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DEPARTMENT OF TRANSPORT
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01-212 3434

Peter Ricketts
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

5 October 1984

Dear Peter,

LAKER

I mentioned to you over the telephone earlier today that my Secretary of State will be circulating the attached paper on the Laker problem. He would like urgently to discuss the issues with colleagues as soon as possible, so as to clarify the UK's strategy for resolving the dispute with the US Government. He would be grateful if the Foreign Secretary would be prepared to chair a meeting of Ministers most closely concerned - the Chancellor, the Secretary of State for Trade and Industry, the Attorney General and of course himself. You thought it might be possible to fix such a meeting on Monday, 15 October, which would give sufficient time to decide our objectives and negotiating strategy before our official delegation meets their counterparts in Washington on 24/25 October.

I am copying this letter to David Peretz (Treasury), Callum McCarthy (Trade and Industry), Richard Gardiner (Attorney General) and, for information at this stage, to Andrew Turnbull (No 10).

Yours,

Dinah

MISS D A NICHOLS
Private Secretary

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01-212 3434

Peter Ricketts 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

8th October 1984

Dear Peter,

LAKER

I regret that in the paper on the Laker problem circulated with my letter of 5 October paragraph 7 was somewhat garbled. Would you please substitute the attached revised text in your copy?

I am copying this as before to David Peretz, Callum McCarthy, Richard Gardiner and Andrew Turnbull.

Yours,

Dinah

MISS D A NICHOLS
Private Secretary

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THE LAKER DISPUTE - THE NEXT STEP

REVISE OF PARAGRAPH 7

Notice of termination of Bermuda II is considered in Annex B. In day to day aviation terms we perceive little risk in a renegotiation; at present the US benefits more in commercial terms than we do, and therefore has more to lose. The complication might be that the US would seek commercial aviation concessions from us in return for an acceptable competition regime. This pressure would have to be resisted as unacceptable in principle. We would hope that denunciation of Bermuda II of itself should not affect privatisation of BA, particularly if carried out in a low key way which emphasised the year's grace for renegotiation. We are however taking further advice on this aspect. If it is to be effective, a decision to opt for denunciation carries with it, at the limit, an implied willingness to face an interruption in direct air services - in reality the ultimate leverage that we possess, since without Government agreement, no commercial air services can lawfully take place.

LEGAL PROCEDURE : Labor

March 83

9 OCT 1984

CONFIDENTIAL

UK-US AVIATION AGREEMENT AND
US ANTITRUST LAW: THE "LAKER" ISSUE

Note by the Secretary of State for Transport

I have reviewed our strategy for trying to resolve the row with the United States over the application of their antitrust law to aviation matters. The attached paper by officials considers the position.

2 Following the US notification that they are considering indictments against British Airways and perhaps Laker, together with three individual ex-employees of British Airways, and that they wish to consult with us before making their decisions, we must clearly make a hard push to resolve this dispute. Pressure will be needed for this. The US must be brought to recognise at senior political level the importance which we attach to more satisfactory arrangements; it may be right for the Prime Minister to send a further message to President Reagan, since the Department of Justice Grand Jury investigation, which he declined in May 1983 to halt, has now been completed; but the timing of this would need care. We also need more specific leverage if the US are to recognise that we are in earnest.

3 The paper by officials considers two means of conveying this: reactivating the preliminaries to arbitration under Bermuda 2; and giving notice of termination of Bermuda 2. I prefer the latter. Arbitrators tend to try to split the difference between positions. Our position is one of principle: we do not accept that a bilateral Air Services Agreement can be overridden by US domestic law. I do not see how we can have our position arbitrated. To agree to it is to agree that our position is tentative. The truth is that a successful outcome to this dispute must rest on agreement between us and the United States, otherwise one or the other of us will find we

cannot live with it. We do not need to make a final choice in advance of a round of consultations with the United States; indeed, for the US to be kept guessing about our precise intentions may be helpful.

4 What we must determine now is whether we intend to fight this case through to a substantially more satisfactory outcome: it is no use implying threats which we are in no circumstances prepared to carry through. At the end of the day, this could include being prepared to suspend air services for a time, if that should prove to be the only way to show that an agreed regime for regulation and the prevention of anti-competitive behaviour is essential in this industry. I consider that we must fight. I therefore seek my colleagues' agreement to our delegation being instructed on the lines set out in paragraph 13 of the paper by officials.

