

NATIONAL COMMISSION TO ENSURE
 CONSUMER INFORMATION AND CHOICE
 IN THE AIRLINE INDUSTRY

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HEARING

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WEDNESDAY
 JULY 31, 2002

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The hearing was held at 9:30 a.m. in the Scott Room of the Westin Grand Hotel, 2350 M Street, N.W., Washington, D.C., David L. Winstead, Chairman, presiding.

PRESENT:

DAVID L. WINSTEAD	Chairman
MARYLES CASTO	Commissioner
THOMAS P. DUNNE, SR.	Commissioner
TED LAWSON	Commissioner
ANN B. MITCHELL	Commissioner
PATRICK V. MURPHY, JR.	Commissioner
JOYCE ROGGE	Commissioner
GERALD J. ROPER	Commissioner
PAUL M. RUDEN	Commissioner

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(9:39 a.m.)

CHAIRMAN WINSTEAD: Good morning. I know we've got a pretty crowded room. I apologize. We appreciate your indulgence while we have expanded here. We needed a little bit more room.

Good morning. I'm David Winstead, and I'm Chairman of the National Commission to Ensure Consumer Information and Choice in the Airline Industry.

I thank you all for coming, both our witnesses and the public, consumers as well as perhaps some media that might be in the audience.

This is our fourth and final public hearing, and it is, I think, a very important one. As I personally have reviewed the testimony, I think the witnesses we hear and experts today really shed a very thorough light on the economics in the travel industry and the distribution of airline tickets. For me, a reasonably new student of this issue, I found the written testimony very, very useful.

Many of you all have been present at our prior hearings, the first of which started six weeks ago here in Washington, D.C. Since that time, we've held two other hearings, one in Chicago, one in San Francisco. I would like to thank our Commissioner, Gerry Roper, for hosting us in Chicago, and Maryles Casto for doing an excellent job in San Francisco as well.

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1 With today's hearings, I believe we really probably
2 have covered a lot of the issues and the aspects of the topics
3 that were charged to this Commission by Congress to look at. For
4 those that are new here today, the statute that formed us in
5 April 2000 was very directed over a six-month period to look at
6 the financial condition of travel agencies and whether there are
7 impediments to information regarding service and products offered
8 by the airline industry and, if so, what effect these impediments
9 may have on the travel agents, Internet distributors, and,
10 ultimately, on the consumer.

11 I think you will hear today from the Commissioners
12 who have been very, very consistent in asking all of our
13 witnesses about that issue. You know, how does this impact on
14 the consumer? How does the traveling public benefit or are
15 injured by developments and issues that may be raised in these
16 hearings?

17 We are going to hear from six witnesses today who
18 understand these issues very, very thoroughly. As I mentioned
19 earlier, I think the economic perspective that they shared to me
20 in their writing I found extremely useful.

21 Our first speaker is Alex Wasilov, who is Chief
22 Operating Officer of one of the nation's largest travel agencies
23 and an early proponent of transaction fees for travel agents.

24 I would mention that in our prior hearings, both in
25 June and July, we have heard from a lot of major airlines,

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1 American Airlines, United, Delta; major travel agencies such as
2 American Express. In San Francisco we heard from a number of
3 companies that are in the website business providing software.
4 At all three hearings we have heard from travel agents, both
5 small and large. So I think we have had an extremely broad
6 spectrum of people engaged in and interested in the travel
7 industry and the airline ticket distribution systems.

8 In addition, we have John Caldwell of Caldwell
9 Associates; Robert Joselyn of Joselyn, Tepper & Associates, and
10 Lorraine Sileo from PhoCusWright.

11 The final two witnesses are really from the
12 academic world and specialize in transportation policy economics.

13 They are Ken Button of the Center for Transport Policy and
14 Logistics at George Mason University, which is in the Washington
15 area in northern Virginia, and David Butler of the Department of
16 Economic Development, the University of Southern Mississippi.

17 At the conclusion of today's hearings, the
18 Commission members will begin their deliberations armed with
19 three volumes of transcripts, opinions of all sectors of the
20 travel industry, and we will be meeting tomorrow and throughout
21 the next three or four months in preparation to issue a final
22 report and recommendation to the Speaker of the House and the
23 White House around November the 15th.

24 I would like to mention I have given this
25 opportunity to all the Commissioners. We have had, as I

1 mentioned, major airlines, small airlines, everybody in between,
2 and today I think we will gain a lot in terms of understanding
3 more about the economic impact of what is going on in the
4 industry.

5 But I did want to give everybody an opportunity on
6 the Commission, as I hope the witnesses will take time, to sort
7 of give us a sense of their position, their company, their
8 background, so that we sort of know where everybody is on this
9 issue.

10 Just to start that process, and then I will go from
11 right to left here with the Commission, I am David Winstead. I
12 am an attorney here in Washington, D.C., but have spent some time
13 in the transportation sector.

14 I was Secretary of Maryland DOT for four years for
15 Governor Glendening, and under me was BWI Airport, the operation
16 of BWI. I also for a year was President of AASHTO, which is the
17 American Association of State Highway and Transportation
18 Officials.

19 My law practice has been generally in real estate,
20 transportation, and legislative/regulatory issues on the county,
21 state, and federal level. So that is kind of my background
22 before I was appointed by Secretary Mineta.

23 So why don't we start with Gerry, on the right, so
24 maybe we can give introductory comments you all would like to
25 make before we start with the witnesses.

1 MR. ROPER: Good morning. I am Gerry Roper. I'm
2 the President and CEO of the Chicagoland Chamber of Commerce.
3 Our Chamber has approximately 2,600 member corporations, many
4 hotels, restaurants, travel agencies, airlines in the six
5 counties of northeastern Illinois.

6 Prior to that, I have managed one of the largest
7 convention and tourism bureaus in the country in Chicago, ran the
8 National Restaurant Show, and managed a number of hotels. So
9 somehow I will be able to help on this Commission.

10 MS. CASTO: I'm Maryles Casto, and I have a travel
11 company. I am not a small agency, but I am not a mega-agency
12 either.

13 I have really enjoyed all of the testimony that has
14 been presented. We think it is very informative. Thank you.

15 DR. MITCHELL: Ann Mitchell from Mississippi. I
16 have a Carlson Wagonlit agency in Starkville, Mississippi, which
17 is the home of Mississippi State University.

18 It has been my privilege to have worked very
19 closely with some of the developments within ASTA for CRS
20 development, to be on the Advisory Board of Carlson Wagonlit
21 Travel for five years, and to be privileged to be a part of this
22 Commission as we look at such an important time in the travel
23 industry.

24 Everybody's in trouble. It is a good time for us
25 to all get together, find out the right solution, and I sound

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1 like a broken record, but if we keep the consumer in the major
2 focus of our efforts, then we will all be okay.

3 MR. RUDEN: My name is Paul Ruden. I am Senior
4 Vice President for Legal and Industry Affairs at the American
5 Society of Travel Agents, which is, I think, the world's largest
6 trade association of professional travel agents. I, too, always
7 aspired to have two jobs. So I am happy to be on the Commission
8 as well, attempting to represent the interests of travel agents
9 of all kinds, from the smallest to the big online agencies who
10 are members of our Society as well, a fact often overlooked.

11 There is something else that often gets overlooked
12 as we continue, as a government and as a society, I guess, to
13 seek philosophical purity with respect to concepts like
14 deregulation. It is certainly important to have a good, strong
15 philosophical and theoretical basis for the policies you adopt,
16 but it is also important, and I think we are going to hear from
17 our first witness today, and several others, some interesting
18 insights into the harsh realities of what it is like to be in the
19 business world trying to do the job that the transportation
20 system is supposed to do, which is to serve the public and to
21 make that system accessible to the public across the board, all
22 segments of the public on a fair basis, while sustaining the
23 necessary level of competition to assure that monopoly power is
24 not exercised at any level in the industry.

25 This tension that exists between these

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1 philosophical principles that we keep hearing about and the
2 realities of doing business in the world as it has evolved under
3 deregulation, that tension is something that is at the core of
4 the issues we are going to have to struggle with on the
5 Commission. I am looking forward to getting on to that phase of
6 it after we hear from all these witnesses today. Thank you.

7 CHAIRMAN WINSTEAD: Pat.

8 MR. MURPHY: My name is Patrick Murphy. I am an
9 aviation consultant here in Washington, D.C. with the firm of
10 Gerchick-Murphy Associates. Prior to that, I spent a career in
11 the federal government dealing with airline economic issues at
12 the DOT and the Civil Aeronautics Board.

13 First, I want to say that I have found the three
14 hearings that we have had very educational, as we have learned a
15 lot about what I think is an accelerating pace of change
16 affecting the airline industry and the distribution of their
17 product. I look forward to today's hearing.

18 Finally, I would recommend, for those of you who
19 haven't seen it, there is a copy of testimony prepared for the
20 Commission by Mike Levine, whom many of you know. Mike will not
21 be able to attend today, but his prepared testimony is out there.

22 I also recommend you see that as well. Thank you.

23 MS. ROGGE: I am Joyce Rogge. I am the Senior Vice
24 President of Marketing for Southwest Airlines, and am very
25 pleased to be here representing the smaller, low-cost fare

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1 airlines, and agree with all the Commissioners that have spoken
2 that we have had a good ride and a lot of testimony to go
3 through.

4 I am looking forward to today as well and getting a
5 new perspective, a little bit of a different perspective from
6 some of the other things that we have heard. So we can pull that
7 all together, hopefully, in the next several days. Thank you.

8 MR. LAWSON: I'm Ted Lawson with National Travel.
9 I have a management firm. My background includes some of the
10 airlines and a hotel management firm in another life.

11 I want to welcome all the witnesses and public.
12 You add a lot to what we are doing, and our progress depends on
13 your participation. I am very happy to see you all here very
14 much. Thank you.

15 MR. DUNNE: My name is Tom Dunne from St. Louis,
16 Missouri, now a hub of American Airlines, previously of TWA and
17 Ozark Airlines.

18 I am basically here as an independent observer, you
19 might say, not affiliated with the airlines or travel agencies,
20 but am concerned about what consumers pay. Especially being in
21 the St. Louis area, after Carl Icahn got done with TWA and the
22 likes and what he was able to do, I am certainly concerned about
23 what it is costing a person to fly and the consumer. That is
24 where I am basically coming from.

25 CHAIRMAN WINSTEAD: Great. Thanks, Tom.

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1 Before we get started with Alex's testimony, let me
2 just mention that the Commission, which started out its activity,
3 as I mentioned, November 15th, and we have six months in which to
4 have conducted these hearings and to get a report back to the
5 White House and the Congress, we would not be as far as we are,
6 and have done a reasonable job in that effort today, if it
7 weren't for a lot of help. Fortunately for the Commission, we
8 have hired a number of good people and consultants. I would just
9 like to introduce them briefly.

10 Dick Fahy, behind us, is Executive Director of the
11 Commission and joined us on May 15th, and has many, many years of
12 background as both a lawyer and in the travel industry. He has
13 been an enormous resource to us.

14 Tillie Fowler, who I think is in the back there,
15 who is a law student here in Washington, is legal assistant to
16 the Commission, also had a number of years up on Capitol Hill
17 working with the Aviation Subcommittee. So it has been very
18 helpful in terms of Congress' interest in this Commission.

19 Bill Jackman, on the far right, has helped us on
20 public relations and communications. We have had a lot of
21 inquiries at our hearings and testimony, and he has been very
22 helpful in getting out notices and press releases on our
23 activity.

24 Dorothea Collins, who is probably out in the hall,
25 but she has been very helpful in getting our Commissioners, who

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1 are from all over the country, to our hearings and logistics, as
2 well as arrangements for these hearings.

3 I would also like to mention that we are
4 independent, as you all know, of DOT. We have our own offices
5 that we have rented for a six-month period on Vermont Avenue.
6 The address with telephone, fax, and a new website are available
7 out front; you can get that. In addition, we hope the website
8 will be announced in the ASTA newsletter. All the testimony we
9 have received to date is online, but we are going to have our own
10 website to make sure that everybody can access it.

11 So we have very good support in place to, over the
12 next number of months, deliberate, produce our report, and make
13 recommendations. I think Dick has counseled me that perhaps, and
14 maybe the Commissioners feel this way, that our efforts through
15 these hearings have perhaps been the easiest part of it,
16 certainly perhaps the most interesting. We have certainly heard
17 from all aspects.

18 I do hope today, as in the past, that through Q&A
19 of the Commissioners that we do get to the critical issues. That
20 is, what the state of the market is, what recommendations you all
21 have as experts and witnesses for the Commission to consider in
22 its report and recommendations.

23 So I want to again thank the staff publicly for
24 their efforts to date.

25 Alex, I welcome you. Thank you, as our first

1 witness.

2 We do have a pretty good schedule today, and I
3 think we have enough time, all of us are committed to hearing all
4 testimony and getting through our questions. So don't feel
5 constrained. We usually try to put out about a 15- or 20-minute
6 window for presentations and about the same for Q&A, but I think
7 we are probably in pretty good shape.

8 But if you could start by introducing yourself and
9 your company and your expertise, we would appreciate it.

10 MR. WASILOV: Thank you. First, let me start by
11 thanking all the members of the Commission for this opportunity
12 to testify in front of you. I think what you are doing is very
13 important for our industry. It is very important for the
14 country. It is very important for the commerce that takes place,
15 not only domestically, but internationally as well.

16 My name is Alex Wasilov, and I am the President and
17 Chief Operating Officer of Rosenbluth International. We are,
18 depending on what month of the year, either the third or fourth
19 largest global travel agency operating in 57 countries around the
20 world.

21 Our business is primarily large corporate travel.
22 We process about \$4 billion worth of both air, car, and hotel
23 travel annually around the world.

24 I would like to talk to you today about some issues
25 that I think are pretty significant for the agency community, but

1 I also think they are very significant for the airline community.

2 I am going to end with a call to action of some suggestions we
3 are making that we think will help create a better business model
4 and allow all participants in this industry to operate more
5 profitably and, as a result, give better service to the consumers
6 that use our services.

7 Travel agencies represent an industry marketplace
8 where prospective travelers have the ability to shop for air,
9 car, and hotel products for both leisure and business purposes.
10 Travel agencies are one-stop shopping malls that have access to,
11 and can evaluate, multiple suppliers as a potential solution for
12 their clients.

13 Travel agencies are the primary and the lowest-cost
14 channel of distribution for the airlines, representing upwards of
15 80 percent of their total sales. Travel agencies also account
16 for approximately one-third of all hotel room sales and car
17 rental sales in the United States.

18 The four principal global distribution systems
19 operating in the U.S. -- Galileo, Sabre, Worldspan, and Amadeus
20 -- provide an electronic infrastructure through which most of
21 these transactions are processed.

22 The function provided by travel agencies in terms
23 of taking reservations, providing customer service for those
24 reservations, as well as fulfilling the ticketing requirements
25 associated with those reservations, are activities that the

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1 airlines have consciously decided to outsource. This outsourcing
2 initiative precipitated the creation of the travel agency
3 industry and has allowed airlines to focus on their core
4 competencies associated with flying airplanes, instead of
5 processing reservations and tickets.

6 The travel agency community, in conjunction with
7 the global distribution systems community, has provided consumers
8 and corporations a location where they can compare offerings from
9 different suppliers inside of one environment. This has, and
10 will continue to be, a valuable service that agencies provide on
11 behalf of all participants in our industry.

12 Traditional travel agencies provide storefront
13 access, telephonic access, and electronic access, or a
14 combination of all these, as a means of interfacing with their
15 clients. Online agencies such as Expedia, Travelocity, and
16 Trip.com provide only an electronic access, similar to the self-
17 booking tools such as Highwire and GetThere, the latter of which
18 provides the traditional agencies with electronic transaction
19 capability for their solutions.

20 It is critical to understand that the vast majority
21 of the transactions booked in travel today are made
22 electronically via the global distribution system, despite the
23 fact that the interaction with the traveler can take multiple
24 forms.

25 The travel agency community -- indeed, the travel

1 community -- I believe is better described as the world's largest
2 industry electronic marketplace, and has been that for the last
3 25 to 30 years, since the creation of the global distribution
4 systems.

5 Airlines also operate agency solutions directly
6 with some of their clients. The approximate 20 percent of
7 reservations that are not processed by the travel agency
8 community are made directly with the major airlines, either
9 through wholly-owned websites or through one of their many call
10 centers. An airline call center only differs from an independent
11 travel agency in that it does not fulfill hotel and car
12 reservations, and that it favors its own product offering, as you
13 would expect it to.

14 Historically, the airline community subsidized the
15 cost of distributing its products through the travel agency
16 community in the form of commissions that were paid as a percent
17 of the ticket price. Airlines also paid for the cost of the
18 infrastructure that provided the electronic access to their
19 inventory in the form of commissions or segment fees through the
20 global distribution system networks. Airlines refer to these
21 expenses as part of their distribution costs.

22 These costs are borne both externally by the travel
23 agency community as well as internally in the form of airline-
24 owned ticket centers, call centers, airport counters, airline
25 websites, and the global distribution system support that they

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1 require.

2 Recently, the airline community has taken a keen
3 focus on reducing their distribution costs by way of reducing the
4 commissions to travel agencies, as well as creating solutions
5 that would reduce the level of segment fees they pay to the
6 global distribution systems community.

7 After a number of travel agency commission cuts
8 over the past few years, the airlines finally eliminated
9 commissions entirely at the beginning of this year. It is simply
10 coincidental that they all came to this conclusion within five
11 days of each other.

12 It is amazing that they only eliminated the
13 commissions to a part of their distribution channel that they do
14 not own, while continuing to subsidize their internal
15 distribution costs out of the ticket revenue that they receive.

16 I am concerned by how airlines can rationalize that
17 the elimination of commissions to travel agencies truly reduces
18 distribution costs. In effect, they have indirectly transferred
19 the cost burden to the consumer or the corporation by forcing
20 travel agencies to institute transaction fees. In reality, they
21 have simply camouflaged a price increase.

22 Unfortunately, this price increase only applies to
23 a selected distribution channel, the travel agency community, the
24 airlines' lowest-cost distribution channel, a distribution
25 channel that they do not own themselves.

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1 In an effort to compete with low-cost carriers to
2 gain market share at an incremental cost, the major U.S.-based
3 airlines have been promoting special discounted fares or web
4 fares exclusively on their own wholly-owned websites. In some
5 cases these reservations are fulfilled through a special
6 arrangement with a global distribution system. In others they
7 are fulfilled directly with the airline, bypassing both the
8 global distribution system and the travel agency community.

9 What appears to be yet another collusive effort to
10 disintermediate the travel agency community occurred
11 approximately 15 months ago, when the most prominent U.S.-based
12 carriers, representing the majority of air volume transacted in
13 the United States, formed their own online travel agency, Orbitz,
14 offering fares that are exclusive or only available through their
15 site.

16 This generation of fare wars has dramatically
17 reduced, and in many instances eliminated, the opportunity for
18 the travel agency community to effectively compete, as they are
19 restricted access to providing these same fares to their
20 customers through the global distribution systems.

21 As a result of these actions, the airlines have
22 only made what is already an uneven playing field even more
23 imbalanced. The net result is that the airlines have spread
24 their internal cost of distribution, which represents roughly 20
25 percent of their volume, across 100 percent of their sales, 80

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1 percent of which is sold and distributed through the travel
2 agency community, by incorporating a portion of their
3 distribution cost in each ticket that they sell.

4 In order to level the playing field across all
5 distribution channels, airlines must first identify their true
6 and fully allocated internal distribution costs and charge a
7 transaction fee to the traveler that, at a minimum, covers these
8 costs for those reservations that they fulfill through their own
9 distribution channel. We have attached an appendix for
10 illustrating this point, which you can review at your leisure,
11 and feel free to ask me questions about that at the end of my
12 testimony.

13 Through their collective efforts, it appears that
14 the airlines are simply trying to enact the price increase
15 through their primary distribution channel that creates a price
16 disadvantage for travel agencies and, as a result, drives
17 distintermediation

18 Up to this point, any actions that have been taken
19 to turn a profit by the airlines, whether directly increasing
20 ticket prices or capping travel agency commissions, has not been
21 successful. Any gain was quickly redistributed in the form of
22 reduced ticket prices to travelers, primarily through their own
23 websites.

24 In this new environment, what could possibly allow
25 us to believe that further alienating their lowest-cost

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1 distribution channel and primary sales support, the travel agency
2 community, would make airlines any more profitable?

3 At the same time, airlines are putting significant
4 pressure on the global distribution systems community to reduce
5 their segment fees. Currently, airlines pay a global
6 distribution system approximately \$4 per segment. The average
7 airline ticket produces two-and-a-half segments. The total
8 segment fee per ticket that most airlines are charged by global
9 distribution system is approximately \$10.

