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The American
Antitrust Institute

COMMENTS

OF

THE AMERICAN ANTITRUST INSTITUTE

RELATING TO

ORBITZ AND THE D.O.T.'S C.R.S. RULEMAKING

Docket Numbers OST-97-2881, OST-97-3014, and OST-98-4775

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The American Antitrust Institute ("AAI") is an independent non-profit education, research, and advocacy organization that believes the antitrust laws are and should be a fundamental keystone of national economic policy.[1] AAI has commented on several important competition issues involving the air transportation industry.[2] A member of the AAI Advisory Board, Dr. Alfred Kahn, on July 27, 2000, presented his personal testimony to the Senate Committee on Commerce, Science and Transportation concerning certain antitrust questions raised by the airlines' Orbitz joint venture. Dr. Kahn spoke to the Committee from his own notes, which he has reconstructed and authorized us to include at the end of this document. Because we think Dr. Kahn has identified important issues, we want to call his testimony to your attention and add our own more detailed comments with respect to the Department of Transportation's potential for resolving the main antitrust problem through application of the Computer Reservation System (CRS) rules to the Internet. At the same time, we wish to emphasize that the D.O.T. alone cannot deal with all the questions raised by the Orbitz proposal. Certain questions can only be answered by the Department of Justice.

BACKGROUND

The nation's five largest airlines--Delta, United, Northwest, Continental and American-- have announced their intention to form a joint Internet web site – using the name Orbitz-- to distribute travel directly to travelers, competing with both online and bricks-and-mortar travel agents. These five carriers represent over 80 percent of the domestic market today, a percentage that would be even greater following a United-USAirways merger. Many additional airlines have joined the venture as non-equity participants. This effort is being organized for the airlines by the Boston Consulting Group[3].

[1] The AAI is described at its website, www.antitrustinstitute.org.

[2] E.g., Testimony before the Senate Commerce Committee on June 22, 2000, regarding the United/USAirways merger, available at http://www.antitrustinstitute.org/recent/74.cfm; AAI column in FTC:WATCH on December 7, 1998, by Advisory Board Member Alfred Kahn, regarding predation at airline hubs, available at http://www.antitrustinstitute.org/recent/14.cfm; a letter by Albert Foer, November 16, 1998, urging an investigation of airlines reducing ticketing commissions for international flights, available at http://www.antitrustinstitute.org/recent/13.cfm; comments to the Department of Transportation endorsing a rulemaking aimed at predation by airlines at hub terminals, available at http://www.antitrustinstitute.org/recent/2.cfm and http://www.antitrustinstitute.org/recent/6.cfm.

[3] The involvement of the Boston Consulting Group will become relevant later in this letter.

According to its sponsors, Orbitz will be an example of competitors continuing to compete on price and product in their core business of air transportation, and in the retailing of that transportation, while collaborating on a pro-competitive effort to create an additional purchasing option for consumers. They say the purpose is to add to the existing distribution channels an option which is online and which offers consumers a comprehensive view of all publicly available schedule and fare options. Using new software[4], Orbitz is supposed to provide more information, faster, than is presently available.

We are concerned that the proposed joint venture may represent an effort by established dominant firms to use the Internet for anticompetitive purposes. Through concerted action and the use of a competitive advantage—the ability to advertise and sell the lowest fares-- that will be available exclusively to the joint venture, the airlines may be able to neutralize or destroy an emerging capacity of electronic distribution services that appear to be more closely aligned with the interests of consumers. The government should be particularly alert to activities of this sort that may set a precedent for the rapidly developing pattern of "legacy" joint ventures aimed at channeling commercial transactions through the Internet. [5]

ANTITRUST ISSUES

Critics of the proposed site argue that it raises concerns on at least four levels. First, there have been reports that the five Orbitz equity partners and the 26 others airlines that have signed on to Orbitz will jointly withhold the carriers' lowest fares and other data from third party travel distributors. If this is the case, as Dr. Kahn points out, it raises significant antitrust concerns. For example, it could represent a group boycott of competing ticket sellers, with the potential for drawing substantial business away from distributors who cannot represent that they are able to sell the lowest fares. Should this occur, and should Orbitz gain a dominant position in the marketplace for travel, the joint venture would

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[4] The software is by ITA and can be beta-tested at www.itasoftware.com. According to the website, the software is available on the marketplace for any user to purchase.

