Trans World casinos?

Bout with Dillon, Read put TWA's future as an airline in jeopardy

Edwin Smart, Chairman of Trans World Airlines, remarked to a financial reporter some 18 months ago that "the airline may have to be liquidated." Today, at least one major commercial bank in New York is giving even odds that TWA, the nation's number two flagship carrier, will indeed expire within the next two weeks.

It is not hard to show that TWA's liquidation is the inevitable outcome of policies instituted nearly 20 years ago, when the basically sound, Howard Hughes-owned airline was taken over by a financial group headed by Dillon, Read—the investment bankers—Metropolitan Life, and a gaggle of Ford Motor-Bendix Corp. "whiz kids" brought in to run things. The TWA story is a case study in what happens investment bankers take over a well-run high technology company.

Over the two decades, in the words of one veteran airline-operating man, management has "done just about everything wrong that I could think possible." He was referring to profitable routes that were wrecked; expanding, money-making freight operations that were abandoned; critical overseas routes that were traded or sold; already developed markets that weren't exploited; and, most disastrous, a fleet that wasn't replaced. Accounting tricks were employed to justify management's decisions. These policies add up to what the London *Economist* politely terms "asset stripping."

The results are readily apparent. TWA has the oldest average plane in the industry—12 to 17-year-old Boeing 707's form the backbone of their operations. It is plagued with large seasonal fluctuations in ridership, and retains a workforce demoralized by what employees judge to be management "stupidity."

The company's stock, once over 100, has been bumping along in the low 20's throughout the 1970s. As an indication of things to come, on June 6, TWA stock bounced up nearly two points with the company's announcement that it will build two gambling casinos in Nevada. As Edwin Smart explained to *Aviation Week* in February 1978, "TWA is not even primarily an airline, because two-thirds of our profit last year came from Hilton International and Canteen Corporation."

The progressive liquidation of the airline by asset stripping is in marked constrast to the line's strong health in the 1960s. After Dillon, Read wrested control from Howard Hughes in 1960, delivery was taken of the Boeing and Convair jets previously ordered by Hughes, and profits took off. The jets, much more efficient than propeller planes and requiring less maintenance, produced a "breakeven" at 50 percent passenger load instead of the 65 percent necessary for the prop planes.

In the airline industry, once breakeven is achieved, it is calculated that 90 cents of every dollar of income is profit, and in the 1960s, intercity and overseas passengers flocked to the airports. TWA stock soared to the low 80s in 1966, when Howard Hughes was bought out, to over 100 by the end of the decade.

While every airline was netting substantial profits, Trans World Airways was in an unusually advantageous position because, unlike Pan American, the other flagship carrier (international operator), TWA had extensive domestic routes with the potential for rapid expansion of services. This would have necessitated large equipment expenditures and an aggressive fight for expansion of routes. But in 1968, TWA chairman Charles Tillinghast, a former Bendix lawyer, made a critical decision—against the airline. Tillinghast decided to buy Hilton International Hotels, a holding and management company that operates hotels owned by other investors or governments, with the funds that should have been ploughed back into the airline.

In 1972, the fate of the airline was virtually sealed by Tillinghast's decision to buy Canteen Corporation for $122 million from International Telephone and Telegraph. What followed was a series of giveaways, losses, flight and route cancellations, and irregular bookkeeping probably unequaled in any major U.S. corporation. The most spectacular giveaway case was that revolving around Hendryk Kwaitkowski.

Where does the money go?

Hendryk Kwaitkowski is reportedly now a Bahamian citizen who lived for a lengthy time in the U.S. by some inexplicable oversight of the U.S. Naturalization and Immigration Service. In 1970 he was named exclusive broker for sales of surplus TWA planes, although he was not an employee of TWA, which has its own sales department (as do most airlines). On Jan. 1, 1975, C.E. Meyer Jr., TWA Senior Vice-President (now President), for Finance signed a contract with Kwaitkowski Aircraft, Inc., headquartered at 30 Rockefeller Plaza, to broker the sale of a dozen Boeing 747's, the line's most modern, to the Shah of Iran, 27 Lockheed L-1011's to Saudi Arabia, and the line's remaining old Convair 880's to a domestic buyer. Kwaitkowski was given an incredible 10 percent commission. Ordinary brokerage goes for 1 to 2 percent. He was also given a $4 million cash advance and a monthly cash payment of $10,000.