10 Over the years the global distribution community
11 has shared some of this revenue with the travel agency community,
12 in an effort to subsidize the cost of equipment required by
13 travel agencies to interface with the GDS platform, create
14 alliances, and drive market share. The travel agency community
15 has traditionally applied this revenue source against their cost
16 of operations.

17 The airlines are putting tremendous pressure on the
18 global distribution systems community today to eliminate this
19 revenue to the agencies in a manner that would ultimately reduce
20 airline segment fees. This additional loss of revenue would
21 force agencies to increase their transaction fees even further,
22 creating an even greater disparity between a total ticket price
23 charged by an airline versus one purchased through a travel
24 agency.

25 The travel agency community represents the majority

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1 of any airline ticket distribution. A healthy airline industry
2 is critical to our economy. The viability of the travel agency
3 community as a low-cost distribution channel is also critically
4 important to our economy.

5 It is time to level the playing field and provide
6 equitable ticket pricing to all channels of distribution. We
7 need to impose transparency of costs, so that consumers know what
8 they are paying for. We should simplify pricing structures and
9 establish fairness and equity for all participants in an industry
10 where shell games have been the normal course of business.

11 This can all be accomplished very quickly and
12 simply if the airline community would institute a transaction fee
13 to cover their internal cost of distribution. This would set a
14 precedent for the existence and justification of transaction fees
15 across all channels of distribution, and would allow the
16 airlines' lowest-cost channel, the travel agency community, to
17 co-exist and prosper.

18 I call on this Commission to apply its influence to
19 accomplish this goal. Let common sense and good business
20 judgment prevail. Thank you.

21 CHAIRMAN WINSTEAD: Alex, thanks very much. We
22 appreciate it. I know we probably have a lot of questions from
23 the Commission, and you do, which we appreciate, based on your
24 testimony, do have recommendations for the Commission to
25 consider. I wanted you to elaborate a little bit more on that.

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1 One statement on page, I guess it was, 3 that I
2 found fairly -- I think one sort of recurring theme I am hearing
3 from my perspective, again not one that has been engaged as a
4 travel agent or with an airline, but the new environment that has
5 evolved and your perspective and statement about it.

6 The alienation of the travel agent or lower-cost
7 distribution is really in contradiction with the concept of
8 trying to sell more tickets. You've got small companies out
9 there that are pushing services and building relationships with
10 clients and looking to make sales of airline tickets and other
11 travel arrangements. I think your comments there are just a
12 theme I have been hearing throughout as to, why aren't we
13 encouraging and why aren't we supporting that end of the
14 distribution chain?

15 But you also had some very strong recommendations
16 and really a calling on this Commission to use its influence to
17 accomplish the goals of transaction fees. Again, as we go
18 through the transcripts, and the transcripts are available, will
19 be available online, we continue to try to focus in on both
20 economic evidence of travel agencies, but also recommendations.

21 On that concept that you have asked us to consider
22 and use our report or recommendations and influence to make a
23 recommendation, if you were to have transactional fees required
24 by legislation or regulation, how would you determine those fees?

25 I mean, what we are continuing to see in testimony

1 from other travel agents over the last three hearings is a wide
2 disparity in terms of fees being charged. With the zeroing out
3 of commissions in March, they have all moved to, obviously, GDS-
4 based fees/incentives as well as charging from \$10, \$15 to \$50.

5 Can you elaborate a little bit, if we were to
6 consider that and recommend that, how that determination in terms
7 of fees will be made? Obviously, the marketplace drives it, but
8 can you comment a little bit more on that?

9 MR. WASILOV: Yes. My recommendation, or our
10 recommendation, would be that you do let the marketplace drive
11 it, that fees associated with the cost of transacting the sale of
12 an airline ticket should be based on the cost associated with
13 that transaction. Let the travel agency community compete
14 against the airlines' infrastructure costs for processing the
15 ticket. Let them compete on the incremental value that they
16 deliver inside of that process, and either charge more or less.

17 But the benchmark should be, what does it cost an
18 airline to distribute a ticket directly to a consumer? If they
19 are forcing the airline community which represents 80 percent of
20 their volume to charge for that service, why aren't they charging
21 for that service themselves? Why are they taking the cost of
22 their transactions, which represent only 20 percent of their
23 volume, and spreading that cost and putting it in the ticket
24 price of 100 percent of their volume?

25 In effect, they are charging the consumer two

1 transaction fees: a portion of their cost that is associated
2 with the 20 percent of their volume that they distribute
3 directly, plus the cost associated with the services that a
4 travel agency community provides. It just doesn't make any
5 sense.

6 The travel agency community in a zero-based
7 environment is the airlines' lowest-cost channel of distribution.

8 It doesn't cost them anything. If they process the ticket
9 themselves and deliver it to the consumer, whether they do it
10 electronically, telephonically, or across the counter, they have
11 a cost associated with that.

12 Why would they want to promote an environment where
13 their costs are higher versus drive consumers to continue to
14 purchase tickets through a channel of distribution where they
15 have no cost? I think the answer to that question is very
16 germane to the topic being discussed.

17 One of the things that the travel agency community
18 provides the consumers is the ability to compare offerings from
19 multiple suppliers. Maybe what the airlines are trying to do is
20 prevent that open market system, which our country and our
21 economy is based on.

22 Certainly, the economics of what they are doing in
23 today's environment doesn't make sense in this industry, and
24 certainly wouldn't make sense in any other industry that I am
25 aware of or familiar with. You don't underprice the distribution

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1 channel that represents 80 percent of your distribution when it
2 is your lowest-cost channel of distributing your products.

3 CHAIRMAN WINSTEAD: Alex, we have heard a lot of
4 testimony in San Francisco and Chicago about the net fare concept
5 as well. How do you differ the two, the one you are proposing
6 versus the net fare?

7 MR. WASILOV: From my perspective, it is where you
8 start from. You have to have some rationality in what you are
9 asking participants in an industry to do.

10 If you ask the airlines to go net fare today, they
11 would be required to reduce the price of their ticket to 80
12 percent of their distribution channel by the amount of the cost
13 associated with distribution in their direct channel.

14 Well, taking whatever the number would be, a \$25
15 price reduction on every ticket across 80 percent of your volume
16 for the airlines today in this environment, where they are losing
17 millions of dollars a day, just doesn't make sense.

18 So a simpler solution, which would benefit the
19 airlines -- because, quite honestly, we have to get the airline
20 industry healthy. Without airlines, travel agencies have nothing
21 to do. Without airlines, corporations can't conduct business.
22 Without airlines, consumers can't enjoy the free time outside of
23 their work environment to relax and take a vacation. We need the
24 airlines to be healthy.

25 Reducing their distribution cost in the way that

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1 they are trying to do it today creates an incremental cost in the
2 total solution to the consumer. It has no final impact on the
3 cost of what the consumer is paying. It is disguised as a
4 significant move by the airlines to reduce costs without raising
5 prices, but they are just forcing the price increase to happen
6 someplace else.

7 So our plea is just level the playing field.
8 Recognize the distribution channel that adds value.

9 Net fares conceptually make sense, but in reality
10 would be almost impossible to initiate. So another way of
11 implementing the same concept would be just to add a transaction
12 fee to what the airlines charge for their tickets today, which
13 will produce an incremental revenue stream for them, which will
14 take prices up slightly in the marketplace today, just on those
15 tickets purchased directly through the airlines. It would help
16 them financially and would create a net fare in reverse by
17 charging all distribution channels the same price for the ticket
18 without the ticketing cost associated with it.

19 CHAIRMAN WINSTEAD: Great. Thanks, Alex.

20 Let me open it up to questions from the
21 Commissioners. Gerry?

22 MR. ROPER: Alex, thank you for -- you are the
23 first one who has attempted to take the dysfunctional family that
24 I keep talking about, which is the airlines and the travel
25 agents, and identifying that, without one, the other doesn't

1 exist. Without the airlines, the travel agents really don't have
2 anything to market.

3 I want to go to your testimony on page 3, and maybe
4 I am taking this out of context, but I am following up on what
5 Ann continually tells us: that if we keep the consumer in front
6 of us, we should be able to accomplish this.

7 You say in your fourth paragraph, "Any gain" -- and
8 assuming the gain was by the airline -- "was quickly
9 redistributed in the form of reduced ticket prices to the
10 traveler." Isn't that a positive?

11 MR. WASILOV: It's a positive in an environment
12 where you have a healthy business that can sustain itself doing
13 that.

14 MR. ROPER: But I am going back to what Ann says.
15 You know, the consumer in this case was helped, correct?

16 MR. WASILOV: The consumer was offered lowered
17 prices on tickets in an environment where offering those ticket
18 prices is forcing the airlines to shut down because they can't
19 operate profitably. So you can say that, yes, there was a short-
20 term gain but a long-term loss. I would say those consumers
21 today are paying for those fares through their taxes, through the
22 subsidies that the government is providing the airlines to
23 survive.

24 So the consumers really weren't paying lower
25 prices. They were just paying them differently. They are either

1 paying them through the subsidies which their taxes provide
2 revenue for or they are paying for them through the price that is
3 charged directly on the ticket.

4 So I honestly don't believe that that was a good
5 thing for consumers. I think it is a very bad thing.

6 MR. ROPER: Yes.

7 MR. WASILOV: If you don't have a healthy airline
8 industry, they are going to either shut down or the government is
9 going to be forced to continue to pour billions of dollars to
10 underwrite their pricing strategies.

11 MR. ROPER: Just the second part, on the last page,
12 you have mentioned, "We should simplify pricing structures and
13 establish fairness and equity for all participants in an industry
14 where `shell games' have become the normal course of business."

15 Because I have been in this business for a few
16 years, I guess I am part of the shell game. But I think the
17 industry that you are talking about are, of course, the travel
18 agents, the airlines, the DMOs, the Amtraks. Everybody has been
19 playing a shell game with the consumers, and we need, as a
20 Commission, to look at this and expose everybody's pricing
21 structure. We need to be saying that this is what a travel agent
22 makes; this is what the airline makes; this is what -- I mean, is
23 that what you're saying to me?

24 MR. WASILOV: Yes.

25 MR. ROPER: Okay.

1 MR. WASILOV: If I could provide a bit more
2 background, over the years the airlines paid commissions to the
3 travel agency community that were too high. You know, they
4 provided enormous profitability in the travel agency community
5 15-20 years ago, and, rightfully, I think started to reduce those
6 commissions.

7 But in the time of those high commissions, part of
8 those dollars were passed on through GDSs to clients, through
9 agencies to clients, and the revenue stream was convoluted. It
10 was not clear. It did not create an environment where the agency
11 community could, rightfully, stand up and say, "We represent the
12 consumer in this environment."

13 That is what I refer to in that comment relative to
14 shell games, that the revenue stream has not been transparent. I
15 think it is time that we get to a situation where that revenue
16 stream is transparent. I believe strongly that the
17 implementation of transaction fees will allow that to happen.

18 Let the different distribution channels, including
19 the airlines themselves, compete in an open market against their
20 distribution costs fairly. Those who have the lowest
21 distribution costs should offer the lowest transaction fees,
22 which I believe is in the best interest of the consumer.

23 MS. ROGGE: Alex, if I could jump in there?

24 CHAIRMAN WINSTEAD: Go ahead, Joyce.

25 MS. ROGGE: In the example that you were giving us

1 in your testimony, which thank you for being here today, the
2 fulfillment fee was \$25, correct?

3 MR. WASILOV: Yes. Let me say that the \$25 fee
4 that is being used here is an example of what we believe is kind
5 of an average in the marketplace. I would not suggest that it is
6 an exact number, but we believe it is very much in the range.

7 MS. ROGGE: So you are suggesting that airlines
8 voluntarily add that fulfillment fee or are you suggesting that
9 the government impose some kind of regulation to have the
10 airlines do that?

11 MR. WASILOV: Well, first of all, I think it is a
12 good thing for the airlines to do voluntarily. By the way, I
13 have yet to speak with an airline or hear an airline comment on
14 this suggestion that doesn't believe this is a good idea.

15 They are very comfortable with taking prices down
16 and following each other, but they are very concerned about doing
17 the right thing in terms of changing the business model and
18 having the industry follow. So I think there is concern about,
19 well, if we did this as an individual airline, would other
20 airlines take advantage of this situation and try to do something
21 to gain market share in this environment where an individual
22 airline is taking this action? So, unfortunately, it will either
23 require leadership or it will require some form of legislation.

24 MS. ROGGE: Well, let me be an airline with a
25 dissenting opinion. Not all airlines have 80 percent of their

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1 distribution with travel agencies. Southwest Airlines doesn't.
2 Many of the other low-fare airlines don't as well, jetBlue being
3 an example of that.

4 So the idea of a fulfillment fee, whether it is \$25
5 -- or a transaction fee -- whether it is \$25 or another price,
6 would, in essence -- I mean, I am asking you this question --
7 would, in essence, raise the fares for the customers on some
8 number greater than 20 percent of the tickets that are sold?

9 MR. WASILOV: Well, for an airline such as yours,
10 which is very successful and very profitable, it wouldn't
11 necessarily have to be an incremental fee. Since you are already
12 making money and you don't have the need to make more money, you
13 could just identify that fee inside of your ticket pricing and
14 just recognize the fact that, if you buy a ticket through a
15 travel agency, there is a fee associated with a process or a
16 service that they deliver. If you buy that ticket directly with
17 Southwest Airlines, we also deliver that same value through
18 ticketing, through customer service, through customer care, and
19 our price for that is "X."

20 It just is confusing when you force one channel of
21 distribution to charge incrementally for that and you take your
22 own costs, whether it is 20 percent, 40 percent, or 60 percent in
23 your case, and spread it across your entire ticket desk. It just
24 makes it very, very difficult for multiple channels of
25 distribution to co-exist.

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1 I don't mean that in any way to be derogatory
2 against Southwest, which I think is a phenomenal airline that has
3 a great business model and is very successful in doing what it is
4 doing. It is just, with the other airlines that aren't as
5 successful, they are creating an unjust pricing structure in the
6 marketplace relative to their channel of distribution.

7 Now if their strategy was to say, you know what, we
8 want to eliminate the travel agency community and we want to
9 distribute all of our products directly and prohibit the consumer
10 from having a shopping mall where they can compare products,
11 compare services, compare price, if that is their strategy to do
12 that, and they are willing to go out and hire 300,000 agents and
13 invest in infrastructure to create huge call centers to do that,
14 that would be their prerogative to do from a business model
15 standpoint. I don't think it would be a smart thing to do, but
16 certainly they have the right and the ability to do that.

17 What doesn't make sense is when they want to
18 continue to distribute 80 percent of their volume through a
19 channel of distribution which has in today's environment zero
20 cost to them, but at the same time are underpricing that
21 distribution channel in the environment the way it is being
22 implemented today.

23 MS. ROGGE: Meaning that they are underpricing it
24 by having web fares or some other kind of --

25 MR. WASILOV: No, they are underpricing it from the

1 standpoint -- and through this illustration I tried to create a
2 simple visual that would explain it.

3 Prior to the reduction or the elimination of
4 commissions, if a consumer bought a ticket from an airline or
5 through a travel agency, they paid the same price. If they
6 bought it through the airline, the consumer inside of that price
7 would pay for the fuel, would pay for the aircraft amortization,
8 would pay for the pilots, would pay for all the costs associated
9 with flying that plane, and they would also pay for the cost of
10 transacting the process of purchasing the ticket.

11 They would also pay for that inside of the agency
12 community, which was reimbursed by the airlines for those costs.

13 So everybody paid the same thing, and the transaction costs were
14 embedded in the price of the ticket.

15 In today's environment, in an effort to improve
16 their profitability, some airlines have decided to eliminate
17 these commissions and force the distribution of their tickets
18 through the travel agency community to have an incremental cost.

19 So now you can buy a ticket for that same price, assuming prices
20 haven't changed over time, from an airline, but if you bought
21 that same ticket through an agency community, now all of a sudden
22 you have to pay an incremental charge to cover the fulfillment
23 process.

24 That is the piece of the equation that we are
25 saying not only is unfair, but just doesn't make economic sense.

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1 It doesn't make business model sense.

2 MS. ROGGE: Excuse me for interrupting for just a
3 second, but, Alex, doesn't the service that you provide as an
4 agency, I mean, you're giving more service than a phone call to a
5 res. center or going online to an airline's website? You are
6 doing more research. You are doing more customer service. You
7 are helping as they go through their travel. I mean, isn't that
8 why customers choose to use travel agencies? So, to me, it
9 doesn't seem unjust that you would charge for that extra service
10 that you provide.

11 MR. WASILOV: I agree that we should charge extra
12 for the extra service that we provide. So if we book air, if we
13 book hotel, if we book car, if we create a leisure tour for
14 somebody, there should be an incremental charge. But for the
15 cost of booking a transaction for a ticket, the agency has a cost
16 associated with that, and the airline has a cost associated with
17 that.

18 They should both charge for that service, and they
19 should charge for that service based on what it costs them.
20 Those with the lowest cost should offer the lowest price and let
21 the marketplace dictate which channels are most effective from a
22 consumer's perspective.

23 So I don't disagree with you. It is just when you
24 get back to that cost of distributing the ticket through an
25 agency, when an agency sells an airline ticket, there is no cost

1 to the airline. When an airline sells a ticket, there is a cost
2 to the airline. Why wouldn't the costs from the airline differ
3 in those two environments? And that is really the point we are
4 trying to make.

5 MS. ROGGE: I think we are going to have to agree
6 to disagree.

7 (Laughter.)

8 MR. WASILOV: But thank you for the opportunity to
9 speak passionately on a subject that -- and, by the way, I am
10 very -- let me explain that this is less of an issue for
11 Rosenbluth. Rosenbluth, because it is in a corporate
12 environment, 98 percent of our tickets transacted are in net-net
13 environments. All right, the prices have been altered for our
14 clients to take into account that we charge a transaction fee.
15 This is not necessarily a positive thing, it would not be a
16 negative thing for Rosenbluth.

17 I am speaking on behalf of the travel agency
18 community as the business person who is looking at this total
19 industry and saying, the business model doesn't make sense. How
20 can we improve it? How could we make it a little bit better?

21 By the way, I think that the beneficiary of what we
22 are recommending is the airline, not the travel agency community.

23 I am actually arguing, I believe, on behalf of what is a very
24 good thing for the airline community, not trying to create a
25 conflict between agencies and airlines. But in this case, what

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1 is good for the airline community I believe is also good for the
2 travel agency community.

3 MS. ROGGE: And I will just do one followup just so
4 that I am clear as well. Certainly the airlines should be
5 looking for ways to have better revenue and to improve their
6 business model, but what concerns me about your proposal is that
7 it is a way for someone else to come in and regulate what the
8 prices are going to be or what the increased transaction fees are
9 going to be. As a representative of a low-fare airline, that
10 makes me very uncomfortable.

11 MR. WASILOV: Let me use an example in a different
12 industry. If we were in the car industry today and General
13 Motors decided tomorrow to say that, if you wanted to deal
14 directly with General Motors, you can buy a car from us for the
15 same price that the best, the largest dealership in the world
16 buys a car from us for. What would happen to their dealer
17 distribution network? How would they handle all the volume that
18 would come into them to sell these cars at such low prices?

19 It would be great for the consumer, but eventually
20 they would have to raise their price because they would have to
21 build the largest showroom in the world in Detroit. It just
22 doesn't make sense.

23 MR. ROPER: Alex, it is called "the Internet."

24 (Laughter.)

25 You can go on there and you can see any car that

1 you want on the Internet.

2 MR. WASILOV: But you still pay market pricing for
3 it, all right, and that's the point. The Internet, for example,
4 has a cost of distribution as well.

5 I mean, part of our recommendation is that if you
6 buy a ticket through the Internet and the processing costs in
7 that environment are \$8-10, charge \$8-10. If a consumer chooses
8 to have someone else go through that process for them and
9 interacts with a travel agent over the phone, and the cost of
10 that is \$30, let the consumer make the choice whether they want
11 to pay that incremental cost or they want to take the lower-cost
12 option.

13 What doesn't make sense is not to charge for that
14 service and disintermediate your distribution channel, which some
15 of the major airlines are doing today by their pricing structure.

16 CHAIRMAN WINSTEAD: Pat, you had a question? We
17 have about five more minutes, Alex. And then Paul.

18 MR. MURPHY: I had a question. I am trying to
19 understand how your proposal would affect the traditional brick-
20 and-mortar travel agency, smaller travel agency. If I understand
21 your proposal, if an airline were to sell a ticket through its
22 least expensive outlet, let's say, over its website, its
23 transaction fee, from what we have been told, would be extremely
24 low since all they have to do is post it through the Internet.

25 On the other hand, we have been led to believe that

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1 the traditional brick-and-mortar travel agency is a higher-cost
2 outlet. Therefore, presumably, they would have a higher
3 transaction fee.