5 I also agree with officials that for the time being we should not undermine our position of principle by issuing consents to our airlines under the Protection of Trading Interests Act. This will not please Lord King, who wishes to visit the United States in the normal course of business, and who is willing to give the evidence that has been sought from him. He would thus be placed in the invidious position, if he does and is subpoenaed, that he would be subject to conflicting requirements under UK and US law (although it is inconceivable that in practice we would prosecute him here).

N.R.

5 October 1984

THE LAKER DISPUTE - THE NEXT STEP

It is becoming increasingly urgent to resolve the dispute which underlies the Laker cases. The fundamental dispute between the Governments can only be resolved by the Governments; and the issues have come again to a head because the US contemplate indicting British Airways and possibly Laker. We have reviewed our strategy for resolving the dispute.

2 Our original objectives are unchanged:

a. on the criminal side (the Department of Justice (DoJ) Grand Jury investigation) to secure no indictment from the DoJ;

b. on the civil side to halt if possible the private treble damage suits in the US courts, as regards the fare fixing allegations; or to influence matters so that any damages against British airlines are confined to minimal levels:

c. to get acceptable inter Governmental arrangements under Bermuda 2 which would ensure no repetition of the "Laker" experience (and which might be helpful in resolving the current disputes). By acceptable arrangements we mean an unambiguous and agreed system of regulation which would:

i. ensure that airlines acting in accordance with decisions of the aeronautical authorities (eg charging fares or operating schedules approved by both governments) would be free from the risk of exposure to domestic criminal or civil competition law enforcement in respect of those matters;

ii. indicate clearly to the airlines the regulatory framework within which they are to operate and the rules which have to be observed, the rules in question being ones which should make sense both from an airline and regulatory policy point of view. We are ready to negotiate changes from past practice to secure this.

3 Our intensive efforts over the last year and a half have produced few positive results -

a. on the criminal side BCal were cleared of the allegations of wrecking the Laker financial rescue package. But we have now been formally invited to consultations on the basis that the DoJ are considering indicting BA and possibly Laker in respect of pricing agreements in 1981 that would afford Laker a favourable price differential; and BA for scheduling discussions with Pan Am. Furthermore if certain BCal Washington-located documents get to the Department of Justice (as they now seem likely to do) further investigations and perhaps indictments aimed at BA and BCal seem to be a real possibility.

b. on the civil front matters have got worse: following the House of Lords decision in July the Laker liquidator is

now vigorously pursuing his suit; and four other class action suits emerged earlier this year. We have to face the prospect of further and serious class actions against BA if the DoJ indicts them on per se offences and if the BCal documents get into the hands of the DoJ.

c. on acceptable arrangements under Bermuda II, discussions in June with the US Government revealed little if any willingness on their part to address the problem with any imagination or any serious intent to head off future problems. This is not an academic issue. A current case illustrates the unworkability of the Bermuda 2 arrangements when US anti-trust law is superimposed upon them. Virgin Atlantic have complained that certain BA (and US carriers) low fare proposals are "predatory". Even if both authorities examine the complaint, conclude that it is not justified, and approve the fares, under US anti- law, Virgin could, in the future, bring a treble damage Laker-type suit in the US courts in respect of fares which the airlines would be required to charge by the authorities. We are still discussing this issue with the US authorities.

Our Strategy So Far

4 At the outset in March 1983, the Prime Minister asked President Reagan to halt the Department of Justice investigation, proposing instead that any problems seen by the US should be handled as an aviation matter. The President refused, on the ground that he had to see that US antitrust laws were enforced. He said that this did not preclude further consultations. Since then our strategy for handling the directly intergovernmental issues in this dispute (2(a) and (c) above) has been first to try to get BCal, the more vulnerable of our airlines, out of the DoJ line of fire; then to wait to see whether the DoJ indeed proposed to indict BA; to be ready if they did to react strongly; and to hope to negotiate a satisfactory outcome. Our strategy for the Laker liquidator's civil action (2(b) above) necessarily had to evolve in relation to developments in the US and English courts. But the use of the PTI Act a year ago marked the point at which we registered within the UK our objection of principle to those actions, insofar as they put in question our position under the Bermuda II agreement (we have, of course, taken no position in the courts on the allegations that BCal sought unlawfully to halt the Laker financial rescue package). The harsh reality is that we have no power directly to affect the subsequent class actions by US plaintiffs in the US courts; nor, since the House of Lords' decision in July, the continuation in the US courts of the Laker liquidator's action. But we are striving to influence their outcome. We have sought to agree with the US an agreed interpretation of the Bermuda 2 agreement which (as well as applying to the future and offering a supporting reason for the DoJ dropping indictments) might have some influence on the handling of the civil cases - though this has always been recognised as a long shot because the interpretation

