The original documents are located in Box 17, folder "Pan American World Airways - Iran" of the Judith R. Hope Files at the Gerald R. Ford Presidential Library.

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OUTLINE OF TERMS AND
DISCUSSION OF BASIC ISSUES

At the request of the Iranian Government, Pan American has asked the Administration to give public approval in principle to a proposed $300 million Iranian investment in Pan Am. Administration approval would in no way bind the CAB which would also have to approve the transaction

Proposed Iranian Investment

The details of the proposed transaction are outlined in the attached annex prepared by the Company and its investment bankers. The principal terms can be summarized as follows:

1. Iran will make available $300 million to Pan Am;
2. $55 million of this amount will be used to acquire 55% of Intercontinental Hotels, an off shore hotel chain now owned by Pan Am.
3. The remaining $245 million will be provided in the form of a 10 year loan with a 10 1/2% interest rate and a three-year grace period with respect to principal repayments. There are provisions for accelerated repayment at Pan Am's option.
4. The loan is conditional upon U.S. banks continuing the current $125 million credit agreement and will be secured pari passu with other senior debt. (Iran is, however, willing to relinquish any collateral if U.S. creditors agree to do likewise.)

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5. About $190 million of the $245 million loan will be used to acquire at discount at least 75% of $390 million debt now held by institutional investors and $55 million of the loan will be used to satisfy current cash needs of the company.
6. Iran will also obtain warrants to purchase 6 million shares of Pan Am which, if exercised, could give Iran 13% of the then outstanding equity. The warrants would be transferable but no transferee could acquire warrants to purchase more than 1% of the outstanding shares without Pan Am approval.
7. Subject to CAB approval, Iran would nominate one member of the Pan Am 17 member board.
8. The transaction would be subject to approval by relevant U.S. regulatory agencies -- particularly the CAB.

Pan Am Timetable

If the U.S. government gives its public approval in principle to the transaction, Pan Am would immediately move to finalize its agreement with Iran. Initially, this would take the form of a letter of intent outlining the general terms of the transaction and would be followed by detailed negotiations of the final loan documents. As soon as the letter of intent was signed, Pan Am would also begin negotiations with its existing bank and insurance company creditors. It is anticipated that the results of the negotiations with its U.S. creditors would have a substantial impact on the final form of the detailed agreement with Iran. As soon as these negotiations were completed, Pan Am would make a final filing with the CAB for approval of the transaction.

Basic Issues

The transaction raises a number of basic questions which must be considered before Administration approval can be given. These include:

1. Why does Iran want to make such an investment?
2. Do we want a foreign government to have a substantial interest in the major U.S. international air carrier -- even though it is highly regulated by the CAB?
3. What effect will the Iranian investment have on (a) the ability of the Defense Department to utilize Pan Am equipment in its Civil Reserve Air Fleet and (b) continuation of the classified contracts Pan Am has with DOD?
4. What are the consequences of a denial on future OPEC government investment in the U.S.? If we refuse to approve the present investment in a heavily regulated industry, what kind (if any) OPEC government investment will we accept?
5. What effect will the denial have on our relations with Iran?

6. (a) Would refusal to approve the proposed transaction substantially increase the likelihood of Pan Am bankruptcy and mean that the government will have to face again the difficult problem of if and how it should assist Pan Am?

   (b) Conversely, is this assistance likely to provide a long term solution to Pan Am's financial problems.

   (c) If Pan Am continues to experience financial difficulties after the Iranian loan, would the USG be under pressure to bail out Pan Am for foreign policy reasons?

7. What effect would substantial Iranian influence in Pan Am have on CAB route awards and our international aviation policy generally?

Discussion of Basic Issues

1. Why Would Iran Make Such An Investment?

In considering why Iran would be interested in making a substantial investment in an ailing U.S. corporation, one must remember that Pan Am has had a long and generally cordial relationship with Iran -- involving technical assistance and participation in classified defense work carried out in Iran. In addition, the Shah himself has a personal interest in aviation matters. Pan Am representatives feel that, while the arrangement could lead to increased technical assistance for Iran National Airlines, the main reasons for the transactions are prestige and Iran's desire to become a major factor in the world wide hotel industry and in international aviation. Pan Am officials also believe that the Iranian offer represents a genuine effort by the Shah to make a constructive, cooperative move toward improvement of Iranian U.S. relations and that the Iranians feel that the investment could be financially attractive if Pan Am's profits improve and its stock price rises.

2. Should a Foreign Government Have a Major Interest in Pan Am?

The answer to this question depends largely on the precise nature and extent of the foreign government's interest. This section summarizes the Iranian interest in Pan Am and concludes that there is little possibility that Iran could exercise effective control over the operations and management of Pan Am.

Iranian Position as a Creditor. Iran is seeking no preferred position and wants only to be treated equally with U.S. creditors. Accordingly, it has insisted that the loan be secured pari passu with U.S. creditors (i.e. Iran will have a pari passu security interest in aircraft and other equipment). However, Iran is willing to relinquish its security if U.S. creditors are willing to do the same. Iran has no interest in being the sole or even dominant creditor and has made continuation of the U.S. bank credit agreement a condition precedent to the investment.

One of the key parts of the proposed transaction is the use of a substantial portion of the Iran loan to purchase at a substantial (i.e. 50%) discount senior debt now held by U.S. institutional lenders. Pan Am would hope to acquire at least 75% of such debt and, if successful, Pan Am's debt structure would be as follows:

Publicly held debt -- $480 million

U.S. Banks -- $125 million

Institutional Senior Debt -- $100 million

Iranian Loan -- $245 million

Depending on how much of the senior debt is purchased, Iran would hold between 20 and 30% of Pan Am total debt.

The precise terms of the Iranian debt have not been agreed and would depend on the outcome of difficult negotiations with current U.S. holders of bank credit and senior debt. Detailed negotiations with Iran would begin after the signing of a letter of intent.

Iranian Equity Position. If Iran exercised its option to purchase 6 million shares of Pan Am stock it would hold 13% of the then outstanding common stock. This, together with approximately 5% now held by other foreign investors, would involve a foreign ownership of Pan Am of approximately 18%. These interests would, however, be substantially diluted if the Iranian investment leads to a merger -- as Pan Am officials hope. The issuance of warrants to Iran would be subject to CAB approval, which would also be required for any further equity acquisition by Iran. Once it acquired 5% of the outstanding shares Iran would be required to file reports with the

SEC stating inter alia whether the purpose of the acquision is to acquire control.

Iran may sell its warrants if it does not want to acquire a permanent equity position in Pan Am. This provision of the transaction was negotiated to enable Iran to benefit financially through a rise in the price of the Pan Am common stock in a way that does not require it to become a shareholder. To protect against the possibility that Iran would transfer the entire 6 million shares to one person (e.g. another OPEC government) the agreement specifically prohibits a transferee from acquiring more than 1% of the outstanding shares without company approval.

Iran Membership on Board of Directors. While Iran would have one member on the board, there is no possibility that this number could be increased without company and CAB approval. The Pan Am board nominates all new directors and any Iranian director would be subject to CAB approval. As further protection, Pan Am common shares carry no cummulative voting rights, a fact which severely limits the ability of Iran to control the Board.

Relationship Between Pan Am and Iran if Transaction is Consumated. Recent news reports have extrapolated from Pan Am's past relationship with Iran to conclude that the proposed agreement would involve a full working relationship in which Pan Am would (1) make Iran National Airlines into a major international airlines, (2) provide technical assistance to Iran Air to fly the Concorde; (3) lease Concordes from Iran for its own use and (4) furnish technical assistance for the F 14 military fighter fleet Iran is purchasing from Grumman.

Pan Am has indicated that this is <u>not</u> part of the current transaction and that there are no understandings with Iran on Iran Air with regard to any of these matters. In this regard, it should be pointed out that Iran has the financial resources to secure any needed technical assistance from other countries (especially France and the U.K.). Furthermore, any technical assistance agreement or any fares re Concorde planes would need to be approved by the CAB before work could be undertaken.

<u>Role of CAB</u>. The entire transaction is subject to CAB approval which Pan Am would seek as soon as definitive negotiations with the Iranians had been concluded. The Board must approve (1) any acquisition of control of Pan Am and (2) interlocking directorships. In addition, any technical assistance agreement with Iranian National Airways would also be subject to Board approval as would any fare agreement for the Concorde. Although Iran has indicated during negotiations that it does not want control, ownership of 10% or more of the voting securities of an airline gives rise to a presumption of control under the Federal Aviation Act. Iran's

ownership of warrants to purchase 13% of the currently outstanding common stock, combined with the substantial creditor interest, would probably constitute legal "control" requiring CAB approval.

Iran has been fully informed of the need for CAB approval. Although they have been warned that the President has no control over the ultimate CAB decision, they do not appear to fully understand that Administration approval in principle does not necessarily mean that the CAB would approve the transaction. Should the CAB ultimately disapprove the transaction, after public Administration approval, Pan Am representatives believe this could cause misunderstandings.

With respect to CAB regulation generally, it is hard to imagine an area where the government and an independent regulatory agency exercise more control. Major operating decisions and any sale of a substantial part of airline assets would be subject to CAB review. International route awards are subject to CAB and Presidential review. In addition, there are specific pre-existing restrictions limiting (a) aggregate foreign equity holdings to 25% and (b) foreign participating in management.

