

## THE CREATION OF WEST AUSTRALIAN AIRWAYS; WHAT THE ACCOUNTANT SAW

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In 1921 Norman Brearley and a number of Western Australian business men and pastoralists established Western Australian Airways to operate the air mail service which Norman Brearley had been awarded by the Commonwealth Government. The service finally started in early 1922 on a sound footing and operated well for a number of years. On 13 December 1926 a new company, called West Australian Airways, was registered in Perth and took over the operations of Western Australian Airways soon thereafter.<sup>1</sup> The reasons for this change have not been previously examined and this article will explore the issues surrounding the change. (To simplify matters this article will use the term 'Airways' to describe Western Australian Airways and West Australian Airways except when the difference between the two companies is important. This also conforms with the general practice at the time when the company was popularly simply called 'Airways'.)

Airways was paid a subsidy of 4/- a mile by the Commonwealth for the first two years of operation under one year contracts covering 1922 and 1923. It continued at that rate for the first and second years of the first three year contract (1924-26) and was reduced to 3/3 for the third year.<sup>2</sup> The first year of Airways second three year contract with the Commonwealth was paid at 3/4 a mile and at 3/- a mile for the second and third years.<sup>3</sup>

The first discussion of a reduction in subsidy accompanied negotiation of a three year contract and the extension of the route south to Perth from Geraldton which was Airways first southern terminus. The company requested a longer contract period because the short term contract did not give it the security it needed to hire and retain staff of quality, spend money on permanent equipment, manufacture and install plant, erect suitable buildings and maintain landing grounds. Short contracts were also unsatisfactory from the investors' point of view.<sup>4</sup> Brinsmead, the Commonwealth's Controller of Civil Aviation, agreed with Brearley and put to the government a proposal that a three year contract be granted with several additional provisions.<sup>5</sup> In September 1923 Brearley agreed with the Commonwealth's proposition and the understanding was formalized in November 1923 with the subsidy payments for the route were to be 4/- in the first year and amounts 'as may be approved after investigation' which would be, for the second year, not less than 3/6 a mile and, for the third year, not less than 3/- a mile.<sup>6</sup> Brearley complained, however, that the Minister for Defense had given a verbal agreement that the subsidy would be fixed at 4/- for the whole of the three year contract but the government appears to have ignored him.<sup>7</sup>

Serious dispute arose between the Commonwealth and Airways in December 1925 when Brearley objected to the governments' proposal to continue the subsidy at 4/- for the second year and reduce it to 3/3 a mile for the third year.<sup>8</sup> Earlier in the year the matter had been investigated by a committee which made a different recommendation. It had suggested subsidy payments of 3/8 in the second year and 3/4 in the third year but, because the government wanted to encourage Airways to replace its Bristol Tourers with deHavilland 50s, it also suggested a grant equal to the

difference between those rates and 4/- a mile be paid to the company to upgrade its aeroplanes.<sup>9</sup> Brearley was therefore really objecting to losing about £5,625 or nine pence a mile in subsidy payments in 1926.

The government changed the committee's recommendation because, from 1922, Airways had built up a depreciation reserve fund to be used to buy replacement aeroplanes. By the end of 1925 this had grown to about £10,000, an amount considered sufficient to buy the necessary aeroplanes.)<sup>10</sup> The government believed that, since that reserve had been built up over a number of years from the liberal subsidy of 4/- a mile, and because that rate had not been reduced 'principally to enable this reserve to be built up', it was reasonable for Airways to pay for the new aeroplanes from that reserve rather than from a special grant.<sup>11</sup>

Brearley agreed to the Commonwealth's new subsidy rates in January 1926 but the matter continued to be important because, also in that month, the Commonwealth asked Airways to say under what terms and conditions, 'with particular reference to the minimum amount of subsidy', the company would continue the service for a further three years.<sup>12</sup> Brearley continued negotiating with the Commonwealth and said repeatedly that he could not recommend acceptance of the rate of 3/3 a mile:

*"to my Board as, with that subsidy, it is impossible in three years to make good the depletion of our Reserve Fund caused by the immediate capital expenditure of £10,000 for new aircraft."*<sup>13</sup>

Eventually Airways agreed to take up a new contract with the Commonwealth for three years, the first year's subsidy being set at 3/4 a mile with the rates for the following two years to be set at an amount that would 'with due economy in management, enable a reasonable profit to be made by the Company'.<sup>14</sup>

