IT IS THE REALITY OF THE COMMERCIAL RELATIONSHIP THAT COUNTS: TRAVEL AGENT FLIGHT CENTRE IS A COMPETITOR TO THE AIRLINES

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IN BRIEF

- The High Court has allowed the Australian Competition and Consumer Commission's (**ACCC**) appeal in its prosecution of Flight Centre for attempted price-fixing arrangements with airlines.
- The ACCC was successful in convincing the High Court that Flight Centre was "in competition" with certain airlines. The High Court therefore held that Flight Centre breached the prohibition against price fixing when it attempted to induce those airlines not to sell tickets directly to customers on their websites at prices that were cheaper than those offered by Flight Centre.
- The High Court came to the view that Flight Centre and the airlines were in competition with each other in the market "for supply of contractual rights to international air carriage via the sale of airline tickets". The Court found that Flight Centre competed with the airlines in that market, notwithstanding its appointment as agent with authority to sell tickets on behalf of the airlines.
- The High Court criticised the ACCC's construction of a functional market for "booking and distribution services" as being artificial and lacking commercial reality. This highlights the need to ensure that market definition accords with the true nature of the commercial relationship between the parties rather than being a construct of a case theory.
- For parties to agent and principal distribution arrangements, the High Court's decision means that the fact that there is an agency agreement is not by itself determinative of whether an intermediary and a principal may also be in competition with each other.
- The High Court has held that it is not the existence of an agency relationship which is relevant, but rather a detailed consideration of the commercial nature of the relationship between the parties as well as the terms and conditions of the agency agreement.
- In this case, it was particularly relevant that under the terms of its agency agreement with the airlines, Flight Centre had an ability to set prices for tickets at any price and was not obliged to "act in the interests" of the airlines in exercising this power. In a practical sense, Flight Centre was therefore able to compete with the airlines for the sale of tickets.

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- The decision also highlights the importance of demand side considerations to understanding the nature of competition and, in this case, whether as a matter of practical reality, an agent and principal are competing with each other for the supply of a product or service.
- In this case, it was relevant that, from the point of view of a prospective customer, a ticket sold by the Flight Centre on behalf of an airline was an alternative to a ticket sold directly by the airline, and the key point of differentiation would almost always be price.
- The High Court's decision has implications for the legality of price parity arrangements between suppliers and distributors in a vertical distribution agreement. These arrangements have become increasingly common, as more suppliers adopt dual and multi-distribution models. The High Court has confirmed that such arrangements may be illegal if the supplier and distributor also compete. It also suggests that in such circumstances, for an agent to be considered as a "true agent" and hence not competitive with its principal that may also be selling direct, the agent must only be acting in the interests of its principal and not have pricing discretion.

BACKGROUND

The ACCC brought proceedings against Flight Centre in 2012. The proceedings alleged that, between 2005 and 2009, Flight Centre sent a series of emails to certain airlines, in which it attempted to induce each airline to stop offering tickets directly to customers at prices lower than the fares made available to Flight Centre via the Global Distribution System (**GDS**), including the commission paid to Flight Centre.

The ACCC alleged that through the above conduct, Flight Centre had attempted to induce the relevant airlines to enter into arrangements which contained a provision that would restrict the price at which the airlines could sell international flights when selling directly to customers via their websites. This was in contravention of the then Trade Practices Act, now the *Competition and Consumer Act,* (**the Act**).

Flight Centre is a travel agent. It has the authority to sell international air tickets to customers by way of a standard form Passenger Sales Agency Agreement (**PSAA**), which Flight Centre had entered into with the International Air Transport Association on behalf of each of its member's airlines. The PSAA provided that Flight Centre, as agent for the airlines, was authorised to sell air passenger transportation as authorised by the airlines.

At the time of the relevant conduct, the airlines were increasing the number of tickets they sold to customers directly online, rather than through travel agents. In some instances, the airlines advertised tickets on their websites at prices cheaper than those which they made available to Flight Centre and other travel agents on the GDS. This raised a particular issue for Flight Centre due to its "price beat guarantee", which obliged it to beat by $1 the price of any ticket a customer found online.

In Australia, unlike in some other jurisdictions, vertical price arrangements are not treated differently from horizontal arrangements under competition law, at least when the parties are held to be "in competition" with each other. It was thus the question of whether Flight Centre and the airlines were in competition with each other that was the key issue in this proceeding.

DECISIONS IN THE COURTS BELOW

The Federal Court

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At first instance, Logan J held that Flight Centre and the airlines were competitors in the market for the supply of air travel "distribution and booking services". His Honour held that as a travel intermediary, Flight Centre provided booking and distribution services in respect of international air travel, both to airlines and consumers [1].