Conclusion. If Iran does not exercise its warrants, it would have no equity interest or control of Pan Am. If it does exercise its option to its fullest extent, Iran would probably be a "controlling shareholder" for SEC purposes and might be deemed to have acquired "control" for CAB purposes. In spite of these legal concepts of control, there is no way Iran could exercise effective or working control over the management and operation of Pan Am.

3. Effect of Iranian Influence on CRAF and Classified Contracts

While concern has been expressed over the possible loss of Pan Am's contribution to the CRAF fleet because of an Iranian security interest in Pan Am's planes, any Pan Am bankruptcy would deny an effective Pan Am contribution to the CRAF program. DOD has indicated that the most important way to ensure adequate participation of Pan Am in CRAF is to keep Pan Am operational and the planes and crews flying -- i.e. keep Pan Am out of bankruptcy. Furthermore, disposition of assets and bankruptcy is controlled by the trustee and not the creditors which means that Iran would not have ultimate control over the disposition of Pan Am's aircraft. In addition, Pan Am officials have given assurances that they will honor all existing CRAF contracts and that this investment will have no impact on negotiations with DOD to expand CRAF.

According to DOD, Pan Am has some defense contracts involving highly classified material. Therefore, the Iranian investment might involve a breach of DOD's Industrial Security Regulations unless (1) Iran is willing to drop its request for a member of the Board and/or place its warrants and security interest in a U.S. trust with U.S. trustees or (2) Pan Am can spin-off its classified work into a separate subsidiary insulated from any Iranian interest.

4. Consequences of Denial on Future OPEC Investment in the U.S.

OPEC investment policies in the United States will be affected by the success or failure of the proposed arrangement. If the deal is successfully concluded without USG opposition, OPEC countries with significant cash reserves in short-term and highly liquid positions will be encouraged to proceed with longer term investments. However, the conversion of investment portfolios into equity positions will continue to be dictated by economic factors, including interest rates and company profitability. We would use this investment -- constructive objective, minimal control, and a highly regulated industry -- as a prototype or precedent to help guide additional OPEC investment in a positive fashion.

A negative decision on the Pan Am case by the USG would be weighed carefully by OPEC finance managers as an indicator of hostile USG attitudes toward other long-term OPEC investments. If it could be made clear that such a decision were based on the merits of the Pan Am issue per se and not on the principle of restricting OPEC investments, the current thrust of OPEC financial policies will not be greatly affected. If, on the other hand, OPEC investors saw U.S. disapproval as signaling a broader U.S. intent to place limitations on OPEC equity holdings in the U.S., the effect of such a negative signal could be profound. It would immediately affect OPEC plans to move into long-term holdings. The sensitivity of OPEC financial managers to the issue will have been increased by current efforts of members of Congress to introduce highly restrictive legislation aimed specifically at limiting the size of OPEC investment in the U.S.

Within the context of OPEC investor reaction, therefore, the proposed Iranian/Pan Am arrangement focuses directly on basic issues of the U.S. position on oil-money recycling:

-Does the U.S. wish longer-term inward investment by oil-producers?

-If not, can the U.S. structure OPEC investments toward short-term instruments without so undermining OPEC-investor confidence that incentives to invest in even short-term positions are not lost?

Analysis suggests that the U.S. should encourage the re-adjustment of OPEC state portfolios toward constructive, long-term, non-volatile and perhaps controlled investments. At the moment an interagency review of foreign investment in the United States is underway. While a consensus has not yet been reached, it is nevertheless possible to say that all but the most extreme policy approaches under consideration would permit some foreign government investment in U.S. firms, including such firms as Pan Am.

5. Effect of Denial on Iranian Investment Policies and U.S./Iranian Relations with Iran.

If the proposed Iran/Pan Am deal were disapproved by the USG for reasons which Iran felt were discriminatory or unjustified, there would probably be a major impact on Iranian investment plans in the United States. Iranian assets in the U.S., about

25% of Iran's total overseas investments, would seek European or other non-U.S. opportunities for investment giving both reasonable return and assurance of approval. This trend would accelerate as the profitability of Iran's short term income-bearing dollar instruments declined along with interest rates through 1975.

If it were clear to the Iranian Government that a decision to disapprove the Pan Am deal was made for reasons which did not affect the principle of OPEC -- and Iranian -- equity investment in the U.S., there would be a negative impact nevertheless, but shorter-lived. Iranian investment planning would be restructured toward projects or areas of profitability more likely to win USG approval. Iranian investments now in the U.S. would probably not seek non-U.S. outlets.

Similarly, U.S./Iran political relations would be affected according to the degree of discrimination which the Iranians believed to be the cause of a USG decision to disapprove the Pan Am transaction. If disapproval (a) were shown to be an act confined to the Pan Am case itself and (b) was meant as no impediment to the broadening U.S./Iranian relationship or to U.S. willingness to cooperate with and assist Iran in other areas (and this would have to be made clear to the Shah at the highest level of the USG if a negative determination is made), the political impact would be relatively short-lived.

6. Effect of the Investment on Pan American Financial Situation

Pan Am's 1974 pre-tax loss was $135 million and estimates indicate a minimum $65 million loss during 1975. Relatively small drops in estimated traffic or revenue passenger miles could create a cash crisis which would lead to bankruptcy. Given the present economic situation, prospects are for level traffic volume in 1975 compared to 1974. In the judgment of Pan Am and its investment bankers, the government's Seven Point Action Plan, a merger, route spin-offs or alternative sources of finance could not provide the relief necessary in time to avert the real possibility of bankruptcy in late 1975. The Iranian investment is, in their judgment, the only currently available way to eliminate this possibility and give the company an opportunity to return to long run economic viability. Pan Am further indicates that this financing will provide a medium term solution to their financing problems by (1) offering immediate short term cash resources, (2) providing relief over the next two years from debt principal repayments; and (3) freeing of assets that could act as collateral for future loans. The only long term solution to Pan Am's situation is a return to profitability. There is no assurance that, absent an immediate threat to Pan Am' survival, management would be motivated to take the drastic actions -- involving route restructuring or merger -- necessary to return to long run profitability. Thus, in the view of DOT, the company's long run viability remains in doubt.

Effect of Iran's Interest in Pan Am on International Aviation Policy Generally

The status of Iran as a major creditor and possibly also significant shareholder of Pan Am could have a profound effect on U.S. international aviation decisions. The extent of the effect will depend on the sensitivity of our relationship to the Government of Iran.

Presidential decisions are most subject to potential influence: route awards (adding to Pan Am's routes; taking routes away from Pan Am; adding or taking away from Pan Am's competitors--the President has ultimate authority); Presidential review of CAB rate decisions (suspending or rejecting a rate not covered by carrier agreement--charter rates, non-IATA scheduled rates) are subject to Presidential veto; Administration decisions on whether to endorse or oppose subsidies for Pan Am; merger approval; etc. Depending upon how sensitive our relationships with Iran are at any given moment of Executive Branch decision, it could have a heavy impact on the decision made.

Many Civil Aeronautics Board decisions are not subject to Presidential review. But the foreign policy implications of CAB decisions are clearly considered by the Board. Thus, no major CAB decision for or against Pan Am could be said to be free from the influence of our foreign policy relationship with Iran.

Initial Congressional and Labor Reaction

Pan Am has consulted with several Senators and received no adverse reaction. They report that Senators Church and Williams were enthusiastic; that Senator Percy was "very affirmative"; that Senator Stevenson felt it was a good solution to a difficult problem which avoided government assistance as in Lockheed and Penn Central; that Senator Scott saw no adverse influence or nothing on foreign policy grounds that caused concern; that Senators Javits, Stevens and Pearson were not adverse but felt it was too bad that a U.S. company had to be supported by a foreign government; and that Senators Jackson and Magnuson both indicated they would remain "neutral".

Meetings have been more difficult to arrange on the House side but Pan Am plans to visit Representative Morgan and members of the House Public Works Committee, which now has jurisdiction over most matters affecting Pan Am.

Pan Am reports that initial contacts with the Teamsters and AFL-CIO indicate that labor will not have major objections to the transaction.

PRINCIPAL PROVISIONS OF TENTATIVE AGREEMENT BETWEEN PAN AM AND IRAN

The agreement contemplates that the Iranian side will make available to Pan Am an amount not to exceed $300 million. The principal provisions of the tentative agreement are as follows:

1) Of the $300 million, an amount (say $55 million) will be used to acquire 55% of the stock of Intercontinental Hotels Corporation, an off-shore hotel chain wholly owned by Pan Am. The exact purchase price is yet to be negotiated. Each side will have a right of refusal in the event either wishes to sell all or any part of its IHC stock.

2) Out of the remainder of the $300 million, the Company will endeavor to acquire at least 75% of the outstanding $389,500,000 of Pan Am's senior debt now held by Institutional Investors at a substantial discount price satisfactory to Iran and Pan Am. Up to $70 million of the amount remaining from the $300 million after the acquisition of the Hotel Company stock and the discount purchase of senior debt will be lent to the Company for its necessary cash needs.

3) The monies made available for the acquisition of senior debt and the Company's cash needs will be in the form of a ten-year loan to Pan Am bearing interest at a rate of 10½% per annum, with a commitment fee of ½% per annum. Since no principal repayments will be required for the first three years, this will improve the Company's cash flow for the first three years by a cumulative amount of roughly $60 million.

4) The agreement is subject to the condition that the banks which have presently extended a line of credit amounting to $125 million, payable on September 30, 1975, will continue that line of credit into the future.

The funds lent by Iran shall share pari passu in collateral with the other senior debt of the Company, but if the other lenders agree to extend their credit on an unsecured basis, Iran will accept that its loan not be secured.

