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# AVIATION AND THE INTERNET

## HEARING

BEFORE THE

## COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

JULY 20, 2000

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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

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# AVIATION AND THE INTERNET

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**THURSDAY, JULY 20, 2000**

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
*Washington, DC.*

The Committee met, pursuant to notice, at 9:30 a.m., in room SR–253, Russell Senate Office Building, Senator John McCain, Chairman, presiding.

## OPENING STATEMENT OF HON. JOHN McCAIN, U.S. SENATOR FROM ARIZONA

The CHAIRMAN. Good morning. I want to thank our witnesses for being here today to discuss the remarkable revolution that is underway with regard to travel purchase on the Internet. Analysts have concluded that travel rates are the number one product that consumers want to buy on the Internet. Perhaps that is the best indication that we have of the potential benefits that the Internet offers air travelers.

American, Continental, Delta, Northwest and United Airlines recently announced their joint efforts to establish an airline-owned travel agency called Orbitz. Orbitz plans to use a relatively new and sophisticated software program to analyze airline flight and fare data for its consumers, to provide them with the best travel options. The test site for the software is impressive.

Even so, the announcement has caused a great deal of controversy. Consumer advocates question whether collaboration among competitors can ever operate in the best interests of air travelers. Concerns have been heightened by the prospect of additional consolidation in the airline industry.

This hearing intends to examine what consumers stand to gain and what they stand to lose from the advent of on-line travel agencies, including Orbitz. What this hearing does not intend to do is focus on what Orbitz's established competitors, namely Travelocity and Expedia, stand to lose from Orbitz's presence in the market. These competitors are engaged in a pitched battle for the growing Internet travel business. By and large, it is up to the marketplace to decide how each competitor ultimately fares, and I strongly believe that such competition will ultimately benefit the consumer.

I suspect that the reaction of the low fare air carrier community to Orbitz is one way for us to gauge the effect that Orbitz will have on competition in the industry. Like it or not, we depend on low fare air carriers for nearly all of the benefits of deregulation. The Department of Transportation estimates these benefits to be $6.3 billion in annual savings to airline passengers.

We need to explore why Southwest Airlines, for example, submitted testimony today stating its unalterable opposition to Orbitz. Orbitz claims to offer, for the first time, competition on the Computer Reservation System booking fee, which would disproportionately benefit the low fare carriers. Why, then, aren't the low fare carriers racing to sign up for these benefits?

The Committee has a history here. Several of us were around when the airlines created Computer Reservation Systems (CRS) for travel agency use to search flight and fare data for their consumers. We found that over time, the airline owners used CRS to disadvantage their competitors. Among other things, they used display bias to shift sales to their airlines, and they used their market power to impose excessively high fees on participating non-owner airlines.

I realize that Orbitz is technically different from the stand and Computer Reservation Systems. However, many of the same problems face us now that faced us when the CRSs were established. It would be foolish for us to ignore our past experience. We need to look at the down-the-road market power of a site that may be the only outlet for the best deals that the airlines have to offer.

[The prepared statement of Senator Gorton follows:]

PREPARED STATEMENT OF HON. SLADE GORTON, U.S. SENATOR FROM WASHINGTON

In a relatively short period of time, the Internet has transformed many aspects of social and economic life in the United States. One of the most important facets of this phenomenon is the development of electronic commerce. The Internet has empowered many consumers by giving them access to seemingly limitless sources of information. Comparing prices and options in various marketplaces has never been easier for an expanding number of buyers, and free markets tend to work best when the flow of information is maximized.

Within this wide open world of the Internet, travel-related information and services form one of the fastest growing sectors. It has been reported that more than 1,000 travel sites have emerged on the Web, offering a staggering array of choices. While sales through the Internet have lagged behind the boom in Web sites, online purchasing is certain to make up an ever-increasing share of all travel bookings. As a general rule, the more competitors there are in such an environment, the better it is for consumers. An exception to this rule would be the presence of a competitor that wields enough market power to tilt the playing field.

The joint venture by the airlines, known as Orbitz, appears to have characteristics that could give it substantial market power. On its face, the banding together of the largest air carriers should give anyone reason to be concerned. None of the major airlines is in business to sell tickets at the lowest possible prices. It is counterintuitive to assume that the big airlines are coming together to do anything other than make more money. One-stop shopping for low air fares is certainly an attractive lure for consumers in the short run, especially if Orbitz offers deals not found in any other single place.

If that lure moves market share to Orbitz, however, the joint venture may be able to act in subtle ways that harm consumers. The history of airline ownership of computer reservation systems (CRS) is a lesson we must keep in mind. Abuses were rampant before regulations were imposed. By then, much of the damage to airline competition had already been done. CRSs gave their owners artificial staying power, which worked to the detriment of carriers that entered the field after deregulation. Even after rules were imposed on the use of airline-owned CRSs, these systems were still able to steer more business to their owners. I recognize the differences between the Internet and CRSs, but there are enough parallels for us to be concerned about Orbitz.

Another troubling aspect of Orbitz is the so-called Most Favored Nation clause, which obligates participating airlines to give Orbitz access to all publicly available fares as well as anything that the airline offers to any other website. While MFN clauses can have benefits in other contexts, it is questionable in this instance. For example, other travel Web sites will never have a chance to best Orbitz by offering unique fares or related offerings. The airlines themselves will have less incentive to offer special Internet fares on their own Web sites because they will have higher distribution costs when those deals are purchased through Orbitz.

I am quite interested in what the witnesses have to say about these issues. Perhaps Mr. Katz from Orbitz can allay some of my concerns. I remain skeptical, however. The Departments of Transportation and Justice must scrutinize this joint venture carefully. Between this matter and the proposed merger of United Airlines and US Airways, both departments will have their hands full in the coming months. I believe their decisions with respect to these transactions will have a profound impact on the course of the airline industry for many years to come.

Again, I want to thank our witnesses for their appearance at this hearing. The first panel is Mr. A. Bradley Mims, who is the Deputy Assistant Secretary of Aviation and International Affairs, at the Department of Transportation, and the Hon. Ken Mead, who is the Inspector General of the Department of Transportation.

Thank you, Mr. Mims. Welcome, please proceed.

Before you do, who do you have with you today, Mr. Mead?

Mr. MEAD. I have Mr. Mark Dayton, of my staff, who directed this project.

The CHAIRMAN. Welcome, Mr. Dayton.

Mr. Mims.

[The prepared statement of Senator Hollings follows:]

PREPARED STATEMENT OF HON. ERNEST F. HOLLINGS,
U.S. SENATOR FROM SOUTH CAROLINA

Good morning. I want to thank the Chairman for holding this hearing on the sale of airline tickets through the Internet.

This Committee has a long history of looking at the distribution of air fares and other information through computers. We held several hearings on Computer Reservation Systems (CRS's) in the 1980's to review what the carriers/owners of the CRSs were attempting to do to the "have-nots." Today, with the creation of new technology, we are at that same point again. This time, the use of the Internet Web sites, even though the site will be owned by the airlines, is one that operates outside of the CRS rules that were crafted in the 1980's by the Civil Aeronautics Board (CAB), and that now fall under the auspices of the Department of Transportation (DOT).

Under the new venture, the big carriers have agreed to set up a new Web site to sell tickets. There are lots of these types of joint venture arrangements among companies to use the Web to conduct business. I want to encourage new technology and new innovations that benefit consumers. However, most of the new joint venture Web sites that have been created involve joint purchasing, not joint selling. The collection of 80–85% of the U.S. domestic airline industry—probably any industry—should give us pause to consider the competitive ramifications. If the owners of Orbitz can demonstrate that there is no harm to competition, and that pricing by the carriers is not adversely affected, I hope consumers find all of these low fares.

Right now, to the traveler, it does not always seem that we have much price competition, at least for those fares that are publicly available. When one carrier announces a fare hike, the other major carriers either match it or reject it. The proposed fare then either sticks or is withdrawn. As a result, for many markets, the publicly available fares are the same for each market. These are the types of fares we see in the papers. However, there is a whole other side to pricing—private fares that the carriers offer to corporations, travel agencies and vacation destinations, whether it is a golf resort or Disneyland. These deals are negotiated separately and are targeted at specific groups of customers.

The carriers also publish on their own Web site fares a series of fares, those that are publicly available through any travel agency, and fares that are only available through that Internet site. The carriers also send out targeted e-mails to selected customers, offering lower fares. Many times, these fares are for last minute flights that the carrier knows are not selling well—a sort of last minute fire sale. These types of fares are difficult for another carrier to track. Under Orbitz, some of these fares will become "publicly available." This could be a benefit to the consumer—he or she can instantly view all of these low fares through one Web site, rather than have to search each and every air carrier Web site. There is also a risk that must be considered. If carriers will be able to track, or be in a better position to track, pricing this may inhibit fare sales. This is potentially troubling and I know that DOT will look into this.

We also have the new electronic commerce navigators, like Travelocity and Expedia, that cut through all of the carrier price data to figure out the best fares for consumers. They use their search engines to plow through the Computer Reservation System data banks, effectively getting around the air carriers' "yield management" systems. Those systems try to squeeze the last dollar out of every consumer, offering seats at different prices, at different times for a particular flight.

We also know that the air carriers want to cut their distribution costs. Today, these costs are made up of a variety of fees—travel agency commissions, running from about 5% of the price of a ticket to a flat $10 per ticket for an Internet sale; and also CRS booking fees (about $3–$4 per segment booked).

The carriers/owners of Orbitz have complained that the CRS fees are too high, one of the reasons they cite for creating Orbitz. However, according to a June 1983 Report to Congress by the CAB, CRS booking fees were .25 cents in 1981, and there were different fares for different participants in a given CRS system. The Report also notes that CRS fees went up to $2–$3 per booking in 1982–83. While the major carriers complain about high CRS fees, and argue that they need to create a new competitor to drive down the CRS costs, what appears to be happening is that Internet travel agencies refuse to give back any rebate to the air carriers that they may get themselves from the CRS vendors. It is not uncommon for a CRS vendor to give any large travel agency an incentive rebate on an annual basis based on certain sales thresholds. Travel agents, whether it is on line, like Travelocity or a traditional travel agent, do not give these rebates back to the carriers.

CRS vendors, like Worldspan, the company that is providing the CRS services for Orbitz, is owned by two of the largest air carriers (and equity participants in Orbitz). Worldspan may set CRS booking fees that are too high, but the owners might have something to say about those fees.

This is an area that I urge DOT to look at carefully. I know that the Department of Justice is in the process of reviewing Orbitz, as well.

## STATEMENT OF A. BRADLEY MIMS, DEPUTY ASSISTANT SECRETARY, AVIATION AND INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF TRANSPORTATION

Mr. MIMS. Good morning, Mr. Chairman.

I appreciate the opportunity to appear before the Committee to address the issue of the marketing of airline services on the Internet. I also appreciate the Committee holding hearings on this issue, which is of great importance.

The Internet offers consumers new ways to shop for and book travel, but also provides airlines new ways to sell their tickets, and gives travel agents new tools to enhance and expand services to their consumers. This fast-evolving practice has the potential to be very beneficial to consumers.

Though this fast-evolving practice has this potential, and while we applaud the innovation being offered in this regard, the Department of Transportation also has a responsibility to ensure that new practices in airline services distribution do not become anticompetitive and/or harm consumers.

Because of the Internet's importance in airline services distribution, my office and the Office of the General Counsel have begun reviewing whether airlines' use of the Internet raises competition and consumer deception issues that may require Departmental action.

Since we have not completed our review, we have not come to any conclusions at this particular time. However, please allow me to make a few observations about developments to date.

In addition to providing consumers with convenient 24-hour access to comprehensive information on travel services, the Internet gives communities, especially smaller ones, an efficient, cost-effective way to market themselves.

The Internet also provides airlines and other travel suppliers with cost-effective methods for obtaining bookings. The Internet has also made possible the growth of on-line travel agencies, which last year captured just over half of all the airline bookings made through the Internet.

It is important to keep in mind that while the on-line travel environment is booming, it is also still a small piece of the travel distribution picture. Only 4 percent of all airline bookings were made on line in 1999, and on-line bookings are expected to account for 11 percent of all bookings in 2003.

Most airline tickets are still sold by traditional travel agencies. Not every consumer would be willing to buy travel on the Internet. A large number of travelers prefer to use travel agents, and many travelers value the personal relationship that they have with their travel agent. And the key part of that relationship is a travel agent's ability to solve problems if something goes wrong.

Some studies have shown that consumers are more likely to find the lowest available fare when they use a travel agency than when they use other sources of travel information.

In short, consumers do not just want to buy tickets; they want travel arranged for them. But we recognize the rapidly changing developments put significant pressure on travel agencies as they try to adapt to a new and very dynamic environment.

As with many developments that promise to benefit many consumers, the use of the Internet in airline distribution might in some ways present potential threats to consumers and competition.

The Department is aggressively examining these issues in order to carry out our responsibility to see whether airlines are engaged in activities that may constitute unfair or deceptive practices or unfair methods of competition. We have therefore requested Orbitz to answer a series of questions on its organizational and operating plans, and further, to provide documents relevant to our inquiry.

If Orbitz's organization and operational plans seem to involve practices that would violate the statutory prohibition against unfair methods of competition, we will take action to redress those problems.

As a separate matter, we are reviewing the enforcement complaint filed by the Association of Retail Travel Agents against the major airlines that created Orbitz. We will be considering whether that complaint warrants the institution of an enforcement proceeding.

The Justice Department is conducting its own investigation into Orbitz, and as Ken Mead will outline, the Inspector General's office is examining Orbitz and the airlines' use of the Internet.

In addition to our review of Orbitz, we are informally reviewing other recent developments in airline distribution. The primary purpose of our efforts is to educate ourselves on the distribution matter so that we may exercise our oversight responsibility intelligently when questions do arise on airline marketing practices that fall within our jurisdiction.

We are also asking interested parties in our pending rulemaking on the Computer Reservation Systems to submit comments on whether our existing CRS rules should be extended to cover in some respects the use of the Internet for airline distribution.

Finally, Mr. Chairman, I'd like to thank you and the Committee for being engaged in these issues, and particularly for holding what I anticipate will be a very informative hearing, which will not only add much to the record but will help the Department in dealing with the many complex issues I've mentioned today.

Thank you, Mr. Chairman—thank you, Mr. Stevens.

[The prepared statement of Mr. Mims follows:]

PREPARED STATEMENT OF A. BRADLEY MIMS, DEPUTY ASSISTANT SECRETARY, AVIATION AND INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF TRANSPORTATION

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to come before this Committee to address the Internet's role in the marketing of airline services. The Committee has wisely chosen to hold hearings on this issue, which is of great importance to airline travelers and the airline and travel agency industries.

Because of the Internet's importance in airline distribution, my office and the Office of the General Counsel have begun studying whether the airlines' use of the Internet raises competition and consumer deception issues that may require regulatory action. Since we have not completed our studies, I do not know what we will conclude. The Inspector General's Office is conducting its own study of airline distribution issues and Orbitz, and will be providing the Committee with its conclusions.

In my testimony I wish to do three things—provide a general description of the airlines' use of the Internet and the development of airline distribution since deregulation, outline the legal and policy principles applicable to the airlines' use of the Internet, and describe the studies we are undertaking to examine the questions presented by the airlines' plans for using the Internet.

The Internet offers many benefits for its users, as anyone who has surfed the web knows well. The Internet provides all kinds of information on travel services and destinations. Consumers who are comfortable using the Internet can easily research travel destinations, conveniently find out what travel services are available, and plan trips. Many consumers like to use the Internet for travel planning and booking—it is quick and convenient—and the Internet is capturing a growing share of travel bookings.

The Internet gives travel destinations, especially smaller ones, an efficient and economical way to market themselves. For example, Megan Ward, the spokeswoman for the Texas Travel Industry Association, stated that small rural Texas communities can obtain websites relatively cheaply and can attract families and other leisure travelers with information not available through other channels: "Definitely the winners are the smaller communities across the country, especially in Texas, who may not have had the funds necessary for marketing. This gives them a massive amount of exposure." Similarly, a tourism official for the Maldive Islands, a nation of 300,000 people, has stated, "Marketing is quite expensive and we are working on a very small budget. Because of the Internet we are able to do a lot of marketing with less expense."

Travel suppliers—airlines, hotels, and cruise companies, for example—have recognized how the Internet provides a means of conveniently and economically providing information and booking services to consumers. The Internet enables travel suppliers to reach new customers who otherwise would be unlikely to use that supplier—or even travel at all.

The Internet also provides airlines and other travel suppliers a less expensive method for obtaining bookings. According to a 1999 study cited by a recent General Accounting Office (GAO) report, for example, each booking made through traditional travel agencies cost America West $23, a booking made through an electronic travel agency cost $20, a booking made through the airline's reservations agents cost $13, and a booking made through the airline's website cost $6.

Because airlines save money when consumers make bookings through an airline website, individual airlines are encouraging customers to use their websites for bookings. Southwest and AirTran, two airlines with a low-fare operating strategy, now obtain at least a quarter of their total bookings from the airline's website. Ryanair, a European low-fare airline, is obtaining a third of its bookings from its own website. The efforts of these airlines to encourage travelers to book through the airline website are consistent with their overall strategy of keeping their costs low, a strategy which requires them to reduce their distribution costs along with their other costs.

Airlines have been offering limited types of discount fares through their individual websites that are not obtainable through other distribution channels, including the airline's own reservations agents. The airlines generally use these Internet fares to sell "distressed inventory"—seats that otherwise would likely go unsold—to travelers willing to travel on short notice in exchange for a low fare. The GAO has found that this practice is common in the travel industry—Amtrak, rental car companies, hotels, and cruise lines also offer some low prices through their websites that cannot be obtained from any other source. The airlines' use of the Internet to sell "distressed inventory" by offering special low fares is comparable to practices followed in earlier years, when airlines used a small number of travel agencies as consolidators to sell seats that would otherwise not be sold. Offering special fares over the Internet may make them available to more consumers.

The Internet's advantages for consumers who are willing to research and buy travel online have caused a rapidly growing number of consumers to use the Internet to book travel. In 1999 just over four percent of all airline bookings were done online. In 2003 online airline bookings are expected to account for eleven percent of all airline bookings.

Not every consumer will be willing to buy travel on the Internet, for a large number of travelers prefer to use travel agents. Many travelers value the personal relationship they have with their travel agent, and a key part of that relationship is the travel agent's ability to solve problems if something goes wrong. Some studies have shown, moreover, that consumers are more likely to find the lowest available fare when they use a travel agency than when they use other sources of travel information. Aside from that, many consumers place more trust in the advice given them by a travel agent than in the information given them by airlines.

As a result, we do not believe that the Internet will cause travel agencies to disappear. A Sabre official has predicted, for example, that travel agencies will account for 65 percent of all airline bookings in 2005 (45 percent by traditional travel agencies and 20 percent by travel agency websites). Many travel agencies have taken advantage of the Internet by creating their own websites. They seek to support and enhance their traditional services and to reach new customers. Most airline tickets are still sold by traditional travel agencies.

The Internet, moreover, has made possible the growth of online travel agencies, particularly Travelocity and Expedia. Last year online travel agencies captured just over half of all airline bookings made through the Internet. Between 1998 and 2001 the annual growth rate in the online agencies' bookings is expected to be almost 100 percent. The Internet also enables Priceline to offer consumers a new method of buying airline tickets, a reverse auction giving consumers the opportunity to try naming their own price for tickets.

Online travel agencies operate in a different environment from traditional travel agencies and so must use new methods of attracting customers, such as creating links with web portals like Yahoo! Online agencies have also begun to buy blocks of airline seats and hotel rooms at negotiated prices substantially below the supplier's published rates, which they then resell to their customers. The online agencies also recognize the need to hire agents to help online customers with problems and special questions. Many observers see the "click and mortar" model as the travel agency of the future.

We expect that many consumers will continue to value the services provided by travel agencies, whether brick and mortar agencies or online agencies (or click and mortar agencies) and that the travel agency industry will continue to remain an important distribution channel for travel services due to these consumer preferences.

The airlines' experimentation with the Internet reflects their search for new distribution methods since the airline industry's deregulation. Since deregulation, the airlines have chosen to use a wide variety of methods for distributing their services. Southwest, for example, has established a strategy of relying on low-fare service that includes downplaying the importance of travel agencies in distributing its services. Southwest thereby avoids the cost of computer reservations system booking fees and travel agency commissions. Many of the newer low-fare airlines rely more on travel agency sales but still try to sell a larger share of their tickets directly to travelers than do the more established network airlines, which depend on travel agencies for as much as eighty percent of their total sales. Airlines generally want to sell their services through as many channels as possible in order to reach as many travelers as possible.

Individual airlines also treat different firms within each channel differently when doing so seems likely to increase the airline's sales. Airlines, for example, use consolidators to sell seats at low fares not made directly available from travel agencies and airline reservations agents. Airlines also commonly give favored travel agencies access to discount fares and marketing benefits not made available to other agencies and enable favored agencies to waive some restrictions on discount fares and to book customers on oversold flights. Those travel agencies having a preferred supplier relationship with an airline or other travel supplier commonly obtain override commissions, incentive commissions that encourage the agency to book a larger share of its customers with the preferred airline.

Like airlines, travel agencies have responded to market demands by developing different operating strategies—some primarily handle corporate travel while others primarily handle leisure travel. Some hold themselves out as generalists while others specialize, for example, on travel to a particular destination or particular types of travel, such as adventure travel. Travel agencies generally are addressing the shifting nature of the airline distribution system by focusing on the sale of travel services that are more remunerative, like cruises, and by providing their customers with advice and insight that travelers cannot obtain from other sources.

Airline distribution costs, which include commissions, credit card fees, computer reservations system fees, and the costs of the airline's own reservations and sales personnel, have made up almost twenty percent of the airlines' total costs. Throughout the 1980's and 1990's, the airlines worked on cutting all of their other controllable costs. They recently began tackling their distribution costs.

The airlines' efforts to cut their distribution costs have harmed many travel agencies. The major airlines have cut their travel agency commission rates and imposed caps on the amount of commission payable on individual tickets. Airlines have also sought ways to sell tickets directly to consumers or through channels less costly than the travel agency channel. These actions have significantly reduced travel agency revenues. As a result, most travel agencies have begun requiring their customers to pay fees for at least some agency services.

Last year the GAO investigated whether consumers have been affected by changes in the airlines' methods of selling tickets, among other issues. The GAO concluded that the airlines' use of the Internet gave consumers new ways to purchase tickets while still allowing consumers to use travel agents if they wished. The evidence available to the GAO, however, did not enable that agency to calculate the overall advantages and disadvantages to consumers of recent changes in airline distribution.

As with many developments that promise to benefit many consumers, however, the use of the Internet in airline distribution might in some ways present potential threats to consumers and competition. Online firms selling travel may engage in practices that could create a risk of consumer deception. The airlines could use the Internet in ways that may reduce the availability of impartial and comprehensive travel information to consumers. And the development by five major airlines of a joint website—Orbitz (originally called T2)—for the sale of travel services raises questions on whether their operation of Orbitz may involve some potentially anticompetitive behavior.

Let me now outline the legal and policy principles applicable to the Internet's use in airline distribution. First, online firms are subject to the same consumer protection provisions as other travel firms. And, like firms in any other unregulated industry, airlines and travel agencies are subject to the antitrust laws enforced by the Justice Department. In general, the antitrust laws prohibit (i) conduct by a single firm which involves monopolization or attempted monopolization and (ii) collective action involving two or more firms that unreasonably restrains trade.

While conduct by a single firm seldom raises antitrust questions, collective action by competitors often presents serious antitrust issues. Nonetheless, the antitrust laws allow competitors to create a joint venture when doing so provides efficiency benefits without unreasonably or unnecessarily restricting competition between the participants. For example, the airlines have long operated programs providing for the accreditation of travel agency firms and a joint clearinghouse for the settlement of the travel agencies' payment for airline services booked by their customers.

This Department has the authority under 49 U.S.C. 41712, commonly referred to as section 411 of the Federal Aviation Act, to prohibit airline practices as unfair methods of competition if they violate antitrust principles, even if they do not violate the letter of the antitrust laws, and to prohibit unfair and deceptive practices.

The Department, as you know, is committed to ensuring that the airline industry remains competitive. In exercising our authority under section 411, we will bear in mind Congress' decision to deregulate the airline industry. Congress did so because it determined that each airline should be free to determine what routes it will serve and what fares it will charge. As part of deregulation, airlines became free to determine how best to distribute their services. The Department no longer has the authority to regulate the airlines' relations with travel agencies unless necessary to prevent unfair methods of competition and unfair and deceptive practices.

As I stated, however, airlines would violate the antitrust laws and commit unfair methods of competition in violation of our statute if they acted collectively in ways that illegally reduce competition. The Department is investigating questions that have been raised by both travel agencies and smaller airlines about Orbitz' potential adoption of restrictions on the airlines' participation in Orbitz that could undermine the competitive position of smaller airlines and other distribution channels. We are also investigating whether Orbitz' operation may also create opportunities for its owners to collude on pricing and service. We appreciate the concerns expressed by many travel agencies and consumers over changes in airline distribution practices that may deny consumers the ability to obtain impartial and complete advice on airline services and fares from travel agencies. Travel agents provide the public with valuable information and strengthen the ability of airlines to compete on the basis of service and fares.

The Department is examining these issues in order to carry out our responsibility to see whether airlines are engaged in practices that may violate section 411. We have therefore requested Orbitz to answer a series of questions on its organizational and operating plans and to provide documents relevant to our inquiry. If Orbitz' organization and operational plans seem to involve practices that would violate section 411's prohibition against unfair methods of competition, we will take action redressing those problems. As a separate matter we are reviewing the enforcement complaint filed by the Association of Retail Travel Agents against the major airlines that created Orbitz. We will be considering whether that complaint warrants the institution of an enforcement proceeding.

The Justice Department is conducting its own investigation into Orbitz, and, as Ken Mead has told you, the Inspector General's Office is examining Orbitz and the airlines' use of the Internet.

In addition to our study of Orbitz, we are informally studying recent developments in airline distribution. The primary purpose of this study is to educate ourselves on distribution matters, so we may exercise our regulatory authority intelligently when questions under section 411 do arise on airline marketing.

We are also asking all interested persons in our pending rulemaking on computer reservations systems (CRSs) to submit comments on whether our existing CRS rules should be extended to cover in some respects the use of the Internet for airline distribution.

Finally, AIR–21 calls for the creation of a National Commission to Ensure Consumer Information and Choice in the Airline Industry, which will study recent developments in airline distribution and make recommendations on whether changes are needed. The Secretary has asked the Congressional leadership for their proposed nominations to the Commission and has asked the major airline and travel agency trade associations for suggestions on who he should nominate.

We will remain mindful of what the Transportation Research Board said last year in its report: "In general, however, changes in the distribution system should be viewed as opportunities to enhance the system's overall benefits to consumers, and should not be dissuaded unless the neutrality and completeness of the distribution system is fundamentally threatened. DOT should remain alert to the possibility of such erosion."

Thank you Mr. Chairman. This completes my prepared statement, and I would be pleased to respond to your questions and those of the Committee.

Senator STEVENS. The Chairman has been called to the phone. Mr. Mead.

## STATEMENT OF THE HON. KENNETH M. MEAD, INSPECTOR GENERAL, U.S. DEPARTMENT OF TRANSPORTATION

Mr. MEAD. Thank you, Mr. Stevens.

Last month we provided the Congress an interim report on airlines' progress in meeting a voluntary set of consumer service commitments.

One of those commitments was to provide consumers with the lowest fare available through the airlines' telephone reservation system. The commitment the airlines made did not extend to providing fares available over the Internet. I'd like to discuss four subjects today that are directly related to Internet sales of airlines tickets.

The first subject will deal with the growth of travel sales over the Internet. I think if I share with you some numbers and some charts that you have in front of you, that they're really the best testimony for why this is an important area for congressional and executive branch oversight.

The second subject is e-fares. E-fares are the deeply discounted, distressed inventory that are offered a few days before flight departure, usually available only on the Internet. Those fares are at the heart of the controversy over Orbitz.

The third subject I'd like to cover is Orbitz, which is an airline-owned travel agency, and it's scheduled to launch this fall. As I'll overview, we see some benefits to consumers from Orbitz, but also some competitive red flags that we think should be dealt with first before launching it; particularly as Senator McCain was pointing out earlier. This Committee has a long history with Computer Reservation Systems. And once these things are launched, they're very difficult to unscramble or deal with. So that's why I think this hearing is particularly timely.

The final subject I'd like to speak about are the Computer Reservation System rules, which were established in 1984. I think they're being rapidly eclipsed by marketplace changes and technological innovation. Their relevance is beginning to wane.

So first, travel sales over the Internet. They are growing at a rapid pace. There are charts in front of you with some figures I'd like to refer to.

In 1996, as Figure 1 shows, less than ½ of 1 percent of airline tickets were sold online. Today it's at 6 percent. This share is likely to grow to at least 11 percent by 2003. To encourage that shift to the Internet, the airlines offer special deals such as discounted fares, available only on the Internet, usually on the airline's own website.

Figure 2 shows that travel will continue to account for a significant portion of all sales made online on the Internet. We're at about $14 billion this year. By 2003, estimates project we'll be at about $29 billion. So this is a growth area.

Figure 3, on the next page, shows that not only will more households be connected to the Internet, but those households are going to be buying more. 67 million households had online capability in 1998. That had grown to 114 million in just 2 years. By 2003, we think that number will be in the neighborhood of 180 million households.

I think it's important to recognize also that while the Internet benefits people by giving them a broad range of information 24 hours a day, 7 days a week, access to the Internet is still problematic for a portion of our population; for some senior citizens, the blind, individuals with certain other types of disabilities, and the economically disadvantaged who cannot afford a computer.

Figure 4 shows why the airlines want you to make reservations on the Internet. Selling tickets on an airline's own website, as this chart shows, can result in sale and distribution cost savings of 75 percent or more. That means no commission, no Computer Reservation System booking fee, no reservation agent cost; a savings of as much as $35 to $40 a ticket. When you multiple that millions of times over, you're dealing with a great deal of money.

I'd like to move to my second topic, which is e-fares.

Senator STEVENS. That chart, can you explain that last one a little bit.

Mr. MEAD. Figure 4, Mr. Stevens?

Senator STEVENS. 1008 percent. Are those figures right? On Table 1 and 2.

Mr. MEAD. Yes. I'm just about to explain those.

These charts deal with e-fares, which are the deeply discounted fares that are available usually only over the Internet. We found in tests, as shown in Table 1, that when you click on the regular fare search engine for fare quotes just 3 days before flight departures, the results, in some instances, were more than 1000 percent higher than the e-fare that was simultaneously being offered on the same website.

I'll give you an example: A flight between Newark and New Orleans. If you look at Table 2, it's the first item on Table 2. Two weeks ago, one airline offered a last minute e-fare of $140 for round-trip travel between Newark and New Orleans.

When we searched the identical itinerary through the same airline's normal website fare search procedure, we were quoted a fare of $1,791, a difference of over 1100 percent. A consumer who did not know to check the e-fares first and click the appropriate place on the website, would have paid $1500 more for their ticket that weekend.

We found that this disparity does not need to exist, because we found four airlines where it did not. The airline telephone reservation agents also could not or would not inform us that an e-fare was being offered on the Internet that could save us hundreds of dollars.

The disparities between the Internet e-fares and the fare quoted over the phone is displayed in Table 2. And on average, the lowest fare available over the phone was more than 500 percent higher than the e-fare available on the airline's website. The range, Mr. Chairman, was 64 percent to 1100 percent higher, for the same trip, same date, same everything.

I'd like to move to Orbitz. The primary concern with Orbitz, which will be jointly owned by five airlines, is the possibility that the airlines will choose not to make their lowest fares, such as the e-fares I just mentioned, these deeply discounted fares, available anywhere but on Orbitz. If that happens, other online agencies fear that they won't be able to compete.

Why is that? That's because Orbitz will then be the only Internet site with the most offerings in one place at the lowest prices.

In the short term, preventive actions can be taken. For example, you could establish an interim provision that would require airlines to make available any fares they provide Orbitz to any of its competitors willing to offer the same financial terms concerning booking fee rebates.

But those agencies should also be expected to agree to not bias their fares and flight displays in favor of any one airline; a quid pro quo.

In the long term, we do see some positive aspects to Orbitz. If its software performs as it promises and if it adheres to its charter, there will be no bias in displays; no one airline will be promoted over another, or unfair preference given to one airline over another.

Now that is, if it adheres to its charter and the software performs as promised.

For airlines that agree to provide Orbitz with their lowest fares, Orbitz will rebate the CRS booking fee by about one-third. That amounts to a lot of money, because the average round trip flight incurs CRS booking fees of between $10 to $16. So you knock off a third of that, and that's a lot of savings.

We do have some concerns about the impacts on smaller airlines and consumers. Here's what they are: If Orbitz is extremely successful and it eliminates its on-line competitors, Orbitz could develop the power to charge premiums to the airlines to participate, which would in turn be passed on to consumers.

Now that would benefit the airlines that are the equity owners of Orbitz, but it would not benefit those airlines that were not equity owners. And in any case, it would eventually have to be passed on to the consumer. We think our suggestion would greatly ameliorate the possibility of that happening.

We also think that, as Mr. Mims was indicating, the Departments of Justice and Transportation need to move expeditiously on this. Orbitz plans to launch operations this fall. It will be in a couple months, possibly by October; and there's nothing in the present law that would prevent them from moving to operations.

Finally, Mr. Chairman, just a word about the CRS rules. They're being rapidly eclipsed, some would say into irrelevance, by marketplace changes and technological innovations. The Internet is potentially replacing many of the functions that were performed by the CRSs, so questions have been raised over whether these regulations ought to apply to the Internet.

Even current owners of the CRSs do not know whether the CRS rules apply to them. And that's because when the rules were first established, they were applied to airline-owned CRSs. However SABRE, which used to be owned by American Airlines, is no longer owned by American Airlines.

In addition to that, the CRSs are forming alliances or allegiances to certain travel agencies, particularly on-line travel agencies. So there's questions about, "Well, should the CRS rules against biased displays also apply to travel agencies if they're going to have that type of relationship?"

You should know that the Department of Transportation has responsibility for updating these rules and that update has been delayed three times since 1997. As the market continues to change rapidly, the Department ought to proceed with these updates without further delay.

I'd like to close by saying that history has shown how very, very difficult it is to fix problems in this area after they occur. So we have an opportunity here to be proactive, and I hope we are.

That concludes my statement.

[The prepared statement of Mr. Mead follows:]

PREPARED STATEMENT OF HON. KENNETH M. MEAD, INSPECTOR GENERAL, U.S. DEPARTMENT OF TRANSPORTATION

Mr. Chairman and Members of the Committee:

We appreciate the opportunity to testify on issues related to sales of airline tickets over the Internet. Last month we provided you with an interim report on the airlines' progress toward instituting a voluntary Airline Customer Service Commitment. The Commitment incorporated a variety of promises including a provision to provide consumers with information on their lowest fares. However, this provision was limited to information provided through the airlines' telephone reservation systems.

The Internet is growing rapidly as an avenue for consumers to research and purchase travel. In fact, this growth is fundamentally changing the airline distribution network. Concerns about what impact the Internet will have on consumers' continued ability to access lowest fares, along with other changes taking place in the ticket distribution network, led to a provision in the DOT's Fiscal Year (FY) 2000 Appropriations Act to review these issues. We have also undertaken an effort to identify the impact of Orbitz, the proposed jointly owned airline website. Our initial work is nearing completion. Today, I would like to make four points directly related to Internet sales of airline tickets.

- **Travel sales over the Internet are growing at a rapid pace.** Airlines have embraced the Internet as a means of significantly reducing ticket distribution costs. In 1996, less than ½ of 1 percent of airline tickets were sold online through airline websites or online travel agencies such as Travelocity or Expedia. Today, online purchases account for an estimated 5.9 percent. By 2003, industry analysts project that percentage to reach over 11 percent. The airlines have facilitated the shift from traditional channels to their websites through special offers such as bonus frequent flyer points and fare specials that are available only by purchasing travel on their websites.

  By 2003, analysts project that over $29 billion will be spent on all travel products over the Internet and that this will account for more than one-third of all product purchases made online. The Internet benefits consumers by giving them the ability to access a broad range of information 24 hours a day, 7 days a week, although for a certain part of the population—some senior citizens, individuals with certain types of disabilities, and the economically disadvantaged—access to the Internet is still problematic.

- **Wide disparities exist between distressed inventory "E-fares" and fares quoted simultaneously for identical itineraries in other areas of the airlines' same websites.**

  In a test of 20 published E-fares offered this summer, we found that "clicking" on separate areas within an airline website can result in fare quotes that differ by more than 1000 percent. For example, one airline offered a last minute E-fare of $140 for round-trip travel between Newark, New Jersey and New Orleans, Louisiana for the week of July 8, 2000. Requesting the same itinerary simultaneously through the airlines' normal website fare-search procedure turned up a round-trip fare of $1,791, a difference of 1,179 percent. The airline's search engine did return a lower price option of $1,200 for a different itinerary, but that was still higher than the E-fare by more than 750 percent.

  In almost all 20 of our test cases, airline telephone reservation agents could not or would not inform us that an E-fare was being offered on the Internet that could save us hundreds or even thousands of dollars. The technology exists to make this information available and consistent throughout these channels, and consumers would be best served if airlines pursued such a policy.

  While these fares are estimated to represent less than 3 percent of all online ticket sales, these fares also have been at the heart of the controversy over whether Orbitz participants will make their lowest fares available exclusively on Orbitz.

- **Orbitz could potentially benefit consumers and airlines by providing a wider range of fare options, bias-free displays, and reduced booking fees, but red flags raised by competitive issues, such as airlines potentially restricting their lowest fares exclusively to Orbitz, must first be resolved.**

  Orbitz is an online travel agency set to launch this fall that is jointly owned by five airlines: Delta, United, Northwest, Continental, and American Airlines. The site will offer comparative information on all airlines' fares and services, in much the same model as its competitors Travelocity and Expedia. Although Orbitz is currently wholly owned by the five airlines, it is soliciting investors and owners from outside the airline industry and may eventually consider a public offering.

In exchange for airlines making their lowest published fares available on Orbitz, Orbitz will offer participating airlines a rebate that will offset as much as one third of Computer Reservations System (CRS) fees incurred for travel booked on the Orbitz site. With the average round-trip flight incurring CRS booking fees of $10 to $16, this rebate could result in substantial savings. If Orbitz' software functions as it has promised and Orbitz abides by its charter, consumers could benefit from having access to a wider pool of options displayed free of bias. However, concerns about the airlines restricting their lowest fares—including the deeply discounted E-fares—exclusively to Orbitz or engaging in other anticompetitive practices will need to be resolved first by the Departments of Justice and Transportation.

*In the short term, actions could be taken to protect against the potential for anti-competitive practices. For example, interim provisions could be established requiring airlines to make available any fares they provide Orbitz to any other entity willing to offer the same financial terms concerning booking fee rebates as Orbitz. Such a provision should be predicated on agreement by these entities to abide by the non-bias regulations that apply to CRSs.*

In the long term, barring any anti-competitive behavior, Orbitz could generate competitive pressure on other online agencies to eliminate bias and upgrade search capabilities. It could also put competitive pressure on CRSs to lower booking costs and improve services. If airlines are successful in drawing consumers to distribution channels that incur lower booking fees—such as Orbitz—the CRSs that provide services for the higher cost distribution channels will lose business. If the CRSs want to keep this business, reducing their fees would give airlines more of an incentive to provide them with their lowest fares.

But there is the potential for harmful impacts on the travel marketplace. If Orbitz is extremely successful and eliminates its online competitors, Orbitz could develop the power to charge premiums to airlines to participate, benefiting its equity owners to the detriment of other airlines and resulting in higher fares to consumers. The Departments of Justice and Transportation need to evaluate the likelihood of these and other scenarios playing out in determining whether prior intervention is needed to protect competition and consumers.

- **CRS rules[1] are being rapidly eclipsed by marketplace changes and technological innovation.** CRSs are the vehicle through which travel agents receive information about and book airline tickets. The existing regulations were implemented in large part to protect consumers and competitors from the biasing of information by the airline-owners of these systems. The airline-owners were biasing displays of data to ensure their own flights got top billing on a travel agent's screen, even if the flights were not the best travel options.

  With the Internet potentially replacing many of the functions performed by the CRSs, questions have been raised over whether these regulations should apply to the new distribution channels, and if they did, whether they would have any meaningful impact. The regulations apply to airline-owned CRSs but with recent airline divestitures of CRSs, even CRSs are unsure about whether they must still comply with the regulations.

  Furthermore, travel agencies have never been subject to the anti-bias rules of the CRS regulations. But given the long history of airlines' anti-competitive CRS practices, the expansion of airlines and CRSs into ownership of online travel agencies raises questions about what regulatory protection may be needed. History has shown how difficult it is to fix problems with airline competition after they occur. If protections against abuses can be instituted early in the game, mistakes of the past can be avoided.

  Technology is proceeding quickly to a point where travel agents and consumers may be able to bypass CRSs entirely to access fare and service information from the airlines. Such potential underscores the waning relevance of the CRS regulations.

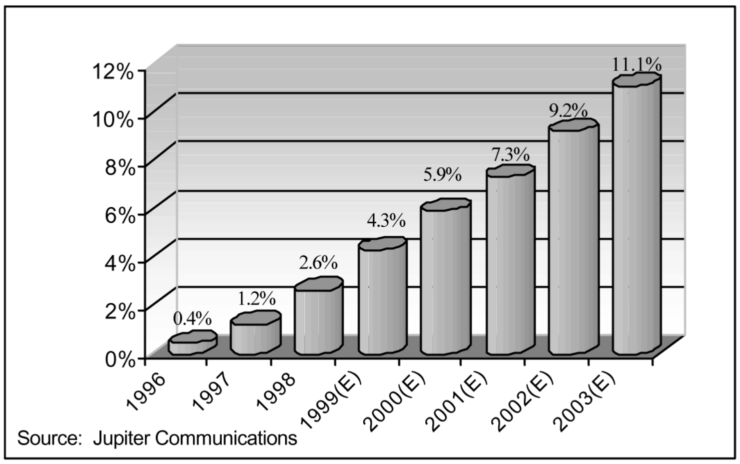
  The Department has responsibility for updating existing CRS regulations and has delayed this process three times since the 1997 sunset date. As the market continues to change rapidly, it is imperative that issues such as those just described, be addressed without further delay.

[1] CRS rules were established in 1984 and amended in 1992.

**Travel sales over the Internet are growing at a rapid pace.**

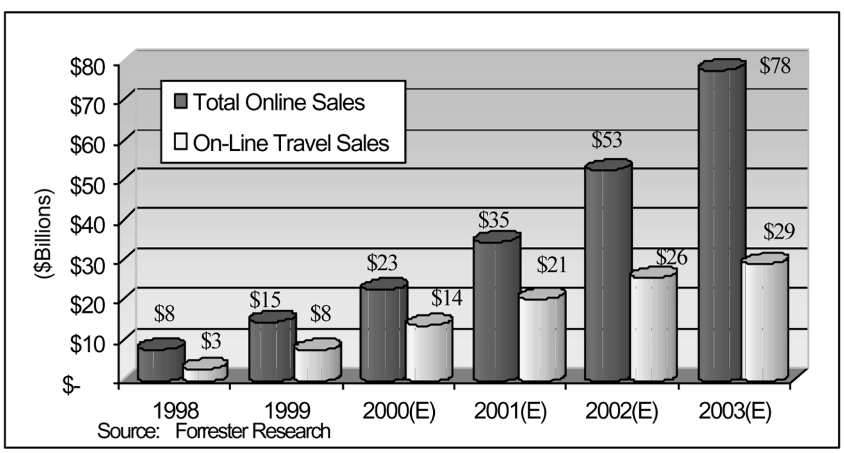
The past 4 years have seen dramatic changes in how airline tickets are sold, in large part a reflection of the growing commercial importance of the Internet. Analysts project that by 2003, more than 11 percent of all airline tickets will be sold through the Internet, nearly triple the 4.3 percent of online ticket sales in 1999 (see Figure 1). While this is an industry-wide average, some airlines have experienced much greater results. One start-up airline reported selling almost 73 percent of its seats online for the week ending July 9, 2000.

