Air America manuals. Similarly Air America will make available to Southern such facilities and personnel as it may from time to time have for training purposes.

7.5. Renegotiation

Apart from rendering such mutual assistance as in this Section 7 of Annex A provided, there shall be no obligation by way of remuneration or monetary payment by either party to the other; provided, that if either party becomes dissatisfied with this arrangement due to an apparent disparity in assistance being rendered, upon notice thereof to the other both parties agree to promptly review this arrangement after which the arrangement may be continued, may be abandoned (in accordance with Article 16), or may be continued with such adjustments hereto, including arrangements for the payment by one party to the other of fees or charges for particular services, or for all services, which shall have been derived by mutual agreement."

4. This "mutual assistance" agreement is basically limited to the following points:

- a. Each will assist the other in the ground handling of their air carrier operations and the maintenance of their aircraft.

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- b. The personnel of each will assist the other in maintaining operations and maintenance schedules with the supervisors of the party being assisted being in charge.
 - c. Tools, part, and equipment will be made available to each other on a replacement-in-kind basis.
 - d. Each will assist the other in their crew member training programs.
 - e. The agreement can be adjusted or cancelled if the assistance given becomes overly weighted in favor of one party.
5. Southern's maintenance agreement with Air Asia provides that Southern will utilize AACL as the primary aircraft maintenance and supply contractor for its aircraft. Air Asia agrees to undertake a complete maintenance and supply program for Southern's aircraft, and components thereof, and provide parts and material procurement with the provisioning of spare parts and engines at Southern's operating stations.
6. Out of these two agreements which go back in much the same form for about eleven years there has developed an "assistance" arrangement that goes substantially beyond the relationship envisioned in the contract wording. While this relationship has apparently been successful in the sense that the companies have been successful in cooperating with each other where third parties are concerned, between themselves the relationship has suffered from the lack of a definitive and conclusive written agreement governing their relations. At times both parties have absorbed expenses that should have been charged to the other.
7. The main "assistance" offered to Southern was the provisioning to Southern of both ground and flight personnel on a more or less permanent basis. Paragraph 7.2 of Contract 69-20 does contemplate that personnel of each party will assist the opposite party, but this is apparently limited to assistance in performing a particular job or project. The personnel being "lent" would be under the supervision of the other party during the duration of this project mainly because the party being assisted is by law responsible for all facets of its operations. In practice this principle has been extended so that personnel have been "assigned" to work for Southern on a full time and more or less indefinite basis (some of these "assigned" personnel have been on Southern's payroll for more than ten years). In an additional deviation from the contract terms the assigned personnel, even at the lower job levels, remained largely under the control of the assigning company.
8. The assigned personnel have been retained on the personnel rosters of Air Asia and Air America and treated as being on leave without pay from these companies. Perhaps all the expenses of these personnel should have been charged to Southern during the time they were employed by Southern, but it

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was a deliberate decision (Home Office) that the matter be treated in this manner. Many expenses were borne by Air Asia/Air America which would appear to be inequitable. Presumably Air Asia/Air America does benefit by keeping these persons on its roster where they could be available for relatively prompt recall should their services be needed. This advantage is probably nowhere equal to costs sustained by Air Asia and Air America in carrying certain employee expenses. These expenses include the assumption of the vacation and travel expenses of U. S. citizen employees on Southern payroll up to April, 1971. During this eleven-year period these costs amounted to several hundred thousand dollars. Air America also paid the "company contributions" to the Air America Retirement Plan for those participants who were assigned to Southern. These payments were made up to January, 1972, at a cost of approximately \$400,000.00.

9. The above personnel expenses perhaps are the greatest expense imbalance between the companies, but there are other areas where one party has assumed expenses that might have been more properly charged to the other party:

- a. Southern leases its B727 aircraft from Air America with the rental being \$200.00 per aircraft hour. Due to a diminished MAC requirement the aircraft hours have been reduced with the result that Air America is losing money by this lease. Air America's depreciation costs on the aircraft, along with related G & A expenses, are such that Air America sustained a loss on the B727 aircraft of \$196,943.00 in 1970 and \$123,887.00 in 1971 (the change to rental based on flight hours occurred on January 1, 1970). This of course may not necessarily mean that Southern has made a "profit" of these amounts since this would depend on the terms on which Southern could have secured B727 aircraft from other parties.
- b. In reverse to the above it appears that Southern has incurred substantial costs in the training of B727 crew members that under other arrangements might not have been incurred. As Southern is the only party utilizing jet crew members the costs of their training could be expected to be assigned to Southern. The cost of training the initial 16 crew members (\$393,868.00) was paid by Southern and Southern has paid the cost of subsequent training for additional crew members except for two supervisory employees. The inequitable aspect of the training expense results from the fact that these crew members are assigned by Air America, are subject to recall by Air America, and are subject to the bidding procedures applicable to all of Air America's crew members. A number of pilots have been trained and then recalled (or they bid to another slot) with the result that Southern is faced with training a new group. This has been occurring at a time when Southern's jet crew member requirements have been decreasing rather than increasing. This is probably not correctable at this date but presumably any written agreement for assigning personnel should contain terms

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governing the length of their assignment in those cases where Southern incurs expense in their training. Southern's present crew member requirement is 11 pilot personnel whereas Southern has trained 46 jet pilots over five years. Of these 46 pilots eleven are currently with Southern, two are on leave without pay, one is in the process of being transferred to Air America, seventeen are with Air America, and fifteen have left.

