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The American
Antitrust Institute

March 16, 2003

Docket Management Facility
US Department of Transportation
Room PL-401
400 Seventh Street, SW
Washington, DC 20590-0001

Filed via http://dms.dot.gov

Dockets OST—97-2881, OST—97-3014, and OST—98-4775

Comments of
The American Antitrust Institute
Regarding
Computer Reservation System Regulations

The American Antitrust Institute is an independent non-profit education, research and advocacy organization that promotes vigorous competition on behalf of consumers through the laws and institutions of antitrust.[1]

I. The current proposal of the DOT does not provide for a level playing field.

We praise the extensiveness of the NPRM's review of the industry and its generally objective consideration of the advantages and disadvantages of regulating various aspects of the market. It appears to us that the NPRM is least satisfactory where it does not provide for a level playing field within the air transportation industry, particularly in its special treatment of Orbitz. Unjustifiable distinctions are made between vertically integrated and independent systems and between legacy and Internet systems. Moreover, both the largest network airlines and the largest travel agents are provided de facto advantages over smaller, low cost competitors. While we advocate depending more strongly on competition, we agree with the thrust of the NPRM that it remains necessary to have rules that deal as directly as possible with certain foreseeable problem areas. We focus our remarks on only a few of the issues raised in the NPRM.

[1] Information about the AAI is at www.antitrustinstitute.org. Our contributors include a wide variety of law firms, individuals, foundations, corporations, and trade associations. A list is available on request and our operating guidelines are on our website. We do not accept earmarked contributions from private parties. Among our contributors have been Sabre, Inc., and Southwest Airlines. These comments are not intended to (and probably do not) represent the positions of these or any other contributors.

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II. The Starting Point Is Free Market Competition, But That May Have To Be Tempered By Institutional Realities.

As advocates of competition in the interest of consumers, we favor the operation of effectively competitive markets as the starting point for public policy. We believe as a general matter that the movement to deregulate air transportation has brought substantial benefits to the American public. The type of marketplace that has evolved in the past quarter century, while far from perfect, generally reflects a dynamic mix between competition and regulation, based on pragmatic rather than ideological considerations. We believe that had antitrust principles been applied more aggressively with respect to mergers, other horizontal collaborations, and predatory practices at hubs, deregulation would have provided even greater benefits.

The air transportation system consists of a vertical chain of functional segments ranging from the manufacturing and assemblage of the components of airplanes through the operation of specific flights. The various segments interact with each other in complex ways and as with most industries, segments can relate to one another through a variety of structures that range from full vertical integration to full market segmentation. The quality of competition in the industry is generated both by horizontal competition within each segment and by the vertical relationships between the segments.

The distribution of inventory (seats on planes) to end-use consumers (travelers) is handled both internally by the various airlines and externally in the market. The choice of relying on vertical integration or market transactions often has important consequences not only for the efficiency of the system but for the competitive process and ultimately for consumers. In focusing on these choices and their implications, we recognize that the ticket distribution sub-system has changed over the past quarter century. Notably:

- The two largest CRS companies (Sabre and Galileo) have become formally independent of airline ownership.[2] (Independence does not mean that these companies do not have special marketing agreements with their former owners or a particularly heavy reliance on their former owners' business.)

- The Internet has made it feasible for electronic travel agents to develop as direct challengers to brick and mortar travel agents, offering consumers hitherto unavailable opportunities to shop the full market intelligently.

- The Internet has made it appealing for airlines to sell their seats directly to consumers with what may be reduced transaction costs.

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[2] A third, Worldspan, has announced that its airline owners (Delta, Northwest, and American) will sell it to a newly formed venture of non-airlines in mid-2004. See http://www.computerworld.com/industrytopics/travel/story/0,10801,79013,00.html. We caution that the announcement of an intended sale is not the same as a sale. The fourth CRS, Amadeus, is owned by three foreign airlines.

● Airlines have terminated the commissions they traditionally paid to travel agents, partially causing a reduction in the number of travel agents and leading to the charging of transaction fees by travel agents to their customers. (Commission override arrangements continue to be used, in effect, as bonuses for selling a targeted percentage of flights for a particular airline.)

● The airline industry (except for a small number of low cost carriers) established its own electronic travel agency, viz., Orbitz, which rapidly became one of the three largest electronic travel agencies and increasingly resembles a CRS.

Further setting the scene are additional changes in the larger air transportation system:

● The structure of the airline industry has changed in that the large national airlines created a hub-and-spoke network systems operating through hubs that are often dominated by a single airline; mergers have led to fewer network carriers; and codesharing alliances have further moderated the head-to-head competition among network carriers.