[5] See, generally, Albert A. Foer, "High Technology Needs Antitrust," an AAI column in FTC: WATCH, June 5, 2000, available at http://www.antitrustinstitute.org/recent/71.cfm.

arguably be able to eliminate certain pro-consumer features now available from independent distributors, such as the ability of consumers to search directly for lowest fares and to search for alternative travel routes.[6]

The second issue is one of public policy regarding the distribution of air travel. In forming Orbitz, the participating airlines are likely to operate outside the CRS rules as currently in place. These rules were established in the early 1980's, before the advent of the Internet, to assure consumers the benefits of effective competition by keeping air carriers that own distribution technology from using it to exclude or injure competitors through biasing the presentation of data. The rules were made necessary because the industry-wide computer reservation system owned by an airline was in fact being used to favor the owner. The rules require, among other things, that a carrier-owner of a CRS must distribute its fares and schedules to all systems to the same extent it participates in the system it owns. The Department of Transportation has a long-pending rulemaking on whether the rules should be updated to expand the definition of CRS to include Internet enterprises, and has called for updated public comments.[7] In this submission, we argue that the CRS rules should apply to the Internet.

The third issue relates to the requirement that airlines provide all their published fares to the joint venture on a nondiscriminatory basis. At first glance, the idea that all published fares would appear on the Orbitz screen would seem advantageous to consumers. But, as Dr. Kahn has suggested, we are dealing with an airline industry that is oligopolistic and a joint venture that includes virtually the entire industry. It has often been the case that price competition among oligopolists benefits from the availability of secret deals that occur as the result of non-public bargaining between a supplier and an important customer. New entrants have a better chance of gaining a foothold and growing

[6] It might be asked, if Orbitz provides all these services and becomes dominant, why should it later cut back on its offerings? First, to the extent that the joint venture is owned by the airlines, it could be used by them to discourage price-cutting competition. Orbitz has suggested that the joint venture will eventually shift over to public ownership. Whether, when, and how this would occur is unknown. The key would be who controls the management and operation of Orbitz, rather than whether the public owns part of it. Harm from a cutback in the range or quality of services (e.g., by biasing data) would be minimized if new entry were feasible, but once Orbitz has dominance, new entry would probably be unlikely. See the discussion below relating to the Boston Consulting Group's analysis.

[7] 65 Federal Register, Number 142, July 24, 2000.

if their prices are not always known by competitors. The question therefore arises as to whether the joint venture, as currently structured, is either too inclusive (capturing too large a proportion of the carriers) or demands too much information from its members.

Fourth, the joint venture creates new flows of information having significant competitive value. The public needs to be assured that information will not be used to tacitly coordinate pricing within the industry.

GROUP BOYCOTT

We have reviewed a document that purports to be an agreement between the equity partners and non-equity partners of Orbitz.[8] Assuming it is indicative of the Orbitz joint venture, it raises the possibility that this coming together of virtually the entire airline industry violates the Sherman Act. The Agreement requires that an airline provide all its published fares (including promotional fares) to Orbitz.[9] While the Agreement specifically states that the member airlines are not bound to provide all of their fares *exclusively* to Orbitz,[10] other provisions make it likely that this provision was written with a wink of the eye. All of the non-equity members are required to provide annual marketing support having what appears to be a multimillion-dollar value.[11] Exhibit B of the contract provides a menu of options by which the airlines can be credited for the

[8] The document is titled "Airline Charter Associate Agreement," referred to hereafter as the "Agreement." We cannot vouch that this is current or in effect. To the extent that some other document is operative, some of our comments may need to be revised.

[9] Section 2.1 of the Agreement, titled "Airline Participation in the Company Site."

[10] Section 7 of the Agreement, titled "No Exclusivity," provides: "The relationship between Airline and Company [referring to Orbitz] as set forth in this Agreement will be non-exclusive."

[11] Section 2.2 of the Agreement, titled "Marketing Support," provides: "(a) Airline shall provide Company with In-Kind Promotions (a) during the initial twelve (12) month period of this Agreement, with a dollar value equal to Airline's Market Share multiplied by _ million U.S. dollars (US$_); and (b) in each subsequent twelve (12) month period in an amount equal to _percent (-%) of Airline's Travel Revenue during the immediately preceding twelve (12) month period not to exceed _ million U.S. dollars (US$_)during any twelve (12) month period following the initial twelve (12) month period of this Agreement. Airline's In-Kind Promotions shall be implemented in accordance with the valuation methodology set forth in **Exhibit B.** Company and Airline shall mutually determine the timing and value of each In-Kind Promotion by mutual agreement of the parties. If either party proposes In-Kind Promotions that are not listed in **Exhibit B,** the parties shall work together in good faith to value such In-Kind Promotions…"

marketing support.[12] Most require out-of-pocket expenditures, which may cost in the millions of dollars. One method, however, has the potential of avoiding all expenditures: full credit is given, dollar for dollar on the difference between the discounted fare and the next lowest published fare, for all fares booked by Orbitz where Orbitz is the exclusive recipient of the relevant data. It would appear that this alternative is the most attractive, by far, in that it both saves cash flow and contributes to the popularity of Orbitz. At the very least, the burden should be on the airlines to demonstrate that this is not a subtle arrangement to achieve exclusivity. [13]