4 So how would this affect the smallest travel agency
5 who don't have the economies that you have?

6 MR. WASILOV: An airline, an online agency, a self-
7 booking tool, in today's environment generates somewhere between
8 1.2 and 1.5 support telephone calls for every transaction. There
9 is no such thing as an electronic transaction that doesn't have a
10 cost associated with it. That is a myth. Anybody who says that
11 has never examined the cost structure --

12 MR. MURPHY: No one has suggested that it has no
13 cost, but all the data we have seen I believe shows there's a
14 hierarchy of costs in distributing tickets, and the airlines on a
15 website is viewed by most as the lowest-cost outlet for the
16 airlines.

17 MR. WASILOV: Absolutely. If people choose to use
18 that, they should use that and the airlines should charge a fee
19 for that transaction that replicates --

20 MR. MURPHY: Right.

21 MR. WASILOV: -- whatever their cost is. If it is
22 \$5, it is \$5. If it is \$8, it is \$8. But why would they not
23 charge on their own site, where they have the same cost that an
24 Expedia would have, but for Expedia to charge, that is the part
25 that doesn't make sense.

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1 MR. MURPHY: But, again, taking this to the brick-
2 and-mortar, mom-and-pop travel agency in small town America, how
3 do they compete when their transaction fee is significantly
4 larger than going online?

5 MR. WASILOV: Let me try to illustrate an example
6 to answer that question. If I owned a small agency somewhere in
7 this country, and in today's environment in order to provide the
8 services that I provide, I have to charge a fee. Let's say in
9 order to cover my costs and support my family, I have to charge
10 -- I'm just picking a number -- \$50 per transaction.

11 The consumer now has a choice of either paying me
12 \$50 to do all the good things that I would do for them or to do
13 that stuff on their own and go online and pick a hotel and pick a
14 car and buy an airline ticket. But in that environment they
15 don't pay any cost for processing the ticket when dealing
16 directly with the airline. Then it is much harder for them to
17 justify the cost that is inherent in their transaction fee
18 associated with processing the ticket.

19 If, on the other hand, an airline said, "You know
20 what, you're right, we have a cost of distributing our ticket
21 when we do it directly, and we're going to charge \$10 for that."

22 And a hotel says, "You know what, we have a cost of distributing
23 our ticket directly. So if you buy from us, we're going to have
24 to incorporate that cost," and let's say that's \$10. And let's
25 say you did the same thing with a car rental agency.

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1 So now if a consumer were to do all those things
2 themselves, they would pay \$10 here, \$10 here, \$10 here, \$30.
3 They might say, "Hey, you know what, the travel agent provides me
4 a lot more value than the 20 extra dollars I am going to pay --

5 MR. MURPHY: So with your proposal there would have
6 to be transaction fees not only for the airline, but for the
7 hotel and for the car rental company?

8 MR. WASILOV: I believe that if the airlines lead,
9 as they did in zero commissions, that all the other participants
10 would follow under the same logic. Because right now what is
11 happening is they are taking their distribution cost that only
12 applies to a small portion of their volume and spreading it
13 across every one of their tickets. So every time you buy a
14 ticket through a travel agency or book hotel room through a
15 travel agency or rent a car through a travel agency, you are
16 paying two transaction fees -- a portion which the airline, the
17 hotel, and the car is embedding in the price of the ticket to
18 cover their own distribution cost, plus the incremental costs
19 associated with the services that an agency provides.

20 MR. MURPHY: Thank you.

21 CHAIRMAN WINSTEAD: First Ted and then Paul.

22 MR. LAWSON: I would like to welcome you.
23 Rosenbluth has definitely been a leader. I think that your
24 appearance here -- you know, we are very concerned with the small
25 travel agency, but I think you give us more of a macro-view of

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1 the industry.

2 If you would, tell me again, because it appears to
3 me that what you are really proposing is a net fare concept. In
4 other words, from a distribution standpoint, airlines would say,
5 "This is what we are going to sell the tickets for, and this is
6 the net fare, and you can add whatever you want onto it." It
7 seems like then the marketplace would determine the efficiency of
8 the distribution channels automatically.

9 MR. WASILOV: Agreed.

10 MR. LAWSON: Why wouldn't that work in that
11 scenario though?

12 MR. WASILOV: Well, it is exactly what I think we
13 are proposing. We are just using different terminology in terms
14 of how to get there.

15 A net fare structure would presuppose that each
16 channel of distribution would add a cost to that net fare
17 associated with the fulfillment of purchasing that product.

18 MR. LAWSON: Correct.

19 MR. WASILOV: Right? So we agree. We have already
20 done that in the travel agency community. The airlines haven't
21 done it yet. We are just asking them to fulfill the promise.

22 MR. LAWSON: Then the airlines would determine what
23 their -- there would be no regulation then, as we are picking up
24 here, there would be no regulation? In other words, the airlines
25 would determine what their fares were on a net basis, and then

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1 the different distribution channels add onto that fare as they
2 choose? Is that your vision?

3 MR. WASILOV: Yes. Let's take an example in
4 today's environment. The airlines are distributing tickets
5 through the agency community for a net price. The agency
6 community is charging a transaction fee on top of that. But for
7 those tickets that the airlines distribute themselves, they are
8 not charging themselves the same net price. They are charging
9 themselves a lower net price. To that lower price, they are
10 adding their transaction cost. So their net price plus
11 transaction fee is different than the net price that they offer
12 to the agency community today.

13 We are just saying level the playing field; make it
14 the same. Either takes ours down on the price of the ticket and
15 yours up or leave ours where it is and take yours up, or charge a
16 transaction fee, though. In that net fare environment you can't
17 have one channel of distribution being forced to charge a
18 transaction fee but another channel of distribution not charging
19 a transaction fee because they have embedded their cost in the
20 net fare of all the tickets in the marketplace.

21 MR. LAWSON: Why do you think they have gone down
22 this road? Obviously, the airlines are losing money. What do
23 you think they have gone down this particular road in their
24 distribution?

25 MR. WASILOV: Well, quite honestly, I think they

1 were forced to. I think they were forced to because they are
2 trying to figure out ways to improve their revenue per ticket,
3 their yield.

4 Southwest excluded, which does a pretty good job of
5 that in the current environment, the major airlines in North
6 America have not done a very good job on that. I mean, how can
7 you have five airlines representing 80 percent of an industry and
8 the whole industry is losing billions of dollars a day? You have
9 to ask yourself that question.

10 And what I think they were forced to do is, how
11 could they increase their revenue through a price increase in
12 such a way that it stuck inside the industry and wasn't perceived
13 to be an increment to their pricing structure, while removing the
14 distribution costs?

15 And by the way, removing distribution costs are
16 good, and that is a very good thing if they disappear. But in
17 this case they don't disappear. They just pop up as an increment
18 the consumer pays on top of the price of the ticket.

19 MR. LAWSON: Thank you.

20 CHAIRMAN WINSTEAD: Tom and then Paul, and then we
21 will try to wrap it up a bit. Go ahead.

22 MR. DUNNE: I've got just a couple of questions
23 here.

24 Your agency -- and I will make it simplistic --
25 you've got, I'm sure, a sophisticated computer system, and I am

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1 sure you spread that across throughout your entire organization.

2 In other words, you don't have one area paying for all of it and
3 another area paying nothing for it. So you charge that amount to
4 all your transactions, a certain amount, a direct cost.

5 MR. WASILOV: Inside of our corporate travel
6 community that is correct.

7 MR. DUNNE: Yes, I'm just saying you do that. So
8 it is similar to what the airlines are doing themselves. They
9 are spreading their costs throughout all the tickets they sell.

10 MR. WASILOV: Our computer network, our IT
11 structure supports 100 percent of our transactions and, as such,
12 we apply that cost to 100 percent of our transactions.

13 MR. DUNNE: Okay.

14 MR. WASILOV: In the scenario that I am painting
15 here for this Commission the cost associated with transacting a
16 ticket is only representative of 80 -- or supports only 20
17 percent of the volume of airline tickets that they sell.

18 MR. DUNNE: But their computer system, whatever
19 system they use to distribute, is still going to cost them
20 somewhere along the line. It is still a direct cost, but it is
21 just the way they are spreading it.

22 MR. WASILOV: For a basic computer system I would
23 agree, but for call centers, for ticket counters, for the costs
24 associated with interfacing with the GDS, which is a discrete
25 cost associated with the transaction of a specific ticket, for

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1 those costs they have discrete costs associated with fulfilling
2 the ticket. It is not something that they invest in that
3 supports everything that the company does. It is a discrete
4 cost.

5 MR. DUNNE: But in your earlier example you said at
6 one time that they were charging fuel when everything else was a
7 part of the ticket cost.

8 MR. WASILOV: Well, no, I was just explaining that
9 a ticket cost today includes all sorts of costs that a company
10 has. It includes fuel. It includes the cost of the airplane,
11 which, by the way, is something that you spread over all your
12 volume because --

13 MR. DUNNE: Exactly.

14 MR. WASILOV: -- airplane costs covers all your
15 volume. Fuel covers all your volume. Electricity covers all
16 your volume. Your basic computer systems inside of an airline
17 support your total business structure, support your total volume.

18 MR. DUNNE: So why wouldn't you put that as a
19 direct cost or those things as a direct cost and spread it
20 throughout all the tickets you sold, no matter what channel you
21 sell them in?

22 MR. WASILOV: I have no issue with that, but your
23 call center costs that are associated with just the tickets that
24 you sell, your GDS fees that are associated with just the tickets
25 that you sell, your ticket counters the cost of which is just

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1 associated with the tickets you sell, those are discrete costs
2 associated with 20 percent of your volume.

3 So if you want to create an environment where your
4 distribution channel makes sense and you're not trying to
5 underprice your distribution channel because you want it to go
6 away, why wouldn't you create the same pricing structure for your
7 own internal store as you do for your indirect channel of
8 distribution?

9 MR. DUNNE: Okay.

10 MR. WASILOV: But on the computer point, on the
11 computer systems I agree.

12 MR. DUNNE: I'm trying to get the direct costs, and
13 what I am saying is, how are you going to pierce this veil of
14 what's direct cost and what's --

15 MR. WASILOV: The airlines know exactly what that
16 number is. I am sure Joyce knows exactly what that number is for
17 Southwest Airlines.

18 MR. DUNNE: And my point is, why shouldn't you
19 spread it over 100 percent of your tickets, no matter what? And
20 I understand where you are coming from on channels.

21 The last question I have: The size that you are,
22 the size of any travel agency can also get breaks in respect to
23 discounts, and what have you, from hotels, car agencies, et
24 cetera, et cetera. Now under the fairness rule that you are
25 proposing, you would then return that portion that you make to

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1 the airlines, since we're all in this thing together?

2 MR. WASILOV: No, to the supplier who provides it.

3 MR. DUNNE: Right. You would return this all to
4 the airlines, too? They would get a break of that, what you are
5 getting back?

6 MR. WASILOV: We would return it to the hotel. We
7 wouldn't necessarily take hotel money and return it to the
8 airlines. I mean, that wouldn't make sense.

9 But we do that today. At Rosenbluth we do that
10 today. We return all those fees that we get from our suppliers
11 directly to our clients, and it is negotiated in the ticket price
12 that our clients get to or negotiate with the airlines.

13 So our business model is pretty transparent today.
14 Our clients get to audit our cost structure. They know exactly
15 what our revenue stream is. They know exactly pretty much how
16 much money we make. We open up our books to our clients. I
17 think transparency in that environment is a very good thing, and
18 we do it today and we would support it for the entire industry.

19 MR. DUNNE: Thank you.

20 CHAIRMAN WINSTEAD: Paul, you had one question, I
21 think?

22 MR. RUDEN: Well, it may be more than one.

23 (Laughter.)

24 I think this is some of the most important
25 testimony that we have heard. We have also heard some other

1 interesting testimony to the effect that some travel agencies,
2 big ones, have offered to pay all the distribution costs,
3 including GDS fees, in order to get access to those Internet low
4 fares that get so much attention, and were turned down by the
5 airlines.

6 I think of that when I hear you say that what is
7 going on now doesn't make sense as a business model. But it does
8 make sense, doesn't it, if, in fact, the hypothetical you
9 mentioned earlier is true? And that is that the real objective
10 here of putting the agents in the position that they are in is to
11 make it impossible for them to function in the marketplace for
12 the long term. Doesn't it make sense then as an airline
13 strategy, if they want to dominate the market, take complete
14 control of the distribution process, to do it the way they are
15 doing it?

16 Why would they resist what you are talking about
17 otherwise? You say they are afraid.

18 MR. WASILOV: I'm not sure.

19 MR. RUDEN: They complain endlessly here in
20 Washington. You are happily spared this probably in
21 Philadelphia, but endlessly complain about how difficult it has
22 been for them for decades. They can't find a way to make money.

23 Now you are proposing a fundamental change in the
24 way the pricing mechanisms works, and not just here, everywhere
25 that I have seen this idea discussed it is reacted to with shock,

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1 as if it was somehow an undermining of fundamental principles,
2 when it seems the exact opposite is true. How do you account for
3 that?

4 MR. WASILOV: I can't. I really can't.

5 As I said before, if an airline wanted to
6 distribute all their products directly themselves, great. What
7 would happen in that environment? Their costs would skyrocket.
8 If their costs skyrocketed, what would they be forced to do?
9 Either lose more money or charge a higher fee. I don't see where
10 that is good for the consumer.

11 In today's environment where there is zero
12 commission, the cost of distributing through the travel agency
13 community is zero. They have a cost associated with distributing
14 tickets. Why wouldn't they incorporate that cost in the tickets
15 in a manner that supports their distribution channel versus this
16 intermediate, say?

17 Could there be another reason why they wanted this
18 intermediate travel agency community? Would that be because they
19 don't like the environment where there is free trade and
20 comparison of pricing inside of an open market? I'm not sure.

21 But at least from my perspective, what we are
22 recommending is not a bad thing for airlines. It is a great
23 thing for the airlines. It is a great thing for the travel
24 agency community if -- if -- the airlines want to continue to
25 promote this low-cost channel of distribution. If they don't, I

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1 can't understand why they would want to increase their costs by
2 absorbing that burden on their own business model.

3 MR. RUDEN: Thank you. That's all.

4 CHAIRMAN WINSTEAD: Thanks, Paul.

5 Alex, thank you very much.

6 MR. ROPER: I'll submit your resume to United
7 Airlines because they're looking for a new CEO.

8 (Laughter.)

9 MR. WASILOV: Thank you.

10 CHAIRMAN WINSTEAD: Alex, thank you very much for
11 joining us. I think your testimony was thorough, and I think we
12 had a lot of good questions, and we appreciate your taking the
13 time and your effort.

14 MR. WASILOV: And please don't misinterpret my
15 passion as being in any way negative. I think what this
16 Commission is doing is great, but it is a very passionate topic
17 for me. I hope that in some way, shape, or form it would help
18 you in your thinking through your recommendations. Thank you
19 very much.

20 CHAIRMAN WINSTEAD: Thanks, Alex.

21 Our second witness is John Caldwell, President of
22 Caldwell Associates.

23 John, thank you for joining us.

24 MR. CALDWELL: Good morning.

25 CHAIRMAN WINSTEAD: If you could just give us a few

1 comments for the record, name, company, a little background, it
2 would be helpful. We have your testimony.

3 MR. CALDWELL: I would like to pass out one
4 addition to my testimony.

5 CHAIRMAN WINSTEAD: John, if I might, we do have
6 your testimony. We've had it for several days.

7 MR. CALDWELL: Yes.

8 CHAIRMAN WINSTEAD: If you could kind of summarize
9 it, because I think most of us have read it --

10 MR. CALDWELL: Sure.

11 CHAIRMAN WINSTEAD: -- that would be helpful.

12 MR. CALDWELL: I understand.

13 CHAIRMAN WINSTEAD: Thank you.

14 MR. CALDWELL: I understand. That was my plan, to
15 do that.

16 CHAIRMAN WINSTEAD: Thank you, sir.

17 MR. CALDWELL: I would like to make a couple of
18 preliminary comments, though. First, by way of my own
19 perspective, I am president of an independent travel management
20 consulting firm based here in Washington, suffering with the heat
21 like everyone else who lives here.

22 (Laughter.)

23 I respect the job of this Commission, and
24 especially another three-and-a-half months until November that
25 you have to get this important report done. I hope it will drop

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1 below 100 degrees before the report is submitted.

2 Just by way of background, my company is
3 independent. I don't work for travel agencies. We don't
4 represent suppliers. We don't represent product developers,
5 airlines. We work only for business consumers of commercial air
6 transportation.

7 Those clients tend to be among the larger users of
8 business air. Sometimes they spend as much as a million or
9 \$500,000 on air tickets up to in a few cases as much as close to
10 a billion in travel and entertainment.

11 So my experience is based on 30 years in the
12 industry. Two familiar faces in this room to me personally
13 include Paul and Dick Fahy, both of whom were involved with
14 myself and others in the competitive marketing investigation
15 involving the deregulation of airlines.

16 I hate to admit it, I have a child that dates that
17 time, at about 35, and we were all involved in that hearing room
18 in those hot days in Washington when the question was, should we
19 or shouldn't we allow regulation to continue? At the same time
20 Congress was making an independent decision to pass the
21 Deregulation Act, I think, of 1978.

22 In those days Paul was doing somewhat a similar
23 job, I guess, as he is doing today, adequately and aggressively
24 representing travel agents, and I think Dick worked for American
25 Airlines. At that time I was General Counsel for what is now

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1 called the National Business Travel Association, and known as
2 National Passenger Traffic Association, made up of business
3 users.

4 My role in that case was, and speaking for the
5 interest of business consumers, to achieve deregulation in terms
6 of the ability of companies to earn commissions, to open their
7 own travel agencies, to deal in a more flexible way in
8 negotiating frankly and dealing direct with suppliers.

9 Because prior to deregulation, there were laws
10 against volume discounting; there were restrictions administered
11 by the ARC against accreditation of companies issuing their own
12 tickets. There was the so-called 80/10 rule that some of us
13 remember, where 80 percent of the tickets had to be issued to
14 outsiders, and you couldn't earn a commission on 20 percent for
15 self-sales, and a host of other regulations tied up in the Bureau
16 of Economics at the CAB.

17 So that is sort of my background, and since that
18 time, I have played an active role individually in representing
19 corporations. I am not here speaking on behalf of any particular
20 client, any particular association. It is my own independent
21 perspective based on 30 years of business representation and an
22 active consulting and legal practice today.

23 I do want to make a couple of just very brief
24 comments about some of the things that were discussed earlier.

25 One, in my view -- and this is summed up at the end

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1 of my testimony, but I will start and end at the same place -- I
2 think any form of substantive re-regulation, especially involving
3 pricing and cost, and some of the things that were discussed by
4 the last speaker and the panel around requiring surcharges or
5 advocating surcharges, or whatever, in my opinion would not be
6 the proper approach.

7 I really think that we have achieved a lot of
8 success with deregulation. Forty-four or 46 percent of the
9 tickets of Southwest the first quarter of this year online --
10 very commendable, connected with a profit that the company has
11 made. Suffice it to say, if we had continued regulation over
12 pricing, we wouldn't have Southwest today.

13 So I think a fundamental risk to this Commission
14 is, in the effort to try to achieve justice -- and justice is
15 important; we're concerned about consumers and small agencies --
16 is to get into the area of re-regulation and congressional
17 suggestions of re-regulation of any kind, especially involving
18 entry and pricing, surcharges, uniformity, would be a mistake.

19 We've got a vibrant airline industry. It's in
20 trouble; we're all in trouble. But I don't think we are going to
21 bail out the airline industry by re-regulation. I'm not so sure
22 personally that the loan support program that the government
23 administers today is in the ultimate best interest of consumers.

24 It is propping up on a rather desperate basis some of the
25 airlines that are in trouble and need cash, but that, in effect,

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1 is a retreat from deregulation. I think we have to be careful
2 about the risk of re-regulation. It is like a little bit of
3 pregnancy.

4 Once we get our toe in that water, to use a bad
5 metaphor, then we are in very, very deep in terms of what might
6 happen. Frankly, it would reduce innovation, reduce the
7 technology players, reduce options for consumers.

8 So I am concerned about that, what I call a "drift
9 option," or not a drift option, a possible option if the
10 Commission were to move into a specific regulation recommendation
11 either to Congress or DOT.

12 Now I want to also preliminarily comment about net
13 fares. A lot of things have been said about net, taking costs
14 out, whatever. Net fares, at least on the corporate side, have
15 existed for several years in this industry. Netting out
16 commissions prior to zero-based commissions was done fairly often
17 in individual, one-on-one negotiations between large customers
18 and airlines.

19 The net effect was that the percentage discount
20 applied on the ticket price without the commission or the
21 override. So we have net fares in existence today. We had them
22 prior to zero-based commissions, and it is done on a one-on-one,
23 negotiated, individual leverage situation in the industry.