● The large airlines have developed unusually sophisticated and extensive practices of price discrimination, making complex the traveler's identification of the optimal product.

● A fringe of low-cost point-to-point carriers, often operating out of secondary airports and often relying on the Internet for ticket distribution, has increasingly challenged the national carriers by their low pricing, forcing the network carriers to reconsider their business model. Delta has announced the launching of a new airline, "Song," to compete head-to-head against the low-cost carriers.

● The dramatic reduction in demand and increase in security and fuel costs that have afflicted the travel industry since September 11, 2001, have led to bankruptcies of major airlines and questions about which airlines will remain in the market and with what economic strength. It is possible that concentration will further increase as the result of market exits in the near to intermediate term.

One question of importance is the extent to which these changes justify (or require) changes in the regulatory role of the DOT. We will address this question in the course of our discussion. Three general points will introduce our discussion.

● Air ticket sales over the Internet in 2001 were still in the 15% range. While expected to grow steadily (we are aware of estimates of 30% as soon as 2004), this market share is relatively low and any policy that depends on consumers making much heavier use of the Internet would seem premature. On the other hand, policy should explicitly recognize that the Internet is a dynamic factor that has already had a dramatic impact on the shopping expectations of computer-literate consumers, implying the need

for a flexible approach that accommodates changes made possible by the Internet as its role becomes increasingly important.

● Any policy based on the current structure of the industry must be tempered by recognition that (a) bankruptcies could lead to a reduction in the present level of competition and (b) the pending alliance of Delta/Continental/and Northwestern, if eventually allowed to occur, could further reduce significant elements of competition among the network carriers. At this particular point in time, we do not know whether this traditionally cyclical industry is at the bottom of a trough exacerbated by unique circumstances from which recovery will be likely; or whether something fundamental has changed, requiring a long-term downsizing of the industry.

● Finally, DOT is not writing on a blank sheet with respect to the CRS segment of the industry. Certain patterns of behavior occurred, were found harmful to consumers and to competition, and were dealt with through the regulatory process. These patterns were identified at a time when CRS companies were owned by the airlines. We will examine whether the patterns are likely to be repeated in the absence of airline ownership.

Our premise is that while a free market approach is the preferred mechanism for virtually all markets, institutional realities may require incorporating elements of regulation. Normally, competitors can be left to compete and if they engage in restrictive business practices, they can be controlled by ex post antitrust enforcement. However, if clear patterns of anticompetitive practices are reasonably foreseeable, it would be more efficient to deal with these administratively in a future-oriented way through rulemaking, rather than relying on a slow, expensive, and somewhat unpredictable antitrust remedy after the foreseeable abuses have already occurred. On the other hand, the antitrust remedy should be perfectly adequate for the garden variety of competitive abuses that occur from time to time in any market.

III. Who Has Market Power?

In thinking about the role of antitrust, the starting point is usually market structure, to determine whether any one competitor or small group of competitors holds such a large share of the market that it can distort the competitive process. The NPRM unfortunately does not go through this analysis with current and detailed data, and we do not have sufficient information to do more than roughly approximate the structure. Basically, there are three vertically-related levels that are of concern: the airlines, the CRS's, and the travel agencies.

As Ronald Coase taught, which functions are to be accomplished within a firm and which are to be purchased in the market is a strategic decision that depends largely on transaction costs. Vertical integration of airlines and the distribution of airline seats is not only feasible but is a common characteristic in the industry structure, as demonstrated by the facts that airlines sell their seats directly to the public, either by telephone or

electronically; that they have owned and still own some CRS's; and that they own Orbitz, which we have characterized as a travel agency that has the potential of becoming a CRS. In addition, some CRS's own electronic travel agencies. But vertical dis-integration is also feasible and a common characteristic, as demonstrated by the transition of CRS's from airline ownership to independence. Among the important transaction costs that help determine "market or hierarchy"[3] is the nature of relevant government regulation.

There are four CRS's, which would represent a high degree of concentration in a national geographic market, if CRS's constitute a relevant antitrust product market.[4] A key question is whether the evolution of the industry has either brought enough competition to the CRS's, or is likely to do so within a very short time, that a broader market definition is needed.