TWA later repurchased one of the 747's at a loss of $5.5 million, and then found that the aircraft had been fitted with inferior engines which had to be replaced.

On July 14, 1978, TWA signed another contract with Kwaitkowski and Intercontinental Aircraft, Ltd., of the Bahamas, giving Kwaitkowski a modest 7 percent commission on this round of sales, plus $10,000 a month—plus something else: paragraph 7 the agreement states, "Upon execution of this New Agreement, TWA shall pay to KAI (Kwaitkowski) $850,000." There is no indication of what the payment was for.

One industry source questioned by *EIR* about this agreement responded, "Why don't you find out what Kwaitkowski does with the money?" So far we haven't been able to. It has been estimated by an industry analyst that Kwaitkowski has received tens of millions of dollars for his "services."

In 1974 a former junior accountant at the airline sued TWA demanding reinstatement. He charged that he had been dismissed unjustly when he reported to management a $100 million shortage on the airline's books. The truth of the charge cannot now be confirmed. The ex-employee cannot be located. But the accounting procedures of the company, as sources familiar with TWA practices confirm, are well suited to covering up such items. These accounting procedures have been used to show, for example, that categories of "profits" are not profits at all, and that the company operations showing these profits are "unprofitable."

When the airline quit the highly profitable air cargo business (freight-only flights' in December 1978, account proceedings were produced to show that the business was "unprofitable," because freighters flew half empty. Airport personnel at Newark called attention to the fact that Flight 17, for example, a freighter bound for Los Angeles, always flew full. But management records showed that this particular flight always returned "light." In their accounting system, foreign traffic being loaded for forwarding on this flight was not counted as payload. Hence, the fullest of payload flights was accounted "light."

In the same way, TWA dumped its Far Eastern lines by claiming unprofitability—a substantial portion of revenues generated by Far Eastern operations was called "domestic," substantially deflating those revenues for accounting purposes. Passenger-flight operations have been treated in the same way. In 1977, when a late-night departure from Philadelphia was abruptly scotched, the crew protested that the plane was packed on almost every flight. The incident threatened to turn into a scandal when the airport manager demanded that the company restore the flight.

Flight personnel recall instances of flights taking off which were never registered on the computer, or were never listed in the flight schedules; they recall arbitrary schedule changes that collapsed ridership on particular flights. They also recall instances in which the company would announce a cargo flight cancellation and, as shippers moved to other carriers, use the drop-off of shipments to justify the cancellation of the flight. In 1975, the Civilian Aeronautics Board publicly condemned TWA's "failure to take full advantage of an essentially profitable route structure."

One of the most amazing stories was that of a DC-9 commuter flight out of Kansas City several years ago. A crewman recalls: "This flight was always packed; I just can't remember an empty seat. One month, when the captain went to get his monthly bid sheet, he couldn't find the flight so he figured they had put on the larger 727 to handle the crowd. When he checked, he found the flight had been cancelled. The reason? 'Ridership had failed to show an increase'."

The route giveaway

Perhaps the most grievous self-inflicted wound was the massive route swap with Pan Am in 1975, in which TWA yielded to Pan Am its most profitable European and Oriental routes including Frankfurt, Guam, Honolulu and Hong Kong. The loss was so great that TWA didn't bother to juggle statistics. It explained to the CAB that year that "the effect of the route swap is not precisely quantifiable" but the "greatest value... is that it will enable TWA to gain from the routes being transferred to it by Pan American a part of the financial contribution it will lose by relinquishing its Pacific route to Pan American." In other words, the airline said, TWA will not lose as much as if Pan Am had given nothing in return for the TWA routes.

The profits lost in giving up the lines are difficult to measure because of, for example, TWA insistence that the Honolulu route be counted as "domestic" rather than part of Pacific operations. But direct cash payouts through March 1977 amounted to over $10 million. These included dismissal costs, station closing costs, and upwards of $1 million worth of paper and legal work.

While TWA gave up Frankfurt—worth $100 million a year to U.S. flagship carriers—it got "exclusive" rights to Paris. Pan Am, however, continued to fly charter flights to Paris. The TWA exec who negotiated the deal, company President Forwood Wiser, became Pan Am's chairman and president 10 months later.

The generally accepted "insider story" was that David Rockefeller of Chase Manhattan ordered the swap to stave off an impending Pan Am bankruptcy. True or not, the swap was in complete accord with the Dillon, Reed asset-stripping policy. With a fleet of aged planes, a disorganized rate structure, and looming recession, TWA management may well claim that all they can do now is run the planes for all they are worth and if casualties from accidents or terrorists increase, there is no choice but to liquidate the airline, since re-equipping would cost about $5.9 billion.