24 We also have today net type of distribution going
25 on with direct connects. There are companies today, as we sit

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1 here, even though the technology is not as far along as any of us
2 would like to see it, that have direct connect relationships with
3 airlines, where they are going right into inventory and they are
4 taking out the GDS fees, and it is being shared or it is being
5 taken back by the company.

6 So we have some of the things that have been talked
7 about in terms of netting out these costs going on, but in the
8 free marketplace, not governed by any uniform approach, not
9 governed by an overall solution that says that the airlines
10 should or must do "X" or "Y."

11 I think we need to keep very much in mind the fact
12 that this is a highly competitive industry. Even though there's
13 concentration, that concentration inevitably occurs in
14 deregulated industries. So that I am just concerned that a
15 movement toward a form of re-regulation, and if, in effect, this
16 is a cost and pricing dispute, which I really think it is to a
17 large degree, we are all caught up, especially the agencies and
18 the corporations, in this battle between the GDSs on the one hand
19 and the airlines on the other.

20 The airlines have basically said to the GDSs, "You
21 guys either reform your pricing or we're going elsewhere," and
22 they're going elsewhere. The GDSs are holding firm and saying,
23 "Our profits are such we're not reducing the cost."

24 The net effect of that is, guess who pays the cost
25 difference? It's the consumer. It comes back to the consumer.

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1 So we are caught in this squeeze now where there,
2 in effect, a debate, ongoing debate, where the airlines have
3 said, "We basically have already committed to Orbitz. You had a
4 chance, GDS. We're now down the road. We're going to sell
5 through a lower-cost distribution channel."

6 So the airlines are already committed to that sort
7 of approach, and the GDSs, frankly, are in a situation where the
8 train is leaving the station. There's a lot of options to GDS
9 distribution, and some of those are available to small, medium,
10 and large-sized travel agencies.

11 I read the testimony in San Francisco that was
12 quite interesting, and I know stimulating to the Commission,
13 about these new technology companies that have got a lot of
14 options, frankly, for going beyond screenscape and accessing
15 inventory and doing fairly quick, fairly low-cost kind of booking
16 of web fares.

17 So it seems to me that the Commission should not
18 look at re-regulation and, secondly, that there is a major
19 question here of what can and will be done, or should be done,
20 and I'll come back to that in terms of recommendations that are
21 not exactly in my testimony.

22 But I think the issue here is whether travel
23 agencies as we have known them and they exist today should have
24 access through traditional channels to all forms of pricing. The
25 GDS is a traditional channel. It supposedly is neutral. It is

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1 available. It is one-stop shopping, and it is out there, and it
2 is being used.

3 My clients in most cases work through a travel
4 agency that has a GDS, with or without a self-booking engine or a
5 web search engine. But the question is, is that the only way,
6 and the required and mandated way, that airfares should be
7 offered? In other words, should, in effect, the airlines, as the
8 suppliers, be required or induced that, no matter what the cost,
9 without getting into the issue of what is more costly or less
10 costly, should they be required that they have to distribute
11 their product in one way in the context of the Internet?

12 I really think it would be stifling to innovation
13 and technology options, and ultimately to consumers, if the
14 airlines are mandated or required to surcharge tickets for
15 distribution costs or, more importantly, they were absolutely
16 prohibited from using alternative forms of distribution.

17 So that is sort of just a general philosophic
18 overview. Now I want to kind of walk through my testimony. I
19 will skip over some of the things that are more generic that I
20 know you have read and you know anyway and go into some of the
21 more details that affect corporate consuming of air
22 transportation.

23 Currently, we have a form of attended
24 disintermediation going on. Now the term is used fairly loosely
25 as to indicate that airlines, and perhaps other suppliers on

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1 their coattail, want to remove travel agencies from the system
2 because they have cut their pay.

3 I used to use this expression when I would go to a
4 trade group of consumers: If you're a travel agent, it's a great
5 business to be in. You wake up one more and discover the guy
6 that's been paying you has suddenly cut off your pay, and the one
7 you want to charge doesn't want to pay you.

8 So it is a fairly difficult business to be in,
9 which is to say consumers and corporations have resisted paying
10 agencies. They thought everything was free. Now with
11 commissions going to zero, the agencies don't have that revenue
12 stream, and guess what's gone up? Costs. There's no question
13 that there is a very serious plight that is faced by travel
14 agencies.

15 But from the corporation standpoint, corporations
16 try to manage their travel. They try to use policies,
17 technology, and concepts of employment with their travelers to,
18 frankly, get the traveler to select whatever the form is, the
19 lowest-cost consistent with the mission of the trip.

20 So this is translated into a number of things that
21 have happened in the corporate environment. Net fares that have
22 been out there, net of commissions, net of overrides.
23 Incidentally, overrides insofar as this what was referred to as
24 this "shell game," they're still out there.

25 Airlines, with all due respect -- and if I sound

1 critical of everybody in this puzzle, it is just the value of my
2 independence perhaps or the downside. Airlines are still paying
3 overrides. They are paying it to large agencies, and there is a
4 mystery from the corporate standpoint of getting those back.
5 They are not auditable. They are sometimes paid back to a
6 central location and allocated back by formula. Sometimes they
7 are called overrides, and sometimes they are called maintenance
8 fees. They are still paying them in the context, in fact, of
9 zero-based commissions.

10 Within a week of the airline announcement of going
11 to zero-based commissions, large agencies were guess where?
12 Right back in the offices of the airlines saying, "You took it
13 away from us on the zero base, but now you've got to give us
14 something more if we're going to move market share to you."
15 Sometimes the airlines agreed and sometimes they didn't.

16 Those deals are not public. They are confidential.
17 They are not auditable. They are not known to the corporation
18 that is in a fee-based deal that is supposed to get all the
19 commissions back. There's still a lot of mystery about that.

20 The same kind of mystery exists from the corporate
21 standpoint with the GDS operator and the agencies. The GDSs
22 rebate back out of what some say is an excessive revenue stream.

23 They pay incentives back to travel companies, especially the
24 large ones. Not all small ones get this.

25 That is on the volume given and delivered by a

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1 managed travel program by the corporation that pays the bill.
2 The corporation's position is that revenue should be directly
3 credited and/or passed through to us. Is that auditable and
4 known? No. Is sometimes some of that revenue given back? Yes.
5 Is sometimes none of it given back? Yes. No one out there on
6 the corporate side knows exactly what the GDS relationship is
7 between the agency and the airlines.

8 So overrides still exist as incentives to drive
9 market share from the standpoint of the airline, and GDS
10 incentives still exist and are very influential out there in
11 terms of using GDS systems. Corporations view that as that money
12 really belongs directly to them and it should be passed back or
13 in an auditable way credited to the expenses that it otherwise
14 offsets.

15 Now corporations today are in these fee-based
16 arrangements. They get whatever credit is out there that the
17 agency is willing or can pass back from what commission stream is
18 left, mainly hotel commissions, and they are in fee-based
19 arrangements.

20 Now a fee-based arrangement simply means for a
21 managed corporate travel program, we are going to pay for the
22 service and we are going to pay for the expenses you have. We
23 either pay it as a fully-loaded fee or we reimburse the expenses
24 monthly and we pay a service charge on top of that, usually a
25 per-transaction charge.

1 In terms of the basic cost to a corporation today
2 or a managed travel program to use a travel agency, it is
3 anywhere from \$35 a transaction to \$60 a transaction. Those are
4 rough ranges of what the cost is.

5 In that are expenses, the markup for the agency,
6 and that is put on top of the ticket price. In some cases the
7 corporation turns around with that fee, and what do they do with
8 it? They pass it back to the individual user, who then passes it
9 back to the budget in his department.

10 Now that is after, incidentally, whatever
11 commission revenues are left are applied against fees and costs.

12 That is a net figure, \$35 to \$60. That is what is really being
13 paid out there today by most companies.

14 Now on top of that, companies expect some delivery
15 of value for that, because they can go in the travel business
16 today -- I don't know if the concept of CTD has even been
17 discussed at all in front of the Commission. Is CTD known by the
18 Commissioners?

19 "Corporate travel department" is a new term. Back
20 in the days when Paul and Dick and I were flailing away with
21 deregulation, CTDs were an impossibility because they were
22 illegal per se. Today, if I run a company, I can go to ARC, and
23 with one qualifier on the staff, I can go into the travel
24 business myself and have a total direct relationship with the
25 airlines, get my own GDS agreement, negotiate my own deals with

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1 the airlines; basically, self-ticket for myself and my employees.

2 I am not supposed to deal with leisure outside the company, but
3 I can become a corporate, accredited travel agent purely engaged
4 in self-sales for the company.

5 So there's a variety of options out there that
6 corporations can follow today to try to cut their costs. Some of
7 those options involve trying to get some of these incentives back
8 that are paid.

9 GDS relationships are just as murky as overrides
10 and just as complicated to follow, because the GDS operators will
11 offer to make a direct contract with the corporation. So you
12 sign a GDS contract, and who operates the GDS on your behalf?
13 The travel agent. It may or may not have its own relationship
14 with the GDS. That is one option.

15 You can have the travel agency, in effect, have its
16 own GDS contract, and you can take a hybrid. A hybrid is
17 basically an incentive payment on top of what is paid to the
18 travel agency that comes directly back to the corporation, based
19 on the corporation helping the agent promote volume to meet
20 threshold.

21 Is the corporation obligated for liquidated damages
22 and a minimum put-through? Not as greatly as the travel agent,
23 but they are at risk. They may have to pay back if they, working
24 with the agent, don't meet the threshold. So you can do that
25 type of arrangement.

1 So I pointed out on page 5 there are three
2 different options for GDS kind of relationships, but there's
3 still a lot of uncertainty about where these fees are going and
4 very little indication, incidentally, of any GDS to date showing
5 any willingness to reduce the cost and fees on traditional
6 booking channels.

7 I am going to comment on it again later when I talk
8 about the Sabre announcement. It is very interesting when Sabre
9 announced this offer to cut fees to \$2 a segment if you just
10 happen to use their booking product and you gave up all the
11 incentives. It is very interesting.

12 The same week they made that announcement the
13 Chairman of Sabre said, "We have absolutely no strategy and no
14 plan today to reduce GDS fees for traditional transactions."

15 So the net effect of that, as somebody said, is
16 rearranging the deck chairs on the Titanic, in the sense of
17 basically nobody gets a reduction in these fees. The airlines
18 are caught in what they claim is a squeeze.

19 Ultimately, if the fees were reduced, where would
20 the burden of that fall? It comes to the travel agencies trying
21 to do the business because they have less incentives that are
22 paid. The fees are not reduced. If the incentives are reduced
23 and taken away, and the agency has less revenue on GDS, what do
24 they do? Pass it on to the customer. So at the end of the day,
25 we've got a GDS industry here, frankly, that is showing,

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1 ironically, very, very high profits.

2 I think the GDS profit showing, I think Sabre made
3 \$15 million in the first quarter, when the airlines are about to
4 go bankrupt. The fees at \$12 or \$14 a trip are considered to be
5 pretty high, sound pretty high, at least to me, and I am not a
6 cost expert in GDS. Those are built into the ticket price.

7 But the offer, basically, to cut the fee for web
8 bookings is really transparently just a revenue retransformation
9 because the net effect of that is not to reduce GDS revenue. The
10 net effect of that is that you have to give up all your
11 incentives if you are an agency and a corporation, which may more
12 than offset the reduction in the \$2 in fee. The net effect then
13 is back again to the idea the consumer pays the difference.

14 At the end of the day, ladies and gentlemen, on
15 these cost transfers and these costs in the industry, the
16 consumer pays the difference. It used to be that the consumer
17 had leverage with the travel agency, back in the days of
18 rebating, to say a little cost here, a little cost there; you
19 guys take care of it. No more. The margins in the travel agency
20 business are so slim that the first iota of increased cost today,
21 or lost revenue, is immediately passed back to the customer.

22 Now I passed out a chart which I want to touch
23 very, very briefly on because I know you are more interested, I
24 guess, in my specific views on what can be done. But I wanted to
25 show, by way of example, how complex the market is and how many

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1 options are out there for companies with managed travel programs.

2 This is this little chart showing corporate options.

3 The first line is the traditional travel agency
4 commercial relationship. Customers, employees, pick up the
5 telephone and they call. The booking is made through the GDS.
6 There is not any self-service reservation. The company gets
7 credit for volume in its corporate deal because it is captured in
8 an ARC report with an agency ticket number that the airlines
9 require. So the corporation gets credit in that case. In this
10 traditional first line, no web fares. This is the way it has
11 been done until fairly recently.

12 The second line is the agency uses a third party or
13 a GDS self-booking tool. Most agencies do not promote, develop,
14 and operate their own SSR. They mostly use a third party or a
15 GDS tool. In that case, on a lot of the transactions that are
16 simple you don't need the telephone. They are no touch. In that
17 case still the reservations run through the GDS and produce a
18 standard ARC report. There's self-service reservations. There's
19 volume reporting and credit on the corporate deals. Again, no
20 web fares. No web fares.

21 The third option: The agency, in effect, then uses
22 a web engine to search all the web fares, and they may take the
23 reservations by telephone. They still operate the GDS, and they
24 may operate with a client a self-booking tool, but there is no
25 volume credit for the corporation. And why? On the web fares,

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1 there has to be created a passive segment that I know you have
2 all heard about through the GDS, which is a non-GDS-type booking.

3 That goes to the back office, but it doesn't produce an ARC
4 report that the airlines recognize as credit on the volume deal.

5 So in that situation right there the company may
6 pay extra and it may take more time to have the web fares
7 searched, and there may be a resurgence of credibility to the
8 program, but there is no volume credit. The airlines are, in
9 effect, cannibalizing their discount programs by, in effect,
10 undermining the partner they have made, because the partner's
11 employees are using a website engine to book on the very airline
12 at the lowest cost, and the company is not getting any credit on
13 the volume discount.

14 So the fourth option, or the last option, which is
15 the newest one this week, just out in BTN, if everybody has seen
16 BTN, July 29, Orbitz and the other online agencies are now going
17 to offer their own self-booking program. They are going to offer
18 self-booking and reporting, and it is reported that perhaps
19 Orbitz is going to work out a reporting structure through ARC.

20 Will that produce volume credits on web fares for
21 companies? Nobody knows. But it is a whole new development now
22 where the so-called online agencies are now jumping into the
23 corporate business and going to offer managed corporate programs.

24 So what is the net effect of this on agencies?
25 Challenge. Challenge and opportunity really.

1 I think it was interesting when Mr. Kern testified
2 in California, when one of you asked him the question, "What
3 about all these new technologies and new search engines and all
4 this technology that's evolving? How do you view that, as a
5 positive or a negative?" And he said two things I thought were
6 interesting. One is, it's a great opportunity; it is a great
7 opportunity for us. And, secondly, he said, "But I'm nervous it
8 is going to take us more time, and more time means lower
9 productivity, and lower productivity means higher costs, and you
10 have to pass through."

11 But the point is there are a lot of options that
12 are evolving. I daresay by the time the ink is dry on your
13 report there will be four or five more options out there in the
14 industry on the technology side of how travel is booked and
15 tracked.

16 Now on the question of web fares, corporations are
17 concerned about web fares. Traditionally, travel agencies
18 guaranteed in a contract with a corporation they would produce in
19 all cases the lowest fare out there. Corporations contracted
20 with those. I have written those in and negotiated them with
21 travel agents.

22 After a few years, a word crept into those
23 contracts. It was called "GDS." Do you know why that crept in?

24 Because agents were able to get newspapers in various markets
25 where the fare is reduced in the newspaper, and the clients were

1 complaining to the agency they weren't getting the lowest fare
2 because it wasn't in the GDS. Where was the fare? It was in the
3 newspaper or it was in the private database of the airline.

4 So the agencies reacted by saying, "We can't
5 guarantee the fares except those that are in the GDS." Now,
6 ironically, what's the value of those fare guarantees? Non-
7 existent, because the lowest fare out there can be on the web
8 fare that's non-GDS.

9 But, as I said to a GDS operator the other week, I
10 said, "Well, you guys are going in the web search business to web
11 fares. You're going to operate web fare engines."

12 Are my guarantees still good with the travel
13 agents? Because they say "via the GDS," and if the GDS operates
14 a web fare chase engine, is the client getting the lowest fare,
15 and you're guaranteeing it if you're going to web search,
16 especially if we are going to pay extra money for it. Answer:
17 "We need to talk to you about that one." "We need to talk to you
18 about that one." So they haven't really figured that out.

19 Well, back to the web fare situation. Use of web
20 fares by indiscriminate travelers surfing at night, looking
21 sometimes for an opportunity to play the game that's called,
22 "Gotcha. Gotcha. We found the lower fare," clearly, it is going
23 on, has gone on. It is part of the pride in the Internet.

24 It varies with companies and with travelers, but
25 the mere fact of the web fare not being accessible through a

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1 traditional channel has impacted managed corporate programs,
2 because the travel manager arrives on Monday and he or she gets
3 100 e-mails saying, "To heck with you guys with your corporate
4 discounts. We beat them every time." "We beat them every time."

5 But that's happening less and less because the
6 airlines, frankly, are beginning to look at that inventory in a
7 different way and beginning to say, well, maybe we'll remove it
8 from the websites. So we have a "now you see it; now you don't"
9 game going on out there with when you can and when you can't find
10 these fares.

11 But the existence of web fares, even with these
12 restrictions, has produced a lot of suspicion and lack of
13 credibility on agencies and on companies managing their travel
14 programs.

15 Now, however, how illusory are these fares? And
16 that is covered really beginning on page 8 of my testimony.
17 There have been audits that have been done that show in 92
18 percent of the cases the lowest fare is on the GDS or the private
19 fare base through the corporate discount, and that there are
20 relatively few low fares out there that on an apples-to-apples
21 basis work for the business traveler.

22 Because what happens is the traveler goes in, goes
23 in and surfs the Net, finds the fare. That's on screen one.
24 Guess what he doesn't look at? The restrictions on screen two
25 and three or the fact that it is going to go around-and-about,

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1 and he's going to have five stops, and he is going to have to
2 leave on a Tuesday and come back on a Thursday. He doesn't look
3 at that very carefully.

4 He calls up and says, well, that beats our fare by
5 15 percent. Well, it is not a fair comparison. The fare on the
6 corporate discount side is unrestricted, involved last-minute
7 travel, and usually non-circuitous routing and non-stop.

8 So that has produced a lot of confusion on the part
9 of corporate travel departments trying to manage and maintain
10 credibility that they've got a good handle over spending.

11 The other thing is that a lot of companies have
12 dealt with this by saying (a) don't use the web fares; they
13 undermine our deal with the airline. That doesn't work in most
14 cases. Why doesn't it work? You're fighting with your
15 travelers. They're smart. They're home. They have time. They
16 like going on the Net. So that doesn't work.

17 So now the companies say, okay, you can use a web
18 fare as long as it is a minimum of \$100 to make the loss of time
19 worth your search and our using; it's got to be a minimum of
20 \$100. That works, but, again, the loss of data for a volume
21 credit occurs and the traveler is still using quite a bit of
22 time. But quite a few companies out there have this \$100 minimum
23 cutoff.

24 Then others say, if you find a lower fare, it is
25 okay to use it. One of my clients called me last week that has a

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1 very, very large program, and he said, in the last six weeks, he
2 hasn't had a single low-fare complaint. I thought, well, that's
3 interesting. I put the phone down. Two days later, another
4 client called me and said, "We've got 100 e-mails about low
5 fares."

6 So there's clearly a perception they're going on,
7 but in the GDS logic of the way these fares are constructed for
8 business travelers, often that logic is more efficient and
9 intuitive than is the web fare logic at the website. So that is
10 another problem with the web fares.

11 Then the other things involve advance purchase, the
12 issue of shifting the cost back to the agency and to the company,
13 and then, of course, the GDSs themselves are operating web fares
14 today. So that are they really valuable and beneficial? In most
15 cases they are not as valuable as they are hyped to be. In some
16 cases they are.

17 Corporations do need a way to do audits and to have
18 web fare engines paid for in order to assure their travelers this
19 isn't going on; that is to say, web fares are not beating the
20 discounts or, if they are, opportunities to get in and book them
21 on those occasions which they do involve a less cost.

22 It is somewhat like the issue years ago of agencies
23 providing low fares under the GDS. Even though the low-fare
24 guarantee was in the contract, did travelers and corporations
25 believe the agency that they were getting the lowest fare? This

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1 is before the Internet. The answer was no. There was always
2 skepticism. There was always the fact the traveler would go to
3 the gate and say, "By the way, can I get a better deal?" And
4 once in a while they might get a better deal. So suspicion
5 lurked out there.

6 That gave rise to the low-fare audit business, and
7 I am sure you have had your agencies audited, where the
8 corporation pays or you pay as the agent to have an audit come in
9 and audit that, in effect, you are finding the lowest fare.