**Figure 1. Growth in Percentage of Airline Tickets Sold Online**



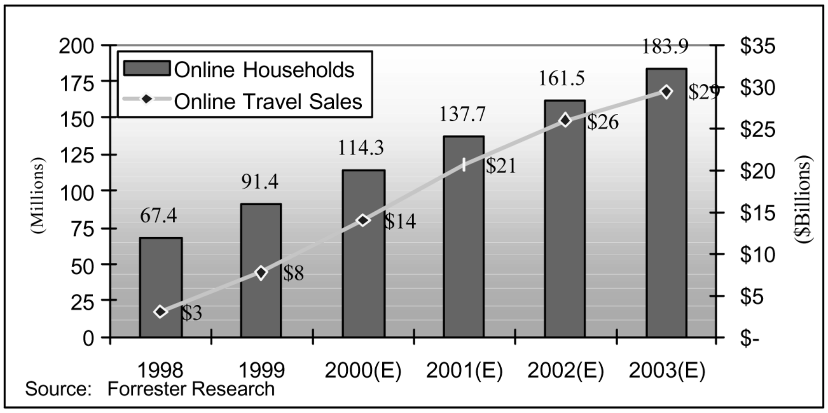

**Sales of all travel sold online will almost quadruple.** In 1999, online travel sales totaled nearly $8 billion, but industry analysts project that online travel sales will reach $29.4 billion by 2003. This will represent over one third of all purchases of all commodities made online (see Figure 2).

**Figure 2. Growth of Online Sales and Total Travel Sales.**



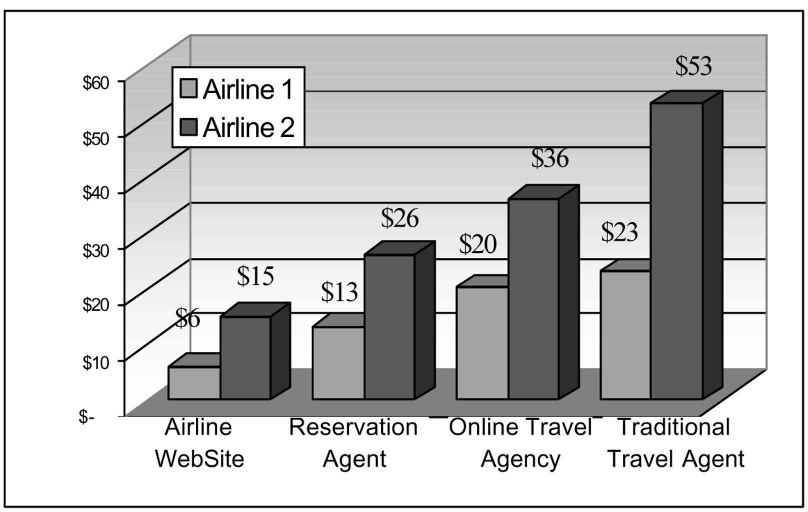

**Growth reflects preferences of consumers and airlines.** Consumers have embraced the Internet for convenience and the depth of information available through electronic channels, although for some sectors of the public—senior citizens, persons with some disabilities, and the economically disadvantaged—access to the Internet is still problematic. The number of households online worldwide is expected to grow at an average annual rate of 17 percent in the next 3 years, but as consumers become more comfortable making purchases over the Internet, total online travel sales are expected to more than double over this period (see Figure 3).

**Figure 3. Growth in Online Households and Online Travel Sales**




**Internet reduces distribution costs.** Airlines and other travel providers realize that the Internet allows them to quickly reach a widely dispersed base of potential consumers while reducing distribution costs by 75 percent or more. Sales on an airline's own website are by far the least expensive avenue for airlines since the electronic search and booking capabilities allow airlines to avoid commissions, CRS booking fees, and reservation agent labor costs. Figure 4 illustrates the costs that two airlines estimate they incur through each of the identified outlets. Airlines' commission policies, labor costs, communications costs, and other factors can vary widely, resulting in wide variances in the costs incurred by each distribution channel.

**Figure 4. Per Ticket Distribution Costs by Channel for 2 Major Airlines**



**Some Internet airfares vary substantially from fares for identical travel offered simultaneously through the same or other channels.**

Our tests of last minute Internet specials (E-Fares) showed that these fares were in some cases over 1000 percent lower than fares for identical travel offered simultaneously on the airline's same website.[2] Additionally, the E-fares were, on average, 560 percent lower than airline ticket reservation agents quoted as their lowest available fares.[3] When asked, nearly all of the 20 agents we contacted for fare information were either unable or unwilling to provide information about the possibility or existence of lower fares on their Internet sites.

While these fares are estimated to represent less than 3 percent of all online ticket sales, these fares have been at the heart of the controversy over whether Orbitz participants will make their lowest fares available exclusively on Orbitz.

**E-fares currently represent a small portion of Internet airline sales.** E-fares are the deeply discounted fares that airlines have begun to make available 2 to 3 days prior to departure as a way of filling seats that would otherwise have flown empty. Comparisons that we performed with sample 3-week advance purchase fares indicated that the E-fares were about one-third less than the airlines' 3-week advance purchase price for similar travel. E-fares may be called different names by the airlines—"dot.com specials," "web-fares," "cyber-savers," etc.—but all refer to last-minute deeply discounted fares that are only available over the Internet.

In 1999, the airline industry as a whole reported Internet ticket sales of about 4 percent. Most of these represented regular fares sold at a limited discount (i.e., 5 to 10 percent off) or at undiscounted rates over the airlines' own websites or through online travel agencies such as Travelocity. Industry analysts estimate that last minute E-fare specials represent less than 1/10th of 1 percent of total airline sales.

**E-fares are far more restrictive than regular fares sold on an airline's website.** Although deeply discounted, E-fares with their many restrictions are only suitable choices for a small percentage of travelers. The E-fares are often not announced until Tuesday or Wednesday for travel only on and over the approaching weekend. Airlines do not offer these fares every weekend and only do so in a limited number of varying markets. In some cases, travel is directional (i.e., E-fare from Miami to Detroit on Friday is not valid for travel from Detroit to Miami on Friday.) Dates, times, and seat availability are often severely restricted, with outbound travel required on specific days (often Friday or Saturday) with a return usually on Sunday, Monday, or Tuesday.

**Test comparison between last minute E-fares and last minute walk-up fares.** As a means of gauging the potential degree of variation in fare quotes from different ticket distribution channels, we tested a sample of 20 E-fares offered between June 17 and July 8, 2000. We selected E-fares from specials posted by eight carriers for the approaching weekend, and simultaneously solicited fare quotes from seven other sources, including airline websites, reservation agents, online travel agencies, and brick and mortar travel agents. Because these E-fares are only available 2 or 3 days before departure, the comparable fare quotes we received from other sources represented full coach fares that are often the only fares that airlines make available within 3 days of departure.

**Test Results:**

**"Clicking" on different parts of an airline's website can result in fare disparities of over 1000 percent.** Our testing showed that in some cases it is possible for a consumer to simultaneously get two different—and widely variant—fare quotes for the exact same itinerary just by "clicking" on different areas of an airline's website. For example, on one carrier's website, clicking on the "dot.com specials" section of the website turned up an E-fare between Newark and New Orleans of $140. Entering the identical itinerary (same dates, same flight numbers) through the regular fare-search engine on the website resulted in a fare quote of $1,791, a difference of over 1,100 percent. Table 1 provides examples of simultaneous round-trip fare quotes received for identical itineraries on the same travel dates by searching different areas of four airlines' websites.

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[2] Our original test consisted of 20 E-fares (offered by 8 airlines) that we compared to quotes from 7 other distribution sources including the normal fare search procedure on the airlines' websites. We subsequently performed additional tests (100 total from 20 airlines) that compared E-fares and fares offered through the websites' normal fare search procedure. We did not seek fare quotes for these 100 tests from other travel agents or airline ticket reservation agents.

[3] Results represent findings from the 20 original tests that included comparisons between E-fares and quotes from airline ticket reservation agents.

Table 1. Variations in Fare Quotes from Different Areas of an Airline's Website

| City Pair | E-Fare | Regular Fare on Web | Difference |
|---|---|---|---|
| Boston—Los Angeles | $273.50 | $2,223.50 | 713% |
| Detroit—Nagoya, Japan | $449.00 | $2,826.90 | 530% |
| Boston—Salt Lake City | $178.00 | $1,971.50 | 1008% |
| St. Louis—Toronto | $159.00 | $1,325.39 | 734% |
| Detroit—Buffalo | $119.00 | $719.00 | 504% |
| San Jose—Portland | $191.00 | $342.00 | 79% |
| San Francisco—Los Angeles | $138.00 | $276.00 | 100% |
| St. Louis—Boston | $192.00 | $1,541.00 | 703% |
| Houston—Washington, D.C. | $157.00 | $1,726.00 | 999% |

- **Airlines should consider disclosing existence of E-fares when an itinerary is requested through the website's normal fare-search procedure.** Airlines understandably offer a variety of fares through different distribution channels as a means of maximizing revenues, but we found some airlines' practices of simultaneously quoting widely disparate fares for the same product within the *same* channel somewhat disturbing.[4] The E-fare tickets have more restrictive policies on exchanges and cancellations, but a strong case could be made for giving consumers the option to choose between an $819 ticket with no penalty for changes and a $147 ticket with a $75 change fee.
- **Airline reservation agents are unable or unwilling to assist consumers with finding lower Internet fares.** Our testing also revealed substantial disparities between the E-fares found on the airlines' websites and the lowest available fares quoted simultaneously over the telephone by the airlines' ticket reservation agents. In nearly every case, the lowest fare quoted by the reservation agent, the full coach fare, was substantially higher than the E-fare. The differences ranged from 64 percent to over 1,100 percent. *On average, the fares offered through airline ticket reservation agents for identical itineraries (same flight numbers on same travel dates), were more than 560 percent higher than available E-fares.* The tests were conducted simultaneously to limit the possibility that the differences were due to changes in seat availability.

Table 2 highlights examples of fare differences found between airline website E-Fares and airline ticket reservation agents over the telephone. It also shows the fares being offered simultaneously through the normal search procedure on the website.

Table 2. Variations in Fare Quotes Between E-Fares, Regular Web Fares, and Airline Reservation Agents

| City Pair | E-Fare | Regular Web Fare | Airline Reservation Agent | Difference from Regular Web Fare | Difference from Airline Reservation Agent |
|---|---|---|---|---|---|
| Newark—New Orleans | $140.00 | $1,791.00 | $1,791.00 | 1,179% | 1179% |

[4] Four of the eight carriers included in our original test have established mechanisms that recognize an itinerary entered into the regular fare search engine as one being offered as an E-fare and will provide the E-Fare quote.

Table 2. Variations in Fare Quotes Between E-Fares, Regular Web Fares, and Airline Reservation Agents—Continued

| City Pair | E-Fare | Regular Web Fare | Airline Reservation Agent | Difference from Regular Web Fare | Difference from Airline Reservation Agent |
|---|---|---|---|---|---|
| St. Louis—New York City (LGA) | $169.00 | $1,593.00 | $1,593.00 | 843% | 843% |
| Dallas (DFW)—Minneapolis | $160.00 | $160.00 [1] | $1,330.50 | 0% | 732% |
| Las Vegas—Los Angeles | $80.00 | $80.00 [1] | $179.00 | 0% | 124% |
| Minneapolis—Austin | $189.00 | $1,469.00 | $1,469.00 | 677% | 677% |
| Cincinnati—New Orleans | $139.00 | $139.00 [1] | $1,095.00 | 0% | 688% |
| Denver—Philadelphia | $252.00 | $1,716.50 | $1,869.00 | 581% | 642% |
| Pittsburgh—Indianapolis | $127.00 | $127.00 [1] | $816.00 | 0% | 543% |

[1] Four airlines' regular website search procedures returned the E-fare specials with their associated restrictions. Unlike the full coach fares returned by other airlines, these fares are non-refundable and have the same heavy restrictions as the E-fares.

When asked, none of the airline reservation agents we spoke to could or would tell us whether an E-fare was being offered that weekend for travel we were purchasing, even when our request was for an itinerary that we knew was being offered as a low-cost E-fare. All indicated that even if one were available, it could not be sold at that price over the telephone.

One carrier indicates on its website that the E-fares listed on the website can also be purchased through a telephone reservation for an additional $20. During our testing, however, we found that this carrier's reservation agents were still not able to provide information about whether these fares were being offered.

We believe the consumer would be best served if information were available about the possibility of alternate fares being available through other channels. This does not mean that every fare should be accessible through every channel, but that airline reservation agents disclose such possibility when it exists. The technology exists to support such a policy.

**Orbitz could potentially benefit consumers and airlines by providing a wider range of fare options, bias-free displays, and reduced booking fees, but red flags raised by competitive issues, such as airlines potentially restricting their lowest fares exclusively to Orbitz, must first be resolved.**

In exchange for airlines making their lowest published fares available on Orbitz, Orbitz will offer participating airlines a rebate that will offset as much as one third of any CRS fees incurred for travel booked on the Orbitz site (rebate equivalent to approximately $3.00 to $5.00 per ticket booked). If Orbitz' software functions as it promises and Orbitz abides by its charter, consumers could benefit from having access to a wider pool of options displayed free of bias. However, concerns about the airlines' restricting their lowest fares, including the deeply discounted E-fares, exclusively to Orbitz or engaging in other anti-competitive practices—such as charging airlines to participate in Orbitz if it becomes the dominant online ticket source—should not be dismissed and need to be resolved first by the Departments of Transportation and Justice.

**Orbitz is an airline-owned online travel agency.** Last fall, Delta, United, Northwest, and Continental Airlines announced their intent to jointly launch an online travel agency that would compete with established travel websites such as Travelocity and Expedia. American Airlines signed on this spring after Sabre, the CRS that owns Travelocity—a future Orbitz competitor—was spun off as an independent entity. Although Orbitz is currently wholly owned by the five airlines, it is actively soliciting private investors and owners outside of the airline industry. Orbitz may eventually consider a public offering.

Each of these five airlines, and most other commercial airlines, have established their own individual websites to sell their own tickets and services over the Internet. While these websites provide the least expensive way to distribute tickets, the airlines know that many consumers prefer the multi-carrier travel agencies where they can compare the fares and services of competing airlines to get the best prices.

On Orbitz, consumers will be able to enter desired travel destinations, dates, and other criteria and the search engine will evaluate the spectrum of possible schedule options and then display a menu of travel options and fares. Orbitz intends to provide links to hotels, car rentals, and other traveler services.

**Orbitz is an attempt by the airlines to lower ticket distribution costs, and most pointedly, to reduce what they believe to be excessive and growing CRS booking fees.** Between 1990 and 2000, fees for direct access (the highest level of participation available at that time) on one large CRS have increased from $2.10 to $3.54 per segment booked, a growth of almost 70 percent (most round-trip flights have between two and four segments per ticket). While CRSs maintain that the increases reflect improvements to the systems, critics have pointed out that the fee growth has far outpaced cost savings achieved during this time from improvements in technology.

Orbitz has attempted to extend an invitation to every airline to become charter associates. Charter associates would be required to provide Orbitz with any fare they have made publicly available anywhere else, and to contribute in-kind marketing support.[5] In return, Orbitz will rebate to the airlines a percentage of CRS booking fees incurred for all tickets booked through Orbitz. Orbitz anticipates that these rebates will effectively reduce airlines' booking fees through Orbitz by about one third. This rebate is possible because Orbitz has negotiated a volume booking incentive agreement with Worldspan, the CRS that will handle the booking functions for Orbitz. Eventually Orbitz hopes to establish direct links with the airlines' internal reservation centers which would allow Orbitz to bypass the CRS and avoid its fees entirely. The technology to do this is not far in the future.

To date, over 30 airlines have signed letters of intent expressing their desire to become charter associates. Airlines that do not choose to participate as charter associates will still be listed in an unbiased way on the Orbitz site. These airlines will not be required to provide their lowest fares to Orbitz, but they also will not benefit from the rebates on CRS booking fees.

**Orbitz is not subject to CRS Regulations.** Orbitz views itself as an online travel agency, similar to Travelocity or Expedia, and contends that, like those agencies, it is not subject to the CRS rules. The CRS rules were intended to cover airline-owned CRSs, and did not extend to travel agencies, regardless of their ownership. As such, travel agencies are permitted to bias in favor of a particular airline the information they receive from their CRSs and report to their customers or even to exclude information from some airlines if they choose. The airlines also may negotiate selective and exclusive deals, such as commission override agreements, special fare sales, and marketing promotions, with individual agencies. The airlines are not required to make these deals universally available.

**Potential Contributions to the Marketplace.** If Orbitz abides by its charter and presents an unbiased display, the site has the potential to provide a valuable tool for consumers to compare fares and services as well as provide smaller airlines a platform to compete on an equal basis with the major carriers.

- **Orbitz may offer more low-fare options.** Orbitz contends that one of its greatest strengths is not its access to airlines' last minute E-fares, but its search engine that can search millions of possible flight combinations to identify lowest fares. Orbitz' competitors have criticized its claims in this area, citing the restrictions and caveats associated with the lower-fare travel that Orbitz software identified in sample comparisons. For example, one trip option required travel to an alternate airport 50 miles away from the destination city. We agree that this option may not appeal to many consumers regardless of any cost savings, but believe that consumers are best served if presented with the choice and permitted to evaluate the trade-offs for themselves.

  Other online travel agencies are skeptical about the ability of Orbitz' software to perform as seamlessly as Orbitz predicts. We plan to evaluate Orbitz' performance when the site is operational.

[5] In-kind marketing refers to advertising, marketing and promotions for the Orbitz website sponsored by the charter associates. These may include print, television, or Internet advertising; name/logo included on inflight magazines or videos, Affinity program supplements such as free or discounted upgrades, or other mutually agreed upon ventures.

- **Unbiased displays provide consumers with more accurate and comparable information.** Orbitz believes its other strength in the marketplace is its commitment to provide unbiased information on all carriers, regardless of the level of participation by each carrier. The fact that Orbitz is jointly owned by competing airlines creates a unique operating constraint. Orbitz' charter specifically states that all information on Orbitz will be displayed without bias, with priority display based exclusively on lowest airfare. Given Orbitz' joint ownership, a decision to allow display advantages to be purchased (i.e., "selling bias" to a particular airline) would have to be made by the owner airlines who would stand to be harmed by such purchase.

  If Orbitz abides by its charter and provides unbiased information to the consumer, it will become quickly apparent to consumers that other outlets may not truly be working in their best interest. These channels may be pressured to reduce or eliminate bias in their own displays.

- **Orbitz' claims of benefits for small airlines are met with skepticism.** Orbitz contends that smaller airlines will benefit most from its non-bias commitment. Larger airlines that have marketing budgets sufficient to purchase display preferences from travel agencies often do so to the detriment of smaller airlines that do not have these budgets. As a result, even if the small airline has a better fare, it may not get top billing on these agencies' displays. In websites that restrict participation, it may get no billing at all. Still, small airlines have expressed skepticism about the intentions of a distribution outlet controlled by the major airlines. Other airlines, including Southwest, believe that the venture proposed by Orbitz does not fit their business strategy.

**Red flags have been raised about Airlines restricting lowest fares exclusively to Orbitz.** The most vocal concerns have been expressed by Orbitz competitors who fear that the airlines will restrict their lowest fares exclusively to Orbitz, which will impede their ability to compete. They view this as an anti-competitive act by the airline owners of Orbitz, aimed at putting their competitors out of business. The critics fear that if the airlines are successful in eliminating their competition, consumers will no longer have choices about where to purchase travel online. This, in turn, could have the effect of raising costs to consumers if Orbitz began to charge airlines premiums for participating in Orbitz once its online competitors were eliminated.

Orbitz counters that its charter agreement does not contain any provisions barring any airline from making any fare available through any channel, and adds that it actually contains an "affirmative non-exclusivity provision" that explicitly states that no airline is prevented from making any fare it chooses available through any channel it chooses. Orbitz contends that in an unregulated environment, airlines are free to set their own prices and decide where to offer their products for sale, and if airlines acting individually choose to make certain fares only available on Orbitz, that is within the airline's legal rights. In statements made publicly, Orbitz has indicated that it agrees that it would be legally problematic if its charter required exclusivity. A recent statement noted, "if [Orbitz] agreements did *collectively* require that certain fares not be sold through other channels, that would be an illegal boycott."

We have reviewed Orbitz' charter and its agreement with participating airlines, and we agree that Orbitz' characterization of its non-exclusivity provision is accurate. This provision, however, is not sufficient reason to dismiss the concerns that have been raised. Airlines acting individually could refuse to participate in other distribution outlets with their lowest, Internet fares, with the intent to maintain Orbitz as the premier supplier of online airline services.

The airlines have stated their intent to continue to participate in a wide range of distribution channels after the start of Orbitz, citing the need to "be on every shelf." Several airlines have indicated that if other sites can provide financial incentives comparable to the Orbitz rebate on CRS booking fees, they are willing to make the low fares they provide Orbitz available to other outlets. It will be important to ensure that the airlines actually follow through on this intent if such offers are presented.

*In the short term, actions could be taken to protect against the potential for anti-competitive practices. For example, interim provisions could be established requiring airlines to make available any fares they provide Orbitz to any other entity willing to offer the same financial terms concerning reduced booking costs, as Orbitz. Such a provision should be predicated on an agreement by these entities to abide by the non-bias regulations that apply to CRSs.*

**Long-term impacts need to be evaluated.** In the long term, barring any anti-competitive behavior, Orbitz could pressure other online agencies to eliminate bias and upgrade search capabilities. It could also pressure CRSs to begin competing through lower booking costs and improved services. But there is the potential for harmful impacts on the travel marketplace. If the airline equity owners of Orbitz refuse to make their lowest Internet fares available to online competitors, Orbitz would have a significant marketing advantage that could allow it to achieve a dominant online market share or even to eliminate its online competitors. In either case, airlines would likely feel compelled to be listed on the Orbitz system or risk foregoing significant business to their competitors.

At such a point, with its market power over the airlines established, Orbitz might choose to charge premiums to airlines to participate (i.e., raise costs) rather than offering reduced costs through lower booking fees. Such an outcome would benefit Orbitz' equity owners to the detriment of other participating airlines. The Departments of Justice and Transportation need to evaluate the likelihood of these and other scenarios playing out in determining whether prior intervention is needed to protect competition and consumers.

**Marketplace changes and technological innovation are rapidly eclipsing CRS rules established in 1984.**

The existing CRS regulations were implemented to protect consumers and competitors from the biasing of information by the airline owners of computer reservation systems. With the Internet potentially replacing many of the functions performed by the original systems, questions have been raised over whether these regulations should apply to the new distribution channels, and if they did, whether they would have any meaningful impact. The regulations apply to airline-owned CRSs, but with recent airline divestitures of CRSs, even the CRSs are unclear whether the current regulations still apply.

The changing environment of travel distribution demands a near-term reevaluation of the applicability and sufficiency of existing regulations to protect consumer interests. The Department has already delayed a reevaluation and readoption of the existing CRS regulations three times from their 1997 sunset date. As the market continues to change rapidly, it is imperative that these issues be addressed without further delay.

**Regulations were developed to protect against airline abuses of CRSs.** Following the deregulation of the airline industry, airlines relied on CRSs to provide travel agents access to the complex and extensive fare and service information that developed as a result of new competition between carriers. In the early 1980s, CRS regulations were introduced to protect consumers from the airline owners biasing information in their CRSs to favor their own carriers.

The airlines' biasing practices harmed consumers by denying them access to unbiased information, and also harmed non-owner airlines that were victims of this bias. The regulations applied to airline-owned CRSs that provided information to travel agents. They prevented CRSs from improving the position of particular flights on integrated CRS display screens based on the identity of the carrier and also required airline-owners of CRSs to participate equally in every other CRS.

The regulations were thought necessary because the travel agents that used these systems were locked into contractual relationships with the CRSs. If the travel agents were receiving biased information, so were their clients. The regulations stopped short of requiring travel agents to present unbiased information to consumers. The rationale was that consumers are free to choose where they get their information since they do not have contractual relationships with travel agents.

**Changing marketplace and technological developments raise serious concerns about the sufficiency and relevance of current CRS regulations.** The current regulations are designed to promote competition and to protect the consumer from unfair and deceptive practices, but the new state of information accessibility poses some difficult questions concerning what protections are needed in the modern marketplace. Confusion exists over whether these regulations apply in the current market, to whom they apply, and how. The issues are complex and we do not have all the answers to these questions today. We can, however, give some context to the controversy.

- **Airlines have begun to divest themselves of CRS ownership raising the question of whether non-airline owned CRSs are covered under existing regulations.** One large CRS has recently become independent and some have contended that it is no longer subject to CRS regulations because it is no longer airline-owned. The Department of Transportation, however, has indicated that it does not agree with this interpretation. This issue needs to be clarified. As airlines divest ownership in CRSs, protections are no longer needed to prevent the airline-owners from biasing data to benefit themselves. However, an independent CRS may have an incentive to solicit participating carriers interested in purchasing preferential display.

- **Existing CRS regulations do not prevent travel agents from biasing information they provide to consumers.** Neither online agencies nor brick and mortar travel agencies are covered by existing bias regulations. Online travel agents such as Expedia or Travelocity may appear to be different entities than brick and mortar travel agencies with retail locations, but from a regulatory standpoint, they are identical. Both act as intermediaries between the airlines and consumers, albeit one has a human interface and the other relies upon a computer program. Both rely upon CRSs to provide information on schedules, fares, and availability, and use the CRS to book travel reservations. Neither is subject to CRS regulations and is not legally bound to provide information in an unbiased manner.
- **Views differ on whether Orbitz should be covered by the CRS Regulations.** Critics have suggested that because Orbitz is airline-owned and providing information on airline fares and services to consumers, it is essentially functioning as a CRS and should be regulated as such. Orbitz contends that it is a travel agency, albeit airline-owned, and should not face different regulations than other online or brick and mortar agencies. Like these agencies, Orbitz will provide information directly to the public. When the original CRS regulations were developed, the determination was made that travel agents did not need to be regulated because consumers were free agents and could make choices about the quality of information they received from various sources.

  The critics who believe Orbitz should be regulated as an airline-owned CRS contend that the owner-airlines are violating the CRS regulations if they do not post the same fares they post on Orbitz on all CRSs. These regulations were developed to prevent CRS airline-owners from limiting their participation in other CRSs as leverage to force travel agents to contract with their own CRSs. For example, absent the regulations, if a travel agent wanted to sell a particular airline's tickets, it might have to use that airline's CRS because the airline would not be listed on any other CRS.

  If Orbitz were subject to the CRS regulations, the five airlines with equity ownership in Orbitz would have to make any fares they make available to consumers through Orbitz also available to every travel agent using another CRS system, even in the absence of equivalent financial considerations such as reduced booking costs. However, it is important to recognize that these other travel agents would not be subject to a similar requirement, even if they were in partnership with a CRS or had commission override agreements with airlines that led them to bias their information displays toward a particular airline.
- **Airline and CRS entry into the travel agency business and technological advancements raises questions about the need for regulatory protections.** Travel agencies have never been subject to the anti-bias rules of the CRS regulations. But given the long history of airlines and anti-competitive CRS practices, the expansion of airlines and CRSs into ownership of online travel agencies raises questions about what regulatory protection may be needed. History has shown how difficult it is to fix problems after they occur. To the extent that protections against abuses can be instituted early, mistakes of the past can be avoided.

  Some parties have suggested that all travel sales over the Internet should be subject to the CRS regulations. Since online travel agencies are virtually identical in structure to brick and mortar agencies, and in some cases represent actual extensions of them, it would be difficult to apply regulations to online agencies without extending them to all travel agencies.

  Orbitz and other entities are nearing a point where direct links can be established with carriers' internal reservation systems to access fare, schedule, and seat availability data, making it possible to bypass CRSs entirely. When this occurs, a determination will need to be made as to whether any protections need to be instituted to safeguard consumer interests, and if so, what these should be.

This concludes our statement. I would be pleased to answer any questions.

The CHAIRMAN. I thank you, Mr. Mead.

Mr. Mims, as Mr. Mead just pointed out, there's been a significant delay in rulemaking on the CRS system rules. When does the Department plan to conclude this rulemaking?

Mr. MIMS. Well, we wish to do that very soon. However, Mr. Chairman, as Mr. Mead has indicated, this industry and the things that are going on with the Internet are very dynamic at this particular time; and we are planning today to post a supplemental notice requesting comments on what's going on with the Internet. We would close that out within a 60-day period and, working with my colleague, the General Counsel, move this rule along. I would like to see this concluded by the end of this calendar year.

The CHAIRMAN. Mr. Mead, in your opinion, why is it that the low fare carriers oppose the creation of Orbitz?

Mr. MEAD. I think there are several reasons. One is that they know the history here; they see the big airlines getting together and I think they are suspicious and they have history to back up their suspicions. I think there's also some suspicion that Orbitz will not adhere to their charter and that over time as Orbitz is successful, Orbitz will have the power to establish big premiums that they charge the airlines for making bookings through Orbitz.

I also think there is a concern on the part of some airlines that all of their fare information and flight information will be available to everybody. And that one of the major airlines can tell at a glance exactly what is happening inside this smaller airline.

And right now, that's not so in the case of e-fares, which are the lowest fares. If a big airline has that information, it can be a potent tool.

The CHAIRMAN. In order to qualify for the discounted CRS booking fee, participating air carriers in Orbitz must enter into a so-called "most favored nation" clause. An airline sells a low fare elsewhere, the MFN clause requires it to offer that fare on Orbitz as well.

Would such a provision inhibit carriers from offering their most cut rate web fares, since it would be uneconomical to sell those fares through the most costly Orbitz travel agent?

Mr. MEAD. No, sir. In fact, as you point out, the charter for Orbitz says that in order to qualify for that rebate, you must provide your lowest fares on Orbitz. That would include those e-fares.

The charter does not prohibit the airlines from giving their e-fares to other distribution outlets on the Internet. The fear is that the individual airlines will see it as in their best interest not to do so. That's the fear.

I don't think the concern is really that people will sit in the back of cigar smoke-filled rooms and agree not give these fares to other Internet distributors. But I think there is a concern that each airline will just see it in its best interest to put them on a website that it owns. Consumers must go nuts having to look at all these different websites to find a different fare; and this website, if it can advertise that it has the largest number of offerings and the lowest fares, the consumers would flock to it. And then they could basically control the market. I think that's the basic concern here.

Senator STEVENS. Senator Rockefeller.

## STATEMENT OF HON. JOHN D. ROCKEFELLER IV, U.S. SENATOR FROM WEST VIRGINIA

Senator ROCKEFELLER. Just a follow-up on that question, Mr. Chairman.

The airlines obviously want to do this. And ordinarily in the Internet business, competition is competition and it's brutal, and a lot of people get forced out of business. Happens every day.

Tell me why you think it is natural behavior that when a company has control of the air fares and the distribution of the information about those air fares that it would, as you suggested, perhaps increase the prices, and use Orbitz as an opportunity to increase prices rather than to simply make cheaper fares available.

Mr. MEAD. I don't think it would happen immediately. I think it would take several years, if it were to——

Senator ROCKEFELLER.—actually, that's not what I was asking you. I was asking, what is it philosophically, or what is the inevitabilty in your mind that leads you to the conclusion that allowed you to make the statement that you did, that they would probably increase fares, whether it's sooner or later.

Mr. MEAD. Because if the phenomena I describe were to occur, and I'm not saying that it would; but if it were to occur, the result would be an inclination to establish premiums, just like it has been on the CRSs, because you have the only game in town.

But that could only occur if the other Internet distribution sites were no longer in business. If they were put out of business, they would feel it was because they weren't getting access to the lowest fares and word got around to all the consumers that the lowest fares were only available on Orbitz. That's where the consumers flocked to; they no longer went to outfits like Travelocity or Expedia.

Without those entities in existence, you only have one; and that I think would explain why they could establish premiums to airlines to participate.

Senator ROCKEFELLER. So you're just saying it would be natural, in a sense monopolistic behavior?

Mr. MEAD. Yes, sir. The suggestion we've made to Mr. Mims' office is that you simply require the airlines to make their lowest available fares available to other Internet providers, provided those other Internet providers are willing to pay on the same financial terms, and also that these other Internet providers agree not to bias their flight and fare displays.

Senator ROCKEFELLER. And if that were the case, then you think it would not be a problem?

Mr. MEAD. I think that would greatly ameliorate the risk, sir.

Senator ROCKEFELLER. Thank you.

**STATEMENT OF HON. TED STEVENS, U.S. SENATOR FROM ALASKA**

The CHAIRMAN. Senator Stevens.

Senator STEVENS. Does Orbitz have any contractual arrangements with major mass purchasers of airline tickets?

Mr. MIMS. Not that I know of at this point, Mr. Stevens.

Senator STEVENS. Like the government, for instance, the federal government. Do they have any special arrangements, any special fares for those who purchase enormous amounts of airline tickets?

Mr. DAYTON. I don't believe they do at this point; they're mostly focusing on getting up and running and establishing the software and website.

Senator STEVENS. They're aimed totally at the individual purchaser, is that what you're saying?

Mr. DAYTON. It's my understanding at this point.

Senator STEVENS. What's the effect of Orbitz on rural consumers? Have you made up your mind on that, Mr. Mead?

Mr. MEAD. It would seem to me that Orbitz would likely have the same effect on rural consumers as it would on urban consumers. It would provide rural consumers, I think, ready access to a very broad range of information, much broader than——

Senator STEVENS. That was my opinion, too, because they would not normally have large travel agencies in their communities.

Mr. MEAD. I think you're quite right, I think there are pluses and negatives to this. And I think we have to maximize the positives and try to control the negatives.

Senator STEVENS. Are you suggesting that the agreement they've entered into prior to Orbitz, that we should mandate that it apply to Orbitz?

Mr. MEAD. Are you referring to the suggestion I was making?

Senator STEVENS. Yes.

Mr. MEAD. Yes, I am. I think it is a——

Senator STEVENS. Can that be done administratively?

Mr. MEAD. We believe it can be.

Senator STEVENS. Thank you.

Mr. MEAD. Mr. Stevens, what I'm concerned about is, you're going to hear later some very vocal views of concern that the lowest fares that are now available on an airline's own websites will be made available only to Orbitz and not to these other vendors.

And I don't think you can just dismiss those concerns when Orbitz says, "Gee, our charter says that the airlines can make them available to these other vendors if they want to." I don't think that goes far enough, in my opinion.

Senator STEVENS. Thank you.

The CHAIRMAN. Senator Wyden.

## STATEMENT OF HON. RON WYDEN, U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you, Mr. Chairman. And I will make it very clear at the outset that I'm very, very skeptical about this entire Orbitz effort. I want to spell out for a moment why I'm so skeptical, and I want to go into particularly this question of safeguards, Mr. Mead, and I think that's the bottom line.

With Orbitz, the airlines want the consumer to believe that they're going to get the lowest fare in one place. And, of course, the hitch is the airlines own the website and they can provide exclusive fares to it; and I guess if Orbitz is successful, they can eliminate on-line competition as well as a lot of travel agents.

And the people who are bringing this to us are the people that you found in July not doing much of a job with respect to following through on their voluntary pledges. We still have wide disparities in fares; you found just recently that clicking on different parts of an airline's website can result in fare disparities of over 1000 percent.

These are the people who sold us on one anticonsumer proposition after another, and I guess what I would like you to tell us is, what are the minimum safeguards, specifically, that would be needed to protect the public here, and what happens if those safeguards aren't put in place?

Mr. MEAD. Let me deal first with these e-fares. I know you came in the room after I displayed this chart; the e-fares are basically the cheap fares. They are currently available only on the Internet.

I think a minimum safeguard here is if you're going to have e-fares and other fares on the web for the same flight, that you ought to have to disclose to consumers that you're engaging in that practice. We know that that is possible to do because we found four airlines that do it, and we found others that didn't. And if you aren't quite fluent with the Internet, you can easily buy a $1,900 fare for a flight that you could have gotten for $178. And not even be aware that there's a $178 offering.

I also think that it would be quite appropriate for the airlines to advise consumers that there may be cheaper fares available via the Internet.

The CHAIRMAN. Senator Wyden, I've been informed that there's been an objection lodged to the hearing, so we're going to have to conclude at 11:30. And also, we're going to have a vote in a few minutes; so obviously we have another panel, and I'd appreciate it. I don't know why we're going through this arcane exercise, but clearly we want to hear from the next panel as well, and I appreciate your brevity.

Senator WYDEN. I wasn't going to ask any other questions. I was just going to say, I think that this is part of a pattern of anticonsumer activity that we've seen from the airlines, and I hope we'll be able to spell out when we have the time to, Mr. Chairman, what the safeguards ought to be here. I think without them, the consumer is going to get fleeced once again.

Mr. MEAD. I wanted to complete the answer for the record, because the record will look very incomplete if I don't.

The other safeguard that ought to be in place is, the airlines should be directed to make their fares available to other Internet distributors if they're willing to pay the same fee that Orbitz is going to be paying, same financial terms; and second, that they agree not to bias their fares or displays on the Internet sites.

I think those will be some pretty meaningful protections.

The CHAIRMAN. Senator Bryan.

I thank you, Senator Wyden.

Senator Bryan.

## STATEMENT OF HON. RICHARD H. BRYAN, U.S. SENATOR FROM NEVADA

Senator BRYAN. Thank you very much, Mr. Chairman. I'll just ask a single question.

Not all carriers are part of this Orbitz system, as I understand it. In the State of Nevada, Southwest has a very substantial presence; they're not part of this proposal.

How does this system work with carriers who are not part of the system, and what are the implications for the consumer?

Mr. MEAD. Southwest Airlines, it's fair to use them as an example. They would not, as I understand it, be participating.

Senator BRYAN. That's my understanding, too.

Mr. MEAD. But they would be displayed, and they would be displayed along with all the other airlines, and according to the charter of Orbitz, in an unbiased way.

But Southwest Airlines would not get a rebate of the booking fee. I think the concern of Southwest Airlines and others is a deep-rooted suspicion that when the major carriers get together, there may be some mischief afoot. They are probably looking to the history of the Computer Reservation Systems, which if you'll recall the early days of those, a couple of the airlines owned them—you'd look up at the display and lo and behold, even though there may be other fares available through other airlines, you see a display that favors the airline that owns the website, even though the fare is higher.

Senator BRYAN. It took a Stanley to find Dr. Livingston in that system of display, as I recall.

Mr. MEAD. Yes. So I think those are a set of concerns.

Mark, would you want to add to that?

Mr. DAYTON. I would agree with that. Southwest will be displayed but you won't be able to book the ticket through the system; what happens is you'd have to call Southwest or get on their website.

One thing for Southwest is that they're very cost efficient in both their website and their travel reservation system. They may believe that, in fact, this new site would actually raise their costs, because as a full member they would be paying booking fees that to date they've avoided.

Senator BRYAN. Thank you very much.

Mr. MEAD. You know, I think what's interesting about this, there clearly are some positive features of this, but I think there's some resentment that "Gee, in order to really market my product I have to be a member of this club or this organization in order to effectively market. And if it's widely successful 2 or 3 years down the road, the owner is going to jack up the fees much greater than they were when I initially joined."

Senator BRYAN. Well, and as you observed, Mr. Mead at your initial response, there is certainly some skepticism that there may be some mischief afoot here, and I think that's the concern many of us have.

Mr. Chairman, I'll refrain from further questions in deference to the time constraints that we face. Thank you very much.

The CHAIRMAN. Thank you very much, Senator Bryan.

Senator Cleland.

## STATEMENT OF HON. MAX CLELAND, U.S. SENATOR FROM GEORGIA

Senator CLELAND. Mr. Mead, it seems to me that one of the values of the technology we have at hand, the concept of a web or a network and the ability for a lot of people to communicate in a web or in a network relatively instantaneously.

That technology lends itself to the spread of information rather than the limitation of information; and that if one were to apply the advances in technology to most any information system, it would, in effect, break down barriers and really create a web of information that all people on the web were tied into.

It seems to me that if one major web dominates all the information and does not share it with a smaller web or other webs, then it kind of conflicts with the whole philosophy of this proper spread of information, especially to consumers, so they have additional information in order to make good, healthy choices. And it seems to me this can apply to the airline industry or any other type of consumption or sales of any kind, or marketing of any kind.

Do you feel that Orbitz is a limiting kind of web or is an expansionist kind of web? Are we better off with it or are we worse off with it, in terms of the consumer getting information and being able to make choices?

Mr. MEAD. It's really both. A very positive feature is the comprehensive set of fares and flights it will have. It will have more offerings.

Second, it will offer the lowest fares in one place, which I think a lot of consumers want; they get frustrated having to go to all these different sites to find them, and they may not even know how to find them.

On the other hand, the airlines that will be owning Orbitz aren't required to give their lowest fares, whatever that ends up meaning, to distributors on the Internet other than Orbitz. I think that's a problem area. I think the fix for that is to say that they have to give it to other online agencies, for almost the very reason that you suggest.

Except that in return for getting this information, these agencies have to offer a rebate of the booking fee just like Orbitz will do, and second they have to agree that once they get this information, they can't bias flight displays and fare displays toward one airline. If you didn't require that, you'd create an uneven playing field because you would have Orbitz playing by one set of rules, where they can't bias their displays by their own corporate charter, but you have these other Internet agencies who get the information and then are free, under the current rules and regulations, to bias the information.

Senator CLELAND. Correct me if I'm wrong, you would allow other, shall we say, networks or webs to enter this larger playing field, but if they played on that field, they'd have to play by those rules?

Mr. MEAD. Yes, sir. In brief, that's exactly what we're saying.

Senator CLELAND. That's fascinating.

I understand that rules were put in place in 1984 to challenge the CRSs to be more competitive since there were some complaints about them by a number of federal agencies. But some three years later DOT put out a study showing that the rules had had relatively little effect in limiting the anticompetitive practices of the CRSs. Is that true?

Mr. MEAD. I think if you look over time, the CRS rules, which legally apply to airline-owned Computer Reservation Systems, did have a good effect in eliminating bias. Back in the beginning these Computer Reservation Systems would actually display in a favorable position on the agent's screen the fares and flight information for the airline that owned the CRS. I guess you might say that's natural behavior. If you own it, why not favor yourself?

But these systems became so powerful, so potent, that the regulators had to intervene, largely in response to pressure provided by this very Committee and the Congress, and said "You can't do that."

I'm not representing that all bias has been eliminated, but a lot has. The problem now is that some of the CRSs, the most powerful CRSs, aren't owned by the airlines. So there's a question, do the rules even apply to them?

The rules have not kept pace, sir, with the Internet. In fact, they were established when I don't think it was possible to make a reservation on the Internet. So we're dealing with a playing field that has changed so dramatically that the whole issue needs to be revisited.

Senator CLELAND. Mr. Mims, you're nodding your head over there. Give us your insight here.

Mr. MIMS. Well, I was going to add to that, Senator Cleland, that at this particular point the Department—let me initially say we have been tardy in issuing the rules on CRS—we have put out a new notice requesting comment on CRS rules, and especially we want to focus on the Internet.

Again, what I want to let everybody know is, we want to get that information within the next 60 days and once we've gathered that information, we will move with some dispatch to issue the rules.

Senator CLELAND. Mr. Mead, I do have the sense that we're playing a little catch-up ball here, and I get this feeling about a lot of these issues involving the web, the Internet, and the technology.

That reminds me of a statement that I saw on a barracks wall when I was a young lieutenant, that "There go the troops, and I must hurry, for I am their leader."

In many ways, we on this Committee struggle with who should adopt the rules, what the rules should be, and if there should be any rules at all, particularly in the world of the Internet. And I think this just presents to us one more challenge.

In conclusion, do you have any recommendation you'd like to leave with us, other than what you've already said, in terms of Orbitz in particular?

Mr. MEAD. I mentioned the one we have for Orbitz. The airlines ought to be making these fares available to others on the same financial terms as they're going to make it available to Orbitz and the people they give it to, those entities ought to agree to display it in a bias-free manner.

A second thing I think is quite important, we found variations within an airline's own website of fares from one location to another that had a 1000 percent difference between the fares. We think the airlines either ought to construct their websites in such a way that that phenomenon doesn't happen, or if they want it to happen, they at least disclose to people that there's a cheaper fare. Because in some of these instances, you could be paying $1500 for a fare when the same location, same itinerary is available for say $190, same airliner.

