Agency, commissions and a 'price beat guarantee'

Lucy Robb Vujcic reports on *Australian Competition and Consumer Commission v Fight Centre Travel Group Limited* [2016] HCA 49

This case arose out of a penalty proceeding commenced by the Australian Competition and Consumer Commission (ACCC) against Flight Centre Travel Group (Flight Centre) concerning Flight Centre's attempt to persuade three airlines to agree not to give discount prices on tickets sold directly by the airlines to customers.

The primary question on appeal was whether Flight Centre, as the airlines' agent, could be said to have acted in competition with them. A majority of the High Court (French CJ dissenting) held that, notwithstanding the agency relationship, Flight Centre was in competition with the airlines and had, as a result, contravened s 45(2)(a)(ii) of the former *Trade Practices Act 1974* (Cth).

Background facts

Flight Centre carried on business as a travel agent, operating from shop fronts and call centres throughout Australia and elsewhere. In practical terms, its business involved selling international airline tickets to customers.

Its authority to sell tickets derived from a standard form Passenger Sales Agency Agreement (PSAA), which it entered into with the International Air Transport Association on behalf of its member airlines.

In the PSAA, Flight Centre was referred to as 'the agent' of the airlines (which were called 'the carriers'). The PSAA provided that the agent was 'authorised to sell air passenger transportation on the services of the carrier and on the services of other air carriers as authorised by the carrier.' All services sold pursuant to the PSAA were 'sold on behalf of the carrier.'

Flight Centre was not obliged to sell tickets on behalf of the member airlines. Nor were the member airlines obliged to sell their tickets exclusively through Flight Centre. However, when Flight Centre did make a sale on behalf of an airline, it received an 'at-source commission.' The commission was calculated as a percentage of the published fare. The published fare was determined by the airlines and published to Flight Centre. It comprised a net amount and the at-source commission. Whenever Flight Centre made a sale, it would remit the net amount to the airline and retain the commission.

The PSAA did not require Flight Centre to sell tickets at the published fare. It was at liberty to set whatever prices it chose. However, the commercial consequence was that the higher the price, the greater its commission, while the lower the price, the more marginal became its commission. If Flight Centre elected to sell tickets below the net amount, it suffered a loss.

Flight Centre also entered into preferred airline agreements with certain airlines. Through those agreements, Flight Centre derived incentive-based commissions and other payments.

As part of its marketing strategy, Flight Centre adopted a 'price beat guarantee' whereby it promised to better the price of any airline ticket quoted by any other Australian travel agent or website by $1. It also promised to give the customer a $20 voucher.

At the same time, airlines were selling discount tickets directly to customers. This caused two problems for Flight Centre. First, the 'price beat guarantee' meant that Flight Centre had to undercut the airlines' price, while still remitting the net amount for each sale. Second, the direct sales prevented Flight Centre from earning commissions and other incentives through the preferred airlines agreements.

Fight Centre considered these developments to be an 'external threat'. Between August 2005 and May 2009, it attempted to confront the threat by sending a series of emails to the airlines involved, seeking to persuade them to abandon the discounts.

The ACCC considered this conduct to be in breach of s 45(2)(a)(ii) of the Trade Practices Act, being an attempt to induce the airlines to enter into a contract, arrangement or understanding that had the purpose of substantially lessening competition.

Legislative framework

The relevant legislative regime is set out in the joint judgment of Kiefel and Gageler JJ.[1] It is sufficient, for present purposes, to note two provisions of the Act.

Section 45(2)(a)(ii) 'prohibited a corporation from making a contract or arrangement, or arriving at an understanding, if a provision of the proposed contract, arrangement or understanding had the purpose, or would have or be likely to have the effect, of substantially lessening competition.'[2]

Section 45A(1) deemed a provision of a contract, arrangement or understanding to have the purpose, effect or likely effect of substantially lessening competition if, relevantly, two conditions were satisfied. The first was that the provision had the purpose, effect or likely effect of fixing, controlling or maintaining the 'price' for 'services supplied' by one party to the contract, arrangement or understanding. The second was that the services in relation to which the price was fixed, controlled or maintained were supplied 'in competition with' the other party to the contract, arrangement or understanding.'[3]

The crux of the litigation concerned the requirement that Flight Centre be 'in competition' with the airlines.