5) As part of the total transaction, Pan Am will make available to Iran warrants entitling it to purchase six million shares of the Company's stock at any time within ten years after the date of the agreement, at the lesser of $2.75 per share or 15% premium of the average daily closing prices from the signing of the agreement to one week prior to the first borrowing. The warrants would be transferrable either through a public offering or in private transactions provided that, unless the Company otherwise agrees, no transferee can acquire warrants to purchase a number of shares greater than 1% of the number of shares of the Company stock then outstanding.

When fully exercised, those warrants would result in Iran acquiring 13% of the issued shares (computed after the full exercise of the warrants), or 8% of the total authorized shares (41 million shares are now issued and outstanding; 80 million are authorized).

6) Pan Am's management will include on the management slate of directors (now consisting of 17 directors, but expandable to 20) one person nominated by Iran so long as Iran continues to hold the debt or the shares acquired through the exercise of the warrants.

7) It is understood that final implementation of the agreement will be subject to requisite approvals by the pertinent U. S. regulatory agencies.

ANNEX 2

(Suggestion for Form of Administration Statement Provided by Pan American)

DRAFT MESSAGE FROM SECRETARY OF STATE

Please deliver the following personal message from the Secretary to the Foreign Minister soonest:

Dear Mr. Minister:

Representatives of Pan American Airways have informed the United States Government of their discussions with regard to a possible investment by the Government of Iran in Pan American Airways.

Although I understand that these discussions have not yet been definitively concluded, I would like you to know that this matter is receiving my personal attention and that of my senior colleagues. In principle, my government would regard such an investment favorably as a further contribution to the close spirit of cooperation that exists between Iran and the United States.

As you perhaps know, investments in American air transport companies are subject to special laws and regulations and possible review by one or more administrative agencies. Although, in advance of such a review, it is not possible to predict precisely how such laws or regulations might be applied to any particular investment, I would hope that these problems can be resolved in a manner satisfactory to your government.

COUNCIL ON INTERNATIONAL ECONOMIC POLICY
WASHINGTON, D.C. 20500

File

February 4, 1975

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MEMORANDUM FOR THE EXECUTIVE COMMITTEE ECONOMIC POLICY BOARD

Re: Proposed Iranian Government Investment in Pan American Airlines

Attached, for consideration on Wednesday, February 5, 1974 is an options paper concerning Pan Am's request for Administration approval of a $300 million Iranian investment in Pan Am.

Part 1 provides a brief summary of the transaction, outlines the key issues and summarizes the reasons for and against Administration approval; Part 2 provides details of the transaction and discusses some of the major questions raised; Part 3 contains options concerning (a) Administration approval and disapproval and (b) the form of any Administration statement in connection with the transaction; and Part 4 sets forth agency recommendations.

JM Dunn

John M. Dunn
Acting
Executive Director

DECLASSIFIED
E.O. 12958, Sec. 3.5
NSC Memo, 11/24/98, State Dept. Guidelines
By WHM, NARA, Date 11/20/00

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PROPOSED IRANIAN GOVERNMENT
INVESTMENT IN
PAN AMERICAN AIRLINES

Contents

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SUMMARY

Pan Am Request - At the request of the Iranian government, Pan Am has asked the Administration to give prompt public approval in principle to a proposed $300 million investment in Pan Am.

Key Aspects of Transaction - Upon completion of the transaction as proposed, Iran would hold 20-30% of Pan Am's debt, have warrants to purchase up to 13% of the equity and have on man on Pan Am's 17 member Board. The transaction would be subject to CAB approval.

Key Questions for Consideration -

1. Why does Iran want to make such an investment?

2. Do we want a foreign government to have a substantial interest in the major U.S. international air carrier -- even though it is highly regulated by the CAB?

3. What effect (if any) will the proposed Iranian Investment have on the (a) ability of DOD to utilize Pan Am equipment in its Civil Reserve Air Fleet and (b) continuation of classified contracts Pan Am has with DOD?

4. What are the consequences of a denial on future OPEC government investment in the U.S.?

5. What effect would denial have on relations with Iran?

6. Would refusal to approve the investment substantially increase the likelihood of Pan Am bankruptcy and mean that the government will have to face again the issue of when and if it should assist Pan Am?

7. Conversely, is Iranian assistance likely to produce a long run solution to Pan Am's financial problems?

Basic Options -

1. Delay decision until current Administration review of OPEC investmnet in the U.S. is complete.
2. Acquiesce in investment as proposed.
3. Acquiesce in investment only on specified conditions.
4. Refuse to endorse investment.

Reasons for USG Approval -

1. Our oil money recycling policy contemplates certain types of OPEC government investment in the U.S. and the present proposal would represent one of the more favorable forms of such investment because:

a. Iran does not seek, and would not have, effective control over the management and operation of the company;
b. Pan Am is in a highly regulated industry where most major decisions affecting the firm are subject to CAB approval;
c. Existing law protects against excessive foreign ownership by limiting it to 25% of equity. (Conversely, our law would seem to expressly permit foreign ownership up to the 25% limit);
d. OPEC government excess reserves are being used in a constructive way by providing funds to an ailing U.S. firm that has been unable to obtain capital elsewhere;
e. Would free up funds of present institutional lenders for investment elsewhere at a time when capital is badly needed.

2. The investment sets a useful precedent for the type of OPEC investment we would welcome (i.e. mainly debt with relatively small equity interest in a highly regulated industry).

3. Failure to approve may irritate relations with Iran.

4. Failure to approve may lead to Pan Am bankruptcy which, as decided by the Administration last Fall, would be undesirable.

5. Even if the result of the current policy review is to place new restrictions on foreign government investment, the proposed deal would be within (or close to) the guidelines now being considered for permitted investment.

6. Public approval now would serve as a useful trial balloon to test Congressional and public reaction.

Reasons Against USG Approval

1. Any decision on the Iranian investment should be postponed until after the current interagency policy review is considered by the Economic Policy Board.

2. Prevents Iranian influence in Pan Am which might be used in a subtle way against our national interest.

3. Approval now might prejudice development of joint consumer nation investment policy contemplated by Secretary of State.

4. Iranian investment in Pan Am might give Iran access to highly classified information unless special protections are devised.

5. Iranian investment might prejudice availability of Pan Am plans for CRAF fleet.

6. Further Pan Am financial problems could lead to another Iranian bailout and increasing Iranian influence over Pan Am (up to the 25% statutory limit on foreign ownership).

7. A bailout of Pan Am could prevent needed restructuring of the company (e.g. merger or spin-off of unprofitable routes).

8. Although it could not effectively control Pan Am, Iran might have "legal control" for SEC and CAB purposes -- i.e. it would be a controlling shareholder for SEC purposes and might be deemed to have acquired "control" for CAB purposes.

Form of Statement if Investment is Approved

1. U.S. unilateral public statement as proposed by Pan Am.
2. USG public statement as above accompanied by Iranian public statement indicating (a) awareness of necessity of CAB approval and (b) no desire to control Pan Am.
3. Joint U.S./Iran Statement (preferably within Joint Commission context) embodying 1 and 2.
4. No public statement but USG informs Iranian government of approval.

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The answer to this question depends largely on the precise nature and extent of the foreign government's interest. This section summarizes the Iranian interest in Pan Am and concludes that there is little possibility that Iran could exercise effective control over the operations and management of Pan Am.

Iranian Position as a Creditor. Iran is seeking no preferred position and wants only to be treated equally with U.S. creditors. Accordingly, it has insisted that the loan be secured *pari passu* with U.S. creditors (i.e. Iran will have a *pari passu* security interest in aircraft and other equipment). However, Iran is willing to relinquish its security if U.S. creditors are willing to do the same. Iran has no interest in being the sole or even dominant creditor and has made continuation of the U.S. bank credit agreement a condition precedent to the investment.

One of the key parts of the proposed transaction is the use of a substantial portion of the Iran loan to purchase at a substantial (i.e. 50%) discount senior debt now held by U.S. institutional lenders. Pan Am would hope to acquire at least 75% of such debt and, if successful, Pan Am's debt structure would be as follows:

Publicly held debt -- $480 million

U.S. Banks -- $125 million

Institutional Senior Debt -- $100 million

Iranian Loan -- $245 million

Depending on how much of the senior debt is purchased, Iran would hold between 20 and 30% of Pan Am total debt.

The precise terms of the Iranian debt have not been agreed and would depend on the outcome of difficult negotiations with current U.S. holders of bank credit and senior debt. Detailed negotiations with Iran would begin after the signing of a letter of intent.

Iranian Equity Position. If Iran exercised its option to purchase 6 million shares of Pan Am stock it would hold 13% of the then outstanding common stock. This, together with approximately 5% now held by other foreign investors, would involve a foreign ownership of Pan Am of approximately 18%. These interests would, however, be substantially diluted if the Iranian investment leads to a merger -- as Pan Am officials hope. The issuance of warrants to Iran would be subject to CAB approval, which would also be required for any further equity acquisition by Iran. Once it acquired 5% of the outstanding shares Iran would be required to file reports with the

SEC stating inter alia whether the purpose of the acquision is to acquire control.

Iran may sell its warrants if it does not want to acquire a permanent equity position in Pan Am. This provision of the transaction was negotiated to enable Iran to benefit financially through a rise in the price of the Pan Am common stock in a way that does not require it to become a shareholder. To protect against the possibility that Iran would transfer the entire 6 million shares to one person (e.g. another OPEC government) the agreement specifically prohibits a transferee from acquiring more than 1% of the outstanding shares without company approval.