From a demand perspective, today's travel agency (the principal customer of a CRS) can obtain airline inventory information from a CRS, from an airline directly, and in some cases from Orbitz. While obtaining information and bookings directly from an airline has been made easier by the Internet, telephone access has always been available. Although we lack data on Orbitz' sales through travel agencies, our impression is that Orbitz must still be thought of as a potential CRS rather than as a current head-to-head rival. Given current regulations limiting the term of contracts, a travel agency has the ability to play off one CRS against another and can periodically switch from one CRS to another.

From the perspective of the actual travelers, i.e., consumers, it is often easy to work directly with an airline rather than use a travel agency, and the relatively new service fees charged by travel agents are likely to cause consumers to seek alternatives before committing themselves to travel agents. E.g., where the consumer does not already know which airline flies a particular route, it is often possible to identify routes and schedules through an electronic travel agency, at no charge, with the potential of booking the purchase directly from an airline by Internet or by phone, thereby avoiding the CRS and the travel agency. We have been told but cannot confirm that only 47% of domestic airline bookings is today accomplished through CRS's.

From a supply perspective, entry into the CRS market has not occurred in recent years. Orbitz appears to be the only potential competitor poised to enter, but it is not clear if or when this would occur.

With only four essentially similar competitors actually in the market, the potential for collusion or parallel behavior would have to be considered by antitrust enforcers. A merger between any two CRS's would no doubt receive intense scrutiny. However, the industry we have described does not contain any monopolists or near-monopolists and

[3] Oliver Williamson, Markets and Hierarchies (Free Press, 1975).

[4] Under the Federal Horizontal Merger Guidelines, the danger zone for concentration begins with five equal-sized companies. Where, as here, the companies are not equal-sized, the concentration is considered more dangerous.

there is no evidence of collusion. The NPRM contains a statement that prices of the CRS's are high (certainly they have been perceived by the airlines to be high) but the evidence is old and would not in any event be sufficient to conclude there is collusion.

The NPRM suggests that the CRS's have market power with respect both to the airlines and the travel agents. If this were true in the past, today's conditions would seem to justify a much weaker conclusion. Without reaching a conclusion on a single definition of product market, it appears to us that the airlines and the CRS's are each strong enough, in the absence of constraining regulations, and have sufficient options to be able to bargain effectively with each other. Both the airlines and the CRS's appear to have stronger bargaining power than the travel agencies, although certain agencies are growing relatively strong. We do not see that an argument of essential facility or of monopoly leveraging would be likely to succeed in this context. This does not, however, end the inquiry as to whether certain practices might be anticompetitive.

IV. A Thought Experiment: Total Deregulation and Vertical Divestiture

A. In the absence of regulation, would airline ownership of CRS's and Orbitz in itself still create problems with respect to screen bias, discrimination, and refusals to deal?

Let us begin by asking what the implications would be if deregulation of the CRS segment were to be total, but ownership of some CRS's and Orbitz were to remain in the hands of the major airlines. We focus on three kinds of problems that led to the current regulations: screen bias, discrimination, and refusals to deal.[5] In this part of the discussion, the issue is not whether these are serious problems requiring a regulatory response, but whether they would continue to occur in vertically integrated firms, if there were full deregulation.

First, would display bias be a problem? That is, in a market where some CRS's and Orbitz are still owned by airlines, would it be foreseeable that the owning airlines would command favorable positions on the screens of the CRS's they own? This probably depends in part on what the independent CRS's do. If the independent CRS's were to have neutral screens and that fact proved to be an effective marketing tool with travel agents, it might force the vertically integrated CRS's to follow suit. However, screen bias in fact occurred in the past and was seen as a major problem prior to regulation. Prior to regulation, neutrality did not develop as a marketing tool and there is no reason to believe that it would be an element strong enough to move market share in the future. Thus, it seems most probable that in the absence of regulation, screen biasing would occur among vertically integrated CRS's. We will elaborate later in this memo.

[5] Bear in mind that in the absence of regulation to the contrary, strategic decisions of a firm to vertically integrate or dis-integrate are frequently reversible.

Second, would airlines discriminate in favor of CRS's that they own, e.g. by providing them more information or other advantages? Again, this happened regularly and created a sufficient competitive problem that a rule was deemed necessary. There is no apparent reason why the problem would disappear simply because some CRS's are now independent.

Third, would airlines refuse to deal with CRS's other than their own, in the absence of regulation? Airlines argue that the CRS's have so much market power, that they are forced to deal with all of them. That is, an airline cannot afford to not have its flights represented in any one CRS, because travel agencies tend to contract with only one CRS and too much business might be lost if some travel agents could not sell the airline's inventory.