That the lowest fares available in the marketplace will be accessed exclusively on the Orbitz system appears to be the fear of the competitors of Orbitz, and it is a concern that should also occur to antitrust enforcers and air transportation regulators. Antitrust is not designed to protect individual competitors from fair but aggressive competition. Rather, it is to protect the fairness of the competitive process, thereby protecting consumers and guaranteeing a level playing field for competitors. When most of the competitors in an industry work jointly with the purpose or effect of damaging one or

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[12] Exhibit B of the Agreement describes six categories of In-Kind Promotion and their valuation method. These include (1) Company name/logo included in advertisements; (2) Company name/logo included on in-flight collateral; (3) Company name/logo included in direct mail; (4) Affinity program supplements; (5) Passenger database information; and (6) Special promotions. The first five items are credited at their actual dollar value or by mutual agreement. The sixth has three subcategories that are of special interest to this analysis: (1) Exclusive promotions or fares available only on Company Site; (2) Promotions or fares available only on Company Site or Airline Site; and (3) Other.

If an airline makes its promotional fares available only on Orbitz, the value is determined by multiplying the value of the discount to the next lowest published fare by the number of discounted transactions booked through Orbitz; or by mutual agreement subject to independent verification.

If an airline makes its promotional fares available only on Orbitz and its own site, the value is determined the same way, except at a 75% discount.

If some other special promotion is utilized, "The value of special promotions credited by Company towards in-kind promotions will not exceed $1 M in any 12 months period." It would appear that this $1 M cap is not intended to apply to the other special promotions.

[13] See Willard K. Tom, David A. Balto, and Neill W. Averitt, "Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing," 67 Antitrust Law J. 615 (2000): "The traditional analysis governing exclusive dealing arrangements has focused on a manufacturer's *requirement* that its distributors deal *exclusively* with it. In recent years, however, some manufacturers have begun to use subtler arrangements in which incentives replace requirements and partial exclusivity replaces total exclusivity." "Total or partial exclusivity is not necessarily the product of contractual requirements. Incentives can also be used to achieve this outcome." At 627. The authors, who were all attorneys with the FTC's Bureau of Competition when the paper was written, provide the legal argumentation for prosecuting some of these more subtle forms of exclusive dealing.

more of their non-cooperating competitors, the competitive process is improperly disrupted. Indeed, the disruption is so pernicious that group boycotts have long been deemed illegal per se, that is, without having to demonstrate the precise linkage to competitive injury and without having to balance the harm against any purported positive benefits.[14]

Airlines obviously compete with one another in the sale of airline transportation.[15] They also compete against other channels of distribution of airline tickets. In recent years, many individual airlines have taken advantage of the Internet to establish electronic sites for selling their own tickets directly to the public, thereby eliminating the need for paying a commission to a middleman. Our understanding is that sometimes these airlines display their lowest promotional fares exclusively on their site and that sometimes they also make special deals with other distribution channels to allow them to sell tickets at these fares.

Information containing lowest-price fares should be viewed as an inventory item that can be bought and sold in the marketplace, with airlines in competition not only with one another but also with other distribution channels. From an antitrust perspective, if we take it as given that the lowest fares will by implicit (if not explicit) agreement go exclusively to Orbitz, and low fares are one of the driving forces that bring customers to a ticket distributor (including an on-line distributor), the practical effect will likely be to withhold from the open market by joint decision of one group of competitors inventory that is necessary for other distribution competitors to survive.[16]

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[14] Group boycotts are also known as concerted refusals to deal. According to Herbert Hovenkamp, per se illegality applies to "[S]o-called *naked boycotts* – that is concerted refusals of competitors to deal with another competitor, customer or supplier when no case can be made that the refusal is ancillary to any legitimate joint activity." Herbert Hovenkamp, Federal Antitrust Policy (West Group, 1994) Sec. 5.4a1. See Lawrence A. Sullivan and Warren S. Grimes, The Law of Antitrust, An Integrated Handbook (West Group, 2000), at Sec. 5.8: "Though any individual trader can decline to trade with any other trader for any reason, horizontal competitors may not act concertedly to inhibit market access to any other trader solely because they want to be spared its competition."

[15] Typically, competition is most direct and of most significance for consumers when it involves moving passengers from point A to point B, known as a city pair. While many airlines are in business, it is rare that more than a handful compete over a particular city pairing.

