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 2) Prime Minister  
 To note AT 29/4  
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FCS/85/118

SECRETARY OF STATE FOR TRANSPORT

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Laker and UK/US Aviation

1. Your minute of 4 April to the Prime Minister and members of the Cabinet reported the substantial progress made by British Airways lawyers towards settling the Laker liquidator's anti-trust suit and that prospects for a settlement of the class actions also appeared to be promising. This is very satisfactory. But, as I know you appreciate better than any of us, other important aspects of our civil aviation relationship with the United States still need to be improved. I hope it may be helpful if I offer some thoughts at this stage on some of those questions.

2. The most immediate issue is the need to negotiate satisfactory arrangements to regulate "capacity" (the number of flights allowed on each route), to replace Annex 2 of the UK/US Air Services Agreement ('Bermuda 2'), which lapses in July 1986. I believe that the course most in our interests will be to discuss replacing Annex 2 in the context of a general liberalisation of bilateral air services, to which we know the US Government attaches considerable importance, including both capacity and the provisions for the official approval of fares. We have been subject to a good deal of US pressure already to liberalise air services; and the feeling still persists in Washington that we have yet to respond adequately to President Reagan's decision in November 1984 to stop the Laker criminal anti-trust proceedings. It would be strongly to the disadvantage of the British airlines if Annex 2 lapsed and was not replaced; but by widening the scope of

/discussions



discussions we ought to be able to obtain better arrangements for the future. In doing so we need to take full account not only of the trading conditions facing British airlines but also of the major business and tourist benefits which the passenger traffic on the North Atlantic currently brings to the United Kingdom, and the potential advantages in these areas which more liberal arrangements should bring. I understand that a first round of UK/US discussions on Annex 2 is likely to take place in June: our officials should be instructed to produce early proposals on the conduct of these negotiations for Ministerial approval, particularly as, in certain circumstances, it might be necessary to give notice of termination of parts of Bermuda II as early as July 1985.

3. In approaching the negotiations we should not in my view seek to make our offers conditional on changes in the United States anti-trust laws to remove private triple-damage remedies from international civil aviation. New and more liberal arrangements on capacity and fares are to our advantage: to attempt to obtain a commitment to legislation which the Administration says it could not at present get through Congress would be pointless and might jeopardise our primary aim.

4. Nevertheless, the threat of private anti-trust actions continues to hang over British airlines even though it is, in our view, incompatible with an agreed bilateral framework for air services. For the present, the British airlines must obviously be meticulous in obeying the law and taking full advantage of such procedural safeguards as already exist. But our aim should remain to secure in the longer term, the ending of civil treble-damage suits in the civil aviation sector - for which there is already some support in the United States. To that end we should take any appropriate opportunity to point out to the United States Administration that the anti-trust threat introduces harmful uncertainty into the airlines'

/operations



operations with practical consequences for passengers, that the existing or even marginally improved procedural safeguards are cumbersome, and that we see mutual advantage in legislative reform.

5. I am copying this minute to the other members of MISC 112.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

Foreign and Commonwealth Office  
29 April 1985

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29 APR 1987

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cc NO



DEPARTMENT OF TRANSPORT  
2 MARSHAM STREET LONDON SW1P 3EB

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

NOPM  
AT  
14/5

( ) May 1985

*Dear Geoff*

LAKER AND UK/US AVIATION

I have read your minute of 29 April about what our objectives and negotiating strategy should be in relation to the Laker case and UK/US aviation more generally.

The immediate issue you raised is the next round of discussions with the United States about the "Annex 2" arrangements for the regulation of capacity. These discussions in early June are exploratory and informal in character, although I hope that they may enable us to form a better judgement than we can make now as to what new arrangements we can negotiate which might prove acceptable to us.