Iran Membership on Board of Directors. While Iran would have one member on the board, there is no possibility that this number could be increased without company and CAB approval. The Pan Am board nominates all new directors and any Iranian director would be subject to CAB approval. As further protection, Pan Am common shares carry no cummulative voting rights, a fact which severely limits the ability of Iran to control the Board.

Relationship Between Pan Am and Iran if Transaction is Consumated. Recent news reports have extrapolated from Pan Am's past relationship with Iran to conclude that the proposed agreement would involve a full working relationship in which Pan Am would (1) make Iran National Airlines into a major international airlines, (2) provide technical assistance to Iran Air to fly the Concorde; (3) lease Concordes from Iran for its own use and (4) furnish technical assistance for the F 14 military fighter fleet Iran is purchasing from Grumman.

Pan Am has indicated that this is <u>not</u> part of the current transaction and that there are no understandings with Iran on Iran Air with regard to any of these matters. In this regard, it should be pointed out that Iran has the financial resources to secure any needed technical assistance from other countries (especially France and the U.K.). Furthermore, any technical assistance agreement or any fares ré Concorde planes would need to be approved by the CAB before work could be undertaken.

<u>Role of CAB</u>. The entire transaction is subject to CAB approval which Pan Am would seek as soon as definitive negotiations with the Iranians had been concluded. The Board must approve (1) any acquisition of control of Pan Am and (2) interlocking directorships. In addition, any technical assistance agreement with Iranian National Airways would also be subject to Board approval as would any fare agreement for the Concorde. Although Iran has indicated during negotiations that it does not want control, ownership of 10% or more of the voting securities of an airline gives rise to a presumption of control under the Federal Aviation Act. Iran's

ownership of warrants to purchase 13% of the currently outstanding common stock, combined with the substantial creditor interest, would probably constitute legal "control" requiring CAB approval.

Iran has been fully informed of the need for CAB approval. Although they have been warned that the President has no control over the ultimate CAB decision, they do not appear to fully understand that Administration approval in principle does not necessarily mean that the CAB would approve the transaction. Should the CAB ultimately disapprove the transaction, after public Administration approval, Pan Am representatives believe this could cause misunderstandings.

With respect to CAB regulation generally, it is hard to imagine an area where the government and an independent regulatory agency exercise more control. Major operating decisions and any sale of a substantial part of airline assets would be subject to CAB review. International route awards are subject to CAB and Presidential review. In addition, there are specific pre-existing restrictions limiting (a) aggregate foreign equity holdings to 25% and (b) foreign participating in management.

Conclusion. If Iran does not exercise its warrants, it would have no equity interest or control of Pan Am. If it does exercise its option to its fullest extent, Iran would probably be a "controlling shareholder" for SEC purposes and might be deemed to have acquired "control" for CAB purposes. In spite of these legal concepts of control, there is no way Iran could exercise effective or working control over the management and operation of Pan Am.

3. Effect of Iranian Influence on CRAF and Classified Contracts

While concern has been expressed over the possible loss of Pan Am's contribution to the CRAF fleet because of an Iranian security interest in Pan Am's planes, any Pan Am bankruptcy would deny an effective Pan Am contribution to the CRAF program. DOD has indicated that the most important way to ensure adequate participation of Pan Am in CRAF is to keep Pan Am operational and the planes and crews flying -- i.e. keep Pan Am out of bankruptcy. Furthermore, disposition of assets and bankruptcy is controlled by the trustee and not the creditors which means that Iran would not have ultimate control over the disposition of Pan Am's aircraft. In addition, Pan Am officials have given assurances that they will honor all existing CRAF contracts and that this investment will have no impact on negotiations with DOD to expand CRAF.

According to DOD, Pan Am has some defense contracts involving highly classified material. Therefore, the Iranian investment might involve a breach of DOD's Industrial Security Regulations unless (1) Iran is willing to drop its request for a member of the Board and/or place its warrants and security interest in a U.S. trust with U.S. trustees or (2) Pan Am can spin-off its classified work into a separate subsidiary insulated from any Iranian interest.

4. Consequences of Denial on Future OPEC Investment in the U.S.

OPEC investment policies in the United States will be affected by the success or failure of the proposed arrangement. If the deal is successfully concluded without USG opposition, OPEC countries with significant cash reserves in short-term and highly liquid positions will be encouraged to proceed with longer term investments. However, the conversion of investment portfolios into equity positions will continue to be dictated by economic factors, including interest rates and company profitability. We would use this investment -- constructive objective, minimal control, and a highly regulated industry -- as a prototype or precedent to help guide additional OPEC investment in a positive fashion.

A negative decision on the Pan Am case by the USG would be weighed carefully by OPEC finance managers as an indicator of hostile USG attitudes toward other long-term OPEC investments. If it could be made clear that such a decision were based on the merits of the Pan Am issue per se and not on the principle of restricting OPEC investments, the current thrust of OPEC financial policies will not be greatly affected. If, on the other hand, OPEC investors saw U.S. disapproval as signaling a broader U.S. intent to place limitations on OPEC equity holdings in the U.S., the effect of such a negative signal could be profound. It would immediately affect OPEC plans to move into long-term holdings. The sensitivity of OPEC financial managers to the issue will have been increased by current efforts of members of Congress to introduce highly restrictive legislation aimed specifically at limiting the size of OPEC investment in the U.S.

Within the context of OPEC investor reaction, therefore, the proposed Iranian/Pan Am arrangement focuses directly on basic issues of the U.S. position on oil-money recycling:

-Does the U.S. wish longer-term inward investment by oil-producers?

-If not, can the U.S. structure OPEC investments toward short-term instruments without so undermining OPEC-investor confidence that incentives to invest in even short-term positions are not lost?

Analysis suggests that the U.S. should encourage the re-adjustment of OPEC state portfolios toward constructive, long-term, non-volatile and perhaps controlled investments. At the moment an interagency review of foreign investment in the United States is underway. While a consensus has not yet been reached, it is nevertheless possible to say that all but the most extreme policy approaches under consideration would permit some foreign government investment in U.S. firms, including such firms as Pan Am.

5. Effect of Denial on Iranian Investment Policies and U.S./Iranian Relations with Iran.

If the proposed Iran/Pan Am deal were disapproved by the USG for reasons which Iran felt were discriminatory or unjustified, there would probably be a major impact on Iranian investment plans in the United States. Iranian assets in the U.S., about

25% of Iran's total overseas investments, would seek European or other non-U.S. opportunities for investment giving both reasonable return and assurance of approval. This trend would accelerate as the profitability of Iran's short term income-bearing dollar instruments declined along with interest rates through 1975.

If it were clear to the Iranian Government that a decision to disapprove the Pan Am deal was made for reasons which <u>did not</u> affect the principle of OPEC -- and Iranian -- equity investment in the U.S., there would be a negative impact nevertheless, but shorter-lived. Iranian investment planning would be restructured toward projects or areas of profitability more likely to win USG approval. Iranian investments now in the U.S. would probably not seek non-U.S. outlets.

Similarly, U.S./Iran political relations would be affected according to the degree of discrimination which the Iranians believed to be the cause of a USG decision to disapprove the Pan Am transaction. If disapproval (a) were shown to be an act confined to the Pan Am case itself and (b) was meant as no impediment to the broadening U.S./Iranian relationship or to U.S. willingness to cooperate with and assist Iran in other areas (and this would have to be made clear to the Shah at the highest level of the USG if a negative determination is made), the political impact would be relatively short-lived.

6. Effect of the Investment on Pan American Financial Situation

Pan Am's 1974 pre-tax loss was $135 million and estimates indicate a minimum $65 million loss during 1975. Relatively small drops in estimated traffic or revenue passenger miles could create a cash crisis which would lead to bankruptcy. Given the present economic situation, prospects are for level traffic volume in 1975 compared to 1974. In the judgment of Pan Am and its investment bankers, the government's Seven Point Action Plan, a merger, route spin-offs or alternative sources of finance could not provide the relief necessary in time to avert the real possibility of bankruptcy in late 1975. The Iranian investment is, in their judgment, the only currently available way to eliminate this possibility and give the company an opportunity to return to long run economic viability. Pan Am further indicates that this financing will provide a medium term solution to their financing problems by (1) offering immediate short term cash resources, (2) providing relief over the next two years from debt principal repayments; and (3) freeing of assets that could act as collateral for future loans. The only long term solution to Pan Am's situation is a return to profitability. There is no assurance that, absent an immediate threat to Pan Am' survival, management would be motivated to take the drastic actions -- involving route restructuring or merger -- necessary to return to long run profitability. Thus, in the view of DOT, the company's long run viability remains in doubt.

Initial Congressional Reaction

Pan Am has consulted with several Senators and received no adverse reaction. They report that Senators Churck and Williams were enthusiastic; that Senator Stevenson felt it was a good solution to a difficult problem which avoided government assistance as in Lockheed and Penn Central; and that Senators Senators Javits, Stevens and Pearson were not adverse but felt it was too bad that a U.S. company had to be supported by a foreign government.*

Meetings have been more difficult to arrange on the House side but Pan Am plans to visit Representative Morgan and members of the House Public Works Committee, which now has jurisdiction over most matters affecting Pan Am.

*Senators Jackson and Magnuson were also consulted and both indicated they would remain "neutral".

OPTIONS

A. Options re Basic Policy Issue

The basic policy decision raised by Pan Am's request is whether the USG should permit an OPEC government to acquire a substantial interest in a major U.S. firm.

