CONFIDENTIAL FILE DA

cfST DTI
HOD FCO
HMT CO
PC

10 DOWNING STREET

From the Private Secretary

19 December 1985

Dear Richard,

A BILATERAL COMPETITION REGIME FOR UK/US AVIATION

The Prime Minister has seen a copy of your Secretary of State's letter of 17 December to the Foreign Secretary proposing that discussion should be resumed with the United States Administration on possible arrangements for the control of anti-competitive behaviour on North Atlantic air services.

The Prime Minister is content with the terms in which it is proposed to pursue this issue, on the assumption that colleagues in MISC 112 are similarly content.

I am copying this letter to the Private Secretaries to members of MISC 112, to the Private Secretary to the Lord Chancellor and to Michael Stark (Cabinet Office).

Yours sincerely,

Charles Powell

(Charles Powell)

Richard Allan, Esq.,
Department of Transport.

CONFIDENTIAL

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign
and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
LONDON SW1

17 December 1985

Prime Minister

An attempt to re-open discussion with the US on anti-trust in the airline industry.

Agree the proposed approach to the Americans?

CDP 18/12

Dear Geoffrey

A BILATERAL COMPETITION REGIME FOR UK/US AVIATION

It is now just over a year since the President of the United States cleared the way for settlement of the Laker liquidator's case, and subsequently the class action, by terminating the criminal investigation of similar charges which was being conducted by a Grand Jury. The President's action also caused the United States team to withdraw from negotiations about arrangements to prevent future disputes about anti-trust under Bermuda 2, which had been making some progress on the basis that the Americans would remove UK/US aviation from the reach of civil actions under US anti-trust law in exchange for bilateral arrangements guaranteeing more effectively for the future that airline consultations which might have an anti-competitive character would not take place without the knowledge and consent of the aeronautical authorities, with penalties for infringement. In addition, as part of the same package, we were prepared to concede more liberal arrangements for the approval of airline tariffs on North Atlantic services.

All this had to be shelved because the President's decision (and our reaction to it) was so bitterly resented especially by the Department of Justice that they were not prepared to co-operate in further negotiations about future arrangements, at least for the time being, and without them no progress could be made. But tempers have eased now, many of the principal protagonists have moved on, and it has been agreed that when our officials are in Washington in the New Year for negotiations about the capacity control mechanism under the Bermuda 2 Agreement, they should also spend one day discussing arrangements for the control of anti-competitive behaviour on North Atlantic air services.

I do not think we can simply pick up the negotiations where they were left off last year. Our proposals for "transparency" in the consultation processes between airlines were a constructive contribution towards the resolution of the dispute which had given rise to the Laker case, but the US side were not at all convinced that we had either the power or the will to prevent anti-competitive behaviour by our airlines. Under the Sherman and Clayton Acts they had both the power and the will, and they were not going to give it up. In any case my Department has given more thought to these matters during the past year, and has come to the conclusion that stronger powers are needed to control anti-competitive behaviour in aviation particularly where, as on the North Atlantic, the regulatory activity of governments is being deliberately pruned back in order to make more room for airlines to exercise their commercial judgement in competing against one another. But it remains our conviction that, consistent with the approach to international aviation generally, any arrangements for controlling anti-competitive behaviour should rest on a firm bilaterally agreed foundation.

It is against this background that my officials have taken the lead in drawing up the enclosed scheme which, subject to your agreement and that of the other colleagues to whom I am circulating this letter, they would like to float with the Americans at the discussions arranged for the first week in January. At this stage the proposals can be no more than a preliminary outline of a possible regime. This would seek to identify those matters which would constitute anti-competitive behaviour and to provide that consultations on them would require the advance approval of aeronautical authorities. In the event of complaints alleging anti-competitive behaviour in other areas an investigation would be carried out either by the aeronautical authority (in our case the CAA) of the country which had designated the airline complained of, or by a commission consisting of representatives of the two aeronautical authorities and a third party acceptable to both sides. Implementation of the findings of these authorities or the commission would be through the national laws and procedures of the two countries.

I believe that a scheme on these lines would demonstrate to the Americans that we are serious about controlling anti-competitive behaviour by airlines on the North Atlantic, and might therefore be sufficient to induce them to consider removing the threat of anti-trust actions in this area, at all events in the US

civil courts. The removal of the civil anti-trust suit from aviation would be a valuable prize in itself but this and the installation of the new bilateral regime which I have in mind would of course require legislation both in Congress and in Parliament. We should have to grant new powers of investigation to the Civil Aviation Authority, and we should have to ensure that adequate and appropriate penalties were available to deter airlines from any temptation to disregard the conclusions reached or the requirement to seek prior approval for certain types of consultation.

My officials first task at the meeting in January should be to find out if they can what relevant changes in US anti-trust legislation are likely to flow from the White House Task Force which has been studying US anti-trust laws, albeit in a domestic context largely concerned with promoting the international competitiveness of United States industry. But if they are to engage in a dialogue about how anti-competitive behaviour should be dealt with in future in UK/US aviation, I would like them to have the authority to float the ideas set out in the attached paper. In doing so however they would have to stress that there was at present no commitment on the part of Her Majesty's Government to implement such a scheme, although we would be very interested in exploring it further with the US authorities if they felt that it might form the basis of a secure bilateral arrangement in this area which could prevent the damage to Anglo/US relations which would certainly arise from a repetition of future cases similar to that generated by the collapse of Laker Airways. They would need to add that in the absence of agreed arrangements on which UK airlines could confidently rely it would be difficult to carry forward further the process of liberalizing North Atlantic air services, either in respect of capacity determination or in respect of airlines' freedom to set fares following their own commercial judgement and subject only to the disapproval of both aeronautical authorities.

