DAVID ROBERT BOUGHEN MEMORIAL ADDRESS

International Aviation and Competition Policy – Complementary or in Conflict?

Russell Miller AM
Aviation Regulatory Group, Minter Ellison

The Aviation Law Association is to be commended for continuing to honour David's contribution through this Address. It is an honour to have been asked to deliver it this year.

As you know, David was a founding member of the Association. In addition to his active practice at the Bar he had a passion for flying. David was a Wing Commander in the RAAF, serving as a member of its Legal Panel. His practice at the Queensland Bar included both civilian and military aviation matters.

I am told that David took to aviation from an early age – that he had inherited his father's love of flying. His father had been a pilot during WWII. David's family reports that the freedom he experienced from aviation was of immense joy to him.

As the Queensland Chief Justice, Paul De Jersey, who knew David personally, said eloquently at this conference in 2007:

His tragic death … substantially diminished a community which respected and admired him.

Why me?

Today I join a long list of distinguished speakers who have delivered this address in David's memory.

So why did the organisers invite me? I have flown many miles, but never as a pilot. My only claim is that aviation has been an enduring feature of my professional career.

The aviation law course at ANU, taught by the late Professor Jack Richardson, inspired me. But opportunities to work in that field were limited so I ventured into the competition field in my professional practice.

Quite early in my career the International Air Transport Association brought me back to aviation when I was asked to assist in relation to a challenge under Australia's *Trade Practices Act*. From then on competition law and aviation regulation became major focuses in my career in the law.

So it will not surprise you that I have chosen the intersection between aviation and trade practices as the topic for this Address in David's honour.

The topic I have chosen is *International Aviation and Competition Policy – Complementary or in Conflict?* – It is a topic of which I am sure David would have approved.

News Reports

Aviation is always in the news - sometimes it is good news and sometimes bad. Consider the following:

- On March 4 *Aviation Weekly* carried the headline *Australia's competition watchdog and Virgin Australia have argued against the proposed codeshare expansion between Qantas and Cathay Pacific.*
- In January the newspapers were full of reports over an aviation fatality. Not an aircraft crash, but the crash of online travel agent, Bestjet.
    - On 2 January *The Guardian* headlined: *Bestjet collapse leaves angry customers thousands out of pocket*.
    - On January 9 *Channel Nine News* followed with the headline '*Where the hell is the money?' Bestjet clients demand answers*.
- On June 27 last year Reuters carried the headline *Air New Zealand hit with $15m fine for price fixing.* Reuters reported:

    > *The court found Air NZ fixed fuel prices and insurance surcharges on air freight services from Hong Kong, and insurance and security charges from Singapore between 2002 and 2007 …*

- On 4 April last year The Guardian carried the headline *Flight Centre fined $12.5m for price-fixing after losing appeal.*

Each of these examples is a manifestation of challenges to international aviation presented by competition policy. Those challenges are not new. They had their genesis 40 years ago. So where did it all begin?

Global Rules

The global rules for international aviation had been forged at the end of World War II. They were based (and continue to be based) on bilaterally negotiated 'freedoms' enshrined in *Air Services Agreements* and derived from the 1944 *Chicago Convention*.

International aviation would not be possible without these agreements. They provide the legal foundation for all scheduled international airline flights.

Australia's first such agreement was with the United States, signed in 1946. Today Australia is a signatory to over 100 such agreements covering the world from Argentina through the alphabet to Zimbabwe.

Even today, capacity – flight frequency and seat numbers – on each international route is required to be negotiated bilaterally. Airlines cannot provide scheduled international services to and from Australia without the Government allocating negotiated capacity to airlines of Australia. The International Air Services Commission has responsibility for allocating capacity on international routes, applying public interest criteria.

The *Air Services Agreements* did more than deal with capacity – with their all-encompassing provisions they fostered and nurtured international aviation.

For instance, they required '*fair and equal opportunity for the designated airlines of each contracting State'* and that remains a requirement today. Indeed, they go further, requiring each country's designated airlines to:

> *take into consideration the interests of the* other party's *designated airline so as not to affect unduly the services which the latter provides.*

That fundamental requirement is backed up by provisions requiring that '*tariffs on agreed services shall be established at reasonable levels*'.

