UNITED STATES OF AMERICA
BEFORE THE
DEPARTMENT OF TRANSPORTATION

Notice of Proposed Rulemaking on Transparency of Airline Ancillary Fees and Other Consumer Protection Issues	)))	**Docket No. OST-2014-0056**

COMMENTS OF THE
AMERICAN ANTITRUST INSTITUTE

I. Introduction

The American Antitrust Institute ("AAI")[1] submits these comments in response to the U.S. Department of Transportation's Notice of Proposed Rulemaking (NPRM) in Docket No. OST-2014-0056 (issued May 23, 2014), *Notice of Proposed Rulemaking on Transparency of Airline Ancillary Fees and Other Consumer Protection Issues*.[2] The AAI's comments address the implications of the proposed rules governing the transparency of airline ancillary fees for competition in (1) the airline industry and (2) across the various distribution channels through which airline fares are sold. The AAI is an independent and non-profit education, research, and advocacy organization devoted to advancing the role of competition in the economy, protecting consumers, and sustaining

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[1] The AAI is managed by a Board of Directors, with the guidance of an Advisory Board that consists of over 130 prominent antitrust lawyers, law professors, economists, and business experts. The AAI's Board of Directors alone has approved this filing for the AAI. The individual views of members of the Board of Directors and the Advisory Board may differ from the AAI's positions. For more information about the AAI, please see http://www.antitrustinstitute.org.

[2] Transparency of Airline Ancillary Fees and Other Consumer Protection Issues, 79 Fed. Reg. 29,970 (proposed May 23, 2014) (to be codified at 14 CFR Parts 234, 244, 250, 255, 256, 257, 259, and 399) (herineafter "DOT NPRM"),

the vitality of the antitrust laws. The AAI has commented frequently on competition issues in the airline industry.[3]

II. The Importance of Transparency for Competition and Consumers

Pricing transparency lies at the intersection of competition and consumer protection law, which share a mutual goal of promoting practices that allow consumers to make the best possible selection from the choices available in the marketplace.[4] There are many practices that potentially impair pricing transparency. For example, sophisticated bundling and versioning techniques can make it difficult for the consumer to discern and compare prices of bundle components. When pricing information is displayed online, the sequence or timing of the display can be manipulated to impair the consumer's ability to effectively comparison shop, and the time incurred to search can be exploited to the consumer's disadvantage.[5] When prices are not transparent, bad deals often are "disguised" as good deals, and consumers may be deceived and misled into purchasing inferior or unwanted products, or products that do not suit their needs.

Federal antitrust enforcers have recognized the powerful role of pricing transparency in protecting consumers and competition. As the Federal Trade Commission has noted, for example, non-transparent pricing of ancillary fees can negatively affect competition by reducing the consumer's incentive or ability to switch suppliers during the

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[3] *See, e.g.*, Diana L. Moss & Randy M. Stutz, Comments of the American Antitrust Institute on Agreement Adopted by the Passenger Services Conference of the International Air Transport Association (DOT-OST-2013-0048-0029); Diana L. Moss, *Delivering the Benefits? Efficiencies and Airline Mergers* (Am. Antitrust Inst., white paper, Nov. 21, 2013), *available at* http://antitrustinstitute.org/sites/default/files/ AAI_USAir-AA_Efficiencies.pdf.
[4] *See* Neil W. Averitt & Robert H. Lande, *Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law*, 65 ANTITRUST L. J. 713 (1997).
[5] *See generally* Event Files, American Antitrust Institute, Invitational Symposium: Strategic Pricing and Challenges for Antitrust Enforcement (June 20, 2012), *available at* http://www.antitrustinstitute.org /events/strategic-pricing-and-challenges-antitrust-enforcement-invitational-symposium.

search process.[6] Pricing transparency can defeat these adverse effects. But if the market cannot deliver such transparency, then it is incumbent upon sector regulators such as the U.S. Department of Transportation (DOT or the Department) to prescribe a reasonable set of "rules of the road" to promote transparency.

