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ARTICLE

High Court of Australia Holds Failed Airline Accountable to Global Airline Clearing House

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Introduction

The attack on the World Trade Centre on 11 September 2001 was a crippling event for the airline industry worldwide. But less than 24 hours after the attacks, the Australian airline industry was hit by another crippling event – the decision by the Board of Ansett Australia to place Australia's second largest airline into administration.

Ansett was a dominant player in the Australian airline industry for over 50 years. Its demise left thousands jobless and many creditors unpaid. One such creditor was the International Air Transport Association ('IATA'). IATA, formed in Canada in 1945, acts as a Clearing House for the hundreds of thousands of transactions that occur between airlines worldwide each month in relation to the carriage of passengers and cargo. Ansett joined IATA in 1951. Under the Clearing House system, the netting of monthly transactions in the clearance process would result in each member airline either receiving a single payment from IATA at the end of each month or making a single payment to IATA.

After Ansett was placed in administration, a dispute arose between IATA and the Administrators of Ansett as to IATA's status as a creditor. IATA argued that it was a creditor of Ansett as a result of Clearing House monthly clearances conducted in August to December 2001 (inclusive). The transactions cleared in those clearances had been performed but not cleared through the Clearing House prior to Ansett being placed in administration. The Administrators did not acknowledge IATA as a creditor of Ansett. They argued that the relevant transactions which had been cleared through the Clearing House (and in respect of the balance of which IATA claimed to be a creditor) gave rise to debts owing by and to Ansett (with other airlines). On this basis, the Administrators argued that the clearances purported to deal with the property of Ansett (being the debts said to be owed to it by other airlines) otherwise than in accordance with the insolvency laws by allowing for multilateral netting. Accordingly, the Administrators refused to acknowledge the operation of the August to December 2001 clearances of the Clearing House in so far as those clearances included claims by or against Ansett. The Administrators argued that the proper way of dealing with the transactions, that had not been cleared as at the date Ansett was placed in administration, was for airlines who were 'debtors' to Ansett as a result of those transactions to pay Ansett, and for those airlines who were 'creditors' of Ansett to lodge a proof of debt in Ansett's administration.

IATA commenced proceedings in the Supreme Court of Victoria in 2002[1] seeking to be recognised as a creditor of Ansett. In these proceedings, Justice Mandie found in favour of IATA. The Administrators appealed to the Court of Appeal of the Supreme Court of Victoria[2] who found in favour of the Administrators by a majority of 2:1.

IATA was granted special leave to appeal to the High Court of Australia in April 2007 and, in February 2008, the High Court delivered judgment in favour of IATA by a majority of 6:1.[3]

The proceedings concerned similar issues to those dealt with in the House of Lords decision in *British Eagle International Airlines Ltd v Compagnie National Air France* [1975] 1 WLR 758 ('*British Eagle*'). In *British Eagle*, it was held that IATA's Regulations, as they stood at that time, were contrary to the public policy and the provisions of the UK Companies Act. This finding was based on the majority of the House of Lords' view that the relevant contractual agreements gave rise to debts between individual member airlines in respect of transactions performed for each other. IATA's contractual documents had been amended in the light of *British Eagle* and the amended documents applied in the Ansett proceedings. The other difference between the Ansett proceedings and *British Eagle* was that *British Eagle* was

Notes

1 *International Air Transport Association v Ansett Australia Holdings Ltd (subject to Deed of Company Arrangement)* (2005) 53 ACSR 501.
2 *Ansett Australia Holdings Ltd (subject to Deed of Company Arrangement) v International Air Transport Association* (2006) 60 ACSR 468.
3 *International Air Transport Association v Ansett Australia Holdings Limited* [2008] HCA 3.

placed in liquidation, whereas Ansett was placed in voluntary administration and had subsequently executed a deed of company arrangement.