10 But now we have the web search engines. So even
11 with GDS fares, there was never a high assurance they were always
12 the lowest fare. Now we have web search engines that undermine
13 that even more.

14 Then we have the phenomenon that you heard about in
15 the testimony last week that very often, notwithstanding the most
16 favored nations clause, the lowest fare through the carrier
17 websites is not at Orbitz. I thought that was interesting.
18 Sixty percent of the time, it was testified before this
19 Commission by one of the product producers in San Francisco, that
20 the lowest fares are not at Orbitz, notwithstanding most favored
21 nations. Where were they? Expedia and Travelocity had lower
22 fares.

23 So the question was asked of the agent or the
24 person, "Why would that happen?" They said, "We don't know.
25 Maybe the airlines don't understand they're leaking this

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1 inventory out or maybe it is intentional."

2 So at the end of the day, for a corporation there
3 is going to need to be audit; there is going to need to be
4 efficient some kind of search engine, and somebody's going to
5 have to pay for it, unless the airlines take these away entirely.

6 The other issues, of course, have to do with the
7 credit on the self-booking and the fact, as I said, self-booking
8 on a web fare, that the airlines have not yet indicated clearly
9 they will accept a non-ARC report on web fare bookings for volume
10 credit. I think that should be achievable through negotiation,
11 but nobody has raised their hand and said, "Don't worry about a
12 non-ARC report. We'll take a passive segment and a GDS report
13 fed by the GDS agency back office, even though it doesn't have an
14 agent ticket number on it." Because to get credit requires
15 agency ticket numbers.

16 So the last wrapup I would have has to do with the
17 Sabre announcement, which is pretty clearly covered there. In my
18 view, it is transferring revenues around and no pricing
19 reduction. Frankly, while it is a helpful sign, it is not going
20 to solve the problem.

21 So what are the solutions that the Commission can
22 look at here. I have treated basically my view that intrusion of
23 any kind by DOT, DOJ, or this Commission in the free market would
24 end up hurting everybody more than, frankly, perhaps some
25 finetuning around CRS rules applying to everybody on an anti-bias

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1 basis.

2 I don't think it is going to work to put out a
3 mandate that says you have to put the web fares through the GDS.

4 In effect, what you are doing, if the airlines are right -- I am
5 not saying they are right or wrong -- you are forcing them to use
6 what they say is the highest-cost distribution channel.

7 Then you are forced then to review, what are those
8 costs? Ergo, you are in cost and pricing regulation, whoever is
9 that gets into that. I think that would be a vast mistake.

10 Now what can be done? Well, one option is to issue
11 the report and go home, obviously. That's an option. You just
12 issue a report and say, "We found it interesting. We make the
13 following findings."

14 Or another extreme would be to recommend aggressive
15 government intervention. I think that would be a mistake.

16 Another option would be to, frankly, come up with
17 findings, and you've got a lot of valuable and useful
18 information, findings, and request that the DOT and the DOJ, DOT
19 defer its CRS rule revisions and the DOJ defer its completion of
20 its investigation until they have all the facts in front of them,
21 because they are the regulatory agencies, to the extent there are
22 any there, that should be involved in finetuning. You could pass
23 on your findings to them and simply recommend and request they
24 hold in abeyance any action, because this is the best fact-
25 finding forum that has ever existed in this industry on these

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1 issues. You could do that.

2 Another thing you might consider recommending is
3 maybe recommending to the agency that has charge of the bailout
4 loan application that they consider incentives. An applicant for
5 a bailout comes in, and they say, "Well, one of the factors we're
6 going to consider is how wide open your web fares are to
7 everybody."

8 You could consider some sort of incentive, a
9 criteria, that might be considered by that panel that decides on
10 applications as to what are the most pro-consumer, innovative
11 kind of approaches that have been taken by the applicant as a
12 factor in whether they get bailed out. That would be in the form
13 of a positive incentive as opposed to a sort of mandate kind of
14 recommendation.

15 That concludes my testimony. Like Alex, as you can
16 tell, I am fairly passionate about this.

17 (Laughter.)

18 CHAIRMAN WINSTEAD: John, thank you. It is very
19 interesting, and I appreciate your summary and also your
20 suggestions at the end, which I think are very interesting.

21 On page 8 you talk about, obviously, your focus and
22 your consultancy is the corporate discount fare booked through
23 the GDS is lower than the identical web fare 90 percent of the
24 time. Again, if this is a reality with all the changes you have
25 mentioned in your testimony, what incentive does the traveler

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1 consumer have in really moving away from the GDS and, thus, from
2 the travel agencies?

3 MR. CALDWELL: Well, less. I mean, if in fact 90
4 percent or 92 percent of the time the lowest fare is through the
5 traditional channel, there should be less incentive. That is
6 part of the reason these audit results are being provided to
7 corporations, to say, please don't go home and waste all of our
8 time; the best deal is still through the GDS.

9 That, I might add, includes the corporate discount
10 that has been negotiated that is loaded by the preferred carriers
11 into the GDS.

12 CHAIRMAN WINSTEAD: Right. John, on a lot of the
13 testimony -- I know you listened to or read the San Francisco
14 testimony -- there is a lot of testimony about the most favored
15 nation provision. On page 14 you talk again, "The most favored
16 nation's provisions in the Orbitz relationships should have a
17 public interest advantage similar to...the GDSs in providing an
18 efficient means for the public to compare prices in one place" or
19 another.

20 Can you just elaborate? There has been an awful
21 lot of testimony from a lot of the agencies about that
22 requirement of Orbitz, and they find it, you know, restrictive --

23 MR. CALDWELL: I understand.

24 CHAIRMAN WINSTEAD: -- that it limits pricing; it
25 limits access; it limits their ability to compete.

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1 So you are saying basically --

2 MR. CALDWELL: I think GDSs were justified years
3 ago, and they were owned by airlines, incidentally, at the
4 time --

5 CHAIRMAN WINSTEAD: Right.

6 MR. CALDWELL: -- competing airlines. They were
7 justified as one-stop shopping locations where a multitude of
8 suppliers could be booked using a travel agency through one
9 source. They were owned by airlines. We had anti-bias rules and
10 whatever.

11 The airlines decided to get out of that business,
12 for a variety of reasons, one being, I think, it was more
13 profitable to sell them, or whatever, than to continue to
14 maintain them. But, you know, there was a year when American
15 made \$300 million on its Sabre system, net to the bottom line.
16 So they were profitable.

17 I think the use of what they claim to be a low-cost
18 location for all these web fares, where, frankly, a consumer or a
19 web engine or a corporation can go one place and get the lowest
20 fares without multiple searches has certain cost-efficiency
21 advantages for the consumer and time advantages. Because having
22 to go to 27 or 40 different sites involves more time, and it is
23 going to cost more money for the search to occur. Now that is an
24 advantage.

25 There is, however, a countervailing question about

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1 whether the airlines have agreed not to compete on low fares at
2 their individual sites, but not having seen this provision -- and
3 I believe it is in a confidential agreement; I don't know if the
4 Commission has access to the actual wording of it or not -- but
5 not having seen it, the airlines characterize it as allowing
6 individual carriers and websites to publish any fare they want,
7 so long as the lowest fare they offer is always in one place. I
8 don't see that as necessarily stifling competition, is all I am
9 saying.

10 Now having worked with airlines, operating one
11 central distribution source has all the risk that we all know
12 exists in a non-monopolistic industry where they could be pricing
13 collusion; there could be price signaling. But, to my knowledge,
14 nothing that has been yet shown proves that is going on or
15 extremely likely.

16 CHAIRMAN WINSTEAD: And, John, your point, again,
17 with the Sabre action recently, obviously, feeling pressure on
18 pricing of their fees, the other comment you made -- and we
19 certainly heard about it in San Francisco -- are all these new
20 tools that are being invented.

21 MR. CALDWELL: Exactly.

22 CHAIRMAN WINSTEAD: So your point in suggesting
23 that re-regulation is not the way to go is also being aided, or
24 your argument is being aided, by these new tools that are, in
25 fact, hopefully, creating greater access.

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1 We did see at Maryles agency the one screen where
2 you had the CRS listings and you had Orbitz and others. So is
3 that the other --

4 MR. CALDWELL: Yes, that is --

5 CHAIRMAN WINSTEAD: -- trend that is sort of
6 underlying --

7 MR. CALDWELL: I think that trend would be stifled
8 by re-regulation. Also, I think the GDSs and the Orbitzes of the
9 world are feeling pressure. They are feeling big pressure. I,
10 frankly, think the existence of this Commission, to give you
11 credit before the report is in, has added some additional
12 pressure.

13 It is interesting, some of these announcements --
14 and they are coming like one an hour -- have come out since you
15 began your hearings.

16 CHAIRMAN WINSTEAD: Right.

17 MR. CALDWELL: I have just come from the National
18 Business Travel Association meeting two weeks ago in Salt Lake
19 City. There was an announcement at every booth of some new
20 technology thing. Frankly, in my negotiations, which I have
21 frequently with the GDSs, I think they are feeling the heat, and
22 we are going to see more announcements and possibly some pricing
23 change, although if you are Sabre and you are sitting on \$14
24 million of profit in the worst quarter for airlines ever in the
25 industry, you may want to think twice about cutting that \$14, or

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1 whatever it is.

2 But I think there has been pressure already, and it
3 is beginning to be felt in the marketplace. But that would all
4 be, I think, undermined by any form of government intervention.

5 CHAIRMAN WINSTEAD: Right. Reinforcing your
6 comments about what is going on, Worldspan and the very good
7 testimony of Mr. Blakely basically said they were redoing their
8 business plan. We asked what that is, and they said it is still
9 in development, but we will be doing it.

10 Paul, you had some questions?

11 MR. RUDEN: Yes, I don't even know where to begin.

12 (Laughter.)

13 MR. CALDWELL: Begin anywhere you like, Paul.

14 MR. RUDEN: History repeats itself, I guess.

15 (Laughter.)

16 We disagree about so many things, but in good
17 faith.

18 MR. CALDWELL: We wouldn't be thinking if we were
19 agreeing on everything, Paul.

20 MR. RUDEN: Well, that's right. If I understood
21 the overall thrust of your testimony, it was to the effect that
22 the airlines have managed to offend their best customers on a
23 regular basis -- they are still doing it -- unilateral decisions
24 against the customers' interests.

25 MR. CALDWELL: Correct.

1 MR. RUDEN: They have enraged the distribution
2 system that still delivers the majority of their business, and
3 they are at war with the technology systems that they built and
4 which are still the backbone of the majority of the business that
5 they get.

6 MR. CALDWELL: The GDSs.

7 MR. RUDEN: Yes.

8 MR. CALDWELL: Because they see the GDS as an
9 antiquated, non-Internet-based system, and the Internet has
10 arrived and we've got to get on that train.

11 MR. RUDEN: I'm sure they have reasons. You say
12 that they are struggling to survive and fill seats regardless of
13 yield.

14 MR. CALDWELL: That's true, too, I think.

15 MR. RUDEN: Well, isn't that nuts?

16 (Laughter.)

17 MR. CALDWELL: I don't disagree it's nuts. A lot
18 of things in the deregulated free market are nuts, and that is
19 one of them.

20 You know, Paul, a number of companies got together
21 and put a White Paper together and went to the airlines and
22 suggested how they price their product. The White Paper was
23 reviewed and, "Thank you very much." The airlines said, "We've
24 got enough problems on our hands, frankly, with all due respect,
25 to having consumers who don't live in our industry telling us how

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1 to price Southwest seats."

2 But, clearly, they are in trouble, and they've got
3 to reformulate the pricing strategy or they will go under, Paul.

4 And they have alienated customers.

5 But my view, to your point about reality as opposed
6 to theory, my view in representing my customers is, we work with
7 the hand that we're dealt. We would like to have things
8 reformed, but if the negotiation requires leverage, so long as it
9 is legal, and it requires use of a technology product and a
10 change in policy and a flexible approach to managing our expense,
11 and so we don't like the way suppliers do things, we have to do
12 it their way or innovate around that way, because we need these
13 guys. I think it is a reality check that corporations are doing
14 everything they can, through policy and technology, to work with
15 their suppliers.

16 But you're right, it is not a pretty time.
17 Airlines don't like to go to meetings with anybody these days.
18 They don't because they get beat up on unmercifully.

19 MR. RUDEN: Well, yes --

20 MR. CALDWELL: Perhaps justifiably, but they do get
21 a lot of heat.

22 MR. RUDEN: Sometimes you get what you ask for.

23 You talked a lot in your testimony about finding
24 lowest prices and the Internet and the technology and all these
25 new tools, and so forth. You would agree, wouldn't you, that

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1 during the dot-com bubble the explosion of new technology
2 companies which were emerging one every hour with enormous
3 amounts of money to spend, virtually all of which failed, would
4 be a lesson to small business people looking at new technology
5 tools invented by companies they never heard of who don't have
6 unlimited funds to spend, that there is a major risk to invest in
7 those things as short-term solutions to an endemic problem like
8 unavailability of low fares?

9 MR. CALDWELL: Absolutely, and you know, Paul,
10 we've had an expression in the industry about software,
11 vaporware, and "gossipware." We have to be especially careful
12 about the last.

13 That is a concern. It is easy to testify in front
14 of this Commission, to offer claims of product efficiency and
15 workability. Until it is really out there working and proven
16 itself with a major client or a good, solid platform of
17 experience, it is not proven.

18 Some of these products may not work as well as they
19 are claimed to work, and I do agree, for a small or a large
20 company, they have to be caveat emptor on this.

21 MR. RUDEN: You talked also a lot about getting the
22 lowest price through the various mechanisms that are out there,
23 negotiation, the alleged magic of the Internet which you concede
24 only works a small percentage of the time to actually to deliver
25 on the promise. But focusing on your corporate clients, aren't

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1 they really interested in something else besides the low price?
2 Aren't they really interested in the best value, so that they
3 don't have a vice president of marketing taking a four-segment
4 trip around the country to save \$100 because they found it on the
5 Internet?

6 MR. CALDWELL: Yes and no. Yes --

7 MR. RUDEN: If they're rational?

8 MR. CALDWELL: Yes, to the extent they are
9 rational, but in this environment today, Paul, just like the
10 airlines can't get seats filled and can't get what they think is
11 yield, and they are losing money daily, companies are losing
12 money. Companies are going through shakeups.

13 It used to be that companies would say, for
14 example, if it doesn't cost more than \$100, \$200, fly coast to
15 coast non-stop -- traveler convenience, good value. Sit on one
16 airplane, no risk of having to land and getting hung up in
17 Denver.

18 Today companies are changing that policy. If it
19 saves more than \$100, you go out of Baltimore on Southwest -- it
20 is just that simple -- even though it is a 50-minute ride. You
21 stop in Denver. So they are not quite as value-oriented and they
22 are more price-oriented than I have seen in this industry, and it
23 usually follows a bad economic time that companies look more at
24 price than they do at value. I think your agency members would
25 probably have seen that in their experience.

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1 MR. RUDEN: When better times come, they will go
2 back --

3 MR. CALDWELL: They will be more value-sensitive.
4 Right now they are worried about the fact that you want to pay
5 anything and they still have to travel, and they are upset about
6 security hassles and delays, all those things. But price is
7 definitely a driver today, notwithstanding inconvenience.

8 MR. RUDEN: All right, well, I don't want to
9 monopolize things. Let me just ask one other set of questions,
10 two sets.

11 (Laughter.)

12 You talked about overrides as if there was
13 something wrong with those, that they were bad because corporate
14 clients can't quite figure out what's going on.

15 MR. CALDWELL: I didn't mean to make it sound like
16 they were bad. As long as I get them and they're auditable,
17 they're fine.

18 (Laughter.)

19 MR. RUDEN: Well, but maybe --

20 MR. CALDWELL: The problem is (a) I don't get them
21 and (b) I can't audit what I do get. So that concerns me.

22 MR. RUDEN: Yes. And at the same time -- well, how
23 would you solve that? You want the government to order travel
24 agencies to disclose those things?

25 MR. CALDWELL: No. No, I don't. I think that is

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1 just one of the drawbacks of the open market. What I do is
2 negotiate with that carrier that I have the greatest confidence
3 and trust in that opens its books the most faithfully. Frankly,
4 overrides may go away as airlines see the company and the
5 consumer driving the volume more than the agency.

6 So in the case of, for example, net fares, they
7 were pretty much overridable without overrides. That is because
8 the company and the airline worked directly, and the company paid
9 the travel agency.

10 So I would hope as the market matures, Paul, we
11 would see fewer impacts of overrides, if the customer's driving
12 the business. If, on the other hand, it is unmanaged travel and
13 leisure travel, airlines are going to pay for share. They are
14 going to pay agencies to drive share, I think. But if the
15 customer is driving share, the override will either go away or be
16 less important.

17 MR. RUDEN: All right. On page 14 of your written
18 testimony, you make a reference to the most favored nation
19 provision in the Orbitz relationship.

20 MR. CALDWELL: Uh-hum.

21 MR. RUDEN: And you say that it "should have a
22 public interest advantage similar to that of the GDS in providing
23 an efficient means for the public to compare prices in one
24 place."

25 MR. CALDWELL: Uh-hum.

1 MR. RUDEN: Would you not agree, though, that it
2 would be entirely possible for the five largest airlines on the
3 planet to independently find it in their interest to post their
4 prices in a single place, so that people could compare it,
5 without having a requirement to do so?

6 MR. CALDWELL: Well, I mean, I think they did this
7 with the view, without being required to, that it was in their
8 self-interest, that they, frankly, were going to provide the
9 consumer benefit and a lower-cost distribution channel. I think
10 they made that decision. I am not saying I agree or disagree
11 with it, but I think there is some consumer advantage.

12 If they are going to proliferate distribution
13 channels outside GDS and throw these fares out everywhere, I
14 think customers benefit if at least they can go one place and
15 know that is where the lowest fares are. It is just that simple.

16 MR. RUDEN: Well, but my question has to do with
17 whether it is your judgment that this agreement between the five
18 largest carriers on the planet -- and what the agreement says, by
19 the way, it is actually very well-known -- it says that, if they
20 post it on their own website, they have to post it at Orbitz.

21 MR. CALDWELL: I don't see that as a problem.

22 MR. RUDEN: And it says, if they give it to a third
23 party, they have to give it to Orbitz.

24 MR. CALDWELL: That is a distribution decision. I
25 think if the airlines decide, in their wisdom, that helps them

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1 distribute more economically, it does have a consumer benefit if
2 it is followed. Now we heard testimony here that it is not often
3 followed, or 40 percent of the time, one of your witnesses said,
4 the lowest fare is not at Orbitz; it's at somebody else's site.
5 But if it is followed --

6 MR. RUDEN: Excuse me. I think you would find that
7 a lot of the explanation for that has to do with the
8 individually-negotiated, what amount to, net prices.

9 MR. CALDWELL: Uh-huh.

10 MR. RUDEN: And that is a different thing than the
11 web fares that are posted on airline sites, given to Orbitz, and
12 then denied to other people. But the record will show whatever
13 it shows in that regard.

14 What I am trying to get here is your judgment. Do
15 you think the most favored nation agreement that they have made,
16 as I have described it, is essential in order for them to arrive
17 at posting their prices in a single place?

18 MR. CALDWELL: Not necessarily, but, again, I think
19 the Commission or any government institution needs to tread
20 gingerly in second-guessing a decision by competitors in an
21 industry as to how they should most efficiently and cost-
22 effectively use a distribution channel.

23 MR. RUDEN: Tread gingerly on a joint decision?

24 MR. CALDWELL: Yes, I think so. I think it is not
25 pricing, Paul. They haven't agreed to set the same prices. What

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1 they have done, as I understand it, is agreed, if we have price
2 anywhere, we can compete and put in any prices we want to, but
3 whatever they are at our website, we are going to post them at
4 this common site.

5 And if I am a customer looking at that, and knowing
6 about the most favored nations, I would say, okay, the option to
7 that is, let's say they didn't voluntarily agree to do that. Do
8 I have to go to six different websites? What is the time and
9 expense to me to do that as opposed to saying, as long as these
10 guys are competing, if they put it all in one place and they
11 don't collude on the level of the fare, maybe that is a cost
12 savings to me as a consumer. That is all I am saying.

13 MR. RUDEN: You've got a lot of "ifs" in there, but
14 we will save that debate for another day.

15 MR. CALDWELL: Well, I don't think there has been
16 any proof yet of collusion or price-fixing or even any suggestion
17 of it that I am aware of in your record.