[16] An individual airline has the right to decide how it wants its tickets distributed. The antitrust problem arises with collective action. A judicial opinion that gives an indication of how a court might view the airlines' concerted withholding of inventory from distribution sources other than their own joint venture is

There is some reason to think this could also be what is intended as part of a larger strategy. In recent years, the airlines have talked about their desire to eliminate or at least reduce the role of middlemen, i.e. ticket agents. They have lowered commissions on several occasions in a manner that has the outward appearance of being uncoordinated, but which has resulted in an industry-wide reduction. As explained in the next section, it is possible that the development of Orbitz is the latest effort of the airlines to consolidate control over the sale of their seats.[17]

CONSUMERS, NAVIGATORS AND BOYCOTTS

If there is a long-range plan on the part of the airlines to eliminate alternative ticketing channels, it would probably have nasty consequences for consumers. The airlines practice the most sophisticated price discrimination in the history of American industry. It is possible on a given flight that each seat was sold for a different price. This can be done because travelers have a variety of needs (e.g., some must arrive at a particular airport at a precise date and time, and are willing to pay a high price to do this, while others have enough flexibility to purchase far in advance or to fly indirectly and at

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U.S. v. Columbia Pictures Industries, Inc., 507 F. Supp. 412 (S.D. N.Y. 1980). A joint venture of movie producers establishing a pay TV network agreed not to make available certain movies to anyone other than the joint venture itself for an exclusive nine-month period. The Court, granting a preliminary injunction, held that this temporary withholding of inventory could be considered a class group boycott subject to per se treatment.

In *Toys "R" Us v. Federal Trade Commission,* 2000 U.S. App. LEXIS 18304; 2000-1 Trade Cas. (CCH) P72,978 (7th Cir. 2000), the Seventh Circuit upheld an FTC order prohibiting a dominant specialized discount toy retailer from entering into vertical agreements with toy manufacturers that limited their ability to sell certain popular toys to warehouse clubs that competed with the discounter. Because the vertical agreements [compare to agreements between various airlines as suppliers of low fare information and Orbitz] were orchestrated by the retailer [compare to the equity-owning airlines operating through their agent, BCG, to construct Orbitz], the overall strategy of Toys R Us was deemed to have both a horizontal and vertical nature. The horizontal aspect constituted a boycott of the warehouse clubs and was per se illegal. Even if a boycott were not deemed illegal per se, the FTC had held, the anticompetitive effects "clearly outweighed any possible business justification" and thus could not pass the Rule of Reason test. If Orbitz were evaluated under the Rule of Reason, it is not clear what possible business justification would outweigh the anticompetitive effects discussed in this submission.

[17] Questions about the intent behind Orbitz do not arise in a vacuum. The government is aware of many aspects of the post-deregulation air industry that operate to undermine the vitality of competition: exclusionary behavior at dominated hubs such as the offer of commission overrides, preclusion of competitors from gates, and predatory pricing; codesharing alliances; consolidating mergers; and misuse of computerized reservation systems.

less crowded times) and therefore a variety of what economists ironically call "reservation prices."

With so many different prices for traveling from A to B by air, a customer must either be extraordinarily diligent (learning the system, taking the time to make it work in his or her favor) or must depend upon a professional "navigator" such as a ticket agent or computerized ticketing service. Without this professional level of assistance, consumers will very often receive their information directly from sellers whose objective is to sell seats that are within the consumer's reservation price, but as close as possible to the top end. The pervasive degree of price discrimination makes this a profitable strategy and arguably leads to an industry strategy of making it difficult for consumers to obtain their reservation information from independent navigators whose profits are based on their ability to serve consumers well. How can we explain the anomaly that Orbitz, composed of airlines, appears to be establishing a system that will help consumers find the best fare?

The concept of navigators is developed in a book by two senior vice presidents of the Boston Consulting Group (BCG), the firm that was selected by the airlines to put together the joint venture now called Orbitz. Because of the relationship between Orbitz and BCG, it is useful to review the BCG analysis. We will quote extensively.

The authors, Philip Evans and Thomas Wurster, focus on the revolutionary process of "deconstruction", which they define as the dismantling and reformulation of traditional business structures, resulting from the new economics of information.[18] "Deconstruction," they say, "implies choice. Choice, beyond a certain point, implies bewilderment. Hence, the rise of the navigator. Navigators may be software programs (such as Quicken), databases (Auto Trader), evaluators (*Consumer Reports*, JD. Power), or search engines (Yahoo!). They can also be people…Navigation may look like a small business, but it is likely to be the fulcrum around which competitive advantage hinges."[19]

[18] Evans and Wurster, Blown to Bits, 39 (Boston Consulting Group, 2000).

[19] *Id.* 64-65.