The replacement of the Capacity Annex should be regarded as a self-contained exercise. The present constraints are irksome to the Americans, but they are justified so long as we do not have at least as good access to the whole of the US market behind their gateways as they do to the whole of the European market behind London. While the balance of opportunities is so much in their favour, it is not surprising that they should want a liberal capacity regime to exploit it to the full: if we can redress that balance (and I have some liberalising ideas in mind which would be to our advantage) it will be interesting to see how long they continue to talk about deregulation and open skies. There has been plenty of evidence in the past - confirmed by their public statements - that their enthusiasm for liberal policies falls away as soon as a relatively weak US airline finds itself up against a strong and powerful competitor such as BA. In the end it may be that they will prefer to settle for a liberalisation of Annex 2 which leaves with both Governments sufficient powers of intervention in the market to ensure that the most powerful airlines are not able to establish a position of such dominance on any particular gateway as to work against the public interest.

I am aware of the view taken by some lawyers that we may have to terminate the Bermuda 2 Agreement in order to be more certain of achieving satisfactory new arrangements to replace Annex 2, but we cannot know whether this will prove correct until we have tested the American position much more fully than we have yet been able to do. Moreover termination would be likely to provoke a major row with the United States and could put at risk our plans for the early privatisation of BA. For both these reasons I am clear that we should continue to explore the scope for a negotiated replacement of the Bermuda 2 capacity arrangements, and I know that our officials are in close touch about that.

So far as tariff liberalisation is concerned we know this too is an important US objective, although here again they have recognised that some limited controls will remain necessary in order to ensure that a powerful airline cannot exploit a monopoly position at the expense either of the traveller who could be forced to pay unreasonably high fares, or of other airlines which might be driven out of business by predatory pricing. As you know we were making good progress towards a more liberal arrangement on these lines last autumn in the context of a package which would also have included US legislation to exclude the possibility of private anti-trust suits in future. The negotiations were suspended when President Reagan called off the Grand Jury investigation into the alleged Laker conspiracy. Our decision to allow BA to settle the current suits represents a major and costly contribution on our part to dealing with the Laker case as a potentially explosive issue in UK/US relations, and one which we believe the Americans should be brought to recognise as being no less important than the step which President Reagan took in relation to the criminal suits.

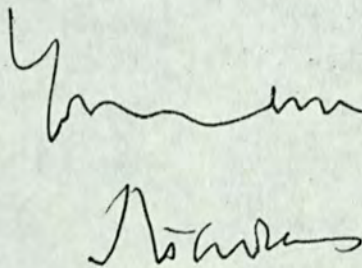
Once the current cases are dealt with my second priority in the anti-trust area is to make sure we get no future cases. Here there is a recent relevant Supreme Court decision (the Southern Motor Carriers case) which may have enhanced our negotiating position in seeking to argue that international aviation should be excluded from the ambit of the private treble damage suits. Once the Laker suit and the Class Actions are safely out of the way, and we and the US authorities have had time to absorb the implications of the new Supreme Court decision, it may be possible to resume discussion of an anti-trust/tariff liberalisation package in an atmosphere less charged with suspicion and ill will than before.

I am sure you will agree with the approach outlined above. More liberal arrangements on capacity and fares are probably not to our advantage, certainly so long as

our airlines do not enjoy free access to the protected US market and are inhibited from competing with full vigour by the shadow of anti-trust. US airlines already have nearly 70% of the North Atlantic Market. Nor do I think that it will be to our advantage to allow the various strands of negotiation to get tangled up if we can help it. Moreover, since the Americans profess themselves so keen to have more liberal arrangements, I find it hard to understand why you should be so ready to give them what they want without asking for fair trading conditions and the menace of private anti-trust suits to be dealt with at the same time. This is even more surprising after they have extracted \$65m from BA and other airlines on what we all agree are bogus grounds.

Our officials are constantly in touch about the whole range of our aviation issues and you and I can always discuss them whenever necessary. But I see no need for a discussion in MISC 112 at present. On the anti-trust and BA privatisation fronts I shall of course continue to keep colleagues fully informed by correspondence and within MISC 112 as and when necessary.

I am copying this letter to the other members of MISC 112 and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to read 'Nicholas Ridley', written in a cursive style.

NICHOLAS RIDLEY

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13 MAY 1985