While this may have been the case in the past, it would seem that large airlines and CRS's bargain somewhat more equally today. In their recent arrangement with Orbitz, the airlines have for the most part chosen not to deal with the CRS's in regard to their lowest fares, which they have made available predominantly, if not quite exclusively, to Orbitz. This amounts to a refusal to deal with CRS's and travel agencies, with respect to a very important market-driving category of inventory. Moreover, a large airline has substantial bargaining power vis a vis a CRS, because while a CRS that could not provide travel agents with booking ability on a major national airline would be at a substantial competitive disadvantage, the airline, while it would suffer some loss of sales by not working with a particular CRS, would nevertheless be able to sell its seats through a variety of other outlets, including other CRS's (and the largest travel agencies usually contract with more than one CRS), on-line and call-up direct sales, and Orbitz.

Thus it would seem realistic to believe that in the absence of regulation an airline that owned a CRS might refuse to deal with one or more other CRS's, at least to the extent of withholding certain kinds of inventory and possible more completely.

To summarize, it seems fairly likely that the three problems of screen bias, discrimination, and refusals to deal that provided the justification for the CRS rules, would likely continue under a no-regulation regime, if vertical integration is permitted. **Our highest priority would be to eliminate all airline ownership of the inventory distribution facilities, other than in-house direct sales.**

B. In the absence of vertical integration, would there continue to be problems with screen bias, discrimination, and refusals to deal?

Now let's ask what would likely happen if vertical integration were not present. Vertical integration could be ended voluntarily, as with Sabre and Galileo and possibly next year with Worldspan.[6] Or it could be mandated by the DOT. Or possibly it could

[6] Last year Orbitz announced that it would sell some of its stock to outsiders, but this did not occur. In any event, the proposal would have left the airlines in management control.

occur as a result of a blend in which DOT adopts a policy that intentionally disadvantages vertically integrated systems.

The central problem, once one eliminates vertical integration by ownership, is that nearly the same degree of coordination can often be obtained through contractual arrangements.[7] So we now ask whether the same types of problems are likely to recur through contract.

Screen Bias. If we assume that none of the CRS's is owned by airlines and there are no regulations, there would still be an incentive for each airline to obtain favorable screen bias if it could, and it can be reasonably predicted that airlines would attempt to gain advantageous screen positioning through contractual arrangements. While the independent CRS's have no self-seeking incentive to bias their screens, they may find it in their interest to accept some forms of consideration in return for providing favoritism to an airline. The CRS may think, for example, that the airline can go to a rival CRS or directly to a travel agency with a similar proposition, so why forego the income? Thus if screen bias is a problem, it must be dealt with directly, and will not necessarily go away simply because airline ownership is ended.

We note that Orbitz, which in many ways is like a CRS that is also open to the public,[8] has bound itself contractually to provide screens that are neutral with respect to the airlines that furnish information. This is the result of the particularistic dynamic involved in creating a new travel agency, owned by the largest airlines, whose business model depended on gaining the participation of nearly all the airlines. Rather than suggesting that other CRS's would likely follow suit by maintaining neutral screens, it points to the importance that airlines place on not allowing other airlines to get a jump on them by biasing a screen. We are concerned that an unregulated competitive dynamic would result in a race toward screen bias.

Discrimination. Similarly, there may be ways by which an airline can gain advantages from a CRS through negotiation and contract rather than through command by airline owners. Thus, if discrimination is seen to be a problem, it, too, must be dealt with directly.

Refusal to deal. It may be considered that an airline's refusal to deal altogether with a CRS or to refuse to provide it with certain kinds of information such as lowest fares, is

[7] According to the NPRM, Sabre and Galileo have marketing agreements with their former airline owners (American and United), and also do a disproportionate amount of business with their former owners. Such marketing agreements have been alleged to result in the same sorts of advantages that direct ownership had, e.g. American can tell a travel agent to use Sabre if it wants corporate discounts on American. The NPRM recognizes these allegations but offers no solution, not wanting to interfere with contracts unless essential. We concur with this reluctance.

[8] Orbitz sells information directly to travelers and is believed to sell to travel agencies as well. It obtains information from a CRS (Worldspan) but also directly from its airline owners and affiliates. According to the NPRM, Orbitz "is planning to create direct connections between itself and many of its airline participants." 67 Fed. Reg. 69370. Thus Orbitz has potential for morphing into a CRS that would be owned by the airlines.

but an extreme form of discrimination. In any event, if it is deemed a problem, the problem is not caused by vertical integration, but rather by the discrepancy in bargaining power that may exist between an airline and a CRS. To reiterate, our premise is not that the CRS has so much market power that it can dictate to airlines, but that the airlines have sufficient leverage to bargain effectively with each CRS.

