Airline joint ventures and competition law regimes in Asia Pacific

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Volatility in the air transport industry has often rendered the financial health of airlines precarious, leading to constant pressure on carriers to lower their cost base. Responding to these pressures, the Asia Pacific region has observed a recent surge in consolidation through alliances. Exploring beyond these industry developments into the regulatory sphere, China's National Development and Reform Commission (NDRC) has also recently initiated a consultation in respect of its *Guidelines on General Conditions and Procedures for the Exemption of Monopoly Agreements (Consultation draft)*, rendering it an opportune time to examine the impact of competition law regimes on airline cooperation arrangements affecting markets in the region.

While ownership and air traffic restrictions continue to dictate the ability and extent to which airlines are able to combine their operations through mergers and acquisitions, joint operation service agreements (so-called "metal-neutral" joint ventures) have recently gained in popularity to replace inter-airline codeshare agreements, a previously prevalent form of cooperation.

Airline joint ventures are known to be more advanced forms of codeshare agreements. They envisage, at least in theory, an even higher degree of cooperation such that in reality, the various airlines *de facto* form a single carrier on selected routes. Beyond the pooling of resources and coordination with respect to capacity, routes, scheduling, marketing, sales and pricing, commonplace features under a codeshare agreement, parties to a joint venture are also expected to share revenue, costs and profits. Characteristics of joint ventures which extend to price-coordination, revenue-, cost- and profit-sharing, limitations on capacity and frequency, and the sharing of markets often raise significant concerns under competition law. In contrast, codeshare arrangements, which are structured to promote coordination only on operational aspects – by allowing one carrier to sell seats on a flight operated by another carrier as its own – tend to give rise to less controversy because they preserve one of the key parameters of competition: the autonomy of pricing decisions amongst competing or potentially competing carriers.

Following in the footsteps of a number of American and European carriers that have entered into joint ventures with respect to their Trans-Atlantic routes, Asia Pacific carriers have begun to seek out similar opportunities with respect to their regional, Europe-Asia Pacific and Trans-pacific operations.

Without speculating further upon their merits and legitimacy under competition law principles, these activities have highlighted the presence of two broad categories of competition supervisory regimes, those where all aspects of passenger air transport, including competition, remains a domain reserved to policy-makers responsible for civil aviation matters, and those which have relinquished these decisions which touch upon competition policy in favour of competition authorities.

The contest for jurisdiction results from a history whereby the mandate to negotiate bilateral air service agreements with foreign nations typically encompassed residual power to authorise contracts or arrangements that designated airfares, capacity and frequencies, practices which were otherwise perceived to constitute blatant violations of competition law.

Japan, Korea and New Zealand are amongst those jurisdictions where national transport authorities determine the legitimacy of airline cooperation arrangements under competition law principles while in Australia, Malaysia, Singapore and Taiwan, competition authorities take the reins. In China, the position is evolving, but the picture that has already emerged is that one of its competition enforcement agencies will occupy the lead role in any review mechanism. Meanwhile, in the case of Hong Kong, it is also clear that any assessments under competition law will be the concern of its Competition Commission. For other emerging Asian economies including Indonesia, the Philippines, Thailand and Vietnam, limited guidance and precedents available to the airline industry means that the regime governing joint ventures remains uncharted territory.

The designations applicable to airline joint ventures vary from one jurisdiction to another. For the purpose of this article, all forms of joint alliance, management or operation arrangements relating to international passenger air transport are broadly referred to as joint ventures.

Jurisdictions where the review of joint ventures under competition law principles is the prerogative of the transport authority

In Japan, provisions under the *Act concerning Prohibition of Private Monopolization and Maintenance of Fair Trade 1947* do not apply to joint ventures relating to transportation between domestic and foreign air carriers. Instead, they are governed by the *Civil Aeronautics Act 1952* and subject to the approval of the Ministry of Land, Infrastructure, Transport and Tourism (**MLITT**). Although there is a requirement to consult the Japan Fair Trade Commission (**JFTC**) on whether an agreement conforms to the criteria supporting an approval decision, the decisions published to date indicate this to be a prerogative of the MLITT; they do not appear to be influenced by any input from the JFTC. In substance, the assessment under competition law principles falls to be determined with reference to the importance of benefits accruing to customers, whether non-discriminatory access to (and liberty to withdraw from) the arrangement is preserved, and whether any restrictions identified are indispensable to the purpose of the agreement.

