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# 92-66 AUTHORIZE AIRCRAFT LOAN GUARANTEES

GOVERNMENT

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## HEARING

BEFORE THE

### SUBCOMMITTEE ON AVIATION

OF THE

### COMMITTEE ON COMMERCE

### UNITED STATES SENATE

NINETY-SECOND CONGRESS

SECOND SESSION

ON

### S. 2741

TO AMEND THE ACT OF SEPTEMBER 7, 1957, AUTHORIZING  
AIRCRAFT LOAN GUARANTEES, IN ORDER TO EXPAND  
THE PROGRAM PURSUANT TO SUCH ACT

APRIL 12, 1972

Serial No. 92-66

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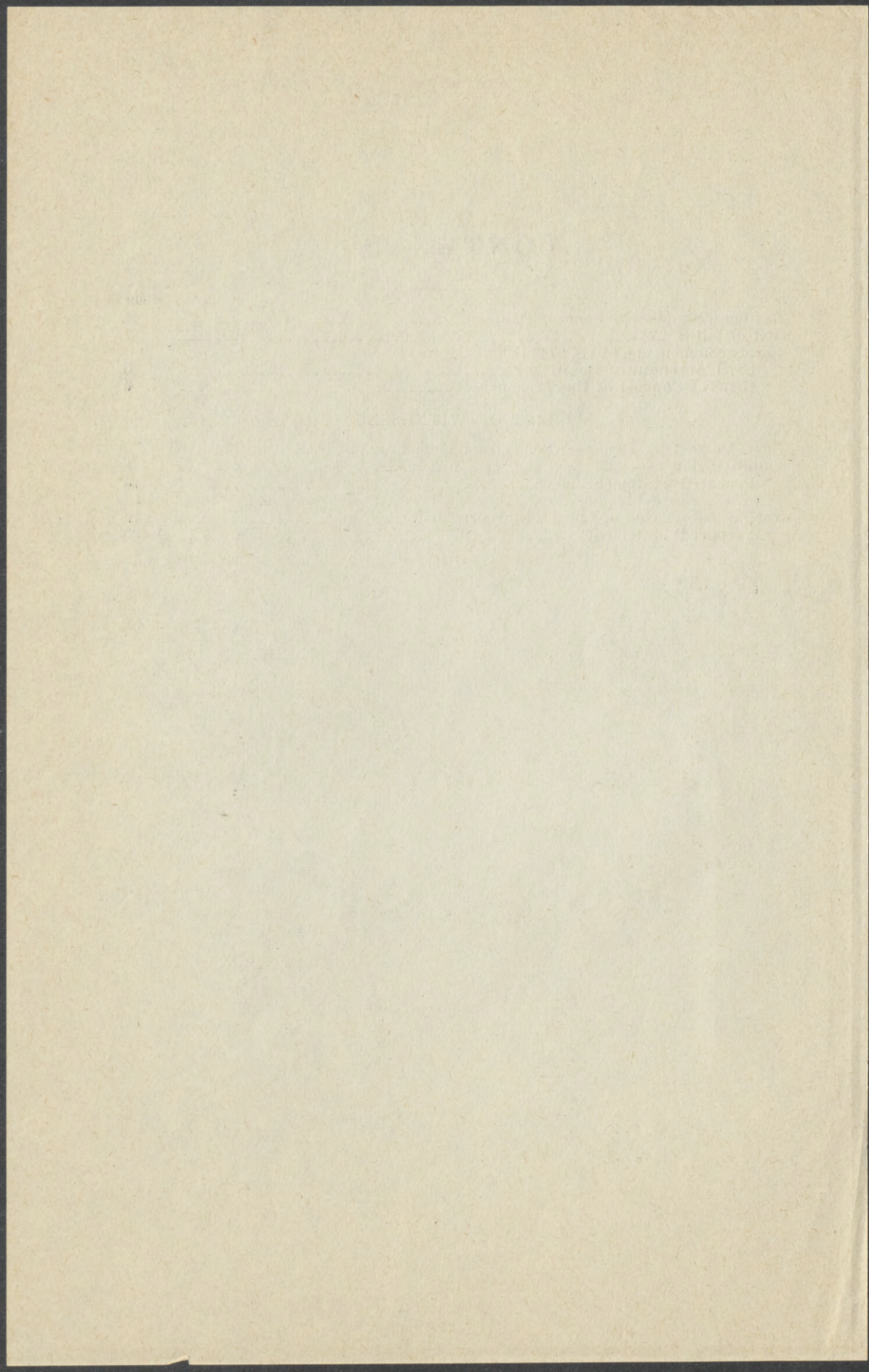
## CONTENTS

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	Page
Opening statement by Senator Cannon.....	1
Text of bill S. 2741.....	2
Agency comments on bill S. 2741 :	
Civil Aeronautics Board.....	5
General Counsel of the Treasury.....	6

### LIST OF WITNESSES

Guth, Herbert J., Director of Aviation Economics, Federal Aviation Administration.....	6
Prepared statement.....	14
Willis, Charles F., Jr., president, Alaska Airlines, Seattle, Wash., on behalf of the Association of Local Transport Airlines.....	16
Prepared statement.....	25



## AUTHORIZE AIRCRAFT LOAN GUARANTEES

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WEDNESDAY, APRIL 12, 1972

U.S. SENATE,  
COMMITTEE ON COMMERCE,  
SUBCOMMITTEE ON AVIATION,  
*Washington, D.C.*

The subcommittee met, pursuant to adjournment, at 10:10 a.m., in room 5110, New Senate Office Building, Hon. Howard W. Cannon (chairman of the subcommittee) presiding.

Present: Senators Cannon, Spong, and Stevens.

### OPENING STATEMENT BY SENATOR CANNON

Senator CANNON. The committee will come to order.

The committee will consider S. 2741 this morning, the bill introduced by Senator Stevens and myself at the recommendation of the Association of Local Transport Airlines amending and extending the Aircraft Loan Guarantee Act of 1957.

Testifying on that bill will be Mr. Herbert J. Guth, Director, Office of Aviation Economics of the Federal Aviation Administration, followed by Mr. Charles F. Willis, Jr., president of Alaska Airlines, testifying on behalf of the Association of Local Transport Airlines.

(The bill and agency comments follow:)

Staff member assigned to this hearing: Robert E. Ginther.

**S. 2741**

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**IN THE SENATE OF THE UNITED STATES**

OCTOBER 26, 1971

Mr. CANNON (for himself and Mr. STEVENS) introduced the following bill;  
which was read twice and referred to the Committee on Commerce

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**A BILL**

To amend the Act of September 7, 1957, authorizing aircraft loan guarantees, in order to expand the program pursuant to such Act.

1       *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*  
3 That the Act entitled "An Act to provide for Government  
4 guaranty of private loans to certain air carriers for purchase  
5 of modern aircraft and equipment, to foster the development  
6 and use of modern transport aircraft by such carriers, and for  
7 other purposes", approved September 7, 1957 (49 U.S.C.  
8 1324 note), is amended—

9           (1) in the second sentence of the first section by  
10       inserting "(1)" after "to enable them to", and by in-

1       serting before the period at the end thereof a comma and  
2       the following: "and (2) refinance aircraft financed at a  
3       higher rate of interest, or on terms otherwise less favor-  
4       able;"

5             (2) in section 3 by inserting after "any aircraft  
6       purchase loan" a comma and the following: "or other  
7       loan or commitment in connection therewith made for  
8       the purpose described in clause (2) of the first section.";

9             (3) in section 4 (b) by inserting before the period  
10       at the end thereof the following: "or refinanced there-  
11       with";

12            (4) in section 4 (d) by striking out "\$10,000,000"  
13       and inserting in lieu thereof "\$30,000,000";

14            (5) in section 4 (e) by inserting after "Secretary  
15       finds" the following: "in the case of an aircraft purchase  
16       loan";

17            (6) by striking out section 4 (f) and inserting in  
18       lieu thereof the following:

19        "(f) Unless the Secretary finds that the guaranteed  
20       loan is needed to continue or improve the service and ef-  
21       ficiency of operation of the air carrier.";

22            (7) by striking out section 6 (a) and inserting in  
23       lieu thereof the following:

24        "(a) The Secretary shall have the responsibility of ad-  
25       ministering this Act and shall make the findings required

1 by section 4 (e) and (f) : *Provided, however,* That he may  
2 make use of the advice of other agencies and instrumentali-  
3 ties of the Federal Government to the extent that he regards  
4 such advise desirable: *And provided further,* That such  
5 use shall not unduly delay the guaranties of loans and their  
6 administration in accordance with the policy of this Act.”:  
7 and

8 (8) in section 8 by striking out “15” and insert-  
9 ing in lieu thereof “20”.

10 By deleting the last sentence of section 1380 of this  
11 title (49 U.S.C. 1380) and inserting in lieu thereof the  
12 following: “The provisions of this section shall not be ap-  
13 plicable to the guaranty of loans by the Secretary of Trans-  
14 portation under the provisions of such Act of September 7,  
15 1957, as amended, but the Secretary of Transportation may  
16 consult with and consider the views of the Board in making  
17 such guaranties.”

CIVIL AERONAUTICS BOARD,  
Washington, D.C., April 12, 1972.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in reply to your request for the Board's views on S. 2741, a bill "To amend the Act of September 7, 1957, authorizing aircraft loan guarantees, in order to expand the program pursuant to such Act."