The foregoing principles are directly applicable to the pricing of airline ancillary fees. Non-transparency can injure competition in a number of ways described in these comments, to the detriment of the flying public. The proposals outlined in the DOT NPRM to increase transparency in airline ancillary fees therefore can protect consumers not just from unfair and deceptive acts or practices, but also from unfair methods of competition. The AAI's comments address a number of areas where the NPRM's proposals to enhance pricing transparency will serve both of these interrelated goals. The NPRM's proposals are particularly important in light of the recent wave of consolidation in the domestic airline industry, resulting in high levels of concentration, and concerns over coordination on capacity, fares, and ancillary fees.

III. Airline Ancillary Fees Yield Enormous and Increasing Revenue Streams

Globally, airlines earned an estimated $42.6 billion in ancillary revenues in 2013.[7] That figure represents a staggering 89 percent increase from as recently as 2010.[8]

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[6] *See* Joseph Farrell, Director of the Bureau of Economics, Federal Trade Commission, Remarks at FTC Workshop on the Economics of "Drip Pricing": Consumer and Competitive Effects of Obscure Pricing (May 21, 2012); *see also* Howard A. Shelanski & Joseph Farrell et al., *Economics at the FTC: Drug and PBM Mergers and Drip Pricing*, 41 REV. INDUSTRIAL ORG. 303 (2012) (discussing workshop comments). For a discussion of deceptive pricing and other deceptive practices as a competition law concern, see Maurice E. Stucke, *When a Monopolist Deceives*, 76 Antitrust L.J. 823, 824-25 (2010); Mark R. Patterson, *Coercion, Deception, and Other Demand-Increasing Practices in Antitrust Law*, 66 Antitrust L.J. 1, 12-16 (1997).

[7] IdeaWorks Company, *Airline Ancillary Revenue Projected to Reach $42.6 Billion Worldwide in 2013*, Oct. 29, 2013, *available at* http://www.ideaworkscompany.com/wp-content/uploads/2013/10/Press-Release-84-Global-Estimate.pdf. IdeaWorks defines ancillary revenue as revenue "generated by additional

Projected ancillary revenue from optional services, such as in-flight sale of food and beverages, baggage fees, premium seat assignment fees, and early boarding fees, accounted for $23.7 billion of the global total.[9] In the United States, the so-called "Major Carriers," which include the surviving legacy airlines and Southwest, accounted for $14.3 billion of global ancillary revenue, including $5 billion from a la carte services.[10] Concurrent with this explosive growth in ancillary fee revenue over the last several years, the average base price of U.S. airfare has increased only minimally, in line with inflation, growing less than two percent in real terms.[11] Comparatively, "[w]hen taking into account all fees and ancillary revenues, airlines are seeing as much as a nine percent increase in average base airfare."[12]

An important implication of these trends is that the airline industry has learned how to unbundle and charge for its various ancillary activities without simultaneously reducing the price of its core offering -- air transportation fares. The ancillary fees that create enormous and increasing revenue streams for U.S. airlines often are shrouded from consumers who are unwilling to incur the considerable and costly inconvenience of tracking and adding up unbundled prices to meaningfully comparison shop an "all-in" (i.e., fare plus ancillary fees) price for air transportation. Once the search process is over

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activities that yield revenue for airlines beyond the core movement of customers from A to B," including hotel booking commissions, sale of frequent flier miles, and the provision of a la carte services. *Id*.

[8] *Id*.

[9] *Id*.

[10] *Id.*

[11] PriceWaterhouseCoopers, Recovering airline industry on track for profitability in 2013, according to PwC (June 24, 2013), *available at* http://www.pwc.com/us/en/press-releases/2013/recovering-airline-industry-on-track.jhtml.

[12] *Id.*

and the consumer sees the all-in fare at the point of purchase, the consumer may be unwilling to restart a costly search for a lower fare, and simply buy the ticket.