Procedural history

First instance

At first instance, Logan J found in favour of the ACCC. There

was little difficulty concluding that, by sending the emails, Flight Centre had attempted to induce the airlines to enter into a contract, arrangement or understanding to stop offering international customers a discount. This satisfied the first condition of s 45A(1).

The critical issue concerned the second condition of s 45A(1). In particular, whether the price fixed or proposed was in respect of services supplied by Flight Centre in competition with the airlines. This required the ACCC to identify the price fixed, the service to which the price related and the market in which the services were offered.[4]

The ACCC advanced two cases. Its primary case was that Flight Centre sought to fix, control or maintain its commission on the sale of airline tickets. It identified two complementary markets. One was an 'upstream market', identified as a market for 'distribution services to international airlines.' The other was a downstream market, identified as a 'booking service to customers.'

Whether an agent had legal capacity to compete with its principal was left to the general law and, in particular, the terms of the contract creating the relationship.

At trial, its secondary case was not identified with precision.[5] It concerned fixing the ticket price in a market described as 'international passenger air travel services.' This market had two stages: sale of the tickets and transportation of passengers.

Logan J rejected the second case on the basis that Flight Centre did not engage in actual carriage but accepted the essentials of the ACCC's primary case.

On appeal to the Full Federal Court

The decision of Logan J was overturned on appeal. The Full Federal Court held that the ACCC's characterisation of the relevant market in its primary case was artificial. At its core, the transaction was nothing more than a contract for the sale of tickets to customers. What the ACCC chose to refer to as the 'booking services' provided by the Flight Centre were an inseparable incident of the sale itself. The full court accepted that Flight Centre competed with the airlines for the sale of tickets to customers but held that Flight Centre acted as the airlines' agent. It could not, therefore, be in competition with its principal and the second condition of s 45A could not be met.

On appeal to the High Court

The principal question addressed on appeal was whether Flight Centre, as the airlines' agent, could have been acting in competition with them for the purposes of the Act.

A subsidiary question related to the proper definition of the relevant 'market'.

Agency and competition

Of the four judges in the majority, Kiefel, Gageler and Nettle JJ held that the agency relationship between Flight Centre and the airlines did not prevent competition arising between them in the market for the supply of international ticket sales. Gordon J did not accept that Flight Centre was an agent of the airlines at the relevant time, holding instead that 'Flight Centre was dealing with its own customers in its own right without reference to any interests of any airline.'[6]

According to Justices Kiefel and Gageler, the agency question was to be resolved by the terms of the agency agreement.

First, an agency relationship is ordinarily created by contract. That contract regulates the basic rights and liabilities of the parties, including fiduciary duties. As a result, it is not possible to say that all agents owe the same duties; it will be a question of the express and implied terms of the specific contract creating the relationship.

Second, the provisions of the Trade Practices Act were not inconsistent with notion that principals and agents could supply services in competition with one another. Their Honours considered s 84(2) of the Act, which deemed conduct engaged in by an agent of a corporate principal within the scope of the agent's authority to have been engaged in for the purposes of the Act *also by* the corporate principal. They concluded: 'Importantly, the provision did not deem the conduct not to have been engaged in by the agent.'[7]

Whether an agent had legal capacity to compete with its principal was left to the general law and, in particular, the terms of the contract creating the relationship. It was relevant to consider the scope of the agent's authority and the extent, if at all, to which the agent was bound by the duty of loyalty.[8] Their Honours held:

> 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.[9]

The two critical factors in deciding the appeal were first, that Flight Centre had the discretion to decide whether or not to sell an airline's tickets, as well as to determine the price. Second,

there was no suggestion that Flight Centre was constrained in the exercise of that discretion to prefer the interests of the airlines. Flight Centre was free to act in its own interests and, in doing so, it competed with its notional principals.

Justice Nettle reached the same conclusion for similar reasons. To call Flight Centre an agent of the airline meant no more than that Flight Centre 'was endowed by the relevant airline with authority to create in favour of the customer the right to be carried by the airline on the flight for which the airline ticket was provided.'[10] The mere fact that airlines had entered the market to provide direct sales in order to avoid paying commissions showed that competition existed between the parties.[11] He concluded:

> Generally speaking, it may be correct that, where an agent has authority to sell for and on behalf of the agent's principal, it is less likely than in other circumstances that the agent and the principal compete with each other for the sale of the goods or services in question. But so to observe in the present case really takes the matter no further.[12]

Ultimately, the effect of the agency was determined by 'the nature, history and state of relations between the principal and the agent.'[13] In factual reality and legal substance, Flight Centre's practice of determining its own prices placed it in competition with its principals.