To complete the picture, when it comes to tariffs, the agreements provide that:

> *The tariffs …, together with the rates of agency commission used in conjunction with them shall, if possible, be agreed … and such agreement shall, where possible, be reached through the rate-fixing machinery of the International Air Transport Association. The tariffs so agreed shall be subject to the approval of the aeronautical authorities of both Contracting States.*

As the movement to privatise government-owned airlines picked up and governments around the world adopted modern competition policies, conflict between the established international aviation order and domestic competition policy was inevitable. How would we reconcile the seemingly irreconcilable differences? I will return to that question shortly. First let's consider how the conflict unfolded

ICAO and IATA

In the 1940's two international organisations emerged to oversee international aviation, and they still do so today.

As you know, ICAO, the government-to-government organisation,

- sets air navigation standards and other technical operational health and safety rules and
- provides a forum for government officials to meet and discuss aviation policy and set and administer operational rules and standards.

The International Air Transport Association, incorporated by a special Canadian Act of Parliament in 1945, is the forum in which airlines resolve the commercial requirements for international air services.

This included determining fares on international routes throughout the world, as mandated by the *Air Services Agreements*.

Those fares were lodged with each relevant government and 'approved'.

It was an offence to charge a fare other than the 'approved' fare. This included the commission rate that could be paid to travel agents – 9% for international ticket sales.

Emerging competition policy

In 1975, over the strong objections of the business community, Australia introduced a modern competition law. It was a law of general application, including to the international aviation industry.

As you can readily imagine, given the well-established rules for international air transport, the international aviation system was quite unprepared for Australia's new competition law. In the absence of an explicit exemption in Australia, which was to take precedence – the international aviation regime or the domestic competition regime?

ICAO resolutions called for the former and continually advocated for that position. As ICAO said as recently as 6 years ago:

> *States must exercise care in applying their national competition laws and policies to international air services. … [T]he traditional approach in many bilateral agreements favouring airline cooperation on issues like capacity and pricing is squarely at odds with competition laws that strictly prohibit price-fixing, market division and other collusive practices by market competitors.*

International precedent supported the ICAO position. Although the USA is the source of the world's strongest competition law – a law dating back to 1890 - authority over international aviation was ceded to the National Civil Aviation authorities who 'approved' IATA fares. This exempted them from antitrust scrutiny, even though the full rigors of US antitrust law applied and was enforced against the aviation industry domestically.

In Australia, as soon as the *Trade Practices Act* came into force in February 1975 Qantas applied for an authorisation for all IATA programs. Authorisations are case-by-case exemptions granted on public interest grounds. IATA was granted an interim authorisation as expected.

But when the Trade Practices Commission came to consider the substance of the matter in 1984, it was a different story.

The Commission refused to grant an authorisation. IATA's global ticket distribution system – the Passenger Agency and Cargo Agency programs - were under threat, not to mention its tariff coordination activities. Diplomatic notes from countries concerned about the possible impact on international aviation followed.

The case moved to the Trade Practices Tribunal, where senior counsel for the Commission opened with an assertion that the IATA system was 'pure price-fixing'. But the Tribunal was never called on to resolve the matter. IATA was able to convince the Commission of the public benefits its systems delivered. The parties reached agreement on a broad-ranging authorisation immunising all IATA programs, including for tariff coordination. That immunity was to remain in place until voluntarily surrendered by IATA in August 2013.

One of the immunised IATA programs was the Passenger Agency Program about which I will say something in the context of *Flight Centre* and Bestjet shortly.

Although IATA's programs had been immunised in Australia, when it came to pricing market forces challenged the established order. In 1979, KLM had advertised a cheap fare between Australia and the Netherlands that had not been approved by the Australian Government. The Government's reaction was swift. As the *Canberra Times* reported:

> *"They may be selling tickets but no passenger has yet been able to fly with one", a government official said yesterday. … It means, in effect, that the sale of the KLM tickets is regarded as illegal.*

The Dutch Government weighed in on behalf of its flag carrier. As the *Canberra Times* reported:

> *The Netherlands warned yesterday … that it would seek arbitration on KLM's low air fares unless they were approved by the Australian Government.*

But it was not KLM that finally succeeded in ending embargo on cheap airfares as we know them today.

The rigid fare approval mechanism that had applied for over 40 years finally crumbled 12 years later at the behest of another airline.

There were no ‘legacy’ airlines then. Only the established airlines pursuing *‘fair and equal opportunity’* to compete on the routes on which they operated.

However, new entrants were starting to emerge. Singapore Airlines, now the No 1 foreign carrier serving Australia, was one. It had been established in October 1972 with limited routes and frequencies, including between Australia and Singapore. As a new airline it was seriously disadvantaged by the fare structure it was required by the *Australia-Singapore Air Services Agreement* to apply.