The situation in Korea is broadly similar. Pursuant to the *Aviation Act 2009*, approvals with respect to inter-carrier joint ventures are granted by the Ministry of Land, Transport and Maritime Affairs, in accordance with prescribed conditions on the substantive content to which an agreement relates. Although the Korea Fair Trade Commission is only entitled to supervise the procedure by virtue of a prior consultation right, its enforcement history in respect of investigations into the air transport industry would suggest a more concrete influence. Irrespective of the extent of intervention, competition law considerations determine the

validity of the agreement; it must be shown not to entail restrictive effects, unjustly deprive customers of benefits or discriminate against a particular customer, or restrict access thereto or withdrawal therefrom.

As regards New Zealand, the Ministry of Transport (**MOT**) is empowered under the *Civil Aviation Act 1990* to grant authorisation with respect to joint ventures pertaining to international air carriage. While prohibitions against practices having the purpose or effect of substantially lessening competition as stipulated in the *Commerce Act 1986* are expressly inapplicable to inter-carrier coordination, competition law considerations continue to be of relevance. In giving authorisation, the MOT will take into account whether the tariffs proposed under the agreement are excessive having regard to whether they afford a reasonable return on investment to the carriers, and whether the supply of services at the proposed tariffs can be carried on for a reasonable period of time. Notably, the extent to which benefits generated therefrom accrue to consumers (or a group of consumers) and international comity also constitute circumstances that contribute to the merits of an application.

Notwithstanding the fact that competition authorities in this category of jurisdictions play a limited role in determining whether airline joint ventures are to be approved or authorised, they all share one common feature – the impact on competition and consumers are amongst the considerations to which a transport authority must give weight. More generally, joint ventures will likely escape challenge where they are concluded following "Open Skies" treaties negotiated between the respective nations of the contracting airlines, a theme which also finds application in jurisdictions where the power to review joint ventures resides with competition authorities.

Jurisdictions where the power to review joint ventures under competition law principles resides with the competition authority

In Australia, airline joint ventures are reviewed by the Australian Competition and Consumer Commission (**ACCC**) in accordance with the "net public benefit" test as stipulated in the *Competition and Consumer Act 2010*. Accordingly, the ACCC is empowered to authorise any arrangements whose anticompetitive detriment would be outweighed by an overall material public benefit, a test which leads to an appraisal of diverse considerations ranging from overall economic consequences on trade and tourism to, for example, environmental benefits. The ACCC exercises discretion in conducting a wholistic assessment of the advantages and restrictive effects of an agreement.

While transparency in respect of the Chinese regime continues to pose an issue, there have been a number of noteworthy developments of relevance to airline joint ventures. More specifically, 2012 saw the conclusion of a *Memorandum of Understanding between the NDRC and the Civil Aviation Authority of China* (**CAAC**) for the purpose of establishing a joint task force charged with responsibility to review airline cooperation arrangements under the Antimonopoly Law, pursuant to which the NDRC would assume a leading role in the review

procedure, with the CAAC acting as the "industry adviser". Despite the absence of any procedural guidelines, a number of airlines have proactively sought to inform the NDRC regarding their cooperation arrangements. More recently, the launch of a consultation in respect of the *Guidelines on General Conditions and Procedures for the Exemption of Monopoly Agreements (Consultation draft)* by the NDRC also swiftly followed a recent statement by the CAAC concerning its discussions with the NDRC and the International Air Transport Association. While it remains too early to tell whether and how these guidelines will apply to the airline industry, they already give a clear indication of the fact that the Chinese authorities will generally refrain from engaging on the issue of exemptions with transaction parties, who are instead expected to conduct a self-assessment to ensure compliance with the conditions set out in Article 15 of the Antimonopoly Law. Yet the broad scope of these conditions, which extend to "public-interest causes", wider economic implication, foreign trade policy considerations and other reasons specified by law or the State Council, would suggest some flexibility in their application, provided it can be shown that consumers are able to share in these benefits.

Although the *Competition Ordinance (Cap 619)* only entered into force in Hong Kong late last year, what is already apparent is that the Hong Kong Competition Commission has a clear mandate to consider the legitimacy of airline joint ventures under competition law. Similar to China and unlike those competition authorities in nearby jurisdictions which encourage parties to file for the review of arrangements suspected of being in breach of competition law, parties are expected to conduct their own assessment of whether arrangements with a local nexus can be justified on efficiency grounds. Replicating the legislative text applicable in the European Union, the scope of benefits which contribute to this assessment are more limited in scope in that "non-economic" or "social benefits" appear to carry less weight – the focus would be on economic efficiencies. Further, parties must also show that a fair share of benefits will be passed on to consumers within the affected market.

