# Competition Law Consultation Paper

# - Representation by Valuair Limited

# Contents


1 Status Of Airline Industry And Should Competition Laws As They Exist Apply To The Airline Industry ..... 2
2 Undertaking Should Include Group Companies ..... 4
3 Guidelines Relating To Predatory Behaviour ..... 4
3.1 Constraint Incumbent's Ability To Reduce Fares ..... 4
3.2 Guidelines On What Amounts To Predatory Behaviour In The Airline Industry 5
3.3 Provision Of Fair Ground Handling Services ..... 6
3.4 Frequent Flyer Programmes ..... 6
3.5 Guidelines Must Be Binding ..... 6
3.6 Guidelines On Enforcement ..... 7
4 Dissimilar Conditions To Equivalent Transactions ..... 7
5 Combining Products For Sale In The Airline Industry ..... 8
6 Powers Of Investigation - Extent Of Confiscation ..... 8
7 Meaning Of "Any Person" ..... 8
8 Timelines In Applications And Appeals ..... 9
9 Timelines For Retention Of Documents ..... 9
10 Protection For Complaints And Frivolous Complaints ..... 9
10.1 Whistle-Blowing ..... 9
10.2 Leniency ..... 10
10.3 Dealing With Frivolous Complaints ..... 10

# Competition Law Consultation Paper

# – Representation by Valuair Limited

Valuair Limited ("Valuair") welcomes this opportunity to provide feedback to the Ministry of Trade and Industry ("MTI") on the Consultation Paper and draft Competition Law Bill ("Proposed Act"), which was issued on 12 April 2004. The feedback provided by Valuair is focused on the airline industry and draws from experiences in key jurisdictions.

Valuair would be happy to discuss any of the comments made here further with the MTI.

## 1 STATUS OF AIRLINE INDUSTRY AND SHOULD COMPETITION LAWS AS THEY EXIST APPLY TO THE AIRLINE INDUSTRY

The airline industry has been characterised by an increasing number of new entrants into an arena where incumbents, given their historical and economic powers and dominant positions, are able to drive them out within a short space of time. Competition for new entrants has been difficult and least because of high structural and regulatory entry barriers. Yet, there are a number of benefits that arise in ensuring greater competition in the airline industry.

The following passages from a speech delivered by Roger W Fones, the Chief, Transportation, Energy and Agricultural Section of the Antitrust Division of the US Department of Justice at an American Bar Association Forum on Air and Space Law bears testimony to this:

> "Even casual observers of the airline industry are familiar with the significant consumer benefits that can result when an upstart airline enters a market -- fares drop and capacity and frequencies increase, sometimes dramatically. It is not unusual for a deep fare cut to double the demand for airline service on a city pair. This not only confirms that competition is good for consumers, but also demonstrates that actual competition enhances consumer welfare far more than the threat of potential entry. Because of its beneficial effect on competition and consumer welfare, the Antitrust Division has a strong interest in assuring that new entry is not thwarted by anticompetitive behaviour by incumbent airlines.
>
> "It is not surprising that Incumbent carriers respond to new entry. The combination of low fares and increased demand may prompt an Incumbent to increase its own service. If it matches the entrant's fares across the board, Incumbent may increase its capacity to handle profitable new traffic generated by the lower fares; and if Incumbent only lowers fares selectively, Upstart may grow, perhaps eventually building a competing hub and spoke network of its own. Either way, the consumer is better off. This is the essence of the competitive process.

> "In some cases, Upstart's lower operating costs and high load factors allow it to survive and even prosper; in other cases, too many passengers decide that the new lower fares offered by Incumbent, combined with other amenities such as better schedules, frequent flier programs, passenger lounges and in-flight service, are a better value than Upstart offers. The higher frequencies and network efficiencies of Incumbent sometimes more than counterbalance the lower operating costs of Upstart; Upstart fails to maintain profitability and must exit. After Upstart's exit, Incumbent's fares and service offerings quickly move back toward pre-entry levels, much to the chagrin of passengers.
>
> "If Upstart is forced to exit a route, it often believes that it has been the victim of 'predation'" -- that is, Upstart suspects Incumbent lowered its fares in order to drive Upstart from the route, and then raise fares back to the previous, highly profitable level. Although an encouraging number of new low cost airlines have begun service, some have foundered or failed in the face of intense competition. It is important that the antitrust enforcement agencies and the courts correctly identify and prevent any instances where Upstart's exit or failure is the result of illegal predation."

It is against such a background, which continues to plague the airline industry, that Valuair submits this representation.

Valuair supports the introduction of competition laws. However, Valuair proposes that there be an express set of guidelines detailing how competition law is to apply to the airline industry. This has been the approach taken in each of the major jurisdictions where competition laws operate, including Canada, the US and the EU. This approach recognises that different industries warrant different treatments and application as regards what is anti-competitive, and that all industries are not forced into a one-size fits all model.