In addition to extending the Act for five years beyond its present expiration date of September 7, 1972, the bill would (1) expand the scope of the Act to include the guarantee of loans for the refinancing of existing aircraft loans, (2) increase the limitation on the total amount of loans that may be guaranteed with respect to a particular carrier from \$10 million to \$30 million, and (3) vest the Secretary of Transportation with discretion under section 410 of the Federal Aviation Act, rather than requiring him, to consult with and consider the views of the Board in making loan guarantees. Certain other changes, largely of an administrative nature, also would be made in the Act.

Although the need for extension of the loan guarantee program may not be as great as the need for the program initially, or even in 1968 when it was last extended, the Board believes that the continued availability of loan guarantees could prove to be useful to some carriers. This would seem to be particularly true with respect to the provision which would authorize the guarantee of loans for the purpose of refinancing current equipment loans. As a result of the recent completion of major reequipment programs by the majority of the carriers which would be eligible to participate in the loan guarantee program, it is not anticipated that such carriers would require major increases in their aircraft fleet. However, as a result of the reequipment program, these carriers presently have substantial loans on their equipment. The refinancing provision could assist the carriers in obtaining lower interest rates on current equipment loans, and lower interest rates on aircraft used in subsidized services should result in lower subsidy costs. Moreover, the refinancing provision could result in funds being obtained from longer-term lenders, such as insurance companies and trust funds which are prohibited from making loans secured only by property.

The proposed increase in the loan guarantee limitation also appears to be desirable since it would enable the carriers to refinance a greater portion of their present debt. The present limitation is too restrictive because of the substantial debt incurred by the local service industry in purchasing modern equipment. In this connection, a restriction should be imposed which would preclude local service carriers from purchasing or utilizing new generation large capacity aircraft which would be unsuited for their routes. One means of accomplishing this would be to prohibit (1) the guarantee of a purchase loan in excess of \$10 million on a single aircraft, or (2) the guarantee of a refinancing loan on an aircraft which initially cost the carrier more than \$10 million.

Except as hereinafter noted, the Board is in accord with the objectives of the bill. However, the Board defers to the views of the Secretary of Transportation as to the need for the provisions which have been discussed since the Secretary is responsible for administration of the aircraft guarantee loan program.

Concerning the provision which would modify section 410 of the Federal Aviation Act so as to make it discretionary for the Secretary of Transportation to consult with the Board with respect to loan guarantees, the Board is opposed to this provision. The Board is primarily responsible for the economic regulation of the airline industry, and has the greatest experience in this area. In addition to administering the subsidy program, the Board receives continuous data on the financial posture of the carriers. Thus, the Board is in the best position to evaluate the economic impact on a carrier and on the subsidy program of a possible purchase or refinancing of aircraft equipment. For these reasons, the Board believes that the Secretary of Transportation should continue to be required to consult with and consider the Board's views prior to making loan guarantees.

The Board has been advised by the Office of Management and Budget that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

(Signed) SECOR D. BROWNE,  
Chairman.

THE GENERAL COUNSEL OF THE TREASURY,  
Washington, D.C., May 31, 1972.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Reference is made to your request for the views of this Department on S. 2741, "To amend the Act of September 7, 1957, authorizing aircraft loan guarantees, in order to expand the program pursuant to such Act."

The bill would broaden the authority of the Secretary of Transportation to guarantee loans to certain air carriers to include the refinancing of aircraft initially financed at a higher rate of interest, or on terms otherwise less favorable. The bill would also increase the total face amount of guaranteed loans which may be outstanding to any one carrier from \$10 million to \$30 million. The present requirement that no guarantee be made unless the Secretary finds that the air carrier is unable to obtain necessary funds on reasonable terms would not apply for refinancing loans. The bill would also extend the Act of 1957 authorizing loan guarantees for 5 years beyond its current expiration date.

The author of the bill in his introductory remarks stated:

This refinancing provision is an attempt to ease the burden of extremely high interest rates these lines currently face absent the guarantee. Since these interest rates are reflected in the costs and therefore the subsidy requirements of the local service airlines, it is entirely appropriate that the Government, through the guarantee of equipment loans, assist in this refinancing if it will have the effect of lowering interest costs. This, hopefully, will reduce the carriers' needs for Federal subsidy to operate the public service routes on which they cannot make a profit.

However, the bill would not limit guarantee eligibility to carriers which would otherwise require direct subsidies.

The amendments to the current guarantee program are not consistent with the purposes and objectives sought to be achieved by loan guarantee programs. A primary purpose of providing Government loan guarantees is to remove private credit market imperfections—situations in which credit is not available to prospective borrowers on reasonably competitive rates and terms. The objective should be the withdrawal of Federal support after the Government has "shown the way." Thus the private financial system is strengthened without permanent dependence on Federal aid and without unnecessary duplication by Government of private risk-taking and administrative functions. In view of the stated intent of the bill, to reduce interest costs to air carriers, and the proposed authority for loan guarantees without regard to whether credit is otherwise available on reasonable terms, the proposal would result in permanent dependence on Federal credit assistance and needless duplication by the Federal Government of the activities of private lenders.

We understand that in testimony before your committee the Department of Transportation saw no need for continuation of the program in view of the limited activity under the program in recent years.

In view of the foregoing, the Department would be opposed to the amendments contained in S. 2741.

The Department has been advised by the Office of Management and Budget that there is no objection from the standpoint of the Administration's program to the submission of this report to your Committee.

Sincerely yours,

ROY T. ENGLERT,  
Acting General Counsel.

Senator CANNON. Mr. Herbert J. Guth, Federal Aviation Administration.

**STATEMENT OF HERBERT J. GUTH, DIRECTOR OF AVIATION  
ECONOMICS, FEDERAL AVIATION ADMINISTRATION**

Mr. GUTH. Mr. Chairman and members of the committee, my name is Herbert J. Guth. I am the Director of the Office of Aviation Eco-

nomics, Federal Aviation Administration, Department of Transportation. The authority has been delegated to me to act for the Administrator and the Secretary of Transportation in all matters relating to the aircraft loan guarantee program. I have a prepared statement which I would like to submit for the record. There is one correction which needs to be made in exhibit A. The footnote by Chicago Helicopter Airways, Inc., should have been placed by Los Angeles Airways.

I would now like to make a short summary statement.

The aircraft loan guarantee program has been in existence almost 15 years, since September 1957. In the first 5-year period, loans totaled \$41,865,858 for the purchase of 68 aircraft. In the second 5-year period, loans totaled \$13,335,224 for the purchase of 13 aircraft. In the last 5-year period, no loans were guaranteed by the Government, yet during this period the local and regional carriers went through a major reequipment cycle and added 239 turbine-powered aircraft to their fleets while retiring 269 piston aircraft. As near as we can determine, there was only one aircraft, a B-737, on order by eligible carriers at the beginning of 1972.

As of March 31, 1972, total loans guaranteed under the program were approximately \$55,200,000 and guaranteed fees collected were \$547,500.

In view of the lack of use of the program since the program was last extended, which covered a period of extremely tight credit conditions, the FAA has no basis for recommending another 5-year extension.

I shall be happy to answer any questions the committee may have concerning the program.

Senator CANNON. You say you have no basis for recommending. Do you recommend against it?

Mr. GUTH. No, sir. If the committee finds that the carriers can make a compelling case for the extension of the legislation, the FAA would not object. We have seen no evidence of a need for such extension.

Senator CANNON. Are there any circumstances that you are aware of as to the reason that no loans were made during the last 5-year period?

Mr. GUTH. No, sir. Our office has not received any communications on that subject from the carriers while we have been administering the act.

Senator CANNON. What has been the repayment situation on the loans; have the loans been kept current, those that may have been made?

Mr. GUTH. There is only one loan outstanding at this time. All others have been paid off. The outstanding loan is currently paid up.

Senator CANNON. Were any of the loans in default at any time?

Mr. GUTH. Yes. Last year a moratorium on two loans was granted by the banks for a brief period. The payments were then resumed and all deficiencies made up. One of those loans was paid off.

Senator CANNON. But there was no default in which the Government had to step in under the guarantee?

Mr. GUTH. No, sir.

Senator CANNON. So in the entire program the Government's guarantee has meant just exactly that, and the Government has collected a fee of a little over a half million dollars?

Mr. GUTH. Yes, sir.

Senator CANNON. How much of an effort has the Government had to put into the program from the standpoint of administration? Has there been any problem there?

Mr. GUTH. Well, certainly not recently, because there has been no activity in the program.

Senator CANNON. I mean over the life of the program.

Mr. GUTH. Initially there was a small staff connected with the administration of the program, but lately there has been none. Any work connected with the program has been done by existing staff.

Senator CANNON. In your prepared statement you said that "Alaska Airlines is the only carrier to have used the existing act since 1965 and that use was to guarantee a loan on two Hercules air freighters for charter use in Alaska oil fields." Is the use of the act to purchase equipment for charter use consistent with Alaska's primary obligation as a local service scheduled route carrier?

Mr. GUTH. Yes. The act defines the eligible carriers as those which hold certificates issued by the Civil Aeronautics Board.

Senator CANNON. Are purchases of aircraft to be used in specialized charter carriers eligible for Government loan guarantee under your interpretation of the act?

