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AT 31/10

L V Appleyard Esq
Private Secretary to
The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign
and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
LONDON SW1

30th October 1984

Dear Len,

AVIATION AND US ANTITRUST: THE 'LAKER' ISSUE

I enclose a copy of the report to my Secretary of State by Mr Knighton, as the leader of the delegation which had talks with the US in Washington last week on the 'Laker' aviation dispute. Your officials will have received this direct.

Unless any colleague would like one, my Secretary of State sees no need for a further meeting of Ministers before the next round of discussions with the US. But he would however like to point out that he endorses the recommendations on immediate tactics at paragraphs 13-15 of the report.

Copies go to Andrew Turnbull (No 10), David Peretz (Treasury), Callum McCarthy (Trade and Industry), Richard Gardiner (Attorney General), and Richard Hatfield (Cabinet Office).

Yours,

Dinah.

MISS D A NICHOLS
Private Secretary

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from: W M KNIGHTON
29 October, 1984

SECRETARY OF STATE

cc PUSS Mr Spicer
Mr Lazarus
Mr Holmes
Mr Stevens
Mr Blanks
Mr Clarke
Mr Beetham
Mr Oates
Mr Fortnam
Mr Wakeling
Mr Reardon
Mrs Ramsay

Mr Roberts DTI
Mr Ayling DTI
Mr Healey DTI
Mr O'Neill FCO
Mr Aust FCO
Mr Chase FCO
Mr Gardiner
Law Off Dept
Mr Burgner Trsy

BE Washington

Sir O Wright
Mr Braithwaite
Mr Maynard

AVIATION AND US ANTITRUST: THE 'LAKER' ISSUE

An account of our consultations with the US last week is in Washington telno 3205 at Annex A and Sir Oliver Wright's comments in telno 3204 at Annex B. In this report I summarise and give my own comments.

2 Briefly, on prospective indictments the Department of Justice (DoJ) were clear that they had evidence of breaches of US criminal law. Our briefing in Washington produced nothing to counter this as regards price fixing between British Airways (BA) and Laker; as regards agreements on scheduling between BA and Pan Am, although BA's attorneys had said the evidence of any agreements were predominantly circumstantial, the DoJ claimed clear evidence of agreements. We presented the considerations (Washington telno 3206 at Annex C) which we argued should lead the DoJ as a matter of comity (self-restraint) not to prefer indictments against our companies, or, especially, the individuals. Mr McGrath, the Assistant Attorney General for antitrust, raised critical 'observations' to which we replied. He gave no clues about his decision - certainly nothing of cheer. The DoJ will be seeing the attorneys for BA and the individuals this week as the next stage in their process. I formally asked that, if after consideration they were still minded to indict, we should be informed of this before final decisions were taken.

3 On future arrangements for Bermuda 2, the important development was that the US side can contemplate going to a new Congress to propose removing private civil antitrust liability (treble damage suits) from aviation. The necessary quid pro quo, for competition policy and associated political reasons is sufficient liberalisation in the bilateral arrangements for establishing aviation tariffs, to enable this to be justified to the Congress. Thus, it appears that this change would be limited to the aviation agreements with particular bilateral partners. As in June, the US was prepared to some inter-airline discussion on tariffs subject to transparency; but they continue to oppose discussion of capacity or scheduling. We maintained our readiness to compel transparency.

4 On the Laker civil suits, while we reiterated that we were looking for something here as part of an overall settlement and the US agreed we should need to discuss this, I deliberately deferred doing so, because their stance will be influenced by the outcome on indictments.

5 On winter low fares, the US made a further proposal, which we have undertaken to consider, for establishing that they do not consider the fares predatory. But it appears that this would still not proof them against treble damage actions, or against DoJ enforcement if there should prove to have been inter airline discussion prior to the filings. We have sought advice on this from our US attorneys. Our immediate reaction was to warn that Ministers were unlikely to be satisfied with anything less than watertight; and that we could give no expectation of a favourable response before 1 November.

6 We are meeting the US side in London on Thursday 1st-Saturday 3rd November and have also reserved 7-9 November, 19-21 November and the week of 26 November. We must maintain momentum. We think Mr McGrath will strongly wish to decide on the indictments before 7 December, when the present Grand Jury's life expires.