"Navigators lower the cost of search, increase its comprehensiveness, and align the search process more closely with the interests of the buyer."[20] Navigators pose a critical challenge to traditional sellers because they tend to be aligned with consumers rather than with sellers. "As their reach goes up [i.e., as navigators' number of customers increases through internal growth and mergers], their affiliation to sellers loosens, which provides a further advantage in competing for buyers.[21] Some navigators get ahead of the others, cross the threshold of critical mass, and then march toward positions of monopoly in their respective search domains. Winner takes all. Armed with superior reach, a high level of consumer affiliation and trust, and equivalent richness…, that navigator is advantaged in navigation against both retailers and suppliers. Retailers are demoted to the physical role of distributor. Suppliers see their business commoditized, or at least forced to compete on product-specific characteristics such as cost, technology, and features. Much of the value potential of the business is drained off."[22]

What should a company or an industry do when its business is challenged by a navigator? The BCG authors make numerous references to the airline industry, so it is probably no coincidence that their prescription appears to be so relevant to the germination of a joint venture that could keep essential inventory out of the hands of air service navigators like Expedia and Travelocity. The authors suggest several lines of defense for a challenged industry, perhaps the most relevant being: "[P]revent the new navigators from achieving critical mass. [23] Suppliers and retailers are the source of the information on product features, price, and availability that the new navigators need. So

[20] *Id*. 151.

[21] Travel agents were historically the agents of the airlines, not of their consumer customers. In recent years, they have come increasingly to represent the consumer. Travelocity is part of Sabre, Inc., which was once owned by American Airlines, but is now an independent company. Expedia, part of Microsoft, was independent from birth. An independent navigator does not worry about the profitability of the airlines, but rather is focused on building up the largest possible body of consumers who will repeatedly use the site, thereby generating fees for the site.

[22] *Id*. 135. For example, electronic navigators make it easy for a consumer to find the lowest applicable fare, whereas the airlines presumably want to sell the highest fare the consumer is willing to accept. Electronic navigators make it easy to find alternative routes from nearby airports, which might be cheaper for the consumer, whereas the airlines would presumably prefer that the consumer's search would be limited to the precise city pair the consumer is initially focused on.

[23] Most Internet-based navigators lose money for a number of years, making them particularly vulnerable to aggressive strategies during the phase when they are trying achieve a critical mass.

simply refuse to make that information available."[24] But this is not so easy. "Unless the selling business is highly concentrated, it is unlikely that the navigator's ability to achieve critical mass will depend on the availability of data from any one source. Therefore, while it is undoubtedly in the interests of all sellers *collectively*, it is not in the interests of any one seller *individually* to deny its own data to the navigator."[25]

When sellers act collectively to influence the essential terms of trade, they are usually called a cartel. The BCG authors offer no comment on whether a collective decision would be illegal or run the risk of being designated a cartel, but they suggest another line of defense with regard to which they reflect an attitude that can be described as even more irresponsible. They suggest that an incumbent firm could "embrace customer affiliation and try to become an advantaged navigator,"[26] e.g., by going into direct competition with the navigator. But, the advice continues, do *not* truly align yourself with the consumer:

> Perhaps, 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…Conceal from the consumer the navigator service's supplier affiliation…The theory is that such a navigator may not be ideal for the seller, but is preferable to the independent alternative, and might suffice to deny to the latter critical mass.[27]

Could the authors have been thinking about something like Orbitz? They note that the strategy "worked for American Airlines' SABRE system, where American was able to bias presentation of a comprehensive flight listing by giving its own offering slightly more richness and greater prominence."[28] This statement, offered without any suggestion

[24] *Id.* 138.

[25] *Id*., 140.

[26] *Id*., 141.

[27] *Id*., 142.

[28] *Id*.

of possible legal impropriety, is accompanied by an extraordinary little footnote at the back of the book: "American Airlines was eventually forced by industry and governmental pressure to stop the practice of presenting schedule information to favor its own flights."[29] Not only do the authors fail to suggest that the CRS rules that emerged to stop this type of display bias were undertaken pursuant to Section 411 of the Federal Aviation Act, specifically to prevent unfair methods of competition and deceptive practices in air transportation and the sale of air transportation,[30] but back in the main text, they identify two (and only two) problems, with their advice, neither relating to a possible antitrust issue. One is nevertheless interesting: they recognize that the incumbent's own navigator product is likely to be inferior from the customer's point of view (because of skepticism about its objectivity) to that provided by an independent third party.[31] In many industries, they say, the incumbents would have to worry about the long-term defensibility of a weakly biased navigator. But "[I]n the airline customer reservations system (CRS) business, the staggering complexity of the data-processing requirements proved a lasting barrier to new entrants." [32] If Orbitz were to knock out the independent navigators, it might well be protected against later new entry, particularly if the network effects result in "winner take all."

This analysis of the role of navigators, using examples from the airlines' experience with computer reservation systems and written by the management consulting firm that was hired by the airlines to design Orbitz, has the appearance of a blueprint for a collective plan to withhold essential inventory (information regarding the lowest priced fares) from new (and still unprofitable) navigator companies, in order to keep them from reaching critical mass.

