

## Article Information

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## Flight Centre v ACCC: thought-crimes and legal fiction

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*The ACCC's loss of appeals in two cases against intermediaries for price fixing (Flight Centre and ANZ/Mortgage Refunds) appears to resolve two conflicting first instance decisions of the Federal Court of Australia. The Full Court was highly critical of the ACCC's economic arguments, going so far as to suggest that markets are not a feature of the real world but are intellectual constructs devised by economists, and that the Court will decide cases based on its own view of commercial reality.*

The key elements of price fixing are that two or more parties to an arrangement must be in competition with each other and that the arrangement has the purpose or likely effect of fixing or controlling prices. The events in both cases preceded the 2009 'cartel conduct' amendments, which add potential criminal sanctions to existing civil penalty provisions for price fixing. The decisions, and areas of uncertainty that remain, accordingly have added significance for distribution models where both the supplier and the intermediary enter into transactions with consumers.

The case turned on the Court's finding as to the relevant market. In competition law, more so in the US than in Australia, market definition has long since fallen from grace because it is too inexact to satisfactorily determine the outcome of cases. The Court noted the well known observation of the High Court of Australia in 1989 that market definition involves value judgments on which opinions may reasonably differ. That is not a satisfactory basis for legal liability to be imposed, especially criminal liability under the cartel conduct provisions. However, despite such concerns, the Federal Court has used market definition to determine the outcome of the appeals, and has gone further to suggest that 'markets' are not real world phenomena but intellectual constructs devised by economists. This approach risks reducing competition law to Orwellian 'thought-crimes'. While legal decisions must be 'based on' findings of fact, the Court says it will apply 'commercial reality'. This may provide a level of comfort for business people, who understand commercial reality. However, it must be noted that judicial decisions in another area of competition law, misuse of market power, have been criticised in the past for relying on judges' commercial intuition, because that is said to mask undisclosed policy reasons. It is desirable for judicial decisions to be based on legal and economic reasoning that provides certainty and predictability for businesses and the lawyers who advise them.

The tension between economics and law is of long standing. The Hilmer Report in 1993 noted a degree of dissatisfaction with then current court procedures for the utilisation of economic material, and recommended that further consideration be given to measures to address the situation, including arrangements for increasing the specialisation of judges involved in competition matters. US experts have frequently expressed surprise at the tendency of Australian judges to decide cases based on close textual interpretation of the statutory provisions. The present cases add to a long line of cases in which judges have expressed frustration with economists. In part this failure of communication is a function of appellate procedure, where appeals can be decided on a point of law thus obviating the need to elucidate the merits in a way that might help analysis of future cases.

It is well established in competition law that markets involve transactions between buyers and sellers. Travel agents sell tickets at the price specified by the airline, and take out their commission. If the ticket price is undercut by another agent or airline, the agent can cut its commission, but cannot cut the airline's price. Sometimes an airline undercuts its own agents. Flight Centre thus loses money when airlines cut prices against it, or when other travel agents decide to cut price and reduce their own commission. This is what Flight Centre attempted to address by agreement with certain airlines. Flight Centre's concerns could be addressed either by: airlines not undercutting ticket prices below those published to agents; or, airlines sharing any price reductions by their agents to meet competition (i.e. agreeing that the agent should not bear the whole reduction). Clearly there are real world phenomena here which led the ACCC to conclude that

structural arrangements in the marketing of airline tickets have created upwards price pressure. While commercial intuition may suggest this is not the case, the merits of the appropriate competition analysis remain to be revealed.

It could be concluded from actual conduct and transactions between airlines, agents and consumers that *ticket prices* are determined by market forces and that agents' commission as a share of airlines' margin is determined by a process of negotiation between agents and airlines, including strategic conduct by airlines undercutting their own agents to make sales free of commission. It would seem unlikely that ticket prices would be affected by altering the margin share. In any event the Court did not need to address the purpose or likely effect of the proposed conduct in question because the case was disposed of by the simple expedient of defining the market. Travel agents do not fly planes, they simply sell tickets as agents for airlines and are remunerated by commission from the airlines. Airlines do not supply booking agency services to themselves or consumers (if they did, each airline would be in a market of its own). So held the Federal Court, in each case adding caveats that other circumstances involving agency/dual distribution models will depend on their own facts and the present decisions do not mean that agents/re-sellers and their principals can never be liable for price fixing.

The Court also warned against use of the terms 'horizontal' and 'vertical' to assist analyse arrangements or relationships, as these are simply unhelpful economic jargon not reflected in the language of the legislation. It is a pity the Court did not discuss the 'anti-overlap' provisions in section 45(6) and the cartel conduct provisions section 44ZZRS. These indicate legislative recognition that vertical relationships between a supplier and its distributors may at one and the same time constitute horizontal relationships that could be captured by the *per se* prohibitions, e.g. price fixing (now cartel conduct) and exclusionary provisions (primary boycotts, market sharing, etc). The legislative intent is that vertical arrangements and relationships *prima facie* should be subject to the competition test under section 47 (exclusive dealing), i.e. should not be condemned unless they have the purpose or likely effect of substantially lessening competition in a relevant market.

There are several points that follow from this. First, the Federal Court is correct in criticising terms such as 'horizontal' and 'vertical' as being imprecise. The scope of section 47 is narrow and the anti-overlap provision does not exempt conduct from *per se* prohibition to the extent it concerns matters beyond the scope of section 47. Thus there remains a real prospect of arrangements which businesses would regard as 'vertical' being subject to *per se* criminal liability under the cartel conduct provisions. Presumably this is the legislative intent. In the present case, the Court appears to have judicially extended the scope of anti-overlap protection by the legal fiction of 'market definition', thus defining away any competition concerns relating to the conduct of suppliers of services and intermediaries in the Flight Centre and ANZ/Mortgage Refunds cases.

Second, it should be remembered that parties may be 'competitors' for the purposes of price fixing (previously covered in section 45A, now in cartel conduct section 44ZZRD(4)) or exclusionary provisions (section 4D and section 45) whether they are in actual or potential competition, i.e. the concept includes parties who are likely to be, or would but for the arrangement be, competitors. The Federal Court is currently divided on whether 'likely' means 'more probable than not' or 'there is a real chance', though the latter appears to be favoured. The statutory language, reflecting economic theory, means that suppliers who appoint an exclusive distributor could be exposed to liability for horizontal conduct unless there is a statutory anti-overlap provision. The Flight Centre case involves an agency relationship, which is a near necessity in the case of services, as they cannot be re-supplied. The position in relation to distribution of goods, where distribution arrangements are commonly on a principal-to-principal basis, raises more significant risks where distributors seek 'price support', or most favoured customer clauses, from suppliers.

Finally, the Harper Review has recommended that section 47 be repealed, on the basis that vertical conduct can be regulated under the competition test in section 45, and that the cartel conduct provisions are incomprehensible and should be substantially re-written. It is suggested that the present two cases decided by the Full Federal Court raise a pressing need to revisit the anti-overlap provisions to provide greater certainty for vertical arrangements, where suppliers may transact direct business that impacts commercial returns to re-sellers, whether they be agents or re-sellers. In most cases the sharing of margin between a supplier and re-sellers should have no effect on competition and, if it is to be regulated at all, should fall for consideration under the competition test, not the *per se* prohibitions which also carry the risk of criminal sanctions.