Of course, common sense shows us that new entrants deal with their disadvantages through keen pricing and superior service, and that is precisely what Singapore Airlines did.

Initially the Australian Government held the line. In January 1991 Singapore Airlines was prosecuted for selling tickets in Hobart at rates below those approved by the Civil Aviation Minister. As the *Canberra Times* reported:

> *[The Minister] had been expressing concern for more than a year over wide spread illegal discounting of international air fares, and had stated that he would enforce the law rather than allow an "open go" in fare discounting.*

But every now and again a legal case will produce unexpected results and this was one of them.

In an about face, the Government withdrew the prosecution, heralding a new era of price competition in the aviation industry.

Pandora’s box had well and truly been opened by the Singapore Airlines decision and dynamic competitive pricing, resulted.

Although the IATA ‘official’ fares remained in place, and IATA Conferences continue to meet and set fares, over time their relevance declined. The emergence of alliances further eroded the relevance of IATA fares in the Australian market. Alliance networks largely replaced multilateral interlining.

As this decline accelerated, old notions faded of airlines being partners in a global joint venture facilitating smooth travel to and from anywhere in the globe. The old order – in which cooperation, so essential to international air travel in earlier times, was the norm - disappeared. In its place came competition, even within alliances.

Some airlines prospered in this new uncertain world - others did not. In Australia:

- Qantas, initially threatened by this new order, emerged stronger;
- Ansett and Compass failed;
- Virgin Australia emerged.

Internationally, Pan Am, the post –World War II behemoth, disappeared, as did SwissAir. KLM was taken over by Air France. Emirates, Etihad and Qatar grew and prospered.

In this dynamic new environment further conflict between international aviation regulation and competition law was inevitable.

Air New Zealand

That brings us to *Air New Zealand*.

Stated briefly, in 1996 widely fluctuating aviation fuel prices resulted in the IATA members resolving to impose a fuel surcharge. But the resolution never came into effect because the US Department of Transportation denied immunity.

If it had come into effect, the Australian authorisation IATA had obtained in 1985 would have immunised it.

Notwithstanding rejection of the IATA proposal, Lufthansa introduced an identical surcharge and other airlines, including Air New Zealand and Garuda, did so as well.

But the problem was that, under competition law understandings between competitors on price are characterised as illegal price-fixing. The result was unprecedented coordinated action by competition authorities around the world. Airlines paid fines and penalties in the USA exceeded $1.5 billion, in Europe $1 billion, in Australia $100 million.

While most airlines resolved their differences with the ACCC and paid significant penalties, Air New Zealand and Garuda fought the ACCC on all grounds, up to the High Court. Their arguments, grounded in aviation law and practice familiar to us all, were essentially twofold:

- First, they said, there is an inconsistency between competition law and the *Air Navigation Act* and *Air Services Agreements.* The relevant Agreements provided for tariff fixing between international airlines for scheduled international air services into Australia. The competition law prohibition on price-fixing is inconsistent with the international aviation regime.
- Secondly, the airlines were required by foreign governments to charge the surcharge because, under local law in the origin countries – Indonesia and Hong Kong and Singapore - the airlines were required to charge tariffs approved by local aviation authorities.

Both propositions were rejected by the High Court. Carefully analysing the legal framework, the High Court decided that there was no inconsistency. International aviation had to abide by Australian domestic competition laws.

Alliances and Code Shares

Let me turn to another established area of airline cooperation of which my earlier March 4 *Aviation Weekly* reference is an example It involves alliances and code sharing - now an ubiquitous feature of international aviation.

In the 1980s and 1990s airline privatisation became the order of the day. British Airways, Air Canada, Singapore Airlines, Lufthansa and Qantas, to name a few, were privatised by their government owners.

Consequently, the '*fair and equal opportunity'* provisions of bilateral air services agreements came under increasing pressure as airlines responded to the need to make profits. Government rates approval mechanisms gave way and, as I have mentioned, the '*rate fixing machinery of IATA*' failed to keep up with the pace of change.

Before alliances and code-sharing entered the picture, fares set in the cooperative environment of IATA Traffic Conferences were essential for interlining. IATA multilateral interlining allowed (and still allows) passengers to:

- buy a ticket in local currency anywhere in the world;
- to fly to almost any destination internationally;
- changing planes and airlines to reach the destination. And baggage arrives as well, mostly.