The financial press has set the stage for the move. In August 1976, Business Week wrote a feature titled, "Can TWA afford its high cost of flying?" noting the obvious about its equipment age and failure to plough profits back into new planes. The Feb. 19, 1978 *New York Times*, noting the aged fleet of aircraft, adds "The 250-plane fleet is suffering the after-effects of the neglect that began when the airline's founder, the late Howard Hughes, controlled the company. Mr. Hughes, it is generally conceded, milked the company to build up his other companies." The truth was just the opposite.

Howard Hughes

When Transcontinental & Western Air, Inc. TWA's corporate predecessor, was awarded routes to London, Lisbon, Paris, Frankfurt, Rome, Milan, Athens, Zurich, Madrid, Algiers, Tripoli, Cairo, Jerusalem and Bombay in July 1945, Howard Hughes, who already owned three quarters of the airline's stock through the Hughes Tool Company, began creating the international airline that would revolutionize world transportation. Hughes' competition was Pan Am. Pan American's guiding influence was Winston Guest, whose business and private life was determined by his marriage to a cousin of former British Prime Minister Winston Churchill.

Hughes knew planes. From World War II experience he knew that their range and capacity was just being tested. He envisioned the larger airships and jets of the 1960s, and helped design the Lockheed Constellations which became the workhorse of the TWA fleet.

But more important, Hughes organized and trained a workforce of the most skilled personnel. Recent retirement lists of TWA pilots are dotted with the names of World War II flying aces families to many veterans. The staff training center in Kansas City became a model for other airlines, many of which sent their employees through the TWA courses. What Hughes considered his most important innovation was the Kansas City repair facility, which, by 1960, employed 6,000 and became Kansas City's third largest industry.

In order to extend the flying time of his aircraft, Hughes subjected each plane to a thorough overhaul at the end of each 6,000 flying hours. Each plane was completely inspected, overhauled, and then flight tested as though it was a new plane undergoing shakedown testing.

Hughes could build and run an airline, but he was always short of capital. Like Henry Ford, Hughes steadfastly refused to increase the amount of outstanding TWA stock. He preferred to raise debt-capital instead, knowing that his opposition would use their stock ownership to vote him out at the first available opportunity. Yet he was forced to turn for debt capital to those he correctly mistrusted. In 1945 for example, Hughes borrowed $30 million from Equitable Life, a sum that was upped to $40 million the following year. In 1947, after two years of losses, when Hughes had to get Equitable's consent for extended borrowing, he was forced to agree to place his stock in an Equitable-controlled voting trust if TWA ever defaulted. In this lay the first elements of his downfall in 1960. His fundamental error was political, not financial.

Hughes' ultimate capital base was his ability to leverage Hughes Tool profits and assets to capitalize the airline. If the U.S. high-technology U.S.defense sector prospered, Hughes Tool and related airframe and defense-related industries close to Hughes would prosper. That depended who controlled Washington, and how they proposed to dispense government contracts.

Of the many attacks on the "military industrial complex" in this period, some were directly aimed at Hughes. In 1949 a Senate Committee chaired by Senator Brewster of Maine, charged Hughes with failing to deliver planes according to agreed-upon Air Force specifications. Hughes denied the charge, noting that the Senator from Maine had a large block of Pan American shares. The probe was expeditiously dropped.

Flagging demand for oil equipment, drooping government contracts, and the airline slowdown during the 1957-58 recession really caught Hughes short, at the very time he was switching to jet aircraft. Hughes wanted to buy between 70 and 100 Convair 880's and Boeing 707's in 1956, the largest order ever for aircraft. When the first Boeings were delivered in 1959, Hughes was desperately short of cash, although Hughes' TWA, unlike other airlines, had fully pretrained repair crews ready for maintenance.

In the fall of 1959, Hughes tried to arrange joint financing with the manufacturers of a new $400 million capital development program involving a large group of Lockheed Electras and Convair 990's. How this deal was thwarted is still unclear, but it was coupled with a pullback by Bank of America, a staunch Hughes supporter until 1959. If the program had succeeded, it would have put TWA far in front of its main competitors, Pan Am and American, and similarly saved Convair and Lockheed.