Airlines currently do not provide important information on ancillary fees to ticket agents and other intermediaries, nor do they make the information available to consumers on their own websites *alongside* the base fare when customers are actually purchasing tickets. Consequently, consumers often comparison shop according to advertised *base* fares, without knowing the true cost of the purchase until after ancillary products have been selected.

IV. The DOT Should Be Skeptical of the Airlines' Suggestion That Market Forces Are the Best Way to Ensure That Information on Ancillary Fees Reaches Consumers

The Department should be skeptical of the airlines' suggestion that "market forces and not government mandates are the best way to ensure that information about ancillary services and fees reaches consumers."[13] The degree to which competitive market forces govern the airline industry has fallen precipitously. For example, consolidation in the domestic airline industry has lessened competition on major routes and at the national level, creating stronger incentives for the airlines to tacitly coordinate on capacity and fares. Indeed, the Complaint filed by the U.S. Department of Justice (DOJ) in opposing the merger of US Airways and American Airlines identified more than 1,000 airport-pairs where the merger would eliminate a competitor and increase concentration to presumptively illegal levels.[14]

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[13] DOT NPRM, at 29,976.
[14] Amended Complaint at Appendix A, United States v. US Airways, No. 1:13-cv-01236 (D. D.C. Sept. 5, 2013).

In the same complaint, the DOJ recognized that “the structure of the airline industry is already conducive to coordinated behavior: Few large players dominate the industry; each transaction is small; and most [base fare] pricing is readily transparent.”[15] Moreover, “the legacy airlines closely watch the pricing moves of their competitors. When one airline ‘leads’ a price increase, other airlines frequently respond by following with price increases of their own. The initiating carrier will lead the price increase and then see if the other carriers will match the increase. If they do not, the initiating carrier will generally withdraw the increase shortly thereafter.”[16]

The DOJ also noted that concentration in the airline industry facilitates coordination in ancillary fees. It stated that “[i]ncreased consolidation has likely aided the implementation of these fees. Indeed, the levels of the ancillary fees charged by the legacy carriers have been largely set in lockstep. One airline acts as the ‘price leader,’ with others following soon after.”[17] When American began charging for the first checked bag in May 2008, for example, both United and US Airways followed within about three weeks. Similarly, in the spring of 2013, all of the then-four existing legacy carriers raised their respective ticket change fees from $150 to $200 within a span of two weeks.[18]

Airlines’ incentives to tacitly coordinate on ancillary fees – whether with respect to increasing the amount of a given fee or introducing a new fee – provide powerful incentives for the airlines to maintain a system of non-transparency. As the amount individual consumers pay in ancillary fees increases, and the percentage of the total price of air travel represented by ancillary fees increases, the stakes of pricing transparency

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[15] *Id*. at 15
[16] *Id*. at 15-16.
[17] *Id*. at 27.
[18] *Id*.

will only increase.[19] Considering the increase in average base fare that airlines have been able to achieve as a result of non-transparent ancillary fees,[20] and the fact that the practice already has been sustained for several years, including on the airlines' own websites, there is little reason for optimism that airlines will end non-transparent pricing practices voluntarily in the near term.

V. Non-Transparency in Ancillary Fees Can Harm Competition

We have seen how a lack of competition in the airline industry drives incentives for the carriers to maintain non-transparency in ancillary fees. But non-transparency can itself harm competition by acting to lock consumers into a purchase, enabling airlines to leverage their market power from the market for airfare products to the market for ancillary products and services. This lock-in is similar to the well-known concept that sellers with market power in "foremarkets" (e.g., durable equipment) can leverage that market power to "aftermarkets." (e.g., service and replacement parts).[21] For example, if a consumer using an online travel agent or an airline's own website purchases air transportation based on an upfront fare, the sunk "costs" of undertaking the search – coupled with the consumer's likely concern that if she delays, fares will only go up – can

[19] To be sure, the additional revenues from ancillary fees could theoretically lead airlines to reduce base fares, and consumer dissatisfaction from increased ancillary fees could lead to reduced demand. Still, if the gains from deceptive pricing practices outpace losses from reduced demand, the airlines can be expected to persist in the harmful strategy. *See* Farrell, *supra* note 6.