could not be in terms retrospective. Attempts to achieve an agreed interpretation were also needed before any subsequent stronger reaction to proposed indictments. But (3(c) above) our opening discussions last May/June showed, despite significant movement on our part, that the US side had not then moved far enough from their traditional positions for a successful outcome. There are signs that our sharp reaction to the failure of that round and the practical example of the current Virgin Atlantic case may have caused them to re-examine their position; but that they have not completed this reassessment.

Negotiations backed by leverage

5 This strategy remains sound: but more pressure on the US Government is now needed to back it; and we need to prepare our next steps if this fails. We should still seek an outcome by agreement: both because a sound trading regime for international aviation must rest on such agreement and for wider political reasons. Pressure is needed because the US appears to lack the political will to modify in this area the claims of its antitrust law, and even given this, will find it far from easy for domestic law and political reasons to respond. Essentially there is a political problem to get the US Administration to recognise that we are not prepared to continue with the aviation agreement on the basis, implicit in their contemplation of indictments, that their antitrust law will apply unconstrained. What ministers say to them over the coming weeks will be important: and there may be a case for a further high level message. But we need more specific indications of our determination and have considered recourse to arbitration under article 17 of Bermuda 2 and notice of termination of Bermuda 2.

6 Arbitration under Bermuda 2 is considered more fully at Annex A. Briefly, the likely outcome is uncertain; the threat of arbitration worried the US in 1983, but might do so less now. In one sense the consequence for us of an unfavourable outcome would not be too serious - certainly compared with the course of continuing to acquiesce in the reach of US antitrust law in aviation - because we could always terminate Bermuda 2 if we did not like the arbitration award. But so could the US. Unless it led the US to make fresh efforts at negotiation, arbitration (as distinct from the threat of it) would leave the issues unresolved for some time.

7 Notice of termination of Bermuda 2 is considered in Annex B. In day to day aviation terms we perceive little risk in a renegotiation; at present the US benefits more in commercial terms than we do and therefore has more to lose. The complication might be that the US would seek commercial aviation concessions from us in return for an acceptable competition regime. This pressure would have to be resisted as unacceptable in principle. Denunciation of Bermuda 2 of itself should not affect the privatisation of BA, particularly if carried out in a low key way which emphasised the year's grace for renegotiation.

We are taking advice on the effect on the privatisation of BA of denouncing Bermuda 2.

8 A final decision on the leverage to be employed would be better deferred until after a new round of discussions with the US. A decision to be ready to employ leverage is desirable now.

Outline of a negotiated settlement

9 Our ideas are on these lines -

(a) Our proposals for the interpretation of Bermuda 2 would provide for a closer supervision of airline consultation than we currently engage in, with regulatory penalties if airlines did not obey the Governments' rules, in return for assurances that once a tariff has been approved there could be no question of private civil actions against airlines for applying it; we should propose a comparable arrangement on discussions about scheduling and capacity.

(b) If we could reach accord on these lines, it would remain difficult, legally and politically, for the US to find a way to halt the current Laker cases, because any action by them could be criticsed as a retroactive confiscation of rights. If this seemed likely to help them to agree to take such action, we would be prepared to suggest to the US authorities that the more serious Laker charges - ie the charges of predatory behaviour by the other airlines designed to put Laker out of business - should be the subject of an ad hoc international tribunal which could award compensation if it found good cause to do so.

(c) We would expect the Department of Justice to drop any charges under the Grand Jury investigation.

Retaliatory action

10 We are considering and will report further on the possibility of action against US airlines, if all else seems likely to fail, to penalise them financially, if our own airlines suffered unjust financial penalties: this would require primary legislation.