I don't think that's too intrusive to ask the airlines to do that.

Senator CLELAND. Thank you very much, and thank the members of the panel.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank the members of the panel, and I appreciate you being here, and we look forward to seeing you again soon.

Our next panel will be Mr. Terry B. Jones, President of Travelocity; Mr. Jeffrey Katz, Chairman and CEO of Orbitz; Mr. Mark Silbergeld, Co–Director of the Consumers Union; and Mr. Paul Ruden, Senior Vice President for Legal and Industry Affairs, American Society of Travel Agents.

Mr. Katz, we'll begin with you, sir. Welcome to the panel.

**STATEMENT OF JEFFREY G. KATZ, CHAIRMAN, PRESIDENT AND CEO, ORBITZ**

Mr. KATZ. Thank you. My name is Jeff Katz and I'm President and the Chairman of the Board of Orbitz, and I know that some have portrayed us as Internet big boys——

The CHAIRMAN. Pull the microphone a little closer, Mr. Katz. Thank you.

Mr. KATZ. I know that some have portrayed us as Internet big boys backed by airline bad boys, and I can understand the viewpoint, but Orbitz is an Internet startup company. We represent new competition using new technology in an effort to present Internet consumers with what we think they really want; comprehensive and unbiased travel information.

It is certainly a bit ironic for me to be sitting here as a former head of Sabre's CRS division on behalf of Orbitz, but I'd like to take a moment to discuss why Orbitz exists and why I am here.

Travel is at the heart of e-commerce. More travel is sold on the Internet than any other category of product, and on-line travel will probably hit $20 billion in revenues in the coming year, not counting Orbitz.

What we have today in this marketplace is a situation where two extremely strong, dominant companies have moved in and established a very potent duopoly in Internet travel, and both have done so with what we call CRS-based Internet sites.

First is Sabre's Travelocity. It is the largest CRS in the world and by itself controls nearly 50 percent of all CRS bookings; the other is Microsoft's Expedia. Between them they have wrapped up through exclusive deals, mergers and their own good initiative, 70 percent of the business of offering multiple airlines to consumers over the net. And they have nailed down in addition long-term distribution deals with the likes of AOL, Yahoo, and Microsoft Network, giving them exclusive distribution to nearly 90 percent of all portal visitors to the World Wide Web.

These sites now sit on a marketplace that they dominate that is expected to quadruple over the next 4 years; and the fact is that they have more lobbyists and lawyers than we have employees.

We think consumers deserve to have more choice and more competition than two major players in such a huge market. We attempt to be part of the solution, not part of the problem. We attempt to bring competition. I think there's clearly room for three.

I'd like to summarize the facts about Orbitz. We believe we have to provide consumers with absolutely comprehensive, unbiased searches and displays of airlines' flights and schedules. In response to a consumer query, we will show more airlines, more flights and more fares than any existing CRS-based site, and we will do that for all airlines big or small, new or old, investors or not, associates or not. And unlike any CRS-based website we will search all airlines, all flights and all fares.

And when I say we will be unbiased, I do not mean simply that we will comply with the existing CRS rules on display bias; we go beyond that. We have to do a better job of giving consumers what they want or they will never use our website; it's that simple. So we have a written guarantee that we will provide unbiased displays into our contracts, and no CRS-based website we know of has taken that obligation to date.

Second and importantly, we provide that comprehensive and unbiased capability by building an all-new technology. Rather than using the old CRS technology which started about a quarter of a century ago, we use the newest generation of processors, independently developed search software, and greatly improved seat availability data.

As you know, the search software we use was developed by a group of M.I.T. grad students beginning some 8 years ago at the M.I.T. Artificial Intelligence Lab, and the founder behind that, Jeremy Wertheimer, is here with us today and available for questions.

Anybody could have introduced the new technology, but until Orbitz came along, nobody chose to do, and I think the reason why not is because competition was not there.

With the efficiencies of this new technology, we are offering something else that is new, revolutionary; and that is a form of price competition on the CRS booking fees. These fees have clearly been found to be excessive; they burden small and low fare airlines in particular, they burden consumers, and they raise the cost of selling through travel agents.

We offer to offset part of that excessive fee to exactly the same degree for any airline, whether an investor in Orbitz or not, and we are the only website that has chosen to do so. If we were denied the ability to do that, what would be lost is the only opportunity in many years to use competition to relieve consumers, airlines and travel agents of the burden of these CRS costs.

Now, much has been made of the fact that airlines have invested in Orbitz. And the fact is, in the view of the financial markets, we are attempting something very, very new here and very, very technologically risky. We are trying to provide the consumer comprehensive and unbiased information by applying totally new technology to a very complex problem. It is hard for most investors other than airlines to even evaluate the risk inherent in such an undertaking.

To take on such an entrenched duopoly is very difficult in today's financial markets, and nobody has as much know-how and in fact incentive to try and bring price competition to CRS booking fees as airline investors do.

But having obtained that initial investment, I am now seeking and expect additional investment from non-airlines, and we expect that new investment to substantially dilute, by more than 50 percent, the interests of the airline investors, and I will do so as quickly as I can.

A second issue has been raised about Orbitz: the idea that we have an agreement with airlines that they will provide fares to us that no one else will have. Let me be very clear: there is no agreement by which airlines are obligated to make any fare available to Orbitz that they do not make available elsewhere, period.

In fact, our contracts not only do not give Orbitz any exclusive right to any fare, they go beyond that; they expressly guarantee that there is no right of exclusivity and that each airline individually has the right to determine what fares it sells and where it sells them. Orbitz does not and cannot prevent any airline from making any fare available through any channel.

Here's the simple fact that most of our CRS-based Internet competitors do not want to face up to, and perhaps something that's difficult to see in the details. At least 99 percent of the time that Orbitz shows the consumer a lower fare than other sites do, it will not be because Orbitz had access to a fare that they did not have access to. It will be because Orbitz did a better, more thorough and unbiased search of the fares that were available to everybody.

Forester Research projects that on-line bookings will grow from 4 percent to 12 percent of all bookings over the next 4 years. We expect Orbitz, if successful, to account for one to 2 percent, and there is no way our less than 2 percent of bookings is going to put anybody out of business, let alone the existing sites or travel agents.

In conclusion, Senators and Chairman, we are a new competitor entering a business, on-line agency websites, that is dominated by competitors numbering two. We cannot be just as good as they are and hope to succeed, to gain ground in this arena that they dominate; we have to be far better than they at offering consumers what they want.

We ask for nothing more than a chance to compete. We believe we will enhance competition in the distribution of air travel. We will give consumers better, more complete information about airlines, flights and fares. We will advance the technology used to bring that information to consumers. We will bring price competition to the computer costs of distribution where it has been sorely lacking, and we have by contract provided that we have no right of exclusivity to any fare whatsoever.

We are more than willing to be judged by consumers, and we believe it should be the consumers who decide which site best meets their needs. Orbitz is the story of new competition. We are the underdog, not the big bad guy, with huge obstacles to overcome to even become number three in on-line travel.

We're willing to take the risk of trying to do that, and I would urge you to please be aware of regulatory proposals from those who might not welcome the competition we bring to on-line travel.

One final comment, Mr. Chairman, if I may: I can tell you that the Europeans fully understand what can be done with this new technology, and they are well along in creating a European-based website that would use exactly the technology we are building at Orbitz. If we do not build this technology in the U.S., it will be built by others, and it will be used by consumers in the U.S., because there is nothing more international than the Internet.

Thank you for the opportunity to testify, and I would be pleased to try and answer any questions the Committee might have.

The CHAIRMAN. Thank you, Mr. Katz.

[The prepared statement of Mr. Katz follows:]

PREPARED STATEMENT OF JEFFREY G. KATZ, CHAIRMAN, PRESIDENT AND CEO, ORBITZ

My name is Jeff Katz, and I am President, and CEO of Orbitz, and Chairman of its Board.

Orbitz is an Internet start-up company. We represent new competition, using new technology, in a new effort to present Internet consumers what they want: comprehensive and unbiased travel information. In that effort we will compete against one of the most dominant and entrenched companies in the American economy: Sabre, the largest Computer Reservation System in the world, and Sabre's Internet arm, Travelocity. They have more lobbyists than we have total employees.

We have found ourselves in recent weeks the victims of a misinformation campaign, and we simply have not always had the resources both to build our new service and to respond to every attack. We therefore thank you for this opportunity to put the facts on the table.

It is a bit ironic for me to be sitting here, as a former head of Sabre's CRS division, on behalf of Orbitz. Let me take a moment to discuss why Orbitz exists, and why I am here.

Travel is at the heart of what e-commerce is all about. More travel is sold on the Internet than any other category of product. Online travel will probably hit $20 billion in revenues this year, not counting Orbitz. Whether consumers will use the Internet to buy travel is not a question to be decided—it has already happened. The question is simply how much choice consumers should have when they use the Internet to buy travel, and how much competition should there be for their business?

Internet travel should be very open to competitive entry. The CRS industry is not, because it has its users, the travel agents, under highly restrictive, long-term contracts that effectively deny most of them any possibility of switching to another CRS or using an additional CRS. But the Internet is not like that. No user is under contract. Any user can switch to any other site at the click of a mouse.

What we have today, however, is an unfortunate situation where two extremely dominating companies have moved in and established a very potent duopoly in Internet travel, and both have done so with CRS-based Internet sites.

One is Sabre/Travelocity. Sabre is the largest CRS in the world. By itself it controls 46% of CRS bookings. It takes the position that the CRS rules do not even apply to Sabre. The other is Microsoft/Expedia. Neither Sabre nor Microsoft has a record of being shy about establishing market dominance and exercising that dominance aggressively. Between them they have wrapped up, through exclusive deals and mergers, 70% of the business of offering multiple airline schedules to consumers over the Internet. And they have nailed down long-term deals with AOL, Yahoo, and MSN giving them exclusive distribution to 90% of all portal visitors to the World Wide Web. Having purchased their largest competitors and locked up the major portals, these two dominant sites are now sitting on a marketplace that is expected to quadruple over the next four years.

It is this very powerful duopoly to which we are attempting to provide some new competition. We think consumers deserve to have more choice and more competition than just two major players in Internet travel. If you think there is an anti-competitive problem in Internet travel, you are absolutely right. And Orbitz is part of the solution to that lack of competition.

We absolutely understand how difficult it will be for us to break into a business so dominated by two CRS-based Goliaths. What we find hard to grasp is how Sabre/Travelocity in particular can look down on us from their lofty and entrenched position and claim that we are bullying them! They recently bought one of their largest on-line competitors in order to further consolidate their power and reduce competition. We think it is clear that they are simply trying to use any device available, including government, to block any new competition.

What we have to do to break into this highly dominated business is clear:

- we have to provide consumers with the complete and unbiased flight and fare information they want and are not getting today,
- we have to break with the old technology of the CRS era and be the first to use today's best technology to solve this problem for consumers,
- and we have to bring some long-missing price competition to the CRS booking fees which have burdened so much of the ticket distribution system.

Let me review each of those points.

First, we believe we absolutely have to provide consumers with absolutely comprehensive, absolutely unbiased searches and displays of airlines, flights, and schedules. In response to a consumer request we will show more airlines, more flights, and more fares than any existing CRS-based Internet site. And unlike any CRS-based website, we will search all airlines, all flights, and all fares before displaying any.

When I say we will be unbiased, I do not mean simply that we will comply with the existing CRS rules on display bias—we will go well beyond that.

Our objective is to provide absolutely unbiased display of every airline's flights and fares, whether they are investors in Orbitz or not, and whether they are associates of Orbitz or not. We want every airline to be fully and equally displayed in Orbitz, and we want Orbitz to treat every airline the same.

We do this not simply because we have to provide that level of quality information if we are to have any chance of winning consumers away from these two dominant websites that have exclusive positions on the portals most consumers use. We have to do a better job of giving consumers what they want, or they will never make the extra step it takes to use our website. It's that simple. And so we have written the guarantee that we will provide absolutely unbiased displays, exactly the same for all airlines, big or small, new or old, into our contracts with each airline, whether they are investors or not. We are now absolutely obligated to be unbiased. Travelocity is not. No CRS-based website we know of has that obligation.

Second, we are providing that comprehensive and unbiased display by building an all-new technology for searching and displaying airlines, flights, and fares. Rather than using old legacy technology from a quarter of a century ago, we are using the new generation of processors; new, independently developed, unbiased search software designed to search all possible airlines, flights, and fares: and greatly improved seat availability data. These old legacy systems still rely extensively on the old Cobol programming language; we will use today's Java. We are the only site demonstrating that Internet sites need not be based on the old CRS technology. And I believe that if we succeed, others will follow. We will have the competitive entry that has been completely lacking in computerized distribution in the CRS-dominated era.

Let me explain more fully what I mean by using new technology to create the kind of truly comprehensive and unbiased displays consumers have been wanting and the large CRS-based Internet sites have not been providing them.

Distributing complete and accurate information about every flight and every fare, every day, is an enormous technological challenge. A quarter of a century ago CRSs began being placed in travel agencies—usually under a contract that made it impossible for that agent to use or switch to any other CRS.

The CRSs were marvels of their day. But think for a moment what the world of computers was like 25 years ago. Computers can do things for people today that no one could have imagined possible 25 years ago.

When you want to travel in the U.S. from City A to City B and back, and you ask one of these CRSs what your airline, schedule, and fare options are, it can search about 5,000 to 10,000 possible combinations for you, and it does that in about one second.

The problem is that from City A to City B and back there are typically somewhere between half a billion and a billion possible combinations of airlines, schedules, and fares. (That is a hard number to believe, but it is true. By the time you take all the possible airlines, over all the possible routings including all possible connections, and all possible fares on each of those flights, and add in all the possible combinations with the return flights and fares, there are that many total possibilities in a typical domestic round trip.) So that CRS is only searching about one one-hundred-thousandth of the options you really have in the marketplace. Despite all those rows and rows of huge mainframe computers and huge disc data storage units, that's the limit of the old CRS's ability to process information.

So what the CRS does is narrow the options it will look at by prescreening out 99.99999% of your options *before* it begins to evaluate them for you based on price and time. Connecting flights over points not on the system's predetermined list of connecting hubs? Doesn't even consider them. Flights offered by an airline with very few frequencies in that market? Doesn't even consider them. Most of the options it throws out are not good choices for you—they're inefficient routings, inconvenient departure times, and the like. But buried in that pile of over half a billion possibilities that the CRS throws out before it evaluates are usually some great options—an alternative city to connect over, a competing airline, a few fares that are lower.

What Orbitz is all about is that we will search absolutely every airline, schedule, and fare possibility in response to your request to go from City A to City B and back—all half a billion to a billion possibilities—and we will do it in one second. In response to your request, we will search through approximately 100,000 times more options than the CRS will, or than the Internet site that uses a CRS for its searches will, in order to be sure we are showing you the best flight options at the lowest fares.

We can do that because computers have changed enormously in the past quarter of a century. Let's take a quick look at how today's technology can do a better job of getting the consumer what he or she wants:

- Data storage. The old systems use large disc data storage systems, and still have severe limitations on the amount of data they can hold. Today's technology can hold vastly more data at a small fraction of the cost. Today a one inch-by-one inch disk, such as the ones used in ordinary digital cameras, can hold every published airline fare in the U.S.
- Computing power. Rows and rows of mainframe computers are impressive to look at, but their actual computing power is limited by today's standards. By assembling modem server processors in parallel, instead of using mainframes, Orbitz will have over 1,000 times the computing power of Sabre, the largest CRS, and at only a small fraction of the cost.
- Search software. The search software of the CRS's is inherently limited—designed to search only the limited pool of options that the CRS can handle in response to your request. Orbitz will use a new search software that was independently developed beginning 8 years ago by a group of grad students at the MIT Artificial Intelligence Lab. It is the first software designed to search literally every airline, schedule, and fare in response to your request to go from City A to City B and back, anywhere in the U.S. or Canada. Having searched and genuinely evaluated all half a billion to a billion possibilities, it will present to you lowest fare first, the best several hundred possibilities—without regard to which airline provides the service. And it will do it in a format that is readily understandable to the consumer and allows the consumer to quickly judge for him- or herself which options are best. This independently developed software is the product of that team of now former grad students led by Dr. Jeremy Wertheimer, who is in the audience today and is available for questions. You, or anyone in the general public, can try out this software today at a test site *(www.itasoftware.com),* but because it is only a test site it does not yet have the powerful Orbitz hardware behind it, and it cannot actually make a booking. Nevertheless, even just as a test site, it has become very popular with consumers and travel agents seeking better information than they can get through CRS's or through CRS-based Internet sites today. Jeremy and his group have received thousands of e-mails from users, both travel agents and consumers, praising the system, and wanting to know when they can begin actually booking through it. I have provided some of those comments at Exhibit A to my testimony.
- Seat Availability. Internet sites only show flights and fares to consumers for which seats are available. Yet each of these sites operates using imperfect and outdated seat availability data, typically checking up-to-date data only after eliminating most flight and fare options from consideration. The result often is that flights and fares for which seats actually are available are not shown to the consumer because the system mistakenly believes, based on stale data, that no seats are available. Thus, the consumer too often does not see the lowest fares or the best schedules. The remedy is to obtain fresher seat availability data and to use it earlier in the search process. Orbitz has designed a new system, using expanded telecommunications and data storage, to do exactly that.

Anybody could introduce these new technologies. The processors are readily available. The data storage is readily available. Jeremy's unbiased and comprehensive search and display software is readily available. Any of these CRS-based Internet sites could choose at any time to expand the telecommunications networks and data systems necessary to improve seat availability. But until Orbitz came along, nobody chose to do all these things.

Why not? Because there was no competition pushing them to make their systems as good as they possibly could be. It was, and still is, in the interest of the old CRS's, and the CRS-based Internet sites, to keep using their existing technology as long as possible. They will only update their existing systems when competitively pushed to do so. We are that new competition.

The CRS's have not needed to worry about competition because they each had a hold on each of the agents the CRS had under contract, such that it was virtually impossible, or prohibitively expensive, for most agents to ever leave their CRS and switch to another. In turn, that means that since no airline can afford not to sell through the travel agents under contract to any CRS, each airline has to pay whatever each CRS charges to sell through those agents. Agents are denied a choice among CRS's, CRS's do not have to compete with each other (either technologically or financially) to win the business of travel agents, and airlines (meaning ultimately passengers) are stuck with the burden of paying excessive CRS fees.

This Committee has repeatedly expressed its concern over the anti-competitive effects of CRS's. These anti-competitive effects for the most part have never been remedied. For example, rules were put in place prohibiting one kind of bias used in CRS's—carrier-specific factors—yet they continued to allow most other forms of bias. And in practice, most of those biases are rooted in the inherent limitations of the CRS technology.

For two decades, the air travel distribution system has been dominated by these CRS's. There are only four of them, and the largest, Sabre, has 46% of CRS bookings. Nobody has been able to break their grip.

The greatest promise of the Internet in the area of air travel distribution should be that it would provide new competition for these CRS's, and that the new technology would be what finally provided some new competitive entry into computerized distribution.

Instead, so far the opposite has been the case. The CRS's, mainly Sabre, the dominant CRS, have moved to duplicate the CRS oligopoly in the Internet world.

We believe the Internet, in combination with the new technologies I have mentioned, can still be a force for new competition, and that is what Orbitz is all about. And that, of course, is also what much of the opposition to Orbitz is all about, as well. Some people don't like new competition.

Third, we are offering something else that is genuinely new, and that is a form of price competition on the CRS booking fees. These fees are clearly excessive, they burden small and low-fare airlines in particular, they burden consumers, and they raise the cost of selling through travel agents without providing any benefits to most travel agents. We are offering to offset part of that excessive CRS booking fee, to exactly the same degree for any airline, whether an investor in Orbitz or not. We are the only website that has chosen to offer to partially offset excessive CRS booking fees. We understand that at least one of our established online competitors, and the CRS behind it, do not welcome that price competition, but we are here to provide it anyway.

Since 1983, when the Department of Justice and others first asserted that CRS booking fees were excessive, these fees have gone up approximately 1400%, while computing costs generally in our economy have gone down by over 99% in the same time period. Clearly the problem of excessive CRS booking fees has only gotten worse since Justice first raised its concerns. Excessive CRS booking fees add to consumer costs, disproportionately burden smaller airlines and low-fare airlines, and have unreasonably raised the costs of distributing tickets through travel agents, to the disadvantage of most travel agents and most consumers.

The simple fact is, CRS's can engage in anti-competitive pricing because they have an effective lock on the agents they have under contract. Airlines have to pay those fees, no matter how unreasonable, in order to reach the customers of those agents. And the passengers of those airlines end up paying those excessive costs. This Committee has justifiably been very concerned over the years about the anti-competitive effects of excessive CRS booking fees.

Orbitz will indirectly provide the first price competition that has ever existed in CRS booking fees. We are not a CRS. We will use one of the smaller CRS's to make the actual booking after a consumer has selected a flight and a fare, and that CRS will charge the airline the normal booking fee. That CRS will in turn pay to us, as CRS's typically do to the largest travel agencies, both online and traditional, a market segment incentive. But we will then share part of that amount with the airline on which the booking was made, in effect offsetting part of that excessive CRS booking fee. No CRS has ever been willing to do that. No CRS-based website has ever been willing to do that. We are willing to do that for any airline, in exactly the same amount, no matter whether the airline is big or small, new or old, a low fare airline or not, an investor in Orbitz or not. Every airline has the same shot at the same offset to the CRS booking fees on exactly the same terms.

What all this means is that Orbitz will challenge the choke hold that CRS's have on airlines and on the costs of distributing airline tickets to consumers through travel agents. If Orbitz is blocked in this effort, by cleverly disguised regulatory proposals or by other anticompetitive obstacles, this extraordinary opportunity to finally bring some price competition to CRS booking fees will have been lost, and so will the only chance to relieve consumers, airlines, and travel agents of the effects of these burdensome and excessive costs.

Sabre, as the largest CRS, has been particularly unhappy about this new price competition we are introducing in the CRS arena. They have never experienced price competition in CRS booking fees before, and they do not welcome it. We have discovered in the past couple of months that there is very little they and their Internet arm, Travelocity, will not do or say to try to prevent that new price competition from occurring.

Let me turn to some of the specific issues that have been raised about Orbitz.

First, much has been made of the fact that airlines have invested in Orbitz.

We think we should be judged by what we plan to do, and by what we actually do, not by who we are, or who our investors are.

The fact is, we are attempting something very new here. We are trying to provide the consumer absolutely comprehensive and unbiased travel information, by applying a number of new technologies to the very complex universe of airline schedules and fares. It was hard for most potential investors to evaluate the risks inherent in such an undertaking. As it turned out, the initial investors in this area were airlines, because they had the expertise to understand what we proposed, to evaluate its risks, to conclude that it would work and would offer consumers better information.

And frankly no other set of investors were initially willing to take on such an entrenched duopoly. And no other set of investors had as much incentive to try to bring some price competition to the area of CRS booking fees.

But having obtained that initial investment, we are now seeking and expecting additional investment from non-airlines, and we expect that new investment to substantially dilute the interests of the existing investors.

No single investor has ever had a majority interest in or control of Orbitz. No single investor has as much as 30% of the equity in Orbitz today. And we expect that within 18 months of launch, no single investor would have as much as 15% of the equity. Furthermore, we expect that, as a result of bringing in more investors and public investment, all airlines together will be reduced below the 50% mark.

Since our mission and our business strategy are to provide absolutely unbiased information to consumers, it was important to us that we not find ourselves in a situation where only one or two airlines were our only investors. The fact that we have five competing airline investors means that they balance each other out—none of them would allow us to do anything to advantage any other airline. The result is that we have no choice but to be absolutely unbiased and neutral, exactly what we want to be and need to be in order to attract customers.

A legitimate question at this point is: Why would any of the major airlines want to invest in something with the objectives of Orbitz? We want to give every airline, big or small, the same unbiased displays—why would the big airlines want to help make that happen? We want to share with every airline, big or small, an offset to the excessive CRS booking fees that weigh particularly heavy on the smaller airlines. Why would the big airlines want to help make that happen?

Ultimately only the airlines can answer questions about their decisions, but I have my own opinions based on my observations of the industry in general. I do not believe the big airlines are helping launch Orbitz because they want to help the smaller airlines, and I doubt this Committee believes that either. But I do believe the big airlines have some very legitimate and compelling reasons to want to help make Orbitz happen, and if helping the smaller airlines is a byproduct, so be it.

The first of those reasons is that the Internet is not going to go away. Even if only a minority of all passengers want to book on the Internet, it will be a sizable enough minority that no airline can afford to ignore it. And the airlines have come to recognize that their own websites, as good as they are for some passengers, will never meet the needs of all consumers who want to use the Internet. They have to have a device that gives consumers who want to use the Internet and who want to search all airlines, flights, and fares for the best options, what they want. And the CRS-based Internet sites out there currently don't do that.

The second reason is that airlines have to control their costs, and one of the costs they have been least able to control is these excessive CRS booking fees. There are individual airlines that pay nearly a third of a billion dollars a year in CRS booking fees, and those costs are passed along to their passengers. They have to find a way to bring normal market pressures to bear on these excessive costs. If smaller airlines benefit disproportionately in the process, so be it.

The third reason is that airlines see the biggest Internet sites increasingly acting in ways that disadvantage their customers. For example, the largest Internet sites, such as Sabre/Travelocity, go to the airlines and offer to increase that airline's market share in return for payment. In other words they will do what they have to do to their system to direct some passengers who would have booked on one airline to another airline, for a price. Some in the industry call this "swinging market share" and some call it "selling bias". But with Internet travel sales increasingly dominated by the two biggest sites, the view increasingly is that this practice is getting out of hand and is contrary to the interests of consumers. A site like Orbitz that competes specifically on being comprehensive, neutral, and unbiased in its displays will moderate this practice by competitive pressure. We believe that will be a benefit even to consumers who do not choose to use Orbitz.

And the fourth reason is, in a deregulated environment, airlines increasingly find that they offer a discounted fare, or open up more seats at an existing low fare, to attract more customers, and yet it uncertain whether those more attractive offerings are ever shown by the largest CRS-based Internet sites to the consumers. This is a disadvantage not only for the consumer, but for the airline, who now is not sure whether consumers did not respond as expected to the discount because the discount did not meet their needs, or because consumers never saw the discount on their Internet display.

Attached to my testimony as Exhibit B* are a series of examples of instances where an airline offered a low fare and it did not show up on Sabre/Travelocity. Sometimes it may have been because Sabre/Travelocity was using stale seat availability data, but other times that does not seem to explain the problem. In one case, Sabre/Travelocity said the airline did not offer *any* flights to a community, when it did! It is hard to understand how these kinds of problems can occur. Consumers are not always seeing the best flights and fares. And airlines are losing customers they should be getting, and wondering why. Is it because the Internet site has sold the "featured airline" status to another airline in that market? Are displays being intentionally manipulated in order to "swing market share"? Whatever the reason, airlines are left to operate in the competitive marketplace half blind, not sure whether the consumer reaction to their fare discount is because it was the wrong discount, or because some of their customers never saw it. Their customers who use the Internet don't like it, and neither do the airlines. They finally got to the point of wanting to do something about it. That something is Orbitz.

A second issue has been raised about Orbitz: much has been made about the idea that we will have fares nobody else will have, and that we have an agreement with airlines that they will provide fares to us that no one else will have.

Let me be very clear about this: there is no agreement by which airlines are obligated to make any fare available to Orbitz that they do not make available elsewhere. Period.

In fact, our contracts not only do *not* give Orbitz *any* exclusive right to *any* fare, they go a step beyond that. They expressly guarantee that there is *no* exclusivity, and that each airline individually has the right to determine what fares it sells and where it sells them, as they have had that right throughout the entire history of deregulation. Orbitz does not and cannot prevent any airline from making any fare available through any retail channel.

And we go even another step beyond that. We have in our contracts a non-discrimination provision by which an airline that chooses to share in the offset we offer on the CRS booking fee, in return agrees that any fare it makes available to the general public through some other retail channel, it will also make available to the general public through Orbitz.

Here is the simple fact that some of our CRS-based Internet competitors do not want to face up to: at least 99% of the time—and maybe every time—that Orbitz shows the consumer a lower fare than they do, it will not be because Orbitz had access to a fare that they did not have access to. It will be because Orbitz did a better, absolutely thorough and unbiased search of the fares that were available to everybody.

Third, much has been made about the threat that the Internet in general, and Orbitz, in particular, supposedly present to traditional travel agents.

In fact, the opposite is true. The Internet in general, and quite possibly Orbitz in particular, are likely to significantly improve the lot of most travel agents.

Much of the travel agent concern has been focussed on the idea that Orbitz will not charge a commission, and will therefore further erode travel agent commissions. That is simply not true. Orbitz, like Travelocity, Expedia and many others, is an online travel agency. We expect to receive, and so far are getting agreements to receive, a base commission similar to what each airline pays every other online travel agent. We expect commissions to be our largest source of revenues. Like any travel agent, we have an interest in base commissions being higher, not lower.

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*The information referred to has been retained in the Committee files.

At present, about 80% of all bookings are made through traditional travel agents, and only about 4% are made through online agents, such as Travelocity, Expedia, and, soon, Orbitz. Our market research tells us that consumers who use travel agents typically do so because they want the person-to-person advice and expertise they get from travel agents, and we don't see much reason why those consumers would want to switch to the Internet. Where we do find dissatisfaction is among the 4% that use the Internet, particularly those customers who want an Internet site that will show them all the airlines and all the best schedule and fare options. Many of those consumers complain that, to be sure they are getting all the airlines and the best schedule and fare options, they have to go to many different sites, because no site gives them all of what they want. We find in our consumer research that consumers are very clear on this point. 92% of consumers of Internet travel site services tell us they are not satisfied with their ability to get all the flight and fare information they want and need at any single existing site. We think the Internet should be able to serve travel consumers better than that. We think consumers have been very clear about what they want and that they are not now getting it. Our plan is simply to give consumers what they tell us they want—comprehensive and unbiased information about flights and fares.

Orbitz is designed to remedy the dissatisfaction of that group of consumers. We see our customers coming primarily from other websites, not from traditional travel agents, because we will not provide what the customers of travel agents want, which is person-to-person service. On the other hand, we will provide what the dissatisfied consumers of other websites are looking for, which is the comprehensive and unbiased information they want to book their travel.

Forrester Research projects that online bookings will grow from 4% to 12% of all bookings over the next four years. But that is expected to be less than the growth for air travel in general, meaning that in that time period bookings through travel agents are actually expected to *increase* slightly. Half of the 12% are expected to be airline website sales, leaving only 6% of all bookings for all online agencies. We expect Orbitz, if successful, to account for one to two percent out of that 6%. There is no way our less than 2% of bookings is going to put anybody out of business.

More importantly, Orbitz, and the technology it is pioneering, are likely to provide important benefits to travel agents.

First, Orbitz will bring competition to the issue of CRS search limitations. We expect that the result will not only be that our customers will get better displays and better information, but that the CRS's and their Internet sites will respond to that new competition—once they get tired of trying to block it—by upgrading their searches and displays. There is no reason they cannot quickly make the investment in upgrading their seat availability system for Internet display, for example. And the day will come when they expand their computing power to search much more broadly, and obtain software that does that broader search. And when that happens, not only consumers, but also travel agents, will benefit. Travel agents have to use considerable skill and energy to work around the technological limitations of the CRS's—better, more user-friendly displays would make the tough job of a travel agent a bit easier.

Second, travel agents have been getting squeezed by higher and higher CRS booking fees. The airlines' costs of selling a ticket through a travel agent consist mainly of the travel agent commission (paid to the agent) and the CRS booking fee (paid to the CRS). The CRS booking fee has been going up steadily, with the result that a higher and higher percentage of the cost of selling through a travel agent has been going to the CRS, not to the average travel agent. To put it bluntly, the CRS is eating more and more of the travel agent's lunch. Orbitz is bringing for the first time some degree of price competition to the world of CRS booking fees. To the extent that new competition can drive down CRS booking fees, or at least limit their growth, travel agents should get a larger share of the value of selling through the travel agent channel.

And third, the key problem for travel agents is that they are tied by contract to one CRS. A combination of restrictive contracts imposed on agents by CRS's, and the practical difficulty of switching CRS's, means that most travel agents have virtually no ability to switch to another CRS. As a practical matter they are typically denied the market choices most businesses have. That means the CRS that has them under contract can largely take them for granted.

The unfortunate result for travel agents is that CRS's use their contractual hold on their travel agents to take for themselves a disproportion of the value of selling a ticket through a travel agent. It is the agent that generates the booking for the CRS, but the CRS often shares very little of the value of that booking with the agent.

If the travel agent could switch CRS's, the agents would soon find that the CRS's were willing to share more of the CRS's revenues with the agents. And that would be even more true if the travel agent didn't even need to switch CRS's. Let's suppose the travel agent would keep its CRS, but could decide for each booking whether to make that booking on its CRS or on a website designed for agent use—or one of several websites designed for travel agent use. Then the CRS could no longer take the agent for granted. That CRS would suddenly be willing to share significant revenue with the agent, in order to get that next booking. Suddenly the agent would find himself or herself in a free-market relationship with the CRS—something that has rarely if ever happened—and that agent would suddenly discover how valuable he or she really is.

Orbitz at present is designed for use by Internet consumers, not by travel agents (though travel agents are welcome to use it for free). However, once Orbitz has developed and demonstrated this technology, it would only take a different business model for Orbitz, or somebody else, to offer a version of that new technology for travel agents.

And that is ultimately why Sabre/Travelocity is working so hard to block Orbitz. They have lived for 2 decades off the power of having the largest number of agents locked up under highly restrictive contracts. If suddenly those agents could exercise some choice, then far more of the value of selling through those agents would have to be shared with the agents. For Sabre/Travelocity that is not a happy prospect.

In conclusion, we are a new competitor entering a business—online agency websites—that is dominated by just two competitors. We cannot be just as good as they are and hope to succeed. To gain ground in an arena that they dominate, we have to be far better than they at offering consumers what they want. Our only strategy for gaining a toehold in this business is to offer absolutely comprehensive and unbiased travel information that allows the consumer to pick the airline, the flight, and the fare, that best meets their needs. Everything we do is aimed at meeting that commitment to offering an absolutely comprehensive and absolutely unbiased view of the choices in travel.

We are not asking for anything but a chance to compete. We are not asking in the slightest to be exempted from any of the nation's antitrust laws. We expect to be held to those high standards, and we expect to meet them. The Department of Justice is currently reviewing our plans and agreements, so there will be no doubt about where we stand under the law. We believe we will be found not only to meet the requirements of the law, but to bring new competition to an arena that government has rightly been concerned about for nearly two decades. We believe we will enhance competition in the distribution of air travel.

All we would ask you is that if we in fact pass all the requirements of existing law, let us compete. Let us offer what we think is better information to Internet consumers of air travel. Let us give absolutely equal and unbiased display to the services of every airline that has published fares, whether they are affiliated in any way with Orbitz or not. Let us bring some degree of price competition to this long-standing problem of excessive CRS booking fees. Let us give every airline, big and small, the opportunity to get neutral and unbiased display for its products, equal to what every other airline gets. Let us offer to every airline to share an equal offset to excessive CRS booking fee costs. Let us and Travelocity and Expedia and others compete on the basis of who can offer the most comprehensive and least biased displays to consumers. And most importantly, let the consumers decide who they think is doing the best job of providing comprehensive and unbiased information. We are more than willing to be judged by consumers, and we believe it should be consumers who decide which Internet site best meets their needs.

Orbitz is the story of new competition. We are the underdog with huge obstacles to overcome to even become number 3 in online travel. We are willing to take the competitive risk of trying to do that. But we urge you to beware of regulatory proposals from those who do not welcome the competition we bring to online travel. Such proposals are likely to be cleverly disguised attempts to block new competition and to further entrench the dominant CRS's and their dominant Internet sites.

One final comment, Mr. Chairman. The United States led the way in developing CRS technology a quarter of a century ago. And whatever else that technology has done, for good or for ill, over the past 25 years, it has been a major factor in the ascendancy of U.S. aviation around the world. I have just flown in last week from Europe, and I can tell you the Europeans fully understand that the mainframe CRS technology is now the technology of the past, and they are well along in creating a European-based website that would use exactly the technology we are building at Orbitz—modern processors wired in parallel, new software capable of searching every single option, and vastly improved seat availability data. If we do not build this technology in the U.S., it will be built by others, and it will be used by consumers in the U.S., because there is nothing more international than the Internet. This technology is coming to computers in our neighborhoods, whether Orbitz exists or not. The only question is will it be brought by U.S.-based companies, or only by others?

Thank you for the opportunity to testify. And I would be pleased to try to answer any questions the Committee might have.

EXHIBIT A

**Consumer Comments About itasoftware.com**

"I just wanted to say thank you for this site! I found it a couple of days ago and have already booked a ticket. I called the airlines for a reservation and was quoted $98 over what you had found. I then told the agent the booking and fare codes and she found the cheaper fare. The site is fast and easy to use! Thank you! I will definitely recommend you to my friends and family and I will continue to use it as my first source for flight information!"—*Catherine*

"This site is AWESOME, I have been able to check heaps of variations of one way, return and multisector flight combinations. This is one of the greatest sites I have seen to check flight information and the speed is incredible, keep up the great work."—*Stephen*

"I've used your software for two different trips and have been very satisfied with your service, efficiency, and usability. Every time I've chosen a flight and then checked with the airline to see if it was available, all of the ITA data were correct and I then purchased my chosen tickets. Thank you very much for a great service—airline customers have too few resources to navigate the byzantine choices. I've recommended you to my business associates and friends numerous times. Keep up the good work!!"—*Bill & Julia*

"Congratulations on the wonderful job you have done with this site! It is the most useful and informative of all the web pages I have tried. You give alot of good information that the other sited don't, such a close connections, etc. I'll continue to use your site from now on when planning a trip."—*Sonja*

"Just tried your site and I love it! It makes it very easy to get information, in very little time. I hope you make it permanent and add hotels, trains and cars!"—*Barb*

"This is by far the best site I've searched for airline ticket prices! Much easier to use than expedia or travelocity."—*Tracy*

"This is Great! Far better than anything else I have seen on the web or otherwise. Power to the consumer—what a concept!"—*Don*

"You guys have made the best travel search engine I've ever seen. I've used just about every one of them over the past 6 years and each has always left me with much to be desired. I know all the tricks and repricing that goes on in the airline industry so can really use a service like yours to view every possible option to get the best possible price. I can't wait to be able to book flights from this site!"—*Ken*

"This is one fantastic website. For the first time I can compare the prices on all airlines, including Southwest, at one time. This is a major time-saver for me and all who use this site. Congratulations on an outstanding product. I look forward to seeing the final version."—*John*

"I just wanted to drop a line to let you know how much I appreciate your site. It has been extremely helpful in planning trips. I have booked two trips using the information your site provided and it was incredibly easy. I hope I will soon be able to book directly from your site. The table is easy to read, and flights are easy to figure out. I love the fact that you include duration of the entire trip—it really helps when planning. Thank you for providing a really great service."—*Christina*

"First off, I'm not a 'letter writing person,' so this is out of the ordinary for me. Your website, even in Beta Version, is grrrrrreat! I've been surfing the web for over a week now to try to get some good prices AND get plenty of info as well. Your site hooked me up in less than ten minutes. Unbelievable! Will I tell a friend? You bet. Thanks for the incredible site and keep up the good work."—*Terry*

The CHAIRMAN. Mr. Jones, welcome.

**STATEMENT OF TERRELL B. JONES, PRESIDENT AND CHIEF EXECUTIVE OFFICER, TRAVELOCITY.COM**

Mr. JONES. Thank you, Mr. Chairman.

Mr. Chairman and Members of the Committee, thanks for inviting me here today. I am Terry Jones and I am President and Chief Executive Officer of Travelocity.com.

Travelocity is the largest provider of on-line travel services today. We offer consumers unbiased travel information so they can shop and compare when making their travel arrangements. We became the top travel site through hard work, consumer service, innovation, and by rising to competitive challenges, and most importantly by looking out for consumers.

As others have mentioned, on-line travel only represents a small percentage today of total travel booked, it's already the most shopped-for product in e-commerce. That's largely because travel and the Internet are a perfect match.

Travel is a complex product. There are literally millions of air fares, and the Internet enables the simplification and delivery of information with unprecedented richness, speed and scope.

Now the Internet is an arena of intense competition. Today thousands of websites fight for business worldwide, and every competitor is just a click away from Travelocity. We welcome competition. It's making us all work harder to serve our customers, to help them compare and find low fares, and it's giving smaller and startup carriers opportunities to compete they didn't have before.

However, no matter how innovative we may be, we and all travel services rely on access to information. People shop on line expecting access to all fares and one-stop shopping. In fact, many people don't complete their reservations on-line today because they are uncertain about whether they're getting the lowest fare.

So without fair access to lowest fares, no one can compete effectively. Before us today is the issue of Orbitz, a soon-to-be started travel agency owned by the five largest suppliers of air travel. It's not a normal competitor; it's owned by a group of airlines that hold and can choose to withhold pricing information.

Now as the Chairman remarked, we've been down this path before, as the Committee knows well, because of past bias cases involving suppliers that own Computer Reservation Systems, DOT rules already ensure that information is not withheld from travel agents who use these systems.

However, these rules were written before the Internet matured, so they don't cover consumer direct channels like the Internet.

We also have cause for concern because the supplier-owners say they have planned to offer certain fares only to Orbitz. Orbitz' chief technology officer recently said in *Internet World,* "We're getting the same stuff as everyone else except the special fares that are on the website of particular airlines we're pulling together in one place to book." In other words, all travel sites will have equal access, but some will have more equal access than others.

Recent public statements by some of the owners of Orbitz have fueled suspicion they may have a tacit understanding that Orbitz will be favored with exclusive access to certain fares.

In addition, the contract between Orbitz and its non-equity partners is artfully drafted to say there is no exclusivity. But what it gives with the one hand it takes away with the other, because Orbitz requires the carriers to contribute financially to market the site, and these carriers can meet their financial obligation by agreeing to post their fares exclusively to Orbitz, an easy economic choice to make.

Then there's the Boston Consulting Group which helped organize Orbitz and continues to manage many of its operations. Principals from the firm recently published a book called *Blown to Bits.* A key suggestion of the book is that sellers should collectively agree not to deal with entities they call "new navigators"; entities like Amazon, Yahoo, and Travelocity.com.

To quote, and I think the quote is here on the Board: "Suppliers and retailers are the source of the information on product features, price, and availability that the new navigators need. So simply refuse to make that information available."

There is a solution; one that protects consumers, ensures fair access to information, and one that's not very complicated. It involves updating the existing rules for systems used by consumers to match those for consumer reservation systems used by travel agents. Those rules require carrier-owners to provide complete access to information to competing systems, ensuring unbiased equal access to information.

The rules in Canada and the European Union, which were adopted after the U.S. rules, already operate in this way. We believe this solution will ensure continued competition, thus inspiring more innovation and protecting consumer interests.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Jones follows:]

PREPARED STATEMENT OF TERRELL B. JONES, PRESIDENT AND CHIEF EXECUTIVE OFFICER, TRAVELOCITY.COM

**I. Introduction**

Chairman McCain, Senator Hollings, I am Terrell B. Jones, President and Chief Executive Officer of Travelocity.com, the leading online travel Web site. I appreciate the opportunity to appear before the Committee this morning to discuss the critical issues relating to travel distribution systems and the Internet.

Travelocity.com provides reservations capabilities for 95 percent of all airline seats sold, more than 47,000 hotels, more than 50 car rental companies and more than 5,000 vacation and cruise packages. This reservations capability is paired with access to a vast database of destination and interest information. To date, Travelocity.com has sold more than 6 million airline tickets and has more than 20 million members.

The online travel market in which Travelocity.com participates is growing at an incredible pace and, according to PhoCusWright, "is the fastest growing e-commerce category, poised to surpass $20.2 billion by 2001." [1] With the rise of the Internet, independent travel agents—both brick and mortar and virtual storefronts—are increasingly seizing this nascent distribution channel to expand the richness and reach of their product and service offerings to the ultimate benefit of consumers. I believe the role played by such agents—delivering rapid, comprehensive travel information to consumers—is critical in maintaining and enhancing effective competition in the commercial airline transportation industry. As we are in the midst of what appears to be an era of airline consolidation—through merger, via "alliances" in numerous forms, by hub consolidation and code-sharing agreements—the role of independent consumer-centric agents—becomes even more essential.