But by the end of last century, IATA multilateral interlining had fallen into disrepute, essentially because the interline fares IATA Conferences set were so far out of kilter when compared with the point-to-point fares competition had produced.

Star Alliance, formed in 1999 by:

- Scandinavian Airlines, Thai Airways International, Air Canada, Lufthansa, and United Airlines, and

One World, formed in the same year by:

- American Airlines, British Airways, Canadian Airlines, Cathay Pacific, and Qantas,

filled the gap that IATA was unable to fill.

It was only a matter of time before code sharing also came to prominence, providing the operational means for airline alliances to operate. Starting modestly with an agreement between Qantas and American Airlines in 1990, code sharing has become of universal significance today.

But alliances, and in particular code sharing, also brought regulatory challenges.

Airlines, regarded by competition authorities as competitors, were entering into cooperative arrangements for which there was no automatic immunity under Australian competition law, or that of many other countries. This brought competition law to the forefront.

No longer was it a matter of negotiating a commercial arrangement and lodging the resultant fares with aviation departments for ‘approval’.

The arrangements needed explicit approval under competition law - approvals that were not always easily obtained.

For instance, in 2002 Qantas and Air New Zealand negotiated a Trans-Tasman Alliance. The ACCC refused to grant an authorisation. On reconsideration by the the Trade Practices Tribunal authorisation was granted after a hard-fought battle. But the alliance never came into effect because the New Zealand Commerce Commission refused approval.

But there are examples of alliances authorised by the ACCC, including the Qantas-Emirates Alliance, reauthorised last year, and a Virgin-Hong Kong Airlines Alliance, authorised the year before.

The Qantas-Cathay code share to which I referred at the start of this Address is another example. Approval is required from the International Air Services Commission whose role is to:

> *foster, encourage and support competition in the provision of international air services by Australian carriers.*

But an IASC decision carries no immunity as far as Australia's competition law is concerned, so code share airlines have to also satisfy the ACCC [and competition authorities at the other end of the routes] if their code share agreements involve joint pricing and are not covered by an existing authorised alliance agreement.

These requirements emphasise the focus of approving agencies on international aviation arrangements that deliver real consumer benefits.

Flight Centre

Airlines are not the only players in the aviation industry that have had to come to grips with competition law. Travel agents, and the IATA system that administers the distribution of airline tickets, have not been exempt either.

The ACCC's Federal Court case against Flight Centre is the latest manifestation of this. It concerned the relationship between airlines and their agents.

One of IATA's most significant achievements was to establish an efficient passenger agency program that has stood the test of time. The IATA Passenger Agency Program, established over 50 years ago, manages the distribution of airline tickets for all IATA member airlines through an accreditation system. IATA accredits travel agents, who are then entitled to sell tickets on IATA member airlines, accounting for sales centrally through IATA.

In order to obtain and retain accreditation, travel agents are required to meet IATA's prudential worthiness criteria. Although the airlines do not extend credit to agents - because all funds received by agents for ticket sales are held in trust for the airlines - nevertheless the exposure of airlines to potential loss is significant.

The general rule is that, once a valid IATA ticket is issued the airline will carry the passenger even if the airline has not been paid by its agent.

Originally IATA issued physical ticket stock to accredited agents and withdrew it when agents defaulted. Physical tickets have, of course, disappeared with the emergence of e-ticketing, but the IATA accreditation system remains essentially unchanged.

The environment t5oday is not the same as when the IATA passenger agency program was developed. At that time commissions were set by IATA at 9% of the approved ticket price.

But as deregulation took hold, competition for ticket sales through agents, who account for over 80% of international tickets, accelerated.

Airlines offered travel agents 'override' commissions – rebates based on volumes of sales. The market responded by creating consolidators – 'super' agents through whom smaller agents purchased tickets rather than directly from the airlines, thereby obtaining a better price.

More recently airlines 'net fares' have become a feature of the Australian market. Rather than earning commissions, agents can sell tickets at any price they decide, up to a maximum price set by the airline, remitting the net fare to the airline and keeping the balance. This sowed the seeds for the *Flight Centre* case.

Flight Centre, Australia's largest travel agency, advertised that it would not be beaten on price. But it was at a disadvantage when airlines offered internet fares at the net price available to *Flight Centre*.

When Flight Centre complained to a number of airlines that it couldn't make money on those fares, the ACCC became involved.

In a case that went to the High Court last year, the ACCC successfully claimed that Flight Centre was attempting to fix prices in contravention of the *Competition and Consumer Act*. The case turned on whether or not Flight Centre was in competition with the airlines for which it was an agent.