[20] *See supra* note 11 and accompanying text.

[21] *See, e.g.*, S. Borenstein, J. MacKie-Mason, & J. Netz, *Exercising Market Power in Proprietary Aftermarkets*, 9 J. ECON. & MGNT. STRAT. 157 (2000); Steven C. Salop, Kodak *as Post-Chicago Law and Economics*, Unpublished manuscript Dec. 13, 1992, presented at ALI-ABA "New Directions in Antitrust Law," Jan. 21-23, 1993; *see also* Gregory T. Gundlach & Albert A. Foer, *The Future of Aftermarkets in Systems Competition: An Overview of the American Antitrust Institute's Invitational Symposium*, 52(1) ANTITRUST BULL. 1 (Spring 2007) (discussing American Antitrust Institute Invitational Symposium: The Future of Aftermarkets in Systems Competition (June 20, 2006)).

induce the consumer not to switch, even after non-transparent ancillary fees are revealed to be unreasonably high.

The lock-in that occurs once a consumer incurs search costs associated with choosing a fare on the basis of an up-front price acts as a type of market power, which can then be used by the seller to increase prices for ancillary products and services. Airlines can thus leverage their substantial market power from the market for air transportation fares, to the market for ancillary products and services. The lack of transparency in ancillary fees during the consumer's search for airfares creates and exacerbates the lock-in problem. By affording consumers the ability to switch to rival suppliers who offer superior fares or terms and conditions, transparency can serve as a potent tool for promoting competition. In a competitive market, it is the threat of lost sales to a close competitor that keeps rivalry healthy and delivers the consumer benefits of lower prices, higher quality, and innovation. Obstacles to switching diminish the core mechanism of competition – consumer choice. The adverse competitive effects of lock-in caused by nontransparent pricing are particularly concerning when markets feature the tight oligopoly we see in the domestic airline industry today.

VI. Several Proposals in the NPRM Can Increase Transparency and Reduce Adverse Competitive Effects

The AAI commends the DOT for its proposals to increase transparency in airline ancillary fees. As a general matter, the NPRM proposals will work to reduce the adverse competitive effects associated with a lack of transparency, including existing coordination on ancillary fees and consumer lock-in. The AAI notes four specific areas in which the NPRM can work to promote competition.

A. The Proposal to Require Display of Ancillary Fee Information Will Reduce Lock-In

The AAI strongly supports the NPRM proposal to require all carriers and ticket agents to disclose the fees for basic ancillary services before the passenger purchases air transportation. Airlines and agents with web sites "must disclose, or at a minimum display by a link or rollover, the fees for these basic ancillary services on the first page on which a fare is displayed in response to a specific flight itinerary search request in a schedule/fare database."[22] The simultaneous display of ancillary fee information – alongside fare information – will significantly increase transparency, reducing the consumer lock-in effect created by the lengthy search process that proceeds through multiple online screens without revealing the total price until the point of purchase. Consumers' enhanced ability to comparison shop and switch suppliers will inject needed competitive discipline that is otherwise lacking.

B. Transparency Requirements Should be Applied Uniformly Across All Sales Channels

The AAI urges the Department to apply transparency requirements uniformly to all market participants and across all distribution channels that are part of the process for marketing airfares to the ultimate consumer. Asymmetric application of transparency requirements could create incentives for airlines to develop workarounds to continue to promote non-transparency. As a result, the AAI supports Proposal #1 in the NPRM, namely that carriers be required to disclose fee information for basic ancillary services to all ticket agents to which a carrier provides its fare information, including Global Distribution Systems (GDSs).

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[22] DOT NPRM, at 29, 978.