A key component to continued growth and consumer gains in the Internet travel market is fair access to information from travel suppliers and, in particular, access to travel suppliers' lowest fares, corresponding inventory, and selling tools. We believe this issue of fair and open access to information is appropriate for this Committee to review, as it raises substantial commerce, transportation and consumer public policy questions. Again, I very much appreciate the Committee's attention to this issue and the opportunity to address the Committee with my testimony.

**II. Travelocity.com and the Online Travel Distribution Channel**

Travelocity.com is a true pioneer of Internet commerce. Since our initial launch in March 1996, our customer base has grown to more than 20 million members. We have built this successful business and a solid brand by constantly innovating and creating new products that take advantage of Internet technologies to bring benefits to consumers and travel suppliers alike. We truly believe we are changing the way consumers shop for and buy travel. Some of our new features and services include: (i) Alternate Airports—which provides alternative city fare information (often bypassing hub airports) in response to a given fare request;[2] (ii) "Dream Maps"—which offers leisure travelers on a limited budget the ability to view "theme" vacations (i.e., beach, ski or national park packages) that compare and select among the best fares for multiple destinations,[3] and (iii) Best Fare Finder—a revolutionary product that shows consumers calendar-based fare offerings, so that they know precisely when advertised low fares are really offered. While travel suppliers are singularly focused—as they should be—on working to improve so-called "yield management" and maximizing the amount of revenue they receive with each sale of inventory, at Travelocity.com we are equally focused on providing *consumers* with what they want. We have invested heavily to improve the speed and functionality of our site so as to benefit our users. As noted by one airline industry analyst, "the philosophy [of independent travel websites] is to push the price lower—a complete reversal of the aims of an airline's own yield management team."[4]

Travelocity.com creates a global storefront for consumers to see, experience, research and buy their travel in one place. As such, Travelocity is the "front-end" or user interface through which consumers access a vast virtual warehouse of travel information, such as supplier inventory, prices and schedules. Just like any other travel agency in the world, Travelocity contracts with one of four computer reservation systems or CRSs for access to this supplier information. Travelocity's agreement for these "back engine" services is with Sabre. As this Committee is well aware, CRSs are closely regulated by the U.S. Department of Transportation (and also by DOT's counterparts in Canada and the European Union) and are required, among other things, to provide unaltered, unbiased airline information to travel agencies.

Currently, the CRS rules in the United States regarding so-called "screen bias" do not apply to the distribution of airline information directly to consumers via the Internet. However, because we believe our customers want neutral and unbiased airline information, Travelocity does not re-order the information we receive from Sabre. Thus the schedule, price, and availability displays you see in Travelocity comply with DOT's rules. Travelocity simply takes the so-called structured data streams and puts the identical information into a more consumer-friendly format for consumers (similar in some ways to taking the old DOS commands and changing those keystroke entries into graphical "point and click" icons to enable consumers to easily navigate the site and utilize the information.)[5]

We do, of course, accept advertising from suppliers as does every other retail website (and, indeed, every media outlet) with which I am familiar. On our home page we frequently run banner ads for particular suppliers (such as airlines, hotel chains and car rental companies) promoting their services. In addition, in several origin-destination markets, we will display a banner ad in response to the consumer's request, featuring a particular carrier or service. An example of such an advertisement is attached to my testimony.[6] We think it is quite obvious to any consumer, particularly any Internet user, that what is being displayed is an advertisement and not a display of flight options.

Independent online travel agents also operate in consumer-centric ways that encourage price discounting by suppliers and enhance market penetration by small and startup airlines. Independent travel sites, such as Travelocity.com, offer these carriers the ability to use our technology to enhance their marketing efforts. For example, we can provide our customers with e-mails containing special offers from the carriers. We have done so frequently and have received a very favorable response from our customers and supplier partners. Some of those partners include Air Tran, ATA, Hawaiian Airlines and National Airlines. Where other carriers have been willing to work with us, we have done promotions with them as well.

**III. Suppliers' Collective Efforts to Enter the Online Travel Channel**

As I will discuss in greater detail below, in the last part of 1999, there was an apparent shift in the individual strategy and focus of airline suppliers in the U.S. in distributing their products (seat inventory and fares) via the Internet. Previously, these carriers had competed quite vigorously with each other, and with us, through improvements in the offerings of their separate websites. In November 1999, however, four of the five largest carriers in the U.S.—Continental, Delta, Northwest and United—announced they had formed a jointly owned, Internet-based sales/marketing agency. In January 2000, apparently some twenty-four additional carriers joined the venture.[7] In April 2000, American Airlines announced that it had joined the venture as an equity owner. The still yet to be launched Internet airline sales/marketing agency was originally dubbed "T2" and has just formally announced its name as "Orbitz."[8]

The apparent distinguishing element of T2/Orbitz is that it will have "unique" access to the low fares and corresponding inventory of the equity owning and non-equity owning participating carriers, and is billed as creating "one stop" shopping and "the only place to go" for consumers who want to save money on airline travel. It is unclear why the airline suppliers apparently shifted resources, investment dollars and development away from their individual sites to collectively focus on investing in and developing a joint Internet sales and marketing agency. As reported in PhoCusWright's Online Travel Investor Report in April 2000, one supplier said "the only thing worse than dealing with 33,000 travel agencies is dealing with two" [evidently referencing Internet successes Travelocity.com and Expedia.]

Travelocity.com welcomes competition. Time and again over the last four years we have faced new competitors and each time we have redoubled our efforts to innovate and bring greater value to our customers. Thus, if T2/Orbitz is simply another online travel site preparing to compete on the merits of its products and services—and on the same level playing field as Travelocity, Expedia, Trip.com, Biztravel.com, Lowestfares.com and many others, then that challenge should be encouraged. Competition will no doubt lead to continued product innovations and gains for consumers and smaller carriers. If, however, the business purpose and goal of this supplier owned sales agency is to improperly tilt the competitive playing field—by withholding certain fare and inventory information from competitors—I believe that is an entirely different matter. If that is the case, and public statements from T2/Orbitz's founders appear to support that proposition, I believe T2/Orbitz raises significant policy issues within the oversight of this Committee. As noted by Chairman McCain, "[t]here are clear antitrust implications with the airlines . . . running one Web site. . . . If each airline wanted to run one, then that would be another matter, but I think it's a great danger that could lead to higher airfares for average passengers."[9]

**IV. T2/Orbitz: The Suppliers' Online Joint Sales/Marketing Agency**

As policy makers debate "fair access to fare and inventory information," it is important to understand just what T2/Orbitz *is* and what it *is not*. While much is unknown about the joint airline sales and marketing site, by focusing on certain key questions, I believe that this Committee will be in a much better position to evaluate the nature of this collective effort by suppliers to establish a position in the online travel channel.

*A. How/Why was T2/Orbitz Formed?*

Our experience was that suppliers were relatively slow to enter the Internet travel distribution channel. The first airline websites did not add significant functionality until 1997 (which is considered relatively late in Internet terms), many months after Travelocity and other online travel agencies had introduced their services to consumers.[10] At some point, the suppliers began to pay much closer attention to this emerging channel of distribution and reportedly developed "fears" that absent decisive action by suppliers, "non-airline entities can use [Internet] technology to interpose themselves in [our] business."[11] As one IATA official noted, airlines were "less aggressive" than other industry participants to adopt the Internet, thus increasing the airlines fear of losing control over distribution.[12]

Apparently, the airlines' collective response to the new Internet distribution challenges posed by "non-airline entities" was the November 1999 announcement of the formation of a jointly owned Internet sales and marketing agency—T2/Orbitz. Public statements by the founders of T2/Orbitz make it clear that the underlying purpose of the effort was to respond to the increasing popularity of agents like Travelocity.com and to such sites' growing role and consumer affiliation in the distribution of air travel information.

*B. What obligations are placed on participating suppliers?*

Evidence of how T2/Orbitz intends to operate in the online travel channel may be found in its non-equity "Airline Charter Associate Agreement." Based on a draft of this agreement I have seen, airline participants may no longer have unique sales or run special promotions with online competitors of T2/Orbitz. Rather, participating carriers must give T2/Orbitz access to all "published fares," which, under the agreement, is broadly defined and includes virtually every fare in a given airline's inventory. This includes: (1) any fares published in a CRS (2) any fares, and corresponding inventory, published in the carrier's internal reservation system, (3) "Internet" fares, including those offered via e-mail to targeted consumers; (4) promotional fares offered to the general public; and (5) fares offered to travel consolidators.

In addition, the Agreement provides strong incentives for participating carriers to provide their lowest fares—a major if not the major attraction for consumers—exclusively to T2/Orbitz. Each participating carrier is obligated to provide T2/Orbitz with substantial "In-Kind Promotions" which can run into millions of dollars [13] for the first 12 months of the agreement. Among other things, "In-Kind Promotion" obligations can be satisfied by offering "exclusive promotions or fares available only on" T2/Orbitz or the participating airline's own Internet travel site.[14] T2/Orbitz also has the right to mutually develop the exact terms of the In-Kind Promotional plan and to determine how such obligations will be satisfied by the smaller carriers, and can withhold certain rebates if the carrier and T2/Orbitz fail to develop a mutually acceptable promotional plan and/or if the carrier fails to adhere to the terms of that plan.[15]

Moreover, T2/Orbitz's requirement that all participants immediately provide to T2/Orbitz all promotions and fares that are offered using alternative distribution methods will insure that T2/Orbitz lacks any incentive to innovate to attract special promotions from suppliers. As the Department of Justice has recognized in somewhat analogous circumstances, such a requirement will insulate T2/Orbitz from any competitive pressure because a participating carrier cannot force T2/Orbitz to improve its services by threatening to take its promotional offerings elsewhere. DOJ successfully urged DOT to remove such "most favored nations" provisions or "parity provisions"—clauses that require carriers to participate in all CRSs at the same level—for carriers that do not own interests in CRSs.[16] In so urging, the DOJ noted that such a provision "removes an airline's ability to obtain better service by credibly threatening to downgrade its participation level. With the most favored nations or parity provision, the downgrade threat is unrealistic because the CRS knows that the airline would also have to lower its participation level in every other CRS." [17] As with the parity provisions at issue in that matter, participating carriers in T2/Orbitz cannot simply divert their promotional efforts to other, more responsive, Internet travel sites without similarly offering those promotions to T2/Orbitz. T2/Orbitz's requirement that any fares and seats offered to other outlets also be offered to T2/Orbitz, will, under DOJ's and DOT's prior reasoning, render T2/Orbitz "unresponsive to consumer preferences" and "anticompetitive." [18]

We think it would raise serious public policy questions if major suppliers use their collective control over inventory and pricing information (and their ability to deny such information to competitors) to tilt the playing field in favor of their joint sales agency and against sites more aligned with consumer interests, such as Travelocity.com.[19] At least in the early stages after T2/Orbitz's announcement, some industry analysts appeared to endorse the joint supplier site: "Due to its size and backing, T2 will eventually take its place among the top three travel sites for both traffic and sales." [20] But, as an Internet industry publication recently noted, "[w]hen the world's oldest and largest corporations announce they are cooperating to confront the future, the rest of the business world should be suspicious."[21]

*C. Assuming T2/Orbitz does not plan to withhold low fares and inventory from competing online travel sites, what is unique about this site?*

It would be difficult to expect that T2/Orbitz will have the same competition-enhancing features as those that will, and have been, developed by independent sites. As Alex Zoghlin, T2/Orbitz's Chief Technology Officer pointed out: "Not every airline is interested in full and complete disclosure to the consumer." [22] Industry analysts have noted as much: "The weak link in T2, analysts agreed, is that airlines would have to bring potential customers to a site where they could compare the fares of the different airline rivals—hardly a wise marketing strategy." [23]

The creation of a joint sales agency through T2/Orbitz does not offer a new technological breakthrough or create some new efficiency in the distribution of supplier inventory, fares or schedules to consumers. For many years such information has been available to travel agents and consumers via automated means, through computerized-reservation systems which collect and disseminate low fares for nearly all airlines. Moreover, airline-sponsored websites are hardly unique nor do they require collective action. Each of the carriers who formed T2/Orbitz already maintains successful independent Internet sites for ticket purchases, and some of these sites already offer comparative flight search and booking capabilities.[24] All of this essentially begs the question of just what is T2/Orbitz.

*D. What lessons can be applied from the history of travel distribution to better evaluate this collective supplier effort?*

Our best guide to determining what T2/Orbitz is may be history. In the 1960's and 1970's, the airline industry developed the first networked industry infrastructure for electronic commerce—the computerized reservation system or "CRS". Interestingly, there was an initial joint supplier effort to create a single CRS from 1974 to 1976. While that effort ultimately failed, it is important to note that the airline suppliers sought the formal approval of the federal government (through a grant of antitrust immunity) *before* they engaged in those discussions and the DOJ, while granting approval, did so subject to a number of conditions. It is my understanding that in regard to T2/Orbitz—which the suppliers have indicated is their attempt to create essentially a new distribution channel to bypass all CRSs—the suppliers have not sought pre-approval (though they say they have informally briefed Justice Department officials prior to issuance of subpoenas). Individual airlines or groups of airlines ultimately established carrier-affiliated CRSs—and not unexpectedly—the owning airlines utilized the best displays in their affiliated system to sell their inventory of airline seats. This Committee is familiar with the ensuing debate and study that occurred in the industry in the early 1980's that led to clear regulations in the distribution of airline information in the United States. These rules continue to exist today, and have even been exported to Canada and the European Union, where they were expanded to cover the distribution of airline information directly to consumers.

In circumstances roughly analogous to that presented by T2/Orbitz, in 1992, the DOT adopted rules requiring "mandatory participation" by airline owners of CRSs in competing systems, partly at the behest of the DOJ (the DOJ supported that proposition in the original rule-making in 1984.) Essentially, DOJ and others were concerned that suppliers were withholding information and desirable consumer amenities, such as pre-reserved seats, boarding passes, etc. from competing CRSs—providing those items only through their affiliated CRS. As you might expect, it was believed that this conduct substantially undermined the utility and value of the competing CRSs. To ensure fair access to such information, the DOT required an airline supplier that owned a portion of a CRS to post the same information in competing CRSs that is posted in the carrier-owner's CRS.

DOT noted that many industry participants were alleging that carrier-owners had "reduced the level of their participation in other [CRS] systems in order to handicap the ability of other systems to compete for subscribers."[25] In requiring that owner-carriers participate in CRSs on equal terms, DOT noted that "[t]his requirement appears justified on competitive grounds, since it would prevent a CRS owner from using its dominance of a regional airline market as a tool for obtaining dominance in the area's CRS market."[26] The rise of the Internet and the ability of travel suppliers to distribute products directly to consumers arguably creates similar concerns.

*E. What is T2/Orbitz's Business Model and does it reveal anything about the joint supplier site's underlying purpose?*

While we do not have access to all of the e-mails, agreements, or other documents that might conclusively demonstrate the business plan and actual intent, the business model set out by their primary consultant raises a number of issues. As set forth in *Blown to Bits,* recently published by Boston Consulting Group, the operator of T2/Orbitz under contract with the founding suppliers, BCG openly embraces and counsels conduct that appears to raise serious issues for those BCG clients that might choose to follow this advice.

In essence, BCG warns that independent Internet sites like Yahoo! and Travelocity.com have "tilted" the balance of power from sellers towards buyers. BCG outlines various features, such as unbiased comparison features and identification of alternative sources of supply, which they describe as the "consumer's gain" and the "seller's loss." In describing how incumbents "have a lot to lose" by the growth of consumer-affiliated (*i.e.,* independent) Internet sites, BCG suggests that product suppliers and traditional retailers "alike fear the rise of the agent navigator who facilitates broad-reaching comparisons without even being party to the transaction."

In order to counter that threat, BCG suggests that independent sites must be "denied critical mass"—or, in the words of the authors, "[i]f enough suppliers refuse to sell through the e-retailer, or enough retailers refuse to provide information to the dispassionate agent, neither the e-retailer nor the agent can achieve critical mass."[27] Of course, BCG implicitly recognizes that achieving such concerted agreement is difficult in the absence of an agreement among competitors to boycott independent sites:

> Obviously, the seller can ultimately stop this game, if only by refusing to operate a Web site. But herein lies the second and more fundamental issue: *it is not obvious that it is in any one seller's interests to do so.* The most rigorously customer-affiliated navigator with the broadest reach is still a source of incremental business to a seller. . . . Therefore, while it is undoubtedly in the interests of all sellers *collectively*, it is not in the interest of any one seller individually to deny its own data to the navigator. But if everyone reasons that way, the navigator will achieve critical mass.[28]

In order to overcome this difficulty, BCG suggests that suppliers can stunt independent sites by "emulating the way the insurgent defines his business." [29] At the heart of this strategy are horizontal agreements among competitors. In this regard, BCG urges suppliers to create their own supplier-initiated sites that will, in essence, mislead consumers and disadvantage non-competing suppliers. Such supplier-initiated sites can "succeed," according to BCG, by using their sites to:

> "provide comprehensive but not necessarily comparable data on one's own products and those of direct competitors, and slightly bias the presentation through the ordering of alternatives and the occasional emphasis or omission." [30]

If T2/Orbitz is indeed predicated on its consultant's model, consumers will be the primary losers.

**V. Conclusion**

The rise of Internet commerce has initiated a true revolution in the travel distribution industry, and holds the promise of greater efficiency and enhanced competition at all levels. As a policy matter, and perhaps as a legal matter, I do not think suppliers should be able to engage in collective action to withhold information from so-called neutral navigators. Notwithstanding the limited information available about T2/Orbitz, based on industry information and T2/Orbitz's public statements, further investigation into this joint supplier sales and marketing site is warranted.

ENDNOTES

[1] PhoCusWright Online Travel Investor Report, p.1, Vol 2, Number 3, April 2000.
[2] *See* Ex. 1.*
[3] *See* Ex. 2.*
[4] *Reuters Finance* (Feb. 23, 2000) at <www.biz.yahoo.com>.
[5] An example of this is attached as Ex. 3.* As you can see, the information on the "green screen" provided by the CRS to the brick and mortar travel agencies is unaltered from the information in Travelocity.
[6] *See* Ex. 4.*
[7] According to the press release at the time, the following carriers agreed to participate: Aeromexico, Air Canada, Air France, Air Jamaica, Air New Zealand, Alitalia, All Nippon Airways, Aloha, American Airlines, American Trans Air, Ansett Australia, Air Tran Holdings, Asiana, Austrian Airlines, British Midland, COPA Airlines, CSA Czech Airlines, Hawaiian Airlines, Iberia, KLM Royal Dutch Airlines, Korean Air, LTU Intl, Mexicana, Midwest Express, Midway Airlines, Sabena, Spirit, Swissair, Singapore Airlines, Vanguard Airlines, and Varig. "Two Dozen Airlines Join Web Site Led by Four U.S. Majors," *Aviation Daily* (Jan. 14, 2000). Among the carriers absent from the group are Alaska, America West, Southwest and TWA.
[8] At least some industry analysts opined that "T2" stood for "Terminate Travelocity," a contention T2 spokespeople deny. *See* "Southwest Airline's Success With On-Line Bookings," *New York Times* (Mar. 1, 2000). Others have suggested that T2 is a reference to Arnold Schwarzenegger's movie about a killer robot. "If the commission cuts were Terminator 1 for many agents, this new airline-owned Web site will be Terminator 2 for those still barely hanging on." *See* "T2 Creators Dismiss Trade's Anticompetitive Fears," *Travel Weekly* (May 29, 2000).
[9] "Travel-Proposed Ticketing Service Draws Scrutiny," CNN.com (June 9, 2000).
[10] Jupiter Online Travel Report at 9 (June 1999).
[11] *"IATA Legal Symposium on eCommerce,"* (presentation by Michael Feldman, February 2000).
[12] *Id.*
[13] The exact total is calculated by the carrier's "Market Share multiplied by ______ million U.S. dollars".

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* The information referred to has been retained in the Committee files.

[14] The value of these exclusive fares is calculated by the difference between the exclusive fare and the next-highest fare offered elsewhere, times the number of tickets. If the fare is made available on T2/Orbitz and not on the offering carrier's own website, a 100% credit is applied toward the in-kind requirements; if the carrier determines to offer the fare independently, the credit is lowered to 75%. The "value" as calculated under this formula is capped up to $1 million dollars for any 12-month time period.

[15] The non-equity owning carriers can also apparently satisfy these requirements by providing T2/Orbitz with "passenger database information" and "competitive purchaser names" (e.g. e-mail addresses of passengers who booked travel through another online agency).

[16] Comments of Department of Justice, Docket OST–96–1145 (Sept. 19, 1996).

[17] *Id.* at 7.

[18] *Id.* at 8 (citing *NCAA v. Board of Regents,* 468 U.S. 85 (1984)).

[19] Although I am not a lawyer, this situation seems strikingly similar to a supplier joint venture formed by the major movie picture studios to "compete" against the then new premium pay-TV channel—Home Box Office. As I understand it, the major studios essentially agree to create a competitor to HBO (called Premiere) that would have exclusive access to certain of the studios' major releases for a certain time period—while such access would be denied to the increasingly popular HBO. *United States v. Columbia Pictures Indus., Inc.*, 507 F. Supp. 412 (S.D.N.Y. 1980). In rejecting the movie studios contention that this restriction was needed to "differentiate" their new service, the Court quickly noted that there were "a number of ways of achieving product differentiation without cornering the market" on Hollywood "hit" movies. *Id.*, 507 F. Supp. at 425. This appears entirely consistent with what the founders of T2/Orbitz have publicly stated—that the formation of T2/Orbitz is "one of the strategies that the airlines have used in response" to the "danger" of electronic travel agents "completely dominating this space, to the detriment of the travel providers themselves."

[20] "Top Airlines' New Travel Site Will Succeed," *The Forrester Brief* (Jan. 24, 2000).

[21] "Oligopolists of the world, unite!", *The Red Herring*, p. 37, August 2000.

[22] "Airline Web Site Defended Against Critics," *Electronic Commerce and Law Report* (June 14, 2000).

[23] "Travel Sites Hope for Seasonal Boost," *CNET News* (June 8, 2000).

[24] As described above, several carriers have established websites that offer virtually a full slate of competing fares offered by other major carriers. In addition, virtually all carriers maintain interlining agreements with other carriers that allow the airlines to sell connecting flights offered by competing carriers. Through these agreements therefore, virtually all major carriers are authorized to sell tickets of competing carriers.

[25] DOT Notice of Proposed Rulemaking, 56 *Federal Register* 12586 (Mar. 26, 1991).

[26] *Id.*

[27] *Blown to Bits* at p. 115.

[28] *Id.* at 139–140 (emphasis in original).

[29] *Id.* at 119.

[30] *Id*. at 142.

The CHAIRMAN. Mr. Ruden.

## STATEMENT OF PAUL M. RUDEN, ESQ., SENIOR VICE PRESIDENT, LEGAL & INDUSTRY AFFAIRS, AMERICAN SOCIETY OF TRAVEL AGENTS INC.

Mr. RUDEN. Thank you, Mr. Chairman.

I would like to open my remarks also with a brief quotation, and I quote now: "The consumer travel window will slam shut. It's over. With the entry of this new heavy hitter, there is no more room for new entrants into the consumer-facing on-line travel space in the U.S., and the small sites like BizTravel.com and Trip.com will feel even more pressure to give up ambitions of becoming travel leaders." That quotation appears in Forrester Research's brief dated January 24, 2000. And it sums up as well as anything, Mr. Chairman, the nature of the dispute that is the centerpiece of your invitation to address the Committee today, which we much appreciate.

The airlines say that they must be able to sell everywhere that consumers want to buy, and that the Internet is where the demand is going. They can save some money, they say, and offer consumers one-stop shopping on the Internet with low fares available nowhere else.

Well, what's wrong with that? First, the data set out in exhibits 1 to 3 in our full written testimony show that while the American public continues to rely upon the independent distribution system to buy most of its air travel, the annual growth in sales is going to the Internet selling space. To foreclose travel agent adaptation to changing buyer preferences through this airline collaboration will deny consumers, both on-line and off-line, the full array of choices and other services they've come to expect, including the choice of channel through which to buy.

In an open and freely functioning marketplace, consumer choices of this nature would prevail.

The Orbitz project is an attempt to collectively interfere with the marketplace by trying to dictate the choice of channel, and to collectively determine channel content.

Second, the Orbitz collaboration appears, by the airlines' own admissions, to involve preferential and exclusive access to the lowest fares the partners offer. It requires the participating carriers to relinquish their normal freedom to experiment with different distribution devices for low fares, by assuring that Orbitz will always get the lowest fares offered anywhere. And there are now suggestions that the airlines are going to give preferential redemption privileges for frequent flier miles to Orbitz, a privilege they have denied to independent travel agents and their consumers for years.

So much for Orbitz being just another travel agency.

Third, the Orbitz agreements contemplate the sharing of client information generated by agencies competing with Orbitz as yet another of the devices by which the airlines pay off their promotional obligations to the joint venture.

Fourth, the Orbitz collaboration takes place in an industry which has a long and relentless history of preference for collaboration and collusion over competition, as is documented in our written statement.

The extraordinary results of this process is graphically illustrated by the chart on my right. And the future is suggested by the chart on my left which includes not just Orbitz, which was known as T2, but T3, T4, T5, and the B2B among the airlines, the details of which are all provided in our written testimony.

This illustrates, Mr. Chairman, the movement toward a global network of jointly operated and preferentially treated websites by the world's airlines. The competitive marketplace would not produce this kind of outcome if the airlines operated independently as contemplated by this country's transportation and competition policies.

Fifth, Orbitz has made much of its claim to innovation, but make no mistake, this fight is not about technology. There's no real new technology here; it's just another piece of software creating yet another search engine, which is likely to be supplanted by someone else's software at the next turn in the road.

This conflict is about the right of consumers to the full package of options for them to consider in a research and buying environment of their choosing. More than half of ASTA members have websites today and more are going on-line every day. They're not as large in scale and sophistication as Travelocity or Expedia, but they represent travel agents' recognition that many consumers are going to the Web, at least for now, and they must go there, too.

At the same time, millions of Americans do not have practical access to the Internet, do not have the ability to successfully use Internet search tools, no matter how simple they may seem, or they simply prefer to deal with a more traditional retail business. Whether this is called the digital divide or something else, it should not in our view be left to a group of large businesses in an industry vested with a public interest to dictate that the best deals be available only where they collectively choose to put them. Nothing in the way of technological innovation warrants such a collusive intrusion into the market by dominant firms.

Even if the Orbitz arrangements do not violate the antitrust laws—and we think that they do—they are contrary to the public interest in the competitive and fair delivery of air transportation, and should be stopped.

Thank you very much.

The CHAIRMAN. Thank you very much.

[The prepared statement of Mr. Ruden follows:]

PREPARED STATEMENT OF PAUL M. RUDEN, ESQ., SENIOR VICE PRESIDENT, LEGAL & INDUSTRY AFFAIRS, AMERICAN SOCIETY OF TRAVEL AGENTS, INC.

The American Society of Travel Agents ("ASTA") is pleased to provide the Committee with the perspective of its travel agency members on the nature and extent of competition in the airline industry as it relates to the distribution system and on the impact of the Internet and, more specifically, the issues raised by the airlines' development of a joint Web-site to sell discounted fares to consumers.

ASTA was established in 1931 and is today the leading professional travel trade organization in the world. Its travel agency members account for more than half of the staffed, agency locations serving the public throughout the United States. ASTA's corporate purposes specifically include promoting and representing the views and interests of travel agents to all levels of government and industry, promoting professional and ethical conduct in the travel agency industry worldwide, and promoting consumer protection for the traveling public. ASTA has provided testimony to numerous legislative committees and fact finding bodies and has appeared in various legal proceedings; it is widely recognized as responsibly representing the interests of its members and the travel agency industry.[1]

ASTA counts among its travel agency members about half of the so-called "traditional" or "brick and mortar" travel agencies in the United States, along with many of the pure on-line Internet agencies and hybrids, who together account for most of the sales of air travel, on and off the Internet, to the 230 million annual United States consumers of air transportation.[2]

**Consumer Access to Information Issues: The Orbitz Cartel**

When ASTA last appeared before this Committee, the focus of the hearing was on passenger rights, or the lack of them. Many bills were before the Committee, and other bills pending in the House of Representatives, dealing with airline competition in areas such as airline predation against new entrant competitors, slot allocations, perimeter rules at restricted airports, hub competition and other similar issues. Some of those issues have been resolved for the time being and others continue to deserve attention by the Congress and other federal authorities.

We told the Committee then, and believe even more strongly now, that failure to attend to the issues arising from the airlines' attempts to subvert the retail travel distribution system will make restoration and sustenance of meaningful airline competition impossible. We were then referring to the pattern of policies and practices adopted by most of the large airlines that are designed, and are having the effect, of making it more difficult for consumers to continue accessing the services of the only source of neutral, comparative price and service information, expertise and personal advice that exists—the travel agency distribution system in all of its forms. Those practices continue unabated and have been supplemented with actions of the International Air Transport Association and the Airlines Reporting Corporation.

What we did not know then was that the airlines were preparing an "end game" maneuver designed to cut off the adaptation of the travel agency distribution system to the Internet while continuing to strangle the independent distributor with cost-increasing and business-interfering practices. We refer to the Internet Web-site known originally as T–2 and now officially named Orbitz. In its current form, based on the very small amount of information publicly available about it, Orbitz will be owned by five of the largest United States airlines, accounting for roughly 80 percent of all domestic air travel revenues. It boasts of providing "last minute web fares from the websites of more than thirty airlines" on a "website like no other." [3]

In its earliest announcements, the founders claimed they would offer "the most comprehensive selection of on-line airfares and other travel information available anywhere on the World Wide Web," a site "superior to all travel sites," a site with "the best of everything." [4]

The airlines' use of the phrase "on-line airfares" does not refer merely to the publication on the Internet of otherwise generally available airfares. It refers instead to the publication of fares not available anywhere but the Internet, and thus leads to the additional claim that "for the first time, on-line travel consumers will be able to compare and purchase the Internet fares offered by several airlines . . . by visiting just one site." [5] "It would support our business model if they supplied special Internet-only capacity." [6]

In reality we believe the airline partners in Orbitz have agreed to arrangements for sharing fares and promotions that are designed to favor Orbitz over all other distribution outlets, on-line and off-line.

Whatever might be said about a fare-aggregation service by a neutral party in an industry with a clean antitrust record, there is reason to believe that the Orbitz project is in reality a collusive attempt by the major airlines to dominate the Internet space, and ultimately to displace the entire independent distribution system for the sale of air travel, through special arrangements to favor the Orbitz Web-site over all other independent Web-sites as regards the sale of "low fare" services.

Orbitz representatives have publicly conceded that the founding agreements for the Web joint venture provide that any carrier publishing a "lowest Internet-only fare" on its own Web-site must also provide that fare to Orbitz and may withhold it from all other distributors. In addition, we understand that the founding carriers and all of the so-called "charter associates," comprising more than 30 airlines at this time, have agreed to provide various levels of in-kind promotional services for the site and that these commitments may be paid off by providing Orbitz with exclusive access to lowest Internet fare offerings. Total marketing support figures of $50 and $100 million have been mentioned. We're not certain of these details, of course, but if this is even remotely accurate, the inter-carrier arrangements for Orbitz are, in our view, unlawful as price fixing and as an exclusive dealing/horizontal group boycott of other distributors.

These arrangements, and likely others of which we are unaware at this time, give the lie to the position that Orbitz is "just another travel agency" scratching out a living in the dust, earning the same commissions and bearing the same costs as all other travel agencies. Orbitz says it is just a little agency with better technology, but this dispute is not about technology. It's about exclusive dealing reached through collusion designed to achieve market domination.

There are two alternative models of how the development of travel retailing on the Internet could proceed from this point forward. One is driven by consumer choices about how to research and buy travel. Airlines and other retail sellers would respond to those consumer demands by providing not only competitive air transportation services but competitive, efficient and innovative distribution services. In this model consumer preferences would dictate which retailer and which airline gets the business.

In the other model, airline decisions about how travel information should be parceled out would drive the outcome. The airlines would collectively dictate the channel choices for consumers.

As we said to the Department of Justice in our February complaint, the Orbitz arrangement appears to contravene the Department of Justice/Federal Trade Commission Antitrust Guidelines for Collaborations Among Competitors, in that it constitutes a marketing collaboration that

> involve[s] agreements on price, output or other competitively significant variables, or on the use of competitively significant assets, such as an extensive distribution network, that can result in anticompetitive harm. Such agreements can create or increase market power or facilitate its exercise by limiting independent decision making; by combining in the collaboration, or in certain participants, control over competitively significant assets or decisions about competitively significant variables that otherwise would be controlled independently; or by combining financial interests in ways that undermine incentives to compete independently.[7]

While the airline founders and other airline collaborators have pooled their money, there is no other apparent efficiency-enhancing asset integration involved that could overcome the anti-competitive implications of the "most favored agency" scheme that is the apparent heart of the deal. Moreover, as the Guidelines state:

> if the participants could achieve an equivalent or comparable efficiency-enhancing integration through practical, significantly less restrictive means, then the Agencies conclude that the agreement is not reasonably necessary [to achieve pro-competitive benefits].[8]

Why did United Airlines or one of the other founders not simply buy the software that Orbitz touts as the most significant innovation in travel since the jet engine and use it to compete against the other airlines? Why are the airlines once again approaching the marketplace as a unit rather than as the individual competitors that the Airline Deregulation Act envisioned? Why won't the airlines compete?

Orbitz is not alone. As the charts accompanying this testimony illustrate graphically, the world's airlines have been swift to copy the idea of the regionally based airline joint venture. Recent reports confirm that representatives of Orbitz have been in discussion with these nascent ventures regarding possible consolidation of operations into what would then be a global consortium of airlines jointly managing the dispersal and display of low-fare services to consumers worldwide. The charts show an industry with an overwhelming multitude of complex commercial relationships. See Exhibits 6–11.

Between the marketing alliances with antitrust immunity, the code sharing deals, the Internet joint ventures and cross-ownership arrangements involving airlines and Internet retailers, there is little left in which the airline owners of Orbitz are not involved in some kind of joint operation with the airlines that are supposed to be their arch-rivals. The Internet selling space is widely recognized as a growing long-term marketplace that can achieve for its participants unprecedented increases in efficiency, reach and content. If consumers want to go there, and many will, then all retailers should have a fair opportunity to reach them there with fully competitive offerings. The Orbitz plan is plainly designed to foreclose that possibility.

If successful in this effort, the airlines will enjoy an enormous economic windfall at the expense of the traveling public. Deprived of easy access to neutral, comparative information, the traveling public will, inevitably, make mistakes in air travel purchases, paying higher than necessary fares when there were cheaper alternatives and getting less optimum service for the travel dollars they spend. The ability of consumers to make optimal choices depends upon their having access to good information about the full array of choices available to them. That is the service that travel agencies have been providing so effectively since airline deregulation and which has led about 80 percent of the air traveling public to prefer agents as their source of information and travel documents. The Congress and other appropriate government agencies must act to prevent the airlines from monopolizing the distribution function.

For those reasons, ASTA urges immediate enactment of the portions of HR 2200, and the companion Senate bill introduced by Sen. Reid yesterday, that would make it unlawful for the airlines to offer differential fares to those persons favored with access to certain technology and would stop the airlines from continuing to operate free of the constraints of state consumer protection and tort laws. We also urge this Committee to communicate to the Department of Transportation that the review of the Computer Reservations System regulations, now years overdue, be given the highest priority. The anti-bias regulations should be applied to integrated Internet fare displays, and the rule allowing airlines to buy transaction information disclosing travel agency sales on competing airlines should be abolished.

It is not just against other Internet sites that the effects of the airlines' collaborative Orbitz effort must be judged. Orbitz is the intended coup de grace against traditional travel agents seeking a place in the Internet selling space. If successful in this strategy, the airlines would have Orbitz as the sole interface between the consumer and the carriers. The history of the airlines' treatment of travel agents, of all sorts, must be understood to appreciate the full potential consequences of the Orbitz venture, and how it serves as the final act in the airlines' script to deprive consumers of all other distribution system choices whether they are "bricks" or "clicks" or some combination.

As Alfred Kahn, the acknowledged "father" of airline deregulation, has observed, deregulation can continue "only in the presence of effective competition as the protector of consumers." Both economic theory and practice within the air transportation industry support the conclusion that the availability of comparative information about air transportation services is essential to vigorous competition among the airlines and necessary to the maintenance of affordable fares and responsive services throughout the country. Since 1978, the stated policy of the United States, as manifested in the Federal Aviation Act of 1958, amended by the Airline Deregulation Act of 1978, has been to promote aggressively conditions of competition between and among the airlines.

Travel agents provide two crucial services essential to assuring the competitive environment necessary for the public to benefit from, rather than be victimized by, airline deregulation.

First, they facilitate entry, exit and price and service competition among existing and new entrant airlines. Agents provide every carrier, in every market, an instant professional distribution system ready and able to inform the public of service and price options and to sell all of the inventory available at any moment, with no additional investment required by the airlines.

Second, travel agents promote the use of air transportation services by the public by serving as the only one-stop, neutral source of comprehensive information and counseling about a complex, constantly changing array of fares and services.

Indeed, the unsurpassed efficiency and effectiveness of travel agents at the daunting task of gathering, sorting, analyzing, and providing advice with respect to the bewildering array of alternatives that make up today's air transportation options has been repeatedly demonstrated.

On its 9:00 p.m. e.s.t, January 19, 1998 broadcast of its "20/20" television news magazine program, ABC–TV presented a segment in which a travel agent was shown to consistently quote a lower fare for given city pairs, under identical conditions, than a reporter could obtain by calling the airlines. Co-host Hugh Downs summed up: "But a good rule of thumb is that a good travel agent can do better than you can."

The "20/20" segment confirmed the findings of an earlier, November, 1997, independent study from the U.S. Public Interest Research Group ("PIRG"), which, in turn, confirmed PIRG's previous 1996 study. In the PIRG study, on October 9 and 10, 1997, PIRG staff, students and volunteers telephoned 8 to 10 travel agents and as many as 5 airlines in each of 28 cities, to obtain quotes for the "lowest" airfares for specific round trips originating in that city. Full fares, 1-week advance and 3-week advance fares were obtained for the departure/return dates of: (1) Thursday, October 16/19, 1997 and (2) Thursday, November 6/9, 1997. All quotes included a Saturday night stay. Departures were requested around 5 p.m. and returns around 6 p.m. on both dates.

The PIRG callers expressed flexibility to depart from any airport serving a multiple airport city, and the willingness to make one stopover. Tickets were not booked, since booking tickets would have changed the pricing structure of that particular flight. The study found that the lowest fares were obtained more often from travel agents than from the airlines.

According to "The 1998 ASTA Consumer Travel Purchase Report," a study conducted for ASTA by Plog Research, Inc., air travelers place greater trust in travel agents than any other travel information source, and technology makes no comparable improvement in credibility for the most experienced travelers. Given the credibility achieved by travel agents, the Plog study concluded, it follows that travelers believe that the best way to insure that they get the travel products and services they desire is to use a travel agent when making air travel purchases.

Because they are already the public's overwhelming choice as a source for travel information and arrangement expertise, there is every reason to believe that travel agents can also deliver air transportation services more efficiently over the Internet and through other electronic systems than can major airlines. Nonetheless, major airlines appear determined to reduce or eliminate the role of travel agents and other independent distributors' in the information, sales and distribution process regardless of the medium.

During the early years of deregulation these functions of the professional full-service travel agency served the needs of the airlines very well. Once the airlines' ability to fix commissions by agreement was ended by the Civil Aeronautics Board, competitive forces led to the expected and inevitable rise in agency compensation to the level of 10 percent of the fare sold as a "base commission" for all transactions. Travel agencies made rapid competitive maneuvering possible in an environment where the race went to the swiftest. As the airlines adapted to the new competitive marketplace, they earned considerable profits during the 1980's. Deregulation thus produced benefits for the major airlines as well as the traveling public.

Travel agencies also benefitted. The public liked what travel agencies did for them, and they flocked to agencies for help with the morass of fares and schedule changes that deregulation produced as the necessary corollary to a free market. The market share of travel agencies for air transportation rose from a pre-deregulation level in the low 40 percent range to about 80 percent for domestic sales and over 90 percent for international business. Travel agencies account for more than $120 billion in travel sales annually, some seventy percent of which is air transportation.

Travel agencies continued to do well even when the fortunes of the airlines turned down in the early 1990's.[9] The airlines lost billions a year while agency sales continued to rise (save only for the Gulf War year of 1991).

More recently, with the consolidation of the industry into a handful of giant carriers, and with various other types of alliances being almost routinely approved by the government, these large airlines began to recognize new fundamentals of the competitive market that had evolved. First, they saw that travel agents were a potential obstacle to their long-term objectives: agents made sure that consumers fully understood *all* of the fare and service options open to them. Second, the airlines came to understand that consolidation of the airline industry, combined with the success of passenger loyalty programs, had yielded genuine market power for them as against the travel agencies and other independent distributors. Third, for the first time, an apparent alternative to distribution through travel agencies had emerged: the Internet, by which the airlines believed they could control directly the information provided to the public without meddlesome interference by travel agents telling a somewhat different, and unbiased, story.

**The Airlines' Strategy**

The airlines' determination to dominate the retail distribution of air travel has a long history:

> Prior to the development of a domestic industry travel agent program, the airlines individually used many methods of distributing their tickets to the general public. Tickets were given with almost no restrictions or controls to hotel porters, bell captains, bootblacks, taxidrivers, barbershop proprietors, and virtually anyone else the airlines felt had a chance to sell their product. The use of such non-professionals had the potential to, and did in fact, cause great disservice to the traveling public and the airlines. The [Civil Aeronautics] Board found that the situation "was unsatisfactory and often resulted in abuses and mistreatment of the traveling public." *ATC Agency Resolution Investigation*, 29 CAB 258, 288 (1959). . . .[10]

The solution developed was joint airline control of the entry and operating standards of travel agencies, accompanied by immunization of the airline agreements from application of the antitrust laws pursuant to special provisions of the Federal Aviation Act. The airlines agreed to share the distributors, making the distributors agents at law and giving the airlines joint control over entry and joint power to terminate. The airlines proceeded with Draconian efficiency:

> A disapproved applicant . . . receives no notice of the grounds for his rejection. Indeed, no record of the grounds for disapproval is made by the [ATC Agency] committee. . . . Agents who have been accredited may be removed from the agency list. . . . No formal notice of review is sent to the agent, who is granted no opportunity to present a defense to charges against him. If the vote is adverse to the agent, his name is deleted from the approved list and his agency agreement is terminated.[11]

The airlines also jointly set commissions for travel agencies, the agreements for which also received antitrust immunity until shortly before the deregulation of the airlines. When deregulation became national policy, the Civil Aeronautics Board withdrew antitrust immunity from commission setting and that practice stopped. The competitive market quickly led to an increase in commissions from the 1977 average of 8 percent to the 10 percent level that would persist until 1995. In the process of deregulating the airlines, however, the Congress conferred upon the airlines a privilege almost as valuable as antitrust immunity: the preemption of state laws "relating to" routes, rates and services of the airlines.

In the time between enactment of the Airline Deregulation Act and the official expiration of the Civil Aeronautics Board, the CAB re-examined the agency programs of both the domestic and foreign airlines. Here too, on the promise of "new forms of distribution" emerging in a more open market, the CAB withdrew antitrust immunity from the agency programs. In the market chaos that followed airline deregulation, the travel agents' share of the air travel business increased to about 80 percent.

