Competition Law and the Airline Industry

Malaysian Airline System Berhad (“MAS”), AirAsia Berhad (“AirAsia”) and AirAsia X Sdn Bhd (“Air Asia X”) have recently entered into a Comprehensive Collaboration Framework to explore opportunities to collaborate on a broad range of areas in which all parties will strive to complement each other’s businesses so as to leverage on their respective core competencies and optimise efficiency for the benefit of consumers.¹

The collaboration has sparked concerns that the tie-up between the two airlines may result in a monopoly or anti-competitive behaviour in the airline industry. Many have expressed their worries that the collaboration may result in less frequent flights, limited travel options and that AirAsia may stop offering low price airfares since MAS is no longer a competitor to AirAsia.

The collaboration agreement would only come into effect after a full competition analysis is completed and is in compliance with the applicable laws with regard to competition law in all the markets that the airlines operate in.² It is noted that the recently-established Malaysian Competition Commission is also looking into the possible impact of the collaboration on the local market.³

This article sets out to examine the competition law issues that may arise from the collaboration in the airline industry.

Competition Act 2010

The Competition Act 2010 (“Act”) was passed by Parliament last year and is scheduled to come into force on 1 January 2012. The Act applies to any commercial activity by any company (including Government-linked companies) within and outside Malaysia which has an effect on competition in any market in Malaysia. Generally, competition law in most jurisdictions around the world covers three main pillars, prevention of anti-competitive agreements; abuse of a dominant position as well as ruling against anti-competitive mergers and acquisitions. The Act does not, however, provide for regulation of mergers and acquisitions which may be anti-competitive, although the Government has not ruled out the possibility of introducing the third pillar in the future.

¹ http://malaysiaairlines.listedcompany.com/news.ihtml/id/263960
² http://www.asianewsnet.net/home/news.php?id=20612&sec=2
Anti-Competitive Agreements
The Act prohibits horizontal and vertical agreements between enterprises where an agreement has the object or effect of significantly preventing, restricting or distorting competition in any market for goods or services. Horizontal agreements which have the effect of price-fixing; market sharing; limit or control of production, market outlets or market access; bid rigging are deemed to be an anti-competitive agreements. Vertical agreements include tie-in arrangements and exclusive dealings which have the object of setting up barriers of entry against new entrants in a particular industry.

Abuse of a Dominant Position
Enterprises are prohibited from engaging in any conduct which amounts to an abuse of a dominant position such as imposing unfair purchase or selling price; limiting or controlling production, market outlets or market access, refusing to supply; applying discriminatory conditions that discourage new market entry; engaging in predatory behaviour towards competitors; or buying up scarce supplies in excess of the dominant enterprise’s own needs.

The Application of Competition Law to the Airline Industry
In the airline industry, the typical competition issues include global alliances, tariff coordination, code-sharing, price-fixing, airport capacity and slots allocation, predatory pricing, frequent flyers programme, corporate discount schemes, travel agent commission, etc. These competition issues may arise from day-to-day dealings with competitors, joint venture partners, airport operators, suppliers, agents as well as customers, and will likely come under the scrutiny by the competition authority.

In many countries, airlines have to seek permission and clearance from the competition authorities before they are allowed to form an alliance. The competition authorities will consider the terms of the agreement, the potential impact on the relevant markets as well as whether the alliance would result in excessive market domination. The competition authorities in many jurisdictions are generally supportive of airline alliances as they would result in cost savings, better connectivity and foster greater synergies between the airlines unless the alliances would result in elimination of competition.

Code sharing
Code-sharing is an arrangement between two airlines where one airline (operating airline) allows another airline (marketing airline), as a code share partner, to market and sell tickets on the operating airline’s flights. The marketing airline that sells tickets under its own code does not actually operate the flight. While code-sharing agreements are generally permissible as they provide substantial benefits to consumers (such as seamless connections, greater network access and competitive airfares), some code-sharing agreements may give rise to anti-competitive concerns as the multiple displays of code-shared flights on computer screens
push down other airlines’ flights to be displayed on following screens which may be missed by consumers searching for other flight options. It may also go beyond this and cover comprehensive integration of marketing and sharing of operational information that results in distortion of healthy competition practices. In this respect, AirAsia has dismissed the possibility of entering into a code-sharing agreement with MAS as it claims that both airlines operate on different market segments and different business models.4

It is believed that both airlines are likely to have a common understanding on joint planning, operating and co-ordinating routes, flight schedules and airfares. In Europe and the US, exemptions have been granted to a number of co-operation agreements between airlines on the condition that the whole arrangement benefits the customers of each party by providing access to a wider range of routes.