This decision was based on Logan J's finding that although Flight Centre acted as agent for the airlines in the market for international passenger air travel services, this market had two functional dimensions, as follows:

- the first dimension was the "upstream or wholesale level of the overarching market for international travel or ancillary products"
- the second dimension of the market was a "downstream or distribution functional level" of the international air travel market.

Logan J considered that the booking and distribution services provided by Flight Centre were substitutable with similar booking and distribution services provided by the airlines directly via their websites. This was because airlines had the ability to "cut out the middle man" in relation to these services [2].

Having found that Flight Centre and the airlines were in competition, his Honour found that the Flight Centre had attempted to induce the airlines to enter into an arrangement which had the purpose, effect or likely effect of fixing, controlling or maintaining the "retail or distribution margin" retained by Flight Centre, or the commission Flight Centre was allowed to deduct from the gross fare [3]. Logan J imposed a record $11 million penalty on Flight Centre[4].

The Full Federal Court

The key issue on appeal to the Full Federal Court was whether Flight Centre and the airlines were "in competition" which each other in any relevant market for the purposes of the Act.

The Full Court conducted an analysis of what it considered to be "the true nature of the commercial relationship" which existed between the parties and the services supplied by each party. The Court considered that the functional market defined by Logan J lacked precision and clarity and "was in fact an artificial construct that did not truly reflect the commercial reality of the relevant commercial relationship and dealings" [5].

The Full Court held that there was no separate market for "booking and distribution services". Rather, the Full Court found that the supply of booking and distribution services was an ancillary part of the market for the supply of international passenger air travel. Despite the fact that the ACCC had not pursued this argument before the Full Court, the Court did recognise that there was an element of "rivalry" between Flight Centre and the airlines in respect of the market for the supply of international passenger air travel services[6]. However, the Full Court held that under the terms of the PSAA, Flight Centre acted as an agent for the airlines in that market, and therefore the parties were not relevantly "in competition" for the purposes of the Act[7].

THE JUDGMENT OF THE HIGH COURT

As with the Full Court appeal, the appeal to the High Court revolved around the issue of whether the parties were in competition with each other in any market.

There were two issues addressed in each of the separate judgements. These were:

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• the appropriate definition of the relevant market
• the relevance of the agency-principal relationship between Flight Centre and the airlines.

Kiefel and Gageler JJ, Nettle J and Gordon J each delivered separate judgments allowing the appeal. French CJ delivered a dissenting judgment in which he said he would have dismissed the appeal.

Defining the relevant market

The ACCC's primary contention was that, as held by Logan J as first instance, Flight Centre and the airlines competed in the downstream market for the supply of "booking and distribution services" to both customers and airlines.
The ACCC's secondary contention was that Flight Centre sold international air tickets in competition with the airlines in a market for the supply of contractual rights to international air carriage to customers.

The High Court agreed with the Full Federal Court that the characterisation of the functional market for the supply of distribution and booking services was "artificial", in part because it could not realistically be said that an airline selling directly to customers was providing distribution services to itself in competition with the distribution services provided to it by travel agents[8]. Kiefel and Gageler JJ and French CJ all agreed with the Full Court that booking flights, issuing tickets and collecting fares are inseparable elements of the sale of air tickets[9].

Kiefel and Gageler JJ criticised the ACCC's attempt to construct a functional market for the supply of "booking and distribution services" in circumstances where such a market was "divorced" from the "commercial context" of the alleged contravention[10]. In this regard, their Honours emphatically stated that the ACCC's preferred market definition was an example of "economic theory doing violence to commercial reality" [11]. This criticism highlights that the ACCC (as well as private parties) should be careful about constructing a market definition to fit their case theory if that market does not accord with the true nature of the commercial relationship between the parties/commercial realities.

All of the judgments accepted the ACCC's alternative argument that Flight Centre was "in competition" with certain airlines in the market for the supply, to customers, of contractual rights to international air carriage via the sale of airline tickets. As discussed below, the majority of the Court (with the exception of French CJ) held that Flight Centre and the airlines were in competition in this market.

Th e relevance of the agent – principal relationship

Unlike the Full Federal Court, the majority of the High Court considered that Flight Centre was in competition with the relevant airlines for the sale of airline tickets, notwithstanding Flight Centre's appointment as an agent for the airlines under the PSAA with authority to sell tickets on behalf of the airlines [12].

Each of the majority judgments agreed with the ACCC's contention that the fact that Flight Centre was an agent for the airlines in the market for the supply of flight tickets to customers did not, by itself, preclude the determination that it was also in competition with the airlines for the sale of such tickets.