Despite many predictions to the contrary, "new forms of distribution" did not arise. Instead the airlines embraced a new method of controlling the agency distribution system that was now serving most of the industry's customers with information and transaction services. In the late 1970's the opposition of the Department of Justice, and other factors, had led to the collapse of industry plans to build a single computer system to provide fare and service information to the agency system. Instead, some airlines, led by United and American, started leasing their own "CRS" systems to travel agents. The flights and fares of non-owning airlines were included, to make the systems more attractive to travel agents each of whom continued to represent all airlines through blanket agency appointments conferred through the Airlines Reporting Corporation and the International Airlines Travel Agency Network.[12] Some airlines became "co-hosts" with the system owners, and it soon became apparent that the airline owners who controlled the information were biasing the computer displays to favor themselves at the expense of non-owner airlines. The Civil Aeronautics Board was forced to adopt comprehensive regulations to control the airline CRS-owners' desire to prejudice downstream air transportation and subordinate the agency distributors trying to provide unbiased information to the public.

Those regulations remain in place and yet another five-year review of them is currently pending at the Department of Transportation.

In the early 1990's a new development occurred that heralded things to come. A number of major airlines were sued in a class action in Atlanta, alleging, among other things, that the airlines were using their CRS systems to signal each other regarding plans to increase prices. These signals, it was claimed, were used to reach consensus on price increases and to threaten or discipline carriers that stepped out of line. The case was eventually settled through the provision of coupons to class members, which coupons were good for a discount on future transportation on the defendant airlines.

The settlement agreement, hammered out behind closed doors, provided that the coupons could not be redeemed by travel agents. If allowed to proceed, this deal would have deprived travel agents of revenue on some $450 million in business and forced their clients to deal directly with the airlines to "benefit" from the coupons. When ASTA complained to the court that the settlement agreement had been used to produce a brand new antitrust violation, namely a horizontal group boycott of travel agents by the defendant airlines, the airlines withdrew that portion of the settlement. When the Department of Justice brought the same allegations against the airlines in Washington, they settled that case too.

As Internet technology emerged in the early 1990's the airlines were relatively slow to move. Independent firms entered this new arena first and most aggressively. Firms such as Travelocity, Expedia and others established name recognition nationally. Having seen a new tool that attracted considerable public attention and patronage in a short period of time, the airlines began a program of reducing travel agency compensation, as reflected in Exhibits 4 and 5 to this statement. While telling travel agencies that they could make up some of the revenue loss by charging the public fees for the agencies' services, the airlines refused to consider changes to ticket documents that would facilitate agents' doing that in the most efficient and customer-friendly way.

At the same time traditional travel agencies also saw that the future of travel retailing was, in part at least, going to be a Web-based process and that they needed to move to that space as well. In the late 1970's CRS systems had made it possible for the smallest travel agency to replicate the inventory available to even the largest retailers and thereby give consumers a full set of choices as well as expert advice. Now in the 1990's the Internet offered the smallest agency the opportunity to expand its market reach across the country, and even across the globe, while achieving new efficiencies in communication and research.

While most of the attention is paid the largest on-line agencies, ASTA's members, most of which are dwarfed by firms like Travelocity and Expedia, are moving rapidly to the Web. Our most recent survey data shows that fully half have their own Web-sites. These do not begin to rival those of the major players in scope and sophistication, but they represent a crucially important presence in this marketplace and, absent interference from the airlines, they will continue to grow in number and complexity. Most of these Web-sites represent the integration or "convergence" of Internet technology with more traditional methods of retailing and are the model of business most typically to be followed by smaller firms seeking niche positions in the Web-based market rather than trying to go head-to-head with larger firms who entered the market earlier.

Agency on-line air sales are estimated to reach 5 percent of total U.S. airline sales in the year 2000 (see Exhibits 1, 2 & 3), slightly ahead of the airlines' aggregate performance in the absence of Orbitz. Most importantly, the current annual growth in retail sales of air travel, driven by a strong economy and high employment, is going to the Internet. Firms not participating in "Internet sales," are both fewer in number and living on a shrinking volume of business despite growth in the overall market.

The airlines were swift to react to agency incursion into the Internet selling space. To name but a few steps taken, the airlines imposed differential commission levels on Internet-originating transactions and, working jointly through the Airlines Reporting Corporation, imposed new identification requirements on Internet-originating tickets to identify those transactions to which the lower commission levels would be applied. They have jointly posted a list of recommended and actual practices that discriminate against on-line transactions.

Here we must emphasize that while some people, including those at Orbitz, have argued that the current dispute about the joint airline Web-site is really a fight by the two dominant on-line agency firms, Travelocity and Expedia, to protect themselves from competition, the reality is that there are thousands of smaller travel agencies that want to use the technology of the Internet to expand and grow their businesses. More importantly, millions of consumers prefer the "traditional" travel agency as the source of information, advice and travel documents either alone or in combination with Internet capabilities. And, of course, there are millions of Americans who do not have realistic and practical access to the Internet and who, if they are to take advantage of travel, must be able to find and access a so-called "traditional" travel agency.

The story is not over. When the airlines were called to account for rising customer dissatisfaction with the way they are treated, the airlines, under threat of action by this Committee and others in Congress, sought the equivalent of a "plea bargain." They produced the "voluntary" service commitment program which was the subject of interim review by this Committee just a few weeks ago. Again, given the opportunity to collude and get an agreed-upon price advantage over the retail distribution system, they did so, this time by providing that the lowest fare guarantee in their service commitment applied only to customers choosing to deal directly with their reservations centers. Customers using travel agents, on-line or off-line, were excluded from this benefit. The same was true for the grace periods provided for holding fare quotes for 24 hours while searching for a better fare elsewhere. It was Atlanta all over again.

The repetitive nature of this joint conduct by the airlines establishes a clear pattern. They now intend to block agent access to the lowest fares and raise agents' costs of doing business while continuing to lower their compensation and interfere with their customer relationships.

Armed with motive and opportunity, the airlines have now embarked on a campaign to reshape the market in their own image. If successfully consummated, this strategy will make it much harder for the public to learn about all of the fare and service options available to them and thus increase the likelihood that they will, on the whole, spend more for air travel than they otherwise would. By restricting access to unbiased and comprehensive information from independent sources, the airlines expect, rightfully, that they will be able to increase the average price consumers pay for air travel.

Travel agency sales of air travel alone exceed $80 billion annually. If the airlines can divert any meaningful amount of this business to themselves, the potential gain to them is enormous, not merely in commissions avoided, but in the higher overall prices that consumers will pay for air travel. Deprived of easy access to independent sources of comparative price and service information, consumers inevitably will end up paying more, on average, even if the airlines never actually raised another fare.

The changes the airlines are aiming at the distribution system are not occurring under conditions of a level competitive playing field in which consumer preferences ultimately control the outcome. Instead, the airlines are using market power, collective activities and other devices to undermine the distribution system to achieve their goal of reducing the public's access to independent comparative price and service information.

The airlines have reduced both off-line and on-line commission rates to levels that do not cover agency costs. This has forced most agencies to charge their own fees to consumers for the sale of airline tickets. Agency tickets sold on the Internet have been singled out for even lower commissions. Enforcement of those discriminations is aided and abetted by the airline-owned Airlines Reporting Corporation. The carriers also enforce brutally discriminatory ticketing policies on travel agents while disregarding those same policies in their direct dealing with consumers.

The airlines jointly have refused to permit travel agency service fees to be placed on the airline ticket stock, thus denying agents an important adaptive efficiency, while they continued for many years to apply self-serving discriminatory compensation policies to their jointly owned sales agency for government and large corporate clients.[13] Finally, they continue, under authority approved by the DOT's CRS regulations, to share detailed information on their competitors' sales to consumers. Details of these activities are set out in Appendix A to this Statement.

Consumers must have access to travel agents and other independent distributors who provide unbiased consolidated schedule and fare information if we are to preserve competition in the airline industry and maintain a system that provides the public with a broad range of options, including access to small airlines and start-up carriers.

Since deregulation, the public has had the choice of buying directly from suppliers such as airlines at no additional cost and overwhelmingly has chosen to deal with travel agencies. Consumers prefer dealing with travel agencies rather than airlines when purchasing air transportation because agencies deliver far more value, convenience and services.

Among the most basic functions performed by travel agencies is to collect and distribute comparative information and advice about the price and quality of travel suppliers' offerings—a function that no single airline can or wants to perform. In addition, consumers' transaction costs are often lower than direct-dealing with airlines, especially because many travel arrangements are joint purchases of the products of several travel suppliers (for example, air transportation and hotel/rental car). In short, one-stop shopping for accurate and unbiased travel services at a travel agency is the essence of the benefit to the public, as against airlines' direct selling methods.

It can no longer be assumed, that, even with new technologies, travel agencies will be able to function in the future as independent sources of the services that consumers value. Slowly but surely, in a myriad of ways including those we have identified above, and in cumulative effect, the major U.S. airlines are destroying the competitiveness of travel agencies and, thereby, extracting ever-higher effective prices for air travel from consumers.

In lock-step, each of the major carriers (American, Delta, Northwest/Continental and United) that comprise the U.S. airline oligopoly, has imposed virtually identical restraints upon independent travel agencies, for the purpose and having the effect of, depriving consumers of the benefits of free and open competition. Specifically, the restraints we have identified, are designed to impede and prevent travel agencies from offering a full range of consumer services and thereby cause travel purchasers to by-pass agencies in favor of direct-dealing with carriers.

The ultimate objective and actual effect of this strategy is to warp the normal discipline of the market place and enable each airline to achieve more than competitive profits by exploiting consumers' inability to search out and obtain the lowest possible ticket prices. In other words, these restraints make possible an adverse impact upon consumer welfare much like that one would expect from traditional cartel behavior.

No airline can be expected to provide the public with unbiased comparative price and service information about its competitors. Consumers may be able to get some of this information from airline-controlled Internet sites, but the fundamental airline strategy of disabling the travel agency distribution system will leave millions of consumers without effective access to neutral comparative information.

The latest airline attempt to deprive the public of its only opportunity to leverage what little competition there is must be stopped. At the same time, the unbalanced conditions that encourage the airlines to try every avenue to deprive the public of its only neutral, unbiased source of travel information and arrangements must be returned to equilibrium.

There are important areas of government action available, short of re-regulation of the airline industry, that would go a long way toward restoring the balance of power and assuring that consumers are not left to the airlines' dictation of distribution channels.

One step is to pass the portions of HR 2200 that would make it an unfair practice under the Federal Aviation Act for any airline to make the availability of a low fare dependent upon the technology used to access information about the fare. This one step would assure that the millions of Americans lacking effective access to the

Internet are not deprived of access to the lowest fares and it would assure all Americans of the freedom of choice as to distribution channel with which to do business. Airlines could continue to offer low fares and consumers would decide how to research them and how to buy them.

Another step, also fundamental, is to fix the problem of federal preemption of state law. When Congress deregulated the airline industry by passage of the Airline Deregulation Act of 1978, it prohibited states from "enact[ing] or enforc[ing] any law *** relating to rates, routes, or services." 49 U.S.C. App. § 1305(a)(1). Obviously, such a provision was necessary to prevent the states from subjecting to their regulation that which Congress had just removed from federal regulation. That federal preemption provision, shielding airlines from state regulation, has now been turned by the airlines into a sword with which they bar the general public and small businesses from holding them accountable under the same state law that applies to virtually every other industry in the country. The result is that the airlines have become a veritable law unto themselves, immune from state-law suits seeking to hold them responsible for harm to passengers as well as their obligations to small businesses. At the same time, the airlines remain free to call upon, and do call upon, these same state law principles against other parties when their own interests are served.

Differences of interpretation in the scope of the Federal preemption that several Justices of the Supreme Court would accord airlines under the Airline Deregulation Act, as well as instances of members of the public and small businesses, including other airlines, being denied a forum for their claims, illustrate clearly that clarification and modification of this troublesome provision must be undertaken.

Absent a comprehensive and active administrative scheme for dealing with private party grievances, there is simply no place to go to get justice from an airline. The Department of Transportation "has neither the authority nor the apparatus required to superintend a contract dispute resolution regime."[14] Clearly, it is unequipped to resolve tort claims.

ASTA supports statutory language it believes strikes the appropriate balance between the airlines' need to be free of state economic regulation of fares and routes in a deregulated environment, and the rights of consumers and others to have redress against airlines for their failures to abide by the same state law standards of conduct all other parties must observe. That language amends 49 U.S.C. Section 41713(b) by providing:

> **This subsection shall not bar any cause of action brought against an air carrier by one or more private parties seeking to enforce any right under the common law of any State or under any State statute, other than a statute purporting to directly prescribe fares, routes, or levels of air transportation service.**

This language currently appears as Section 3 of HR 2200, and also in Section 7 of S. 477, the "Airline Competition Act of 1999," offered by Senator Schumer, and as Section 9 of H.R. 272, the "Airline Competition and Lower Fares Act," offered by Representative Slaughter.

Finally, if the government allows the airlines to proceed with Orbitz as planned, it will have done at least three things: (1) defeated completely the goals of the Airline Deregulation Act of 1978, (2) rung the death knell of many small businesses throughout the United States who will have no effective means of competing with collusive airline distribution systems, and (3) left consumers with no long-term hope of relief from the anti-competitive behavior of the airline industry.

In such circumstances, where the airlines will for all practical purposes be a single enterprise (when effect is given to all the other relationships, immunizations and preemptions that the law and regulators have provided them), it will be essential to permit the distribution system to join together in collective action, with similar relief from the antitrust laws, in dealings with the airlines. If the United States air transportation system is to be run by an unregulated cartel, elemental fairness, not to mention the welfare of the millions of consumers who prefer not to deal directly with the airlines, requires that travel agencies and other distributors of retail air services be allowed to collectively bargain as a union would. Absent such relief there would be no semblance of fairness or competitiveness in the marketplace that the airline industry of three or four carriers would produce.

## Conclusion

Independent providers of travel services are absolutely necessary for optimal consumer welfare. Consumers derive substantial benefits from the presence of travel agents in the travel service market. This is as true of the Internet as of the more traditional selling space, maybe more so.

Both economic theory and recent history teach a clear and important lesson: the firms that comprise the U.S. airline oligopoly are prone to anti-competitive acts of predation and collusion.[15] Their past conduct demands constant and heightened scrutiny of their practices toward travel agencies.

The acts and practices we have discussed threaten permanent injury to the competitive process and, unchecked, will result in the transfer to the major carriers of vast amounts of wealth that consumers would otherwise enjoy. These and other carrier-imposed restraints deny to travel agencies the freedom to take independent actions that would make their operations more efficient and responsive to consumer demand.

By restricting travel agency output, these restraints also enable individual carriers to exercise power over price in discrete geographic markets for air transportation. Taken together, their aggregate effect is to allow carriers collectively to overcharge consumers on the order of hundreds of millions of dollars more annually than they could earn under fully competitive conditions—a rate of welfare loss that will only increase over time unless the carriers' anti-competitive conduct is stopped.

By restraining the competitiveness of an industry segment that serves all travel suppliers, not just airlines, the long-run welfare loss is even more severe than the loss extracted by a single monopolist that overcharges customers by setting price above its marginal costs.

At its core, and as a whole, the carriers' anti-competitive strategy is designed to erode the ability and incentives of consumers to seek and obtain the services of travel agencies, including emergent on-line booking services and auction sites. The airlines know and have acted upon the fundamental truth that when consumers are deprived of comparative information in making travel purchases, they almost always end up paying more—not because fares rise in absolute terms but rather because consumers are unaware of lower fares and are therefore not able to claim them. Simply put, carrier practices that even modestly reduce competition from travel agencies produce immediate and out-sized gains in carrier profitability, not because of increased efficiency but by exploitation of consumers' inability to obtain the lowest price when dealing directly with them.

ASTA appreciates the opportunity to have presented its views, and remains at the Committee's disposal to assist in any way it can.

## Appendix A

*Non-compensatory Commission Policies*

The first action in the airlines' anti-consumer campaign began in 1995, when the major airlines, save only Southwest Airlines, capped travel agency commissions at $50 per round-trip ticket. This was followed in September, 1997, with across-the-board reductions in the domestic base commission rate from 10 percent to 8 percent. In 1998 international commissions were capped at $100 per round-trip and in October, 1999, a third domestic reduction, to five percent capped, was imposed.[16] In dollar terms, the total compensation reduction to agents is well over 30%.[17]

At this time, consumers have overwhelmingly elected to continue to do business with travel agents, but millions of consumers now pay transactions fees to agents, fees which agents have been forced to adopt to off-set airline commission cuts. Consumers who are unwilling or unable to pay travel agent transaction fees must contact airlines directly and often pay higher fares as a result. As airlines continue to reduce agency commissions, many consumers may be willing to pay higher fees for the right to do business with agents, but millions of other consumers will be forced to deal directly with major airlines.

This puts the consumer right where the airlines want him, bereft of a neutral source of information to deal with a bewildering array of complex air fares and services. As travel agents are forced out of the industry and airlines secure more direct consumer business, consumer alternatives will continue to decrease resulting in significantly higher consumer travel costs. This "revenue squeeze" has made entire segments of airline ticketing activity non-remunerative for agents, a major factor in the exit of 18 percent of independent U.S. travel agencies from the air retail industry during 1995–2000,[18] as well as in a shifting of resources by the remaining agencies to non-air sales. This is the first decrease in the number of travel agencies since World War II, and more closings are expected as agency operating reserves are exhausted.[19]

Small domestic airlines, many international airlines, and start-up airlines who depend upon the travel agency distribution system will be adversely impacted if not eliminated. There is no alternate distribution system available to these types of airlines.

Major airlines have generally misrepresented the reason for agency commission cuts, citing a need to reduce expenses and pass savings on to consumers. In fact, airline ticket prices have steadily increased, and airlines are regularly posting record profits. Not one penny of the alleged cost savings can be discerned to have been passed on to consumers through better service or lower ticket prices. There have been no consumer benefits, and consumers are paying the highest airfares in history.

*Agency Transactions Originating On The Internet*

Major airlines have also adopted discriminatory and non-compensatory commission policies for bookings originated on-line.

Commissions paid to on-line travel agencies and other independent on-line ticketing services are at a general rate of 5 percent with a $10 maximum, which is well below these firms' costs. The airlines have thereby succeeded in arresting in its incipiency an effective counter-measure available to agencies to offset reductions in commissions on traditional sales: unfettered access to consumers through high-volume, low-cost electronic marketing systems.

Most recently, in implementation of the airlines' non-compensatory Internet transaction policies, their jointly owned alter ego, Airlines Reporting Corporation ("ARC") has begun issuing special numbers called Electronic Reservations System Provider numbers ("ERSP" numbers). Virtually all the major airlines have informed travel agents that they must attach these special numbers to every transaction that originates on the Internet. The only apparent purpose for this requirement is to help the airline enforce its discriminatory commission policy with regard to Internet transactions.

In this scenario, the airlines, through ARC, are collectively facilitating the enforcement of commission policies designed to keep travel agents from becoming meaningful participants in the electronic marketplace.

*New Entrant Obstacles*

For at least the second time since airlines were deregulated, the so-called "new entrant" airline group, which typically operates on a no-frills, low-cost, and thus low fare, economic model, is finding it difficult, often fatally so, to compete with major established airlines. Major airlines monopolize airport facilities, earn huge returns from the computer reservations systems they control and own (and through which almost all airline reservations are made), target small carriers using massive give-aways (such as frequent flyer program points), and employ temporary fare-cutting tactics to deter or block new market entry.

A competitive market for travel services, i.e., one in which consumers anywhere in the U.S. can readily turn to independent agents to reduce search costs and avoid buying errors, makes it possible for new carriers to enter the market and for small carriers to expand without bearing the full costs of second-stage entry (developing their own distribution network). Thus, carrier practices that restrain the ability of agents to compete also tend to raise entry barriers in air transportation markets. Federal agencies such as DOJ and DOT have long been concerned about market conditions that impede entry and expansion of small, low-price carriers, and there is good reason to believe that erosion of travel agency competitiveness will translate directly into less competition in the market for air transportation.

Moreover, market imperfections, including consumers' notorious lack of information about carriers' complex, ever-changing and often poorly visible price and service offerings, enable carriers with market power over particular routes and facilities to discriminate against captive consumers. By restricting travel agencies' output, individual airlines can and do exercise and maintain market power in discrete geographic markets for air transportation, especially city-pairs involving a "hub" where the carrier is the dominant or monopoly provider.

If the major airlines are successful in destroying most or all of the smaller, new entrant airlines, competition in airline pricing and schedules will diminish even further.

*Discriminatory Ticketing Policies*

Major airlines refuse to permit agents to offer certain benefits and concessions to consumers, such as the refund of so-called "non-refundable" tickets, while reserving to themselves the right to make such refunds. Transgressions are punished severely with airlines levying cash penalties against agents to which agents are summarily required to acquiesce or face the greater penalty of losing their ability to issue tickets altogether. The airlines themselves often issue such refunds. The airlines then typically force the agent to repay the commission earned on the original sale.

Similar discrimination in competitive practices occurs with respect to price-saving opportunities such as the sale of "back-to-back" and "hidden city" tickets, as well as highly publicized special fares that require consumers to purchase directly from airlines. These discriminations have the consequence of interfering with the relationship between the travel agency and its clients, by, among other things, impairing the agency's credibility in the eyes of the customer.

"Back-to-back" tickets, are a pair of tickets issued to permit the traveler to avoid the Saturday night layover normally required to get a discounted ticket. Airlines prohibit agents from issuing these tickets, and normally demand the agent pay the full coach fare as the penalty for so doing.

"Hidden city" tickets, in which the passenger buys a ticket A–B–C, which is cheaper than a non-stop A–B ticket, then gets off the plane at B, are also forbidden and punished severely. In addition, major airlines, while acknowledging passenger contracts for passage legally exist only between passengers and airlines, nonetheless reserve the right to penalize travel agents financially when consumers buy inexpensive round-trip tickets, travel one-way, and throw away the return portion of the ticket. Such policies confuse and anger the public, while undermining the relationship between the travel agent and his client, who expects the agent to find and ticket the lowest fare available.

Airlines have also adopted an identical condition upon redemption of frequent flyer awards that arbitrarily forces consumers to by-pass agencies. These awards are mostly earned at employer expense but are commonly used by individual travelers for leisure trips, many of which would have been arranged through travel agencies. The airlines divert substantial revenue from agencies by requiring awards to be redeemed directly from airlines.

As recently as January 11, 1999, Delta Air Lines announced initiation of a $1 surcharge for each published fare component on all U.S. domestic fares. Under this scheme most round-trip tickets, which are constructed using two fare components, would include a $2 surcharge. Additional surcharges would apply on tickets constructed using multiple fare components. This surcharge, however, would not be applied to tickets issued via Delta's SkyLinks Internet website.

Thus, Delta's scheme penalized all of its customers who wished to avail themselves of the opportunity to receive comparative cost data by consulting a travel agent. The avoidance of the $1 surcharge penalty by using the Delta website was "fool's gold" placed in consumers' paths to lure them into remaining in the dark about fare alternatives that could potentially save them hundreds of dollars.

Delta cited increased computer reservation system ("CRS") booking fees as its justification for this punitive charge for using a travel agent. Since the airlines by and large own the CRS systems, they are both responsible for, and benefit directly from, the increased CRS booking fees of which Delta complained.

In this case, at least, the public outcry was so great that the other airlines declined to match the Delta surcharge. It was dropped after a few weeks. Delta nonetheless stated that any passenger seeking to get credit for having paid the $1 surcharge would have to pay a $75 change fee that Delta imposes on discount tickets.

*Airlines Use of Joint Assets*

The airlines also use discriminatory collective or joint operation of assets to offer concessions, benefits and services to the public while denying comparable access to such concessions, benefits and services through travel agents and other independent air transportation distributors, including, but not limited to, joint sales activities, denial of competitive tools, and denial of distribution efficiencies. The airlines operate several collective businesses that are used to disadvantage travel agents and to limit public access to comparative price and service information.

These include ARC, which controls both who can become a travel agent and the settlement of funds between travel agents and the airlines. ARC is also involved in the formatting of standard agents' ticket stock. When the airlines cut commissions in 1997, the travel agency community sought the inclusion on the ticket document of a space where the agent could insert its own service fee and process the charge through ARC along with fares, taxes, and other charges on the ticket. The airlines have made it clear that this important competitive efficiency mechanism will not be provided to travel agents.

More recently ARC has begun providing "accreditation" of corporate customers, purporting to make them "agents" of the airlines that sell to them, so that the corporations can have standard travel agents' ticket stock and settle accounts with the airlines through the same system used for travel agents. In purpose and effect, this program is collective action that facilitates the carriers' strategy. Among other things, it enables them jointly to target, select, large volume corporate accounts that constitute a large and lucrative source of agency profitability and skim the "cream"[20] for themselves.

Another example, until recently, was the operation of SATO, Inc., the functional equivalent of a mega-sized travel agency (air sales of about $1 billion) that the airlines collectively owned and used to compete with travel agencies for government and corporate business.[21] The airlines claimed that SATO was more cost-effective than travel agencies and was operated on a non-profit, strict cost-pass-through basis, but there was evidence that the actual cost of SATO on a percentage-of-ticket-price basis was several points higher than the average actual cost of travel agency commissions. And when the airlines capped travel agent commissions, no reduction was placed on SATO's working "commission," thus increasing the advantages it had over regular travel agencies.

In fact, exempt from the same commission caps and ticketing restrictions that the carriers have imposed upon travel agencies, SATO enjoyed an effective commission rate of approximately eleven (11) percent, almost twice as much as agencies' average gross commissions on air sales. SATO has now been sold, but its historical collective use as an unfair competitive weapon against travel agencies remains a fact.

*Agents' Transaction Data*

One of the most egregious of the airline practices in question, is the process whereby the airlines share competitively significant sales transaction data in violation of the confidentiality interests of the travel agents and other independent air travel distributors who generated the transactions.

Confidential business information generated by travel agencies is routinely captured and shared by the airlines in a manner that would be blatantly unlawful absent regulations issued by the Department of Transportation. Those regulations require each computer reservations system (most of which are controlled by airlines) to make available to all participating U.S. airlines all marketing, booking and sales data that it generates from its systems.

In addition, ARC sells to airlines travel agency "total sales" figures, information that would normally be confidential unless a business consented to its disclosure. Because airlines are major competitors of travel agencies, there are serious questions as to whether they should have access to proprietary data of this kind.

If competitors in any other industry were to sit around a table and exchange this type of information in the ordinary course of business, we believe that the Department of Justice would lower the antitrust boom on them. Yet the airlines are free to share competitive information about their operations with their competitors without apparent concern. And the information is then used to disadvantage the travel agency, the only independent source the public has for neutral, comparative information.

ENDNOTES

[1] See e.g. *Investigation into the Competitive Marketing of Air Transportation*, C.A.B. Docket 36595, aff'd; *Republic Airlines, Inc. v. C.A.B.*, 756 F.2d 1304 (8th Cir. 1985); *In re Domestic Air Transportation Antitrust Litigation*, 148 F.R.D. 297, 61 USLW 2610, 1993–1 Trade Cas.(CCH) ¶ 70,165 (N.D.Ga., 1993); *U.S. v. Airline Tariff Publishing Co.*, 1993–1 Trade Cas. (CCH) ¶ 70,191 (D.D.C., 1993); *Spiro v. Delmar Travel Bureau, Inc.*, 591 N.Y.S.2d 237 (A.D. 3 Dept. 1992); and *Crowder v. Kitagawa*, 81 F.3d 1480 (9th Cir. 1996).

[2] Based on Travel Industry Association of America 1998 estimate of 221 million air person-trips taken in the United States, grown by 4 percent to 2000 annual estimated.

[3] http://www.orbitz.com.

[4] Joint Press Release of United Delta, Northwest and Continental, November 9, 1999.

[5] *Id*.

[6] Attributed to Ben Burnett, Vice President of Boston Consulting Group, a firm retained to act as "temporary launch manager." "Nearly Two Dozen Airlines Will Join Planned Web Site of Four Big Carriers," Susan Carey, *Wall Street Journal*, February, 2000.

[7] Antitrust Guidelines for Collaborations Among Competitors, April, 2000, at 14.

[8] *Id*. at 9.

[9] The agencies' share of airline sales rose from 55 percent in 1977 to 81 percent in 1995. P. Ruden, *Competition in the Distribution of Travel Services* 5 (ASTA 1997).

[10] Initial Decision of Administrative Law Judge Ronnie A. Yoder, *Investigation into the Competitive Marketing of Air Transportation*, CAB Docket 36595, served June 1, 1982 at 44, n. 3, final decision in Order 82–12–85, December 16, 1982.

[11] *ATC Agency Resolution Investigation*, 28 CAB 258, 260 (1959), footnotes omitted.

[12] These programs were originally administered by the airlines' trade associations. They were spun off into separate companies owned directly by the airlines when the CAB terminated antitrust immunity.

[13] SATO was later sold to non-airline interests. See Appendix A.

[14] *American Airlines, Inc. v. Wolens*, 513 U.S. 219, 232.

[15] See for example, *U.S. v. Airline Tariff Publishing Co.*, 1993–1 Trade Cas. (CCH) ¶ 70,191 (D.D.C., 1993).

[16] The last three reductions were all led by United, the lead investor in Orbitz.

[17] The commission rate for June, 2000 domestic air transactions was 4.10 percent according to official Airlines Reporting Corporation reports. In January, 1995, before the commission caps, the rate was 10.01 percent.

[18] Between March, 1995, the first full month after the first commission caps, and March, 2000, the number of agency firms accredited by ARC declined from 23,978 to 19,739. Source: ARC Monthly Statistical Information.

[19] Later ARC reports confirm this. Year-to-date terminations of defaulted agencies were up 39 percent at the end of June, 2000.

[20] As Justice Brennan observed, concurring in *White Motor Co. v. U.S.*, 372 U.S. 253 (1963):

> Instead, [defendant] seeks the best of both worlds—to retain a distribution system for the general run of its customers, while skimming off the cream of the trade for its own direct sales. That, it seems to me, the antitrust laws would not permit . . .

[21] Since this paper was first written, the airlines have announced that SATO, Inc. has been sold to private investors who will operate it as a travel agency. We do not know at this time with certainty whether a special relationship between SATO and the airlines will survive this sale.

**Explanation of Exhibits** *

Exhibit 1 Total Airline Sales by Distribution Source—Assumes that travel agency airline ticket market share is 75 percent, with annual volume increases of 7 percent in 2000 and 5 percent in 2001. Based on ARC monthly statistical reports and estimates of Internet shares by PhoCusWright, a technology consulting and research firm specializing in the travel industry/Internet areas.

Exhibit 2 Airline Sales by Distribution Source—Same data as Exhibit 1 shown in percentages of total airline sales.

Exhibit 3 Online Airline Distribution Marketing Share—PhoCusWright estimates of the agency and airline shares of the online airline market.

Exhibit 4 Average Commission Rate (All Fares)—From ARC monthly statistical reports, showing the average annual commission rate on sales reported through ARC, domestic and international sales combined.

Exhibit 5 Total Travel Agency Sales vs. Commissions—Contrasts the US travel agency industry (online and off-line) sales of air fares, as reported through ARC, with commissions paid for such sales, also as reported through ARC.

Exhibit 6 Airline Relationship Chart—Details in chart form the relationships reflected in Exhibits 7–11.

Exhibit 7 Equity Interests—Indicates equity/warrant ownership among eight major domestic airlines and other carriers.

Exhibit 8 Equity Interests in Computer Information Resources—Indicates equity interests in various large Internet retailers and Computer Reservations System companies.

Exhibit 9 Alliance and Code Share Relationships—Shows reported code share and major marketing alliances formed as of creation of the chart. SkyTeam is not included.

Exhibit 10 Orbits/T–2—Adds Orbitz to the picture.

Exhibit 11 Global Cartel—Illustrates the other global airline joint ventures on the Internet.

* Exhibits 1–11 have been retained in the Committee files.

The CHAIRMAN. Mr. Silbergeld.

**STATEMENT OF MARK SILBERGELD, CO-DIRECTOR, CONSUMERS UNION**

Mr. SILBERGELD. Mr. Chairman, Consumers Union and Consumers Federation of America, which joins in my testimony, thank you for holding this hearing and for inviting us to participate.

Orbitz, simply put, may provide its founding air carrier investors, the nation's five largest airlines, with a vehicle for collusion as to travel ticket prices, explicitly or through carrier or Orbitz-designated conditions of doing business. And, it may serve to eliminate or severely curtail the competition from existing on-line travel agencies, that is, competition to the airlines' current ticket sale distribution systems. And, as well, as to favored consumers with Internet access at the expense of those who cannot readily search and book reservations via the Internet.

Consumers could be severely affected if the Orbitz Internet travel agency were to further enhance the industry's ability to direct most travelers to ticket prices that are price-optimal as to carriers but not to the individual traveler.

When supposed competitors coordinate their sales, they reduce the likelihood that independent action by brokers will reduce price. And when supposed competitors exchange information about prices or about the price/quality mix of products, they increase the opportunity for anticompetitive parallelism.

The most important thing that these hearings can do, Mr. Chairman, is to identify the marketplace concerns of the traveling public, to sort out the competing claims about the effect of Orbitz on air travel and other travel and entertainment markets, to identify appropriate safeguards and to take whatever additional steps through oversight or through legislation are necessary to make sure that those safeguards are in place and in effect.

I would emphasize what the DOT witnesses said earlier this morning; that the safeguards need to be in effect before Orbitz actually starts up so that we do not have the specter of the government trying to change process of a business once that business is already in place and proceeding to do what it intends to do, whatever it intends to do.

Consumers need airline booking agencies, whether they be bricks and mortar or whether they be on the Internet. Their information should be based on a thorough search of relevant data, presented in an unbiased manner, and be equitable with respect to consumers who cannot access the Internet or use it with facility as well as to those who can.

As this Committee well knows and as has been repeated this morning, this is a joint venture by an industry that does not have a history of price competition. If anything, the airline industry sells tickets in the atmosphere they have created, which can only be compared to a rug bazaar in which the seller sizes up each individual purchaser, checks out to see if they're wearing diamonds or plastic, and tries to sell them a ticket that is price optimal based upon their own computer-assisted calculation of what that individual passenger is willing to bear.

Three passengers sitting abreast on the same flight to the same destination may well have paid three wildly varying fares for that same transportation.

So we are not talking here about an attempt to find the best price for the consumer. We are talking about an industry that has a history of trying to nail each consumer to the wall, to get the highest price, the figure they can take that consumer for.

This venture has been managed in its development by the Boston Consulting Group, which as previous witnesses have described, has published a book that describes the problem, and how to solve the problem, of a "consumer-oriented navigator," as *Blown to Bits* calls it. The navigator becomes consumer rather than seller oriented and makes it necessary for the individual sellers to compete. It does this by comparing their prices and service quality for the consumer against those of their competitors, and the solution suggested in that book is simply to deny the information, to act in a parallel, conscious manner, so that the navigators cannot operate to the consumer advantage.

What happens, then, is that same firm, Boston, takes over and helps this already anti-competitive industry to integrate their ticket sales vertically forward and carry out that prescription for avoiding competition that would result from price comparison and service quality comparison.

This should raise red flags all over the country, and it should result in the most thorough possible investigation by the Justice Department and the Department of Transportation, that those two departments can possibly mount. And it needs to happen before Orbitz actually goes into business with this business plan as a booking plan.

Orbitz, on the other hand, is clearly operating in the realm of verbal assurances. It has told various forums that it plans to reduce the airline's degree of investment in the venture. That it is seeking other investors to replace airline investment, that it has not described any plan for doing that, is anything other than an attempt to make this collusive effort sound as innocent as possible.

When I asked Orbitz' representatives whether they had any plan to have public directors on the Board of Directors, for instance, all they could say was that the plan didn't preclude it, but certainly they couldn't tell me that the plan included it. That would be a potential safeguard, not enough safeguard by itself, of course, but one safeguard against the use of this venture as a platform for collusion.

As to the thoroughness of the price search, Mr. Chairman, Orbitz makes certain representations, but operators of existing CRS systems dispute that this new technology is going to give us anything more useful.

Ordinarily, the marketplace would sort that out, but when there is collusion by the sellers in the venture that makes the claim, then it seems to me that there has to be a very, very thorough comparative test of those and the marketplace alone is not going to do it.

"Equitable access in the digital divide." I would only remind the Committee that according to the Federal Communications Commission's most recent official figures, only about a quarter of U.S. households have Internet access, and in addition to that many consumers, as we've heard this morning, are not sophisticated enough, even when they get on line and use the existing on-line travel agencies, to find the cheapest fares. What the DOT witnesses described this morning suggests that we need a lot more than mere access in order to assure that all consumers, even sophisticated consumers, can use the systems efficiently.

So I would conclude, Mr. Chairman, by urging the Committee to take a look at the things that need to be done. I cannot imagine this going forward without some kind of a consent order that is enforceable by the Justice Department. We need a plan for reduction of airline ownership of Orbitz to a less than controlling interest on an appropriate and strict timeline.

We need Orbitz' Board of Directors to include independent, public directors who will be responsible to the public and assure that it is not used and its business plan does not serve as a mode of collusion.

We need periodic Justice Department review of Orbitz' business plan and a requirement for periodic reports under a Consent Order, revised Department of Transportation regulation on all reservation systems, whether or not they're owned by airlines, whether or not they're on the Internet to assure that everybody is putting that information out, unbiased, on a level playing field, and provisioned by the airlines of deeply discounted tickets in all venues.

I thought that Mr. Mead's recommendation in that respect was eloquent this morning, and we strongly endorse it.

I thank the Chairman for the time, and I will be happy to answer any question.

The CHAIRMAN. Thank you.

Senator Bryan and Senator Cleland, the vote just started, and because of this 11:30 imposed deadline, perhaps you would like to go over and vote and then come back and I'll wait until you get back and then go and vote if that's agreeable to you.

Mr. Katz, I think it would be only appropriate to allow you to respond to any comments that have been made at whatever length you choose to respond.

Mr. KATZ. Thank you, Mr. Chairman.

I think the core of the issue that I continue to hear and, of course, I'm very respectful of the concerns and am very personally familiar with not only the history but what it means to be an airline executive setting prices and doing yield management, and a CRS executive trying to determine best search algorithms and best technology.

Let me go back to the fundamentals.

Our airlines are investors in a very high-risk proposition. They represent the Board of Directors, and I am building the management team. I as head of the management team have the obligation to run this business in the best interests for the long-term of consumers. We do not require airlines to give any fare or anything to us that they are not free to give to others. If they choose to do so, and I presume that will have a lot to do with the economic terms and conditions with which——

The CHAIRMAN. Could I interrupt you just for a second with a question, Mr. Katz; and I don't intend this hearing to be adversarial.

If the airlines have an investment in Orbitz, why wouldn't they be inclined not to give that same information to the competitors of the enterprise that they have an investment in?

Mr. KATZ. The airlines want to see the business grow and be successful. The airlines have a huge interest to see there be more than 2 and, frankly more than 3, competitors in the next 20 years Internet environment. So they want to do what is best to encourage competition and have more than two competitors.

The CHAIRMAN. And, yet, they've made a significant investment in one.

Mr. KATZ. They've made a significant investment in one, because if you were to go out and have a meeting with Morgan Stanley or Goldman Sachs today and say, I have this great new technology, I have this wunderkind from MIT who's got a great new fare engine, I'm going to go compete against Microsoft and Sabre, they'd say, "Nice idea, good-bye." Or "find me other investors who have $50 million, and then maybe I'll consider it."

And that's exactly what the airlines have done.

And then they further said, "go find somebody who knows this business a little bit and has a chance at least to compete on a know-how business," and that's also what they've done.

The whole notion of fares I think we overplayed. Our whole marketing competition and our whole customer promise is to leverage the new technology. When you have the opportunity to look at Orbitz in the marketplace, the main thing you will see is more choice. You will see simply more airlines, more fares, and those fares, and I'd say with over 99.5 percent probability, those fares will be fares that are readily available to everybody, but the nuances of the way the CRSs work simply limit the ability of today's approach in CRS to find them in the appropriate amount of response time.

The CHAIRMAN. Could I interrupt again?

Do you understand and appreciate—I hope you do—because of our previous involvement with an airline-owned CRS, where the Department of Transportation and the GAO were able to conclude that there was bias in the system toward the owners; can you appreciate the skepticism, then, that exists here?

Mr. KATZ. Completely. Completely. With all due respect, I've been there, done that.

We are contractually obligated to be unbiased, and we don't have a product, we can do no more than say we will and contractually do so and abide by the law. We have no exclusivity on any fare by contract. We get no fare before it is simultaneously available to the public. We get no fare that has not come from a mechanism that is Department of Justice consent decree compliant.

This is really about competition not collusion. I understand the skepticism, but as Chairman of this Board, I can tell you, not on my watch. We understand the law, we can comply with the spirit and the letter.

The CHAIRMAN. Is there anything else you'd like to say?

Mr. KATZ. I think I'd also like to say there's been a lot of words transmitted, for example, on frequent flyer redemption, and so on. These features are currently not planned, certainly that I'm aware of it, or that our business is working on.

We are working on investors. We certainly have plans to have outside investors.

And, again, we welcome the competition the other competitors can offer and, if they choose to compete, they probably will receive the fares. But if the deck is stacked in a way that we are not allowed to come into the markets in a fair and open way, there will be no CRS price competition, there will be no new technology, and there will be 2 duopolies. And as this market gets big, a lot of the fears that have been raised by Consumer Union or travel agents will certainly happen more likely with 2 than with 3 or 4 or 5. If we don't get in, nobody else is likely to come in.

The CHAIRMAN. Do all carriers have an opportunity to invest in Orbitz on the same terms as American, Continental, Delta, Northwestern, United?

Mr. KATZ. All carriers have the opportunity to participate on exactly the same terms. We're new, so we're just starting, but we also have low fare carriers coming in—AirTran, Vanguard, Spirit. We're working hard on America West and expect to get their agreement to participate, and we're even working hard on Southwest and hope to convince them that they, too, can benefit from an opportunity like Orbitz with a lower cost channel of distribution than otherwise available.

The CHAIRMAN. Is that participation the same as equity ownership?

Mr. KATZ. That participation is exactly the same as would be offered whether they were investor or not.

The CHAIRMAN. You make concrete assurances that the customers will never be presented with flight display bias. Will the air carriers that are not equity stakeholders in Orbitz have the same opportunity to inspect Orbitz' flight display algorithm periodically to ensure there's no display bias?

Mr. KATZ. We would invite any seller through Orbitz to evaluate our Safeway, search for any problems they might have. In fact, I would say we go further than today's actual CRS rules do, in terms of the whole area, not only bias but also consumer privacy.

The CHAIRMAN. Mr. Jones, have you made the same offer on the same financial terms that Orbitz has made to the airlines in order to sell their e-fares through Orbitz?

Mr. JONES. No, don't believe we have made the same offer.

As was discussed earlier, we're looking for a general group of fares to be offered here, not just e-fares but all fares, because we don't know what this group of sellers as they get together will do.

So I was pleased to hear the DOT suggest that they extend their regulation to cover all fares. They suggested an economic alternative as well that we hadn't heard before, which we'd like to learn more about to see if that's appropriate, although the fees that they mentioned were negotiated between a company that the airlines own so we're not sure that was an open negotiation, because they owned the company they negotiated with, but I'm pleased to understand what those are and see if that's an appropriate solution.

Mr. KATZ. Mr. Chairman.

The CHAIRMAN. Go ahead, Mr. Katz.

Mr. KATZ. I might add that we have negotiated this agreement with quite a number of carriers, nearly 30, and only 5 of them at present are owners, so I think given that we have already accumulated 30, I can say it's been a fair and open negotiation. We have quite quickly accumulated a portfolio of carriers who seem to have an interest in the business model.

Mr. JONES. Again, isn't the question—pardon me, sir——

The CHAIRMAN. Go ahead.

Mr. JONES.—isn't the question really about fair and open access to information? The fees are an issue that have been discussed here. It's quite interesting, too, that the owners of Orbitz own a CRS, and they could be reducing fees there as well should they choose. They haven't chosen to do so. So I think the fees are one issue, but access to information seems to be a very different issue. As you said, you've been down this path before, but fair and open access to information is quite important across the spectrum that we're talking about.

Mr. KATZ. Mr. Chairman, there are—fair and access information is a nice ideal. This is really about competition. It's about letting a new player come into the marketplace, a lower-cost new player.

It is, to some degree, analogous to Southwest. They brought into the U.S. airline marketplace low cost competition, and growth ensued and low fares ensued. With lower costs, we can, in fact, support lower fees, and therefore we ask our associates to give us the opportunity to promote with our lower cost the lower fares into the marketplace.