This same issue is the subject of an interagency review to be presented to the EPB and NSC for consideration within two to three weeks. The first matter requiring consideration is, therefore, whether any decision on Pan Am should be postponed until after receiving the results of this review. Pan Am has requested a prompt answer (i.e. this week) and believes that any substantial USG delay in responding could kill the transaction.

Option 1 - Delay any decision until broader policy review is completed.

Pro - Avoids potential embarassment of approving present investment and subsequently adopting policy which would have prevented it.
- Ensures full benefit of the current interagency review and means that the Pan Am case is considered in light of all broader policy issues re OPEC investment.
- Interagency review to be completed soon so delay not apt to be more than three weeks.

Con - Public is aware of terms of deal and a prompt Administration position is required.
- Delay may mean Pan Am loses opportunity for Iranian investment.
- Delay may become an irritant in US/Iranian relations.
- Proposed transaction is within (or very close to) the limits being considered in the current policy review for OPEC government investment.
- Result of review may be adoption of more liberal policy and temporary delay may have given incorrect signal as to our policy.

Option 2 - Permit investment as proposed.

Pro - Sets useful precedent for future pattern of OPEC government investment (i.e. mainly debt with relatively small equity interest in highly regulated industry).

- Provides substantial assurance that the deal will go forward with its benefits to Pan Am.
- Avoids any possibility of irritating relations with Iran by delay.
- Recognizes that terms are reasonable for a corporation in Pan Am's current financial condition.
- Excellent test case or trial balloon and Congressional and public reaction can be taken into account in shaping final policy.
- Ensures availability of operational planes for CRAF fleet if Iranian investment prevents Pan Am bankruptcy.

Con - May set direction of our basic policy without benefit of the fuller review being undertaken as part of the overall study of OPEC investment in US.
- Present investment may be the opening wedge to greater Iranian influence if Pan Am runs into financial difficulty in the future.
- May prejudice DOD ability to utilize Pan Am CRAF fleet in event of emergency.
- Approval now might prejudice development of coordinated consumer nation policy toward OPEC investment.
- Any Iranian influence might mean foreign policy considerations would enter into USG and/or CAB treatment of Pan Am.
- May breach DOD Industrial Security Regulations.

<u>Option 3</u> - Permit investment only on specified conditions.

Pro - Minimizes any risk inherent in foreign government investment in Pan Am.
- Ensures that the terms of the investment are within the range of options now being considered as a part of the broader policy review.

Con - Imposition of conditions might kill Iranian investment in Pan Am
- Conditions not needed as proposed terms reasonable, Iranina influence in Pan Am would not give it effective control over management and operations and company is already closely regulated by the CAB.

NOTE: THESE SUBOPTIONS SHOULD BE CONSIDERED ONLY IF OPTION 3 IS ACCEPTED.

If it is decided to impose conditions, there are a number that one could adopt. Some of the most promising include:

Suboption 3a - Prevent Iran from being secured *pari passu* with US creditors

Pro - Reduces the already minimal risk that Pan Am planes would not be available to CRAF
- Reduces Iran's influence as a creditor (especially its rights in event of a bankruptcy).

Con - Might upset deal or irritate Iran by forcing it to take inferior position to US creditors
- Not necessary as Pan Am's influence as a creditor is limited by existing creditor's rights and bankruptcy laws.

Suboption 3b - Require reduction in amount of equity Iran could acquire from 13% to 10% (for CAB purposes) or 6% (for DOD purposes).

Pro - Reduces the already minimal risk of actual control over management
- Avoids presumption of "control" in Federal Aviation Act and presumption of "foreign control" under DOD Industrial Security Regulations

Con - Might upset deal or needlessly irritate Iran.
- Reduction from 13% to 6% would have no effect on amount of actual or effective control (as opposed to legal control).
- Any subsequent merger (which Pan Am hopes would be made possible by the Iranian deal) would substantially dilute Iran's 13% interest.
- Even reduction below 6% might not satisfy DOD and prevent breach of Industrial Security Regulations.

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Suboption 3c - Require Pan Am to spin-off all classified defense work into a separate subsidiary in which Iran had no direct interest.

Pro - Avoid problems with DOD Industrial Security Regulations.
- Would be more acceptable to Iran than other alternatives to solve DOD problems with Iranian control (e.g. require Iran to put its warrants and security interest in a U.S. trust controlled by U.S. trustees).

Con - May be difficult, if not impossible, to segregate Pan Am classified contracts.
- Would not satisfy DOD concern re availability of Pan Am planes to CRAF fleet.

Suboption 3d - Require Iran to drop its request for a Pan Am Board member.

Pro - Eliminates any risk of Iranian access to classified information via Board membership and should help prevent breach of DOD Industrial Security Regulations.

Con - Would probably upset deal as Iran wants to be treated equally with other major creditors.

Suboption 3e - Require transfer of warrants to be subject to CAB or USG approval.

Pro - Avoids transfer to "undesirable" potential shareholders (e.g. an unfriendly OPEc government).

Con - Might upset the deal
- Could put CAB or USG in embarassing position of having to chose between potential transferees
- Neglects fact that transfer already subject to Pan Am approval and that any one transferee can acquire no more tha 1% of the outstanding stock.

Suboption 3f - Approve subject to condition that Pan Am and Iran subsequently conform the terms to any specific limits ultimately adopted as a result of the current review.

Pro - Ensures consistency of policy while giving Pan Am the prompt answer it has requested.

Con - Complicates negotiations with Iran and Pan Am creditors
- Proposed terms are within (or very close to) any limits that are likely to be adopted

Option 4 - Refuse to approve investment.

Pro - Prevents any Iranian influence in Pan Am that could be used contrary to our national interest.
- Eliminates the very minimal risk that the CRAF fleet not available in time of national emergency.
- Eliminates the possibility of "creeping Iranian influence" over Pan Am if a further bailout is needed in the future.
- Prevents Iran from getting major stake in international hotel business.
- Prevents Iran from increasing its prestige and world wide visability and would be a very minor deberrant to Shah in his desire to become the dominant military/economic power in the Gulf.
- Allows time to develop coordinated consumer nation policy re OPEC investment.

Con - May force Pan Am into bankruptcy by denying it only present source of financial relief.
- Failure to permit non-controlling OPEC government investment in a highly regulated industry would be taken as an indication that we wanted no long term OPEC government investment in our economy and could seriously handicap our objective of obtaining sound, long term investments from them.
- Would undoubtedly affect relations with Iran by rejecting a favorable deal offered in good faith.

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B. Options re Pan Am Request for USG Public Statement of Approval

Option 1 - Make unilateral USG statement along the lines suggested by Pan Am -- i.e. approve in principle but note that transaction subject to CAB approval. (See Annex 2)

Pro - Satisfies Iranian request and enables Pan Am to proceed to finalize transaction.
- Puts Administration on record that deal subject to CAB approval and clearly indicates that the Administration has no control over the CAB process.

Con - Unilateral USG approval followed by CAB disapproval might upset Iran and damage US/Iranian relations.

- Any USG statement of approval be interpreted as favored treatment for Pan Am.

Option 2 - Make USG statement as in Option 1 but also insist on a public statement from Iran indicating (1) spirit of cooperation; (2) no desire to control affairs of Pan Am and (3) Iran recognizes that transaction subject to CAB approval.

Pro - Same advantages as in Option 1
- In addition, puts Iran on recrod as publicly recognizing CAB approval needed and indicating no desire to control Pan Am.
- Iranian public statement of intent minimizes public and Congressional fear and provides basis for quelling their possible concern.

Con - Insistence on public statement of Iranian intentions runs risk of insulting Shah by implying we do not trust informal assurances.

- Any USG approval may be interpreted as favored treatment for Pan Am.

Option 3 - Insist on a Joint US/Iranian Statement (preferably within the Joint Commission context) stressing spirit of cooperation, US appreciation of Iranian loan, need for CAB approval and understanding that Iran does not want or intend to control the affairs of Pan Am.

Pro - Same advantages as in Options 1 and 2
- Puts foreign government investment in US corporations on a government to government basis
- Establishes clear precedent for prior consultation and discussion for major OPEC government investment in the US.

- Makes the investment a joint effort and improves cooperation between the US and Iran
- Joint Statement could be more acceptable to Iran as it treats Iran as responsible partner and emphasizes the spirit of cooperation.

Con - Same as in Option 2.
- May establish a harmful precedent for OPEC governments seeking informal approvals of investments.
- USG may not want to appear overly cooperative with Iran in order to avoid implication that we favor Iran over other OPEC countries.
- Joint Statement might prejudice development of joint consumer nation policy toward OPEC government investment.

Option 4 - Refuse any public comment on the proposed investment.

Pro - Does not involve the Administration in the transaction and leaves matter entirely to CAB.
- Eliminates possibility of embarassment which would result from CAB disapproval after CAB approval.

Con - May kill the proposed investment as Iran and Pan Am have indicated they would not proceed without some public approval by USG.
- May force Pan Am into bankruptcy by denying them only source of financial relief.
- Neglects fact that any OPEC government investment in a major US company is an important matter calling for responsible action (including a public explanation) by the Administration.
- Failure to permit OPEC government investment in a highly regulated industry would be taken as indication that we wanted no OPEC government investment in our economy.