In summary, although these three patterns of problematic behavior became recognized as problems at a time in which airline ownership of CRS's was prevalent, the patterns are not likely to disappear simply if vertical integration is eliminated. Since we have already argued that the patterns are likely to reappear in a fully deregulated environment, the question is whether these patterns should continue to be recognized as so problematic that their regulation be by administrative regulation rather than by antitrust.

V. Administrative Regulation or Antitrust?

We understand that an argument exists over whether the DOT has the statutory authority to regulate independent CRS's. We assume here, without taking a position based on legal analysis, that the jurisdiction exists for DOT to impose regulations on any CRS or ticket agent. We would observe, however, that with respect to markets that include both airline-owned and independent competitors it does not make sense for the DOT to regulate only the airline-owned competitor. In order to facilitate a level playing field, it would be better to use the authority over the airlines to mandate divestiture, so that competitors will all operate in the same regulatory environment. [9]

A. Screen Bias: Will There Be an Information Market Failure?

We have a national (indeed, international) network of air routes, and the system will function most efficiently if every traveler has full information with respect to certain information about each route that is potentially capable of serving the traveler's needs.[10] The system is uncommonly complex, in large part because of the airlines' extreme

[9] It is reported that only 41% of U.S. total travel bookings are for air (estimated to decline to 37% in 2004). Tour packages, cars, hotels, and cruises account for the other bookings. PhoCusWright, Travel Market Analysis 2002-2004, Prepared for the National Commission to Ensure Consumer Information and Choice in the Airline Industry, 5 (July 25, 2002). These industries are clearly not subject to the DOT's regulation, yet the majority of their bookings go through travel agencies and CRS's. Query whether DOT's regulation of CRS's and travel agencies for their air business would also regulate their behavior for the other businesses. If this is so to any significant degree, it may be prudent public policy to cede the air-related activity to the FTC, whose jurisdiction over competition and consumer protection is the model for Section 411, so that all would play by the same standards. The Federal Trade Commission Act specifically excludes FTC jurisdiction over air carriers, but jurisdiction over independent computer systems is undisputed.

[10] Critical information includes times, dates, and prices of flights, availability of seats, and alternative routes.

employment of price discrimination. Most consumers either are not able or cannot take the time to master all the intricacies of the system. Airlines want to sell the highest price seat that the customer will purchase. Consumers, in turn, seek the assistance of independent navigators, specialists in the workings of the system who can assist the traveler find the optimal reservation.[11] To the extent that a traveler is deprived of the independent navigator (i.e., the brick and mortar travel agent or the consumer-driven electronic travel agent), the traveler will likely either over-pay or be under-served, in either event receiving less than the optimal value made available through the market.

Airlines seek favorable screen bias to increase the probability that their flight will be sold by the agent to the traveler. The traveler may of course be well-served, if there are no more optimal flights to be had; but more likely will be induced through screen bias to purchase a sub-optimal product. This may or may not create a large deadweight loss to society (depending on the extent to which travelers reduce their flying because of the extra expense), but it definitely represents a redistribution of wealth from the consumer to the airline and, to the extent that the travel agent is compensated through a commission override system, to the agent.

This situation may appear to be akin to what occurs in a retail store when a customer does not know that the store is willing, if pushed, to negotiate a price lower than indicated on the price tag, or when the hotel clerk fails to mention that lower rates are available. In effect, the consumer is penalized for not asking enough questions. Generally, this is not something that has justified government intervention unless there is also affirmative misrepresentation. In most commercial transactions, "puffing" and silence are permitted, and the standard is "Let the Buyer Beware."

With CRS's, additional factors come into play that point in a different direction. First, when airlines were still compensating agents on all ticket sales, there may arguably have been no fiduciary obligation to the consumer. Now, the consumer is explicitly paying the travel agent a fee for a service that is presented as objective, complete, and in the consumer's interest. This arguably gives rise to a fiduciary responsibility, as when an attorney or other profession is paid for objective advice.[12]

Second, while the individual travel agent may not be aware of ways in which the screen has been biased by the CRS, the airline certainly is aware and intends to influence some travelers to make purchases that are objectively sub-optimal compared with what would have occurred with full and unbiased information. This level of misrepresentation may warrant intervention.

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[11] See Philip Evans and Thomas S. Wurster, Blown to Bits (Harvard Business Press, 2000).