It is about competition, and there are many thousands of fares which even Orbitz will not have—group fares, government fares, corporate fares, Association of American Retired People fares, left-handed tennis player fares. These fares are not available except to certain travel agents, cheaptickets.com, specialty providers of that kind. Orbitz won't have these and these represent a massive portion of what is sold and travelled today. So it's about competition, it's about letting the low-cost provider get into the market and compete.

The CHAIRMAN. Mr. Katz, I mentioned in my opening statement that one of the major aspect and reduction in cost to air travel is the so-called "low fare airlines," specifically Southwest but Air Transit and others.

So we sort of look at—anecdotally, I was told that when Southwest announced that they were going to Raleigh–Durham, that fares dropped by some 25 percent before their first flight took place, and we were seeing other hubs where they're allowed in that was reduction in fares as a result in competition, a principle I think most of us believe in.

But, yet, the low fare carriers are in opposition to your enterprise.

(1) Why do you suppose that is; and (2) Is there a way that you can think of bringing them around to supporting your effort?

Mr. KATZ. Mr. Chairman, a super question.

First of all, Southwest is a great airline. Having worked abroad, I can tell you they are the world model for consumerism and for low cost competition.

We do have low fare carriers flocking to Orbitz already. We have Vanguard, we have Spirit, we have AirTran, and, as I mentioned, we are working diligently on Southwest. What makes Southwest a great carrier is low cost, and part of the way they get their low cost is they do not participate in any CRS system and do not pay any booking fees except to Sabre, who has created a very unique, very interesting product, which allows them to charge Southwest a low fee, and they're the only one for whom this product seems to fit in the world.

Therefore, what Orbitz brings by lowering CRS booking fees to any participant is another form of cost competitiveness against Southwest of these other low fare carriers, and I could imagine Southwest would like to hang on to this cost advantage which they now have and have alone.

A second important fact to realize is that Orbitz has a great search fare engine. You can get on the web and see what it does even today. www.itasoftware.com.

The CHAIRMAN. We won't charge you for that commercial.

[Laughter.]

Mr. KATZ. But what happens when this low fare search engine is put to work is that, more often than today, what will be displayed through Orbitz will be low fares by other airlines, not just Southwest, and these low fares will now be as visible as Southwest low fares might have been visible, and that perhaps is another cause for concern they have about their competitive advantage.

A great carrier. We would love to have them in, and I think and hope we can find a way to make them a deal where they continue to have low cost and are satisfied with what we help them bring to their customers.

The CHAIRMAN. Thank you. Time requires me to go in order to make the vote. If you would just relax for a few minutes, I think Senator Bryan and Senator Cleland will be back with their questions, and then I'll return.

Thank you very much.

[Recess.]

Senator BRYAN. (Presiding.) Thanks very much. Let me now defer to Senator Cleland for any questions that he may have to ask.

We are going to be rejoined by the Chairman momentarily.

As you will recall, because an objection has been lodged, we will have to adjourn this hearing at 11:30.

Senator Cleland.

Senator CLELAND. Thank you very much, Mr. Chairman. Thank you for avoiding a disaster.

Let me just say, I've been thinking, trying to connect the dots, that an information society in which we find ourselves a part, and 70 percent of the jobs have to do with exchange of information, and that exchange of information has been dramatically accelerated by technology, sometimes referred to as the Internet, sometimes referred to as the web.

It does seem to me that in order to make the information society work, especially for consumers, that consumers be given additional information, or great information, or information more accurately, more instantaneously. And then with that information, they have the opportunity to compare quality, compare backgrounds, compare brands, compare prices, and this is a fundamental rule in the information society, in the world of the Internet, in the world that we live in.

Now, if you apply this to what we're talking about here, and that is airlines and fares or access to information about fares or the making of reservations, it does seem a little unusual that the Boston Consulting Group, which helped found the Orbitz group we're talking about here, mentions in the book *Blown to Bits* that the economics of information requires imperfect markets.

And that's the originators of information have some ability to limit the access of others to it through copyrights or patents or simple secrecy, they'll never earn the return to justify the original investment. If there is no limit on the ability of others to copy it, owning information is worthless.

Another quote from the book, suppliers and retailers are the source of the information on product features, price and availability that the new navigators need, "new navigators," I presume being consumers. Some simply refuse to make that information available. That's a little disturbing.

My comment, Mr. Katz, to you is, I know you've mentioned that you feel that Orbitz is making information available that is comprehensive and unbiased, but the challenge is that it is a "Platform for collusion." Which is it?

Mr. KATZ. Well, I think this is really simply in the end a question of competition not collusion. I understand the viewpoint, I understand the concerns. We talked about it a bit earlier when the Chairman was here.

All I can say is that we are doing what one can do to make sure that this is not a collusive endeavor, and I'll say it very specifically: we're contractually obligated to be unbiased. We have no exclusivity on any fare. We are the low-cost channel, therefore, it is more interesting for any airline to provide us with those e-fares rather than some other channels.

We get no fare before it's simultaneously available to the public. All fares we receive are compliant with the Department of Justice consent decree mechanism. And, as Chairman of the Board, I can only commit that we understand the law, and we commit to follow the law, and we ask for a chance to compete in a very, very tough market with competitors that have 70 percent market share already.

Senator CLELAND. Do you feel that there is any need for any additional regulations or additional laws?

Mr. KATZ. Well, my personal view and my personal experience has always been that the consumer coming to a site, booking or not booking, is always the harshest form of regulation in governance.

I think if we are allowed to come to market, show what we can do, the marketplace channels will work. We will be very, very lucky to achieve number three position in this marketplace. We don't have access to AOL to MSN, et cetera, those are locked up. It's a very challenging road. And what we simply do is say we'll be unbiased, we have the new technology, we are low cost, much as Southwest has done for the low-cost environment.

Let us benefit where we can from the low costs, but the other competitors are free to make any offer and do any deal they want with airlines. I suspect they will do so. I suspect that will happen.

Senator CLELAND. Thank you very much.

Mr. Silbergeld, is Orbitz comprehensive and unbiased, or is it a platform for collusion?

Mr. SILBERGELD. It is a potential platform for collusion, it is a joint venture by an industry that has not only been noncompetitive, but has engaged in enormous number of practices through the use of market power to prevent consumers from gaming the purchase transaction the same way the airlines individually game it.

They now are colluding to set up a system whereby they have a joint business plan.

I would have been very happy to hear Mr. Katz say that they could live with the Inspector General's recommendations this morning about the universal availability of those deeply discounted fares. I have not heard that said yet.

Senator CLELAND. Mr. Ruden, do we have a comprehensive and unbiased system in Orbitz or is it a platform for collusion?

Mr. RUDEN. Well, Senator, as we've indicated, we think that it's collusive by its nature and experience here should teach us not to allow a repetition of things that have gone on in the past. I was interested in listening to Mr. Silbergeld and to Mr. Mead struggling to come up with a list of palliatives and Band-aids and restraints and controls and regulations and alterations to the business plan that might overcome some of the problems that these folks, who speak for the public with no commercial interest in this matter, think are necessary.

It sounds almost like we're talking about a national epidemic, with the resources to be devoted to trying to contain something like this, when the simpler solution is to simply make the airlines compete one-by-one the way the Airline Deregulation Act and other national transportation policy contemplates.

There is no reason that we have heard yet, other than "Wall Street made us do it," that one of these giant airlines could not have, on its own initiative, taken the software, and I'll accept for present purposes that it's everything they say it is, for sake of argument, take that software and use it against their competition and then force the competition to find better software.

That's the way the market will work, and that's the way in the end consumers benefit from the dispersal of information, as you have correctly indicated, as the cornerstone of an open marketplace.

Senator CLELAND. Mr. Jones, do we have an open marketplace here?

Mr. JONES. I don't think we do, Senator Cleland. Clearly, the current laws just don't cover this, as we have a group of producers coming together, and that's why we support extending the regulations to give this fair and open access.

Because you can have an unbiased system, you can have a great search engine, but if there aren't any fares in it, it really doesn't do much for the consumer. So having more people have those fares will cause competition.

We have airlines that come to us with fare specials but nothing is long-term because they go and give them to somebody else to move things around, to create competition. It's like a sale in a grocery store. It happens in one store and then it happens in another.

Supplier interaction with sites like ours is useful because that competition is good. If that all goes to one place and a group of owners say this is the only place that will happen, we are quite concerned about that.

So, again, I think it's appropriate to consider the solution posed by the DOT this morning to extend the rules to cover this kind of behavior, because it's not just about e-fares. It may be about e-fares today; what fares is it going to be about tomorrow or a year from now? As the Internet and fares themselves dynamically change, we don't know where this might go.

I think many of the comments have been made saying, this needs to be done now and quickly before something happens so that we have taken care of this issue, because we have seen this problem in the past, and we know what the solution should be.

Senator CLELAND. And some of the rules that you suggest be transferred to the new technology have to do with experience of the CRSs in the past?

Mr. JONES. Yes, they do. It's my belief, and I was there when the rules were imposed, the rules were put into place for displays in travel agencies, but they weren't really to protect travel agents, they were to protect consumers in the end to get that in fairly to the consumer. Well, now the consumer themselves, of course, are manipulating these systems, and yet there's no rule to protect them to say that things should be unbiased or that fares should be distributed equally when owners are there involved in owning a system.

So I think we have consumer protection at heart here, and if we apply these rules to the display of fares to consumers, then I think we have a fair and equitable solution.

Senator CLELAND. Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Cleland.

Let me follow-up on that, Mr. Jones.

You're saying that if you could write out a wish list of things for us to do in the Congress it would be to extend the regulations currently that apply to the CRS system that do not apply to this Internet system. Do you believe that that would be sufficient to level the playing field?

If I misunderstood your comment, I don't want to characterize it improperly.

Mr. JONES. No, I think that is correct. The rules, as they're written today, have several categories, and one of them deals with how things are displayed, to be displayed in an unbiased fashion, which means there's no undisclosed manipulation in flights to the consumer.

The consumer says, order them by time, they're ordered by time. The consumer says order them by price, they're ordered by price. It's not undisclosed manipulation.

In addition those rules say that if there are a group of airlines that own one of these sites, a producer, in this case today a CRS, in the new world would be a travel agent or a CRS producer, and they give specific information or fares or flight availability to one that they own, they must give it to all.

They don't have to give it out, they can just keep it for themselves on the airline site. But if they do give it to anyone else, then it must be generally available, and we believe that's quite important.

The CHAIRMAN. Mr. Katz, what's wrong with that? That sounds reasonable to me. What's wrong with that?

Mr. KATZ. If I may.

The CHAIRMAN. Sure.

Mr. KATZ. The CRS rules today, as Mr. Mead pointed out, are a very complicated patchwork of rules that were created in the middle 1980's to deal with competition issues of airlines and CRSs in the middle 1980's. There are fewer airlines and there was no Internet, and the rules are so strange today that they don't even apply to the biggest CRS in the world, Sabre. So I think it's a complicated issue.

One, I believe, should try to think through or I hope people try to understand that first what Orbitz does to be unbiased and comprehensive, it uses a completely different methodology developed at MIT by a bunch of smart guys. It uses new technologies before it can even find all the fares, flights, and airlines which the CRSs don't do today.

So principal number one is: We are really doing something new and risky.

And principal number two, the airlines can do what they like; principal number two is if a competitor says, OK, I'll give you a CRS rebate, too, once you book on Internet site XYZ, then a CRS has the privilege and the opportunity, which an Orbitz will never have, of raising a booking fee through the travel agency channel or through other means, and that offsetting mechanism is something we'll never be able to do.

We are the low-cost channel. That's the way we do it. We start from scratch, much as Southwest started from scratch.

Because we're the low cost channel, it is more interesting for airlines to sell through us, and I would ask that you let us provide that information and the statements of collusion are simply statements of concern.

There are mechanisms to control us should there ever be any hint that that's happening, and I don't want to work at a business where it's happening because the consequences are personally too painful.

The CHAIRMAN. Mr. Katz, there is a history, I think, that gives some of us some skepticism and some concern. Acknowledging for the sake of argument that yours might be a new technology, I still don't understand why the underlying principals, admittedly the language would have to be changed to reflect the new technology as you've characterized it, but those same underlying principals, it seems to me, would be available.

I gather you're telling us from your perspective you don't want any regulations to be adopted to apply to this system?

Mr. KATZ. Well, as a consumerist, of course, I said earlier I think the consumers are tougher regulators than government, and I understand the concerns and the skepticism.

The CHAIRMAN. We've come a long way from caveat emptor. I mean, the consumers over the years have asked governmental agencies at the state level and at the federal level to kind of intervene to balance the playing field in a whole realm of services and goods that are sold in the marketplace, so there's some history.

Let me ask specifically a couple of questions. We're going to have to adjourn this because of the objection in 2 minutes.

How do you propose dealing with the carrier that's not a member or participant of your system? I mentioned in the earlier colloquy with Mr. Mead, that Southwest, as I understand, how do you display their fares? How are they to be treated in this system?

Mr. KATZ. Any carrier that's not what we call an associate member of Orbitz, we will display all their fares that are publicly available, all their flights that are publicly available in an unbiased manner. You will be able to book them as you would any other carrier.

Southwest is a rather unique situation. They only participate in one CRS, Sabre, and therefore they're only bookable through Travelocity or Sabre Travel Agent. Any other travel agent, any other website can display their fares, as we will. Then you must call Southwest directly and book the flight.

The CHAIRMAN. But those carriers that participate, or to use your language, are associates. What agreements or conditions are imposed upon them as a condition of their association?

Mr. KATZ. We ask that they provide us with all their fares, as they do every other on-line travel site, including Internet fares. And we say further that any fare they provide to others they must also provide to us.

The CHAIRMAN. Are there any exclusivity provisions with respect to their relationship with you that are part of these agreements?

Mr. KATZ. There's absolutely no exclusivity. They have the right to provide whatever they want to whoever else they want.

The CHAIRMAN. And I would take it that there's probably some type of contractual arrangement that they enter into, a contract as a condition? Are those contracts available? Can we take a look at those?

Mr. KATZ. Those contracts are certainly floating around in the public, and if we can make—I'm sure we can do the arrangement; this is an agreement that we've made in private with another party. If we can make an arrangement where we could ensure that they would be kept in confidence, we'd be happy to do so.

The CHAIRMAN. I can't speak for the Chairman. I'd like to see if that could be pursued because I'd like to see a copy of that contract, and we'll talk with you and our staff later to see how that might be effected.

Unfortunately, our time is expired. Gentlemen, let me thank you for your perception and involvement. I apologize for the truncated nature of today's proceedings. But we had a vote and now an objection.

This hearing will stand adjourned.

[Whereupon, at 11:30 a.m., the hearing adjourned.]

# APPENDIX

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MAX CLELAND TO HON. KENNETH M. MEAD

*Question 1.* How would you respond to the charge that the U.S. airline industry has begun to operate as a single enterprise, of which the joint web-site is just the most recent manifestation?

Answer. We believe that, overall, the airline industry continues to operate competitively, although there are problems with high airfares in some markets. Nonetheless, past behaviors by the airlines have justified a healthy dose of skepticism regarding the airlines' plans to operate a joint website and it is appropriate that the Government and others scrutinize development and operation of this venture. Our assessment, at this time, is that there is nothing unique to the structure of Orbitz that would encourage or facilitate collusion on pricing or other anti-competitive behaviors. The airlines will have no greater access to each others' fares than they currently have through browsing their competitors' websites and purchasing CRS data. Although Orbitz will gather much of this information in one place, it will not offer a substantially greater platform upon which the airlines can communicate on forward pricing.

We have proposed that interim measures be established to ensure that the airlines make their lowest fares available to any other online travel agency that is willing to offer the same financial conditions in return. This would ensure that the airlines' choices for where they distribute their lowest fares are based on solid financial reasoning and not as a means of harming or eliminating their competitors.

*Question 2.* Mr. Mead, both as the IG, and before that in your GAO days, you did a lot of work on the computer reservation system (CRS) issue. My recollection is that not only the GAO and the DOT, but also the Department of Justice and the Civil Aeronautics Board, when it still existed, raised concerns about the CRS's and their anti-competitive practices, including excessive booking fees, the extremely high profitability of CRS's, the highly restrictive contracts CRS's imposed on travel agents, and bias in CRS displays. Rules were put in place in 1985, but 3 years later, DOT put out a study showing that the rules had had relatively little effect in limiting the anti-competitive practices of the CRS's. Can you please give us your view of the anti-competitive practices and effects of the CRS's?

Answer. The regulations established in the 1980's and subsequent amendments have gone a long way to solving the original display bias problems in airline-owned CRSs. The blatant biasing of displays by the owner-airlines to favor their own services is gone, although some allege that architectural bias still exists in the form of searching and displaying services on the basis of certain criteria, such as airplane size, that would tend to favor large airlines over smaller ones. The OIG has not independently verified whether or to what extent such bias exists, and whether it would actually be in violation of existing regulations.

Although the OIG's work to date has focused on the airlines' practices related to ticket distribution, a number of CRS issues have emerged through this work that are of concern.

**First,** CRS fees continue to rise unchecked. Limited competition between only four CRSs has allowed significant and sustained booking fee cost increases. For example, between 1990 and 2000, fees for direct access on one large CRS have increased from $2.10 to $3.54 per segment booked, a growth of almost 70 percent. While CRSs maintain that the increases reflect improvements to the systems, critics allege that the fee growth has far outpaced cost savings achieved during this time from improvements in technology. If CRS fees continue to escalate unchecked, airlines will need to raise fares to accommodate the increases or accept reduced profits. It is our opinion that a more competitive CRS environment could help check the rate of further growth.

**Second,** access to competitor pricing, sales, and inventory information could result in an unfair competitive advantage for large carriers. Under the structure of the current system, all carriers have a legal right to obtain the marketing, booking, and sales data of their competitors for all sales made through a CRS. This rule was developed to address concerns that only airline owners of CRSs would have access to data on their competitors which they could use to an unfair advantage. The decision was made to make these data equally available to all carriers. These data are currently available for between 75 and 80 percent of all sales. Information on the remaining 20 to 25 percent of tickets, which are sold directly by the airlines through their phone reservation systems or websites, is not available to sources outside the respective airlines.

For tickets sold through travel agents that are processed through a CRS, airlines can obtain and then use this information to develop competitive pricing, scheduling, and sales strategies to try to attract some of their competitors' market share. While small airlines theoretically have the same ability to use these strategies against their larger competitors, they believe the larger airlines gain a stronger competitive advantage because of their ability to direct significantly greater resources to analyzing the data and developing competitive strategies.

In addition, in earlier work, we identified the potential for override agreements between travel agents and airlines to influence the neutrality of information provided by the agent to the consumer. These override agreements are based on an agent's ability to move market share to a particular carrier. Without information on the total market, a carrier can measure growth in an agent's total sales, but it cannot measure the growth relative to the market. If transaction data were no longer made available except with respect to a carrier's own transactions, override agreements would be virtually unenforceable.

**Third,** a significant problem with the CRS regulations is that changes in the industry and ticket distribution environment have rendered them increasingly obsolete. The regulations apply only to airline-owned CRSs, which are rapidly going by the wayside. Also, the non-bias requirements apply only to integrated CRS displays. The regulations do not apply to what an agent actually presents to consumers or how an online agency displays data on its website. As technology evolves closer to the point where CRSs may no longer be the primary vehicle through which information about airline services is communicated, decisions need to be made over whether these regulations are even necessary; if they are, what modifications need to be made to make them relevant to the current state of the industry; and/or whether new regulations need to be developed to foster competition and protect consumers.

*Question 3.* Is it fair to say that for the past 20 years, competitive entry into the CRS industry has been extremely difficult, if not impossible?

Answer. While the first attempts to create CRSs were made in the 1960's, the CRS industry did not become established until the mid 1970's. Since that time, only a small handful of CRSs (four today) have emerged and maintained sufficient market share to remain viable. Competitive entry into the CRS industry has been extremely difficult for several reasons.

- **Start-up costs.** In the 1970's, the development of a CRS was an enormously expensive proposition at a time when the costs of computer hardware and software were far greater than they are now. When American developed SABRE, it devoted thousands of labor-hours to extensive programming efforts, building an expensive data network to handle the tremendous—and growing—volumes of computer traffic that developed, and creating a SABRE marketing organization of several hundred people. American did not earn a profit on SABRE until 1984, 9 years after SABRE had begun operation. Still, today, starting a CRS would involve large up front capital costs to develop the system and large marketing expenses to establish a customer base among travel agents.
- **Uncertain future.** As technology changes and the Internet gains acceptance in business and home use, CRSs are facing the need to develop ways to reach beyond the dedicated CRS terminal in a travel agency and meet the needs of a diverse group of users including individual consumers and corporate travel managers. In order for the information provided through the CRS to be available to everyone in a user-friendly format, many issues, such as distribution security and widely diverse hardware and computing capabilities, must be resolved. Even the most experienced industry players do not know exactly which technology, distribution medium, and channels are ultimately going to survive and be the preferred choice of end customers. The existing systems continue to make the investments necessary to meet these challenges because newcomers to the industry are faced with the prospect of large investments in technology and development that bear a significant risk of not paying off.
- **Travel agent contracts.** The key to CRS profitability is the CRS-travel agency relationship. Competition to convert agencies from one system to another con-

tinues to be intense. Throughout the years, travel agents have selected their CRSs on the basis of technical factors and prices, but also as a function of the agent's relationship with the airlines. Agents have tended to choose the CRS of the carrier with the most airline capacity in its particular city, and in some cases it has been alleged, were "forced" to do so by the vendor-airlines. An agent choosing an alternative CRS might find itself excluded from special fares made available to his competitors.

In 1992, DOT adopted new rules, which among other things, required vendors to offer agents the option of a 3-year contract term in addition to the previous 5-year standard. Vendors now offer this option, although most agents choose the 5-year contracts because of lower monthly rates. A new CRS entering the scene would not only have to break down the established relationships between airlines and agents, but also the contractual relationships between agents and their CRSs.

*Question 4.* Is it fair to say that Orbitz, in particular, and the new technologies it represents, in general, are a form of new competition for these CRS's, or perhaps indirectly for the CRS's and directly for the major Internet sites that are based on the CRS's?

Answer. As *currently* structured, Orbitz is not competing with CRSs as much as it is competing with other travel agencies. By passing on a portion of the volume booking incentive that Orbitz has negotiated with Worldspan, Orbitz is making itself a less costly distribution outlet than other online or brick and mortar travel agencies. In offering this lower cost outlet, Orbitz is hoping to entice airlines to offer lower fares on Orbitz than they would choose to offer through other more costly avenues. Orbitz will then use these lower fares as a marketing tool to lure consumers to its website. Orbitz competitors that want these same low fares will be pressured to offer airlines the same kind of financial incentive to make these fares available.

As currently *envisioned,* however, Orbitz could eventually pose strong competition for the CRSs. In the near term, Orbitz will be dependent upon Worldspan to process the "back-end" or booking functions for its transactions. In the not-to-distant future, however, Orbitz is hoping to establish direct connections with the airlines' internal reservation systems. When accomplished, Orbitz would no longer require a CRS for most, if not all, of the booking transactions and in fact would be functioning essentially as a CRS. To the extent airlines could steer passengers' air travel purchases to Orbitz or their own websites, where no booking fees would be incurred, the airlines could stand to save hundreds of millions of dollars each year. The CRSs would need to respond with competitive price actions, or their bookings and revenues will begin to wane.

*Question 5.* Do you believe that the Department's CRS regulations should apply to Internet sales?

Answer. As part of our Congressionally-requested work related to airline ticket distribution and access to low airfares, we are continuing to review issues related to the adequacy of existing CRS regulations and other CRS-related issues. We have not yet formed an opinion on these issues.

Nevertheless, there is little question that the current CRS regulations, as drafted in the early 1980's and amended in the early 1990's have been eclipsed by marketplace changes and technological innovation. When the rules were written, few consumers even knew what the Internet was. By 2003, according to Jupiter Communications, 63 percent of all consumers will have access to the Internet from their own homes. The Internet presents new opportunities and challenges to airline ticket distribution, and raises concerns that did not exist 20, or even 10 years ago.

The regulations were originally drafted, in part, to prevent airline-owners (vendor airlines) from biasing the data in their systems to favor their own services over other airlines (non-vendor airlines). Now that airlines are divesting or diluting ownership in the CRSs, it is unclear whether the independent CRSs are still required to comply with the non-bias requirements. While airlines cannot introduce bias into their own CRSs to favor their own services, there are no prohibitions against an airline purchasing bias in an independently owned CRS. This underscores the need to reevaluate the relevance and scope of the existing regulations without further delay.

Orbitz, as well as Travelocity, Expedia, and hundreds of other travel web-sites, operate as online travel agencies. They receive data from their CRSs which they present electronically to their customers. Just as brick and mortar travel agents are not legally bound to present unbiased information to their customers, online agents have no legal responsibility to present travel options in an unbiased manner. It would be difficult to argue the merits of regulating information passed along electronically and not applying the same standards to brick and mortar agencies. In fact, many online agencies are simply an electronic storefront for well-established brick and mortar agencies; and it would seem contradictory to regulate one and not the other.

The Department is in the process of reviewing extensive comments received in response to its Supplemental Notice of Proposed Rulemaking issued on the CRS rules. We will also be reviewing these comments and discussing them with stakeholders in order to form an opinion on what, if any, regulations should apply to the sale of airline tickets over the Internet.

*Question 6.* There have been claims that the practice of biasing the display of information viewed by travel agents is still practiced by the computer reservation system vendors. In your opinion, does this practice still continue today? If so, to what extent?

Answer. Allegations of architectural bias persist today, but to our knowledge, there is no comprehensive assessment of the problem's extent. It is also not clear whether the existence of such bias would be a violation of existing regulations. Current CRS regulations do not require a specific algorithm to be applied, but require that whatever algorithm is used must be used consistently and not be based on carrier identity. The criteria selected and the weight given to the selected criteria may favor some airlines over others, but as long as they are objective criteria—such as aircraft size or elapsed time—it would appear to be a legitimate and legal application.

We note that in the early 1990's, non-vendor airlines (those airlines that did not own CRSs) claimed that hidden bias still remained in the CRSs. Their claim was that by allowing the vendor airlines to choose the display algorithms, they could prioritize criteria that would favor their own services. Although some parties believed that the Government should prescribe the order in which flights are displayed to travel agents, the Department rejected this idea, believing that the marketplace was the best judge of the most efficient schedule displays.

Although the CRS regulations prohibit CRS vendors from intentionally biasing the integrated displays seen by travel agents, the regulations do not extend to the practices of travel agents or independent software vendors that provide electronic interfaces for the data supplied by the CRSs. Travel agents that have commission override agreements with air carriers might welcome a software program that structures the data display to highlight and give preference to the offerings by carriers covered by the override agreements. Such displays would make it simpler for agents to promote those services that will help them satisfy the booking volume requirements of their override agreements.

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RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MAX CLELAND TO PAUL M. RUDEN

*Question 1.* ASTA has requested the Department of Justice to investigate Orbitz for possible violation of our anti-trust laws. Why do you believe the driving force behind Orbitz is to squash competition rather than to reduce distribution costs, as the airlines maintain?

Answer. First, the issues raised by Orbitz should not be viewed as a simple choice between two views of the airlines' intent. The question is whether the collaboration among competitors is likely to have anticompetitive consequences compared to the outcome when the airlines are required to act independently as true competitors. The least anti-competitive outcome should always be preferred, regardless of the airlines' "intent." Orbitz contains elements that plainly restrain competitive behavior (most favored distributor clause, payoff of in-kind promotion with exclusive access to lowest fares, natural propensity to favor their own joint investment over independent parties). No reason has yet been advanced why an individual airline, or multiple airlines acting separately, could not have undertaken what Orbitz proposes.

Second, history keeps a dear school. When allowed to collaborate, the airlines have consistently shown a marked tendency to harm their competition. They do it through the Airlines Reporting Corporation. They demonstrated it in their collective plan to settle the class action price-fixing case against them in Atlanta in the early 1990's by including a provision that would have eliminated travel agents from redeeming $450 million in coupons issued to consumers under the settlement). They did it through the computer reservations systems when they biased displays to damage competitors. They did it when they negotiated collectively to establish the so-called Voluntary Customer Service Commitment last year (creating benefits available only through their direct-call reservations systems). Given their history, we see no reason to trust them in the Orbitz collaboration.

*Question 2.* How are traditional travel agents doing in the competition with on-line agents? Do you believe there is a continuing role for the traditional travel agent in the Internet age and that travelers will continue to seek out traditional travel agents for added services that a website like Orbitz, Priceline, Travelocity or Expedia cannot or does not offer?

Answer. For this question we take "traditional travel agent" to refer to a purely brick-and-mortar agency location, configured to permit physical visits by clients but otherwise equipped with computer reservations systems and access to the Internet.

The answer is that the traditional travel agents are, and will continue, to function as long as they have equal access to products and services, including prices, available in the broader marketplace so that they can respond to consumer demand with their own particular form of market presence. Right now, demand for air travel is strong. Most of the growth in air sales appears under our analysis to be going to the on-line distribution channel and more traditional agencies are either abandoning air sales altogether or are reducing the economic importance of such sales to the agency's financial outcome. In short, agencies are adapting to changing circumstances. Many have set up their own Web sites and many more will soon do so. The traveling public continues to seek out traditional agencies for a broad range of travel services.

As long as these agencies are permitted to adapt (i.e., the airlines are prevented from jointly creating barriers and obstacles to such adaptation), the traveling public, leisure and corporate, will continue to enjoy access to the full line, full service channel option that is still, and will remain, preferred by many millions of them. The problem presented by Orbitz is that it represents a collective attempt, among several others, to cut off agency adaptation to the technology-based marketplace that is evolving.

*Question 3.* As I recall, your organization advocated for stronger provisions in the CRS rules to protect travel agents from abusive and restrictive contracts by CRS's. DOT adopted some of the protections you advocated, but not others. So the DOT rules, while they provide some protections to travel agents from abusive CRS contracts, do not provide as much as you originally advocated. Is that correct?

Answer. Yes, it is correct. And, as a result, travel agents have continued to suffer economically at the hands of the CRS's and their airline owners. By way of example, because of the airlines' reduction in commissions starting in 1995, many travel agencies have been forced to reduce the share of their business represented by air travel sales. This is a smart and widely recommended technique for adapting to the changed marketplace. However, many agencies are parties to one-sided CRS contracts that impose penalties on them if the volume of air tickets processed falls below specified thresholds. In many cases these thresholds were non-negotiable and thus the agency's adaptive strategy runs into another economic punishment from the largely airline-owned CRS's. (We understand that one CRS no longer has a majority interest in airline hands, but during the relevant period, airline dominance of CRS ownership has been complete.)

*Question 4.* Is it your position that the largest CRS should not be required to abide by the CRS rules, including the rules protecting agents from abusive contracts? In other words, should it be allowed for CRS's, if they do not happen to be owned by airlines, to force agents to sign 100 year contracts, or insist on exclusive use of their CRS, two of the practices prohibited by existing CRS rules? Would you support making the CRS rules apply to all CRS's, regardless of who happened to own them, if they had travel agents under contract?

Answer. We believe that all of the four major CRS's continue to be bound by the DOT's CRS rules because the rules cover all carriers that "own, control, operate, *or market* computerized reservations systems for travel agents." The CRS regulations in turn require covered airlines to "ensure" that CRS operations comply with the rules. We are not aware of any airline owner or marketer of a CRS claiming that it is unable to comply with that mandate. For the present, therefore, no CRS may engage in the conduct outlined in the question.

Were a CRS to both cease to be owned and marketed by an airline and thus emerge from this regulatory regime, the issue would then arise as to whether that CRS was free to exercise its market power over travel agents and, ultimately over consumers, without restraint. The regulatory jurisdiction of the Department of Transportation under current law would cease in that case. ASTA's probable position would then be that Section 5 of the Federal Trade Commission Act would apply to the operations of that CRS and that attempts to exercise market power as outlined in the question would violate that section. This view is based in part upon the fact that Section 411 of the Federal Aviation Act, which is the statutory basis for DOT's CRS regulations, was intended to be, and has always been interpreted as, the analog of Section 5 of the FTC Act. Conduct that was judged to violate Section 411, and thus was prohibited by the CRS rules when DOT had jurisdiction over the CRS due to its airline relationships, would, in the absence of those relationships, violate Section 5. We would likely see the adoption by the FTC of a Trade Regulation Rule emulating the CRS regulations at that point.

A shorter answer, then, is that we would not willingly accept a situation in which a CRS, not owned or marketed by an airline, was free to impose its will without restraint on travel agencies.

*Question 5.* If the government prevents an airline from recovering its cost to sell its tickets, is it possible the airline will simply quit offering the lowest fares that cannot be sold economically through every outlet?

Answer. Requiring airlines to make all fares available for sale through every medium will not prevent airlines from recovering their selling costs. Nor are pricing decisions made on the basis of actual retail selling costs. There is no relationship between most Internet-only fare levels and selling costs of any channel. When it was cheaper to sell tickets through travel agents than it was by direct sales through airline city ticket offices and reservation center calls, airlines charged the same price for each channel. Prices are set to move inventory of a perishable product now considered mainly to be a commodity (constrained by the extent of competition in the market), and to gain a competitive advantage and/or deter entry (constrained only by whatever limits on airline market power may exist), and to maintain or increase market share. The relationship of such prices to selling costs is often indeterminable and incidental.

In any event, the issue raised by Orbitz is somewhat different. Orbitz involves joint airline action that appears clearly calculated to deprive competitors, both current and prospective, of access to the lowest fares. Such joint determinations of channel selection and content should not be allowed in any circumstances.

*Question 6.* Your testimony takes issue with the fact that the airlines' "lowest fare" guarantee extends only to its telephone reservation agents.

Answer. What would be the value of extending that guarantee to travel agents, given that perhaps the travel agents' most significant role is to find their customers the lowest fares?

Most travel agents today will find the lowest fare for any client to whom this factor is important. The problem is that the airlines are withholding some fare inventory from agents. The public for whom the absolute lowest fare is crucial, therefore, is denied the right to have such fares ticketed through their favored distribution source. To the extent that airlines are required to make such fares available for ticketing through travel agents, the public will have the freedom to select their distribution source without fear that they are automatically excluded from certain discounts.

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RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MAX CLELAND TO MARK SILBERGELD

*Question 1.* By providing the flying public with a one-stop website, Orbitz has said that it is boosting competition, since everyone who wants to buy an airline ticket will know what's out there. Do you, in fact, believe that Orbitz will be a boon to the traveling public?

Answer. No, not as Orbitz is presently constituted. There are several reasons for this conclusion. *First,* there are already several independent Internet sites that provide one-stop shopping for airline ticket searches and bookings. Consumers Union does not believe that they do the job that needs to be done for travelers seeking best fare information and bookings. But it is doubtful that a new competitor owned by the major air carriers, as contrasted with rules to prohibit certain unfair or deceptive practices, is the answer to this problem. (Although, of course, new booking service market entrants that serve to actually increase competition should be welcome.) *Second,* Orbitz seeks to define the market in which it will be participating, and in which it proposes to increase the competition, as travel booking services. But the ultimate product for the consumer is air passenger carriage. Booking services is a related but secondary market. Additional competition would be welcome in that market, but not if it serves to decrease competition in the primary market of air travel. Vertical integration of the carriers into the secondary services market through a joint venture may well serve to further restrict competition in the already non-competitive primary market. *Third,* Orbitz premises its claim on the proposition that it has a superior search engine which provides consumers with far more information, hence better information, regarding flight/price options. This may well be a false premise. Consumers need *viable* option information that identifies the lowest cost tickets available for the trip they plan within the travel parameters they specify. More information, as contrasted with more *accurate* information, does not necessarily identify more viable options. Listings of thousands of connections between a city pair are useless to most consumers. Few of the many options identified are viable, because they involve multiple stops, changes of aircraft, and lengthy travel times. Other computer reservations services may well be able to identify the same viable options as can Orbitz. *Fourth,* more accurate identification of viable options than is now available to consumers undoubtedly will occur *only* if the Department of Transportation revises its Computer Reservations Systems rules to cover services in all venues and regardless of airline ownership. Orbitz has not agreed that it should be covered by a modernized set of rules. Additional competitors, as contrasted with more effective and unbiased search result presentation, will not necessarily increase competition, especially if a new entrant can serve to restrain competition in ticket prices (see answers below).

*Question 2.* Do you share ASTA's concerns that Orbitz will "inevitably lead to price fixing"?

Answer. Yes, most certainly as the ownership of Orbitz is presently constituted, and unless there is a Justice Department order addressing the competition issues now under investigation. In fact, we are concerned that the investor air carriers may *already* have created a business plan that constitutes price fixing and other anticompetitive practices, even before Orbitz commences ticket-booking services. The sorry history of the major air carriers with respect to competition does not suggest that either the purpose or the outcome of Orbitz will be increased competition in airfares.

*Question 3.* I have heard concerns from some of the low fare airlines that there are more disadvantages than advantages in participating in Orbitz. How would you speculate things might change for the small airlines that elect to participate in a system such as Orbitz? What do you think would be the impact on their customers?

Answer. The primary concern is that the major carriers will find ways to use Orbitz to carry out predatory pricing strategies to run these smaller participants out of business, then raise prices and fail to fill the service gaps that result. This obviously would disadvantage current users of discount air carriers.

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RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. ERNEST F. HOLLINGS TO HON. KENNETH M. MEAD

*Question 1.* More and more airlines are divesting their interests and ownership in CRSs: AA has divested of Sabre, CO has sold its shares in Amadeus, US has sold its interests in Galileo, and UA has sold its interests in Galileo. Interestingly, however, each of these carriers (with the exception of US) has invested a collective $100 million (according to press reports) in a new distribution means—Orbitz—that is in many ways a virtual CRS on the Internet. Is this a replay of the early 1980's—and a concerted effort by the airlines to regain control of distribution of information to consumers?

Answer. The better answer to the question is not that Orbitz is an attempt to regain control of distribution, which the airlines never really relinquished, but an attempt to regain control of *distribution costs.*

While the degree of confusion and debate over Orbitz may make it *seem* like the 1980's all over again, the issues are different. In essence, Orbitz views itself as an attempt to *fix* what went wrong during that time. During the 1970's and early 1980's, the airlines chose to develop separate and competing entities—the Computer Reservation Systems (CRS)—which each hoped to bias towards their own services. CRS regulations were implemented in the early 1980's that curbed much, although not all, of this abuse. In contrast, Orbitz promises to display flight information in an unbiased manner.

Subsequent to the original CRS regulations, the airline-owners of the CRSs raised fees in an attempt to offset revenues lost from not being able to blatantly bias displays. Rising CRS fees have made a significant dent in airline profits; one major airline reports that booking fees now represent over $300 million each year. Airlines have been successful in limiting other distribution costs by reducing and capping commissions, but CRS costs continue to grow. As airlines divest of their interests in these entities, the profits of the CRSs no longer contribute to the airlines' bottom lines, and the incentive grows to avoid or at least pressure CRSs to price competitively.

The airlines that have chosen to invest in Orbitz, albeit at a magnitude of about one-half the amount suggested in the question, see Orbitz as a way of lowering distribution costs, particularly those of the CRSs. The incentive to participate in Orbitz is a rebate of approximately one third of the CRS booking fees incurred on *every* ticket booked through the site.

Since deregulation, the airlines have been free to determine how, where, and at what cost, they choose to make their services available to the public. Most airlines have realized that they need to tap every possible distribution source, regardless of its costs, in order to remain competitive. But they are not legally obligated to do so. One exception is Southwest Airlines, whose business strategy is to utilize primarily those channels that do not incur external costs, including CRS fees or commissions. Like Southwest, the airlines that are participating in Orbitz are also striving to lure more business to channels with lower distribution costs, and the booking fee rebates that Orbitz promises makes it an attractive choice.

*Question 2.* Don Carty recently testified before the Senate Judiciary Committee that Orbitz would have exclusive fares. What assurances did the owner/carriers of Orbitz make during the course of your investigation as to how Orbitz will operate? Have you seen any indication that the owner carriers will withhold certain low fares from other distribution channels and make them available only on the Orbitz website?

Answer. Mr. Carty stated before the Senate,[1] "it is envisaged by this particular site that some offerings will be made on this site that won't be made on other sites." This statement invokes a concern among Orbitz competitors and consumer groups that the participating airlines intend to withhold certain low fares that they provide to Orbitz from other distribution channels.

In our testimony before the Committee, we proposed that interim provisions be established to protect against the possibility that airlines might withhold their lowest fares from competitor agencies, not just to lower their distribution costs, but to drive their competitors out of business. Our proposal would help ensure that given a level playing field, the airlines would not be able to act in an anti-competitive manner. The proposal would require airlines to make available any fares they provide Orbitz to any other agency willing to offer the same financial terms concerning booking fee rebates as Orbitz. Such a provision would be predicated on agreement by these agencies to abide by the non-bias regulations that apply to CRSs.

We have not seen, and Orbitz assures us that they do not exist, any agreements, tacit or express, among the Orbitz participants or owners to restrict any fares exclusively to the Orbitz site. Our interpretation of the charter agreement indicates the opposite—it explicitly *allows* any participant to make available the fares it provides to Orbitz to any other entity, on- or off-line. The only restriction is that participants cannot make a *lower* fare available elsewhere.

However, just because the airlines are not contractually required to, or have not made commitments to provide certain fares exclusively to Orbitz, that does not mean that an airline might not independently decide to do so. Airlines are free to choose what fares they offer and where they offer them, and an airline may decide that it is not economically feasible to offer certain deeply discounted fares through higher-cost distribution outlets. On the other hand, the airlines may, for a variety of reasons, decide to provide their Internet-only fares to entities besides Orbitz that provide *less attractive* financial terms, or even non-financial incentives. The Orbitz charter explicitly allows participating airlines to make such choices, and as long as they are made independently and have a solid financial basis, we support the airlines' right to choose what fares are made available in which channels, even if that means limiting certain fares to Orbitz.

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RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO TERRELL B. JONES

*Question 1.* I am told that the airlines offer their e-fares only through inexpensive distribution outlets. In other words, if Travelocity was priced as inexpensively as Orbitz, the airlines would readily sell their e-fares through Orbitz.

Have you made the same offer, on the same financial terms, that Orbitz has made to the airlines in order to sell their e-fares through Orbitz? If not, why not?

Answer. Before describing the various discussions that have occurred with the airlines, it is helpful to understand how Travelocity earns revenues from travel suppliers. We derive revenues generally from two sources: 1) transaction fees, which in

[1] Statement of Don Carty, Chairman, President, and CEO of American Airlines, May 2, 2000 before the Senate Judiciary Committee, Subcommittee on Antitrust, Business Rights and Competition

turn consist of (a) commissions paid directly by travel suppliers to us and (b) the booking fee incentive paid to us by our CRS provider; and 2) advertising sales.

My understanding is that the "offer" made by Orbitz to the airlines relates to the two financial components of transaction revenues. That is, Orbitz will receive a commission charged for each ticket issued, but, in exchange, will rebate all (or most) of the booking fee incentive paid to Orbitz by Worldspan, its CRS provider. (I use the term "offer" here somewhat reluctantly because Orbitz is of course controlled by the very parties to whom the "offer" is being made.) I have also been informed that Orbitz will not accept airline advertising on airline-related web pages, hotel advertising on hotel-related web pages, and so on.

Each airline sets its own commission policy for brick and mortar and on-line agencies. With respect to commissions, I believe Travelocity is fully competitive; we have had no indication from any airline that Orbitz has "offered" to accept a lower commission than is currently paid to Travelocity. Those commissions are now capped generally at $10 for a roundtrip ticket, $5 for a one way ticket for bookings made by on-line agencies such as Travelocity. For example, assuming that we sold a one way full-fare coach ticket from Washington D.C. to Minneapolis/St. Paul on Northwest Airlines at $826 (the one way fare as of August 10, 2000) Travelocity would receive $5. For a round-trip ticket with a price of $1752, Travelocity would be paid $10. We believe this cost is *lower* than the associated internal fulfillment cost of the airline itself, when messaging costs, reservations calls, and other expenses are accounted for.