Defining 'the market'

Section 45A requires proof of competition between the parties engaged in the act of fixing, controlling or maintaining a price. Section 45(3), operating alongside s 4E of the Act, requires that the competition occur in a market.

The ACCC questioned whether, in rejecting its primary case, the Full Federal Court had failed to take a sufficiently functional approach to market definition.

Justices Kiefel and Gageler addressed this question in detail. They held that 'a market is a metaphorical description of an area or space (which is not necessarily a place) for the occurrence of transactions'.[14] Competition in a market is 'rivalrous behaviour' in respect of those transactions.[15]

Markets are defined by reference to their dimensions: product (the type of services provided), function (the level within a supply chain at which those services are supplied), geography (the physical area within which those services are supplied) and, occasionally, temporal (the period within which the supplies occur).[16] In *ACCC v Flight Centre*, the dispute concerned the characterisation of the first two dimensions.[17]

Their Honours emphasised that the definition of a market involves a value judgment, in light of commercial reality and the purposes of the law.[18] In characterising the market in its primary case as involving two complementary up- and downstream markets for ticket sales and distribution services, the ACCC adopted an economic theory that 'did violence to commercial reality.'[19] Their Honours held:

> The functional approach to market definition is taken beyond its justification, however, when analysis of competitive processes is used to construct, or deconstruct and reconstruct, the supply of a service in a manner divorced from the commercial context of the putative contravention which precipitates the analysis.[20]

The difficulty lay not in characterising Flight Centre's service as ticket sales with an upstream distribution component but in characterising the *airlines* as providing distribution services *to themselves*. 'Booking the flight, issuing the ticket and collecting the fare were part and parcel of the airline making the sale. They were inseparable concomitants of that sale.'[21] Their Honours ultimately concluded that, '[w]hatever other difficulties the ACCC's primary case might encounter, it was unsustainable because it rested on attributing to Flight Centre and to the airlines the making of supplies of services of a description which did not accord with commercial reality.'[22]In separate judgments, Nettle J and Gordon J agreed with the approach adopted by Kiefel and Gageler JJ.[23]

Justice Nettle separately addressed a different aspect of the market test. His Honour held that the Full Federal Court erred in rejecting the ACCC's secondary case. His Honour acknowledged that Flight Centre could not transport passengers but defined the relevant marked in terms of the supply of the right to convey the passenger.[24]

The question of competition was then a matter of the degree to which the service offered by Flight Centre was capable of substitution with the service offered by the airlines. 'The greater the degree of substitutability between goods or services, the greater the degree of competition between suppliers of those goods or services, and vice versa.'[25] His Honour considered that:

> From the point of view of a prospective customer, an airline ticket sold by Flight Centre on behalf of an airline would be in most respects functionally identical to an airline ticket sold directly by the airline. Apart, perhaps, from the prospective customer's perception of extra sales service and purchasing convenience, the only difference between the two offerings would be price. 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 ticket sold directly by the airline; and, in terms of generally accepted competition principles, that means that the cross-price elasticity of demand as between an airline ticket sold by Flight Centre and an airline ticket sold directly

> by the airline would approach positive infinity. Other things being equal, that connotes a high degree of competition between airline tickets sold by Flight Centre on behalf of airlines and airline tickets sold directly by each airline…

The dissent

Chief Justice French dissented on the agency question. He acknowledged the differential prices offered by Flight Centre and the airlines, the commercial pressure placed on Flight Centre and the apparent competition between them. However, he held that characterizing Flight Centre's conduct as anti-competitive 'assumes a concept of competition under the Act which is in tension with that of an agency relationship at law. It opens the door to an operation of the Act which would seem to have little to do with the protection of competition.'[26]

Endnotes

1. At [38]-[44].
2. At [38].
3. At [39].
4. At [47].
5. At [51].
6. At [152].
7. At [81].
8. At [83].
9. At [84].
10. At [125].
11. At [130].
12. At [147].
13. At [147].
14. At [66].
15. At [66].
16. At [67].
17. At [68].
18. At [69].
19. At [71].
20. At [70].
21. At [73].
22. At [75].
23. At [123] and [150], respectively.
24. At [124].
25. At [126].
26. At [23].