Mr. GUTH. Yes, that is correct.

Senator CANNON. How does the FAA determine or how has it determined, in the past, in guaranteeing loans, that private financing for the equipment is not available to the carrier?

Mr. GUTH. The carrier, in applying for a guarantee, must certify to us that private financing is not available.

Senator CANNON. Do you require more than certification of the carrier that financing is not available?

Mr. GUTH. The bank must submit a statement that it will not make the loan without the Government guarantee.

Senator CANNON. How do you go about determining the reasonableness of interest? The law says that the Secretary must determine before guaranteeing a loan that private financing for equipment is not available to carrier or carriers upon reasonable terms. What criteria do you set up for the reasonableness test?

Mr. GUTH. We determine the reasonableness of the interest on a case-by-case basis.

Senator CANNON. I understand, but what are your criteria? In other words, suppose a carrier came in and said we can't obtain a loan on reasonable terms and obtained a certificate from the bank and you found out that they could obtain a loan if they wanted to pay 12-percent interest. Would you consider that a reasonable term or not? I mean what is your criteria?

Mr. GUTH. It would depend on the existing market conditions and the interest rates that were considered reasonable at that time.

Senator CANNON. What is a reasonable interest rate? Is 12 percent reasonable?

Mr. GUTH. I think the exact interest rate considered reasonable would vary at different times.

Senator CANNON. I am trying to find out whether you have any criteria set up to determine when these loans should or should not be

made. If you do not have any, just say so. But if you do, I don't think we ought to be talking around in circles: "It will depend on the circumstances"; everybody knows that. I would think you would have some sort of guidelines set up in your Agency to determine the conditions on which loans are guaranteed. Do you have those or do you not?

Mr. GUTH. Yes, we do have criteria to determine when loans should or should not be made.

Senator CANNON. What are they?

Mr. GUTH. The carriers have to submit data concerning their financial and operating condition, the routes on which they are going to operate the aircraft, and traffic projections for these routes, and an indication of how the addition of the particular aircraft will improve their financial viability. They must also indicate whether the bank would grant the loan without the guarantee and, if so, on what terms.

Senator CANNON. Do you have any criterion as to how much over the prime rate is considered reasonable? If a carrier could get a loan at, say, 5 percent above the prime interest, would you consider that reasonable or unreasonable?

Mr. GUTH. We do not have a criterion of that sort.

Senator CANNON. You don't have any indication of why the carriers have not used the act in recent periods? Have any of them stated why they didn't, whether the regulations were burdensome or anything of this sort?

Mr. GUTH. No, sir; we have had no communication with the carriers on that subject.

Senator CANNON. You just don't know, is that it, why they have not used it?

Mr. GUTH. That is correct.

Senator CANNON. Have you had any applications in recent years that have been made and turned down?

Mr. GUTH. No, sir.

Senator CANNON. Have you had any applications at all that have been made and turned down? Has every application that has ever been made been granted?

Mr. GUTH. I do not have that information with me today, but I would be glad to supply it for the record.

Senator CANNON. Would you check that out and supply for the record whether there were any applications that have been made and were turned down by your people?

Mr. GUTH. Yes.

Senator CANNON. If so, you might want to amplify the reasons.

Mr. GUTH. I will supply that for the record.

(The following information was subsequently received for the record:)

There were seven applications for aircraft guaranteed loans which were docketed but did not result in a loan guarantee, as follows:

*Alaska Airlines*, docketed 11/13/57: Application refiled on 10/27/58, and withdrawn by the carrier on 10/4/60. Reasons for withdrawal were not given, but apparently it was because of the C.A.B.'s refusal to approve a loan guarantee in view of the States-Alaska Service Investigation instituted in December 1958.

*Hawaiian Airlines*, docketed 1/27/59: Application withdrawn by the airline because of its ability to obtain bank financing without a guarantee.

*Mohawk Airlines*, docketed 7/24/59: Application withdrawn by the airline because of its ability to obtain bank financing without a guarantee, and because

of an increase in the amount of a guarantee made to the banks by General Dynamics on the sale of a fifth CV-440.

*North Central Airlines*, docketed 12/4/59: Application withdrawn by airline because of its ability to obtain bank financing without a guarantee. This was done after the staff of C.A.B.'s Guarantee Loan Section advised the carrier that it could not approve the application because of various major problems involved.

*Chicago Helicopter Airways*, docketed 8/15/60: Application refiled 10/10/61 due to a change in equipment plans. Application withdrawn 6/4/62 by the airline pending finalization of equipment plans.

*Los Angeles Airways*, docketed 10/30/64: Application was for the purchase of a fifth S-61L helicopter and the modification of the four helicopters on hand to equip them for instrument flying. The application was never approved because of the C.A.B. order of September 21, 1965, eliminating subsidy payments to the airline beyond December 31, 1965, which would have made repayment of the loan very doubtful. The airline is now in bankruptcy.

*Alaska Airlines*, docketed 5/17/65: Application was for the purchase of two Hercules aircraft for charter work in connection with the North Slope oil exploration and was denied on the basis of (1) the high interest rate of six percent, (2) the financial condition and earnings record of the airline and (3) the uncertainty of earnings in view of the lack of firm commitments from the potential users. The application was refiled, however, and approved in January 1966, based on the purchase of only one Hercules with an interest rate of 5¾ percent, netting the lender 5.525 percent after paying the 0.25 percent guarantee fee on 90 percent of the loan. An application for a loan to purchase a second Hercules was approved in early 1967.

Senator CANNON. Senator Stevens.

Senator STEVENS. Has the Department issued regulations pursuant to the authority that is granted in the original act? The act authorizes the Secretary to issue regulations pertaining to the guarantee as to terms and conditions. Have those been issued by the Department?

Mr. GUTH. Yes, sir, if you are referring to the requirement of data and information that the carriers have to submit in order to support their request for a guarantee.

Senator STEVENS. Could you give us a set of regulations that have been issued by the Secretary pursuant to the act as it presently stands and as it has been amended? Would you file those for us for the record?

Mr. GUTH. Yes.

(The following information was subsequently received for the record:)

#### TITLE 14—AERONAUTICS AND SPACE

#### CHAPTER I—FEDERAL AVIATION ADMINISTRATION, DEPARTMENT OF TRANSPORTATION

[Docket No. 9442]

#### SUBCHAPTER O

#### PART 199—AIRCRAFT LOAN GUARANTEE PROGRAM

#### Revision of Part

On May 15, 1968, the Secretary of Transportation delegated to the Federal Aviation Administrator, effective June 13, 1968, all functions, powers, and duties of the Secretary under the Act of September 7, 1957, as amended (49 U.S.C. 1324 note), relating to the Government guarantee of private loans to air carriers for the purchase of aircraft and equipment (33 F.R. 8341).

Subsequent to this delegation, a new Part 199 of the Federal Aviation Regulations was adopted by the Administrator dealing with the deviation from the terms of Government guarantee of private loans to air carriers for the purchase of aircraft and equipment. This was the only function left in force under the Act of September 7, 1957, since the authority to guarantee loans under that Act had expired on September 7, 1967.

The most recent development occurred when Public Law 90-568 (82 Stat. 1003), which was approved on October 12, 1968, extended the authority to guarantee loans for an additional five-year period to end on September 7, 1972.

This revision of Part 199, accordingly, provides procedures for the administration of the aircraft loan guarantee program extended by Public Law 90-568. It also designates the General Counsel of the FAA as the official responsible for administration of the program on behalf of the Administrator. The information submitted under this Part shall become available to or shall be withheld from the public in accordance with Part 7 of the Department of Transportation Regulations, particularly § 7.59.

Since this revision relates to Departmental management, procedures, and practices, notice and public procedure thereon are not required, and it may be made effective on less than 30 days notice.

In consideration of the foregoing, Part 199 of the Federal Aviation Regulations is revised, effective March 1, 1969, as hereinafter set forth:

PART 199—AIRCRAFT LOAN GUARANTEE PROGRAM

*Section*

- 199.1 *Applicability.*
- 199.3 Applications for Government guarantees.
- 199.5 Contents of applications.
- 199.7 Action taken on applications.
- 199.9 Deviation from the terms of agreements.
- 199.11 Authority of FAA General Counsel.

§ 199.1 *Applicability.*

This Part applies to applications for aircraft loan guarantees as provided by the Act of September 7, 1957 (49 U.S.C. 1324 note), and as extended by Public Law 90-568 (82 Stat. 1003), and to requests for approval of deviations from the terms of guarantee and loan agreements concluded after September 7, 1957.

§ 199.3 *Applications for Government guarantees.*

The lender shall make application for an aircraft loan guarantee under this Part by filing with the General Counsel of the FAA an original and five copies of Form FAA 2950-1 and Form FAA 2950-2 prepared by the lender and air carrier, respectively, together with an original and five copies of any supporting documents. These forms may be obtained from the General Counsel, Federal Aviation Administration, 800 Independence Avenue, S.W., Washington, D.C. 20590.

§ 199.5 *Contents of applications.*

Each application for an aircraft loan guarantee under this Part must contain the following information:

(a) *Form FAA 2950-1. Application for aircraft loan guarantee to be submitted by the lender.*

- (1) Name and address of lender.
- (2) Name and address of air carrier.
- (3) Amount of loan, maturity date, interest rate, purchase price, term of loan (years), and guarantee requested.
- (4) Disbursement schedule.
- (5) Repayment schedule.
- (6) Collateral.
- (7) Indication whether lender would grant this loan, or a comparable loan, without government guarantee.
- (8) The lender's name, authorized signature, title, and date.

