

MAR 21 1966

**Memorandum**

**To: Secretary of the Interior**

**Through: Assistant Secretary, Public Land Management  
Under Secretary**

**From: Director, Office of Territories**

**Subject: Trust Territory air service**

This refers to your telephone request to us for further information concerning Trust Territory air service, which request followed your conversation recently with representatives of American Airlines. These representatives, as I understand it, told you of their interest in providing air service in the Trust Territory; indicated that they had excess equipment which would facilitate their doing so on an economical basis; and said they would themselves consider constructing and operating hotel facilities in the Trust Territory, to increase the demand for air service in the area.

As I indicated, we then expected soon to receive the preliminary report of a CAB team which visited the Pacific earlier this year. That report, dated February 21, has been received and states in pertinent part as follows:

"Discussions should be opened immediately with Pan Am looking toward a revision, at least on an interim basis, of the operating contract for the Trust services. Under the present contract, Pan Am is, in effect, paid a flat fee per mile operated whether or not a single passenger or piece of mail is carried on the schedule. Accordingly, there is no commercial incentive for Pan Am to utilize its sales facilities or operational know-how to generate traffic. Moreover, this contract system places responsibility for scheduling in the Government rather than carrier management. Apart from significant administrative problems in obtaining authority for emergency schedule changes, which occur not infrequently in this kind of service, it substitutes for commercial motivation, experience, and know-how as a guide to scheduling, government fiscal policy. The incongruity is patent.

"The objectives in the contract revision should be to secure a contract, without risk of significant increase in payment to the carrier, under which the Trust would guarantee to the carrier minimum revenue for a given schedule

pattern (bi-weekly service from Saipan to each District Center). The revenue should be designed to meet the carrier's break-even need for the proposed operations. The carrier should be paid for all cargo and passenger transportation services directly provided for the Trust but should receive no guarantee of revenues beyond those necessary for support of the minimum pattern. All revenues above the minimum should be shared by the Trust Territory and the carrier under a system which is designed to provide maximum incentive to the carrier to increase service. Thus, the carrier ought to be allowed a higher participation in revenue for a thrice-weekly service than for a bi-weekly one. Patently, any such contract would require a high degree of administrative experience for control; it is believed that the present economic consultants may be able to provide this capability."

We have now received the preliminary reaction of the Trust Territory Government to the above proposal. In his letter of March 9, the High Commissioner states the following:

"Contract revision is a matter that has been under consideration for some time. In view of possible extension of schedules and service, we will be obliged to enter into discussions with Pan American on necessary revisions. The objective stated by Mr. Rosenthal of securing a revision which would increase service without a significant increase in payment to the carrier by introduction of a commercial motivation and business management is indeed desirable. Such a contract would be a long step in the direction of full commercial operation. We would like to have a more detailed outline of what is intended and, if possible, some sample contracts of the type suggested that may have been used elsewhere. Efforts to date to interest Pan American in a contract in which they would have a basic financial interest have been nonproductive although we have again approached them on this matter. The development of a contract along the lines indicated is a specialized subject and one on which we would presumably need assistance from both the staff of the CAB and possibly from our Economic Development consultants. To the extent that the administration of such a contract would require a high degree of management experience, we should be prepared to add such management capability to the staff using the advice and assistance of the economic consultants as required."

Additionally, we have discussed the matter with both Mr. Rosenthal (the head of the CAB team and the person who signed the February 21 letter), and the High Commissioner.

As a result, we have reached the following conclusions:

1. The objective outlined by Mr. Rosenthal, and concurred in in principle by the Trust Territory, is surely worthy of achievement. The aim is, simply stated, to obtain better and more frequent air service in return for a lesser expenditure of public money.

2. A decision concerning certain aspects of this matter must be made by April 1 of this year, which is the date under the current contract on which the Trust Territory Government must notify Pan American if it (the Trust Territory) wants to perpetuate the current contract for another year. The current contract, entered into only after receiving proposals which resulted from a widespread solicitation among air carriers, is for a basic five-year period expiring June 30, 1967, but subject to annual renewals within that five year period. The contract year runs from July 1 through June 30. Whatever happens in the meantime, we would not extend the five-year contract without re-advertising it.

3. In the usual situation, we would prefer not to enter into a new contract for this kind of service, or to agree to substantial amendments to an existing contract, without obtaining competition. (American is but one of several carriers which have told us of their great interest in Trust Territory air service.) That is, we would prefer to follow our usual practice of inviting proposals from all interested potential contractors, of evaluating these proposals, and of choosing the one which offers the most favorable terms to the Government. To do otherwise is likely to subject us to a charge of favoritism.

4. The Trust Territory Government is not, as a matter of law, bound by the Federal contracting rules, and accordingly it could, if the situation warranted, negotiate with one company only. We think this is a situation in which negotiation with Pan American only, for a modified one year extension, is warranted.

5. The subject matter with which we are here dealing is exceedingly complex. The task of drawing up an invitation for proposals, and probably a proposed contract, will require expert help. We will doubtless have to ask the CAB for assistance. In order in fact to accord potential contractors a decent opportunity to offer proposals, we will need to give a considerable time (I would tentatively say 60 days at a minimum, and preferably 90) to them to review the facts and prepare their proposals. Additionally, because Pan American, alone among possible bidders, has (a) personnel capable of operating amphibious aircraft and (b) suitable maintenance facilities on Guam (both of which are essential to the Trust Territory operation), some few months must be available to permit the successful bidder, after a contract is awarded to him, to commence actual operations.

6. In the circumstances, it would clearly be impossible to invite proposals looking toward a new air service contract commencing on

July 1 of this year. Mr. Rosenthal's advice, which we have somewhat reluctantly accepted (reluctantly because we are anxious to have a new and better contract entered into as speedily as possible, as a result of full competition), is that we ought not to try to undertake to have a new contract commence any earlier than July 1, 1967.

7. As an interim measure, with the expectation that the result could be both better and cheaper (to the Government) air service, we propose to ask the Trust Territory (a) to give notice to Pan American by April 1 of its intention to continue the contract, and (b) to ask Pan American (to which Mr. Rosenthal has sent a copy of his letter of February 21) to offer modifications in the current contract along the lines outlined in Mr. Rosenthal's letter, quoted in pertinent part above. Clearly if Pan American is unwilling to modify the contract substantially, the Trust Territory Government will be, for the upcoming one year without power to force it to do so. The Trust Territory apparently believes Pan American will be unwilling. Mr. Rosenthal has discussed possible contract changes with Pan American, in an effort to show the extent to which Pan American itself would derive economic benefits from the kinds of changes he has in mind. Neither Mr. Rosenthal nor we can predict Pan American's receptivity to these proposed changes, but it seems clearly to the best interests of the Trust Territory to attempt now to achieve them.

In light of the great hope you expressed, that the Trust Territory Government could forthwith disengage from its current contractual arrangement and enter into a contract with a company willing to invest its own funds on something approaching a commercial basis, we seek your concurrence in an arrangement which may have the effect of postponing such new contract by a year. If the circumstances permitted a course of action in which we could achieve better and earlier results, we would recommend it. I am persuaded that they don't, and accordingly, I ask that you concur in the action outlined in paragraph numbered 7 above.

(Sgd.) Mrs. Ruth O. Van Cleve

Ruth O. Van Cleve

MAR 31 1966

I Concur:

(Sgd.) Stewart L. Udall

Secretary of the Interior

VanCleve:emr  
Rewritten: 3/21/66  
cc: Mr. Rosenthal