The aim of the guidelines is not to exempt the airline industry from competition laws, but rather to recognise the unique nature of the market and to ensure better regulation. The following should be dealt with in guidelines:

- Efficient interventions against predatory pricing and other abusive behaviour
- Prohibition on airline price cooperation through tariff consultations
- Adequate control of airline mergers and alliances
- Open and non-discriminatory business conditions in travel agent agreements
- Interventions against anti-competitive effects of corporate discount schemes
- Efficient restrictions on frequent flyer programmes
- More efficient and non-discriminatory slot allocation procedures
- Enhanced competition between airports
- Enhanced access to ground handling and other infrastructure services

## 2 UNDERTAKING SHOULD INCLUDE GROUP COMPANIES

The Proposed Act defines the word "undertaking" widely. This means that the anti-competitive provisions will also catch all inter-group company dealings.

Such an approach does not accord with commercial reality nor with the way the Competition Commissions in other jurisdictions have interpreted the scope of "undertaking". Competition Commissions particularly in the EU have interpreted "undertaking" to recognise group companies as being a single economic entity.

Valuair is of the view that Singapore should adopt the approach the other Commissions have taken by providing expressly that "undertaking" will exclude group companies. This would avoid any potential for doubt. There must also be a definition of what constitutes group companies. For this purpose, Valuair proposes that the definition be stated with precision. Specifically, Valuair proposes that the definition extend only to ownership, so that only wholly owned subsidiaries and majority owned subsidiaries fall within the scope of the single economic entity rule.

## 3 GUIDELINES RELATING TO PREDATORY BEHAVIOUR

As proposed in section 1 of this submission, guidelines should be introduced to regulate the airline industry so as to keep anti-competitive behaviour at bay. Some suggestions as to what such guidelines should deal with are provided in the following sub-sections.

### 3.1 Constrain Incumbent's Ability To Reduce Fares

To increase competition in the airline industry, one of the most effective manners would be to place restrictions on the incumbent's ability to lower its fares. Valuair is not calling for an outright prevention of the incumbent to lower its fares, but rather to place conditions on how it does it.

Where it is evident that the incumbent has lowered fares to match a new entrant's low fares on a route, the incumbent should be made to retain that lower fare for a fixed period of time to show that it is genuine about meeting competition rather than merely driving out the competition. The fixed period should be one that is realistic, say for at least two (2) years.

The requirement to maintain the lower fares should not only be imposed where the incumbent has indeed been shown to have engaged in predatory pricing, normally defined as pricing below variable and or marginal costs. The requirement should apply as long as the fare is lowered to match the new entrant's fare.

Such an approach will indeed ensure greater consumer welfare by the introduction of new entrants who are given a fair chance at competing in that market.

### 3.2 Guidelines On What Amounts To Predatory Behaviour In The Airline Industry

As observed in the previous section 3.1, predatory behaviour should not be found only if the incumbent lowers its fare such that it is below variable costs or marginal costs. To restrict it to such a narrow consideration is not reflective of the airline industry as a whole where major carriers, who are usually the incumbents, operate differently from budget carriers.

Given that there is a difference between the two types of carriers, guidelines should be introduced to define the scope of when predatory behaviour is found in the airline industry. The guidelines could include the following pointers (not exhaustive):

- An incumbent introducing a route, previously non-existent for the incumbent, simply because a new budget entrant has entered the market with that route.

- An incumbent introducing an additional flight to a route at a timing similar to or very close to that of a new budget entrant in the market.

- An incumbent providing additional frequent flyer miles (say double or triple what is normally offered for that route) to a route introduced which matches closely the route and timing of a new budget entrant.

- An incumbent introducing bulk discounts to corporate clients where none existed previously on the routes, which matches closely the route and timing of a new budget entrant.

- Tying in or threatening travel agents such that they are prevented from selling the tickets of the new budget entrant. Agreements with travel agents can be viewed as a vertical arrangement, which is exempted pursuant to the Third Schedule of the Proposed Law. Yet, such arrangements do seriously constrain budget airlines' access to travel agents. In the EU, such agreements are viewed as anti-competitive and guidelines to that effect have been provided.

The guidelines on this front should also specify what costs which will not be considered when determining what amounts to engaging in predatory behaviour. This has been referred to as "allowable costs" in Canada, for instance. To simply go with the general interpretation of variable costs or marginal costs may not be as effective in the airline industry given that the nature of the costs involved vary considerably. Indeed the Competition Tribunal in Canada (until recently) as well as the Commission in the EU have not consistently applied when the incumbent's costs are considered to have dropped so low that it is considered predatory. Guidelines can help alleviate some of the uncertainty in this area.