(b) *Form FAA 2950-2. Statement of carrier in support of application for aircraft loan guarantee.*

- (1) A list of all banks (or other sources) from which the air carrier has attempted to negotiate a loan during the past year.
- (2) Indication whether the air carrier has attempted to obtain equity capital during the past year.
- (3) The type, quantity, and cost of equipment to be purchased with the proceeds of this loan.
- (4) Name and address of seller(s) of aircraft and major groups of spare parts.
- (5) The purchase plan.
- (6) Use to be made of new equipment.

- (7) Expected financial effect of new equipment on air carrier.
- (8) Names of common stockholders controlling, directly or indirectly, more than 5 percent of the stock of both the lender and the air carrier; and
- (9) The air carrier's name and authorized signature, title, and date.

§ 199.7 *Action taken on applications.*

(a) Upon receipt of the application and supporting materials, the Administrator may communicate with the Civil Aeronautics Board and the lenders and air carriers, where necessary, in order to obtain additional or clarifying information before approving or disapproving the application.

(b) The Administrator may approve an application for an aircraft loan guarantee in accordance with the provisions of the Act of September 7, 1957, as amended.

§ 199.9 *Deviation from the terms of agreements.*

No deviation from the terms of any guarantee and loan agreements made after September 7, 1956, may be made without the prior approval by the Administrator. An original and four copies of requests for such approval, and an original and four copies of any supporting documents, shall be filed with the General Counsel of the FAA.

§ 199.11 *Authority of FAA General Counsel.*

The functions of the Administrator under §§ 199.7 and 199.9 of this Part are exercised by the General Counsel of the FAA.

This revision is made under the authority of the Act of September 7, 1957, as amended (49 U.S.C. 1324 note; 82 Stat. 1003), sections 6(a)(3)(A) and 9 of the Department of Transportation Act (49 U.S.C. 1655(a)(3)(A) and 1657), and section 1.4(b)(4) of the Regulations of the Office of the Secretary of Transportation (49 CFR 1.4(b)(4)).

D. D. THOMAS,  
*Acting Administrator.*

Issued in Washington, D.C. on February 25, 1969.

Note: The reporting requirements contained herein have been approved by the Bureau of the Budget in accordance with the Federal Reports Act of 1942.

(Docket No. 11264; Amdt. 199-1)

PART 199—AIRCRAFT LOAN GUARANTEE PROGRAM

PERFORMANCE OF OPERATIONAL FUNCTIONS

The purpose of these amendments to Part 199 of the Federal Aviation Regulations is to state the general course and method by which the operational functions of the Aircraft Loan Guarantee Program under the Act of September 7, 1957, as amended (49 U.S.C. 1324 note; 82 Stat. 1003) are performed. These functions formerly performed by the General Counsel, will now be performed by the Director of the Office of Aviation Economics.

Since these amendments relate to agency management, procedures, and practices, notice and public procedure thereon are not required and they may be made effective in less than 30 days.

In consideration of the foregoing, Part 199 of the Federal Aviation Regulations is amended, effective July 30, 1971, by striking out the term "General Counsel" wherever it appears in § 199.3, in the second sentence in § 199.9, and in the section heading and text of § 199.11, and substituting the term "Director of the Office of Aviation Economics" therefor in each case.

(Act of September 7, 1957, as amended, 49 U.S.C. 1324 note, 82 Stat. 1003; secs. 6(a)(3)(A), 9, Department of Transportation Act, 49 U.S.C. 1655(a)(3)(A), 1657; § 1.47(d), Regulations of the Office of the Secretary of Transportation (49 CFR 1.47(d)).

Issued in Washington, D.C., on July 22, 1971.

K. M. SMITH,  
*Deputy Administrator.*

Senator STEVENS. You have already told the chairman there have been no complaints made concerning any of the conditions that have been imposed. Are you familiar with those conditions that have been imposed on past loan guarantees?

Mr. GUTH. Do you mean the requirements of the act and our procedures?

Senator STEVENS. Are you familiar with the covenants and conditions that have been inserted in the loan guarantees in the past in regard to this type of guarantee issued by the Department?

Mr. GUTH. I am familiar with some of them. I think one that you are probably referring to is the requirement that the carrier, on any major financial transaction it wants to enter into, must get a waiver not only from the bank but also from the Government.

Senator CANNON. What do you mean?

What do you mean, a waiver from the Government?

Mr. GUTH. If a carrier that has a guaranteed loan wants to enter into an additional financial transaction that would affect its financial capability in some way, it normally must get a waiver from the bank to engage in that financial activity. The carrier, to comply with the terms of the guarantee, must also get a clearance or waiver from the Government.

Senator STEVENS. Isn't it true that your program has insisted on maintaining the Government's priority on assets even though they were subsequently purchased, so that the subsequent equity financing or subsequent capital financing through institutions involving loans that weren't guaranteed, you required a waiver on those to preserve the Government's first priority in regard to the assets that were involved in your loan guarantee?

Mr. GUTH. Yes, sir.

Senator STEVENS. And this, in effect, makes certain that the Government maintains first position, position on the assets of the company so long as there is an outstanding loan?

Mr. GUTH. Yes, sir; on those assets connected with the guaranteed loan.

Senator STEVENS. On the total assets of the company?

Mr. GUTH. No, sir. Only on that aircraft purchased with the guaranteed loan and on attachments to that aircraft.

Senator STEVENS. I think that Mr. Willis will testify about that, Mr. Chairman. As I understand it, your position is that you don't oppose the bill but you are not in favor of the bill because you haven't got any justification at the present time for extending the program so far as your activities are concerned; is that correct?

Mr. GUTH. Yes, sir.

Senator STEVENS. The period of time when the program was used extensively was a period of conversion, was it not, from prop planes to jets and during the upgrading of the carriers that used the loan guarantee program?

Mr. GUTH. Yes, sir. The carriers in the late 1950's and early 1960's converted or began converting primarily from DC-3's to turboprops like the Fairchild and Convair aircraft. But I would point out that, in the last 5 years, there has also been a major reequipment program going on among carriers that are eligible for these loans, one in which they moved increasingly to large jet aircraft.

Senator STEVENS. Other than this one loan that you have mentioned, do you have any pending applications?

Mr. GUTH. No, sir.

Senator STEVENS. Thank you very much.

Senator CANNON. Thank you, Mr. Guth.

(The statement follows:)

STATEMENT OF HERBERT J. GUTH, DIRECTOR, OFFICE OF AVIATION ECONOMICS,  
FEDERAL AVIATION ADMINISTRATION, DEPARTMENT OF TRANSPORTATION

Mr. Chairman and Members of the Committee:

I am Herbert J. Guth, Director of the Office of Aviation Economics, Federal Aviation Administration, Department of Transportation. I appreciate the opportunity to appear before this Committee today to discuss the aircraft loan guarantee program and to comment on S. 2741.

The Aircraft Loan Guarantee Program was established on September 7, 1957 by Public Law 85-307 and subsequently extended for five-year periods, in 1962 by Public Law 89-670 and 1967 by Public Law 90-568. It is currently administered by the Federal Aviation Administration of the Department of Transportation. The purpose of the program is to help qualifying air carriers obtain loans for the purchase of aircraft suitable for local, short-haul and certain other operations in circumstances where commercial lending sources are not available without a guarantee. Loans guaranteed for any one carrier may not exceed \$10 million. The program has never been funded in that no borrower has ever defaulted in payment.

Coverage under the current program is extended to air carriers holding a Civil Aeronautics Board certificate of public convenience and necessity for local and feeder service within the U.S. or within Puerto Rico, for operations wholly within Hawaii or Alaska, between Alaska and the forty-eight contiguous States, and between Florida and the British West Indies, or for metropolitan helicopter service. A listing of all carriers eligible for loan guarantees under the program is presented in Exhibit A.

The bill under consideration today, S. 2741, would extend the program for an additional five years, increase from \$10,000,000 to \$30,000,000 the ceiling on loans extended to a single carrier, and authorize the Department to guarantee loans for refinancing aircraft purchases. The types of air carriers covered by the program would not be changed.

The Department supported extension of the program in the 1967 hearings. We were cognizant of the fact that when the program was first introduced, the need for the legislation was based on the proposition that the increased efficiency afforded by the purchase of new aircraft could or might reduce the subsidy payments which the local service and territorial airlines required. It was reasoned that their ability to continue the development of potential traffic would depend on the service they could offer the public. Since its enactment, the program has been implemented consistent with legislative intent and has been successful in providing a means whereby carriers could improve the quality of their equipment. During the approximately 14½ years that the Aircraft Loan Guarantee Program has been in existence, a total of \$55,200,000 in loans have been made, and 90 percent of this amount has been guaranteed. A total of 81 aircraft have been financed under the program. A breakdown on the amount of each loan and the equipment purchased is presented in Exhibit B. Total guarantee fees collected by the Government have amounted to \$547,524 as of March 31, 1972, which is estimated to have exceeded the cost of administering the program.