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[29] *Id*., 241, at n. 4. The footnote also points out that the CRS rules "eliminated a competitive advantage for the airline but also eliminated a competitive *disadvantage* for SABRE. Since SABRE the navigator is now a business twice as valuable as AA the airline, the shareholders probably benefited." SABRE is now independent of American Airlines.

[30] 49 USC 41712. *United Airlines v. CAB*, 766 F.2d 1107 (7th Circ. 1985).

[31] Evans & Wurster, *op. cit*.,142.

[32] *Id*., 143. The second reason is that sellers acting to protect their own businesses from commoditization, might happily commoditize each other's.

As Dr. Kahn says, "While an *individual* seller may well have the right to resist the "commoditization" of its product—as I understand at least one of the Orbitz organizers has characterized its purpose—by setting up its own distribution system, it is and should be contrary to the antitrust laws for carriers to do so collectively. The other Internet booking agencies claim that one important way in which they compete—and, by so doing, put pressure on the carriers to compete as well—is, precisely by making special, exclusive promotional deals with individual airlines; if indeed the commitments of its several members to Orbitz would preclude such deals, the venture would clearly weaken competition—not only at the distribution level, but even more important, among airlines themselves."

NONDISCRIMINATORY PUBLISHED FARES, MOST FAVORED NATION, COLLUSION, AND ENTRY

The Agreement requires participating airlines to provide Orbitz with all their published fares on a Most Favored Nation basis, in comparison with other Internet Travel Provider Sites such as Expedia or Travelocity.[33] Currently, individual airlines often make special deals with such sites, as a way of promoting their offerings. This has a pro-competitive effect in an oligopolistic industry, by adding an unpredictable, upsetting element, making it more difficult for competitors to remain comfortable with each other's pricing decisions. In other words, secret deals can undermine the tacit collusion that often occurs in concentrated markets.

[33] Section 2.1(a) of The Agreement provides: "Airline shall …provide complete, timely, and accurate information on its Schedules, Published Fares, and Seat Availability to Company…and shall provide Company with nondiscriminatory access to Seat Availability for Published Fares…" Section 2.1(b) provides: "To the extent that Airline offers any of the following in connection with the display or sale of Air Travel Provider Site: (i) Published Fares, (ii) Schedules, (iii) Seat Availability, (iv) Service Enhancements, (v) frequent flyer program account information, (vi) frequent flyer promotions…(vii) functionality or processing of frequent flyer transactions, or (viii) the purchase, sale or redemption of frequent flyer miles, Airline shall offer Company the same on a MFN Basis." "MFN Basis" is defined to mean that the Airline shall offer Orbitz terms and conditions equal to or better than the most favorable terms and conditions offered by the Airline to any other Internet Travel Provider Site. An Internet Travel Provider Site is defined as "an Internet site that offers access to information concerning Airline's schedules, Published Fares, and Seat Availability…" The definition "excludes the Orbitz site, the Airline Internet Site, the Alliance Partner Site and the Airline Internal Reservation System. In other words, there is a Most Favored Nations provision that assures that any terms and conditions on fares that an airline provides to an Internet distributor like Travelocity or Expedia must be provided to Orbitz on a matching or better basis.

Normally, one might expect that having all fares published in one place at one time would be beneficial to consumers. But there may be too much of a good thing. With virtually every air carrier participating in Orbitz and all required to provide Orbitz their best fares on a MFN basis, the opportunity for disruptive pricing has been minimized. The result improves the probability of tacit collusion and makes it more difficult for new entrants to break into a market through special promotions in conjunction with non-Orbitz Internet sites.

INFORMATION FLOWS

Questions need to be asked and answered with respect to the flows of information that will occur as a result of the Orbitz joint venture. One concern that many antitrust experts have with the new exchanges that are blossoming on the Internet is whether they will facilitate new and dangerous strains of the price fixing disease.[34] The Justice Department settled a lawsuit against the Airline Tariff publishing Company in 1994[35] based on allegations that the leading U.S. airlines had employed a computer system, run by an airline joint venture, to fix prices. Under the antitrust laws, it is not enough to show that competitors engage in parallel behavior, such as charging the same prices. To be illegal, there must be evidence of something more. In the Airline Tariff case, according to Jonathan Baker's analysis, the government produced evidence that there was a great deal of communication among the airlines that amounted to offers, negotiations, and acceptances. The conduct was too complex to have been arrived at other than through agreements. Finally, the claims of legitimate business justification were unconvincing. The consent order prevented the airlines from using various communications methods to engage in quasi-public negotiations about price levels.

The Airline Tariff case demonstrates that cyberspace enriches the opportunities for communication. At the same time, it may be more difficult to infer an agreement from

[34] See Jonathan B. Baker, "Identifying Horizontal Price Fixing in the Electronic Marketplace," 65 Antitrust Law J. 41-55 (Fall 1996). The danger is that collusion can take place in the fresh-air, without resort to smoke-filled rooms, without leaving any evidence of collusion.