The High Court of Australia's decision

There were two key issues to be determined by the High Court:

1. whether, on the proper construction of the Regulations and Agreements, the only legal relationship of debtor and creditor that existed was that between Ansett and IATA rather than between Ansett and individual member airlines; and
2. whether the IATA Regulations and Agreements were contrary to the public policy of the insolvency provisions regulated by the Corporations Act 2001 and the Deed of Company Arrangement executed by Ansett.

Each of these issues is addressed separately below.

IATA's Regulations

An airline wishing to attain membership of IATA is required to execute various agreements between the airline, IATA and other member airlines of IATA. These agreements include the Multilateral Interline Traffic Agreements relating to the carriage of passengers and cargo (the 'Agreements'). The Agreements provide for member airlines to perform services for each other by carrying passengers and/or cargo.

Article 8 of the Agreements states that member airlines agree to pay each other member airline in relation to such transactions 'in accordance with the applicable regulations and current clearance procedures of the IATA Clearing House'. Regulation 9(a) of the Clearing House Regulations ('the Regulations') was held by the majority of the High Court to be the critical regulation which sets out the legal relationship between IATA and member airlines and as between each individual member airline. It states:

> 'With respect to transactions between members of the Clearing House which are subject to clearance through the Clearing House ... no liability for payment and no right of action to recover payment shall accrue between members of the Clearing House. In lieu thereof members shall have liabilities to the Clearing House for balances due by them resulting from a clearance or rights of action against the Clearing House for balances in their favour resulting from a clearance and collected by the Clearing House from debtor members in such clearance'

IATA argued that the Agreements and Regulations, particularly regulation 9(a), gave rise to a debtor-creditor relationship between IATA and Ansett only and that no such relationship existed between Ansett and other member airlines in respect of transactions cleared through the Clearing House. Justice Nettle, who delivered the Court's judgment against IATA in the Court of Appeal decision, conceded that 'if reg 9(a) stood alone, it would be hard to resist [IATA's] argument'.[4]

The Administrators argued that Regulation 9(a) did not create a debtor-creditor relationship between IATA and individual member airlines exclusively and that the Regulations and Agreements, when read and interpreted as a whole, in fact created a debtor-creditor relationship between individual airlines. The High Court accepted IATA's argument that the Regulations and Agreements give rise to a debtor-creditor relationship between individual member airlines and IATA (and not between member airlines themselves), and found that this relationship is not contradicted by other terms of the IATA Regulations so as to deny its effect. Chief Justice Gleeson stated:

> 'Regulation 9(a) means what it says. It cannot be ignored. It is not repugnant to some overriding provision. It is consistent with the other provisions. It makes good commercial sense. It should be given effect according to its terms.'[5]

His Honour went on to find that 'the property of Ansett did not include debts owed to it by other airline operators and the liabilities of Ansett did not include debts owed by it to other airline operators'.[6] His Honour used the words of Lord Morris, one of the Lords in the minority in the House of Lords in *British Eagle*, in describing the nature of Ansett's rights:

> 'The relevant property of Ansett was "the contractual right to have a clearance in respect of all services which had been rendered on the contractual terms and the right to receive payment from IATA if on clearance a credit in favour of the company resulted".'[7]

Accordingly, the Court found that pursuant to the terms of the IATA Regulations, 'no liability to effect payment arises between airlines and the only debt or credit which arises is that between IATA and the member airline in

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4 (2006) 60 ACSR 468 at [95].
5 [2008] HCA 3 at [22].
6 [2008] HCA 3 at [23].
7 *Ibid.*

relation to the final, single balance of all items entered for the relevant clearance'.[8]