Conventional wisdom, reinforced by the IATA Passenger Sales Agency Agreement, was that Flight Centre was simply an agent for the airlines it served.

It will surprise none of you to observe that agents should be able to discuss prices with their principals, especially when their remuneration depended on it. This is a normal part of the agency relationship. That is precisely what Flight Centre did. It complained to airlines that it had to match their advertised prices and made nothing from the sale.

In a controversial split decision, the High Court decided that, although Flight Centre was the agent of the airlines to which it had complained, that did not preclude it also being a competitor. The ramifications of this decision have not yet been fully assessed. As my partner, Justin Oliver said in a recent article:

> *… where the law treats the acts of agents as acts of the principal, is it really possible for the agent and the principal to supply a product in competition with each other …?*

That is a question for another day.

Bestjet

Finally let me say a few words about Bestjet, the $10 million+ travel agency insolvency reported in January. The full story is yet to unfold.

As I have said, IATA accreditation required (and still requires) travel agents to meet prudential requirements consistent with the level of airlines' financial exposure. This meant that agents had to provide IATA with sufficient security to cover ticket sales.

But protection of the airlines is one thing – what about protecting consumers? Travel agency licensing had been introduced in Australia in 1974 in the wake of a number of travel agency defaults that left travellers stranded. It was an offence to carry on an unregistered travel agency business.

While registration may have ameliorated the problem, it did not remove it. In the 1980s a further string of defaults led to calls for what *Choice* referred to as:

> *a safety net against licensed travel agent collapse, compensate[ing] consumers who were left high and dry when agents went bust.*

State and Territory Governments introduced a special fund – the Travel Compensation Fund – to which travel agents were required to contribute. The purpose of the Fund was to compensate consumers for travel agency defaults.

But then came competition policy initiatives directed at freeing up markets by removing government 'red tape'.

Deregulation – allowing freedom for market participants to compete - became the order of the day. The Federal Government kicked this off by paying bounties totalling almost $27 billion to State and Territory Governments over a 13 year period to free up markets. Ultimately one of the casualties was the Travel Compensation Fund.

In 2013 the Fund was abolished. At the time the Victorian Assistant Treasurer stated:

> *Now, after over two decades in operation, the national scheme has steadily become ill suited both to modern industry practices and to how consumers purchase today. The rise of electronic commerce in particular has fuelled the growth of direct distribution channels. Making travel arrangements is now predominantly an online business, with consumers cutting travel agents out of many transactions.*

Direct purchasing, credit card charge-backs and private travel insurance were seen as an acceptable substitute.

There is little doubt that the claim that consumers are cutting out travel agents is inaccurate. Travel agents account for more than 70% of international airline ticket sales and online travel agents like Expedia are well established.

It remains to be seen whether consumers are sufficiently protected by credit card charge-backs and private travel insurance. Bestjet is likely to ultimately provide an answer. But we do know that:

- Credit card companies have been covering passengers, but only those who used an applicable credit card to pay Bestjet. Not all credit cards provide this cover.
- As to travel insurance, many policies specifically exclude losses arising from travel agent insolvency.

Conclusions

So how should we sum this all up?

First, while international aviation policy and competition policy could not be said to be complementary, we have found a way for them to peacefully coexist.

Secondly, it can be said that, where conflict arises, competition policy has won out.

Is that a bad thing? No, I do not think it is.

The cooperative shield, so necessary for international aviation in earlier times, is no longer required. Competition law has had a healthy moderating effect on cooperation, without banning it outright, and the international aviation industry has thrived and prospered as a result.

As the statistics show, more people are travelling more often than ever before.

For instance, over the past 10 years the number of passengers carried internationally to and from Australia has almost doubled. In 2007/8 23 million passengers travelled on scheduled international air services to and from Australia. In 2017/18 that number had risen to 41 million.

New airlines, large and small, have commenced services to and from Australia. Emirates and Etihad are well known examples, but more recent examples include SriLanka Airlines, Samoa Airlines and Donghai Airlines from Shenzhen, China.

Passengers have more choice – more choice of airlines, routes, prices and service – than ever before. For instance, the travel website, Kayak, lists over 100 options on the Sydney – Singapore route alone, with return prices in business class ranging from just over $1,000 to $6,800.

Competition policy may not be perfect, but its contribution to a robust aviation industry that serves Australia well, cannot be denied.