With respect to booking fees, both Travelocity and Sabre have approached the airline owners of Orbitz for the purpose of reaching commercial arrangements to provide Sabre and Travelocity access to their e-fares. In particular, Sabre has developed a new program under which Sabre provides a discount of 30% off a carrier's normal booking fee for "distressed inventory," the typical low fare inventory made available by airlines only through their proprietary websites

This special program, called Clearance Fare Outlet, was designed for the very purpose of facilitating the sale through Sabre of e-fares by on-line Sabre agencies, such as Travelocity.com and many others. The 30% discount off the normal Sabre booking fee would put the net booking fee to be charged to carriers by Sabre at a level equivalent to the net Worldspan booking fee the carriers would pay for bookings made in Orbitz. (The written testimony of Kenneth Mead, the DOT Inspector General, filed with this Committee on July 20, 2000 observed that carriers would receive a discount of 1/3 off the normal Worldspan booking fee for Orbitz generated bookings; Sabre's normal booking is roughly the same as that of Worldspan.)

Published reports have placed the initial start-up costs of Orbitz, after marketing and advertising costs, at about $100 million. Given this substantial up-front investment, we believe that the "net cost" to these five carriers of each booking generated through Orbitz will actually be far higher than the fee for fares sold by Travelocity through the Sabre Clearance Fare Outlet.

In short, Orbitz' owners have indeed been offered a booking fee that would give them a comparable—if not lower—net cost per booking for these e-fares than the costs they will absorb for e-fare bookings made through Orbitz. Unfortunately, my understanding is that none of the Orbitz owners has yet agreed to participate in this special discount program for e-fares. By contrast, I've been informed by Sabre that National Airlines, Air Trans Air and other carriers have agreed to be participants in Clearance Fare Outlet.

I do want to clarify one other point in the Committee's question, as it relates to the issue of booking fee rebates from Orbitz to its owners. If the term "same financial terms" means an offer by Travelocity to rebate its booking fee incentive on all airline bookings—rather than just on e-fares—I would have serious reservations about the impact of such a proposal on independent travel agencies. Nearly three quarters of Travelocity revenues come from transaction fees, and booking fee productivity payments are a substantial portion. Requiring us or any large on-line travel agency to rebate a substantial portion of revenues on one hundred percent of bookings—in exchange for getting access to e-fares—would seriously impair the economics of the business. While an airline-funded travel agency perhaps could agree to such terms—knowing that its losses from operations could be funded by carrier-owners perhaps indefinitely—I doubt that most independent travel agencies would accept such an "offer."

Alternatively, if the proposal is for each CRS vendor to return one third of all transaction revenues in exchange for access to e-fares, it would seem to me that this would equally undermine the economic arrangements between the vendors and their thousands of agency subscribers. While I obviously do not speak for Sabre, it is unlikely that the CRS vendors—which have invested billions of dollars in the hardware, software and telecommunications infrastructure that are the essence of a CRS—would accept such an offer.

*Question 2.* Travelocity claims that it will not have "access" to the Web fares that Orbitz will. It seems to me, however, that you do actually have "access" to these fares, which you can purchase through an airline's Web site on behalf of a customer, you simply won't be commissioned on that sale. In what other industry has Congress required a seller to pay another party a commission to sell its product?

Answer. Travelocity does not have access to the Web fares as a travel agent. While theoretically Travelocity (or really any company with a credit card) could purchase such a fare "on behalf of our customer," Travelocity could not provide any additional benefit to its customers. The sale would not be serviceable through Travelocity; in the event of a change in plans, or a schedule change, or other event requiring re-ticketing, Travelocity would not be able to assist the customer, as the booking would not reside in Travelocity. The customer would be required to deal directly with the airline, creating confusion and an unacceptable experience for Travelocity users.

Travelocity's objection to Orbitz having such fares, when Travelocity does not, has nothing at all to do with whether such fares are commissionable. (In fact, as noted in our response to the first question, we believe Orbitz will in fact receive a commission on such fares.) Our sole concern is the failure of airlines to allow such fares to be sold by third party websites other than Orbitz, even on a non-commissionable basis.

The Department of Transportation has long required under its CRS rules that carriers that own a CRS participate in competing systems and pay for such participation so long as the fees charged are commercially reasonable. The same public policy considerations that lead DOT to prohibit carriers owning a CRS from refusing to participate in competing systems in a non-discriminatory way apply with equal force to carriers owing Orbitz. Without such a duty, large carriers jointly owning or controlling a website targeted at consumers can use their leverage as airlines to distort and even undermine competition with their website.

My understanding is that there are in fact instances where Congress has required a supplier to offer its product to reselling companies, who may compete with the supplier downstream at the end user level. A few examples are set out below:

- Under the EPA Act of 1992, the Federal Energy Regulatory Commission (FERC), is statutorily impowered to force utility companies, under certain circumstances, to "wheel" power across or into its transmission systems to a competitor for resale.
- In the telephone arena, Local Exchange Carriers must, in essence, sell interconnection services to Competitive Access Providers (i.e, competing sellers of telephone services). 1996 Telecommunications Act 47 U.S.C. Sec. 251(c). In addition, the FCC and implementing regulations pursuant to this Act outline a myriad of instances where other telephony companies must "sell" various types of services to competitive resellers.
- Under the Staggers Rail Act, railroads can be compelled to participate in through routes and joint rates, which, in essence, forces a railroad to allow a competing rail company to sell the others' rail services. 49 U.S.C. Sec. 10705(a)(1).
- Cable companies are required to carry certain local broadcast channels (in essence, "sell" their transmission capacity by foregoing opportunity costs associated with the carriage of other programming) under the Cable Television Consumer Protection and Competition Act. 47 U.S.C. Sec. 534.
- Virtually every state requires liquor and alcoholic beverage manufacturers to sell their products through an independent third party distributor.

In each of the above cases where a supplier is required by legislation (or by an agency acting pursuant to such legislation) to sell through other independent distributors, the supplier is being forced to "split" with the distributors a share of profits it would otherwise obtain if it had been allowed to refuse to deal with those distributors. In economic terms, this requirement has the same financial effect as requiring Orbitz carriers to sell their products through other independent outlets and to treat those competitors of Orbitz in a non-discriminatory way in terms of booking fees and commissions.

It is also worth noting that in Canada and in Australia the competition authorities in 1989 and 1993, respectively, required large air carriers who were joining to back a single CRS to enter into consent decrees agreeing not to discriminate against competing CRSs and, for that purpose, to participate in those competing CRSs and to pay them booking fees. The banding together of the five biggest carriers in the U.S. (accounting for over 80% of all enplanements) to back Orbitz is nothing short of the Internet Age equivalent of the combinations of large carriers in days gone by in Canada and Australia to back a single CRS. The competitive risks to airline and distribution channel competition posed by such combinations might require exactly the same sort of safeguards that anti-trust officials in Canada and Australia insisted upon as a precondition for allowing those CRSs to begin operations.

*Question 3.* To borrow a phrase from your testimony, what is particularly "consumer centric" about Travelocity entering into contracts with airlines to swing market share for a particular airline, regardless of whether that carrier is offering the lowest fares in the market? Are there techniques that Travelocity uses to "swing share," other than by offering discount fares on that airline?

Answer. Travelocity generally receives a modest commission that, as stated above, is capped at $5 one-way/$10 round trip, and thus has little or no incentive to "swing market share" regardless of the fare charged. Indeed, Travelocity has gone to great lengths to promote low-fare search capabilities on its site with such features as best fare finder, alternate airports, and fare watcher. In one recent example, Travelocity e-mailed all its customers to advise them of an unadvertised sale by most major airlines. We believe this can save our customers tens of millions of dollars.

In a few instances, Travelocity has entered into agreements in which commissions are increased depending on the total sales the airline achieves through Travelocity versus the airline's existing market share. These are quite common in the travel agency business. The important point here, however, is that Travelocity fulfills such agreements *while still offering consumers comprehensive unbiased displays.* This is because on-line airlines can achieve desired results through the use of: 1) banner advertising on the site; 2) targeted email messages to our customers; 3) links to special promotion fare offerings.

In each instance of a special promotion Travelocity ensures that it is obvious to consumers that an advertisement is being shown. We do not reorder the displays received from our CRS provider (Sabre), which comply with the CRS rules. Travelocity has already stated it will abide by the CRS rules if extended to the Internet, so long as the principals of Orbitz agree to be bound as well.

It is logical, and understandable, that the principals of Orbitz would be vehemently opposed to the conduct of a travel portal or on-line agent in selling advertising space and in otherwise "moving market share." This is because advertising tends to increase the total volume of promotional sales among competitors. Special promotions resulting from the desire of airlines to preserve market share tend to lead to "fare wars," thus reducing the net prices charged to consumers. However, we believe this result is entirely "consumer centric."

*Question 4.* In your testimony, you state that "it is unclear why the airline suppliers apparently shifted resources, investment dollars and development away from their individual sites to collectively focus on investing in and developing a joint Internet sales and marketing agency." Is it possible that the ability to create a one-stop shopping forum is a key reason for this investment, since that is what consumers prefer.

Answer. To determine the actual objectives and motivations of the principals of Orbitz, we would urge the Committee to obtain the formative documents and e-mails that have been provided from the carriers and the Boston Consulting Group to the Department of Justice in its current price-fixing inquiry.

The existing airline distribution infrastructure allows for the airlines to easily create a one-stop shopping forum with all fares. This could be accomplished by each of the airlines providing such fares through computerized reservation systems. Orbitz does not make this objective easier to accomplish, thus one must question whether this is indeed a "key reason" for the investment as opposed to one potential benefit.

Whatever the stated objective in creating Orbitz, we believe the Committee could still have legitimate concern over the effect on airline competition of an agreement among airlines not to invest in their own individual websites (let alone not to deal with third-party sites). We would refer the committee to the testimony submitted by Southwest Airlines in this regard.

*Question 5.* Travelocity has criticized Orbitz's ability to offer special fares that nobody else has. Does Travelocity run fare specials that none of its competitors has? If so, why is that different from Orbitz's running a fare special that none of its competitors has?

Answer. Travelocity, Expedia and other on-line travel sites have regularly run *sales and special promotions* with carriers. The typical duration of such exclusive promotions is four weeks or less. If this is all that Orbitz and its principals were proposing to do, we suspect that groups like Consumers Union and Consumer Federation of America would have fewer objections.

Travelocity has no agreement with any carrier that permanently requires such carrier to provide it with EVERY sale made available through a competitor. Travelocity has no agreement with any carrier that in effect BARS such carrier from ever running a special sale on another website—even its own website.

Orbitz goes much further. It eliminates an existing form of competition among independent on-line agents (special sales) and through its most favored nations provision severely lessens the incentive of airline participants to undercut the prevailing price.

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RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO HON. KENNETH M. MEAD

*Question 1.* Some of the low fare carriers have raised the prospect that Orbitz will make it easier for the major carriers to monitor their activities, both on the front end—their pricing—and on the back end—what inventory they have sold at what fares. Enhanced monitoring, the low fare carriers claim, would hurt them competitively.

Do you agree with this concern? Please feel free to elaborate in your answer.

Answer. On the pricing issue, although Orbitz will have each carrier's e-fares in one place for the first time, it is currently very easy for competitors to monitor each other's e-fares. The advent of Orbitz, therefore, does not materially change the competitive situation with respect to price information. In the short term, Orbitz will provide booking information on e-fares that currently are only sold on each airline's own website and is, therefore, not available to an airline's competitors. In the long term, however, if Orbitz abides by its charter and follows through on its business plan, Orbitz will actually reduce the inventory and sales information available to an airline's competitors.

Orbitz' charter specifically states that all data related to sales of tickets over the website are the sole property of the airlines whose tickets are sold. In the short term, Orbitz ticket bookings will be processed through a CRS, so this information will still be available to competitors. However, Orbitz hopes in the future to establish direct links with airlines' internal reservation systems, which will allow bookings to occur without the need for a CRS. When and if this happens, and if Orbitz abides by its charter, information related to these bookings will not be available to any other airlines.

If Orbitz adheres to its charter and this business plan, Orbitz can be viewed as a potential outlet to relieve small carriers from unwanted scrutiny of their pricing and inventory details. Under the structure of the current system, all carriers have a legal right to obtain pricing and inventory information of their competitors for all sales made through a CRS. This rule was developed in the early 1980's to address concerns that airline-owners of CRSs would have access to data on their competitors which they could use to an unfair advantage. The decision was made to make these data equally available to all carriers. These data are currently available for between 75 and 80 percent of all sales. Information on the remaining 20–25 percent of tickets, which are sold directly by the airlines through their phone reservation systems or websites, is not available to sources outside the airlines.

For tickets sold through travel agents that are processed through a CRS, airlines can obtain and then use this information to develop competitive pricing, scheduling, and sales strategies to try to attract some of their competitors market share. While small airlines theoretically have the same ability to use these strategies against their larger competitors, they believe the larger airlines gain a stronger competitive advantage because of their ability to direct significantly greater resources to analyzing the data and developing competitive strategies.

Orbitz offers a potential partial fix to what we see as a continuing concern related to open access to airline booking data. But this fix is down the road and will only apply to the bookings processed through Orbitz. Under its best-case scenario, Orbitz projects that this will represent 2 percent of all ticket sales. We would encourage the Department to revisit its rules on granting open access to booking data in light of competitive concerns raised by smaller airlines, as well as consumer protection issues the OIG has raised in conjunction with travel agent overrides.

*Question 2.* Mr. Mead, I asked this question during the hearing, but your answer focused on the exclusivity issue instead. I want to restate the question to make sure that I was clear. In order to qualify for the discounted CRS booking fee, participating air carriers in Orbitz must enter into a so-called "most favored nation" clause. If an airline sells a low fare elsewhere, the MFN clause requires it to offer that fare on Orbitz, as well.

Would such a provision inhibit carriers from offering their most cut-rate Web fares, since it would be uneconomical to sell those fares through the more costly Orbitz travel agent?

Answer. We don't believe this would be the case. Airlines currently offer a very limited number of last minute, deeply discounted fares via their own websites. The airlines sell these seats at very low cost but with restrictions that are so severe in terms of travel dates, length of stay, and available flights, that they result in having very limited appeal for most travelers. As a result, their sales constitute only a fraction (less than 1⁄10th of 1 percent) of an airline's total ticket sales.

The airlines have generally limited these fares to their own websites because selling them through travel agencies or their own phone reservation systems incurs labor costs, commissions, and CRS booking fees that would make it difficult to justify such low fares. Orbitz will provide a more costly outlet than the airlines own websites, because of commissions and (reduced) booking fees, and in most cases their phone reservation centers, but it will provide substantial savings over bookings through travel agencies, including its online competitors. If the airlines' options are to incur slightly higher costs to sell these tickets on Orbitz, or eliminate these fares entirely and fly these seats empty, it is likely that these sales will continue, but with the following potential caveats:

- Airlines will post these last minute fares on Orbitz but institute other incentives for booking directly through their own websites, such as frequent flyer bonuses or other non-fare related promotions.
- Airlines will slightly increase fares on these deeply discounted tickets to cover the added costs of their sale through Orbitz (booking fees, commissions). It is unlikely that the increases would be substantial or sales would diminish.
- Airlines that believe the financial costs of providing these fares to Orbitz outweighs the savings that they would receive on all booking fees—not just e-fare specials—will choose not to enter into this MFN agreement. Those airlines will be able to make their fares available through any channel they choose without being required to make them available on Orbitz. They will not, however, receive any rebates on their booking fees for sales through Orbitz.

What can or should the government do about the uncompetitive aspects of the MFN clause?

Answer. The MFN clause, at face value, does not appear to be anti-competitive. The Orbitz charter explicitly allows carriers to make available the same fares it makes available on Orbitz to any other distribution channel. Although the airlines have contended that they will make their lowest fares available to any other channel that is willing to provide the same financial incentives as Orbitz, the concern remains that the individual airlines will each choose not to do so.

This concern could be addressed by requiring the airlines to make these fares available to other travel agencies under specific conditions. Other agencies would have access to these fares if they are willing to offer the airlines the same financial terms (in the form of CRS booking fee rebates) and are willing to abide by the CRS regulations prohibiting bias. Possible protections could take the form of a departmental action or a formal agreement by the airlines to voluntarily adhere to these requirements.

*Question 3.* Southwest Airlines has laid out the following concerns about Orbitz. What is your response to each of these points? Southwest's concerns are:

Orbitz may lead to collusion by participating airlines on prices charged to the public.

Answer. We do not see anything unique to the structure of Orbitz that would encourage or facilitate collusion on pricing. The airlines will have no greater access to each others' fares than they currently have through browsing their competitors' websites and purchasing CRS data. In the current state of technology, airlines can become instantaneously aware and respond immediately to changes in their competitors' fares and services—although Orbitz will gather this information more easily in one place, it will not offer a substantially greater platform upon which the airlines can communicate about pricing.

Orbitz may stifle competition among airlines by effectively replacing the competing websites of individual airlines with a single website that discourages independent decision-making.

Answer. Orbitz will provide significant savings over other travel agencies and some airlines' phone reservation systems, but it will still be more costly for airlines to book travel through Orbitz than through their own websites. All airlines would prefer to ultimately draw consumers to their own websites instead of Orbitz, but know that for most, this is impossible. The large pool of price-sensitive consumers who patronize travel agencies for their ability to compare fares and services across airlines are unlikely to ever become exclusively loyal to one airline. For these consumers, the airlines would prefer they do their comparison shopping on Orbitz than on one of its more costly competitors.

It is more likely that airlines will continue to compete with Orbitz by offering consumers incentives other than price to purchase travel directly on their websites. These websites provide such substantial savings over Orbitz (no commissions or booking fees) that it would never be in the interest of the airlines to forego their own websites' operations in favor of forming one "mega" Orbitz site.

Orbitz may mislead the public by presenting the illusion that it offers neutral and comprehensive fare information while actually offering selective and/or biased displays that favor the airlines that own and control Orbitz; and

Answer. Orbitz' charter commits to providing an unbiased display of airline fares and services. To our knowledge, no other online agency has made such a commitment. For Orbitz, this means that it will not enter into any marketing or override agreements that enable one carrier to receive preferential or "enhanced" display treatment. For small carriers, this will mean that their fares alone will define where they are featured in the Orbitz display.

Orbitz' decision to provide a bias-free display is not a legally required one. As a travel agency, it is not covered by the bias restrictions in the current CRS regulations—a point we made in our testimony. No travel agency, including Orbitz' competitors, are restricted in how they present information received from their CRSs. The concern with Orbitz is that information could be displayed in such a way that the airlines owning and controlling Orbitz will be favored. However, if this were to occur (which would be contrary to the Orbitz charter), it would not be markedly different from other travel agencies' practices of displaying information in such a way that the airlines that have purchased preferential display options are favored.

Although it is not legally compelled to present bias-free displays, the fact that Orbitz is jointly owned by competing airlines makes it more likely that it will comply with its charter. The Orbitz charter specifically states that all information on Orbitz will be displayed without bias, with priority display based exclusively on lowest airfare. Given Orbitz' joint ownership, a decision to allow display advantages to be purchased (i.e., "selling bias" to a particular airline) would have to be made by the owner airlines who would stand to be harmed by such purchase.

Finally, if Orbitz markets itself to the public as a bias-free agency, it could be considered a deceptive practice if it then offered selective and/or biased displays. The Department of Transportation has oversight for such activities and our expectation is that such a practice would result in swift and meaningful action. In fact, any travel agency—regardless of ownership—that holds itself out to be unbiased and comprehensive should expect similar treatment if it then engages in practices that bias displays in favor of a specific carrier's services or otherwise treat a carrier's services preferentially.

Orbitz may facilitate coordination by the major airlines to use their combined resources to stifle competition from nonparticipating low fare airlines.

Answer. Our testimony raised the possibility of potential long-term harmful impacts on the travel marketplace. If the airline equity owners of Orbitz refuse to make their lowest Internet fares available to online competitors, Orbitz would have a significant marketing advantage that could allow it to achieve a dominant online market share or even to eliminate its online competitors. In either case, airlines would likely feel compelled to be listed on the Orbitz system or risk foregoing significant business to their competitors.

At such a point, with its market power over the airlines established, Orbitz might choose to charge premiums to airlines to participate (i.e., raise costs) rather than offering reduced costs through lower booking fees. Such an outcome would benefit Orbitz' equity owners to the detriment of other participating airlines. One way this could be mitigated is by diluting ownership among more airlines and soliciting non-airline owners. As we suggested in our testimony, another way would be to require the equity-owner airlines to make their lowest fares available to other channels willing to offer in exchange the same terms and conditions as Orbitz. The Departments of Justice and Transportation need to evaluate the likelihood of this or other scenarios playing out to determine whether prior intervention is needed to protect competition and consumers.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO A. BRADLEY MIMS

*Question.* Following up on your prepared statement, Mr. Mims, what questions have been raised by the smaller airlines about "Orbitz's potential adoption of restrictions on the airlines' participation in Orbitz that could undermine the competitive position of smaller airlines . . . ?

Answer. Each airline that becomes a "charter associate" in Orbitz will obtain a rebate on the computer reservations system fees incurred when a traveler uses Orbitz to book the airline. Status as a charter associate requires certain obligations from the airline, however. It must make available to Orbitz all of its publicly-available fares sold through any other distribution channel, including Internet fares otherwise offered only on the airline's own website. The airline must also assist Orbitz' marketing efforts. Some smaller airlines have complained that the "most favored nation" clause on fares unduly restricts their ability to offer special discount fares through other distribution channels and to engage in special marketing promotions with other travel agencies and distribution firms. They have also complained that the obligation to bear some marketing expenses is subject to a cap which in practice will benefit the largest airlines and will require smaller airlines to bear a larger share of the marketing effort than is justified by the relative amount of their sales. One airline has complained that it was turned down when it asked to become one of Orbitz' owner airlines.

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RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO PAUL M. RUDEN

*Question 1.* Mr. Ruden, your organization advocates that an airline's most inexpensive fares should be required to be sold through every medium, regardless of the cost to the airline of a particular medium of ticket sales.

If the government prevents an airline from recovering its cost to sell its tickets, is it possible the airline will simply quit offering the lowest fares that cannot be sold economically through every outlet?

Answer. Requiring airlines to make all fares available for sale through every medium will not prevent airlines from recovering their selling costs. Nor are pricing decisions made on the basis of actual retail selling costs. There is no relationship between most Internet-only fare levels and selling costs of any channel. When it was cheaper to sell tickets through travel agents than it was by direct sales through airline city ticket offices and reservation center calls, airlines charged the same price for each channel. Prices are set to move inventory of a perishable product now considered mainly to be a commodity (constrained by the extent of competition in the market), and to gain a competitive advantage and/or deter entry (constrained only by whatever limits on airline market power may exist), and to maintain or increase market share. The relationship of such prices to selling costs is often indeterminable and incidental.

In any event, the issue raised by Orbitz is somewhat different. Orbitz involves joint airline action that appears clearly calculated to deprive competitors, both current and prospective, of access to the lowest fares. Such joint determinations of channel selection and content should not be allowed in any circumstances.

*Question 2.* Your testimony takes issue with the fact that the airlines' "lowest fare" guarantee extends only to its telephone reservation agents.

What would be the value of extending that guarantee to travel agents, given that perhaps the travel agents' most significant role is to find their customers the lowest fares?

Answer. Travel agents today will find the lowest fare for any client to whom this factor is important. The problem is that the airlines are withholding some fare inventory from agents. The public for whom the absolute lowest fare is crucial, therefore, is denied the right to have such fares ticketed through their favored distribution source. To the extent that airlines are required to make such fares available for ticketing through travel agents, the public will have the freedom to select their distribution source without fear that they are automatically excluded from certain discounts.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO MARK SILBERGELD

*Question 1.* I understand Orbitz' competitors concerns that air carriers will offer exclusive deals on Orbitz that will not be available elsewhere. From an antitrust perspective, however, is it permissible for individual airlines to reach that decision as long as they did not act collectively to reach that decision?

Answer. In the airline industry, that decision reached individually would still be the appropriate subject of antitrust scrutiny. The industry is not competitive in many geographical (i.e., route-by-route) markets, has a history of anticompetitive behavior (as Members noted during the hearings) and a history of parallel behavior. In such an industry, there are serious antitrust concerns about conscious parallelism that would warrant Justice Department review. Further, the airlines cannot now go back in time to reach the same decisions individually that they have already reached collectively. In other words, the anticompetitive decisions reached through the platform of T2/Orbitz cannot be undone.

*Question 2.* In order to qualify for the discounted CRS booking fee, participating air carriers in Orbitz must enter into a so-called "most favored nation" clause. If an airline sells a low fare elsewhere, the MFN clause requires it to offer that fare on Orbitz as well.

- Would such a provision inhibit carriers from offering their most cut-rate Web fares, since it would be uneconomical to sell those fares through the more costly Orbitz travel agent?
- What can or should the government do about the uncompetitive aspects of the MFN clause?

Answer. The MFN might well inhibit airlines from offering their most cut-rate web fares under the MFN arrangement, depending on how the clause is worded in the agreement. If the agreement reaches e-fares, the last minute bargain fares, the answer most probably is yes. The government needs to review the MFN clause and impose restrictions on it, in a consent order issued by the Department of Justice, so as to assure that the MFN clause does not prohibit the issuance of lowest-cost fares individually based on individual decisions by each participating carrier. Otherwise, the MFN clause serves to set floors on fare bargains. And it serves as an agreement to refuse to offer lower prices based on lower selling costs of the competitor travel sites, where such lower costs exist. It may well be that a Department review will conclude that the MFN clause is inherently anticompetitive, in which the clause should be banned by departmental order. Any conditions short of a ban on implementation of the clause must be susceptible of effective monitoring and enforcement.

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JOINT PREPARED STATEMENT OF NANCY LINARES, CTC, CHAIRMAN OF THE BOARD AND ALEXANDER ANOLIK, ESQ., GENERAL COUNSEL, ASSOCIATION OF RETAIL TRAVEL AGENTS

Chairman McCain and esteemed members of the Senate Commerce Committee, we want to begin by thanking you for shining the spotlight on Orbitz and similar airline-owned entities that threaten to cripple competition in the U.S. air travel market.

This morning, we wish to request that the Congress should take all necessary steps to investigate and remedy the anticompetitive effects of Orbitz and other proposed Internet sites jointly owned, operated, and funded by consortiums of major U.S. and international air carriers.

We make this request on behalf of the Association of Retail Travel Agents ("ARTA"), a nonprofit trade association organized and existing under the laws of the District of Columbia and headquartered at 2692 Richmond Road, Suite 202, Lexington, Kentucky 40509–1542.

ARTA is the largest nonprofit association in North America representing travel agents exclusively, with more than 4,600 travel agent members in the United States and Canada. Most of ARTA's travel agent members are appointed by the Airlines Reporting Corporation ("ARC") to sell airline tickets to the public, including tickets on the air carriers identified as joint owners of the Internet sites in question. In the sale and distribution of airline tickets to the public, regardless of the sales methods used (*e.g.,* telephone, fax, Internet, in-person agency visit), these ARTA members compete for sales with the airlines themselves.

On November 9, 1999, four U.S.-based air carriers—United Airlines, Delta Air Lines, Northwest Airlines, and Continental Airlines—announced plans to launch a jointly owned Internet travel site in six months to sell airline, hotel, car rental, cruise, tour, and other travel services to the public. According to press reports, the jointly owned site will stand apart from competing Web sites by operating as a one-stop shopping location offering features such as exclusive discount fares and preferred seating arrangements available only through the airline-owned site. The new site—initially named "T–2" by the press for "Travelocity Terminator" (a reference to the leading independent online travel agency), but now called "Orbitz"—will be developed by the Boston Consulting Group, a Chicago-based general management consulting firm.

On January 13, 2000, 23 additional U.S.- and foreign-based air carriers signed letters of intent to become charter associates in T–2: American, USAirways, ATA, AirTran, Hawaiian, Midwest Express, Midway, Vanguard, Air Canada, Air Jamaica, Air New Zealand, Alitalia, All Nippon Air, Austrian, British Midland, COPA, CSA Czech, Iberia, KLM, Korean, Mexicana, Singapore, and Varig. (American later joined the four founding airlines as an equity owner.)

On May 11, 2000, 11 European-based air carriers announced the creation of a similar jointly owned site (dubbed "Me-Too" by travel trade editors): Aer Lingus, Air France, Alitalia, Austrian, British Airways, British Midland, Finnair, Iberia, KLM, Lufthansa, and SAS.

Relying heavily upon Antitrust Guidelines for Collaborations Among Competitors (issued jointly by the Federal Trade Commission and by the U.S. Department of Justice in April, 2000), ARTA alleges nine separate concerns that, taken separately or jointly, support our primary concern:

**Orbitz and other airline-owned sites harm competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement.**

1. **These airline-owned sites constitute a *per se* illegal agreement to share the domestic air travel market by allocating lines of commerce.**

   Currently, the airlines that own Orbitz and Me-Too sell air travel via their own individual airline Web sites, via leading online travel agencies such as Expedia and Travelocity, and via independent travel agencies that have their respective agency Web sites with booking engines.

   By combining assets, exclusive airfare discounts, frequent flyer mile promotions, preferred seating arrangements, and other competitive strengths not available through the other retail channels, Orbitz and Me-Too will succeed eventually in crippling or destroying other online retail outlets for air travel—leaving these air carriers (collaborating openly via the two sites) in complete control of the online travel sales market.

   The overall competitive effect of these agreements is the concerted, deliberate re-allocation of online air travel commerce by air carriers *from* a somewhat competitive mix of independent single-airline sites, independent online travel agencies, and independent retail travel agencies with their own Web sites *to* a single-channel distribution system controlled directly by consortiums of U.S. and international airlines.

   These consortiums can claim not one single true efficiency in this collaboration. Typically, participants in an efficiency-enhancing integration combine assets to achieve procompetitive benefits that they could not achieve separately. However, the individual air carriers in these consortiums operate their own respective successful Internet sites, and they sell growing amounts of air travel via online travel agencies that earn "capped" commissions. Because equal or comparable procompetitive benefits may be achieved through these practical, significantly less restrictive means, the Orbitz and Me-Too agreements are therefore not reasonably necessary.

2. **These airline-owned sites limit independent decision making by the competing air carriers.**

   In launch announcements, the Boston Consulting Group and its airline clients make clear their intention to enforce collective policies on competitively significant variables such as quality, service, and promotional strategies to increase market power—in effect, "to create the most comprehensive travel site on the Web." *USA Today*, Nov. 10, 1999, B–1. "Identical to the commitments of the initial airline partners [United, Delta, Northwest, and Continental], the additional [23] airlines will provide a number of services to the site including *co-op marketing programs, access to customer loyalty programs and exclusive marketing support*." BusinessWire, January 13, 2000, emphasis added.

   In effect, this agreement reduces the individual airlines' control over assets necessary to compete and thereby reduces their ability to compete independently. Also, it combines the financial interests of the individual air carriers into a single jointly owned site in ways that undermine incentives for the airlines to compete independently (*e.g.,* the single site reduces or eliminates comparative airline advertising, thereby harming competition by restricting information to consumers on price and other competitive significant variables).

**3. These airline-owned sites facilitate horizontal collusion.**

Orbitz and Me-Too will greatly increase the temptation for their airline owners to engage in practices of price signaling, display bias, and price fixing that air carriers have attempted—and federal agencies have largely succeeded in preventing—in other airline-owned electronic media, notably computerized reservation systems ("CRSs") and the Airline Tariff Publishing Company ("ATPCO").

Prior to its demise in 1985, the Civil Aeronautics Board ("CAB") found that the domestic airlines that owned CRSs displayed information on the system screens viewed by travel agents in a way that favored their own flights over the flights of competing airlines that may have been better choices from the consumer's perspective. The CAB adopted regulations (currently enforced by the Department of Transportation) to eliminate "display bias" so that travel agents and consumers could receive objective and accurate flight information about all air carriers listed on respective CRSs. *See* 14 C.F.R. § 255.1–255.12.

In 1992, the Department of Justice filed suit against eight major U.S. airlines alleging that they colluded to raise prices and restrict competition by signaling airline price changes through elaborate footnotes and codes filed with ATPCO (a central computer system owned by the airlines that distributes changes in ticket prices to major airlines and CRSs). Two years later, the air carriers settled the suit by agreeing to restrictions on the use of ATPCO footnotes and codes and to a prohibition on pre-announcing price increases except where widely publicized. (In April, 2000, Rep. Peter DeFazio asked the Justice Department to review the airline industry's current compliance with the 1994 settlement.)

The Orbitz and Me-Too sites raise the very strong probability that this horizontal collusion—prohibited and largely eliminated by federal agencies in other contexts—would be resurrected on the Internet.

For example, the airline owners of these sites will share—in electronic formats that make data manipulation a simple process—information relating to price, output, costs, and strategic planning, as well as current operating and future business plans. These data will be available as individual company data, rather than aggregated data, so that respective airline owners can identify individual firm data—in effect, "automating" the horizontal collusion.

Further, ARTA alleges that the Orbitz and Me-Too sites foster express or tacit collusion among the airline owners and charter members in a manner akin to the coordinated interaction theories outlined in *Horizontal Merger Guidelines* at 14.

**4. These airline-owned sites lead to unhealthy levels of market concentration.**

"In some cases . . . a determination of anticompetitive harm may be informed by consideration of market power." *Antitrust Guidelines* at 12.

Just as the major U.S. air carriers have developed "fortress hubs" to carve up and protect their respective shares of the U.S. air travel market, the Orbitz and Me-Too jointly owned sites will become "fortress Web sites" that the owner airlines will use ultimately to inflate airfares, curtail consumer choices, and choke competition posed by smaller rival airlines and independent retailers.

On the one hand, "market share affects the extent to which participants or the collaboration must restrict their own output in order to achieve anticompetitive effects in a relevant market." *Antitrust Guidelines* at 17. The larger the percentage of total supply that a firm controls, the less severely it must restrict its own output in order to produce a given price increase, and the more likely it is that an output restriction will be profitable.

In the case of the Orbitz site, the collective market share of the participating domestic airlines (as owners or as charter members) totals as follows (figures reflect revenue passenger miles obtained from the current volume of *Aviation Daily Data* at 88, and the total reflects rules found in the Commission's *1992 Horizontal Merger Guidelines* for calculating market share):

| | |
|---|---|
| United | 19.07% share |
| American | 16.95% share |
| Delta | 15.96% share |

| | |
|---|---|
| Northwest | 11.29% share |
| Continental | 9.06% share |
| USAirways | 6.26% share |
| American Trans Air | 1.70% share |
| Hawaiian | 0.73% share |
| AirTran Holding Corp. | 0.52% share |
| Midwest Express | 0.30% share |
| Midway Airlines | 0.15% share |
| Vanguard | 0.13% share |

The airline owners and charter members of Orbitz control an extraordinary 82.12% domestic market share—an almost unprecedented stranglehold being brought to bear on the online travel marketplace.

On the other hand, "market concentration affects the difficulties and costs of achieving and enforcing collusion in a relevant market." *Antitrust Guidelines* at 18. The Federal Trade Commission uses the Herfindahl-Hirschman Index ("HHI") as an aid to interpret market concentration data.

Calculated by summing the squares of the individual market shares of all participants, the HHI results before and after the formation of Orbitz show a tremendous difference:

| | |
|---|---|
| HHI *before* Orbitz | 1,215 |
| HHI *after* Orbitz | 6,800 |

"When the post-merger HHI exceeds 1,800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise." *Horizontal Guidelines* at 13. In the case of Orbitz, the airlines' joint forces will result in an extraordinary increase in their collective market power as measured by the HHI.

(ARTA argues that the joint ownership and operation of Orbitz constitutes, in practical terms, a merger of significant corporate resources, meeting the general requirements of the HHI instrument.)

ARTA echoes the prescient comments of former CAB Chairman Alfred Kahn: "[W]hen I see what can only be described as real monopolistic exploitation of travelers with limited alternatives, I do worry about the sufficiency of competition in the airline industry." *Conde Nast Traveler*, Sept. 1998, 132.

**5. These airline-owned sites fail the "safety zone" test.**

Section 4.2 of the *Antitrust Guidelines* outlines a "safety zone" to provide participants in a collaboration with a degree of certainty in those situations in which anticompetitive effects are so unlikely that the arrangements are presumed to be lawful without inquiring into particular circumstances. "Absent extraordinary circumstances, the Agencies do not challenge a competitor collaboration when the market shares of the collaboration and its participants collectively account for no more than twenty percent of each relevant market in which competition may be affected." *Antitrust Guidelines* at 26.

The airline owners and charter members of Orbitz control an extraordinary 82.12% domestic market share—more than four times the maximum threshold of the "safety zone" outlined by federal antitrust officials in the *Antitrust Guidelines*.

**6. These airline-owned sites fail four of six factors affecting the ability of the participants to compete independently of each other.**

Among the six factors listed in *Antitrust Guidelines* at 19, the Orbitz and Me-Too sites fall short in four areas:

"(c) the nature and extent of participants' financial interests in the collaboration or in each other;"

> The greater the financial interest in the collaboration, the less likely is the participant to compete with the collaboration. In the case of Orbitz, the five equity airline owners—United, Delta, American, Northwest, and Continental—currently control a 100% interest in the site, According to press reports. Therefore, they will receive a lower net return from aggressive independent collaboration.

"(d) the control of the collaboration's competitively significant decision making;"

"[T]he collaboration is less likely to compete independently as participants gain greater control over the collaboration's price, output, and other competitively significant decisions." *Antitrust Guidelines* at 20. As full equity owners, the primary owners—United, Delta, American, Northwest, and Continental—will presumably make final decisions regarding Orbitz' operations, staffing, and promotions. Further, they will presumably exert veto rights such as the refusal of new entrant airlines as participants of Orbitz.

"(e) the likelihood of anticompetitive information sharing;"

Given the concerns outlined in section 3 of this letter, ARTA alleges that the likelihood of anticompetitive information sharing by the airline owners and charter members of Orbitz and Me-Too is extremely high.

"(f) the duration of the collaboration."

"In general, the shorter the duration [of the collaboration], the more likely participants are to compete against each other and their collaboration." *Antitrust Guidelines* at 21. In this case, Orbitz and Me-Too are designed to operate as permanent Internet sales sites, reducing effectively the incentives for their airline owners and charter members to compete independently.

While the adoption of appropriate safeguards to prevent anticompetitive information sharing may mitigate such concerns, the track record of these airlines as outlined in section 3 of this letter speaks against any reasonable reliance simply upon the good faith of the air carriers involved.

**7. These airline-owned sites exclude entry by new online travel agencies and by new start-up airlines.**

The proven difficulty of entry by start-up air carriers and online travel agencies in competing against the airline owners and charter members of Orbitz and Me-Too in traditional avenues is well documented. In this instance, that track record supports ARTA's contention that entry by new or additional competitors would not be "timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the anticompetitive harm of concern." *Antitrust Guidelines* at 22.

In 1999, Federal Trade Commission staffers recommended a review of the planned acquisition of Ingram Book Group by Barnes & Noble, arguing that the control of an important part of the book distribution marketplace might enable Barnes & Noble to shut off competing sellers from Ingram's services or to deny access on competitive terms, thereby raising the costs of Barnes & Noble's rivals. Ultimately, the acquisition would have led to less competition on the Internet for bookselling. In the same vein, ARTA argues, the Orbitz and Me-Too transactions will lead ultimately to less competition on the Internet for travel sales.

**8. These airline-owned sites pose an enormous threat to the online privacy interests of traveling consumers.**

Orbitz and Me-Too generate substantial questions about the confidentiality of traveling consumers' personal data and the sharing of that data among the sites' airline owners and charter members.

Typically, online sites run by air carriers collect a larger than usual assortment of personal data, including emergency contacts, passport and visa information, and other details beyond the consumer's contact information and credit card information collected by other e-commerce sites. Accordingly, the risks of misuse of these data rise in proportion.

In particular, ARTA argues that the Committee should consider carefully the anticompetitive effects of the merging of online and offline data by these airline owners and charter members. *See* "Electronic Commerce and Beyond: Challenges of the New Digital Age" by FTC Chairman Robert Pitofsky, Woodrow Wilson Center "Sovereignty in the Digital Age" Series, Feb. 10, 2000.

**9. These airline-owned sites support price discrimination based on the "digital divide."**

The announced sales policies of Orbitz and Me-Too to offer special discount airfares and reservation benefits available exclusively through these Internet sites greatly exacerbate the negative effects of the "digital divide" facing consumers.

According to National Telecommunications and Information Administration (NTIA) surveys, whites are more likely to have access to the Internet (particularly from home) than Blacks or Hispanics have from any location. At almost every income level, households in rural areas are significantly less likely to have Internet access than those in urban or central city areas. More than 61 percent of those with college degrees now use the Internet, while only 6.6 percent of those with an elementary school education or less use the Internet; in fact, this gap actually widened by 25 percent from 1997 to 1998. While almost 59 percent of Americans making more than US$75,000 frequent the Internet from any location, only 16 percent at the lowest end of the pay scale (US$5,000–US$10,000) use the Internet. *See* "Falling Through the Net: Defining the Digital Divide," NTIA, July 1999.

While consumers across racial and socioeconomic boundaries may counter a lack of Internet access by shopping more aggressively in local markets—*e.g.,* they can generally find local sales prices on compact discs sold at similar discounts on the Internet—the special sales and exclusive airfares available through Orbitz and Me-Too cannot be found by consumers shopping locally through traditional retailers or through the airlines' traditional direct sales methods (*e.g.,* toll-free reservation numbers).

**Conclusion.**

In conclusion, we urge the Committee to take all available steps to prevent further consolidation in the online travel market via Internet sales sites that are jointly owned by the major air carriers.

Though the Orbitz and Me-Too sites are not yet functional, ARTA argues that the very nature of the agreement governing these collaborations between competitors jointly controlling more than 80 percent of the domestic airline market "give[s] rise to an intuitively obvious inference of anticompetitive effect." *California Dental Ass'n v. FTC*, 119 S. Ct. 1604, 1617–18 (1999). As the *Antitrust Guidelines* state, federal antitrust officials generally challenge agreements without a detailed market analysis in cases where "the likelihood of anticompetitive harm is evident from the nature of the agreement . . . absent overriding benefits that could offset the anticompetitive harm . . . " *Antitrust Guidelines* at 4.

Further, we believe that the Committee should act swiftly in order to be sensitive to the reasonable expectations of participating "charter agreement" air carriers that have made significant sunk cost investments in reliance on the Orbitz and Me-Too agreements that may later be judged anticompetitive.

Thank you for the opportunity to submit these comments.

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ORBITZ,
*Chicago, IL, August 25, 2000.*

Hon. JOHN MCCAIN,
Chairman,
Committee on Commerce, Science, and Transportation,
Washington, DC

Dear Mr. Chairman,

This is to follow up on the hearing your Committee held on July 20, regarding Aviation and the Internet.

As you noted in the hearing, circumstances on the Senate floor, unrelated to this hearing or to your Committee, resulted in the hearing having to be concluded early. As a result, we were not always able to fully respond to the concerns you raised in the hearing, despite your good efforts to provide adequate time for response. Some of the questions you raised, and the questions you have posed since the hearing, certainly merit a fuller response than was possible in the time constraints of the hearing. This is to provide you that fuller response, as well as to respond to your post-hearing questions.

You raised the question of opposition to Orbitz from low-fare airlines. For a start-up company, my view is that we are making good progress getting the interest and commitments of low-fare airlines. Most low-fare airlines are very supportive of Orbitz, once they learn what we are offering. Among the airlines that have already signed associate agreements with Orbitz are Aloha, Hawaiian, Midway, Midwest Express, Spirit, and Vanguard. And we are actively engaged in getting the interest of others. Before we launch I am certain we will have signed up a very good representation of low-fare airlines, because only Orbitz represents their base fares and their special fares without bias and in such a user-friendly way.

What I think is most compelling for low-fare airlines is the simple truth that we offer all airlines, including low-fare airlines, absolutely equal and unbiased display. And they need not invest one nickel in Orbitz to obtain this benefit. Many smaller airlines have complained over the years that they cannot get truly equal "shelf space" in the CRSs, and now in CRS-based Internet sites. In Orbitz they will be displayed on exactly the same terms as the very largest airlines.

