Prime Minister (1)

Content with this approach, subject to the views of colleagues? I think it is consistent with the continuing support for liberalisation which you gave in your meeting with Mr. Wallis. CDP 24/11

PRIME MINISTER

AVIATION AND ANTI TRUST: THE LAKER ISSUE

US/UK discussions on future aviation arrangements and the interaction with the US anti trust law resume in London on Tuesday 27 November. You have said that you would review our position closely to see what scope there was for some greater degree of liberalisation. In this minute I make proposals on that point.

Before the announcement of the US decision not to bring indictments, we had established a brief for the next round of discussions (my letter of 15 November to the Foreign Secretary, and subsequent correspondence; the outline settlement is in Annex B to Mr Knighton's submission of 12 November, circulated with my private secretary's letter of 13 November). The US have informally indicated their bid in the piece of paper which Ambassador Price pressed into your private secretary's hand after Mr Wallis' visit: a copy is annexed.

The third and fourth US points are essentially the competition part of a settlement and our counterpart to the US getting rid of the treble damage action from aviation. They give no problems of substance, though it must remain our position that price co-ordination talks are not at present governed by US anti trust law, because our dispute about the past remains live until the private suits have been disposed of. We shall also want new commitments expressed in terms of what we agree to, rather than in a blank cheque that our airlines have to comply with US anti trust law. We must take care that our undertaking about the use of the PTI Act in the future extends only to circumstances for which we have an agreed regime and where the Department of Justice are playing to the rules; in particular it must not inhibit us from maintaining in force the present Order and Directions, or using the powers in

the Act against any further civil actions (or Department of Justice enforcement) for events in the past or in the future before a new agreement takes effect.

These competition provisions should, once they are public, provide President Reagan with a strong basis for defending his decision on indictments. By establishing what airline behaviour is allowed and is not allowed, and by providing for UK as well as US enforcement, they will enable him to say that the future is taken care of and that this shows that it was appropriate for him, given the strong differences over the matter, not to seek to punish for the past.

The US also sought liberalisation of the agreement, ostensibly to help them with the argument in Congress over removing the treble damage remedy. We were prepared to accept liberalisation of the arrangements for establishing fares, not least because this suits our own objectives. But we resisted (I sent a message to Mrs Dole) a wide ranging commercial renegotiation, as not appropriate to an urgent settlement of the anti trust dispute.

Now, following the President's decision, the US are raising their sights again and are trying to secure new opportunities for their many airlines. In looking at this I am fully conscious of the political case for a forthcoming approach - though I am also very conscious that the civil suits which we consider unjustified could yet wreck British Airways' privatisation. I must also have in mind that we have just gone to great lengths to strengthen the position of British Caledonian, who are none too strong a participant in the US market and are just about to restart a service to New York. I must not prejudice their position.

In this context the first two points in the US list, relating to the commercial arrangements in Bermuda 2 on pricing, capacity and market entry, raise issues of some importance both for the

travelling public and for our airlines. Bermuda 2 is in practice already one of the most liberal and competitive international aviation arrangements (a reflection of this is that the powerful United States airlines are out-earning ours by a factor of 9 to 5). Our aviation objectives entail liberalisation of the present international regulatory system, but also the maintenance of fair trading conditions for our airlines, not least because, where we liberalise more rapidly than do other countries in their mutual arrangements, there will be a natural pressure for those dealing with us to dump any surplus capacity into our market with them. When liberalising, we still need to be able to protect against unfair trading practices such as dumping and also (as in visible trade) to have some safeguard against trading pressures which would cause unacceptable damage to our industry and perhaps put the airlines of other countries into a position of market dominance which might harm the interests of our consumers.

In applying this approach to Bermuda 2 we have already offered to the United States the 'substantial flexibility in pricing, akin to what is known as dual disapproval' for which they ask. We have said that there must be some 'safety net' arrangement to ensure fair trade and they seem to have accepted this in principle, although the details remain to be finally negotiated. We have however insisted that there must be equality of opportunity between our airlines and theirs; and that, given the competitive advantage which their airlines have by reason of the access which we do not fully share to the vast US domestic market, we must protect the ability of our airlines to compete effectively and with some degree of equality for US traffic into the US gateway cities. We have therefore stuck firmly to a proposal that in respect of pricing between these "behind points" and London, US airlines must charge domestically available (market set) fares for carriage between US "behind points" and US gateways in order to qualify for the liberalised pricing arrangements envisaged. This policy (which we refer to as the "sum of sectors" approach) is a very important element for the UK in any liberalised pricing arrangements.

I have so far declined to include any changes on capacity and market entry in the package - indeed they were not in the original outline. These are the most difficult areas for us, because of the market power which US airlines enjoy in their huge domestic market to which our own and foreign airlines do not have equal access. The provisions covering entry and capacity contained in Bermuda 2 are cardinal for enabling our airlines to have adequate access and opportunities in the US market. I fear therefore that any radical changes in these arrangements which the US might seek to the advantage of their airlines, particularly within the sort of timescales involved, would severely damage the ability of British airlines to compete on equitable terms. I have however identified a modest number of limited proposals in this area, on which the delegation might fall back, if it looks really necessary to do so.

There is one other potential problem: the Department of Justice earlier volunteered, as part of a settlement, the possibility of an amnesty from their enforcement in respect of any past conduct by our airlines which they regarded as contrary to the antitrust law. Their evident dislike of the President's decision may now lead them to resist including this. We however always considered it important and a recent re-evaluation shows that for us this should be a cardinal aim as part of a settlement.

Overall, I consider that the package towards which we were working offers the prospect of a fair agreement. There are signs that the President's decision may make it harder to secure, because of dissensions within the US side. But we shall make strenuous efforts to secure agreement next week. I shall be monitoring progress.

I should be glad to know, by Monday morning, that you and other colleagues are content that our delegation should proceed on the lines set out in the previous correspondence, as qualified by this minute.

I am sending copies to the Foreign Secretary, the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, the Attorney General and to Sir Robert Armstrong.

Dinah Nicholas

pp NICHOLAS RIDLEY
22 November 1984

(approved by the Secretary of State & signed in his absence)

## FUTURE AVIATION ARRANGEMENTS

The U.S. needs:

(1) substantial flexibility in pricing, akin to what is known as "dual disapproval";

(2) a relaxation of restrictions on capacity, with regard to both frequencies and designations of carriers;

(3) enforcement of the full disclosure of any price coordination talks in accordance with Bermuda II; and

(4) a commitment from HMG not to invoke its blocking statute against U.S. government enforcement actions in the event of future violations by U.K. carriers, as well as a commitment to impress upon its carriers the need to comply with U.S. antitrust law in the future.

FCS 84

10 DOWNING STREET

*From the Private Secretary*

23 November, 1984

Aviation and Anti Trust: The Laker Issue

The Prime Minister has seen your Secretary of State's minute of 22 November about the position which we should adopt in the US/UK discussions on future aviation arrangements beginning on 27 November. Subject to the views of colleagues, she is content for Mr. Ridley to proceed along the lines he proposes.

I am copying this letter to Len Appleyard (Foreign and Commonwealth Office), David Peretz (H.M. Treasury), Callum McCarthy (Department of Trade and Industry), Henry Steel (Law Officers' Department) and Richard Hatfield (Cabinet Office).

C. D. POWELL

Miss Dinah Nichols,
Department of Transport



CST