Kiefel and Gageler JJ concluded that there was nothing contained in the Act which was "inherently inconsistent" with the notion of an agent supplying contractual rights against the principal in competition with the principal [13].

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Having then considered the general principles of the law of agency at common law, Kiefel and Gageler JJ stated [14]:

"To the extent that an agent might be free to act, and to act in the agent's own interests, the mere existence of the agency relationship did not in law preclude the agent from competing with the principal for the supply of contractual rights against the principal. Whether or not competition might exist in fact then depended on the competitive forces at play."

Each of the judges engaged in a detailed consideration of the commercial nature of the relationship between Flight Centre and the airlines as well as the terms and conditions of the PSAA. In this regard, the majority judgments can be contrasted with the dissenting judgement of Chief Justice French.

The majority accepted the ACCC's argument that in cases where the agent adopts a degree of independent pricing and financial risk, including where the terms of the agency agreement provides for the agent to have pricing discretion, the parties may not be in a "true agency" relationship in relation to any competitive activity.

The majority judges considered it crucially relevant that although Flight Centre was obliged to remit the airlines a net amount for tickets it sold (which was calculated from fare published on the GDS less Flight Centre's commission) Flight Centre was not constrained by the PSAA from selling tickets to customers at any price in its own discretion [15]. It was also considered relevant that in exercising that discretion, Flight Centre was not constrained by the terms of the PSAA to prefer the interests of the airlines to its own [16].

Kiefel and Gageler held [17]:

"Flight Centre was free in law to act in its own interests in the sale of an airline's ticket to customers. That is what Flight Centre did in fact: it set and pursued its own marketing strategy, which involved undercutting the prices not only of other travel agents but of the airlines whose tickets it sold. When Flight Centre sold an international airline ticket to a customer, the airline whose ticket was sold did not."

Nettle J similarly emphasised that:

"Flight Centre had an unimpeded contractual right to determine the prices at which it sold an airline's tickets to customers and, consequently, a contractually unimpeded right to put downward competitive pressure on the prices charged by the airline for its tickets in direct sales". [18]

Gordon J adopted a more explicit approach to the "true agency" question, asking whether in relation to the relevant conduct, Flight Centre was in fact an "agent" of the airlines. Her Honour answered this question in the negative, stating [19]:

"The description of Flight Centre as "principal" or "agent" at various stages of the transaction may be legally accurate, but it masks the proper identification of the rivalrous behaviours that occur at the point at which Flight Centre is dealing with its own customers in its own right without reference to the interests of any airline. At that point, the description of Flight Centre as "agent" is simply wrong. At that point, Flight Centre in its own right was competing against all sellers of tickets, which includes the airlines and other travel agents. Flight Centre was not acting as an agent."

French CJ, on the other hand, held that Flight Centre and the airlines were not in competition in any relevant market and that Flight Centre's proposals with respect to the pricing practices of the airlines were not proposals offered by it as their competitor, but as their agent [20]. In particular, His Honour considered that the alleged

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contravening conduct by Flight Centre *"related to an activity…which lay at the heart of an agency relationship, namely the same by Flight Centre or its airline principals of contractual rights to travel on those airlines."* [21]

In His Honour's view, it would be inconsistent with the law of agency to treat Flight Centre as in competition with the airlines when it created contractual rights between customers and the airlines, because under the PSAA what Flight Centre did in selling an air ticket was properly regarded as an action of the airline itself. [22]

Demand side considerations/the behaviour of customers

Although this point was not considered by all of the judges, Nettle J in particular considered that it was relevant to consider the question of competition between the agent and principal from the point of view of a prospective customer. His Honour considered it relevant that, from the point of view of a prospective customer, a ticket sold by the Flight Centre on behalf of an airline was an alternative to a ticket sold directly by the airline, and the key point of differentiation would almost always be price.

His Honour stated [23]:

"From the point of view of a prospective customer, an airline ticket sold by the Flight Centre on behalf of an airline would be in most respects functionally identical to an airline ticket sold directly by the airline…consequently, from the point of view of the prospective customer, the airline ticket sold by Flight Centre on behalf of an airline would be close to perfectly substitutable for the airline sold directly by the airline….Other things being equal, that connotes a high degree of competition between the airline tickets sold by Flight Centre on behalf of airlines and airline tickets sold directly by each airline and therefore, the existence of a market for the sale of airline tickets in which both Flight Centre and the airlines competed."