Brearley was not happy with the way in which the Commonwealth tried to reduce its subsidy payments to Airways. During the negotiations Brearley advised the Commonwealth that Western Australian Airways proposed to undergo a reconstruction to coincide with the beginning of the new contract at the end of the 1926. The new company, to be called West Australian Airways, would take over the operations of the old company. After Brearley gave the Commonwealth assurances that the new company would not pay the old one any consideration for goodwill, that all the subscribed capital would be fully paid up and that 'such of the assets of the old company as are necessary to the operation of the service' would be handed over, the government agree to the formation of the new company and its operating the airmail service contract.<sup>15</sup>

In correspondence about the change Brearley gave three reasons and later the Commonwealth believed that there was a fourth. Brearley's first reason was that the change was necessary for 'our future expansion, which includes the exploitation of low• powered aircraft'.<sup>16</sup> (This is probably a reference to the beginnings of the aero club movement in Australia and the establishment of the Perth Flying School by Airways about 1928.) Later he expanded his explanation to say that the limited capital of the existing company had proved detrimental in negotiations with British aeroplane constructors and this needed to be overcome. He also said that Airways was contemplating expansion and, during the period of the contract being negotiated:

*the policy of the Directors will be to foster and develop the industry by an increased capital outlay in several directions, greater flying activity, and increased local production of aircraft components, rather than increasing the amount for distribution among shareholders.*<sup>17</sup>

The third reason, given well after the creation of the new company was more relevant to the problems confronting Airways in its negotiations with the Commonwealth in 1926. Brearley said that, after the Commonwealth had overturned the recommendations of the committee and decided to pay 3/3 a mile, preliminary steps had been taken to wind up the company and a decision reached that, if some way could be found to continue operating the airmail service, it should be done by a new company. By severe reductions in operating expenses the company had been able to continue flying on that reduced subsidy. He concluded by saying that if the recommendations of the committee had been adhered to or if 'the negotiations in February-March 1926 had been of the same mutually satisfactory nature that had been experienced both prior to that time and during the past months' the reconstruction of the company would not have been necessary.<sup>18</sup> In this way he laid the blame for the company reconstruction with the Commonwealth.

The Commonwealth came to believe that the change had been undertaken simply to enable about £17,000 of assets in the old company to be returned to the shareholders. Only 'such assets of the old company as are necessary for the operation of the service' were given to the new company so the Bristol aeroplanes which Airways was replacing, the reserve fund and other minor considerations remained with the old company and were returned to shareholders when Western Australian Airways was wound up.<sup>19</sup> Apart from the loss of the existing reserve the Commonwealth would, in future when calculating the level of subsidy, have to take into account a very much lower reserve in the new company. That would make it very difficult to 'secure that reduction in the rate of subsidy which it might reasonably have expected to obtain.'<sup>20</sup> In addition, although Brearley had said the reconstruction would improve the company's capital, this had not happened and no new capital had been brought into the company. The Commonwealth believed that Airways' directors had 'not been straightforward' in what they had said but the Commonwealth was, by the time this had been discovered, committed to the new contract with the new company. The accountant's report on Airways' reconstruction concluded:

*If the Department were not legally bound in regard to the new Contract, I would have no hesitation in recommending that the execution of the Contract be deferred pending further information from the Company. I am of the opinion that the interests of the Department have been very seriously affected by the reconstruction of the Company, and I therefore submit the whole of the facts as they are at present available for consideration as to whether the matter of the contract can be reopened.*<sup>21</sup>

No exact figure could be set on the amount returned to shareholders in the old company following the reconstruction although it was estimated at over £17,000.<sup>22</sup> (This is about \$850,000 in current day terms.) When asked to explain Brearley replied that the reconstruction was 'normal business procedure, fully justified by the attendant circumstances' and approved by the Minister in writing. The old company had provided the new company with all the necessary equipment for its business and a Government Loan Bond of £5,000 before distributing the balance of its cash reserve to shareholders. Brearley did not, however, directly deny the allegations made against the business conduct of Airways.<sup>23</sup>