[12] Perhaps the fiduciary obligation would disappear if the travel agent gave explicit notice of biases and omissions, but this solution seems impractical. Our vision of travel agents as independent navigators is undermined by the practice of undisclosed commission overrides. As the NPRM suggests (67 F.R. 69404), such overrides might be reduced if there were reforms to reduce the amount of data that is released on bookings made by individual travel agencies. We agree that such reform is desirable for the purpose of reducing the ability of large airlines to pick off new entrants and low-cost carriers.

With CRS's, screen bias also creates a problem of inefficiency for the system. One problem is that the traveler is not likely to know whether the screen is biased. However, if the prevalence of screen bias were to become generally known, consumers would feel compelled to confer with multiple agents or to research fares for themselves on the Internet or to place calls to the various airlines. The latter is clearly inefficient—time-consuming and labor intensive-- from everyone's perspective. Recourse to the Internet has benefits, but the Internet only works for computer-literate consumers, and plays too small a role at this point in time to be seen as a sufficient solution. Moreover, the Internet tends to be less useful for planning travel that is relatively complicated. Thus, a systemic loss of confidence in the ability of travel agents to provide objective service would lead to significant inefficiencies beyond the inefficiencies implicit in the making of sub optimal reservations.

Why would not competition among travel agents lead them (and through them, the CRS's and airlines) to provide neutral screens? Perhaps the reason is that many consumers are infrequent customers of travel agents and their repeat business is not all that important. (In effect, the large corporate customer would get a different level of service.) Perhaps the reason lies in the difficulty customers have in determining whether they are receiving optimal value. In any event, we have experience, prior to the current regulations, telling us that competition for consumers does not lead to neutral screens.

But there is a problem that goes beyond wealth transfer and inefficiencies. If screen bias systematically favors certain strategic segments of the industry, it may disadvantage other segments. Under an unregulated regime, the larger airlines would have more to gain through the contractual purchase of screen bias because of their larger number of flight offerings, and so it can be predicted that screen bias would be a mechanism for their creating entry and mobility barriers that would help protect them from the competition of smaller airlines and new entrants. In an industry that is already concentrated and may soon become more concentrated, depending greatly on the rivalry of fringe carriers to keep the concentrated national carriers on the ball, this should be recognized as anticompetitive. As the Transportation Research Board concluded in its1999 study of entry and competition in the airline industry:

> Travel agents—and the CRSs they use—provide an important service to consumers by making information available about the fare and service offerings of competing airlines. They also offer small airlines and new entrants access to a national network for marketing their services and distributing their tickets. Continued improvements to this system and the advent of new means of ticket distribution by airlines and agents—including Internet options—should be encouraged, since the potential gains from advances in distribution are so large. Nevertheless, ensuring and instilling impartiality in the system, however it evolves, should remain a priority for DOT.[13]

[13] Transportation Research Board, Special Report 255, Entry and Competition in the U.S. Airline Industry, Issues and Opportunities 13 (National Academy Press, 1999).

If agreeing to participate in an arrangement to bias screens were not regulated, would it be susceptible to antitrust or other statutory control? Perhaps it could be prosecuted as a conspiracy between the airline and the CRS to defraud consumers, but equally likely, it might be found merely to be a form of advertising, similar to paying a newspaper more to receive superior location for an ad, which may have a degree of First Amendment protection and is in any event not usually seen as needing government intervention. Perhaps, relying now on antitrust, the contract to provide screen bias would be deemed an anticompetitive agreement in restraint of trade, by virtue of its likely effect on low-cost carriers and new entrants.[14] But in court, proving effects could be very difficult, if not impossible, and if a violation were eventually found, there may be no remedy that would restore the competitive vigor of the injured rival. In short, antitrust would be a high transaction cost solution to a predictable problem.

There does not appear to be any strong argument in favor of screen bias and the fact that Orbitz was compelled to promise a neutral screen to its owners and affiliates indicates that even the largest airlines are willing to live without it, provided that competing airlines are not able to obtain an advantage.