CONFIDENTIAL

January 31, 1975

PRINCIPAL PROVISIONS OF TENTATIVE AGREEMENT BETWEEN PAN AM AND IRAN

ANNEX 1

The agreement contemplates that the Iranian side will make available to Pan Am an amount not to exceed $300 million. The principal provisions of the tentative agreement are as follows:

1) Of the $300 million, an amount (say $55 million) will be used to acquire 55% of the stock of Intercontinental Hotels Corporation, an off-shore hotel chain wholly owned by Pan Am. The exact purchase price is yet to be negotiated. Each side will have a right of refusal in the event either wishes to sell all or any part of its IHC stock.

2) Out of the remainder of the $300 million, the Company will endeavor to acquire at least 75% of the outstanding $389,500,000 of Pan Am's senior debt now held by Institutional Investors at a substantial discount price satisfactory to Iran and Pan Am. Up to $70 million of the amount remaining from the $300 million after the acquisition of the Hotel Company stock and the discount purchase of senior debt will be lent to the Company for its necessary cash needs.

3) The monies made available for the acquisition of senior debt and the Company's cash needs will be in the form of a ten-year loan to Pan Am bearing interest at a rate of 10½% per annum, with a commitment fee of ½% per annum. Since no principal repayments will be required for the first three years, this will improve the Company's cash flow for the first three years by a cumulative amount of roughly $60 million.

4) The agreement is subject to the condition that the banks which have presently extended a line of credit amounting to $125 million, payable on September 30, 1975, will continue that line of credit into the future.

The funds lent by Iran shall share pari passu in collateral with the other senior debt of the Company, but if the other lenders agree to extend their credit on an unsecured basis, Iran will accept that its loan not be secured.

5) As part of the total transaction, Pan Am will make available to Iran warrants entitling it to purchase six million shares of the Company's stock at any time within ten years after the date of the agreement, at the lesser of $2.75 per share or 15% premium of the average daily closing prices from the signing of the agreement to one week prior to the first borrowing. The warrants would be transferrable either through a public offering or in private transactions provided that, unless the Company otherwise agrees, no transferee can acquire warrants to purchase a number of shares greater than 1% of the number of shares of the Company stock then outstanding.

When fully exercised, those warrants would result in Iran acquiring 13% of the issued shares (computed after the full exercise of the warrants), or 8% of the total authorized shares (41 million shares are now issued and outstanding; 80 million are authorized).

6) Pan Am's management will include on the management slate of directors (now consisting of 17 directors, but expandable to 20) one person nominated by Iran so long as Iran continues to hold the debt or the shares acquired through the exercise of the warrants. Non-cumulative voting

7) It is understood that final implementation of the agreement will be subject to requisite approvals by the pertinent U. S. regulatory agencies.

ANNEX 2

(Suggestion for Form of Administration
Statement Provided by Pan American)

DRAFT MESSAGE FROM SECRETARY OF STATE

Please deliver the following personal message from the Secretary to the Foreign Minister soonest:

Dear Mr. Minister:

Representatives of Pan American Airways have informed the United States Government of their discussions with regard to a possible investment by the Government of Iran in Pan American Airways.

Although I understand that these discussions have not yet been definitively concluded, I would like you to know that this matter is receiving my personal attention and that of my senior colleagues. In principle, my government would regard such an investment favorably as a further contribution to the close spirit of cooperation that exists between Iran and the United States.

As you perhaps know, investments in American air transport companies are subject to special laws and regulations and possible review by one or more administrative agencies. Although, in advance of such a review, it is not possible to predict precisely how such laws or regulations might be applied to any particular investment, I would hope that these problems can be resolved in a manner satisfactory to your government.

AGENCY RECOMMENDATIONS

1. CIEP recommends Options A-2 (or 3c if DOD raises objections on grounds that the investment would breach the Industrial Security Regulations) and B-3 (i. e. announcement of approval via a joint US/Iranian statement).

2. NSC recommends Options A-2 and B-3 (but notes that, in its view, Pan Am may be overstating the need for a public statement of approval by the U. S. G.).

3. OMB recommends Options A-2 and B-1 (contingent upon an acceptable NSC/DOD review of the national security implications.)

4. Treasury recommends approval and feels positive public statement should be made.

5. Defense takes no position for or against but points out that the investment as proposed would create problems with respect to (a) their CRAF program and (b) their Industrial Security Regulations unless special arrangements are made to (i) isolate classified defense work in a separate subsidiary and (ii) insure that American crews fly CRAF planes and (iii) provide that any Iranian liens are subject to a CRAF call.

6. Transportation recommends against the loan. DOT believes that the loan would take pressure off Pan Am to take drastic actions needed to return to long-run profitability (e. g. merger and/or route restructuring). In DOT's view, the Administration should refuse the loan, push a merger (preferably with TWA), work on the Seven Point Action Plan and hope for the best.

   DOT also believes that Iranian influence in Pan Am would inject an undesirable element into CAB and Presidential decision making processes in cases involving Pan Am. Added foreign policy pressures resulting from Iranian influence might, in DOT's view, prejudice route award and rate cases in Pan Am's favor.

7. State generally favors the investment on foreign policy grounds but its final decision is subject to further consideration of the effects of Iranian influence on Pan Am.

8. Commerce

File

THE WHITE HOUSE

WASHINGTON

Mike Duval

February 6, 1975

MEMORANDUM FOR: John W. Barnum, Transportation
Philip W. Buchen
Arthur F. Burns, Federal Reserve Board
James H. Cavanaugh, Domestic Council
Frederick B. Dent, Commerce
Michael Dunn, CIEP
Robert Elsworth, Defense
Alan Greenspan, CEA
Robert T. Hartmann
James T. Lynn, OMB
John O. Marsh, Jr.
Charles W. Robinson, State
Donald Rumsfeld
Brent Scrowcroft
William E. Simon, Treasury
Frank G. Zarb, FEA

TO

FROM: L. WILLIAM SEIDMAN

SUBJECT: PROPOSED IRANIAN GOVERNMENT INVESTMENT IN PAN AMERICAN AIRLINES

Attached is a decision memorandum on a "Proposed Iranian Government Investment in Pan American Airlines." Please forward your comments and recommendations to my office by noon, Monday, February 10, 1975.

A more detailed outline of terms and discussion of basic issues is also attached for your information.

If you have any questions, or if you anticipate a delay in submitting your comments and recommendations, please telephone my office immediately at 456-6537.

Attachments

~~CONFIDENTIAL~~

~~CONFIDENTIAL~~ ACTION

MEMORANDUM FOR

THE PRESIDENT

FROM: L. William Seidman

SUBJECT: Proposed Iranian Government Investment in Pan American Airlines

As you know, initial negotiations have been completed with respect to an Iranian Government investment of $300 million in Pan American Airlines. Because the controversial issue of OPEC government investment is involved, both Pan Am and Iran are seeking a favorable signal from the Administration before proceeding further with the transaction.

Any agreement reached by the parties would ultimately be subject to CAB approval of matters relating to potential Iranian control of Pan Am. A favorable Administration decision would, therefore, not necessarily ensure successful completion of the transaction. A negative signal would, however, almost certainly stop the proposed investment.

Decision Required. The main decision required is whether the Administration should approve in principle the proposed Iranian investment in Pan Am.

Terms of Transaction. After completion of the transaction as now proposed, Iran would hold approximately $245 million (20-30%) of Pan Am's debt, have warrants to purchase up to 13% of its equity and have one member on Pan Am's 17 member Board of Directors (see attached Annex I for further details of transaction).

Basic Issues -- Several broader issues must be considered in order to reach a decision on the Iranian/Pan Am request. They are:

-- Our policy with respect to OPEC government investment in the U.S.
-- Our policy with respect to recycling and the impact of denial on the future flow of OPEC funds to the US.
-- Foreign policy implications - especially Iranian/U.S. relations.

-- Foreign government influence in key U.S. firms
-- Injection of an undesirable foreign policy element into the CAB and Presidential decision making process in cases involving Pan Am.
-- Effect on Pan Am's long run economic viability.

Discussion of Key Issue: OPEC Government Investment in U.S. - One of the principal objectives of our recycling policy is to encourage OPEC nations to make long term constructive investments in the consuming nations. Such investments contribute to our current balance of payments, help alleviate the current capital shortage, and give the OPEC countries a stake in our economy which should provide some incentive for them to refrain from actions which would have a negative effect on our economy and their investments. An interagency review of foreign investment in the U.S. is underway and, while not complete, it is possible to say that all but the most extreme views would permit some foreign government investment in US firms - including firms like Pan Am.

Our existing laws and regulations are such that there is minimum danger that a foreign investor could use his investment here in a way that would cause serious harm to our economy or national security. However, a major reservation has been raised concerning the political and economic influence that a foreign government might obtain through substantial investments. Although the substance of these concerns have never been clearly defined, those that hold this view maintain that a foreign government could make subtle use of such influence to harm our national or economic security interests but in a manner that would put it beyond the reach of existing law.

There is an added difficulty in the present case in that Pan Am is regulated by the CAB and, in some cases, the President. The Department of Transportation is concerned that Iranian investment in Pan Am would inject additional foreign policy considerations into the deliberations of the CAB and the President in making decisions involving Pan Am or other international carriers. On the other hand, other agencies look upon CAB and Presidential regulations as an added safeguard to ensure that the Iranians would not use their investment in a way contrary to our national interest.

Advantages of a Favorable Decision

1. A favorable decision would indicate to other potential OPEC investors that the U.S. is willing to accept constructive long term OPEC government investment.

2. The investment would set a useful precedent for the type of OPEC investment we would welcome (i.e. mainly debt with a relatively small equity interest in a firm in a highly regulated industry).