18 MR. RUDEN: All right, well, we will agree to
19 disagree about that as well, I suppose.

20 MR. CALDWELL: Okay.

21 MR. RUDEN: My final question has to do with your
22 recommendations.

23 MR. CALDWELL: Right.

24 MR. RUDEN: You said we should put off the CRS
25 rulemaking or recommend that DOT defer it?

1 MR. CALDWELL: Well, I am suggesting, as one
2 option, Paul, that the DOT, like the snail it has been on this,
3 moving slowly and, hopefully, inexorably toward some sort of
4 revision in the rules, the Internet issues have now become
5 enormously important. I don't know what the record is or
6 knowledge and fact basis is that DOT is operating on. You are
7 gathering a lot of important facts from a lot of interesting and
8 important elements of the industry. I am just suggesting one
9 option might be to suggest to the DOT, "You should take into
10 consideration our record and our recommendations before you
11 finalize your rules." That's all I am saying.

12 MR. RUDEN: So really it is not so much putting it
13 off as asking them to read the record? Right?

14 MR. CALDWELL: Well, and your report.

15 MR. RUDEN: Well, all right.

16 MR. CALDWELL: I mean, your report might have
17 things in it that would say, we feel finetuning requires -- I
18 mean, for example, I think anti-bias rules should apply to all
19 these guys, so they don't bias screens. So you might come up
20 with that conclusion, and maybe you would want to share that with
21 the DOT.

22 Or, more importantly, let's assume that doesn't
23 happen. The DOT comes out with its rules. You come out with
24 your report. Ships are passing in the night. All this time an
25 important study has been given by you to issues of great concern,

1 should be, to the DOT, and they've gone out and issued rules that
2 preempt some of the things that your Commission has found. I
3 don't think that would be in the public interest. That is all I
4 am saying.

5 MR. RUDEN: Thank you.

6 CHAIRMAN WINSTEAD: Thank you, John.

7 Gerry and then Ann.

8 MR. ROPER: John, thank you for your experience,
9 passion, et cetera.

10 Based on all your experience, are we going to see a
11 national commission to ensure consumer information and choice in
12 the hotel industry, the rental care industry, the cooking school
13 industry, the bike tour industry? I mean, is this what's next?
14 Because this is what I am hearing the agencies are --

15 MR. CALDWELL: Well, I mean, BTN this week, as a
16 matter of fact, Business Travel News -- and, incidentally, I
17 commend especially this issue to the Commission of Business
18 Travel News because it's got a lot of things on web fares,
19 products coming out, and whatever.

20 There's an article in here, I think it's July 29th,
21 about complaints from corporations over having their hotel
22 negotiations cannibalized by web fares. So it spreads.

23 I mean, the airlines have always been the parents;
24 the hotels and everybody else have been like the stepchildren
25 that have followed along. So there could be a movement that

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1 would say we've got to study all of these things, but the
2 airlines are the ones threatened with going out of business, and
3 probably the most important part, not that the others aren't
4 important, of the economy. So you could see that. I don't know
5 if it would be wise.

6 MR. ROPER: I think that your page 15, the last
7 paragraph, if I could interchange a couple of words, and if you
8 agree with it, and maybe comment on it. It says, the last two
9 sentences or three sentences, "Agencies adapting to reliance on
10 automated processes at the same," blah, blah, blah -- could we
11 say, "hotels, airlines, rental car agencies" --

12 MR. CALDWELL: Yes.

13 MR. ROPER: -- "if they don't adapt"? Okay, good.
14 Thank you.

15 MR. CALDWELL: I mean, if you're not on the
16 Internet --

17 MR. ROPER: Absolutely.

18 MR. CALDWELL: -- you're not going to be around.
19 With all due respect -- and Paul is here -- the fact that the
20 record shows today 70 percent of tickets being issued by
21 traditional travel agencies in the face of Southwest having 44-46
22 percent of its revenue online, American 18 or 20 percent online,
23 those numbers could flip in the next two years.

24 MR. ROPER: You're talking about passing ships in
25 the night there.

1 MR. CALDWELL: Exactly, and in the meantime, to use
2 a bad metaphor, no one would turn out the lights.

3 MR. ROPER: Yes.

4 MR. CALDWELL: I mean, that's the kind of
5 environment we are in now, and technology is going to drive that,
6 irrespective of the motives of people. Technology is here. If I
7 had been an airline and ignored the Internet, I think my job
8 would be at risk over that issue alone.

9 CHAIRMAN WINSTEAD: Ann, you had a question?

10 DR. MITCHELL: Yes. I think one thing you did for
11 us, Mr. Caldwell, was to underscore how complex dealing with
12 airfares is and how simple efforts are made to convey to the
13 public that it is just as simple as pushing a button, to their
14 detriment in many cases.

15 One of my big concerns for the people who are
16 buying airline tickets, we keep talking about the lowest fare,
17 the lowest fare, the lowest fare, but the biggest customer of the
18 airline industry is the business traveler whose fares are
19 unconscionable to me.

20 In looking at their trying to save their industry
21 and trying to become profitable, what would you say about the
22 pricing policies that they have followed, and what now is being
23 done in this effort with their distribution channels?

24 MR. CALDWELL: I would say two things. One, your
25 earlier comment, to a certain degree, is good news for travel

1 agencies, which is to say, with all these different systems that
2 are out there and all these opportunities, travelers and
3 companies are outsourcing more and more of the management of
4 their travel to companies that are technology savvy. That means
5 an intermediary that does a good job, is low cost, can maybe
6 survive and do very well. So opportunity is out there.

7 To the second part of your question or comment
8 about the airfare structure, it is a mess. What is going to
9 happen, and is happening, is we have seen a reformulation of that
10 by these low-fare, low-cost carrier strategies that the carriers
11 are adopting. They are adopting those now with the recognition
12 that years ago the theory was only leisure travelers would go on
13 those.

14 I remember when Southwest announced, everybody
15 said, "Southwest? That's interesting, but who's going to stand
16 in line with a card and get on an airline when I could have a
17 caffe latte in American's first class?" Well, that's all flipped
18 around now, and the airlines realize that, reformulating their
19 old cost strategies.

20 Quite ironically, after some got out and now are
21 getting back in, like U.S. Air's sale of Metrojet, got out of the
22 business having failed, now coming back with small planes
23 catering to business, lower costs, and, hopefully, different fare
24 structure.

25 You're right, the fares are out of line and they're

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1 crazy, and it is a mess. I think it is going to straighten
2 itself out around a different kind of pricing the airlines are
3 going to have to come up with, because they are not filling those
4 seats at 2,000 bucks a pop.

5 Those fares are sitting there unused, a lot of
6 them. People will not pay these outrageous, unrestricted fares.

7 They are going to the Internet, and good news for Southwest and
8 jetBlue and these other carriers. They are formulating,
9 interestingly enough, commercial business strategies now.

10 My clients used to never hear from low-cost
11 carriers except Southwest -- appropriate kudos. They never came
12 to see them. Now they are on their doorstep, and the airlines
13 are having to react.

14 So I think a more rational pricing structure could
15 be coming, but it hasn't been the history of the past of the
16 industry. They have had MBAs and they have had the consulting
17 firms of the world, and they have had everybody study everything,
18 it seems to me.

19 They keep coming back to the fact they've got very
20 high fixed costs, uncontrollable labor costs, and a diminishing
21 market, and it is hard to make money in that business. I
22 empathize with them. I think it is a tough, tough call, but
23 they've got to simplify this pricing.

24 Corporations want it simpler. They know it is not
25 going to be a push of a button, but they want it simple, simpler

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1 pricing and other things.

2 CHAIRMAN WINSTEAD: Pat has a question and then
3 Tom, I think. Go ahead, Tom, why don't you?

4 MR. DUNNE: Mr. Caldwell, I certainly appreciate
5 your testimony and your report because it fairly accurately puts
6 things in the proper perspective. Your passion puts it there
7 even better.

8 One of my questions I have here, in a recent packet
9 of information I received prior to one of our meetings, there was
10 a commentary in there from The Wall Street Journal about Barry
11 Diller and also Henry Silverman. Barry Diller taking and buying
12 Expedia, Silverman buying Galileo, and then a part of the
13 article, too, is where Sabre bought 30 percent back of
14 Travelocity, which they started.

15 Could you also or would you care to comment? Do
16 you see maybe a reverse effect, such as the airlines have
17 gathered together an Orbitz -- which was a bad word, because
18 that's all we hear about Orbitz now, how bad Orbitz is -- do you
19 see something here with these kind of gentlemen getting into the
20 act, that maybe the travel agency market itself is in danger of
21 being grabbed up by a huge conglomerate which would then control
22 the airlines with respect to the number of passengers they could
23 provide?

24 MR. CALDWELL: Well, with all due respect to those
25 companies you have referred to, I don't think they have that kind

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1 of power and/or capitalization. Also, you may have seen the
2 latest report on Cendant's profits, and they were down; I don't
3 know if it was in the loss category, but they have been losing
4 money.

5 MR. DUNNE: Right.

6 MR. CALDWELL: The strategy there is vertical
7 integration. It has been tried before by the airlines and didn't
8 work. Remember when United Airlines tried to get into the hotel
9 business and the car rental business, and they didn't really
10 succeed?

11 Now independent, outside companies coming in to do
12 this, interesting opportunities for consumers and companies, but
13 I think the risk of domination is pretty non-existent from that.

14 I am more concerned about, with all due respect to my
15 differences with Paul, about the potential of oligopoly on the
16 airline side, moving into collusion. That does concern me. I
17 think it requires government review, Justice Department scrutiny,
18 but not intervention. So I am more worried about that side of it
19 that we haven't seen, and my clients are.

20 My clients are worried they are going to wake up
21 one day and there's going to be the "Rule of Three" -- three
22 agencies and three airlines, and nowhere to go -- more so than
23 they are about companies coming in and dominating distribution.

24 CHAIRMAN WINSTEAD: Pat?

25 MR. DUNNE: Thank you.

1 MR. MURPHY: Just a couple of quick comments. One,
2 Paul said he didn't know where to begin because he disagreed with
3 much. Let me say I don't know where to begin because I agree
4 with virtually everything you have said.

5 MR. CALDWELL: Thank you.

6 MR. MURPHY: And I do think that the mere existence
7 of this Commission and the holding of these hearings may be the
8 most powerful effect that we can provide, by creating uncertainty
9 and forcing people to move even quicker in new directions than
10 they might otherwise.

11 I also think, as someone who worked on the last
12 round of CRS regulations within the government, that I have a lot
13 of sympathy for DOT trying to grapple with these issues at a time
14 when change is almost accelerating.

15 I agree with your view that, when is the right time
16 for DOT -- and, frankly, right now OMB -- to make a move in this
17 area? Because almost as soon as they write something, it could
18 become obsolete. Also, they could influence the market in a way
19 that they didn't intend to.

20 So I just want to thank you for your comments, and
21 know I appreciate them very much.

22 MR. CALDWELL: Thank you.

23 CHAIRMAN WINSTEAD: Any other compelling questions?
24 Maryles?

25 MS. CASTO: Yes. John, I have a question. You had

1 mentioned that in the travel industry you talked about the "Big
2 Five," the airlines, the big, major airlines, but we don't talk
3 about the "Big Five" in the travel industry, the travel agencies.

4 I have noticed that, when consultants do go out to kibitz for
5 their corporate accounts, they always look at just the mega-
6 agencies. That also impacts the small agencies.

7 MR. CALDWELL: Uh-hum.

8 MS. CASTO: What do you say about that?

9 MR. CALDWELL: Well, that is a tough issue because
10 in some of those instances companies do that because of the
11 global nature of their operations, requiring a global network
12 that is more than just franchises and local companies. The Big
13 Five tend to have more of that, so that when we sponsor an RFP
14 shop for a multinational, they may have operations in 30
15 countries and they may love the potential for real good customer
16 service from local smaller agency that may not have that clout,
17 that reach, that technology platform in Singapore or Munich.
18 Increasingly, companies are globalizing their consolidation of
19 agency services.

20 MS. CASTO: But with technology the way it is,
21 though, you don't need to operate all over the place.

22 MR. CALDWELL: Outside the U.S., I wish that were
23 the case. Technology, the situation in the travel agency, is
24 five to ten years behind the U.S. outside the U.S., especially in
25 Singapore or Latin America. So bricks and mortar are still a big

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1 issue outside.

2 MS. CASTO: I disagree, but that is okay.

3 (Laughter.)

4 CHAIRMAN WINSTEAD: John, I think that probably
5 expires most of our questions. We really appreciate it. It was
6 very good testimony. We appreciate your thorough response and
7 also some ideas on some recommendations for us to consider.

8 What we are going to do for a minute, our next --
9 we thank you again.

10 MR. CALDWELL: Yes, sir.

11 CHAIRMAN WINSTEAD: Robert Joselyn is going to come
12 up, and we have to move this projector back so that he can make
13 his presentation. If we could just take, for the audience and us
14 as well, take a five-minute break, our intent is to come back at
15 noon, a little bit thereafter, do one more witness, and break for
16 lunch from 1:00 to 2:00, and then take the afternoon witnesses at
17 2:00. Thank you.

18 (Whereupon, the foregoing matter went off the
19 record at 11:56 a.m. and went back on the record at 12:10 p.m.)

20 CHAIRMAN WINSTEAD: If we could reconvene, we would
21 appreciate it. Those who want to sit in the audience and look
22 back, for the Commissioners, I think we can see your
23 presentation.

24 Robert, why don't we go ahead, and if you could
25 provide your name and your background for the record, and then

1 get into your testimony? We appreciate your coming and sitting
2 through the morning session with us.

3 DR. JOSELYN: Thank you. I found the morning
4 session very interesting.

5 This is going to be a little different in a couple
6 of aspects. First of all, I am going to do things a little
7 differently. I am not going to read from my testimony. You were
8 provided with that in advance, although I would suggest to the
9 press and to the Commission that, having thought about what I was
10 going to say for the last ten days after having submitted the
11 written testimony, that I am going to some finetuning as I go
12 through.

13 As I read back through it myself, at least as I
14 read it, I characterized some things that were a little bit
15 different than the way I am thinking. So I am going to try to
16 choose my words carefully in the presentation today.

17 The other thing, obviously, I am not going to do is
18 I am not going to sit. I think better on my feet. People who
19 know me in here know that that is where I feel the most
20 comfortable.

21 I thank the Committee for inviting me. I thank
22 you, Chairman Winstead, for having me here today, and everybody
23 else on the Committee, for sharing my opinions, which, again, I
24 think are going to be a little bit different than some of the
25 things that you have heard.

1 Joselyn, Tepper & Associates is a management
2 consulting firm in the travel industry. We have done over the
3 years consulting for virtually every kind of participant within
4 the distribution system, including airlines and cruiselines and
5 tour operators and convention and visitor bureaus and travel
6 agencies and hotel and travel index, and CRS/GDS firms, and so
7 on. We have really spanned the gamut. The vast majority of what
8 we have done over the years, however, has been for travel
9 agencies and travel agency organizations.

10 I don't know whether you want to go much more into
11 my background. I've got a structural engineering degree, an MBA,
12 and a doctorate in operations research. I was a college
13 professor for a number of years. I don't normally admit that in
14 public.

15 But I think the most important part of the
16 background is that, when I left the University of Denver as a
17 tenured associate professor of marketing, I formed a management
18 venture group which, among other things, opened some travel
19 agencies from scratch. So at one time I was in the travel agency
20 business. I also at one time got involved with a regional
21 consortium of agencies and became president and CEO of that. So
22 I think I bring today a perspective of having been a participant
23 or consulting to a wide variety of participants in the industry
24 itself.

25 The issues that I was asked to talk about today are

1 a number of issues directly, and I have listed them here:

2 Do travel agencies add value to the sale and
3 purchase of airline transportation? Do travel consumers derive
4 benefits from travel agency services as compared to alternative
5 purchase options?

6 Secondly, do travel agencies have access to
7 Internet-only airfares?

8 Third, will airline net fares with separate
9 distribution charges level the playing field for travel agencies?

10 That has certainly been a topic of discussion this morning.

11 Is the financial condition of travel agencies
12 declining, and will travel agencies survive?

13 You know, when I looked at the title of this
14 Commission, which is the National Commission to Ensure Consumer
15 Information and Choice in the Airline Industry, and I looked at
16 the questions that I was asked to talk about, I asked, are these
17 tangential? Are these really addressing the issue that is the
18 title of the Commission?

19 I guess they are tangential unless you believe the
20 travel agencies at this point in time provide the best source of
21 unbiased, consumer-oriented, value-driven information to the
22 consuming public. If you believe that, as I do, then, in fact,
23 these issues aren't tangential, unless you believe that there is
24 the possibility that some airlines, not all, Joyce, some
25 airlines, okay, that some airlines have engaged in practices to

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1 discourage and disadvantage the travel agency community, for
2 reasons that will financially benefit themselves which are, in
3 fact, directly harmful to consumers. And if you believe that,
4 and I do believe that, all right, then it is not tangential to
5 this Commission at all. So I don't think the questions are
6 tangential.

7 Let's look at the questions now, and let me attempt
8 to answer them the best I can.

9 Do travel agencies add value to the sale and
10 purchase of airline transportation? Do consumers derive
11 benefits?

12 Throughout the discussions this morning and the
13 previous hearings that you have had, I think that there has been
14 a lot of grappling with understanding the distribution system
15 itself. I fully understand that, because when I first got
16 involved with the travel industry and started looking at travel
17 agencies and looked at the distribution system, very frankly, it
18 didn't make much sense to me, at least in terms of the classic
19 concept of distribution systems, as you might see in a beginning
20 marketing textbook.

21 So I sat down one day in my office in 1984, when I
22 still lived in Boulder, Colorado, and I started sketching out the
23 distribution system for travel, and I had a wastepaper basket
24 full of crumpled-up pieces of paper, until I finally drew a model
25 that I put in your report without a lot of explanation, but, in

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1 fact, is important today. So if you will let me be professorial
2 for just a second, this bears heavily on the testimony that I am
3 going to give and some of the comments I am going to make.

4 The first thing I did in trying to understand the
5 agent's role in the distribution system is to not to think of the
6 agency in the classic sense of being an intermediary distributor
7 within a distribution system, but, in fact, consider an agency as
8 being in the position of having fundamentally two customers. I
9 call this the two-customer model.

10 Okay, the agency adding the supplier customer, of
11 main focus here today, that supplier being the airline industry,
12 and the second customer being the traveler. Now to understand
13 this, you've got to go back to the fundamentals of what is a
14 customer relationship. A customer relationship fundamentally is
15 an exchange in values. Somebody does something for somebody
16 else, and somehow they get compensated in return for what they
17 do.

18 If you define a customer relationship that way, I
19 think it is easy to say, even though legally it may be something
20 different, but it is easier to understand the role that travel
21 agencies played over the years.

22 What value do travel agencies historically provide
23 suppliers? They represented their products in the marketplace.
24 They saved suppliers time. If they weren't there, and the
25 supplier had to do the tasks that the agency was performing

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1 themselves, it would take the supplier time, and engage in
2 promotion on behalf of their products.

3 Frankly, they engaged in market development by
4 encouraging more people to travel, the discretionary travelers,
5 who might have spent their money on non-travel alternatives that
6 satisfied some of the same underlying needs.

7 In return, over the years, for the benefits that
8 the supplier received, whether it be airlines or cruiselines or
9 anybody else, but airlines specifically today, when they sold the
10 product, they were paid a commission for the product.

11 The agency also had travel customers, and this is
12 the historical model in which they did two things. No. 1, they
13 sold somebody else's product, and like any other retailer up and
14 down the block, whether it be a shoe store selling Nikes or
15 whether it be a music stores selling somebody else's CDs, and so
16 on, they sold the airline transportation, the cruises, the rental
17 cars, the hotel rooms, and so on. It wasn't the agency's
18 product; it was somebody else's product. They always owned it,
19 and so on.

20 In addition to that, the agency augmented the
21 purchase of other people's product with their own product, which
22 fell into five categories. I am not going to spend a lot of time
23 on this, which obviously I could, but I won't.

24 But what is the agency product? What is the value-
25 add that agencies did in selling other people's product? They

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1 saved the consumer time versus alternative ways to acquire the
2 product. They provided them with information and expertise,
3 which either allowed that customer to make a better purchase
4 decision or have a better travel experience.

5 When they traveled themselves, they certainly
6 involved personalization in the purchase. I'm only going to say
7 this, having been a college professor and having taught consumer
8 behavior, one of the things we know is that, when customers buy
9 intangible products, personalization in the buying process is
10 important to them, and so is accountability.

11 So is being able to grab somebody by the throat if
12 something didn't go the way you thought it was going to go when
13 you purchased the product. You know, try to find "Sally
14 Cyberspace" when something goes wrong, or even an airline
15 reservationist sitting in some city that is remote from your own.

16 So the agency supplemented that product.

17 The historical model was interesting in that
18 agencies hoped that the commissions paid to them for the cost of
19 providing the services that they did to the airlines was large
20 enough to cover the cost of those services, but large enough to
21 cover the costs associated with the services they had
22 traditionally given away to the consumer.