IMPLICATIONS

There has, until the High Court's judgment, been a level of uncertainty in Australian law about the circumstances in which principals and agents in vertical distribution agreements may be "in competition" with each other for the purposes of the Act. The diverging decision (to that of Logan J) in *ACCC v Australia and New Zealand Banking Group Ltd* did not assist with this uncertainty. [24]

For parties to agent and principal distribution arrangements, the High Court's decision provides some guidance as to whether they may also be in competition for the purposes of the Act. In particular, the decision confirms that *the fact that there is an agency agreement is not by itself determinative of whether the parties may also be in competition with each other*. The High Court has held that *it is not the existence of an agency relationship which is relevant, but rather a detailed consideration of the commercial nature of the relationship between the parties as well as the terms and conditions of the agency agreement.*

The judgment suggests that for an agent to be considered as a "true agent" and hence not competitive with its principal that may also be selling direct, *the agent must only be acting in the interests of its principal and not have pricing discretion*. In this case, it was particularly relevant that under the terms of the PSAA, Flight Centre had an ability to set prices for tickets at any level and was not obliged to "act in the interests" of the airlines in exercising this power. In a practical sense, Flight Centre was therefore able to compete with the airlines for the sale of tickets.

The decision also highlights the importance of demand side considerations to understanding the nature of competition and in this case, whether as a matter of practical reality, an agent and principal are competing with

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The High Court's decision has implications for the legality of price parity arrangements between suppliers and distributors in a vertical distribution agreement. These arrangements have become increasingly common, as more suppliers adopt dual and multi-distribution models. There has also been a growing concern by regulators around the world regarding the competitive impacts of pricing parity arrangements, particularly in the context of dual and multi-distribution channels where the supplier sells direct to customers as well as via an intermediary. The High Court has confirmed that such arrangements may be illegal if the supplier and distributor also compete.

The ACCC has recently accepted narrow price parity clauses in the agreements between certain online travel booking agents and hotels, after the parties agreed to amend the terms in response to ACCC concerns. In January 2014, the same online travel booking agents offered binding undertakings to the UK competition regulator, the Office of Fair Trading. The extent to which the pricing parity clauses accepted by the ACCC in this case may raise concerns following the High Court's judgment will require further consideration.

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[1] ACCC v Flight Centre Ltd (No 2)(2013) 307 ALR 209 at [137]-[139] and [142].
[2] ACCC v Flight Centre Ltd (No 2)(2013) 307 ALR 209 at [142], [144].
[3] ACCC v Flight Centre Ltd (No 2)(2013) 307 ALR 209 at [110], [112].
[4] ACCC v Flight Centre Ltd (No 2)(2014) 234 FCR 325.
[5] Flight Centre v ACCC (2015) 234 FCR 367 at [126]-[127], [134] and [176].
[6] Flight Centre v ACCC (2015) 234 FCR 367 at [173].
[7] Flight Centre v ACCC (2015) 234 FCR 367 at [175] and [182].
[8] ACCC v Flight Centre [2016] HCA 49 at [7] (French CJ), [73]-[74] (Kiefel and Gageler JJ), [123] (Nettle J).
[9] ACCC v Flight Centre [2016] HCA 49 at [7] (French CJ), [73]-[74] (Kiefel and Gageler JJ).
[10] ACCC v Flight Centre [2016] HCA 49 at [70] (Kiefel and Gageler JJ).
[11] ACCC v Flight Centre [2016] HCA 49 at [71] (Kiefel and Gageler JJ).
[12] ACCC v Flight Centre [2016] HCA 49 at [26], [92] (Kiefel and Gageler JJ), [124]-[125] (Nettle J) and [150] (Gordon J)
[13] ACCC v Flight Centre [2016] HCA 49 at [82] (Kiefel and Gageler JJ).
[14] ACCC v Flight Centre [2016] HCA 49 at [84] (Kiefel and Gageler JJ).
[15] ACCC v Flight Centre [2016] HCA 49 at [34], [89] (Kiefel and Gageler JJ), [132] (Nettle J) and [161] and [175] (Gordon J).
[16] ACCC v Flight Centre [2016] HCA 49 at [34], [89] (Kiefel and Gageler JJ) and [177] (Gordon J).
[17] ACCC v Flight Centre [2016] HCA 49 at [90] (Kiefel and Gageler JJ).
[18] ACCC v Flight Centre [2016] HCA 49 at [132] (Nettle J).
[19] ACCC v Flight Centre [2016] HCA 49 at [177] (Gordon J).
[20] ACCC v Flight Centre [2016] HCA 49 at [24] (French CJ).
[21] ACCC v Flight Centre [2016] HCA 49 at [17] (French CJ).
[22] ACCC v Flight Centre [2016] HCA 49 at [19] at [21] (French CJ).

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[23] ACCC v Flight Centre [2016] HCA 49 at [127] (Nettle J).
[24] [2013] FCA 1206.

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