To summarize, the practice of screen bias has a demonstrated track record and would likely recur in an unregulated CRS market whether in the presence of vertical integration or not. The practice has negative consequences for travelers, for system efficiency, and for smaller airlines and entrants. Although it is difficult to evaluate the practical importance of each of these problems, the third, creation of barriers of entry and mobility, would seem to be determinative because of the likely direct impact on the nature of competition. If DOT finds this to be true, and recognizing that screen bias could be difficult to control after the fact by other existing laws, then **screen bias should continue to be regulated by the DOT.**

B. Discrimination and Refusals to Deal: The Mandatory Participation and Non-Discriminatory Booking Fee Requirements

Airlines have complained that under the CRS rules they are compelled to pay super-competitive booking fees to the CRS's. This assumes that under mandatory participation, the CRS's have substantial market power. The large airlines argue that under a deregulated regime, they could strike better deals with the CRS's, thereby bringing enhanced efficiency to the system. In an unregulated market, large airlines could presumably approach a CRS and make the following type of offer: "We will pay you a very low fee on each booking and we will provide you all of our flight information, or if you would prefer, we will pay your standard higher fee on each booking and provide you only some of our information; or if you don't like either alternative, we will simply not deal with you at all."

[14] The FTC could conclude that this is an "unfair method of competition" under Section 5 of the FTC Act, but the Commission generally interprets Section 5 to cover acts and practices that would violate (or perhaps very nearly violate) either the Sherman Act or the Clayton Act.

This offer would no doubt be more sophisticated in practice, but it illustrates that a large airline potentially has substantial bargaining power because its withdrawal from a CRS would leave that CRS with the equivalent of a telephone book that covers only some of the phones in the metropolis. In a network industry, it is essential to be hooked into a large part of the entire network, and best to have total access. Whereas no individual telephone customer has a large enough role in the network to threaten the functioning of the phone book by withdrawing its telephone number, large airlines would seem to control a substantial-enough portion of the market so that their absence from a CRS could undermine its ability to function. While the CRS could respond that the airline would lose customers by not being booked through the CRS, it seems likely that the CRS has the most to lose, in that the airline can still go through other CRS's, its own website and call center, and the largest travel agents who use multiple CRS's. Southwest, which does not sell its seats through CRS's other than Sabre, demonstrates that this is at least feasible. Ironically, the larger airlines argue that the CRS's today have undue market power, but in the absence of regulations, they would seem to have the upper hand.

Should it be against public policy for an airline to negotiate different deals (not only whether to participate, but at what informational and price level) with different CRS's? The argument against government intervention is that when comparably strong companies have full scope to negotiate with each other, the system operates most efficiently. One opposing argument is that if CRS's will have to capitulate, in varying degrees, to the large airlines, the large carriers will gain an advantage over the smaller ones, who will end up paying higher fees for essentially the same services.

A second argument goes to the heart of what information the consumer should be able to access when making an air reservation. In our discussion of screen bias, we focused on the role of the independent navigator in an efficient system. If an unregulated market leads to different CRS's having access to different inventories, this raises the consumer's transaction costs in trying to navigate within the system and increases the proportion of transactions that will be sub-optimal from the consumer's perspective.[15]

These considerations lead us to favor a requirement that routes and schedules of all of the airlines be made available to any CRS, so that whatever travel agency is used, the consumer can know that all relevant information is available. This does not imply that an airline must book through the CRS or travel agent. The agent would be free to book the flight directly through the airline or to advise the consumer that this can be done. Under this arrangement, no airline would be mandated to participate in any CRS, but the system itself would not be unduly degraded by this reduction in regulation.

This still leaves open the problem of price discrimination. Our laws (and economic analysis) have recognized that price discrimination can be either

[15] One of our concerns about Orbitz has been that while it must portray itself as an independent navigator today as it builds market share, if it gains significant market share, the interests of its airline owners may take precedence over the interests of consumers, i.e. the system will be susceptible to tilting in favor of selling higher priced seats wherever possible. Of course, the risk of bias also exists for 'independent' navigators who contract with airlines to provide favored services.

anticompetitive or pro-competitive, depending on circumstances. Neither the Robinson-Patman Act, which is notoriously difficult to invoke (and does not in any event apply to services), nor Section 2 of the Sherman Act, which requires a showing of monopoly power, is likely to be a useful control over CRS's charging higher booking fees to smaller airlines than to larger ones.

One question asked in price discrimination cases is whether the difference in prices is cost-justified. DOT might well take evidence on this question. On the face of it, there is no reason to expect that the CRS's costs of serving the various airlines would vary significantly by the size of the airline.

Another question would be whether smaller airlines that are being required to pay higher booking rates than larger airlines would have any realistic alternatives to the CRS. The example of Southwest would probably make it difficult for another low-cost carrier to argue that CRS's are an essential facility and that they therefore have a right to access on equal terms with all other users.

Another alternative, at least in theory, would be for small carriers to forego the CRS's that discriminate in favor of larger airlines and create their own CRS, a kind of Orbitz for low-cost carriers. The DOT might take evidence on whether this is practical or likely. We are not aware that any such idea has currency.