23 The word was used in the first testimony this
24 morning about "subsidy." I don't like that word, but, in fact,
25 what agents chose to do is they chose - and what the airlines and

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1 other suppliers chose to do is pay commissions large enough to
2 subsidize services and benefits that were ultimately provided by
3 the agency to other consumers. Now I don't like the word
4 "subsidy" because, basically, part of that was paying the agents
5 for actually the kinds of things they did.

6 The last piece of this model is, while the cash
7 actually may be physically went through the agency, fundamentally
8 it went to the supplier. The supplier provided the travel
9 services themselves, and the money came back to the agency in the
10 form of commissions. Again, traditional model of the agency,
11 very important for some of the things I am going to say.

12 Do travel agencies add value to the sale and
13 purchase of airline transportation? The answer I think is an
14 unqualified yes. I think there is evidence in the marketplace to
15 show this.

16 First of all, airline commissions, it comes right
17 off of the ASTA website, Paul, out of a report that you did on
18 that, basically, documenting the decline in airline commissions
19 over the period from 1995.

20 By the way, if you have particular questions about
21 service fees today, I would probably be a good person to ask
22 because I started talking about service fees as making sense in
23 the travel industry for travel agencies in 1984. I was generally
24 regarded as an amusing eccentric for a number of years and
25 remained so until 1995, on February 9th when Delta did the

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1 commission caps almost overnight, and I became almost a prophet,
2 but I never took either one of those labels. Still a lot of
3 people think I am an amusing eccentric, but we will not go there
4 today.

5 (Laughter.)

6 Okay, airline commissions clearly declined. What
7 happened during this same period of time? And you have heard
8 about it this morning. I think John talked about it, other
9 people. Agencies, in fact, had to, as that revenue stream
10 declined, agencies had to implement service fees. Interestingly
11 enough, there were some doing that before 1995. Notice on the
12 bottom chart, a little hard to see there, 2.8 percent of the
13 agencies were, but by the year 2002, 95 percent of the travel
14 agencies were charging some sort of service fees. So it is kind
15 of an interesting chart. As one is going down, the other one
16 mirrored it and went up exactly.

17 What does this tell us? It tells us that every
18 time the travel agency community during this time period went out
19 to the consumer and said, "I need to charge you for the services
20 we're providing for you and the value provided to you," that most
21 consumers reached in their pocket and paid for it. Now the
22 agencies lost some volume over this time period, but, very
23 frankly, the elasticity of demand wasn't very elastic. All
24 right? In fact, they were able, very successfully, to implement
25 service fees through this time period.

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1 Pre-1995, the model that you just saw was basically
2 agencies getting 100 percent of their revenue from commissions
3 paid by suppliers for the services provided by suppliers. What
4 happened in post-1995 and pre-zero-percent commission was, in
5 fact, that the agencies went to a dual-income source. Just so
6 that everybody knows that I am not totally unfair to the
7 airlines, I ran around for years saying that it really didn't
8 make sense for an airline to subsidize the cost of services
9 provided by an agency to somebody else's benefit.

10 And one of the things is that airline faced their
11 own financial challenges, and they said, "I'm willing to pay you
12 for what you do for me, but I'm no longer willing to pay you
13 enough to cover the cost of that which you have chosen to give
14 away to somebody else. If that actually has value, go get the
15 money from them."

16 That is exactly what travel agencies did, and they
17 were successful, and that was the consumers saying that they had
18 value. Do travel agencies add value to the sale and purchase of
19 airline transportation? I think the answer is yes in terms of
20 the commercial marketplace, too. This is in my testimony, but I
21 would read it here.

22 This was a USA Today article on the NBTA meeting in
23 Las Vegas a couple of weeks ago, where Kevin Iwamoto was
24 interviewed there. It was interesting, some of the questions and
25 answers even there.

1 Question: "Are they, business, letting travelers
2 book more of their own travel?"

3 His answer is, "Once you start booking outside the
4 corporate structure, you lose on many fronts." I think John
5 addressed some of this before. "You lose data. You lose policy
6 control. You lose information. September 11th showed that we
7 need to know where all our travelers are. If they're booking
8 their own travel on the Web and something tragic happens, we have
9 no way of letting management know, or even their families, where
10 they are. Some of the technology may," a fact that we have
11 talked about this morning, "may offset that."

12 Question: "Could travelers save the company
13 thousands of dollars by using the Web to book travel?"

14 "Sometimes yes; sometimes no," was the answer. I
15 think that is a myth. In what way? People aren't factoring in
16 the cost of doing that. People are highly-paid individuals and
17 they're playing a travel agent role or self-booking tool.

18 Actually, I have always over the years said this is
19 sort of like -- you know, corporations were worried about people
20 playing Pacman on their PCs for a number of years and wasting
21 time. Booking their own travel was sort of Pacman, but they were
22 losing more money while they were doing it. But we will see that
23 in a second, too. This should not be their purview. They should
24 concentrate on their core job.

25 Is there some evidence of this? And I think there

1 is. Referred to or alluded to a couple of times today was the
2 auditing that is done of airfares. The most prominent firm doing
3 this is TOPAZ.

4 They had a news release that came out July 12th,
5 which was really frequently. They had another one that came out,
6 I think, on March 22nd of this year, both basically arriving at
7 the same conclusion.

8 They asked, basically, are travelers getting better
9 fares online? What they found in their study on the agency
10 versus the Internet, and I can talk to you about how they did
11 this, and so on, is that, in fact, there was \$116 differential in
12 the airfares compared to when the agency actually went out and
13 tried to find the best fare for the travel requirements there, to
14 \$594 for what they found on the Internet, that there was \$116
15 differential between the two.

16 One of the reasons -- and I am going to come back
17 to this in a moment -- of course, was negotiated airfares, which
18 the agencies, which most of these large commercial agencies,
19 which are who TOPAZ's clients are, had access to that were not
20 available on Internet sites. But I want to come back to that
21 point in a minute.

22 The second chart out of the TOPAZ study that I put
23 for you is the Internet versus travel agency lowest fare found,
24 77 percent of the time on the agency, 8 percent on the Internet.

25 John mentioned the 90 percent before. If you go back to the

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1 March 22nd study that they released, they talked about 93 percent
2 and 7, but what the 93 percent was is where the agency found a
3 matching or lower fare. In the most recent release of the study
4 they dropped out the matching and just went to the lower fare.
5 So that's why you see the 77 and 8 percent, and it doesn't add up
6 to 100. The differential between those two, which is a 15
7 percent differential, was cases where the agency actually found a
8 similar fare or the same fare.

9 Do travel consumers derive benefits from travel
10 agency services as compared to alternative purchase options? I
11 would submit to you, again, ASTA statistics from their own
12 studies. Of all the things that consumers have been paying
13 travel agencies for as of this last year, 95 percent on airline
14 tickets, special-promotion rail, exchanges, refunds,
15 cancellations, many of those related to, by the way, air bookings
16 to event bookings, right down the line, customers are saying, you
17 guys are valuable; you guys are worth it.

18 Do travel consumers, non-business consumers, derive
19 benefits from travel agency services as compared to alternative
20 purchase options? Unfortunately, to my knowledge, there is no
21 comparable TOPAZ-like data for the non-managed air travel portion
22 of the business.

23 We see some anecdotal stuff. We see every once in
24 a while, whether it is USA Today or somebody else, they go out
25 and they test, and they test three agencies, and somebody goes to

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1 the Internet. It is not a very controlled research environment.

2 They say, "Gee, in this case this is where we found the lowest
3 fare." Very frankly, most of those are lousy research. They are
4 good press, make nice articles, but they are pretty lousy
5 research.

6 I can say that actually because I taught research.

7 I worked in a couple of research firms, and I wrote a college
8 marketing research textbook. So I know a little bit about how to
9 conduct some of these studies.

10 So, to my knowledge, there is no thing. However,
11 having said that, I would submit to you that it is likely that
12 fare consumer options or consumer options for finding fares more
13 than offset corporate fare agreements, although customers don't
14 have -- or customers do have direct access in the leisure and
15 non-managed travel business. Okay? While we have corporate
16 agreements, what we heard before -- and I am trying to remember,
17 was it, Ann, whether you mentioned it before -- is the outrageous
18 airfares offered, and I mean, obviously, that was a subjective
19 opinion of your own, but the airfares offered to commercial
20 travelers.

21 In other words, basically, we know they have less
22 flexibility. Because they have less flexibility, we are going to
23 take advantage of the situation by charging them a lot more. And
24 we all know that that is existent in the marketplace.

25 It is likely the consumer fare options, in order to

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1 be able to get advance-purchase discounted tickets and things, at
2 least more than offset what happens in the corporate arena in
3 terms of fare agreements.

4 It is a given that the average non-commercial
5 traveler has more flexibility than the average commercial
6 traveler. They can leave tomorrow morning. They can fly in and
7 out of different cities. They can go next week, if they have to,
8 and so on. So they have more flexibility. I think we would all
9 agree that is a given.

10 It is likely that the average non-commercial
11 traveler has less air travel booking experience than the average
12 commercial traveler. I think we say that people who are
13 traveling all the time and dealing with their bookings all the
14 time probably know a little bit more.

15 Having said all this, I would submit to you that it
16 is possible that the gap between -- I don't have the research,
17 but I would like to suggest to you that it is possible the gap
18 between agency-based air purchases and Internet-based air
19 purchases for non-managed air travel is probably at least as
20 great as the gap TOPAZ found with managed commercial accounts.

21 In other words, they said, managed commercial
22 accounts, \$117. I am saying, given all these conditions, my
23 guess is that gap is at least that much in non-managed air
24 travel.

25 Now several things have come up this morning. By

1 the way, when this model began to evolve, my agency clients over
2 the years said, "Boy, will it ever go to zero? Will the
3 commissions ever go to zero?" I said, "No, I really don't think
4 so," which, by the way, probably destroys all my credibility here
5 this morning, but I said, "Because it doesn't make any sense for
6 it to go to zero."

7 Why would an airline -- yes, they have lower
8 alternative costs of distribution. Yes, they have lower
9 alternative -- by the way, the agency distribution cost was lower
10 than the airline cost when they had to use their personnel and
11 their res. center personnel at 10 percent, much less at 5 or
12 anything else. Okay?

13 It doesn't make any sense to me, is what I told the
14 agency, for airlines to pay travel agencies less than their least
15 alternative cost of distribution. It makes no sense whatever.
16 And, yet, they went ahead and did that and went to zero
17 commissions.

18 Now I had to ask myself why. Maybe I have seen too
19 many "Columbo" reruns or something like that. But, you know, you
20 look for explanation. If this doesn't make any sense, you look
21 for an explanation that they went ahead and did it anyway, and
22 you eliminate all the things that aren't possible, then you've
23 got to look at what's left.

24 One of the things that I think that we did, and I
25 think we have done a little bit of it this morning, is that we

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1 have had a tendency to look at only the cost side of the
2 equation. Now I know somebody in San Francisco mentioned this,
3 and I am certainly going to jump back on this bandwagon. What we
4 have said is that the airlines are looking at this that they have
5 eliminated the commissions to agencies.

6 By the way, dealing with agencies is not -- I am
7 going to disagree with one of the comments this morning -- not
8 costless. Even at zero commission, it is not costless. You have
9 to maintain relationships with the agencies. You have to have
10 some kind of -- there is some infrastructure there that costs the
11 airlines. So it is not zero. It is not zero even at zero
12 commissions. All right?

13 But what was the reason? If it is not on the cost
14 side, perhaps the reason or the motivation for doing this was on
15 the revenue side. So I would submit that my bottom line on this
16 is that one possible rationale for the current airline anti-agent
17 distribution strategy -- and I can't look at it as any other way
18 than anti-agent -- is that it allows airlines to take advantage
19 of consumer confusion, consumer lack of industry-specific
20 knowledge, and the absence of value search skills possessed by
21 travel agent professionals, to increase their average revenue
22 percent.

23 To me, that goes to the heart of what this
24 Commission is. That is, if we can get these consumers, they can
25 do one of two things. They can go to the agency, and they've got

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1 a professional working for them, who on the commercial side is
2 saving them \$117 average on sale, on the leisure side, heaven
3 only knows what because we don't have the numbers. Those
4 numbers, the additional gain in revenue on average may dwarf what
5 is happening on the cost side. If, in fact, this is the case,
6 that is a rationale.

7 Another rationale is that we want to control the
8 business in some way or another. Frankly, this goes to the heart
9 of what this Commission is all about.

10 We had an Administration in Washington here once
11 that, I guess, sort of won because they kept saying, "It's the
12 economy, Stupid." The more I looked at this for this Commission
13 hearing, I kept saying, wait a minute, it's not the cost side; it
14 is the revenue side that may be the issue that is driving this.

15 I want to go back and say one thing. Is it up to
16 the government to tell this story to the public? I don't think
17 so. I think it is the agency community that needs to do the
18 research and tell this story in a very aggressive way to the
19 public in terms of the value that they provide.

20 I think it is obvious to any of us who have tried
21 to book on the Internet, understand the complexities of doing so
22 -- okay, there's a rumor; I don't know, it's just a rumor that
23 Arthur Andersen is the guys that wrote the computer algorithms
24 for the Internet sites, but that may or may not be true.

25 (Laughter.)

1 Are they doing it on purpose? I don't know. Do
2 they know about it? Do they know what the differential is? I am
3 absolutely positive.

4 Do travel agencies have access to Internet-only
5 airfares? Yes. Yes, of course they do. Okay? I mean, you
6 heard about the technology in San Francisco. I know early on you
7 had some people who said, "No, we don't have access to Internet-
8 only airfares." Of course, they have access to Internet-only
9 airfares. They have it with some of the technology that we have
10 talked about, that you heard about in San Francisco, and they can
11 go to a PC like anybody else.

12 So, as I suggested in my written testimony, I think
13 if anybody answered, "We don't have access," they have miscast
14 the issue. You know what the issue is. I'm not going to dwell
15 on it. They may have access, but it is less efficient than using
16 the GDS system, if they were in there, and at an additional
17 direct cost to get the information. The efficient access is at a
18 reduced level of labor productivity. It takes a lot longer to do
19 that. Access is at some differential of available information,
20 primarily availability in terms of fares.

21 By the way, the problem with looking at Internet-
22 only airfares -- and I don't know this piece of the TOPAZ study
23 -- is you can find stuff on the Internet, and it is there until
24 you collect to book. All right? So it may be posted there and
25 it may appear to be there. That is the problem that travel

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1 agencies have, is somebody came and said, "I found this fare on
2 the Internet," but in fact they never really went the next step
3 and tried to book that airfare. When they did, they would find
4 out that, in fact, it may not be available, depending on the site
5 you are going to.

6 Utilization can degrade the value of agency
7 corporate travel management services. Mr. Iwamoto certainly
8 mentioned that before in his article. By not being able to track
9 information, by not being able to meet negotiated requirements, a
10 number of things the agency can't do when it is outside the loop
11 and you can no longer travel it.

12 Utilization can degrade the value of consumer
13 agency travel management service. If, in fact, you book, and an
14 agency can do this, an agency can go and say, "My covenant with
15 you is finding the lowest airfare. I happened to find it on
16 Orbitz, and I will facilitate that booking for you for a fee,
17 with the full understanding you're no longer booking through me
18 as an intermediate agent, but in fact you're booking directly
19 with the airline," and you can do that. An agency can do that,
20 but, in fact, if that customer has an issue or a problem or a
21 change they need to make afterwards, the agency can't do it; the
22 airline can. So, in fact, the value of travel management service
23 declines there, too.

24 Of course, utilization can have serious negative
25 impact on some agency CRS/GDS agreements that have threshold

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1 requirements. I know that is an issue that you looked at, too.

2 Will airline net fares with separate distribution
3 charges level the playing field for travel agencies? My answer
4 to that: Yes, it's possible. It could happen. Philosophically,
5 it could happen, but it is really unlikely to work. All right?

6 There's a lot of reasons I think it is unlikely to
7 work. First of all, the airline-calculated distribution charge
8 to make it a level playing field, and I believe one of you asked
9 this question before -- Tom, it may have been you that asked this
10 question -- the airline-calculated distribution charge will need
11 to be in a competitive range of the average agency-required
12 service fee.

13 I will tell you right now, and I say this not
14 boastfully, there's nobody on the planet Earth that has worked
15 with as many agencies as we have in implementing service fees. I
16 will tell you that when we talked about the cost per transaction
17 this morning, you heard one number of \$25. That is really at the
18 low range. It really depends on how you do your accounting how
19 you get it. But, in fact, maybe it is \$25. Even standing here,
20 we couldn't possibly imagine that it would be the same for
21 Larned, Kansas and downtown San Francisco in terms of labor costs
22 and everything else involved. So maybe \$25 at the low end. It
23 may be \$80 at the high end. Assume a \$45 average.

24 Yes?

25 MR. RUDEN: Bob, excuse me. I don't mean to

1 interrupt, but --

2 DR. JOSELYN: Go ahead.

3 MR. RUDEN: -- you're making a really basic point
4 here. Why is that necessarily so?

5 DR. JOSELYN: Why is what necessarily so?

6 MR. RUDEN: Rosenbluth's argument was not that the
7 airlines added charge to its own fares --

8 DR. JOSELYN: Right.

9 MR. RUDEN: -- had to equal what agencies --

10 DR. JOSELYN: He did not make that argument.

11 MR. RUDEN: He is of the view that those --

12 DR. JOSELYN: He did not make that argument.

13 MR. RUDEN: -- would float competitively. The
14 airline and everyone might have different charges for different
15 types of access.

16 DR. JOSELYN: You're absolutely correct. What I
17 said, and I tried to use my attorney words here, in a competitive
18 range, okay? And the reason is, if the airlines came on and
19 said, "Okay, we'll do it. We'll do it, but it's five bucks" --

20 MR. RUDEN: They would be lying then, wouldn't
21 they?

22 DR. JOSELYN: Sure, they would be lying. And if
23 the agency had to charge \$50, then that really didn't fix the
24 situation.

25 Here's why this concerns me: I have been in this

1 industry a long time, and I had airline people years ago tell me,
2 "We're paying agencies," back when they were paying 10 percent
3 and saying, "Well, it only costs us 5 percent when people call
4 our res. center." Well, you know what, as we have seen,
5 accountants have become very, very good, and have been over the
6 years, in making the numbers be whatever they want them to be.

7 (Laughter.)

8 What they did is, first of all, they were comparing
9 apples and oranges. Nobody ever who was going to Kansas City to
10 buy an airline ticket to visit their grandmother stopped and
11 asked an airline reservations person where they might eat when
12 they are in Kansas City, but they did that with an agent. The
13 people who required more service didn't go to airline reservation
14 centers. So we are comparing apples and oranges.

15 Then, secondly, I don't think they fully allocated
16 their overhead. So the issue is, yes, they would be lying, but
17 lying has taken on a whole new meaning in business recently.

18 Yes?

19 MR. RUDEN: I really want to understand your
20 testimony. What you are saying, then, is you don't think that,
21 even if airlines conceptually said, okay, Mr. Wasilov is correct,
22 this makes more sense, but then they would game it so that it
23 didn't work?

24 DR. JOSELYN: Yes. Hang with me one second here --

25 MR. RUDEN: All right.

1 DR. JOSELYN: -- because you haven't had a chance
2 to see this. This wasn't in my written testimony, but it is up
3 here on the screen.

4 MR. RUDEN: Okay.

5 DR. JOSELYN: What comparative distribution costs
6 would an airline use? Would they compare it to a res. center
7 cost, where they have live human beings? Would they do it with
8 their Internet costs? Would those costs be fully allocated?
9 Would the president's salary be allocated at least some percent?
10 Would everything in the organizations be allocated? And who is
11 going to monitor this? And over time, are you not only going to
12 say they have to do this, but we have to have an ongoing
13 legislative body that monitors that they do the accounting right
14 and do it fair and do it consistently? Again, I am saying it is
15 possible but unlikely.

16 And then the third thing, and this is the issue, is
17 the airlines would have to play fair. If, in fact, it is the
18 airlines' intention to move as much business out of the travel
19 agent distribution system and into their own preferred options,
20 they could do one of two things.

21 Let's take a \$100 airline ticket. They could say,
22 "Well, yes, it costs us \$45," the same thing I said was an
23 average for an agency. So it is a \$100 airline ticket and it is
24 \$45 to book through us, in which case the playing field is level.

25 But if, in fact, I really didn't want that to be

1 the outcome, I could say, "It's really \$140 and it is a \$5
2 distribution cost the way I do my accounting." So the truth of
3 the matter is, ultimately, unless somebody is going to police
4 this, you have to assume that the guys are playing fair and
5 playing honest, and being that. I am not sure, given what I have
6 already said, that I believe that would be the case.