- c. Related to this practice of switching crew members back and forth is the procedure of not releasing a crew member to his new employer until he has qualified in the new flight program. A number of Southern crew members have returned to Air America but have remained on Southern's payroll and expense until they qualified in their new job position. This may be an administrative convenience insofar as transferring personnel goes, but it is not a fair sharing of expenses. The same policy however works in Southern's favor when crew members are assigned to Southern.
- d. Air America and Air Asia have provided personnel services to Southern at points other than Japan even though the mutual assistance agreement is limited to Japan by its terms. No compensation is provided for this service and any assistance given in return is minor. In the past much of Southern's traffic, accounting, personnel and operations functions in regard to planning and overall supervisions was performed by personnel in Taipei. There has been no record of the manhours and expenses involved in this, but over the years it would have been quite large. Personnel records have been maintained in Taipei along with most statistical records concerning Southern's operations. Southern has a representative in Taipei on the Southern payroll but his office space and secretary are provided by Air Asia. Insurance matter and aircraft scheduling are coordinated through Air Asia Taipei personnel; flight following for sectors away from Japan is performed by Air America/Air Asia personnel; American employees are paid through the AAL Hong Kong office; in negotiating its POL contracts with Esso, Air Asia includes Southern which provides Southern with a lower rate (but Southern does of course pay for its own POL); Air America provides Southern with a small office and store space in Saigon (TSN) free of charge except for small charges for up-keep of the office and equipment used by Southern; Southern is audited annually by Lybrands and does pay for the time spent by Lybrand personnel on Southern's accounts but does not pay any share of the travel expenses and per diem expenses of Lybrand personnel who travel to the Far East; at stations where Southern is handled by Air America the local Air America manager acts as Southern's representative, often performing services beyond those contemplated in the handling contract (such as Air America's Kadena AB manager maintaining complete liaison with the LSG customer) and the handling charge is Air America's standard fee; World Airways shares the cost of a Boeing 727 tail gantry at Yokota AB with Southern and Air America, the cost of this being borne by Air

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America even though Air America does not operate B727 aircraft; certain fringe benefits for Southern's Japan-based Chinese employees, such as retirement and annual leave costs are borne by Air America; Southern's employees have free use of Air America's medical facilities; Southern utilizes Air America air freight specialists on its LSG flights on an actual cost basis without any application of G & A or profit; Civil Air Transport personnel in Saigon assist in the handling of Southern flights, but on a charge basis.

- e. The current maintenance rate in Southern's agreement with Air Asia does appear to be equitable now (but sometimes have been too low in the past) in view of the downward trend of engine overhaul costs. Air Asia does procure supplies for Southern in excess of those called for in the agreement (such as passenger food items secured through Air Asia's North Hollywood Office) but Southern is billed for this expense at Air Asia's in-bin cost (vendor's invoice cost plus 13.5% for North Hollywood's procurement expenses, inland freight, insurance handling charges, etc.).
- f. Southern utilizes the communications system which Air America has set up in the Far East and to the United States (contracted from third parties) but the system costs are prorated and Southern pays its equitable share on a monthly basis according to usage.
- g. From time to time Southern provides route support for Air America personnel and supplies but this is limited in amount due to requirements set up by MAC. Southern provides similar route support to other MAC carriers and in turn is provided route support by other MAC carriers, particularly World Airways.
- h. There are five vehicles at Yokota/Tachikawa of which Air America owns four and Southern one. Each bears all the costs of the vehicle(s) it owns but they are used in common which probably results in Air America having a disproportionate cost. However, at various times in the past Southern has provided vehicles at other stations, such as Clark AB, when the cost of such vehicles should have been paid by Air America as the vehicle services should have been provided under the aircraft handling agreement. In practice Air America would use the Southern vehicles in carrying out its handling agreements with other carriers such as Braniff or Flying Tigers. The reason for Southern having ownership of these vehicles appears to be the ease with which Southern could import vehicles.
- i. Southern and Air America have a joint training program in Japan for flight crew members, this arrangement having been approved by the FAA. In practice Southern has borne a disproportionate share of this cost since most of the higher paid American training personnel have been carried on Southern's payroll. Conversely Air America has carried an uneven costs

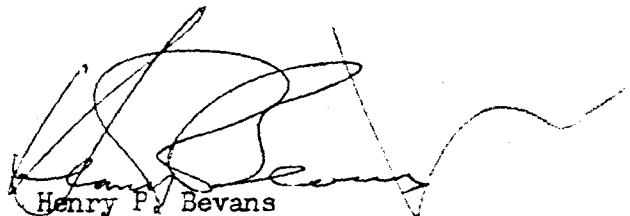
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of ground maintenance personnel in Japan. During the ten-month period of April, 1971 through January, 1972, for example, an average of 2,731 manhours per month was required for maintenance of the B727 aircraft whereas Southern's maintenance personnel in Japan could only produce a maximum of 1,340 hours per month. This imbalance is being corrected by the transfer of eight Japanese maintenance personnel from Air America to Southern effective 1 February 1972.

10. The above sets for the major inconsistencies in the relationship between Southern and Air America/Air Asia. Doubtlessly a detailed examination would point out additional discrepancies. Should you desire us to make any specific changes at this time please so advise.



Henry P. Bevans

cc: File

HPB/wJM/nz