### 3.3 Provision Of Fair Ground Handling Services

The guidelines should deal with ensuring fair provision of ground handling services. Budget airlines, as opposed to major carriers, require less ground handling services. They typically do not require catering services, nor the more advanced baggage handling systems necessary for interlining.

It is common for large carriers to operate their own ground handling services, occasionally through subsidiary or associated companies. This could lead to budget carriers being provided with less competitive terms for ground handling.

Valuair recognises that it is not entirely possible to have one or more independent ground handling services, which really is the only way to ensure the most effective competition amongst service providers. But it proposes that to counter the potential anti-competitive behaviour that budget carriers may be subjected to, clear guidelines are necessary.

### 3.4 Frequent Flyer Programmes

Major carriers globally tend to offer travellers frequent flyer programmes, which include mileage accruals which can be exchanged for free flights and upgrades amongst other things. The purpose of such frequent flyer programmes is to encourage customer loyalty. Such programmes clearly have the potential to distort the market.

Given that budget carriers are unlikely to offer the same attractive terms, major carriers, including incumbents, can use such programmes to impede competition. Attention should be paid to circumstances when the frequent flyer miles or rewards are specifically increased to entice the customer to fly certain routes at certain times, which are in direct response to the entry by the budget carriers. Valuair thus recommends guidelines to be introduced on this front, so that airlines are guided as to when the provision of frequent flyer air miles will be viewed as impeding competition.

### 3.5 Guidelines Must Be Binding

Section 61(1) of the Proposed Act provides that guidelines will be issued to undertakings to order their affairs to ensure compliance with the competition laws. Thus, Valuair's proposal for guidelines can be issued under this section 61(1) of the Proposed Act.

Section 61(4) of the Proposed Act, however, could restrict the effectiveness of the guidelines as it provides that the guidelines are not binding on the Commission. This should be modified to allow the guidelines to be equally binding on the Commission as well so that the guidelines can be used as a shield against the Commission too.

### 3.6 Guidelines On Enforcement

In providing guidance on when predatory behaviour is to be found, as discussed in the preceding sections, there must also be guidance on how enforcement will be effected. Canada has, in this regard, introduced a set of Enforcement Guidelines on the Abuse of Dominance in the Airline Industry in February 2001. That could be a possible approach to adopt. To do so, would lead to greater certainty as to how competition will be regulated in the airline industry.

## 4 DISSIMILAR CONDITIONS TO EQUIVALENT TRANSACTIONS

Sections 34(2) and 47(2) of the Proposed Act provide, inter alia, that the following is reflective of anti-competitive behaviour or abuse of dominance respectively:

> "apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage."

This prohibition is too wide, and may prove to be counter-productive, especially given the use of the phrase "equivalent transaction". The phrase "equivalent transaction" is not defined and will capture all transactions, which have the same qualities. It does not contemplate that the transaction could be with differing trading parties with differing qualities. The provision can therefore extend to differing pricing terms being offered to one trading party who has good financial credentials as opposed to another trading party who is a new customer. Although this could not have been the intent of the legislation, it is a possible impact.

In the airline industry, there are also a number of instances where dissimilar conditions have to be applied to ensure greater business efficacies, respecting different trading methodologies and proper risk management. These include the following:

- Different pricing structure and terms and conditions of transactions applying to volume purchases as opposed to once off customers.

- Different point of purchase / sale. To illustrate, fares quoted on-line might be different from fares quoted by travel agents or by the call centre.

- Related product-bundling which has value-added benefits to the service provided and which have as its ultimate effect greater consumer welfare. To illustrate,to bundle hotel accommodation, car rental, airport transfers, sightseeing tours, travel insurance etc with the sale of an airline ticket would be value added services to the provision of airline tickets, and ought to be allowed provided it is beneficial to the consumer and there is an opt-out choice afforded to the consumer.

The illustrations cited do not have as their objective the prevention restriction or distortion of competition, but could unknowingly have the effect of preventing, restricting or distorting of competition. Given that section 34(1) of the Proposed Act is all encompassing, the stated illustrations could fall foul of that provision. They may not, however, fall foul of section 47 of the Proposed Act as an abuse of dominance must be shown in the latter instance.

## 5 COMBINING PRODUCTS FOR SALE IN THE AIRLINE INDUSTRY

Section 34 of the Proposed Act is very wide and can potentially prohibit all horizontal arrangements that airlines may enter into with their competitors. Valuair proposes that appropriate wording should be introduced into the provision so that where it can be clearly shown that where such agreement, including the bundling or tying does have commercial benefits to the consumer, it should be permissible.

Bundling or tying (ie making the purchase of a good dependent upon the purchase of some other good or service) is caught by sections 34(2) (e) and 47(2)(d) of the Proposed Act. Such transactions are a very common feature in the airline industry. One example is where an airline offers customers a discount on their airline ticket on the condition that the customers also purchase insurance from a named company.