3. Denial would be interpreted by OPEC nations as an indication that we intended to limit their investment in the U.S. and could have a major negative effect on such investment here.

4. Because of its generally favorable features, the transaction provides a good test case to sample Congressional and public reaction to substantial OPEC investment in U.S. companies.

5. The investment would avert another Pan Am cash crisis in late 1975 and might provide the type of medium term financial relief necessary to enable it to consummate a merger needed to create a viable airline.

Disadvantages of a Favorable Decision

1. The investment might take pressure off Pan Am to take the drastic actions required to return to long run profitability (e.g. merger or route restructuring).

2. Iranian influence in Pan Am would inject a new, and what some consider an undesirable, element into CAB and Presidential decision making in cases involving Pan Am and other international airlines.

, if approved,

request for

3. Further Pan Am financial problems could lead to another Iranian bailout which would increase Iranian influence in Pan Am and thereby set precedents for larger shareholdings in US companies by foreign investors.

Spell out

4. Unless special arrangements are made by Pan Am and Iran, the Iranian investment might prejudice the availability of Pan Am planes for the CRAF fleet and/or give Iran access to classified information.

this will either happen or not. Spell it out. Tell the P. what the risk is this is to the general to permit an intelligent decission.

Agency Recommendations

(1) Treasury, State, Commerce, OMB, CIEP and NSC all favor approval of the investment (subject to satisfaction

of DOD requirements re CRAF and classified contracts). The main reasons for their recommendations are the positive effect it would have on (i) our prospects for attracting more OPEC government investment and influencing its movement into constructive, long term ventures in the US and (ii) the short term financial condition of Pan Am.

(2) The only dissenting agency is Transportation which believes the investment will prevent needed restructuring of Pan Am and would inject an undesirable foreign policy aspect into CAB and Presidential decision-making which could have a profound affect on US international aviation decisions.

(3) Defense takes no position for or against but points out that the investment would create problems with respect to availability of Pan Am planes for CRAF fleet and isolation of Pan Am's classified work from Iranian access unless special arrangements are made by Pan Am and Iran.

Initial Congressional and Labor Reaction - The subject of OPEC investment in the U.S. is already an important issue in Congress as several bills to restrict or limit foreign investment have been introduced. Any decision on the Iranian case will undoubtedly evoke Congressional comment.

Pan Am representatives have consulted a number of key Senators and report that so far they have encountered no adverse reaction. Views ranged from Senators Church, Williams and Percy, who were reported to be enthusiastic, to Senators Jackson and Magnuson who both indicated they would remain neutral.

Need Cotton's views

According to Pan Am, initial contacts with the Teamsters and the AFL-CIO indicates that labor will not have major objections to the transaction.

My Recommendation: I recommend. . .

Domestic Council - approval

Approve Iranian Investment in Pan Am ________________

Disapprove Iranian Investment in Pan Am ________________

Will discuss ________________________________

Nature of Public Statement - If you decide to approve the Iranian investment, you should then decide whether to authorize a public statement to satisfy the Iranian and Pan Am desire for public Administration endorsement of the principle of the transaction.

A public statement could have advantages in that it (1) would indicate clearly the Administration position on an issue of importance to Iran and other OPEC investors (2) might be used to reemphasize to Iran that the transaction is subject to CAB approval and conditional upon satisfactory arrangements with DOD with respect to the CRAF fleet and classified contracts. There would be particular advantages in a parallel or joint statement with Iran in that Iran would clearly acknowledge that it recognized the need for DOD and CAB approval and that it had no desire to control the management or operation of Pan Am. Such a statement would greatly assist in allaying public and Congressional fears of an OPEC takeover.

The main disadvantages of a USG public statement are that (1) it might appear that the Administration was favoring Pan Am or trying to influence the ultimate CAB decision and (2) it could set a precedent leading to similar requests from other investors.

the key Q is: Does FA Act of '56 require P. to decide this issue? If yes, then the section must be rewritten. If no, then P overrule CAB stm if he takes a position.

Agency views - The agencies favoring approval also favor a public statement of support making it clear that the transaction is subject to CAB approval and conditional upon working out acceptable arrangements with DOD concerning availability of Pan Am planes for the CRAF fleet and Iranian access to classified defense material.

The NSC and the CIEP strongly recommend that we condition any official statement of approval on issuance of a parallel or joint statement by Iran in which the Iranian government clearly acknowledges that (1) the transaction is subject to CAB approval and satisfactory working out of DOD requirements and (2) it has no desire to control management or operation of Pan Am. A joint statement could be made quite naturally in the context of the Joint Commission in order to please the Shah.

Approve Joint or Parallel US/Iran Statements ____________________

Approve Unilateral US Statement ____________________

Disapprove Public Statement ____________________

Will Discuss ____________________

better alternative? State + Transportation issue statement of approval along w/ their Iran counterparts.

~~[illegible]~~
~~[illegible]~~
~~[illegible]~~

CONFIDENTIAL January 31, 1975

PRINCIPAL PROVISIONS OF TENTATIVE AGREEMENT BETWEEN PAN AM AND IRAN

The agreement contemplates that the Iranian side will make available to Pan Am an amount not to exceed $300 million. The principal provisions of the tentative agreement are as follows:

1) Of the $300 million, an amount (say $55 million) will be used to acquire 55% of the stock of Intercontinental Hotels Corporation, an off-shore hotel chain wholly owned by Pan Am. The exact purchase price is yet to be negotiated. Each side will have a right of refusal in the event either wishes to sell all or any part of its IHC stock.

2) Out of the remainder of the $300 million, the Company will endeavor to acquire at least 75% of the outstanding $389,500,000 of Pan Am's senior debt now held by Institutional Investors at a substantial discount price satisfactory to Iran and Pan Am. Up to $70 million of the amount remaining from the $300 million after the acquisition of the Hotel Company stock and the discount purchase of senior debt will be lent to the Company for its necessary cash needs.

3) The monies made available for the acquisition of senior debt and the Company's cash needs will be in the form of a ten-year loan to Pan Am bearing interest at a rate of 10½% per annum, with a commitment fee of ½% per annum. Since no principal repayments will be required for the first three years, this will improve the Company's cash flow for the first three years by a cumulative amount of roughly $60 million.

4) The agreement is subject to the condition that the banks which have presently extended a line of credit amounting to $125 million, payable on September 30, 1975, will continue that line of credit into the future.

The funds lent by Iran shall share pari passu in collateral with the other senior debt of the Company, but if the other lenders agree to extend their credit on an unsecured basis, Iran will accept that its loan not be secured.

5) As part of the total transaction, Pan Am will make available to Iran warrants entitling it to purchase six million shares of the Company's stock at any time within ten years after the date of the agreement, at the lesser of $2.75 per share or 15% premium of the average daily closing prices from the signing of the agreement to one week prior to the first borrowing. The warrants would be transferrable either through a public offering or in private transactions provided that, unless the Company otherwise agrees, no transferee can acquire warrants to purchase a number of shares greater than 1% of the number of shares of the Company stock then outstanding.

When fully exercised, those warrants would result in Iran acquiring 13% of the issued shares (computed after the full exercise of the warrants), or 8% of the total authorized shares (41 million shares are now issued and outstanding; 80 million are authorized).

6) Pan Am's management will include on the management slate of directors (now consisting of 17 directors, but expandable to 20) one person nominated by Iran so long as Iran continues to hold the debt or the shares acquired through the exercise of the warrants.

7) It is understood that final implementation of the agreement will be subject to requisite approvals by the pertinent U. S. regulatory agencies.

File

For Immediate Release

Washington, D.C., February 7, 1975---O. Roy Chalk, former head of Trans Caribbean Airways (now American Airlines), D.C. Transit System of Washington, D.C. and International Railways of Central America, stated today that he was confident there was a U. S. solution to the financial plight of Pan American World Airways without resort to foreign intervention by the Government of Iran.

Mr. Chalk stated he is prepared to submit a definitive proposal for the acquisition of Pan American and intends to meet with General William Seawell, President of Pan American in order to discuss the same.

Mr. Chalk continued, "I am aware that if I desire to proceed further with the matter, I will ultimately be required to obtain prior Civil Aeronautics Board approval of any contract to acquire 10% or more of the voting securities, capital and/or properties of Pan American, which I am prepared to do."

Mr. Chalk further stated that over the past year, "I have discussed my solution of the subject with persons of importance in Government, with leading banks, with airline executives and others who are interested in resolving the financial problems of Pan American. The reaction in all cases has been most encouraging."

He continued, "Because of the Iranian emergence into the field, the time has come for immediate action by U. S. businessmen to avert a foreign takeover. An Iranian group, at this moment, is being guided through the halls of Congress by a Pan American vice president, apparently lobbying for Congressional support."

Mr. Chalk expressed the opinion that, "The contemplated foreign takeover by a Middle East power of any U.S. air carrier would be a severe blow to our international prestige and our national pride, as well as constituting a possible serious military disadvantage and blunder." He pointed out that, "Most U. S. jet aircraft in international operations are registered in the CRAF Program, our Civilian Air Force Military Reserve. I intend to so inform General Seawell and at the same time discuss my proposal with him."

# # # # # #

For further information contact: Mrs. Dianna McCray, 3600 M Street, N.W., Washington, D.C. 20007 - Tel. 202 - 965-9700

Roy Chalk

COPY

File

O. ROY CHALK

February 13, 1975

The President
White House
Washington, D. C.