Later the Commonwealth discovered another problem caused by the reconstruction. With the subscribed capital of the company doubled the usual ten percent dividend which the Commonwealth calculated into its subsidy payment was doubled.<sup>24</sup> To counter this the Commonwealth changed its calculations to allow a dividend payment of five percent to shareholders of the new company but, in 1928, a seven and a half percent dividend was paid,

equal to 15 percent in the old company.<sup>25</sup>

As if to add insult to injury the Commonwealth discovered, late in 1927, another way in which it suspected Airways had profited from its subsidy payments. The company's first three deHavilland aeroplanes had been bought from Britain by the old company but the three subsequent aeroplanes had been built under licence by the new company in the Airways Perth hangar. The Commonwealth discovered that the cost of these aeroplanes had not been charged to any reserve fund but under the expenditure heading of 'maintenance'. Since the Commonwealth had taken the cost of maintenance into consideration when calculating subsidy rates it had, indirectly, paid for those three deHavilland aeroplanes. 'It means that the Company has procured three new machines out of our subsidy instead of from Capital', exclaimed the finance officer in apparent shock and dismay.<sup>26</sup> Airways commented that 'as the accounts of the Company are open to investigation, we cannot agree that our methods would mislead the Department'. Brearley said that it was well known that Airways had constructed three aeroplanes so any investigating officer should have searched in the company's accounts for the item, implying that the problem was the Commonwealth's not his.<sup>27</sup>

When Airways faced the reduction of its subsidy payments its policy was to remove as much as possible from its accounts to keep the level of subsidy that it could claim from the Commonwealth as high as possible. The liquidation of Western Australian Airways and the formation of West Australian Airways was one way to do this. Another was to separate subsidiary activities from the main company so that any profits those companies made could not be counted by the Commonwealth. Two such activities were aerial surveying and insurance.

In 1927 and 1928 Airways undertook aerial surveying for the Perth City Council and the State Government. Knowing that if this activity increased the company's profits the subsidy payment could be lowered, Brearley set up another company called 'Air Surveys Limited' and shareholders in Airways were invited to subscribe to it. Air Surveys Limited chartered aeroplanes from Airways at the normal rate and operated successfully for a few years quite profitably until no other aerial survey work was forthcoming.<sup>28</sup> No mention of this company appears in any of the financial records left by Commonwealth investigating officers.

At the beginning of 1925, after an aeroplane had been destroyed by fire at Onslow, Brearley decided to create his own insurance company because, to that point, insurance companies had made a profit from Airways.<sup>29</sup> The 'Permanent Insurance Company' was established and, once again, Airways shareholders were invited to invest in it. They made profits until the company was wound up in 1928.<sup>30</sup> Expenditure on insurance premiums by Airways between 1923-24 and 1926-27 were £10,758 and claims came to £433 so a very healthy profit would have been made from this business.<sup>31</sup> Again, no mention of this activity or the profits it made were taken into account in calculating the rate of subsidy to be paid to Airways.

The Commonwealth appears to have taken Brearley's various stratagems relatively calmly, perhaps because there was nothing it could do about them but also because any serious threat to Airways would damage the Commonwealth's efforts to establish a sound civil aviation industry in Australia. Nevertheless, after its experience with the creation of West Australian Airways the Commonwealth became less generous and helpful in its negotiations and in calculation of subsidy rates. It set them for the remaining two years of the second three year contract at 3/- a mile. These rates were calculated quite simply by examining the company's income and expenditure and then adding sufficient to enable a five percent dividend to be paid.<sup>32</sup> Little consideration was given to rates of depreciation or the building of any reserve fund; that

apparently became the business of the company and it would have to do as best it could with as little financial help from the Commonwealth as it could reasonably give.