For Malaysia, airline joint ventures are assessed by the Malaysia Competition Commission (MyCC) exclusively within the framework of the *Competition Act 2010.* Restrictive agreements may be relieved from liability on the basis that they give rise to "net economic benefits" and the statutory wording clearly recognises the importance of "social benefits". An explicit threshold requirement, as in the European Union and Hong Kong where a "fair share" of benefits must accrue in favour of consumers, is also notably absent from either legislation or MyCC's guidance. Nevertheless, any flexibility to adopt a generous interpretation allowing for the consideration of wider non-economic implications is constrained by MyCC's *Guidelines on Chapter 1 Prohibition*, which compel parties to show that these benefits are passed on to consumers. This requirement adds a layer of complexity associated with the onus of proving that the claimed efficiencies are readily enjoyed by consumers. Importantly, MyCC is also the only competition authority in the region that has recently found an airline cooperation arrangement in breach of competition legislation, as illustrated by its infringement decision of March 2014 against Malaysian Airline Berhad and AirAsia Berhad and AirAsia X Sdn. Bhd,

which concerned a collaboration arrangement identified as an outright market-sharing arrangement. While recognising the possibility of airline joint ventures being pro-competitive, the collaboration arrangement incorporated aspects of market-sharing and joint management control which were thought to go beyond the scope of such joint ventures. The absence of a foreign carrier's involvement may however explain the unusually stringent application of competition law principles in this case. The decision has since been reversed on an appeal lodged before the Competition Appeal Tribunal, whose decision was rendered in February 2016. In its judgment, the Tribunal explains that MyCC's decision was flawed because it had failed to give any reason or analysis to establish that the collaboration arrangement constituted market-sharing, and, on that basis, an infringement by object.

At neighbouring nation Singapore, the *Competition Act 2004* also adopts a similar "net economic benefit" test in considering the overall competitive effects of airline joint ventures. However, its application by the Competition Commission of Singapore (**CCS**) to date would suggest a more generous approach (comparable to that adopted in Australia) in the valuation of efficiencies – benefits recognised in the decisions published to date have included the fact that a joint venture will improve tourism or "strengthen Singapore's position and competitiveness as an air hub". Moreover, the CCS' *Guidelines on the Section 34 Prohibition* also mention the possibility of aggregating efficiencies across closely-related markets, demonstrating a certain readiness to accommodate "out-of-market" efficiencies which are common to so-called network industries. Interestingly, the CCS is also amongst the most active of authorities in Asia that regularly give approval to coordinated activities in the passenger air transport industry - a result that owes itself to Singapore's comparatively liberal civil aviation policy.

In the case of Taiwan, all carriers must apply for approval from the Ministry of Transport and Communications (**MTC**) prior to commencing any airline joint ventures. The *Civil Aviation Act 1953* expressly subjects joint ventures to the approval of the Taiwan Fair Trade Commission (**TFTC**) – which fall squarely within the purview of Article 7 (concerted action) under the *Fair Trade Act 1991*. This is also confirmed in *The Reviewing Rules for Approving the Alliance* promulgated (under Article 58-1 of the *Civil Aviation Act*) by the MTC together with the TFTC, which require any cooperation proposal submitted to the MTC to include an approval decision from the TFTC. Although this appears to confirm the TFTC's predominant role in the consideration of joint ventures, the absence of any TFTC decisions on the matter suggests that in reality, it shows deference to the Civil Aeronautics Administration, an agency operating under the supervision of the MTC. Relevant criteria that will be considered by the MTC include the impact of the cooperation arrangement on air fares, services and other consumer interests, as well as on the carriers' overall ability to reduce costs, improve service quality, efficiency and operate viably.

The fact that national transport authorities only have limited influence in the review process has not diminished the extent to which international comity and policy considerations are

taken into account in this second category of regimes. A closer examination also reveals a divergence in approach to the consideration of "benefits" as between Australia, Malaysia and Singapore on the one hand – where overall interests of the economy and "social benefits" (sometimes extending to public interest benefits) are accepted, and Hong Kong on the other hand – where economic efficiencies appear to carry more weight. In the first sub-category, competition authorities retain considerable flexibility to appraise the overall competitive effect on consumers and the economy as a whole, an analysis which ultimately boils down to a question of policy choice. The historical importance of industrial policy in the enforcement of competition law in China may also lead it to follow a similar path. However, despite the more restrictive approach adopted in Hong Kong, the statutory wording contained in competition legislation still affords at least some discretion to factor in benefits which are not strictly generated in the relevant markets in which efficiencies arise and anticompetitive harm is suffered. In respect of these "out-of-market" efficiencies, it would be up to the parties to establish a degree of commonality amongst consumer groups which otherwise fall into distinct relevant markets.

Conclusion

Despite the apparently distinct legal frameworks within which airline joint ventures are considered, depending on the relevant authority in charge, a cursory review of selected regimes in Asia Pacific reveal significant commonalities, not in the methodology applied in analysing their effects on competition, but the fact that relevant assessment criteria are more often than not obscured by underlying policy considerations.