As a result of an increasing ability to obtain loans without a Government guarantee, there has been little use of the program by eligible air carriers since 1965 and no use of the program since the 1967 extension. For the five-year period ended 12/31/70, the flight equipment investment for the four groups of certificated carriers authorized by the Act increased 3.2 times, from \$228 million to \$734 million. Long term debt for the same period increased 4.3 times, from \$129 million to \$559 million. However, the only guaranteed loans made during this period were to Alaska Airlines for two Hercules airfreighters for use in charter operations in connection with the North Slope oil fields in Alaska. One loan is currently outstanding in the amount of approximately \$780,000 with a maturity date in March 1974.

The fleets of the nine local service carriers included only about 7 piston aircraft at the end of 1971. The other aircraft in the fleet as of that date were all turbine powered: 163 turbo-jets and 250 turbo-props, for a total of 420 active transport aircraft. There are few outstanding orders for new aircraft.

On the basis of these statistics, we see no reason to continue the aircraft loan guarantee program. Although the program has been of use in the past and has been effective for the purpose for which it was designed, its lack of use in the last five years indicates that further extension of the program is not necessary.

I would again like to thank the Committee for giving me the opportunity to appear here today. I would be happy to answer any questions the Committee may have.

## EXHIBIT A

## AIRCRAFT LOAN GUARANTEE PROGRAM—DEPARTMENT OF TRANSPORTATION

## CARRIERS ELIGIBLE FOR GUARANTEED LOANS (21)

*Local service carriers (9)*

1. Air West, Inc.
2. Allegheny Airlines, Inc.
3. Frontier Airlines, Inc.
4. Mohawk Airlines, Inc.
5. North Central Airlines, Inc.
6. Ozark Air Lines, Inc.
7. Piedmont Airlines, Inc.
8. Southern Airways, Inc.
9. Trans-Texas Airways, Inc.

*Hawaiian carriers (2)*

1. Aloha Airlines, Inc.
2. Hawaiian Airlines, Inc.

*Alaskan carriers (5)*

1. Alaska Airlines, Inc.
2. Kodiak Airlines, Inc.
3. Reeve Aleutian Airways, Inc.
4. Western Alaska Airlines, Inc.
5. Wien Consolidated Airlines, Inc.

*Caribbean area and Florida to British West Indies (1)*

1. Caribbean Atlantic Airlines, Inc.

*Metropolitan helicopter service (4)*

1. Chicago Helicopter Airways, Inc.
2. Los Angeles Airways, Inc.<sup>1</sup>
3. New York Airways, Inc.
4. San Francisco & Oakland Helicopter Airlines, Inc.

## EXHIBIT B

## SCHEDULE OF EQUIPMENT PURCHASES AUTHORIZED BY GUARANTEED LOANS

Carrier	Amount of equipment purchased	Amount of loan <sup>1</sup>	Equipment <sup>2</sup>
New York (1st loan).....	\$2,053,342	\$1,000,000	5 V-44B helicopters.
Bonanza (1st loan).....	4,805,003	4,324,500	6 F-27's.
Piedmont.....	5,732,636	4,850,000	8 F-27's.
Pacific (1st loan).....	5,145,565	4,531,000	6 F-27's.
North Central.....	2,600,000	2,340,000	5 CV-340's.
Aloha (1st loan).....	2,545,000	2,290,000	3 F-27's.
Wien Alaska (1st loan).....	1,450,300	1,305,270	2 F-27's.
Frontier (1st loan).....	2,500,000	2,250,000	5 CV-340's.
Ozark (1st loan).....	2,354,440	2,118,996	3 F-27's.
Pacific (2d loan).....	620,000	469,000	3 M-404's.
Aloha (2d loan).....	2,450,153	2,200,000	3 F-27's.
Bonanza (2d loan).....	1,605,637	1,125,000	2 F-27's.
Frontier (2d loan).....	1,000,000	900,000	2 CV-240's.
Pacific Northern.....	4,701,248	4,125,455	1 B-70.
Los Angeles.....	3,212,930	2,891,637	4 S-61 helicopters.
New York (2d loan).....	3,800,000	3,200,000	4 V-107 helicopters.
Ozark (2d loan).....	1,265,000	1,125,000	4 CV-240's.
Mackey (1st loan).....	920,000	820,000	2 DC-6's.
Mackey (2d loan).....	1,050,000	900,000	4 DC-6's.
Bonanza (3d loan).....	10,837,090	6,500,000	3 DC-9's.
Wien Alaska (2d loan).....	444,000	399,600	4 PC-6A's (porters)

<sup>1</sup> Amount guaranteed is 90 percent of loan in all cases.

<sup>2</sup> Includes spare parts in most cases.

<sup>1</sup> Scheduled services temporarily suspended.

Senator CANNON. The next witness is Mr. Willis, president, Alaska Airlines.

**STATEMENT OF CHARLES F. WILLIS, JR., PRESIDENT, ALASKA AIRLINES, SEATTLE, WASH., ON BEHALF OF THE ASSOCIATION OF LOCAL TRANSPORT AIRLINES**

Mr. WILLIS. Mr. Chairman, my name is Charles F. Willis, Jr. I am president of Alaska Airlines, Inc. I am appearing here today in behalf of the ALTA group of carriers to support the guaranteed loan renewal legislation. I have given the committee a prepared statement and would generally like to comment that the amended legislation has been unanimously endorsed by all the ALTA carriers. Many airplanes were acquired through this legislation, and in ALTA's opinion it is good legislation and is something that should be continued for bolstering the financial support of the small carriers.

Inasmuch as the Government has received very fine compensation and has received no losses as a result of it, we heartily recommend favorable consideration by the committee. I would like to answer any questions you may have, sir.

Senator CANNON. In your statement, you say you recommend the extension because of the increased cost of equipment, is that correct?

Mr. WILLIS. Yes, sir. When the legislation was first enacted, airplanes were in the \$500,000 to \$3 million range, and \$10 million per carrier, considering the fleets of the various carriers involved, was considered adequate. Today, for example, a 727 is exactly twice the price of what the aircraft were when the legislation was first enacted.

Senator CANNON. Do you know how many carriers plan to use the authority if this legislation is passed?

Mr. WILLIS. No, sir; I don't know that. But I have talked with all the member carriers frequently over the last year, and they all support having the legislation at such time the legislation would give them support when they wish to expand their fleets.

Senator CANNON. It is my understanding that none of the local service carriers has any orders or plans to purchase new equipment in the foreseeable future. In fact, many carriers have indicated that they have serious overcapacity. If that is so, why is there any urgent need at this time to extend the provisions of the program, particularly in light of the fact that it hasn't been used in recent years?

Mr. WILLIS. There are two questions there, Senator. There is no immediate need for it at this moment. As I said a little bit earlier, the need really lies in the year or two from now when reequipping or obsolescence requires further purchase by the carriers and the possible need for this financial support. The expansion from \$10 million to \$30 million is because of the size and cost increases that the equipment has appreciated over the past few years.

Senator CANNON. You have supported an addition to the act to make it so the equipment could be refinanced as well as purchased. In light of high interest rates, you might get a more favorable rate. If that is the case, why didn't more of the carriers use the act in the last few years if the original purchase would have resulted in a lesser or lower interest rate?

Mr. WILLIS. Unanimously, I think I can state in talking and discussing with the financial men in the local service carrier organizations they felt that the onerousness of the covenants which were imposed in the second go around, if I may use that characterization, were so difficult as to make the management of the loan itself between the carrier and the Government almost impossible to handle. A lot of carriers paid more than they should have, and we were one, even though we did use the guarantee on some Hercules acquisitions.

They do have on their books very high interest rate loans which they could get down to maybe one half of 1 percent or 1 percent over prime by using this act for refinancing the equipment.

Senator CANNON. What were some of the covenants that were imposed that made this very difficult?

Mr. WILLIS. Senator, you wouldn't want me to sit here that long, but the covenants basically are, anything you do, any business decision the company makes, you need to go first to the bank, the bank then goes to the various Government agencies, and almost a full-fledged hearing and exhibits is prepared before the reply comes back to the carrier through the bank.

This carrier, speaking of Alaska Airlines now, not ALTA, it has taken us over a year for approval for a simple commercial transaction that there was no need to bother the Government in the first place. It didn't tamper with the substance of the loan, it didn't tamper with the guarantee. I talked to DOT, the FAA, the CAB staffs over the years, and we all agree that the covenants are onerous, but they were there when the loan was taken by the carrier.

You might very well ask, "Why did you take those covenants?" Why? We had no choice.

Senator CANNON. You had no choice because you couldn't get a loan elsewhere or you couldn't get a loan at that interest rate?

Mr. WILLIS. We couldn't get a loan elsewhere first and we couldn't get a loan at that interest rate. On the Hercules loan, a loan was negotiated in 1966 at an interest rate of 1½ percent over prime, which is less than 6 percent now.

Senator CANNON. What rate of interest are the carriers now paying to finance their equipment without going through this process, do you know?

Mr. WILLIS. No, sir. I can speak generally. It is anywhere from 8 to 14 or 15 percent.

Senator CANNON. So that would be how much over prime at the particular time?

Mr. WILLIS. 100 to 125 percent over prime, up to that amount.

Senator CANNON. I think the committee would want to have something on file to show what likelihood there is for the use of this authority if it is granted. Your testimony indicates that you don't know of any of your members at the present time that would use it.