Another feature that seems to be appealing to low-fare airlines (who we know are particularly cost conscious) is that we offer them an indirect offset to the CRS booking fees they pay. This is of critical importance to most low-fare airlines, because CRS booking fees, while excessive for all airlines, weigh particularly heavily on low-fare airlines. This is because these fees constitute a much larger percentage of a low-fare ticket than of a full-fare ticket. The booking fee offset offered by Orbitz, while identical for any associate airline, whether large or small, low-fare or not, investor in Orbitz or not, as a percentage of the ticket cost offers savings far greater for the low-fare airline.

And third, the smaller low-fare airlines have complained increasingly that the CRS rules (Part 255) on booking data do not protect them from being at a competitive disadvantage in access to and use of that data. At Orbitz, we have solved that concern by doing what no CRS has been willing to do: we provide by contract that all booking data on Orbitz is the property solely of the airline on which that booking was made. This puts the low-fare airlines on an absolutely even footing with any other airline with respect to data at Orbitz.

The on-the-record exception to this favorable view of Orbitz is Southwest, and that is because Southwest is the notable exception to other airlines in so many ways. Southwest is an excellent airline, with a great and unique business plan, and a history that puts it in a position no other airline can duplicate. Southwest is the only airline that has managed to put itself in a position where it pays no CRS booking fees. Every other airline envies Southwest in that regard, but no other airline can duplicate the peculiar history by which Southwest has achieved that result.

Southwest prevents sale of its tickets on all CRSs but one, and has a unique (and impossible to duplicate) arrangement by which it pays no CRS booking fee (but does pay a smaller alternative fee) on that one system. Orbitz will list Southwest flights and fares and give Southwest absolutely unbiased display, but like most systems, Orbitz will not be able to sell Southwest seats, because Southwest does not allow its seats to be sold in a way that incurs any CRS booking fee (even a reduced one). We sympathize with Southwest's position on booking fees, and are working on a way in which we can make it possible for Southwest seats to not only be displayed on Orbitz, but to be sold on Orbitz without incurring any CRS booking fee. But in the interim, as is the case with most CRSs and travel agents, customers of Orbitz would see the Southwest display, and then call Southwest to make the booking.

However, from a competitive point of view, Southwest's greatest competitive advantage, particularly over other low-fare airlines, is that the others pay a CRS booking fee and Southwest does not. Therefore, it presumably sees the offset to the CRS booking fee offered by Orbitz as benefiting its airline competitors, and particularly its low-fare airline competitors, more than it would benefit Southwest. In our view, one of the primary reasons Southwest has therefore elected to oppose Orbitz, is in the hopes of preventing its competitors, especially its low-fare competitors, from getting even a portion of the booking fee advantage it now enjoys alone.

There is one other marketing nuance that makes Southwest what many think of as the consumer role model for air travel. In America most people view the Southwest name and brand as synonymous with "low price." When Orbitz launches it will be much easier than ever before, however, for consumers to find low prices on all airlines (including Southwest). For the first time, it will be easy to see the best deals of all airlines. This will be good for consumers, but not exactly an "edge" that Southwest would like, from their own marketing point-of-view, to see shared with others.

Southwest's tactical position notwithstanding, the CRS booking fee problem has disproportionately burdened low-fare airlines for years, and is only getting worse. Nothing would so benefit low-fare airlines as a break on the excessive CRS booking fees they pay. Orbitz offers low-fare airlines that break.

You raised the question of whether airlines would choose to put many of their lowest fares on Orbitz, and thereby disadvantage other channels. Of course, only the airlines themselves can answer this question with certainty. However, the fact is that there are many fares already out in the marketplace through specialized websites, clubs, and specialized travel agencies. Thus one can see that where the costs and distribution efficiency make sense, the airlines are quick to put special fares out into the market through multiple channels. In this airlines are no different from those who market other goods, whether they are selling cars, or pants, or books.

What I can say categorically to the question of where airlines will choose to put their fares, is that the Orbitz agreements expressly provide that no airline is or would be required to put fares on Orbitz and not on other channels. The agreement

Orbitz has with airlines is very explicit that there is no exclusivity—the airlines would remain free, as they are today, to decide what fares to sell and where to sell them. But your question goes beyond that, to whether individual airlines would *choose* to put fares on Orbitz and not on other channels.

My view, as somebody who has worked both on the airline side and on the distribution system side, is that airlines must sell at least 99% of their fares through all channels. However, most airlines also have their own websites, and selling through those websites (which typically do not incur CRS booking fees and other costs) is far less expensive than selling through travel agents, and is even less expensive than selling through Orbitz will be. Yet typically these airlines choose to put 99.9% of their fares on all channels. And the one-tenth of one percent of all fares that today they put only on their own website are so low (typically "distressed inventory" seats that are about to be flown empty) that they simply cannot be sold economically through many of the more expensive channels.

This is simply a reflection of a very basic and compelling fact of the airline life—it is a narrow margin business, and no airline can afford to turn its back on the customers who use any particular channel, even relatively small channels. You raised the question of the Committee's concern in the past about the CRS industry, and its concern now that some of those same issues might apply to the Internet in general and to Orbitz in particular. You and your Committee were quite right to be concerned about CRS in the past, and you should be every bit as concerned about it today. As Inspector General Mead pointed out in his testimony, the existing CRS rules have not been adequate and are rapidly being overtaken by changing circumstances. We are even at the point where the largest CRS in the world does not appear to be covered by the CRS rules. This is clearly an absurd outcome. But as important is the fact that the CRS rules never effectively dealt with excessive CRS booking fees, never fully protected travel agents from restrictive CRS contracts, never afforded the agents and their customers truly unbiased displays, and never adequately protected smaller airlines from unequal access and misuse of booking data.

It would be a tragic and bitter irony for consumers and for competition if, after years in which government expressed all these concerns about CRS but did so little about them, it now, on the basis of its concerns about CRS, squelched the one possibility for competition to CRSs. The effort against Orbitz is being directed and fueled by Sabre, the largest CRS in the world, and Sabre is doing so in order to slow or prevent a potential competitor from entering its highly uncompetitive business. Sabre holds nearly 50% of CRS booking, holds nearly 50% of online agency bookings (through its Internet arm, Travelocity), and has used its dominance to raise booking fees over the last 17 years by approximately 1400%. While Sabre/Travelocity now raise their "concerns" about competition, it is they who benefit most from the absence of competition, who "swing market share" on the Internet in return for payment, and whose Internet site is funded by their extraordinary CRS booking fee profits. Sabre/Travelocity knows that blocking Orbitz is the key to perpetuating their dominant position, built on the market power of their CRS. Orbitz is not, in fact, a CRS, but an important antidote to the long-standing anti-competitive problems of CRSs.

You asked for our views on the proposal made by Inspector General Ken Mead at the hearing. We understand that the proposed regulation would require an airline, if one online travel agency offered it the same benefits as that airline received from another (e.g., in the case of Orbitz, indirect offset of part of the booking fee, unbiased displays, etc.), to grant the same benefits to the first agency as it had granted to the second (e.g., in the case of Orbitz, access to webfares). We assume that the proposal is to put the same requirement on all online agencies, not just on Orbitz.

We do not believe that the principles embodied in this proposal, if fully and effectively implemented, would harm consumers or competition. But attempting to reduce these principles to a regulation could have far-reaching and unintended consequences, with significant harm both to consumers and to competition. For example, Mr. Chairman, attempting to mandate these principles as a rule could well result in CRS owners of online agencies increasing their booking fees, and portal-owned online agencies increasing their subscription fees. These are "financing opportunities" that Orbitz simply could not compete with, and the pro-consumer and pro-competition benefits of Orbitz would simply be lost.

And furthermore, as much as some appear to worry about our potential to be too strong in the market due to our access to webfares, I worry that any rule attempting to implement Mr. Mead's principles may not be implementable. And as a former head of an airline, I can predict that if the rule is not implementable, the result will not be good for consumers, because airlines will retrench to selling their best fares only on their own websites.

Mr. Mead's proposal, and your question, clearly merits a more thorough discussion, so please allow me to respond at greater length.

First, we note that the proposal recognizes that the key issue before the Committee is not simply access to e-fares. The Inspector General keenly understands that there is a relationship between the current lack of any price competition for CRS booking fees, and the issue of the availability of fares. He has clearly rejected the idea that government should simply and unconditionally require that all fares be available through all channels, and has done so on the basis that that would not be good for consumers or for competition. Orbitz has the potential to for the first time in twenty years bring a degree of price competition to CRS booking fees, some degree of competitive pressure on other sites to improve the quality of the displays and information they make available to consumers, and some degree of competition on other CRS practices, such as the use and misuse of booking data. It is important that that potential new competition not be lost.

Second, although we cannot predict whether other online agencies would choose to match the benefits offered by Orbitz (and we do not know for certain how each airline would respond to any such offer), we clearly believe that every airline would eagerly accept such an offer, even in the absence of regulation. It is a simple matter of their economic interests: if it was in an airline's interest to enter into an agreement with Orbitz, then it would be even more in its interest to enter into equally favorable deals with additional retail channels. The airline would not only be able to reach more consumers, but would also receive an indirect offset of the excessive CRS booking fees on a larger percentage of its ticket sales, which by itself would be of considerable value to most airlines.

Third, it is an absolute fact that no airline that wishes to enter into a deal with the same benefits as its Orbitz deal (or any other deal) with another online agency will be prevented from doing so because of the airline's agreement with Orbitz. Every Orbitz agreement, with every airline, expressly provides that the agreement is non-exclusive, and that the airline is free to join in promotions and other marketing arrangements with any other retail channels, as the airline deems appropriate.

Moreover, if the government were to decide to impose the Inspector General's concept by regulation (i.e. that airlines accept an Orbitz-like agreement from any other online agency), it also must ensure that those regulations are far more exacting, and far less subject to creative evasion, than the current tattered rules that supposedly control anti-competitive CRS behavior. If the government wishes to adopt the Inspector General's proposal as a regulation, the government should implement it effectively. If it does not, the proposed regulations would only further entrench the market power of the CRSs.

What would it take to effectively implement the Inspector General's proposal by regulation? Let me mention a few of the prerequisites.

First, the requirement that other online agencies would also have to offer an equal indirect offset of the CRS booking fee would have to be more than illusory. Because Travelocity, for example, is merely the Internet arm of Sabre, the largest CRS, Travelocity could on the surface comply with the indirect offset requirement, but in fact evade it through increased booking fees on Sabre. To effectively implement the Inspector General's proposal, the government therefore would have to cap CRS booking fees. (Indeed, it would need to consider requiring the CRSs to *reduce* their fees, to reflect the vast decline in the cost of computing power over the past twenty years.) Since Part 255 was first adopted, the government has fretted that CRS booking fees were excessive and the product of monopoly power, but it has never before been willing to intervene and stop their upward spiral. If the government is now finally willing to do so, the benefits for consumers, agents, and competition (especially for the low-fare airlines) could be significant.

We also emphasize that Orbitz' offer to indirectly offset CRS booking fees applies to *all* fares sold through Orbitz. If another online agency is to have a right to the same deal as Orbitz, then in return it must offer the airlines the same deal as Orbitz. The proposed regulation must therefore require that an offset be provided for *all* fares sold through that agency on any given airline.

Second, as the Inspector General recognized in his testimony, Orbitz has offered the airlines not only indirect offset of the CRS booking fee, but also far superior displays. Orbitz will provide genuinely unbiased and comprehensive information, which consumers can rely on to show them the best flights and fares. Every airline, investors and non-investors alike, will be treated the same. Unlike Travelocity or some other sites, an airline would not pay to obtain "preferred" status on Orbitz. My written testimony to the Committee included numerous examples of instances in which an airline had offered an attractive promotion to consumers, only to discover subsequently that Travelocity failed to show that promotion to its users. This is a disservice both to airlines and consumers.

Unbiased and comprehensive displays are an inherent part of Orbitz' agreement with the airlines. If other online agencies want to match that benefit for consumers and airlines alike, I welcome the competition. But again, other online agencies should not be able to automatically get the e-fare access Orbitz gets from the airlines without providing the same benefits to the airlines, and to consumers, as Orbitz does. Any regulation implementing the Inspector General's proposal should require more than mere compliance with Part 255's display requirements. Instead, it should require that searches on that site be genuinely unbiased, that the site comprehensively searches not just selected but all available information about flights and fares, and that its displays be as unbiased and comprehensive as those of Orbitz. And any continuation by the online agency of override commissions or other incentives to "swing market share" should be presumed to be evidence of continuing bias—if a site is being paid to "swing market share," it is hard to see how it can do so and be strictly unbiased, as is Orbitz.

Third, Orbitz' deal with the airlines includes another important benefit for the airlines (and for competition): the ownership of their own booking data. This has been a particularly troubling issue for low-fare airlines. Part 255 promises all airlines equal access to the data compiled by CRSs from the sale of tickets. But the rule has not worked in practice; for example, CRSs can price the data beyond the easy reach of a new-entrant carrier. Orbitz solves this problem. By contract, applicable to every participating airline, Orbitz provides that the data generated by the sale of a ticket through its system will be the sole property of the airline on which that booking was made. Every airline, whether an investor in Orbitz or not, has in the case of Orbitz ultimate control over its own data.

This is also an inherent and indivisible part of the benefits Orbitz provides to every participating airline. Any regulation implementing the Inspector General's proposal should require other online agencies to also give participating airlines ownership of the data compiled from the sale of their tickets.

Finally, if the goal of any proposed regulation is somehow to "level the playing field" and provide equal access for all participants to resources they might need to compete effectively, the regulation should not focus just on the one resource seized upon by Orbitz' adversaries (i.e. webfares), but also on other key resources (such as access to the major Internet properties) that can provide a critical advantage to an Internet-based business. Sabre/Travelocity contends that it needs access to webfares in order to compete, and that airlines should be compelled to give them to it, apparently even if it is unwilling to match what Orbitz offers in return for access to those fares. At the same time, Sabre/Travelocity and Microsoft/Expedia, the two dominant online agents, have secured exclusive access to the six most-visited Internet properties, including AOL and Yahoo—exclusive relationships Sabre/Travelocity describes as critical to success in online travel sales (see attached chart). These exclusives are extraordinarily powerful barriers to new competitors. For example, over three-quarters of all Internet users use portals with which Travelocity has locked up an exclusive arrangement. Yet Sabre/Travelocity apparently wants to continue to deny Orbitz, or other potential new entrants, a chance to obtain access to those key Internet properties, even if Orbitz (or another potential new entrant) were willing to meet or beat the terms Sabre/Travelocity has paid to obtain such exclusivity. Why should the proposed regulation dictate that the dominant, established players get access to one resource, but continue to allow them to retain contractually exclusive access to another? No regulation should sanction such an inequity, particularly when it favors the established players and penalizes the prospective new entrants trying to break into the market.

In sum, if government were to impose Mr. Mead's concept by regulation, that regulation must require that other online agencies not just appear to offer but actually offer consumers and airlines the same benefits as does Orbitz, and that established incumbents not retain contractually exclusive access to Internet resources that others may need to compete. The Inspector General's proposal is, at its heart, a right to match. A regulation implementing that proposal should ensure that established players like Sabre and Travelocity cannot get the benefits of matching without truly matching and therefore reforming their practices and meeting every pro-consumer and pro-competition obligation in the Orbitz arrangement. It should also ensure that new entrants get an opportunity to gain access to the necessary resources that the dominant incumbents have already locked up. And of course, any regulatory requirement must apply to *all* online agencies, regardless of whether or not they are owned in whole or in part by an airline.

This is not simply a matter of fairness. Orbitz, and the new technology we will bring to the distribution of air travel, are the last best hope to correct many of the competitive problems that have plagued consumers, agents, and airlines in the CRS arena for two decades. Orbitz has the intent, and the ability; to bring new competition with respect to automation costs, display bias, unequal access to data, and other issues that continue to plague the CRS arena, despite the well-intentioned efforts of the DOT through Part 255. But if the systems that already control 70% of the online agency displays and sales need not offer all of the same pro-consumer and pro-competition features of Orbitz to get the same access to e-fares as Orbitz, then they will never upgrade their systems to compete with Orbitz, and nothing will change; Sabre and Microsoft will consolidate their dominance of online travel and the anti-consumer and anti-competitive practices that characterize the CRS arena will continue unimpeded. We do not believe that is what the Inspector General intends or has proposed.

Finally, the Inspector General's proposal would require the government to for the first time enact rules that specifically regulate the content of the Internet. This is an issue with societal implications far beyond air transportation. There is widespread concern that once the government starts regulating Internet content, even for a worthy purpose, it will be that much harder to keep that regulation from rapidly spreading to many other aspects of the Internet. If, as we believe, the Inspector General's proposal would merely duplicate what would happen in the marketplace without regulation, then this may not be an appropriate place to cross the Rubicon of regulating Internet content.

In general, we believe that the Inspector General's concept will be realized without regulation, in that airlines will accept offers from other online agencies which offer approximately the same value as Orbitz does. Attempting to impose the concept by regulation, however, would be a complex task if done effectively, and would be a sham otherwise.

A closely related concept, which I should also address, is the question of whether government, by regulation, should require Orbitz, and possibly other online agencies, to adhere to Orbitz' commitment to unbiased displays, or at least to Part 255-compliant displays. This, of course, raises the same issues of Internet content regulation that I have just discussed. But setting those issues aside for a moment, my point is simply that Orbitz will be truly unbiased, while the other major online agencies not only are biased, but also sell that bias to airlines. It would make no sense to regulate the displays of the only truly unbiased system, and not the displays of those that clearly are biased. Our position is that, while we do not believe regulation of display bias on the Internet is necessary (we believe the competitive pressure that Orbitz will bring to the market will force the other online sites to limit the degree of bias they build into their systems), we believe that any regulation of online agency displays should apply equally to all online agencies. We would also suggest that under any such regulation, any online agency that accepts payment from individual airlines, in the form of override commissions or otherwise, for the purpose of "swinging market share," should not be considered to be unbiased.

You also asked whether low-fare airlines were precluded—or are precluded—from investing in Orbitz.

Let me be as clear as I can be as to how Orbitz envisions its relationship with low-fare airlines. We actively seek the participation of low-fare airlines in Orbitz. Our entire business strategy is based on the idea that we will hold out to the consumer that we are the best site to visit because we will offer all publicly available flight and fare options, of all airlines, and will offer them in an unbiased and readily useable and understandable way. If we cannot do that, there will be no reason for us to exist, and certainly no reason for the consumer to ever bother to visit our site.

That is why we are committed to offering unbiased and comprehensive displays to every airline, offsets to CRS booking fees on the same basis to every airline, ownership of marketing and booking fee data to every airline, non-exclusivity to every airline, and so on.

Moreover, any airline can have all these benefits without having to invest in Orbitz. For many airlines, especially many of the low-fare airlines, the greatest barrier to their participation in Orbitz would be if they had to invest in order to get those benefits.

We are pleased that a number of low-fare airlines have already signed up as associate airlines. And it is important to note that all airlines, whether low-fare or not, whether associates or not, will be displayed in Orbitz exactly as if they were investors.

If an airline wishes to invest as well as participate in Orbitz, I welcome their interest. In fact, I am actively looking for additional investors. In part in response to the concerns some have raised about airline investment in Orbitz, I am at this time focusing my efforts on attracting non-airline investors, so that, as Orbitz has always planned, airlines will soon own less than 50% of Orbitz. However, I am more than willing to talk with any potential investor willing to invest in Orbitz at its current equity valuation. My mission, in fact, is to make Orbitz truly open to all interested investors, by making it a publicly traded company.

One final complexity that I must call to your attention. Attracting non-airline investors is key to dealing with concerns about airline investment in Orbitz. I can assure you that launching an enterprise such as Orbitz is an expensive proposition, and has only been made more expensive by the tactics some of our competitors have engaged in to try to prevent us from entering the market. Indeed, their threatening statements about Orbitz have been designed to handicap Orbitz' efforts to attract additional investors, and to ensure that we will not be able to assuage any lingering concerns about our airline ownership, much less bring Orbitz online. The government should not help the established players bar Orbitz from the playing field, either directly or indirectly, before it has even had a chance to bring competition to CRS booking fees, to bring unbiased displays to consumers, and so on. It should be consumers, not the existing competitors, who decide which Internet sites best meet the needs of consumers.

Thank you again, Mr. Chairman, for the opportunity, both in the hearing and now, to respond to the issues regarding the Internet. In general I would say that serious competition issues have existed in the CRS industry and continue to exist today. The Internet has the ability to provide new competition that could improve the practices of the CRS industry and of existing CRS-based online agencies, with respect to booking fees, display bias, booking data access, and perhaps even agent contracts. It is imperative that government not take any action that would, however inadvertently, prevent the Internet from playing this important pro-competitive and pro-consumer rule. Otherwise, government would find that it had simply helped perpetuate and entrench the CRS problems it has long been concerned about.

In this regard, it is particularly important to recognize that Orbitz has not even come to market yet. What we are dealing with is wild speculations about what might happen in the future, not acts that have occurred. It would seem highly prejudicial to remedy problems that have not occurred, and are quite unlikely to ever occur. (This is particularly true when the established players who fret that they *might* not get access to all fares in the future, today hold by contractual right exclusive access to key Internet properties.) Even in the CRS arena, where the problems were well known and thoroughly analyzed by government, the resulting regulations often proved ill suited to solving the problems. To regulate before the problems are even known is far less likely to produce regulations which are effective and which avoid unintended and negative consequences. At this point, if government were to regulate, it would be chasing ghosts, often ghosts conjured up only in the fevered imaginations of competitors—parties whose interests should not be assumed to be the same as those of consumers. I would urge that we allow reality to catch up with this debate. Let's identify an actual disease before we start injecting the patient with drugs. There will be time enough to observe whether any of these dire predictions have any basis in reality, and to correct actual problems in the unlikely event they occur.

Orbitz will benefit low-fare airlines with respect to the CRS problems which have burdened them disproportionately; will be an important and long-needed new competitive discipline to CRSs (and CRS-based websites); is strictly non-exclusive, allowing airlines to conclude similar arrangements with any other online agencies willing to do so; will offer the most comprehensive and unbiased displays available to consumers and (we hope) by that competition push other sites to offer more comprehensive, less biased information to consumers than they do today; and we are taking Orbitz in the direction of more open investment by more kinds of investors. The proof is not in what anybody says, but in what we do. And once we are up and running, you will find that what we do is pro-consumer and pro-competition. We will demonstrate the basic economic principle that better information to consumers makes for better competition.

Thank you again for the opportunities you have afforded us to present our views. If you have any further questions or concerns, I would be more than happy to discuss them with you, including meeting with you. I believe Orbitz represents an important new option for consumers, and I do not see how denying consumers that option can benefit the public interest.

Yours truly,

JEFFREY G. KATZ,
*Chairman, President and CEO.*

Attachment

On-Line Travel Agencies' Affiliations With Top 10 Internet Sites [i]

(Ranking Based on Neilson/Net Ratings' Estimation of the Number of Unique Visitors in July 2000)

| Property | Unique Home Visitors [ii] | Reach (% of Internet home users) | Unique Work Visitors [iii] | Reach (% of Internet work users) | Affiliation with Travel Site | Exclusive |
|---|---|---|---|---|---|---|
| 1. AOL Websites [iv] | 53,051,036 | 60.15 | 21,031,727 | 66.19 | **Travelocity** | Yes; 5 years; Travelocity (TVLY) will pay $200 mill to AOL; AOL will pay TVLY a % of ad revenues [v] |
| 2. Yahoo! [vi] | 47,566,989 | 53.94 | 21,002,396 | 66.1 | **Travelocity** | Yes; TVLY will pay at least $28 mill over 3 years; expires end of 2002.[vii] |
| 3. MSN and<br>4. Microsoft [viii] | 35,158,084 and 32,750,239 | 39.87 and 37.14 | 17,456,689 and 17,964,294 | 54.94 and 56.54 | **Expedia** | Yes; 5 yr. carriage and cross promo agreement; Expedia will pay Microsoft $2.0 mill in 2000 and $2.2 mill in 2001, plus incentive fees [ix] |
| 5. Lycos Network | 24,174,846 | 27.14 | 12,019,437 | 37.83 | **Travelocity** | Yes; 2 year agreement expires 9/15/00 [x] |
| 6. Excite@Home | 21,568,038 | 24.46 | 10,947,874 | 34.46 | **Travelocity** | Yes; TVLY must pay a minimum of $11 mill; expires 2002 [xi] |
| 7. GO Network | 18,308,910 | 20.76 | 9,614,102 | 30.26 | **Travelocity** | preferred provider on the Go Network Travel Center; one year term; TVLY will pay Go Network a % of net revenues derived from GO Network users and the co-branded sites; TVLY must purchase certain level of advertising [xii] |

| | | | | | | |
|---|---|---|---|---|---|---|
| 8. About.com | 14,333,886 | 16.25 | 7,538,170 | 23.73 | **Travelocity** advertising banner appears throughout the Air Travel section of About.com site.[xiii] | Appears to accept ads from other travel sites, but with less favorable placement. |
| 9. Time Warner Sites | 14,163,776 | 16.06 | 7,958,742 | 25.05 | CNN properties, which are owned by TW, link to **leisureplanet** exclusively;[xiv] other TW sites' deals (if any) are unclear | Exclusive with almost all CNN Properties, including CNN.com, CNNfn.com, CNNSI.com, CNNtraveler.com; 3 year agreement signed 12/99[xv] |
| 10. AltaVista | 13,242,720 | 15.02 | 8,031,204 | 25.28 | **Trip.com** | Yes; $15 mill for 5-year contract signed 4/07/98.[xvi] |

[i]In addition to the above-listed alliances, TVLY also has alliances with, among others, the following Internet sites:

[a]Priceline.com (exclusive marketing and customer referral agreement). According to TVLY's press release, "Priceline.com, Travelocity.com Marketing Alliance Launches," 4/10/00, "the two companies will share the largest user base in the Internet travel industry, estimated at more than 22 million." See also Jones,Terrell, PhoCusWright Investor Conference, 4/27/00, "Key Partnerships" slide 8 at *http://media.corporate-ir.net/media__files/NSD/TVLY/presentations/tvly__000427-01/sld008.htm*. According to Media Metrix's estimation, Priceline was the 45th most visited Internet Property, based on the number of unique work and home Internet users for June 2000. (Media Metrix Press Release, "Media Metrix Releases U.S. Top 50 Web and Digital Media Properties For June 2000 & Reveals Number One Web Sites Within New Categories," 7/20/00, available at *http://www.mediametrix.com/press/releases/20000720a.jsp).*

[b]Road Runner (3-year alliance which expires 12/20/02). Road Runner will provide TVLY with premier positioning and promotion in its travel-related areas. TVLY will pay Road Runner a fixed amount for each person who visits TVLY directly from the Road Runner service and another fixed amount for each person, directed from Road Runner, who purchases a ticket; expires 12/20/02; renewable upon mutual agreement. (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99).

[c]iwon.com. (See Jones, Terrell, PhoCusWright Investor Conference, 4/27/00, "Key Partnerships" slide 8 at *http://media.corporate-ir.net/media__files/NSD/TVLY/presentations/tvly__000427-01/sld008.htm).* According to Media Metrix' estimation, iwon.com was the 21st most visited Internet Property, based on the number of unique work and home Internet users for June 2000. (Media Metrix Press Release, "Media Metrix Releases U.S. Top 50 Web and Digital Media Properties For June 2000 & Reveals Number One Web Sites Within New Categories," 7/20/00, available at *http://www.mediametrix.com/press/releases/20000720a.jsp).*

[ii]See Neilsen/Net Ratings. "Unique Home Visitors" refers to the number of individual users estimated to have visited the specified site, through home access to the Internet, in July 2000. The estimates are based on a sample of households that have access to the Internet and use Windows 95/98/NT or MacOS 8 or higher.

[iii]See Neilsen/Net Ratings. This refers to the number of individual users estimated to have visited the specified site, through work access to the Internet, in July 2000. The estimates are based on a sample of at-work users that have access to the Internet. Individuals that visited a site through an Internet connection at work may also have visited a site through a home connection and would be considered a separate visitor for home use estimation purposes.

[iv]The AOL Websites include AOL's proprietary network, AOL.com, the CompuServe Service, Netscape Netcenter, and Digital City. (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99).

[v]Under the agreement, TVLY is the exclusive travel booking system for AOL for the five years ending 3/31/05, on the United States versions of AOL, AOL.com, the CompuServe Service, Netscape Netcenter, Digital City and, for a one-year term, AOL Plus. (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99). In addition, AOL is obligated to place promotions throughout the AOL properties that will permit AOL users to link to TVLY–AOL co-branded sites. *Id.*

[vi]Yahoo! is a minority investor in TVLY. (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99).

[vii]See Travelocity SEC Form 424B3 filed 02/08/00 (Proxy Statement/Prospectus filed in connection with TVLY's merger with Preview Travel). TVLY is the exclusive provider of air, hotel and rental car booking services for Yahoo! (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99). See also Travelocity Press Release, "Yahoo and the Sabre Group Team Up to Bring Users Travel Booking Services," 11/10/97, available at *http://svc.travelocity.com/pressroom/pressrelease/0,1090,14|TRAVELOCITY,00.html.*

[viii]Microsoft Corp. is an 85% owner of Expedia, Inc. (See *www.hoovers.com,* Expedia, Inc. Company capsule).

[ix]See Expedia Prospectus, 11/9/99, at 44 and 59. Under the terms of the partnership, Microsoft will supply Expedia with premium placement on the MSN.com website, the Hotmail email service and the WebTV platform. According to Expedia's Prospectus, Hotmail is one of the largest e-mail systems in the world, and WebTV is one of the largest providers of television-based Internet access. According to Media Metrix's June 2000 data, Hotmail was the leading E-mail service website with more than 20 million unique visitors. (Media Metrix Press Release, "Media Metrix Releases U.S. Top 50 Web and Digital Media Properties For June 2000 & Reveals Number One Web Sites Within New Categories," 7/20/00, available at *http://www.mediametrix.com/press/releases/20000720a.jsp*). In addition, MSNBC.com and Expedia jointly produce the travel section on MSNBC.com's site. (See Travel Section, MSNBC.com at *http://www.msnbc.com/news/trav-main__front.asp, which has a direct link to Expedia.com*).

[x]See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99. Under the agreement, TVLY and Lycos have a co-branded site that is promoted throughout the Lycos Web site. Lycos will display a minimum number of Internet links to TVLY and the co-branded site. TVLY is obligated to make payments to Lycos, as well as pay a portion of commissions TVLY earns through the co-branded site in excess of specified thresholds, and pay Lycos "fees for providing links to [TVLY's] services above specified thresholds." *Id.*

[xi]See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99. Excite@Home is a global media company focused on combining leading brand and media with distribution. The company is the result of a merger between Excite, Inc. and @Home Network in 1999. (See "Excite@Home Fact Sheet available at *http://corp.excite.com/about/facts.html*). Prior to the merger, TVLY had separate agreements with Excite Inc., a leading Internet search engine provider, and @Home Network. TVLY is the exclusive provider of travel booking services for Excite's Travel Channel (City.Net) in the United States and for the WebCrawler Travel Channel. The agreement with Excite expires in 2002. (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99). TVLY is the exclusive travel booking service provider for @Home Network subscribers. @Home is a leading provider of high-speed Internet services via the cable infrastructure. Under the *TVLY-@Home* agreement, @Home agreed not to create a channel that provides travel information for any of TVLY's direct competitors or to allow any competitor to place any promotional material on @Home Network Web pages on which TVLY is featured. In addition, TVLY committed to pay @Home the greater of a set fixed quarterly rate or a variable rate equal to a portion of TVLY's revenues from advertising on @Home and from the sale of services to @Home subscribers. This agreement expires in 2001. (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99; see also Travelocity Form 424B3 filed 02/08/00, and Travelocity Press Release, "@Home Network Taps the SABRE Group to Deliver a One-Stop Shop for Travel Services," 4/21/98, available at *http://svc.travelocity.com/pressroom/pressrelease/0,1090,39|TRAVELOCITY,00.html*).

[xii]See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99. Go Network (Infoseek) will not sell banner advertising space on the Go Network Travel Center to 3 previously identified competitors of TVLY. The agreement provides that, after March 2000, either party can terminate the agreement upon 90 days notice. In addition, the parties may mutually agree to extend the deal for one year terms. *Id.*

[xiii]The "front page" of this section is available at *http://airtravel.about.com/travel/airtravel/mbody.htm*.

[xiv]See, e.g., "CNN, Leisureplanet Travel in Circles," *The Standard*, 12/21/99, available at *http://www.thestandard.com/article/display/0,1151,8406,00.html*. CNN made a $20 million equity investment in leisureplanet.com and Leisureplanet.com committed to purchase $30 million in advertising on CNN properties. (See Leisure Planet Press Release, "CNN Newsgroup to take $20 Million Equity Stake in Leisureplanet as part of Strategic Agreement," 12/20/99, available at *http://leisureplanet.com*).

[xv]See Leisure Planet Press Release, "CNN Newsgroup to take $20 Million Equity Stake in Leisureplanet as part of Strategic Agreement," 12/20/99, available at *http://leisureplanet.com*.

[xvi]See Trip.com press release, "TheTrip.com and AltaVista Search Site Sign Exclusive $15 million five-year deal for Internet travel service," 4/7/98, available at *http://www.trip.com/information/pressroom/article/1,1298,1-1-7,00.html*. Galileo is Trip.com's parent company. (See "Partners of TRIP.com" available at *http://www.trip.com/information/partners/resources/*).

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PREPARED STATEMENT OF SOUTHWEST AIRLINES CO.

Southwest Airlines is pleased to submit this statement to the Senate Commerce, Science & Transportation Committee in response to its hearing on "Internet Sales of Airline Tickets."

**Overall, Internet Sales of Airline Tickets Have Been Enormously Beneficial to Travelers, but the Potential for Abuse Exists from Collective Ventures like Orbitz.**

The subject of this hearing is critically important for the cost, convenience, and accessibility of air travel by the public. As it has in many industries, the Internet is transforming the sale of air transportation to empower individuals to deal directly with suppliers so that they may choose for themselves among the travel options that are available. Just a few years ago, only the most technologically savvy consumers "surfed the net," and even fewer used the Internet for the purchase of goods and services. Today, most households either own personal computers or have access to them, and individuals are making an increasing number of financial transactions over the Internet with confidence. Air travel is no exception to this trend, as airlines and other travel providers have developed numerous websites—such as Southwest Airlines' site at *www.southwest.com*—that allow individuals to book seats directly with airlines over the Internet.

In fact, research by independent organizations has shown that the correlation between use of the Internet and travel is especially strong. In a 1999 report, the Travel Industry Association (TIA) found that the number of online travelers has grown 190 percent in the last three years to 85 million people.[1] TIA also found that online travel is already the largest Internet commerce category and predicted that online travel sales will approach $30 billion by 2003.

These trends have profound implications for the traveling public. As demonstrated by the popularity of Southwest's own website, the emergence of online booking options by individual airlines as well as independent (non-airline owned) websites has brought consumers new, low-cost means of making travel arrangements. These online options have also intensified competition among airlines by opening new ways for rival carriers to attract customers with low fares and additional services.

But, just as the Internet has been a positive force for change in the sale of airline tickets, it has also opened the door to potential abuse, by creating new ways for airlines to collaborate in ventures that would stifle competition and harm consumers. This "dark side" of Internet ticket sales is illustrated currently by Orbitz (formerly T–2), a joint venture of the largest airlines to consolidate their Internet sales into a single mega-website which they will jointly own and control. Unlike individual airline websites and independent online sites, this collective venture has the dangerous potential to strengthen major airlines' dominance and control over the information that is provided to consumers, reduce independent decision making by participating airlines, and to facilitate coordinated actions against non-participating low-fare carriers such as Southwest.

The ability to sell airline tickets on the Internet thus produces both enormous public benefits—as illustrated by individual airline sites and independent on-line options that promote competition, and the risk of serious public harm—as illustrated by collective Internet sales ventures that will reduce competition. The appropriate governmental authorities must recognize this fundamental difference between unilateral and collective action, and craft public policy accordingly. While Internet sales by individual airlines should be encouraged, the government should not allow collective ventures like Orbitz to control the flow of information to consumers or otherwise suppress competition among airlines.

**Individual Airline Web Sites—Like www.southwest.com—Are Procompetitive and Beneficial to Consumers.**

Southwest's entry into the world of e-commerce began in 1996 as something of an experiment, with a homemade web page produced at the initiative of a few company employees. From this modest beginning, Southwest's Internet site has grown in the last few years to become not only the largest individual airline website but one of the top e-commerce sites among all industries, in terms of revenue generated. In February of this year, Southwest announced that approximately 25 percent of the company's revenues are being generated through its website, a pace that will produce more than $1 billion in e-commerce revenues for the year 2000.

By accessing *www.southwest.com*, consumers may view the full range of Southwest's flight schedules and fares that are available to any of the 57 destina-

[1] *Travelers' Use of the Internet*, Travel Industry Association of America, 1999.

tions that Southwest serves in the U.S. By simply entering basic information about desired travel dates and destination, the consumer receives all flight and fare options that are available, and may purchase seats with a few clicks on the computer.

The enormous popularity of Southwest's website, as well as the growing usage of other individual airline sites, demonstrates how much the public has come to enjoy the convenience, efficiency, and freedom of choice that the Internet can offer. Additionally, the low cost of Internet bookings benefits all passengers. For Southwest, the transaction cost of selling tickets via the Internet is approximately $1 per booking, compared to about $5 per booking through the company's own reservation agents, and $10 per booking through travel agents. The lower cost of Internet sales is a significant public benefit, because Southwest passes these savings on to consumers in the form of low fares. Considering that ticket distribution costs are Southwest's third largest expense category (after salaries and fuel), the savings from Internet bookings make a significant contribution to keeping the company's bottom-line costs—and thus its fares—low.

Individual airline sites like Southwest's, as well as the many independent non-airline-owned online booking sites, have also enhanced competition among airlines by providing a new arena for competing carriers to display their fares and services, to make special offers, and otherwise to attract passengers from their rivals. All of this independent and unilateral activity generates significant benefits to consumers—in greater personal convenience, lower travel costs, and increased airline competition.

**Unlike Single-Airline Web Sites, Collective Ventures Like Orbitz Have the Potential to Control the Flow of Information to Consumers and Reduce Airline Competition.**

The Committee's interest in holding the present hearing is understandably driven by concern over Orbitz, a prospective Internet venture owned jointly by five major U.S. airlines and joined by approximately 30 other airlines as non-equity "associates." Orbitz claims that it will offer exclusive access to the lowest fares available by U.S. airlines. Southwest is neither an owner nor a participating airline in Orbitz,[2] as Southwest prefers to make its fares available to the public unilaterally rather than in combination with its competitors.

Until recently, there has been no governmental scrutiny of Orbitz, despite the fact that this cooperative venture is owned by airlines that together represent over 80% of the U.S. air travel market (over 90% if the United-USAirways merger is consummated). Several weeks ago, the Department of Justice announced that it was investigating Orbitz for possible antitrust implications. The Department of Transportation recently stated that it has also begun to investigate Orbitz.

Among the concerns that have been raised by numerous parties regarding Orbitz are the following:

- Whether Orbitz will lead to collusion by participating airlines on prices charged to the public. This concern is especially relevant in light of the past actions by major airlines to coordinate their fares via electronic signaling.[3]
- Whether Orbitz will stifle competition among airlines by effectively replacing the competing websites of individual airlines with a single website that discourages independent decision-making.
- Whether Orbitz will mislead the public by presenting the illusion that it offers neutral and comprehensive fare information while in actuality offering selective and/or biased displays that favor the airlines that own and control the system.
- Whether Orbitz will facilitate coordination by the major airlines to use their combined resources to stifle competition from non-participating low-fare airlines like Southwest. This is especially relevant in light of mergers and other types of consolidation now being proposed in the airline industry.

Southwest shares these concerns, and we urge Congress, the DOJ and the DOT to investigate them fully. In doing so, the authorities should remember that *all of the airlines participating in Orbitz already offer their fares to the public over the Internet* via their individual websites, as well as through independent, non-airline owned sites that offer unbiased displays. Thus, all major airlines *already* have access to the efficiencies and cost-savings that Internet sales of tickets offer, via their

[2] According to press reports, Orbitz has claimed that it will "offer" Southwest's flights on its website. Southwest has not consented to the use of its proprietary information on the Orbitz site, and does not understand how Orbitz can make this claim.

[3] See *U.S. v. Airline Tariff Publishing Co., et al.*, 1994 WL 45430 (consent order settling DOJ complaint of price-fixing against several major airlines).

separate, individual, competitive sites. We question the justification for combining these independent websites into one cooperative venture owned and operated jointly by a group of airlines that are supposed to be competitors of one another.[4]

The basic problem with Orbitz is its very structure, whereby all major airlines other than Southwest would combine to establish a single distribution outlet for their Internet fares. Would the nation's major oil companies be allowed to combine operations to sell gasoline through a single dealership? Would the major U.S. automakers be permitted to collectively sell cars through a single distributorship? Of course not. And, for the same reasons, the major airlines should not be permitted to combine their Internet sales operations into a single venture under their joint control.

Moreover, Orbitz must be viewed in the larger perspective of today's airline industry, in which the Big Six airlines have launched an unprecedented drive for consolidation. United Airlines and USAirways have already proposed to merge, of course, and there are widespread reports that the other four are also seeking mergers, leaving three airlines to control over 90% of the nation's air travel market. At the same time, those airlines are not only proposing to combine their Internet ticket sales through Orbitz, but—according to recent press reports—are also preparing to launch another collective Internet venture (Hotwire.com) to jointly market unsold seats to consumers.

Viewed in this perspective, it appears that Orbitz is just one part of a larger effort by the major airlines to consolidate their operations, coordinate their decision-making, and to concentrate their resources to more easily deal with their few remaining airline competitors (primarily Southwest). Orbitz could play a critical role in this strategy by serving as a type of "control valve" over the information provided to consumers about available fares and services, and a facilitator among airline participants to coordinate their actions against competitors. Recent history has shown that the mega-carriers will not hesitate to combine forces to disadvantage low-fare competition. Internet technology spawns new opportunities to achieve that objective.

Special vigilance is needed to prevent these consequences. The stakes are huge: numerous studies have demonstrated that the only significant price competition in the airline industry today occurs in markets served by a low-fare airline. The DOT found, for example, that "at network hub cities where low-cost carriers do not compete, fare premiums are quite high and are increasing." [5] Further, Southwest Airlines has been widely recognized not only as the nation's principal low-fare airline, but the only nationwide source of price discipline in the industry today. As the Transportation Research Board recently concluded in a major study of airline competition,[6]

> "No other airline operates in the same way on the same scale as Southwest Airlines. This airline alone accounts for about 75% of the passenger traffic carried on low-fare airlines . . ."

It is therefore crucial that the Congress and agency decision makers take all necessary steps to prevent joint efforts that would threaten the growth of low-fare competition.

Because of both the severity and complexity of the dangers posed by Orbitz, Southwest does not believe that they may simply be "fixed" by subjecting Orbitz to DOT regulation in some fashion. Regulation inherently lags behind technological change, and has the additional risk of harmful "spillover" to innocuous or procompetitive entities such as single-airline websites. Consequently, Orbitz and other collective airline ventures that pose similar anticompetitive consequences should simply be prohibited.

Consumers are entitled to fare and schedule information that is unfiltered and unrestricted by a consortium of the major airlines. Consumers are also entitled to continue to receive the benefits of low-fare competition provided by Southwest and others, free from *collective* efforts to suppress it. Joint ventures of the major airlines

[4] Antitrust guidelines recently issued by the DOJ note that "marketing collaborations" that involve competitively sensitive assets such as an "extensive distribution network" can result in anticompetitive harm:

> Such agreements can create or increase market power or facilitate its exercise by limiting independent decision making; by combining . . . control over competitively significant assets or decisions about competitively significant variables that otherwise would be controlled independently; or by combining financial interests in ways that undermine incentives to compete independently.

*Antitrust Guidelines for Collaboration Among Competitors*, Federal Trade Commission and Department of Justice, April 2000 at p. 14.

[5] *The Low Cost Airline Service Revolution,* April 1996.

[6] *Entry and Competition in the U.S. Airline Industry,* Special Report 255 at p. 52 (1999).

like Orbitz should not be permitted to interfere with these worthy and proper expectations of the public.

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