If indeed it is essential for low-cost carriers to be able to book their flights through travel agents (and therefore through CRS's) and if there is likely to be substantial (not cost-justified) price discrimination on the part of CRS's between larger and smaller airlines, and if the non-cost justified differential between the fees paid by large and small airlines were great enough to negatively impact on competition, and further if it would be impractical for smaller carriers to create their own CRS, then there would be a solid case for the DOT to mandate that all CRS's provide non-discriminatory access to all airlines that desire to do business on standard terms. **Given all the "if's," we think that it should not be necessary to have a non-discrimination requirement for booking fees, provided that routing and scheduling information of all the airlines is provided equally to all CRSs.**

C. The CRS and the Travel Agent

Current rules regulate aspects of the subscriber contract terms between CRS's and travel agencies. These developed out of recognition of the power imbalance that was reflected in contracts that effectively tied agents into their CRS for long terms. The difficulty in these arrangements was that they severely limited competition among the CRS's. The rule limited contracts to five three years, if three year contracts were also offered.

Some have questioned whether the CRS's have so much market power that this type of regulation is needed. They point to the fact that CRS's today must compete not

only with each other, but also with others such as Orbitz and airline websites. In this overall market, the share of CRS's might be too small to give them market power. Moreover, if contract duration is capped by regulation, this might restrict the ability of a CRS to negotiate a deal that would be highly advantageous to a travel agent, but would require a longer term to justify the CRS's investment.

On the other hand, if CRS's were free to negotiate any type of contract with travel agents, it is possible that they would (as they did prior to regulation) attempt to tie up as many agents as possible through long-term contracts. Most travel agents (some of the larger being the exception) work with only a single CRS, for reasons of expense and other efficiencies. Reinstitution of long-term contracts would reduce the competition between CRS's, which comes into play most directly when a travel agent is in the position to switch CRS's. From the perspective of innovation, although long-term agreements might make possible certain investments in a relationship, it seems at least as likely that the continuing kick of competition, as CRSs face the possibility that a travel agency will switch providers, will provide sufficient incentive for innovative improvements. **Retaining a rule that caps the term of contracts between CRS's and travel agents would therefore be pro-competitive.**

D. The Role of Orbitz

AAI has previously provided the DOT with its views on Orbitz.[16] Although we welcomed it as a new entrant in the travel market, we expressed strong concern about the implications of its being owned by the major airlines and about the antitrust risks that this presents. More particularly, we focused on the combination of the Most Favored Nations provision and the incentive provisions for airlines to provide their lowest fares (web fares) exclusively to Orbitz.

Orbitz has from its inception been under close scrutiny by both the DOT and the DOJ. It would not be unreasonable to assume that it may be pulling some of its strategic punches in light of this scrutiny. Although some of the airlines have recently reached agreements with certain travel agents to provide them with web fares, the potential for exclusivity and favoritism remains. We believe that **Orbitz should be required to compete with CRS's and other travel agents on a level playing field, and the best way to assure that would be to require that the airlines sell Orbitz to investors from outside the industry, much as Worldspan has announced it is doing, and to reject the MFN clause.**

The fact that Orbitz operates on the Internet should not be a distinguishing factor for regulatory purposes. Whatever rules apply to other CRS's and travel agents should apply equally to Orbitz. All the more, because if Orbitz can obtain sufficient airline information directly so that it can bypass other CRS's, it would become a combination

[16] See http://www.antitrustinstitute.org/recent/85.cfm and http://www.antitrustinstitute.org/recent2/204.cfm.

travel agency and CRS, owned entirely by the airlines, thereby raising all the old questions of ownership to a new degree.

Conclusion

We urge DOT to approach the question of the airline reservation system with a pragmatic, non-ideological mindset that takes into account established patterns of anti-competitive behavior and maintains rules that will circumscribe the recurrence of such behavior, unless it is reasonable to predict that competitive forces themselves will provide effective circumscription. For competition to do its job, the rules should attempt to keep all players on a level playing field, providing no special benefits to those who operate on the Internet or happen to be vertically integrated. We believe that elimination of vertical integration will go a long way toward achieving the level playing field ideal, but that it will probably still be necessary and appropriate to protect against screen bias; to mandate that all airlines provide route and schedule information to all CRS's; and to cap the duration of contracts between CRS's and travel agencies. While the competitive effects of discrimination will need to be monitored, we do not believe the case has been made for continuing the antidiscrimination or mandatory participation regulation at this time.

Respectfully submitted,

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