Mr. WILLIS. Senator, my testimony was right now I don't believe it would be used for new equipment. I do believe, and we could prepare such a document and submit it to the committee, that a lot of the carriers, including ours, will come in for refinancing of present equipment on more favorable bank terms.

Senator CANNON. I wish you would supply for the record the number of aircraft and the amounts of loans that you anticipate would be

refinanced by your members and a chart showing the approximate interest rate saving that you think would occur if this legislation were passed.

Mr. WILLIS. All right, sir.  
(The information follows:)

As to the future use of the aircraft guarantee loan law if it is renewed as proposed, a poll of the membership of the Association was made and responses have been supplied by all but two members (Aloha and Reeve). The members were asked the following questions:

(1) Assuming S. 2741 is enacted into law and assuming further that your present equipment financing can be renegotiated on more favorable terms with such guarantee, would you be interested in applying for such a loan and if so in what approximate amount?

Of the eleven responses to this question, one indicated contemplated financing which might require a guarantee of as much as 25 million dollars. Another response indicated a guarantee on refinancing of approximately 12 million dollars. A third response indicated a total long term debt of approximately 33 million dollars which, if refinancing were possible, any portion of which would be undertaken for a guarantee. A fourth response from Alaska itself indicates an interest in a financing package for all of its jet aircraft which could be between 15 and 25 million dollars at this time. A fifth member, while not contemplating any change in financing at the present time, would certainly give the matter serious consideration if a guarantee loan could be obtained which would be more advantageous.

(2) Assuming S. 2741 is enacted into law and irrespective of your Company's interest in refinancing existing arrangements (question 1), do you regard S. 2741 as useful and desirable for future initial acquisition of aircraft?

Of the eleven responses, ten strongly endorsed S. 2741 and believe it to be useful and desirable for future initial acquisition of aircraft. Only one disagrees.

Senator CANNON. I might say personally I am not as impressed about the refinancing provisions as I am about the original purchase provisions. I can understand how a company might be really handicapped if it couldn't get an equipment purchase loan absent the Government guarantee. But on the other hand, if a carrier has a loan presently and it was able to renegotiate it, why, that puts a little different light on it in granting a guarantee for an entirely new financing program.

I imagine there are a lot of citizens in the country who would like to have Government guarantees on a refinancing program so they could refinance at a lower interest rate.

Mr. WILLIS. On that point, this carrier, Alaska Airlines, if this carrier had not had \$7 million of the \$10 million available, we would have used the guarantee for 727 acquisitions. Because it was not available, because we were up near the maximum, we are paying an effective rate of over 20 percent on two loans. Now, this is almost an impossible economic situation for a carrier to carry.

If it had been a \$30 million limit like we are supporting here, our equipment would have come in at about 7 percent or 6½ percent, and saving in subsidy alone would have been tremendous for just one carrier. I know that doesn't sound as exciting as new equipment and it is maybe not as necessary.

But if the limit was up to \$30 million, we would be much more viable and we could stay away from these high interest rates.

Senator CANNON. You say you are paying about 20 percent now for your loans?

Mr. WILLIS. Yes, sir; I said effective, the way these institutions do this, and they are the high-money people.

Senator CANNON. You know we have usury laws in most of the States in this country, and, under any of them I am aware of, that would certainly be a usurious interest rate.

Mr. WILLIS. The way it is gotten around, first there is a basic interest rate which is within the usury scope, and then there is kickers and sweeteners, and warrants and escalation, all kinds of things. By the time you get through and an actuary gives you what it is costing you, I can show you over 20 percent through some of these institutions' methods of going about buying equipment and leasing it back to you.

Senator CANNON. I would certainly be very interested in having a detailed breakdown of any loan that you are paying a 20-percent equivalent.

Mr. WILLIS. I would be glad to supply it.  
(The information follows:)

A detailed breakdown of the Alaska leases and loans which amounted to 20% or greater interest rates are as follows:

CIT and Kendall-Shaefer leases—these long term leases on 727 aircraft carry an effective interest rate of approximately 6% on the full value of an airplane for the entire twelve year period. This is computed to be 14% simple interest. At the end of the lease period Alaska is required to zero time the aircraft which will cost 1½ million dollars, the equivalent of an additional 6% simple interest for a total interest rate of approximately 20%. The CIT lease also provides for an option of 50,000 shares of Alaska stock at \$9 per share.

General Investment Development loan offer—one proposal made to Alaska involved an offer that 6 million dollars would be borrowed and 44½ of it would be turned over to Alaska, i.e. \$2,640,000. The escrow agents, attorneys and general investment fees would amount to 6% of this. This would reduce the figure to \$2,280,000. Alaska would pay 10 years' interest on the full 6 million at 7½% per annum. This equals 4½ million dollars, which amount would be repaid in 45 months at \$100,000 per month. The net simple interest cost of this transaction would be 40%.

National Equipment Leasing lease—Alaska leased \$300,000 worth of equipment. Repayment on this was \$5,400 a month for 66 months and \$2,920 a month for 30 months amounting to \$444,000. The \$144,000 paid in excess of the value of the equipment amounts to simple interest of almost 19%.

The only type of covenants that should be included in guarantee loans are the following:

- (1) The supplying of financial statements.
- (2) The maintenance of corporate existence and the continuation of a going business.
- (3) The right at any time to inspect the aircraft that are guaranteed.

The list of aircraft owned and leased by ALTA members as of December 31, 1971, by type of equipment is shown in the attached.

## AIRCRAFT OWNED AND LEASED—DECEMBER 31, 1971

	Convair 580/600	Martin 404	Fairchild F-27/FH-227	Nihon YS-11	BAC 1-11	Douglas DC-9-10	Douglas DC-9-30	Boeing 737	Boeing 727	Miscellaneous	Total
Air West:											
Owned			22			1	3				26
Leased			3			3	11				17
Allegheny:											
Owned	41		17		17		13				88
Leased					6		16				22
Frontier:											
Owned	32							2			34
Leased								8		2	10
North Central:											
Owned	25						10				35
Leased	9						5				14
Ozark:											
Owned			21			2	7				30
Leased						5	3				8
Piedmont:											
Owned			9	21				12			42
Leased											
Southern:											
Owned		17				3	1				21
Leased						8	3				11
Texas International:											
Owned	22					8					30
Leased	3					3	4			3	13
Aloha:											
Owned								5			5
Leased											
Hawaiian:											
Owned	7						4				11
Leased							4				4
Alaska:											
Owned									9		9
Leased								4			4
Reeve:											
Owned											
Leased									12		12
Wien Consolidated:											
Owned			5					3		10	18
Leased								1			1
Total:	127	17	74	21	17	14	38	17	14	31	355
Owned	12		3		6	19	46	14	4	5	109
Leased											

Source: Forms 41, schedule B-43.

Senator CANNON. Senator Stevens.

Senator STEVENS. Mr. Willis, in your statement, you point out these negative covenants in the guaranteed loans. I take it that your suggestion is that the covenants, which pertain to subsequent financing which are not in any way connected with the equipment purchase or the loan involving the guarantee, are the things that are basically restricting utilization of this law as far as the carriers are concerned, is that right?

Mr. WILLIS. Yes, sir. That is exactly the reason no one has used it since we used it in 1966. When the lawyers and the management of these carriers took a look at these covenants, it was just more than they could handle. The reason we went ahead with it, these Hercules were special-purpose airplanes to haul the oil rigs and equipment to the north slope, and it was the only aircraft that could do this job. As the committee might know, our carrier alone, by using the Hercules aircraft, opened up Prudhoe Bay, the biggest oil supply in the world, and carried over 200 million pounds of freight which would not normally have been carried to the slope.

That generated all kinds of new traffic in the lower 48 going to Alaska.

Senator STEVENS. There are two purposes to this bill. One is to increase the limit to \$30 million. If you can get us some indication from the other carriers as to their prospective utilization of this guarantee program if there is an increase, I think it would carry great weight when the committee considers this bill. The second thing has to do with the covenant procedures and the indication from not only your carrier but from the other ALTA members concerning what these covenant procedures have done so far as the companies are concerned which led them not to follow this guaranteed loan procedure.

The testimony as I understand from Mr. Guth indicates there is only one application pending. That means you are the only company that has presently any charge against the \$10 million.

Senator CANNON. He has one loan outstanding, but none pending.

Senator STEVENS. That is correct. My point is that, in order to justify the increase to \$30 million, you not only have to show the necessity in terms of your own concern but also in terms of utilization by all ALTA members. If the covenant restrictions were limited and if the \$30 million were available, how many companies would use this procedure?

Mr. WILLIS. On behalf of ALTA I would like to supply that information both on reequipment and a series of recommendations on what the covenants should be to keep it on a very businesslike and proper basis protecting the Government's guarantee.

Senator STEVENS. As I understand the SBA procedure, when you get a guaranteed loan, it is on a particular project. You get a loan and the Government takes a first position on that particular project; but the Government does not insist on absolute first priority on all subsequent transactions to my knowledge.

Mr. WILLIS. If this legislation could be administered the way the SBA is or the way the RFC was, on that basis you just mentioned, Senator, this would be fine, and the loan guarantee would be used.

Senator STEVENS. You just had a substantial change in your route situation. Are there any equipment demands on your company at the present time which have not also been imposed on the other carriers? Are you going into an equipment purchase program now?