My dear Mr. President:

As you are aware, Pan American and the Iranian Government have been negotiating an agreement whereby the Iranians would provide Pan American with substantial financial resources in exchange for an equity in the hotel business and some needed technical assistance. With the concurrence of the Civil Aeronautics Board they would be granted a position on Pan American's Board of Directors and eventually thirteen percent of the common stock. In addition, the Iranian Government would become Pan American's largest creditor. Under long established Board precedent, as well as common business practice, the consummation of these arrangements would result in the Iranian Government having a substantial measure of control over Pan American and the operation of its fleet.

Moreover, to the best of my knowledge, the Iranian Government does not plan, nor could it contribute either the managerial or financial skills necessary for any long term solution to the Pan American problem.

But apart from the prospect that the Iranian deal may prove to be a band-aid where surgery is necessary, there are other aspects which create major public interest problems.

In the first instance, you may note that Pan American is the largest United States flag contributor to the United States Civil Reserve Air Fleet (CRAF) which is our Air Force's back up logistics service in case of national emergency. As you are aware, the CRAF activity includes a dedication of crews, maintenance facilities, and the other necessary components for immediate operational capability.

Pan American supplies over forty percent of the Boeing 747 capacity in CRAF and over twenty-nine percent of the overall United States flag capability in CRAF. Patently, the prospect of foreign government control of Pan American, even if such control is less than total, is potentially a serious matter from the standpoint of our national interest and one which warrants public discussion before the deal is consummated.

There is another serious question which I believe should be discussed before this arrangement is finalized. I refer to the precedent which would be established by the Iranian bail-out of Pan American. Thus, if the United States Government is prepared to endorse the control of Pan American by a foreign oil power, could the United States later react negatively were this or any other foreign interest to seek control of United States communication companies, utilities, banks, insurance companies or other vital United States businesses? In short, is the proposed Iranian investment in Pan American a trojan horse for other investments in potentially sensitive areas?

It is against this background that I have accelerated my efforts to develop a United States business interest approach to Pan American. As implied, it has been my long held view that Pan American is a company which has grown beyond the ability of any foreseeable management to operate efficiently and economically. Nor are there, in my judgement, policy changes which the United States Government could or should make to create a more salubrious economic climate for Pan American profitability. I do, however, have a plan that could retain the economic status of Pan American as a viable corporate entity.

I might say that in the discussions which I have had with informed industry observers and interested government officials there was a considerable agreement with my judgement in this regard.

Accordingly, when the first news of the Iranian deal became known, I embarked upon a major effort to place my views before the major United States flag carriers. These discussions are currently in process. It is my intention, should these carriers respond affirmatively, as I anticipate, to complete a plan for a joint offer to be made to Pan American for the acquisition of its assets and the assumption of its liabilities. I believe that I can offer greater security to Pan American's creditors, greater long term job opportunities for its loyal and effective employees, and a reasonable return for its shareholders - and this can be done without any sacrifice of important United States interests.

Certainly, with an arrangement of this type in the offing, there is no sound reason why the United States Government should be stampeded into approval of the Iranian bail-out.

Please accept my kindest personal regards.

Sincerely,

O. Roy Chalk

bcc: Mr. Michael Duvall
Executive Office of the President

5/21/75
NEA/IRN:BBMorton
(Drafting Office and Officer)

UNCLASSIFIED

DEPARTMENT OF STATE

Memorandum of Conversation

file

DATE: May 17, 1975
in Mr. Sober's office

SUBJECT: Iranian Loan/Investment in Pan Am; Iran Air Discount Fares

PARTICIPANTS:
Lt. General Ali Mohammad Khademi, Managing Director, Iran Air.
Sidney Sober, Deputy Assistant Secretary, NEA.
Robert Binder, Assistant Secretary, Department of Transportation.
Michael Styles, Director, EB/AV.
Byron Morton, NEA/IRN.

COPIES TO:
NEA
NEA/IRN (2)
EB/AV
Amemb Tehran
Dept. of Transportation
Pan Am Task Force (see attached list)

Mr. Sober opened the conversation by thanking General Khademi for accepting his invitation to come in for an informal talk about the proposed Iranian arrangement with Pan Am. Although the Department has no direct role in the negotiations, it does maintain an interest in them, wants to be helpful if possible and wants to be sure that the parties are well aware of all issues involved. Mr. Sober recalled the February 16 joint release by which the USG had indicated it had no objection in principle to the proposal and which had referred to the fruitful consultations and warm cooperation between our two governments.

General Khademi began a discussion of the history of the proposal by pointing out that the Shah had made it clear from the start that he does not intend for Iran to gain any control of Pan Am. He does want to help an airline that has been of great assistance to Iran. Khademi said that the deal goes back to an approach by Pan Am Chairman Seawell to Iran in August 1974. Subsequent discussions have gone relatively smoothly and only three major problem areas remain:

1. The management of Intercontinental Hotels Corp. (IHC) -- severance of IHC from Pan Am, as contemplated in

the talks to date, would cause a change in the handling of overheads and thus in the IHC profit situation. Also, the flow of management talent between IHC and Pan Am would be different once they are separated. Iran wants some guarantees against adverse effects of the severance.

2. Iran is not clear about U.S. regulations on the right to register the Pan Am stock it may acquire. Its U.S. advisers are working on this.

3. Pan Am wants a clause in the agreement that Iran will not sell 1% or more of Pan Am's total stock to any single party without Pan Am's concurrence. The Iranian side does not feel comfortable with such a formal restriction, although it has no plans for a quick sell-off of stock.

There are also some technical problems to be worked out between Pan Am and its current creditors.

Khademi said that he thought that a preliminary agreement setting the principles on which the final agreement would be based could be signed fairly soon. The final agreement would probably take an additional six months to complete. Mr. Binder and Khademi discussed the possibility that the CAB could carry out its consideration of the proposal on the basis of the preliminary agreement.

Mr. Sober said we have been in touch with Pan Am, which has told us it has kept the Iranian side fully informed of all the financial issues -- including the contingency that the Iranian loan would not of itself be sufficient to solve Pan Am's problems and that a merger with another U.S. airline might well be necessary. He said that there was a strong body of opinion in Washington which felt a merger would be required. Khademi said that Pan Am had been frank about this possibility and went on to discuss the possible merger partners. He indicated that Iran would have no problem with a merger. Mr. Sober noted that any proposal for a merger or major route restructuring for Pan Am would have to be carefully studied in light of the possible impact on other air carriers and the domestic and foreign air commerce of the United States; the USG is not in a position at this time to tell Pan Am or the GOI whether it would support or oppose such a transaction, and our position could be established only after a thorough assessment of the particular transaction and its implications for our air commerce. Mr. Binder agreed and described the Federal Action Plan, under which a policy study is now under way on governmental support for U.S. international air carriers. He emphasized that he could not predict the outcome of the study. General Khademi indicated his understanding of these points.

General Khademi brought up the issue of the 40% discount Iran Air wants to give GOI employees and Iranian students on flights to and from the United States. He noted that the discount was ordered by the GOI, is in effect on routes to all other countries served by Iran Air and has caused no problem for competing airlines. Mr. Sober pointed out that the U.S. regulation has been in effect for years and applies across the board -- there is no intention to single out or discriminate against Iran. The Iranian proposal presented us with a serious problem in that no airline now enjoys the right to offer such a discount. We had proposed consultations, but Iran should understand how difficult this issue was for us. Khademi expressed appreciation that the U.S. had permitted the discount to stand for flights already scheduled, pending consultations on the issue. He said that the Iranian Embassy will be sending a note proposing talks to start either June 2 or June 16.

The meeting ended with expressions of mutual appreciation for the opportunity to talk together frankly and constructively.

Attachment:

Pan Am Task Force
distribution list.

NEA/IRN:BBMorton/bk 5/21/75

Honorable Charles W. Robinson
Under Secretary for Economic Affairs
Department of State
Room 208
Washington, D. C. 20520

Honorable Edward C. Schmults
Under Secretary
Department of the Treasury
Room 3430, Main Building
Washington, D. C. 20220

Honorable John K. Tabor
Under Secretary
Department of Commerce
Room 5840
Washington, D. C. 20230

Honorable William P. Clements, Jr.
Deputy Secretary
Department of Defense
The Pentagon
Room 3E942
Washington, D. C. 20301

Honorable Thomas E. Kauper
Assistant Attorney General
Department of Justice
Room 3109
Washington, D. C. 20530

Honorable James T. Lynn
Director
Office of Management and Budget
Washington, D. C. 20503

Honorable Alan Greenspan
Chairman
Council of Economic Advisers
Room 314
Old Executive Office Building
Washington, D. C. 20506

Honorable Arthur F. Burns
Chairman
Federal Reserve System
Federal Reserve Building
Room B2046
Washington, D. C. 20551

Honorable Roderick Hills
Counsel to the President
The White House
West Wing
Washington, D. C. 20500

Honorable John M. Dunn
Deputy Executive Director
Council on International
Economic Policy
Room 208
Old Executive Office Building
Washington, D. C. 20506

Mr. James Cannon
Domestic Council
The White House
West Wing
Washington, D. C. 20500

Honorable L. William Seidman
Assistant to the President
for Economic Affairs
The White House
West Wing
Washington, D. C. 20500

Honorable Michael Raoul-Duval
Associate Director
Domestic Council
Room 216
Old Executive Office Building
Washington, D. C. 20506

Robert Hormats
NSC Room 361 Old Executive Off Bld

Robert Oakley
NSC Room 386 Old Exec Off Bldg

PAN AM TASK FORCE