Assessment

7 These discussions have opened for the first time a prospect of achieving our objective on future arrangements (para 2 c of the officials' paper which you recently circulated to your colleagues). We want to secure this as far as possible before the privatisation of BA. The US have clearly taken a seminal step at senior level in being ready to get rid of the treble damage suit from aviation and more than once emphasised that they had decided to 'keep it simple' and not have it applying in some circumstances but not in others.

8 But their price is mostly in furthering US commercial aviation objectives. We are not yet clear after initial probing just what this price will be: indeed, the US position is not finally determined. So we have to feel our way forward, rapidly.

9 On fares liberalisation, I have warned the US side against locking themselves into too high a demand pointing out that your over-riding objective is to restore the bilateral to health in respect of antitrust, before considering changes in the commercial side of it. I did this partly for negotiating tactics. But partly because your objective on the commercial side combines a wish to reduce regulation, with maintaining sufficient ability to fight unfair trading, including dumping. The Bermuda 2 safeguards against dumping are partly in the tariff provisions, partly in the capacity provisions of Annex 2, which expire on 23 July 1986 unless renewed in some form by agreement of both parties, and partly in the general provisions on fair competition in Article 11. In the early 1970s we had only the first and third of these safeguards and these proved inadequate when the US airlines were ruthlessly dumping capacity in a way that they could afford to do because of the size of their home market. We had a number of rows; despite these our market share dropped to 25 per cent. It is now around 35 per cent. This was part of the background to the negotiation of Bermuda 2.

10 Looking as you are for reduction of regulation, it is logical to tackle fares first, capacity second and market entry third, as we are doing in Europe. But you may have hesitations in the Bermuda 2 case about a major loosening up on fares until you are clearer about the future of the capacity arrangements (on which Mr Stevens has been having preliminary informal discussions with the US, planned quite separately, this last weekend). You will want the views of the CAA and of our airlines on this and on the US ideas on transparency and we are seeking these.

11 A package acceptable in itself on future arrangements is likely to be tied by the US to the competition content of Bermuda 2. This seems both unavoidable and acceptable. It could be agreed in advance, but come into force only after legislation to enable the US to move on treble damages, thus reducing the risk of a second negotiation inspired by the US Congress. We shall want to tie it to the absence of any indictments; but it may not be possible to discuss this with the DoJ; and it may prove unnegotiable. We need not yet decide whether you would be prepared to acquiesce in some indictments. We should aim to seal off any new DoJ investigation of past conduct: if this could be done in time, it would help over the BCal US documents, which for the time being BCal are still able to withhold. I would still aim for some DoJ help on the civil suits, eg an indication that they had found no evidence of predation against Laker.

12 Our disapproval of the winter low fares and our manifest intention to enforce this has clearly helped greatly to concentrate minds in Washington on our proposition that the aviation agreement is in disarray. It has thus for the present supplied the leverage we were seeking. And the impact on the airlines

will touch US commercial interests. We shall be advising on the latest US proposal when US legal advice is available. But without the 100 per cent security from treble damage action which seems unlikely to be available, I think we should be justified in declining to approve the low fares for the time being. If we can arrange an overall settlement by end November or early December, we might then be justified in taking a risk. At that stage we could be looking for a good atmosphere in the Congress.

13 The gathering of evidence which would enable enforcement against carriage at the disapproved low fares needs to be handled with care: as far as possible it should be directed at airlines rather than passengers. Our stance should be to maintain our position firmly, rather than, at this stage, to raise the temperature. We shall discuss with Mr Spicer.

14 For contacts in the coming days with senior US people (outside the Justice Department) I recommend that Ministers might take the following line. The discussion of future arrangements has opened up a possibility of sensible settlement of the dispute: but there is a long way to go. The prospects could yet be jeopardised if the DoJ decided to indict; this would present Ministers here with a severe political problem in accepting any settlement. Conversely, we have put considerations of principle to the DoJ on why they should not indict in this disputed matter; and agreement on future arrangements would further strengthen these considerations: so if we agree on the prevention of anticompetitive actions by airlines for the future, the DoJ should consider leniency (in their terms) for the past.

15 We do not recommend a high level message on indictments at this stage. But the Embassy will be keeping their ears to the ground with this in mind.

W.M.K.

W M KNIGHTON
Deputy Secretary
S.11/04, 2 Marsham St.
212 3109
29 October, 1984