Acquiescence in the US position

11 The alternative to deciding now to fight hard for a settlement is to fudge the issues. The maximum fine on British Airways from DoJ indictments would be $1 million on each of (probably) two counts. No doubt the civil suits, like the vast majority of such actions, can be - indeed may eventually have to be - settled: at a price. But we cannot recommend such a fudging, since it would fail to restore, indeed gravely compromise, the sound operation of the whole aviation relationship. No doubt uncertainty about the impact of US antitrust law

in the field has, latently, been present for many years. But until this case the US Government had held back from major antitrust enquiries and - even more important - there had been few private actions. The Virgin Atlantic case (paragraph 3(c) above) clearly shows the practical problems for airlines and Governments which have now been exposed. We are at a turning point - the end of the long drawn out preliminaries - and must now fight strongly, if flexibly, for an acceptable solution.

Consents

12 We have before us requests by the airlines for consents (under the Protection of Trading Interests Act instruments) for the release of UK based information for use in their defence in the US civil actions. The House of Lords assumed that we should grant such consents to the extent necessary to enable the British airlines to defend themselves; but if we do so we shall be sacrificing, at a critical juncture, the principle that we do not accept the unilateral application of US anti-trust law in this field. We need not give a final refusal to such requests: if matters go badly we might later consider on balance that it was right for our airlines to have every means to defend themselves. A reasonable stance for the time being would be to say that we were in active discussion with the US Government on the dispute and that we were not prepared to consider granting these requests at the present time.

Recommendations

13 Ministers are invited to agree that in the course of the consultations following the DoJ proposed indictments, our delegation should:

a make clear that it is now urgent to reach an overall settlement of this dispute;

b be authorised, if the US side appear unwilling to make an adequate response, to make it clear to the United States that Ministers have determined that they cannot any longer continue to leave the working of the agreement in an unsatisfactory condition;

c if the US side seem willing to negotiate seriously with us, should be authorised to offer to co-operate with them before an international ad hoc tribunal to determine any appropriate compensation arising from the circumstances of Laker's demise.

Ministers are also invited to agree that:

d requests for consents under the PTI Act instruments should be dealt with as proposed in para 12 above.

Annex A

Arbitration under Bermuda 2

When Ministers first looked at the question of arbitration and agreed that we should be prepared to resort to it (the threat which led to the non-paper arrangements being agreed by the US Government) it was considered that on the strict legal merits the chances of success were not more than 40%, but that these prospects would be enhanced by the nature and composition of an international arbitration panel. Since then the terms of Lord Diplock's speech in the House of Lords' judgment have not improved the chances of success. He pointedly avoided making any finding on the effect of Bermuda 2 while at the same time saying the British airlines operating in the United States were subject to US law. Obviously if we lost on arbitration on all counts we should have a Bermuda 2 agreement as interpreted by the arbitration which was completely unsatisfactory from our point of view. But that is the de facto position now and we would still have the option of regnegotiating Bermuda 2 - though we would be facing a US Government with their tails up. If the US was unsuccessful (and anything less than 100% success would be of severe embarrassment to them) it is difficult to predict how they might react; they might themselves seek to renegotiate Bermuda 2. Broadly speaking we conclude that the downside risks of going to arbitration are not great.

2 We would expect a hostile reaction from the US Government if we went for arbitration. An immediate effect might be to dissuade the Department of Justice from proceeding with any indictments they may be currently contemplating let alone instituting any new Grand Jury investigations. If they did not agree to this the arbitral tribunal might require the United States not to take any steps which might prejudge the outcome of the reference. How it might affect discussions with the US Government on an agreed interpretation of Bermuda 2 is unpredictable. They might well refuse to discuss the matter until the arbitration was settled. Or they might be so concerned about the implications of losing that they might move quickly to get the whole dispute, including future arrangements, settled as quickly as possible.

3 The effect upon the private suits of launching an arbitration is uncertain. In strict legal terms there is no reason why the US courts should take any account of this development. However this would be new ground and there might be beneficial effects. It would certainly give our airlines more ammunition in the US courts and enable them to show directly that there was a serious inter-governmental dispute. Nor is it to be ruled out that the arbitration panel might request the US Government to

intervene in the domestic US proceedings with a view to getting those proceedings stayed pending the outcome of the arbitration. Failure to go to arbitration might weaken the position of our airlines in the US court since they wish to use arguments relating to Bermuda 2 and the position of HMG. (The same argument, namely that failure to go to arbitration represents a positive weakening of our position, would be equally valid in the criminal case if for example we failed to react in that way to a DoJ indictment.) Finally, a decision to arbitrate might affect the perceptions and attitudes of the private parties in the Laker case - for example it might promote an acceptable out of court settlement.