[35] *United States v. Airline Tariff Publishing Co*., 1994-2 Trade Cas (CCH) para 70,687 (D.D.C. August 10, 1994 (final consent decree). Additional citations to this are at footnote 20 in the Baker article, note 34 *supra*. This consent decree may need to be modified to apply to the Internet.

parallel prices if pricing information is shared among rivals. The airlines may have learned from the Airline Tariff case that they need to be subtler in the way they share and utilize information about their rivals' terms of trade. Only a review of the most detailed level of planning for the Orbitz joint venture –something that cannot currently be done by a member of the public—can identify potential problems and techniques for minimizing any such problems.

Particular attention should be paid to the role of directors of the joint venture. Presumably, many of these will be high officials of competing airlines. In their role as directors, they may exercise a fiduciary responsibility for examining in detail and jointly discussing the data that comes into the joint venture. They will, for example, decide jointly how fares will be shown and made public. What institutional limitations will protect the public from these directors using their information and/or conversations with fellow directors for price-fixing purposes?

SOLUTIONS

The Internet offers many opportunities for restructuring industries in ways that create significant efficiencies. E-commerce takes many forms and the forms themselves are changing rapidly. Government should not intervene prematurely or with a heavy hand, but neither can it afford to stand aloof while experiments take place that have the potential of creating significant harm to the competitive process. Orbitz may very well be a joint effort of the airlines to reduce their distribution costs, but it may also be an effort to achieve a reduction in competition. The devil is in the details and we do not have access to all the details.

If our concerns about the competitive effects of Orbitz are realistic, there are several approaches that can be taken by the government. With respect to the possibility of a group boycott, the Justice Department can seek a preliminary injunction against Orbitz. It has been reported that the Justice Department is investigating Orbitz, but the nature of the investigation has not been disclosed. A parallel remedy for the group boycott potential may be for the Department of Transportation to amend its CRS rules so that the non-discrimination provisions will apply to the Internet. The rules could easily assure that any fare information provided by an airline to any reservation system other than one it operates

only for its own flights, be provided on a nondiscriminatory basis to any other system that seeks it.

While applying the CRS to Internet activities would keep the airlines from withholding low fare information from competing ticket channels, it would not deal with the other side of the problem, the requirement that participating airlines not provide lower fare information to competing channels. Questions relating to the elimination of secret deals would have to be evaluated by the Justice Department. They raise the possibility that the joint venture is overbroad, including too large a proportion of the airline industry, or that the MFN provision may be an unnecessary ancillary aspect of the joint venture that can be anticompetitive in its effect. None of Orbitz' competitors has the clout to require that the airlines give them MFN guarantees. Orbitz can do this because of its ability to bring virtually the entire airline industry together under a single roof, holding out the promise that business will be pulled away from the independent navigators and that booking through Orbitz will result in a rebate on booking fees. We can see where this benefits the airlines, but competition in the sale of airline reservations would be enhanced if this provision were not permitted.

Finally, the entire question of the potential for collusion can only be addressed by a searching inquiry into exactly how the joint venture will be managed and operated. Given the ever-increasing concentration of the industry and its history for misusing computer systems for anticompetitive purposes, the appropriate attitude of investigators should be one of skepticism.

Sincerely,

Albert A. Foer, President
The American Antitrust Institute

Enclosure: Testimony of Dr. Alfred Kahn

Summary of my Oral Statement
Before the Senate Committee on Commerce, Science and Transportation
on Antitrust Issues in the Airline Industry
July 27, 2000

Alfred E. Kahn

Before proceeding to a listing of the major antitrust issues in the industry, I emphasized the importance of another factor that poses severe obstacles to competition in airline markets—the way in which we are organized to provide and price access to infrastructure—specifically air traffic control and airport services.

I then identified, as the three major current antitrust issues,

1. the identification and prevention of predation or unfairly exclusionary conduct;
2. mergers; and
3. the Orbitz venture.

All of these, I pointed out, are extremely difficult to resolve, even in the context of specific cases; about none of them am I in a position to offer firm conclusions; but all clearly deserve intensive investigation by the antitrust enforcement agencies and, in the case of predation, the Department of Transportation, which has explicit statutory authority in that area comparable to that of the FTC in the rest of the economy.

Since I had already presented testimony on the first two issues before three committees of Congress during the last few months, I proposed to concentrate on the antitrust questions that the Orbitz venture seemed to me to raise, with the qualification, once again, that I am not in full command of the facts and therefore am not in a position to offer a final judgment.

Orbitz is, as I understand it, a joint venture of all the major carriers—assertedly open also to all other airlines on equal terms—to provide universally comprehensive,

competitively neutral, instantaneously available information about all available fares and flights (except, I understand, so-called E-fares) in a convenient form for immediate access over the Internet to travelers, in direct competition with other such Internet booking media as travel agents generally and such companies as Travelocity and Expedia, in particular.