C. The DOT Should Minimize "Opt Outs" for Consumers on Fee Disclosure Information

The AAI encourages the Department to minimize the number of "opt outs" for consumers in the rules regarding transparency. For example, the NPRM proposes "to require all carriers and agents to disclose the fees for these basic ancillary services before the passenger purchases the air transportation."[23] The Department then asks for comment on whether it should "require the ancillary service fee information to be disclosed only upon the consumer's request, or require that the information be provided in the first screen that displays the results of a search performed by a consumer."[24]

There are many downsides to not disclosing ancillary fee information to all consumers. For example, additional and possibly costly functionality would be required in redesigned websites to accommodate a "yes" or "no" consumer response to whether to display ancillary fee information on the first search results screen. More to the point, consumers often initiate multiple searches, or change the parameters of their searches while in the process of searching. Those parameters would presumably include (after the Department's rulemaking goes into effect) ancillary fee information. Requiring the consumer to respond to a "yes" or "no" command multiple times would needlessly complicate the search process. It could actually defeat the transparency-increasing intent of the proposed DOT rules.

D. The Department's Decision on Transactability Will Have Important Consequences for Inter-Channel Distribution Competition

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[23] *Id.*
[24] *Id.*

Perhaps one of the biggest innovations in sales and marketing has been the advent of the Internet. Online retailing has revolutionized how consumers purchase goods and services. The expansion of multi-channel distribution has, in many cases, delivered benefits to consumers in terms of convenience, the ability to gather information, and ease of transactability. The marketing of airline fares and ancillary fees occurs through multiple channels, including traditional brick-and-mortar travel agents, online travel agents, and airlines' own websites. Meta-search engines such as Kayak and Google aid consumers in their search process by aggregating fare information and providing tools that consumers can use to gather information.[25]

Multichannel distribution of airline fares is an important feature of modern air transportation marketing. Competition within channels (intra-channel) and between channels (inter-channel) helps consumers meet their varied needs. Indeed, the NPRM notes that more than one half of air transportation is booked through the travel agent channel, a subset of which services large customers through managed travel.[26] This competition is particularly important under current market conditions where increased consolidation and concentration has led to higher fares, reduced service, and non-transparency in ancillary fees.[27]

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[25] *See generally* Event Files, American Antitrust Institute, Invitational Symposium: Antitrust Challenge of Multi-Channel Distribution in the Internet Age (June 22, 2011), *available at* http://www.antitrustinstitute .org/events/invitational-symposium-antitrust-challenge-multi-channel-distribution-internet-age; Gregory T. Gundlach, *Overview of Symposium on Antitrust Challenges of Multichannel Distribution and Shopper Marketing*, 58(1) ANTITRUST BULL. 1 (Spring 2013).

[26] DOT NPRM, at 29,974.

[27] *See, e.g.,* Michael D. Wittman & William S. Swelbar, Evolving Trends Of U.S. Domestic Airfares: The Impacts Of Competition, Consolidation, and Low-Cost Carriers 8, MIT International Center For Air Transportation (Report No. Icat-2013-07, Aug. 2013),. *available at* http://Dspace.Mit.Edu/Bitstream/Handle/1721.1/79878/Icat-2013-07.Pdf?Sequence=1; *see also* U.S. Department Of Transportation, Aviation Industry Performance, A Review of the Aviation Industry, 2008–2011 (DOT Report) App., Fig. 23, 30 (No. CC-2012-029, Sept. 24, 2012).

The NPRM seeks comment on whether the basic ancillary services that are disclosed to consumers should be transactable, or available for purchase through all channels that carriers decide should sell their fares.[28] Perhaps the strongest argument in favor of "transactability" is that the ability to purchase air transportation (e.g., fare *and* ancillary fees) only through some channels can skew competition between distribution channels. Maintaining a level playing field by requiring transactability across all channels is important for competition and the consumer. The AAI thus urges the DOT to require in its final rule that ancillary services also be transactable.

Respectfully submitted,

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[28] DOT NPRM, at 29, 979.