Mr. WILLIS. We are in the process and just completed 2 days ago the acquisition of two more 727's and one 707. Again we are not able to purchase those. We are leasing them at high rates with options to buy at the end. But the net effective rate is very, very expensive to the carrier.

Senator STEVENS. How many other carriers are using this lease arrangement rather than purchasing their own equipment? Has there been a substantial conversion within the industry from ownership to leasing in the past years?

Mr. WILLIS. In our industry, the local service group, there is quite a few carriers using long-term leases instead of purchases.

Senator STEVENS. Is that related to the high interest problem?

Mr. WILLIS. Yes, sir. A lease is nothing more than another mode of purchasing with an option at the end. It is all tacked on the lease price. The carrier ends up paying 18- to 20-percent effective rate by the time he is through a 10-year program.

Senator STEVENS. I think the committee would be interested in that if ALTA can assist us and tell us how many carriers were leasing during the time this program was effective. As I understand it, there was a period of time when there were substantial amounts outstanding under this loan guarantee program. Then we came into a drying out period. I don't understand, if this law was so effective at the beginning, why it is now that industry, which as I understand it has as a matter of fact increased demands on it financially, doesn't use the loan guarantee program.

Mr. WILLIS. First, the commercial banks are against the program. I think they have testified here or previously. Being against it, when they get a program on their desk, speaking of the bank that we are involved with, the loan officer writes it up the way he feels: it is so difficult, they don't want it, they will tell you they don't want it, because the interest is not what they are getting today and it doesn't escalate with the prime rate, and the carriers have stayed away from it because it is just too difficult to operate your company and having to take 6 months up to a year for approval for anything you want to do—any major acquisition; that includes an aircraft engine. When we blow an engine, we can't wait around for 6 months to get one. If you go out and get it, you are in default.

Then you get all kinds of notices. One default triggers every other default. The bank officer that negotiated this first loan with me, after I signed it, he said: "Now you are in default; that is the way I wrote it. You will stay in technical default." So, automatically, you have these problems which are like dominoes going down the line with all your creditors.

Senator STEVENS. I was interested in your comment about the effect of this on subsidy. Can ALTA tell us how many of these carriers that are involved in the leasing procedure take higher cost than the guaranteed loan purchase procedure—how many of those carriers are receiving subsidy?

Mr. WILLIS. All of them are receiving subsidy. The direct relationship between savings and subsidy is the amount of the savings, because interest is an allowable expense, and lease costs are an allowable expense under the subsidy rate proceeding. If you are paying an exorbitant amount of interest, you are paying subsidy money to these lenders.

Senator STEVENS. That disturbs me, because the guarantee programs in SBA and FHA have effectively kept the interest rate down on costs where there is a subsidy. If this program is not working, I think we ought to go further than just beyond the idea of raising it to \$30 million. I think we ought to find out why this program isn't effective with the industry which is in effect dealing with another program, the subsidy program, which is under the jurisdiction of the committee.

Mr. WILLIS. This is a good program. This has been one of the few programs that the Government is involved in that has made a profit. No one has lost a penny on it. It is just that the administration has gotten so entangled and so difficult to manage, the carriers have said we can't run an airline and have this on our backs. I wouldn't have gone to the guarantee loans on the Hercules except there was no other way to get this aircraft.

Senator STEVENS. If you can give us any details on that, we would appreciate it, particularly on this day-to-day operation you have mentioned in terms of the procedures to get further waivers, and in terms of the day-to-day expenditures that must be made by management to keep an airline going, such as the engine that you mentioned. I think the committee would be interested in that.

Mr. WILLIS. We can do that, and I will, sir. I would like to add one comment. One of the problems with the administration of the law has been that the authority to give these waivers or the administration of it has passed from the CAB to the Department of Commerce, from the Department of Commerce to the Department of Transportation, to the FAA, and different people picking up completely without any background with this program.

It has sort of bounced around from one department to the other.

Senator STEVENS. I have no further questions.

Thank you, Mr. Chairman.

Senator CANNON. I think there are a couple of things that we ought to put in proper context here. You indicate that the carriers don't use the program because it is so burdensome. Yet there are a very substantial number of carriers that have used it and they have used it not only once but they used it on at least two occasions.

Mr. WILLIS. Yes, sir.

Senator CANNON. So, it obviously was a workable program. The airlines wouldn't have come back the second time if they hadn't been able to use it effectively the first time.

You talk about the subsidy and your leases. Is it a fact that while a lease cost is considered as a cost in determining the subsidy, actually you save money by leasing rather than outright purchase, do you not, because if you purchase outright, the only thing that you can write off for tax purposes is your depreciation and your interest charge as an operating expense? Yet, with a lease charge, you can write off the whole thing as operating expense. So, you are really in a preferred position

from the standpoint of both taxes and subsidy if you lease rather than purchase. Isn't that a fact?

Mr. WILLIS. No, sir.

Senator CANNON. Why?

Mr. WILLIS. You are much better off to purchase, because at the end of the purchase price—I can give a very clear example. When we bought a Convair 880, when we replaced it with 727's, we owned that aircraft and we sold it for almost as much money as we paid for it originally.

Senator CANNON. But I am talking about your day-to-day operations. I said, from the standpoint of tax purposes and from the standpoint of subsidy, you get a higher writeoff if you are leasing the equipment than you do if you are buying it, because if you are buying it, you get credit only for your interest charge from your operating expense and from your subsidy charge, isn't that right?

Mr. WILLIS. Yes, but the net effect is better to purchase your equipment.

Senator CANNON. The net effect is you have an aircraft after you have bought it, that is true. But in your day-to-day operations, your year-to-year operations, you are money ahead by paying out lease charges rather than by purchasing it, and I think that is maybe one of the reasons that you find some of the carriers have not used this program in recent years. There have been a number of carriers that have come back the second time for guarantees which to me doesn't indicate that the covenants are so burdensome that they just couldn't live with them.

Wouldn't you agree with that?

Mr. WILLIS. No, sir. They came back the second time, and by that second time the covenants and the administration of the act had gotten too difficult—and this is first hand to me from the carriers involved—that they thought it was better to pay more money and get a high-cost lease program or high-cost bank money than use the program. I think the information you have asked for, Senator, will—I can clearly show this.

Senator CANNON. I hope so. You yourself, you have been back the second time, haven't you? You are on your second loan?

Mr. WILLIS. Yes, sir.

Senator CANNON. Was it more burdensome the second time than the first?

Mr. WILLIS. Yes, sir.

Senator CANNON. In what respects?

Mr. WILLIS. The negative restrictions put on the carrier, which basically come to the fact that you can't do anything without getting all these approvals.

Senator CANNON. Weren't those restrictions placed on for the first loan?

Mr. WILLIS. No, sir.

Senator CANNON. Your testimony is that the restrictions that are required are more burdensome than those required by the SBA in their lending programs; is that right?

Mr. WILLIS. I think if this program followed the SBA, it would be excellent, and it would be well used; yes, sir.

Senator CANNON. I am going to ask Mr. Guth to comment on that in just a moment.

Senator STEVENS?

Senator STEVENS. No further questions.

Senator CANNON. Thank you very much.

(The statement follows:)

STATEMENT OF CHARLES F. WILLIS, JR., PRESIDENT, ALASKA AIRLINES

My name is Charles F. Willis, Jr. I am President of Alaska Airlines, Inc., a scheduled certificated air carrier with its headquarters located in Seattle, Washington. Its route authority enables it to provide air transportation to the largest segment of population in the State of Alaska as well as between the largest cities of that State and Seattle.

I appreciate the opportunity to appear here today on behalf of the Association of Local Transport Airlines in support of S. 2741, the aircraft loan guarantee renewal bill. The Association, as you know, is made up of the nine local service carriers, the three main Alaskan carriers and the two carriers serving between the Hawaiian Islands. One of the primary missions of these carriers is to provide air service to the smaller communities of the United States, many of which have no other means of public transportation.

Since 1957 when Congress enacted the first law providing for the guarantee of loans for the purchase of aircraft and equipment (P.L. 85-307, September 7, 1957, 71 Stat. 329), the United States has guaranteed a total of twenty-three separate loans for 58.2 million dollars to assist the smaller airlines—the local service, Alaskan and Hawaiian carriers—to purchase 81 new aircraft. Throughout the program the United States has not incurred a single loss in backing the credit of these carriers. The Act has been helpful to the carriers and, more importantly, has enabled them to acquire modern, convenient and more efficient aircraft and thereby to provide the traveling public better service.

The Association of Local Transport Airlines has strongly endorsed this Act in the past and has authorized me to appear here today on its behalf to support renewal of the Act for an additional five-year period. It is the belief of the Association, however, that the Act should have certain changes and some of these changes are embodied in S. 2741. Such modifications are necessary in order for the Act more effectively and efficiently to meet the needs of the smaller carriers and the communities which depend upon them for air transportation services.