**Price fixing**

In the past few years, dozens of airlines around the world have been slapped with hefty punishments by competition authorities for involvement in price-fixing cartels. For example, in November 2010, 11 airlines were fined a total of €799 million (about US$ 1.1 billion) by the European Commission for fixing the price of fuel and security surcharges on cargo flights worldwide over a six year period from 1999 until 2006.5

Back at home, in July 2011, MAS announced that it would pay US$ 3.35 million to a number of freight forwarders in the US to settle claims alleging that MAS was involved in price-fixing of airfreight shipping services and related surcharges, although MAS has denied any wrongdoing and claimed that the settlement was to allow MAS to focus its full attention on further strengthening its business and to keep its legal costs to a minimum.6

**Abuse of a dominant position**

Merely being in a dominant position is not unlawful; it is the abuse of a dominant position that is prohibited under competition law.7 Examples of an abuse of a dominant position in the airline industry include imposing excessive, predatory, or discriminatory pricing; the exclusive application of only one tariff on a given route; offering discounts or commissions with a view to excluding competitors from the market; and refusing to supply or allow access to essential facilities.

**Predatory pricing**

Predatory pricing is a huge concern amongst the airlines in the fight for larger market share. Predatory pricing is where a company sets the price for its products or services below the cost of producing or providing the products or services in order to force its competitors to exit the market. Once the competitor is eliminated, the company will then raise its price to an exorbitant level to recoup loss of revenue suffered during its predatory pricing exercise.

In 2008, AirAsia claimed that MAS had engaged in unfair competition and predatory pricing in its “Everyday Low Fares” campaign.\(^8\) While the claim was subsequently found to be baseless, it highlighted the risk of engaging in predatory pricing. However, in light of the collaboration, it is unlikely that there will be any predatory pricing. Instead, it is likely that airfares in both airlines will be aligned to complement each other in their respective market segments.

**Frequent flyer programmes**

Frequent flyer programmes and corporate discount schemes which have the effect of providing incentives for customers to stick to one particular airline may be viewed as creating an anti-competitive effect. Similarly, travel agent commission agreements which tie travel agents to one particular airline and discourage them from selling tickets for other airlines may be anti-competitive and should generally be avoided. For example, British Airways was found to have abused its dominant position by operating a commission scheme that had the effect of excluding British Airways’ competitors from the UK markets for air travel.

**The MAS-AirAsia Collaboration**

The collaboration will see MAS and Firefly concentrate on providing full service long and short haul flight services while AirAsia and AirAsia X will focus on low cost, no frills long and short haul flight services. On one hand, some may view that this as effectively reducing or removing competition as each airline will dominate a market segment with no competitor in that segment. On the other hand, it also appears that even with the collaboration, the airlines will continue to face competition from each other and from other airlines in the market. It is noted that consumers will still have sufficient options to fly with many other airlines in the market.

Tan Sri Tony Fernandes, the Group CEO of AirAsia, has assured the public that AirAsia’s identity as a low-cost airline will not be changed as the collaboration is aimed at focusing on the core competency of each airline and to foster closer collaboration between the airlines so as to enable them to compete with other big players in the industry.\(^9\) As such, so long as the...

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airlines comply with the applicable laws, including competition law, the collaboration may eventually yield greater benefits to consumers.

**Conclusion**
The International Chamber of Commerce has recognised that the trend of forming alliances and other forms of cooperation among airlines is increasing and that it can be beneficial to the industry and consumers. However, it also felt that these cooperative agreements must be subject to fair and objective competition rules so as to create a stable and predictable legal environment and, at the same, protect the rights and interests of other airlines and players in the industry.\(^{10}\)

Under the Act, companies which are found to have infringed any of the prohibitions may be liable to a fine of up to 10% of their global revenue for the period during which the infringement occurred. Directors, CEOs, COOs and managers may also be severally and jointly liable to hefty fines and imprisonment. Despite being separate legal entities, a parent company and its subsidiaries will be considered as a single enterprise if they form a single economic unit within which the subsidiaries do not enjoy real autonomy in determining their actions on the market. Anyone who has suffered loss or damage as a result of the infringement also has the right to take civil action against the company.

It would be interesting to see how these two airlines, which have previously been regarded as competitors, will collaborate with each other instead. Will they no longer be in competition and, if so, will the law allow that?

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