British Eagle and the public policy argument

The Administrators sought to rely upon the *British Eagle* decision of the House of Lords to argue that the Clearing House arrangements were 'repugnant' to the insolvency laws governing the administration of Ansett. In *British Eagle*, the House of Lords, by a majority of 3:2, found that the Agreements and Regulations, as they stood at that time, on their proper construction, created a debtor-creditor relationship between individual member airlines. Further, the majority found that the Clearing House system was at conflict with, or an attempt to by-pass, the insolvency laws and, in particular, by seeking to circumvent the principle that creditors of an insolvent company should be paid on a *pari passu* or equal basis. The House of Lords held that it was contrary to public policy to allow the 'mini liquidation' of the IATA Clearing House (in reference to the multilateral netting that occurs in the clearance process) to prevail over the general liquidation with the result that Clearing House members are paid in priority to other creditors of British Eagle. In the Ansett case, Justice Kirby, in his dissenting judgment, illustrated this point in the following way:

> '… creditors of an insolvent company must not "be allowed to leave [their] assigned place in the queue and step ahead of others". Airlines have to deal all the time with passengers and shippers who try to jump the queue. Such conduct is not acceptable at airports or in airline offices. Nor, without clear and express legal authority, is it acceptable in the courts of law or elsewhere, once the provisions of insolvency law have been engaged and apply.'[9]

The High Court recognised that this case differed from *British Eagle* in various respects. Importantly, the terms of IATA's Regulations had been amended since the decision in *British Eagle*. In fact, IATA specifically amended the Regulations after the *British Eagle* decision so as to more accurately reflect the intent of the member airlines to create a debtor-creditor relationship solely between individual member airlines and IATA (rather than between member airlines themselves). The Court also acknowledged that this proceeding arose in the context of an administration pursuant to Part 5.3A of the Corporations Act 2001, rather than a liquidation, as was the case in *British Eagle*.

The Administrators' arguments in relation to public policy were wholly rejected by the majority of the High Court. The Court determined that the IATA Regulations were not, in their current form, repugnant to the insolvency laws governing the Ansett Administration or the terms of the Deed of Company Arrangement executed by Ansett. This finding followed from the majority's finding that the Agreements and Regulations only gave rise to debtor-creditor relationships between each individual airline and IATA. Specifically, the Court found that the rights and obligations of IATA, pursuant to the Regulations, were not affected by the supervening administration of Ansett, and Ansett's Administrators took those rights and obligations (being rights and obligations between IATA and each individual airline) as they found them. Further, the Court stated that the 'rule of public policy [asserted by Ansett] finds no footing in the relevant provisions of the [Act]' and that 'those provisions take effect according to their terms and are not to be supplemented or varied by the superimposition of a rule [of public policy] of the kind alleged.'[10] By rejecting the existence of a relevant 'rule of public policy', the majority gave primacy to the statutory nature of Australian insolvency law. The majority of the Court did not however need to express an opinion on whether, if the true effect of the Agreements and Regulations was as asserted by Ansett, the Clearing House clearances effected after Ansett was placed in administration would have been held to be invalid by reason of an inconsistency with any of the statutory provisions or provisions of the Deed of Company Arrangement executed by Ansett.

Conclusion

The result of the High Court of Australia's judgment is that the Administrators must recognise IATA as a creditor of Ansett and they cannot pursue airlines in respect of transactions cleared in the August to December 2001 clearances.

Aside from these immediate consequences, the judgment is of significant importance in the following respects:

1. the judgment preserves the integrity of the IATA Clearing House and the continued application of the Clearing House Regulations, as a matter of Australian law, to claims relating to members who become insolvent in respect of transactions performed but not cleared as at the date of the member's insolvency;

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8 [2008] HCA 3 at [60].
9 [2008] HCA 3 at [179].
10 [2008] HCA 3 at [93].

2. the decision of the High Court of Australia, whilst only binding in Australia, will be of persuasive effect as a precedent in Courts of other countries in which similar issues may arise in the future; and
3. the judgment provides some guidance for the formulation of similar multilateral netting arrangements for use in other industries.

The High Court's decision is of significant importance for the international aviation industry as it preserves the integrity of an institution which is efficient and has significant commercial benefits. The judgment may also be of significance in other industries in which clearing houses operate, although the operation of each clearing house (and the manner in which that operation changes in the event of insolvency, if at all) will depend upon the terms of the documents governing its operation.

International Corporate Rescue

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