The present aircraft loan guarantee Act, originally passed in 1957, contains provisions which limit its flexibility and fail to give recognition to the changed requirements of the carriers under present conditions. Indeed we feel that modifications are essential if the Act is to accomplish under conditions today the objectives Congress had and has in mind in the statute. For example, the total face amount of a loan which may be guaranteed to any single carrier is ten million dollars. While this amount ten years ago was considered adequate, the cost of aircraft during the ensuing period, particularly those useful and available over the routes operated by the carriers involved, has increased substantially. A Fairchild F-27 aircraft, the loan for which was guaranteed in 1958, cost approximately \$700,000. The Lockheed Hercules aircraft for which a loan was guaranteed in 1966 cost \$2,775,000. Twin engine DC-9 or Boeing 737 aircraft presently cost approximately \$4,200,000. Thus, it can be seen that very few units of aircraft which are today used on the routes of the carriers intended to be benefitted by the Act, can be financed by a ten million dollar loan. The bill before you, S. 2741, recognizes this problem by raising the limitation from ten million dollars to thirty million dollars. We urgently endorse and support this amendment.

Other amendments in the bill, all of which we strongly endorse, include provision for the making available of guaranteed loans to refinance aircraft earlier financed at rates of interest higher than those now available or on terms more favorable than those that could be obtained except through a guaranteed loan. Presently the Act is limited "to purchase aircraft". If the Act continues so restricted, the carriers must continue to carry the burden of high interest rate loans which well might be refinanced on more favorable terms if a suitable guarantee were obtainable under the Act for such refinancing.

Another proposed amendment which we strongly support is a change to clarify responsibility for the administration of the Act. The purpose of this modification is to make implementation of the Congressional intent in the Act less burdensome and time consuming and thus encourage broader use of the guaranteed loans by the local service carriers. The fact that the Act has not been more broadly used is due in no small part to the feeling, both with the carriers and the financial institutions, that the burdens of the administrative procedures in the administration of the Act have been too onerous. While the proposed amendment in this connection is necessarily couched in general terms and does not specify expressly how the burdens of administration will be lifted, it states clearly the Congressional intent that the Department of Transportation is charged with the primary responsibility of administering the Act and is not required to consult or seek approval of other agencies if any undue delay will result.

It is my opinion that negative covenants in guaranteed loans imposed by the Department should be limited to those which are absolutely necessary to the security of the guaranteed loan itself. This has not been the case in the past. For example, a covenant imposed against a consolidation or merger is wholly redundant. Approval of a consolidation or merger is a function of the Civil Aeronautics Board and there is, therefore, no reason for the Department of Transportation to include any such covenant in a guaranteed loan agreement. Other examples include covenants prohibiting capital expenditures and restricting equity financing. While protection for the guarantor (the Government) must, of course, be imposed, covenants in past guaranteed loan agreements have definitely hindered management in its day-to-day operation of the airline and imposed governmental control to a degree never, in my opinion, intended by Congress.

The administration of the program must be simplified. At present, the lender, in order to insure that the guarantee is not voided, must affirmatively see that there is compliance with or waiver of each and every covenant. The lender, normally a bank, is not in a position to grant waivers or extensions without first obtaining the full approval of the Government, the guarantor. Prior to the Department of Transportation, the Department of Commerce administered the Act. The Department of Transportation today delegates the administration of the program to the Federal Aviation Agency which has invariably asked for the Civil Aeronautics Board's opinion prior to authorizing any loan, change in the loan agreement, waiver or extension. Approval by the Secretary of the Department of Transportation, as required, obviously cannot be expected expeditiously in view of the necessity of his obtaining the prior approval of the other Federal agencies. Under this present procedure, it has required in some instances from six months to a year to obtain approval for a normal business transaction. A period of six weeks expired before approval of a charter of one of Alaska's Hercules aircraft was granted. Such a delay almost caused the loss of the charter contract.

We, therefore, support the proposed amendment which would provide new and more certain policy guidelines for administration of the Act. It will permit the Secretary of Transportation to consult with the Civil Aeronautics Board with respect to the original approval of each guaranteed loan but would not require that he communicate with the Civil Aeronautics Board (or other agencies) each time a waiver or covenant or other minor adjustment in the loan agreement might be required.

The proposed bill does not contain one provision which the Association believes should also be included. This amendment would increase the limit of the guarantees from 90% to 100% bringing it into accord with guarantee loans made available to other segments of the transport industry. Specifically, it is our proposal that Section 4(a) and (b) would have inserted therein 100 in lieu of 90. I am sure that the Subcommittee is aware of the fact that Government guaranteed loans for other industries are now provided at 100%. The 90% limitation has been a definite impediment of the Act and it is unclear as to why it was originally imposed.

I thank you for the opportunity to appear here today. We urgently request that favorable action be taken with respect to S. 2741 so that the present Act does not expire and so that it may be amended as suggested by the bill and by my testimony as presented here today on behalf of the Association of Local Transport Airlines.

Senator CANNON. Mr. Guth, would you step back up here again.

If you have some people assisting you, please bring them up here so they don't have to shout at you, you are entitled to have your technical people present to assist you. There have been some very serious questions raised here that I would like to get the answers to, to find out what the true situation is. Would you go ahead and respond? You have heard the allegation that on the second loan the burdens imposed by the Government were more onerous, more difficult than those imposed on the first loan; is that a fact?

Mr. GUTH. Senator, I don't know the answer to that question.

Senator CANNON. Does one of your staff people have the answer?

Mr. GUTH. No, sir. We would have to go into the record and see whether on the second loan, in effect, the conditions that the bank has imposed are more onerous than were imposed on the first loan. That seems to be the question.

Senator CANNON. Will you then check and supply us, for the record, the facts as to whether on the second loans, the Government imposed more onerous conditions than it did on the first loans, and if so, what they were and why. Also do you require a more burdensome lending arrangement than the SBA requires, and particularly with reference to afteracquired equipment? In order words, must a borrower provide security and have his new sellers take the secondary position to the Government if he acquires equipment after the original loan? If either of your assistants can answer that right at the present time, I will be glad to have it right now. Otherwise you can supply it for the record.

Senator STEVENS. May I interject there.?

Senator CANNON. Let's find out if either can answer here now.

Mr. SCHELLENBERG. My name is Carl Schellenberg, General Counsel's Office, FAA. I would like to clarify a misconception that may have arisen with regard to the Government's acquiring superior rights on certain assets of the carrier. If we are merely talking about the particular aircraft that the loan references, it is correct to state that the Government is interested in preserving a first lien upon that aircraft and any attachments to it. But with regard to the rest of the total assets of the particular airline, the Government does not require a first priority position.

Senator CANNON. What you are really saying is that if a man buys an aircraft under your loan program, you have a first lien on that aircraft, and if he thereafter loses an engine and has to buy a new engine to replace it, you insist that engine be covered under your first priority; is that right?

Mr. SCHELLENBERG. In so far as it is attached to the aircraft; yes.

Senator STEVENS. That is my point. The afteracquired property clause in the SBA would only come into effect if there were some type of delinquency and you went into a receivership or into some type of insolvency proceeding. However, as I understand it, in your program you require a waiver at the time the company buys the replacement engine, you don't rely on an after-acquired property clause.

You do agree that the Government has a first priority at that time?

Mr. GUTH. We will have to check on that, Senator.

Senator STEVENS. I think this is the problem. I have handled a lot of SBA loans in my day for small businesses. Everyone signed an after-

acquired property clause in SBA, but if you build a building and then suddenly have to replace the furnace, you don't have to go to the SBA to get a waiver to make certain that that furnace comes ahead of the person that sold the furnace.

Under certain procedures, the person who supplies the after-acquired property can preserve his first interest and the SBA has recognized the necessity to keep a business going. In some instances, you would never get somebody to supply that equipment. We went through all this after our earthquake in terms of the priorities on which the Government insists.

In some instances the SBA does take a second and third position in order to keep the business going, notwithstanding the fact that there is already an outstanding guarantee.

In this instance when you have a jet engine that has to be replaced or you have a substantial modification that has to be made to comply with new FAA regulations, if the FAA says, "Yes, you can do that but whoever finances that is going to take a second place because we already have first place on this aircraft." You are not accepting the fact that the business has to keep going. As I understand the restricted covenants involved, the FAA has insisted on each occasion that any new modification or any new equipment, the supplier has to agree to a waiver to take a second position to the guaranteed loan even though that is a new piece of equipment or a new addition to the aircraft to comply with new regulations.

This is a very onerous and burdensome thing if you are going to keep an airline going. I think if you relied on the SBA after-acquired property clause, it would be an entirely different matter.

Senator CANNON. I am not going to ask you to comment on that, because that was not only a question, a series of them, and a speech, but I must say I disagree with my colleague here, having handled some of these things in the past.

If you loan money on a airplane that has four engines on it, you would expect to have the first right to the airplane that has four engines on it. Now, if each of the four engines is changed and you then have an airplane with no engines left as the Government collateral, because somebody else has a priority right to the engines, the Government's collateral is seriously diminished.

In any event, we have asked you to check that and supply additional facts for the record. I wouldn't want an airplane that I lent money on to come back to me minus four engines if it was a four-engine airplane in the event of a default.

Senator STEVENS. I have an alternative for you, just guarantee that subsequent loan and everything is all right. That is really what we are saying. In the past, you haven't been able to increase your guarantee because of the limits or because of the restrictions. If you just include that after-acquired property in your guarantee, it will give you first place every time.

I am willing to have four engines too but I don't think you recognize the necessity of acquiring that replacement. When you have the replacement, you have to have the guarantee or the guy that is going to take second position will refuse to do it.

Senator CANNON. This hearing will adjourn.  
(Whereupon, the hearing was adjourned.)