By March 1960, Hughes' thinking was quite straightforward: he needed short-term cash desperately. Hughes Tool was running out of cash. On March 1, Irving Trust tightened the noose by cutting off further revolving credits for the airline. Dillon, Reed then offered to put together a refinancing plan which brought in Metropolitan Life as a major lender.

Dillon, Read proposed that Met Life, Equitable, and the banks provide $160 million in senior financing, plus an additional $150 million in junior and revolving fund financing for the tool company and airline. Hughes got his short-term cash by obligating the tool company to guarantee some $67.5 million. This left him extremely vulnerable if the long term financing due to be closed on July 21 fell through. It fell through.

In the weeks leading up to July 21, Met Life and Equitable announced that they would only enter the Dillon, Read plan if two qualifications were met. If at any time there was a change in management that they considered adverse, they would demand a voting trust to vote Hughes 77 percent of TWA stock and, if such an "adverse change" took place before the closing, they were not obligated to go through with it.

Twenty-four hours before the closing, the President of TW, former Navy Secretary Charles Thomas resigned, an "adverse change" that brought down the whole deal.

There is a certain plausibility in the account given of his resignation. According to *Fortune* magazine, Thomas, in May of that year, was offered the chairmanship of the Irvine Ranch, a 95,000 acre undeveloped tract of land outside of Los Angeles—later famous as Charles Manson's hangout. In fact, Thomas might just as well have become the manager of these vacant areas, since he was generally incompetent at the airline, and had achieved the post through a concession by Hughes to the insurance companies and Dillon, Read.

After playing the Thomas card, it was a matter of reeling Hughes in. By September, Hughes agreed to the stock trust, but on condition that he could buy it back by paying debt.

Met Life's hatchetman, chief financial officer, Harry Haggerty, known at the time as the "man with a heart of stone," agreed to let Hughes buy out the stock trust for a premium of 22 percent. Hughes tried once again to bring General Dynamics, parent of Convair, into a refinancing deal with the bank creditors—he was fully aware that the insurance companies were orchestrating his destruction—but this too fell through, and on Oct. 30, Irving Trust and Equitable threatened to foreclose on the tool company and personal notes given by Hughes, thus threatening to take his base of operations away in bankruptcy proceedings.

"The Hughes problem had been solved"

Met Life gave Hughes "until the end of the year" to come to terms. On Friday, Dec. 30, 1960, 35 banks and financial executives from Met Life, Equitable, Irving Trust, Dillon, Read, Lazard Freres, Lehman Brothers and others sat in the conference room at Chemical Bank headquarters in New York to watch Hughes Tool financial vice president Raymond Holliday sign the articles of defeat. As one Luce publications writer gloated: "The Hughes problem had been solved."

In early December, 1960, before Hughes had formally capitulated, Grant Keehn, president of Equitable, called Ernest Breech, then retiring chairman of Ford, a front man for the McNamara-RAND "whiz kids" and previously of Bendix Corporation. Keehn asked Breech to act as one of the three trustees controlling Hughes's TWA stock. Keehn told Breech that it was not a question of corporate politics but rather, "it was his (Breech's) duty to the nation."

Breech, together with the other Met Life appointed trustee, a Morgan-run nonentity named Irving Olds who was a former head of U.S. Steel, quickly elected a new board of directors (using their control of Hughes's stock). They called in Charles Tillinghast from Bendix, who agreed to become president only if Breech would become chairman—to which Breech agreed. To guarantee that Hughes was financially out of the picture the trustees arranged a new financial deal, bringing in Prudential, this time with a proviso that if the voting trust were ever dissolved, the insurance companies would call in all their loans immediately.

Events in Washington proceeded in step with the takeover of the airline, Dillon, Read senior partner Douglas Dillon became Treasury Secretary under newly elected John F. Kennedy, and laid the basis for the subsequent wrecking of the American currency by institutionalizing through London the Eurodollar market and other "off-shore banking." Robert Strange McNamara's Whiz Kids flooded Washington to dismantle long-standing defense contract commitments, disorganize development programs, and bounce protechnology personnel from the Department of Defense.

Ultimately, putting TWA back together again rests on bringing the high technology industrial forces together with the political desires for growth and economic development held by the majority of Americans. Then the nation can answer with a resounding "no," the sardonic question asked in a recent TWA employee bulletin: "Are we (the employees) to become hotel desk clerks and vending machine mechanics?"

—*Leif Johnson*