#### ENDNOTES

1. Certificate of corporate registration for West Australian Airways, 13 December 1926, Western Australian Archives Ace 2782, AN 144/26.
2. Letter to Minister for Defense from Managing Director, Western Australian Airways, 22 September 1923. file 192/12/321, CRS A705; Letter from Secretary, Department of Defense to Managing Director, WA Airways, 5 December 1925, file 192/12/528, CRS A705, National Archives of Australia (hereafter NAA).
3. Note by Minister for Defense on minute 'Revision of Subsidy - West Australian Airways Co - for year ending 30th December 1928'. file 192/12/569, CRS A705; Letter from Secretary, Department of Defense to Secretary, West Australian Airways, 19 December 1928, file 617, CRS A705, NAA.
4. Letter from Managing Director, Western Australian Airways to Controller of Civil Aviation, 22 May 1923, file 617, CRS A705, NAA.
5. 'Western Australian Aerial Contract', minute from the Controller of Civil Aviation, 27 June 1923, file 617, CRS A705, NAA.
6. Letter from Managing Director, Western Australian Airways to Controller of Civil Aviation, 27 September 1923; Letter from the Secretary, Department of Defense to the Managing Director, Western Australian Airways, 17 November 1923, file 192/12/321, CRS A705, NAA.
7. Letter from the Managing Director, Western Australian Airways, to the Controller of Civil Aviation, 28 March 1924, file 192/12/497, CRS A705, NAA.
8. Letter from the Secretary, Department of Defense, to Managing Director, Western Australian Airways, 5 December 1925; letter from Managing Director, Western Australian Airways, to Secretary, Department of Defense, 15 December 1925, file 192/12/582, CRS A705, NAA.
9. Minute from the Controller of Civil Aviation, 24 November 1924, .file 192/12/528, CRS A705, NAA.
10. 'Western Australian Airways Ltd., Subsidy', file note, November 1925, file 192/12/582, CRS A705, NAA.
11. 'The West Australian Airways Limited - Reconstruction of old company Western Australian Airways Limited', minute from Finance Officer, 23 March 1927, file 192/12/551, CRS A705, NAA.
12. Letter to Secretary, Department of Defense, from Managing Director, Western Australian Airways, 1 March 1926, file 192/12/528, CRS A705, NAA.

13. Letter to Secretary, Department of Defense, from Managing Director, Western Australian Airways, 1 March 1926, file 192/12/528, CRS A705, NAA.
14. Letter from Managing Director, Western Australian Airways, to Secretary, Department of Defense, 20 July 1926, file 192/12/528, CRS A705, NAA.
15. Ibid.
16. Letter from Managing Director, Western Australian Airways to Secretary, Department of Defense, 24 April 1926, file 192/12/582, CRS A705, NAA.
17. Letter from Managing Director, Western Australian Airways, to the Secretary, Department of Defense, 20 July 1926, file 192/12/528, CRS A705, NAA.
18. Letter from Managing Director, Western Australian Airways, to the Secretary, Department of Defense, 29 November 1927, file 192/12/569, CRS A705, NAA.
19. 'The West Australian Airways Limited; Reconstruction of old company Western Australian Airways Limited', minute from Finance Officer, 23 March 1927, file 192/12/551, CRS A705, NAA.
20. Ibid
21. Ibid.
22. 'The Reconstruction of the Western Australian Airways Co Ltd', minute from Finance Officer, Air services, 22 August 1927, file 192/12/551, CRS A705, NAA.
23. Letter from Managing Director, Western Australian Airways to the Secretary, Department of Defense, 2 August 1927, file 192/12/551, CRS A705, NAA.
24. 'Western Australian Airways Limited. Revision of Subsidy for year ending 4/12/28', minute from Finance Officer, Air Services, 7 November 1927, file 192/12/569, CRS A705, NAA.
25. 'Revision of Aerial Mail Service Subsidy (Perth to Derby) for the year ending 4th December 1929'; minute by Finance Officer, Air Services, 10 December 1928, file 192/12/617, CRS A705, NAA. CRS A705, NAA.
26. 'Revision of Subsidy - Western Australian Airways Co - for year ending 4th December 1928'; minute from Finance Officer, 29 November 1927, file 192/12/569, CRS A705, NAA.
27. Letter from Managing Director, Western Australian Airways, to the Secretary, Department of Defense, 29 November 1927, file 192/12/569, CRS A705, NAA.
28. Sir Norman Brearley, *Australian Aviator*, Rigby Limited, Adelaide, 1971, pp. 128-130.
29. Ibid, p. 123

30. Ibid, pp.123-124, Brearley gives the impression that the company lasted for many years but this is incorrect. It is possible that another reason for the winding up of this company was that Airways was about to buy four very expensive de Havilland Hercules aeroplanes and the loss of one of these would have challenged the viability of his insurance company.

31. 'West Australia Airways Limited, Revision of Subsidy for year ending 4/12/29', minute from Finance Officer, Air Services, 7 November 1927, file 192/12/569, CRS A705, NAA.

32. 'West Australian Airways Limited. Revision of Subsidy for year 2/12/28', minute from Finance Officer, Air Services, 7 November 1927, file 192/12/569; 'Revision of Aerial Mail Service Subsidy (Perth to Derby) for the year ending 4th December, 1929', 10 December 1928, file 192/12/617, CRS A705, NAA.