At first blush, this appears to be—and could well be—entirely beneficial to consumers, offering travelers comprehensive market information in competition with other information- and ticket-distributing mechanisms, which have no entitlement to protection against competition—provided it is efficient and fair.

Moreover, for such a venture to provide this valuable service, it would or might appear necessary for the participants to commit themselves to (a) make all their lowest fares and inventories available to Orbitz (except, as I understand it, the E-fares offered by the carriers on their individual web sites and acceptances of Priceline bids, which are not regarded as posted prices), and, as a corollary (b) to make no special deals of ticket and seat offerings with other booking agencies that are not equally available to Orbitz (i.e., to give Orbitz "most favored nation" treatment). Such undertakings would appear on their face to be essential for the venture to succeed—that is to say, in antitrust terminology, reasonably ancillary to the success of a legitimate joint venture.

Orbitz also, however, raises inescapable antitrust questions—specifically, whether such a collective undertaking by all the major carriers, however reasonable on its face, may also be anticompetitive, in either *intent* or likely *effect* (to use the criteria pertinent to a rule of reason evaluation under the antitrust laws—that is, intent or effect) it poses threats to competition (a) among the participant carriers, (b) by outside, more typically low-cost low-fare non-major carriers, who have played a disproportionately important

role in bestowing on travelers the benefits of price competition, and/or (c) in the distribution side of the business—i.e., to competition between Orbitz and other Internet booking agencies.

(a) As for the first, there is the familiar fact that in an oligopolistic industry, the negotiation of special, preferably secret deals with large buyers or distributors in a position to threaten to supply their own needs or take their business elsewhere is a particularly effective form of competition, reflecting an exercise of countervailing power on the buying side of the market, in an oligopoly whose members will typically be reluctant to cut prices openly and across the board; and that the prohibition of any such special deals or a requirement of their full disclosure and equal availability, in advance, to all comers, will discourage it. So the very jointness of the venture and the ancillary commitments of its members (as I understand) not to enter into any special exclusive promotions with independent distribution agencies and/or openly to disclose their lowest available fares (except, as I understand it, E-fares) to their rivals—which may in a sense be essential to the venture—may justify the inference of anticompetitive intent or, whatever the intent, an anticompetitive effect among the partners.

(b) What about the independent airlines, which typically compete more heavily on the basis of price? Orbitz will evidently be open to them on equal terms, free—as Mr. Katz has testified—of the onerous booking fees charged by CRSs. I urge the Committee to hear their views. I was struck by the fact that Southwest Airlines not only does not want to join but openly opposes the venture. This might be simply because Southwest, being virtually unique in its ability to compete on its own, will not feel it has to join: it points out that its own web site is enormously popular and saves it 80-90 percent of the cost of selling tickets in other ways—and does not want to see its competitors be

strengthened in their ability to reach travelers who seek the lowest possible fares. On the other hand, the history of the last 20 years demonstrates that when Southwest speaks, consumers do well to listen.

I urged the Committee and the antitrust agencies also to probe the view of these other, far less well-known low-fare carriers. Orbitz claims it will improve their access to the market. On the other hand, it seems to me possible that they feel, on the one hand, compelled to join Orbitz in order to have equal access to the market but also fearful that in so doing they would have to give up the right to make special promotional deals with non-carrier-owned Internet distribution agencies, and so be impaired in their ability to compete effectively.

(c) As for competition among Internet booking agencies, such as Travelocity and Expedia—they emphatically claim (1) that they will *not* have full access to Orbitz' low fares and low-fare inventories, and (2) that they compete in part precisely by making special, *exclusive* promotional deals with individual carriers, which the commitments of its members to Orbitz would preclude.

If these last claims are correct, the Orbitz venture takes on the aspect of a group boycott of competitive distribution agencies, which should I think be illegal per se under the antitrust laws and flatly impermissible. While an *individual* seller may well have the right to resist the "commoditization" of its product—as I understand at least one of the Orbitz organizers has characterized its purpose—by setting up its own distribution system, it is and should be contrary to the antitrust laws for carriers to do so collectively. The other Internet booking agencies claim that one important way in which they compete—and, by so doing, put pressure on the carriers to compete as well—is, precisely by making special, exclusive promotional deals with individual airlines; if indeed the

commitments of its several members to Orbitz would preclude such deals, the venture would clearly weaken competition—not only at the distribution level, but even more important, among airlines themselves.

I concluded by expressing my regret that I have in my testimony on these antitrust issues been unable to offer definitive judgments of particular cases; I expressed the hope, however, that I had helped the Committee understand the essentiality of the antitrust agencies investigating them, and of Congress giving them the means to do so.