On the face of the provisions stated, such a bundled product would clearly be regarded as anti-competitive. Yet, the ultimate benefit to consumers could be higher than the apparent anti-competitive effect that it has. Also, the customers are not forced to acquire the product and can always opt for alternatives from other competing airlines. As such, where the benefits of such a practice clearly outweighs any potential distortion or restriction in competition that it might have, then the conduct should be permitted. The problem with the relevant provision however is that it is stated in very wide terms. It leaves much to chance in determining whether the transaction would be struck down or otherwise. Of course an exemption could be applied for, but it adds unnecessary costs and reduces business efficiency.

Valuair therefore proposes that guidance be provided on how the provision on bundling in a horizontal agreement should apply. It should in fact be made clear that where the arrangement has clear pro-competitive and beneficial qualities to customers, it should be allowed, although as a by-consequence it has anti-competitive effects.

## 6 POWERS OF INVESTIGATION - EXTENT OF CONFISCATION

The Commission's power to take away documents with or without a warrant is widely stated. The relevant provisions state that the Commission can take away documents that have "a bearing on the investigation", that is "relevant to the investigation", or that is "of the relevant kind".

Such a wide power if exercised can be disruptive to the business operations. As a compromise, the business should be allowed to make copies or retain such equipments under prescribed conditions to enable the business to carry on its business.

## 7 MEANING OF "ANY PERSON"

The provisions dealing with the Commission's power to conduct investigations generally provide that the Commission or any inspector can inter alia require "any person" to produce a document. This is very wide. The scope of who can be required to provide documents should be narrowed.

Additionally, given the wide scope of the section, even past officers and employees can be called upon for investigation. If so, who has the onus of ensuring that the officer or employee attends at the investigation? An employer will obviously be placed in a difficult position, as the employer is unlikely to be in a position to ensure that an ex-officer or ex-employee attends at investigations. The problem is exacerbated as far as the airline industry is concerned as many foreign employees, including pilots, are employed who leave Singapore once their term of employment ends. It would be a heavy onus to place on employers.

## 8 TIMELINES IN APPLICATIONS AND APPEALS

The Proposed Act is silent on the procedures that the Commission and the Board of Appeal will adopt for hearings. The Proposed Act also does not provide any timelines within which the Commission and the Board of Appeal must hear submissions and hand down its decision?

Valuair proposes that guidance must be provided on procedures and timelines. Providing guidance on the timelines is an important requirement that aids certainty as to what are key target dates for the filing of requisite documents and the grant of the final decision. This will enable businesses to better plan their activities without the concern of pending complaints hanging over them.

Without timelines clearly set out, there is a possibility that a party intending to commence a private action may fall foul of the limitation of actions provisions contained in the Limitation Act. If no guidelines on timelines are to be introduced, then Valuair proposes that a proviso be included to clarify that the cause of action for any private action will only accrue at the point the final decision is handed down.

## 9 TIMELINES FOR RETENTION OF DOCUMENTS

The Proposed Act is silent as to the length of time that documents and other relevant materials should be retained for the purposes of investigation. Valuair proposes that a similar timeline as that stated under the Income Tax Act as well as the Companies Act be adopted, so that documents need only to be retained for a period of no more than seven (7) years.

## 10 PROTECTION FOR COMPLAINTS AND FRIVOLOUS COMPLAINTS

### 10.1 Whistle-blowing

The Proposed Act is silent as to the position of whistle-blowers, save possibly for section 78(1)(c) of the Proposed Act which requires the Commission to maintain the secrecy of the complainant or person who provided any information. However, this provision is limited in application, and so there is merit in introducing provisions to encourage whistle-blowers. This is because anti-competitive behaviour is difficult to detect.

The relevant provision should allow directors, officers and other employees of the company purportedly engaging in anti-competitive behaviour to notify the Commission if the company is in breach of any anti-competitive laws, without fear of reprisals, including unfair dismissals, demotion in position, and deduction in salaries and other employment terms and conditions. At the very least such a person should be accorded immunity from prosecution or from civil liability.

### 10.2 Leniency

With increased whistle-blowing activities, the Commission would have its hands full. Valuair thus suggests that leniency provisions be introduced to give some measure of flexibility to the Commission to deal with the offenders.

### 10.3 Dealing With Frivolous Complaints

Although whistle-blowing is encouraged, frivolous complaints should be discouraged. This is because such complaints could result in unnecessary increased costs for the business affected by the investigations. It can also result in disruption to work in the event that documents and equipment are removed from the premises of the business. The Proposed Act is silent as regards frivolous complaints. Valuair proposes that a procedure be introduced on how frivolous complaints should be handled, including the possibility of imposing sanctions.

---