I hope that colleagues will be content to allow an exploratory discussion to take place on this basis on the understanding that it would be done without commitment. In the light of US reactions I would propose to make a further report and to seek colleagues' agreement to former proposals for the future conduct of these negotiations.

I am sending a copy of this letter to our colleagues on MISC 112, to the Lord Chancellor, and to Sir Robert Armstrong.

NICHOLAS RIDLEY

CONFIDENTIAL

ANNEX (outline draft)

COMPETITION ON NORTH ATLANTIC AIR SERVICES

1. The Contracting Parties, considering that agreements or concerted* practices which have as their object or effect the prevention, restricted or distortion of competition are contrary to their principles have decided that where such agreements or practices relate to North Atlantic air services operated under this Agreement they shall be subject to the arrangements for the prevention of anti-competitive behaviour set out in this Annex.

2. The designated airlines' licences and permits will be amended to require compliance with the arrangements as set out in this Annex.

3. Airlines which wish to consult about arrangements to:

a. Directly or indirectly determine the levels of airline tariffs including the conditions attached to them;

b. Directly or indirectly determine the capacity to be operated on any route or routes or the allocation of capacity shares to particular airlines;

c. Directly or indirectly pool or share the cost of operating any route and/or the revenue arising from such operations;

or to enter into any agreements arising out of such consultations must follow the agreed procedures (to be attached), which provide for the aeronautical authorities of both countries to be closely informed about the arrangements for airline consultation and any conclusions reached so that they can satisfy themselves

*This draft deals only with concerted practices; further consideration needs to be given to the control of anti-competitive behaviour by a single airline, or by more than one airline acting in the same way without prior concertation.

that any agreements which may be proposed as a result are consistent with the policies of the Contracting Parties for the encouragement of effective competition in operation of North Atlantic air services, and so that they can take any necessary steps to approve or disapprove any practices flowing from such agreements.

4. Airlines are free to engage in consultations on other matters, and to enter into agreements relating to them, but they may be required to desist from any practices which on enquiry are found to prevent, restrict or distort competition, unless such practices are justified on technical, safety or operational grounds, while allowing consumers a fair share of the resulting benefit.

AUTHORITIES

5. The authorities for the purposes of this competition regime will be the CAA (UK), the DOT (US) and a commission made up of one member drawn from the UK authority, one member from the US authority and a third member acceptable to both sides.

COMPLAINTS

6. Governments, airlines or individuals may lodge complaints about suspected anti-competitive behaviour either with the CAA or with the DOT.

INVESTIGATIONS

7. The authority of the Contracting Party which designated the airline which is the subject of complaint will decide whether or not an investigation should be undertaken. Where airlines of both countries are the subject of the same complaint an investigation will take place unless both authorities decide otherwise.

8. Where the complaint is against airline(s) of only one of the Parties, its authority will conduct the investigation.

9. Where the complaint is against airlines of both Parties, the investigation may be carried out by the authority of one of the Parties only, if the authority of the other agrees. Otherwise it will be carried out by the commission, assisted by the authorities of both Parties.

10. Terms of reference including the timescale will be clearly defined at the outset of any investigation. The authority carrying out the investigation will determine its own terms of reference after consultation with the authorities of the other party. The commission will consult both aeronautical authorities. Any extension or redirection of the terms of reference will be determined in the same way and may require a reappraisal of who should conduct it.

RESULT OF INVESTIGATIONS

11. The authority conducting the investigation, or the commission, will make a finding as to whether the practice(s) complained of is contrary to the principles regarding fair competition set out in this Annex. If the practice(s) complained of is found to be contrary to those principles the authority concerned, or the commission, will also propose what remedial action should be taken. In urgent cases the authority or commission may seek an undertaking from the airline(s) concerned or propose interim action on the basis of a provisional finding.

12. In the event of a Party considering that either authority has failed to act, or has acted inadequately or improperly, it may seek consultations, and if it is not satisfied with the outcome of those consultations it may ask the commission to institute or take over the investigation.

13. The authority (or commission) conducting an investigation shall communicate a proposed statement of its findings and any remedial action to all directly interested parties and to the other authority (or to both authorities). If an undertaking is offered which in the opinion of the authority or the commission

constitutes satisfactory remedial action, they may communicate this with or without a proposed statement of finding. The parties and authorities shall have [28] days in which to make any representations in response to such communications.

14. Subject to any intervention under paragraph 12. the body carrying out the investigation shall then issue a final finding together with a statement of any remedial action it considers necessary, taking account of any undertakings which may have been given or offered, which should also be recorded.

15. The findings would be implemented by measures which may comprise legally binding undertakings given by the airline(s) concerned to, or orders made by, the authority of the country which designated the airline(s).

OFFENCES AND PENALTIES

16. Both countries will make it an offence:

a. to fail to disclose consultations or agreements covered by paragraph 3. above;

b. to fail to comply with an undertaking given under paragraphs 11. or 15., or an order made under paragraph 15.

17. Jurisdiction over such offences will be exercised exclusively by the country of the authority to which the undertaking was given or which made the order. Exclusive jurisdiction over an offence under paragraph 16(a) above would lay with the Party which designated the airline.

18. There will have to be adequate and appropriate penalties of broadly equivalent effect in both countries; their scale and nature will have to be discussed and agreed taking account of the laws and practices of both Parties.

CONSULTATIONS

19. Either government may request consultations under Article 16 as to the operation of this regime. Such consultations shall not be requested for the purposes of intervening in or seeking to revise individual investigations or decisions of the authorities, except to the extent that provision is made for such consultations in this Annex.