Annex B

Notice of termination of Bermuda 2

The agreement provides that a year's notice of termination can be given by either party. Notice once given can only be withdrawn with the consent of the other party.

2 The US airlines currently and in recent years have earned more than the UK airlines (roughly £900 million as against £500 million in 1983/84) from the bilateral air services. The US Government and airlines might therefore see themselves as the more vulnerable in a major renegotiation.

3 Renegotiation following notice of termination based on the antitrust dispute might be difficult to confine to that issue: the US might well bring forward other objectives. So unless we adopted a determined and single minded approach the process could be long drawn out and the antitrust issue might well get muddied and confused by being handled as part of a wider package deal - rather as it was in 1977.

4 The Laker litigation has unavoidably brought uncertainty (over and above its immediate financial implications) about the regulatory regime over the North Atlantic, which cannot be helpful for the market's assessment of British Airways' privatisation. Notice of termination might increase this uncertainty - or it might increase confidence, by displaying our determination to resolve the dispute. Logically, since the present or any changed regime would apply to all airlines, the market should not consider this factor as affecting the competitive position of BA relative to US airlines. Perception of a serious UK/US crisis might make the market nervous.

5 If a satisfactory resolution of the dispute had not been negotiated by the end of the year's notice period, both sides would face the question whether they were prepared to make interim arrangements for services to continue, to retreat from their positions, or to face an interruption in services. If we are not to be in a weak position from the outset, we must be prepared to contemplate the last, which would pose problems for US as much as for UK airlines: Pan Am for example remains in a very weak position and is heavily dependent on UK routes.

Flag 6

DRAFT TO STATE DEPARTMENT

(Usual opening) and has the honour to refer to the unresolved dispute between our two Governments as to whether it is consistent with their respective rights and obligations under Bermuda 2 for the provisions of United States antitrust law to apply to the activities of their designated airlines.

2 With regard to one facet of the dispute, the proceedings before the Grand Jury in respect of tariffs and capacity agreements, the US Government has indicated that it is considering the possibility of indictments against British airlines, and Her Majesty's Government have agreed to the suggestion of the US Government that there should be consultations under the non-paper arrangements about this. Her Majesty's Government wish, however, to place on record their extreme surprise and disappointment that the United States Government should even be considering the possibility of indicting British airlines and officials of those airlines in relation to discussions and acts of competition which were consistent with UK law and policy.

3 Her Majesty's Government consider that quite apart from the particular points which arise from the decision of the United States Government to invite HMG

contd/.....

to discuss the question of indictments, it underlines the urgency for representatives of the two Governments to continue efforts to achieve a comprehensive resolution of the dispute. The need for these efforts is also clear from the recent judgments of both the House of Lords and the US Court of Appeals for the D C Circuit which have recognised that there is indeed a dispute not capable of resolution by the Courts, but only by the two Governments at the diplomatic and executive levels. Perhaps more importantly because the dispute has not been resolved there is a serious danger of the aviation relationship becoming unworkable. This is illustrated by the failure of recent enquiries to elicit whether the US authorities consider a proposed airline tariff to be, as alleged by a competing airline, predatory. HMG had not hitherto thought it necessary to raise this question before considering a tariff since in its view the act of approval by the two Governments is determinative of competition questions such as predation. However in view of the dispute it is clearly necessary for airlines to know with certainty that approved tariffs can be charged without risk of liability. Moreover the possibility of civil treble damage liability on a potentially crippling scale from suits already brought and still in prospect together with the possibility of indictments of British airlines calls in question the continued validity of the route rights granted to British airlines under Bermuda 2.

contd/.....

4 Discussions would have as their aim a solution, which would not only prevent a similar dispute from arising again, through agreement on procedures to control anticompetitive conduct, but which would also deal satisfactorily with all the current problems arising from the dispute, that is to say the civil actions brought by Laker Airways in the US District Court, the associated "class actions" and the criminal proceedings.

5 As stated in its Note 39 of 28 March 1983, Her Majesty's Government believe that the obligation of each Government to perform the Agreement in good faith requires that each Government should do its utmost to resolve the dispute and that it is in the interests of both Governments that this dispute should be resolved as soon as possible.

6 The occasion of consultations suggested by the USG in relation to the proposed indictments also presents a good opportunity at which the discussions suggested above might be taken up on an informal basis. HMG wish to inform the USG however that they reserve the right to call for further formal consultations under Article 16 of Bermuda 2 should that be necessary.