7 The last thing I am going to say here today, and
8 this is a philosophical issue, is that I asked myself -- and
9 let's not make any mistake here. I am a huge fan of travel
10 agencies. These are hard-working, entrepreneurial, consumer-
11 caring people. This is a group of people -- I have been around
12 this industry for a long time -- this is a group of people, and I
13 don't understand, maybe you also have to be a masochist, who have
14 always worked twice as hard under the commission system to make
15 half as much.

16 There was always a conflict of interest in terms
17 of, if I didn't work hard and find the best value, I would have
18 made more money. I will tell you that in all of my years
19 associated with the travel industry, I have never encountered an
20 agency that operated that way. They have always worked twice as
21 hard to make less money in doing that.

22 Having said that -- so this is not an anti-agent,
23 but I will tell you what it is in a moment -- what precedent is
24 there for making any business disclose their average distribution
25 cost and charge for it separately? I tried to think, and just

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1 maybe I didn't think of it, but I tried to think of any other
2 business or any other industry where that is a requirement in the
3 industry, and I couldn't come up with one.

4 Now if you went ahead and made the recommendation
5 to do this, I am not opposed to you making the recommendation,
6 but I am opposed -- I care enough about the agency community, I
7 am not going to stand up here today and tell them that I think
8 this is a likely solution because I think it is chasing rainbows.

9 What happens when you chase rainbows is that those
10 people who are on the cusp of survival in the agency community,
11 it will divert their attention. They will wait for a solution,
12 legislative solutions, and they won't do some of the things they
13 need to do to deal with the ugly realities, whether they are fair
14 or unfair, that are out there today.

15 So what I am saying here is, yes, this could work.

16 This could work under the conditions I am talking about, but I
17 personally think it is an unlikely solution.

18 Is the financial condition of travel agencies
19 declining? Absolutely, yes. Absolutely, yes, and we get to see
20 -- you know, I am in the consulting business, and people don't
21 come to you when times are wonderful. They come to you when
22 times are not so great. We see financial statements. They are
23 declining actually for the first time seriously in many years. I
24 want to talk about that in a minute.

25 They are declining for a lot of reasons, though.

1 The economy is not good, affecting a lot of businesses. There
2 are fears of terrorism, although I think that is a far smaller
3 issue than the economy. I think that pretty much for most parts
4 of the marketplace was a fourth quarter 2001 issue, not true
5 necessarily in the Northeast, where there was certainly a
6 different emotional impact.

7 Third, direct travel industry supplier competition
8 for customer patronage via the Internet and other direct
9 marketing alternatives is beginning to take its toll with travel
10 agencies. A word on that, okay?

11 I am not going to spend any time on this, but when
12 I taught marketing at the university level, we said, okay, this
13 is what distribution channels look like. I call this the
14 "wonderful world of textbook distribution," where we had a number
15 of participants, each doing something valuable for the
16 distribution channel, nobody trying to do anybody else's job. It
17 never existed in the travel industry that way.

18 The truth of the matter is, if you go back -- and I
19 did a training program for a major airline for about seven years
20 on a consulting assignment -- if you go back and look at when
21 travel agencies started, before that, there was direct travel
22 industry supplier/customer relationship and agents weren't in
23 there. For economic reasons, the travel agent was inserted into
24 the process or became part of the process, and, again, for
25 economic reasons, but never during this time did travel industry

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1 suppliers ever stop selling directly.

2 So we hear a lot of talk in the industry over the
3 years about bypass. The truth of the matter is agents weren't
4 there to start with, and there always has been bypass. Again, I
5 won't, unless you want to ask me about that -- that's what the
6 industry looked like. In fact, what it has evolved into is
7 something like this where we've got a whole bunch of
8 participants, everybody doing business with everybody else, which
9 is what I call "spaghetti" distribution, which increases the
10 consumption of alcoholic beverages and antacids in the industry.

11 But the truth is that we have a distribution
12 system, because the product is intangible until the moment of
13 consumption, that is electronically available worldwide
14 instantaneously wherever the electronic information is available.

15 And one of your big issues here: It allows distribution
16 relationships and patterns that might not exist if it was a
17 tangible product.

18 Finally, on this one, reduction and ultimately
19 elimination of airline commissions, certainly impacted. Two of
20 the charts you saw before. I will tell you, and I know this is
21 not going to make some people happy, our clients in the last few
22 years made more money in the travel agency business than they
23 ever made. The reason for this is that, as the commissions
24 declined and they added fees, while in fact some volume went
25 away, they more than made up for the loss of revenue on the

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1 volume with fees, and agencies did very, very well, to the point
2 where some of our clients basically said, "Can't wait for the
3 next commission cut." A lot of people couldn't. You know, I am
4 not saying this as a sample of everybody in the industry, but
5 those who dealt with it properly did quite well.

6 I think this is different at zero. What has
7 changed at zero commissions from what has happened in the past?

8 First of all, the fee increase to remain whole is
9 the largest jump ever. What happened in those other cases, we
10 started out with 5, we started out with 10, we went to 15, we
11 went to 20. Okay, a lot of agencies were at 25. All of a
12 sudden, we are now going from 25 to 45 on average, and I've got
13 to tell you that is the largest single significant increase that
14 agencies have had to cope with. So that is the No. 1 reason.

15 Secondly, the economy is far less robust. This
16 started in 1995. Everybody in here remembers the good old days
17 of the late nineties. People were making money. The stock
18 market was up. Corporations, they were saying, "Hey, we don't
19 want you" -- John talked about form -- "We don't want you going
20 out there doing your own travel and everything like that, and we
21 don't want you stopping in Denver, and we don't want you -- you
22 know, just get to work because we are making money hand over
23 fist."

24 The economy was far more robust. Both in the
25 commercial arena and for consumers, everybody said, "I don't have

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1 enough time in my life," and they were willing to pay for time.
2 So when we asked them for fees, they said, "Okay, that's okay,
3 given the value I receive."

4 The Internet alternatives for direct buying are
5 better than they were. They are still cumbersome for the
6 consumer. I don't know how fast you guys are on the Internet.
7 I'm fairly comfortable with it, but even with high-speed access I
8 can't make an airline reservation in less than 20-25 minutes by
9 the time I log on, get on, go through the options, and all that
10 stuff. But the truth is, it is better than it used to be, so
11 that they are better there.

12 All of that means, going back, that the elasticity-
13 of-demand issue has changed, I think, dramatically with zero
14 commissions. It has changed dramatically.

15 If we go back, I think, now, and people say, "What
16 do I do if I go to 45," I said here you are going to see a lot of
17 your business go. We are going to push a lot of people self-
18 purchase options then, do-it-yourself options, which is exactly
19 what I think the airlines want to have happen. They want them to
20 go online. They certainly don't want them to call their
21 reservation staff.

22 Will travel agencies survive? Some. The answer is
23 some. The travel agency is having to cope, as many businesses
24 are, with a very dynamically-changing business ecosystem. They
25 are sitting there. Their competition is changing. Technology is

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1 changing. Distribution relationships are clearly changing.

2 Consumers are changing. They're smarter than they
3 have ever been before. They have more access to information than
4 ever before. They are walking in the doors to the agency armed
5 with information and misinformation like they have never done
6 before that agencies have to deal with.

7 The human resources challenges in the travel agency
8 business has been a tremendous challenge to get quality people in
9 an environment where agency margins have been declining and they
10 are competing with talent with lots of other industries that are
11 making more money.

12 All of these are challenges to the travel agency
13 business. Will they survive? Okay, the answer is some of them.

14 Well, I have always said, in a dynamically-changing
15 business ecosystem, it is the mutants who will survive. I think
16 you heard that in a different way this morning in terms of
17 reacting to change.

18 One consequence is that the term "travel agent" no
19 longer has a uniform meaning. Again, Paul, I know the legal
20 definition. In fact, they still are legal agents of the
21 supplier, and so on, but bear with me in terms of business
22 conceptual model.

23 What we have basically had for the last 150 years
24 is a model that says, you're the agent for the supplier or you
25 are a sales agent, compensated when you sell supplier products,

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1 but you are an agent for the supplier. In reality, what I think
2 has happened over the years is that the agent has become the
3 agent for the buyer and aligned themselves more with the buyer
4 and the buyer's needs and finding them the best value.

5 This is a model, however, along with commissions --
6 and I think it is not only going to be in the airline industry, I
7 think there are going to be challenges in other parts of the
8 business as well -- this is a model for whom the clock is
9 ticking. This is a model that is going away, in my opinion.

10 I put in some charts in there that probably made no
11 sense at all until I talk now. I think there are two models that
12 we are going to see agencies evolve to. One is a travel retailer
13 or a merchant who basically no longer thinks of their revenue
14 stream as commissions from products they sold, but, in fact, it
15 is the differential between cost of goods sold and suggested
16 retail or the retail price they can get -- a very different
17 model, okay?

18 This is a model in which agencies would take
19 inventory risks, go to airlines and say, "We're going to own, we
20 want to own seats on all of your departures or on these
21 departures, and we will take the inventory risk in advance, and
22 we want to negotiate a rate based on that, on owning those
23 seats." They own it. They know what their cost of goods sold
24 is. They know what suggested retail is out there, and they
25 market in a completely different way. This takes a lot of money,

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1 both in terms of inventory ownership and the ability to promote
2 yourself.

3 Then, finally, the travel consultant or service
4 company that basically says to the client, either commercial or
5 leisure, "I'm going to sell you everything at net. I'm going to
6 sell you everything at net, and I'm going to charge you for what
7 I do for you. So I'm going to sell you every cruise, every tour,
8 every hotel, every rental car at net, but when you come in and
9 sit down at my desk, the meter is running. When I do something
10 specific for you, the cash register rings."

11 I believe that this industry is moving to one of
12 the last two models. In fact, and John said this right before
13 me, it has already moved there in terms of the big commercial.
14 The big commercial marketplace moved to that model over the last
15 10 years dramatically.

16 Almost every major commercial account in this
17 country, and in many other countries as well, because we do
18 consulting -- I have been in 23 countries in the last 18 months
19 myself. It is basically the buyers come back and said, "We don't
20 want you to have a conflict of interest. We want you to sell us
21 everything. If you get any commissions, what you do is you
22 credit them against the fees you are going to charge us," which
23 is the fee-based model he was talking about before.

24 In fact, the commercial marketplace, at least with
25 large commercial clients, has moved into that model. So it is

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1 nothing new. It is nothing unique. It has been there.

2 On the leisure side, I think that is the way the
3 model is going to be. I think 10 years from now we are going to
4 come back and that is what we are going to see on the leisure
5 side as well, mostly that model, with some of the major
6 organizations who can take inventory risks and bear the
7 promotional burden moving into the travel retailer model.

8 But I think the agent for the supplier is like an
9 old car that we have repaired a lot of times. At some point
10 you've got to say, let's move on.

11 Will travel agencies survive? -- the question I
12 asked before. The answer, again, as I did before, some of them.

13 And they won't look, I think, like the agencies before. How
14 many businesses do look like they did 10 or 15 or 30 years
15 before? They don't.

16 Let me give you a summary of what I think were my
17 key points of the testimony today. Again, I want to say that I
18 don't want certainly anybody to think I am anti-agent. I am not;
19 I am pro-agent. I just think some of the things that have been
20 suggested aren't realistic.

21 Okay, travel agencies bring documented value to
22 consumers and to airlines. I would love to see a TOPAZ-like
23 study on the leisure side. I think it would show results that
24 are at least as dramatic in terms of the value that agencies can
25 bring simply on the basis of dollar savings.

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1 I believe airlines recognize that consumers pay
2 more on average, maybe too much, when they can lured into self-
3 booking options or into purchasing direct. One method for
4 accomplishing this is by making comparative information more
5 difficult to acquire.

6 They are complex. You know, my airfare to come
7 here initially -- and I think I put this in my report -- was \$700
8 or \$750. I got a human involved who knew what they were doing
9 who said, "Gee, maybe you can fly through St. Louis instead of
10 through Dallas. Maybe if you came into one airport, National,"
11 which I did last night, "but go out of BWI tonight, maybe we can
12 save on the fare there." And guess what? It's \$300-and-change.

13 Was that worth an agency \$45 fee? I would submit it is.

14 Part of the logic for zero-upfront commission to
15 travel agents uses the bullet point above. Agencies have access
16 to Internet-only fares, just not the ability to do so through
17 their CRS or GDS systems, as is the case with other fares, and to
18 sell those fares as an intermediate agent.

19 I want to say one thing about airlines offering
20 Internet-only fares. This, again, is not the only industry where
21 suppliers may sell their product direct to customers, but on
22 different terms than they do for through the distribution system.

23 There are other industries that do that as well.

24 The real issue with the inability to sell Internet-
25 only airfares as an intermediate agent are the costs and

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1 inefficiencies associated with utilizing the Internet to book
2 travel on behalf of their travel purchasers, the back-end service
3 disadvantage agents have with both corporate and leisure clients,
4 and their contractual commitments with CRS/GDS companies.

5 Finally, requiring airlines to offer net fares with
6 separate add-on distribution fees could level the competitive
7 playing field between travel agencies and the airlines, but is
8 unlikely to do so, if the airlines do not want it to -- if they
9 don't want it to. Beyond this, requiring the airlines to do this
10 would seem to impose regulation on airlines not applicable to
11 other industries.

12 Airline actions have and will cause substantial
13 financial distress to a sizable portion of the travel agency
14 community. One barometer of that that we see in our office is
15 the degree and number of mergers and purchases. Very frankly,
16 I've got to tell you that a lot of the agency community now is
17 hemorrhaging like I have never seen it hemorrhage before, and for
18 the reason that their world with the zero commission has been
19 turned upside down to a degree it wasn't before.

20 The net result of this will be a reduction in
21 alternative sources of relatively unbiased information that
22 consumers have access to. Again, I think that this is what the
23 Committee is about.

24 A common thread throughout all the issues being
25 addressed is the collective and/or collusive actions by airlines

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1 with respect to pricing, marketing, and distribution strategies.

2 I will tell you, you know, you came here and you asked for
3 recommendations. You asked for recommendations.

4 I asked myself, if the antitrust laws were truly
5 enforced in their intent, if they were truly enforced, whether a
6 lot of the issues that your Commission has been talking about
7 would go away, and my answer was yes.

8 I think if there is one thing that I would go back
9 to -- to give you an analogy, when I was getting my doctorate, I
10 had a course; there were eight of us in a class, I remember. Our
11 assignment was real simple in that class. At the beginning of
12 the course the professor said, "Okay, this is the first day of
13 class, so we're only going to meet one more time, and it's the
14 last day of class. The objective for the eight of you is to
15 rewrite the Sherman Antitrust Act."

16 The eight of us spent the entire semester rewriting
17 the Sherman Antitrust Act. If, in fact, given the fact that we
18 had done that for an entire semester, I will tell you flat out on
19 our rewrite Orbitz would not be allowed to exist.

20 It is ironic to me that something like Orbitz can
21 let the airlines get together. We always talk about collusion in
22 terms of consumer pricing, but there is also collusion in terms
23 of distribution strategies. It is ironic to me that what we
24 always seem to have to do is that we let somebody build something
25 like this and put a billion dollars into it, and then challenge

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1 the antitrust issues associated with it, as opposed to seeing
2 something so patently, hey, we're going to let all the biggest
3 airlines get together and create their own distribution system
4 together.

5 It would have made a lot more sense to me saying,
6 "Before you guys go a step further with this idea, prove that
7 it's not an antitrust issue." Anyway, it is my opinion. Okay,
8 as the guy on HBO says, I could be wrong.

9 Travel agencies as an institution will survive,
10 although perhaps evolving to business models far different than
11 typical today, certainly consolidation. Individual travel
12 agencies will survive or not based on their vision, their
13 courage, their capabilities and resources. As is the case with
14 any business, survival comes with no guarantees.

15 I thank the Committee for having me here today, and
16 I am certainly open to questions.

17 CHAIRMAN WINSTEAD: Bob, thank you very much. I
18 think it was a very good presentation. I think the graphics were
19 very helpful.

20 I know we don't have a lot of time because it is
21 almost one o'clock, but I am sure that a lot of Commissioners
22 have some questions.

23 You know, you made a lot of statements and you have
24 been a student of the industry for many years, like some of the
25 members on the Commission. You come back to that issue, "It's

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1 the revenue, Stupid" that is driving all this, with your
2 statement.

3 This issue of consumer confusion, I mean I think
4 Ann and others have talked about our concern needs to be the
5 consumer. One of the things, I would be very honest with you, I
6 am a little frustrated about through the course of these hearings
7 is that we really have -- you know, it is hard to get the
8 individual consumer taking time out from their family to come
9 here and to talk about their experience and what they would like
10 to see or the problems they are encountering with their agency
11 dealings now or their frustrations in trying to find through the
12 websites or Orbitz, or whatever, the right fares.

13 I was curious, part of what I would like to know,
14 because you have been dealing with agencies, advising them, and
15 your, I think, analysis of the model that is evolving is
16 accurate, from what I am seeing just in the last nine months from
17 the evidence.

18 But tell me about your thoughts on the consumer
19 side. Can you just sort of speculate, if you don't have the
20 evidence, of what the consumer that is in the 20-to-30-year
21 bracket feels about all this right now versus the 40-to-50,
22 versus the 60 and above? We haven't had that, and yet I think,
23 obviously, that is some information that can be useful. Can you
24 comment on that a little bit?

25 DR. JOSELYN: Yes. I think the airlines have

1 taken, and the people who do Internet marketing have taken, a
2 page, chapter and verse, right out of big-box store marketing.
3 Big-box stores did a great job, whether they were the Wal-Mart's,
4 or whoever they were, of creating the impression among consumers
5 that, if you went to a place that looked like a warehouse, did
6 not have comfortable and elegant facilities in which to shop, and
7 you didn't have anybody to give you advice, and if you found
8 somebody, they didn't know anything, that, in fact, it must be
9 cheaper as a result.

10 In fact, I think all of us here know that in some
11 cases there are bargains there and things are cheaper than you
12 might find at more full-service retailers, but in many cases the
13 things are not less expensive, but they did a great job
14 convincing people that was true.

15 I think the same thing is happening here, and I
16 think --

17 CHAIRMAN WINSTEAD: Your comment about other
18 industries, there is one. I mean, I know the big-box retailers.

19 DR. JOSELYN: Right.

20 CHAIRMAN WINSTEAD: Our firm does a little zoning
21 work, and I know there are huge frustrations in a lot of
22 communities and the state region about the mom-and-pop store on
23 old Main Street and what the impact on it is going to be with the
24 Costco. You are suggesting, when you talk about other industries
25 that are sort of experiencing the same phenomenon, that is one,

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1 correct?

2 DR. JOSELYN: Right. Yes. So I think they have
3 done a great job creating a mindset that it must be cheaper. I
4 think it takes a while for that to get over.

5 I think the issue here is information. You know,
6 as I thought about it, even speaking today, if I had a couple of
7 recommendations, first of all, the recommendation was, you know,
8 make sure that the antitrust laws are enforced vigorously; that
9 to what extent collusion does exist, that that gets stopped.

10 But the second issue that would be very helpful is
11 having a similar study to TOPAZ in terms of what is happening in
12 the non-managed travel marketplace and making that aware. I
13 personally think -- I don't know what the results would be, but I
14 am telling you, I'm guessing, and I think I'm right that people
15 would be astounded. I think they would be a little upset, too.

16 CHAIRMAN WINSTEAD: Again, on the consumer side, I
17 mean independent of the testimony we have received, people that
18 are out trying to get fares, mostly personal from people who have
19 talked to me and my family, people, what is your sense of where
20 they are? I mean, you comment about confusion, that consumer
21 confusion is good for revenue. Do you get a sense from talking
22 to your clients and agencies that people are much more confused
23 now than they were three years ago or five years ago? And will
24 the tools that we have been hearing about help to diminish that
25 confusion?

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1 DR. JOSELYN: I think they have been confused for
2 some period of time. As a matter of fact, airline deregulation,
3 which some of the agency community fought tooth and nail, by the
4 way, was one of the best things that ever happened to the agency
5 community in that it created a chaotic airfare system. Customers
6 got confused and went to a professional to try to help sort it
7 all out. So I think the result was that that helped it.

8 Why consumers have been confused, I think the issue
9 now is that consumers believe that somebody has written a
10 computer algorithm to do what the agent did and that that
11 algorithm can do it at least as well or better, and they are
12 convinced of that. So I am not so sure that they feel confusion.

13 I believe that when they go -- I have members of my
14 own family who believe that they can go to the Internet and they
15 are convinced that they can do it better than a professional
16 travel agent can do it. I think many times they wind up paying
17 twice as much as they ought to pay, and they don't know it,
18 because they come out of there saying, "I know I got the best
19 deal."

20 So I think I would answer the confusion question
21 that way.

22 CHAIRMAN WINSTEAD: Joyce and then Ted and then
23 Gerry.

24 MS. ROGGE: Bob, thanks for coming. It was very
25 enlightening.

1 I wanted to go back to the TOPAZ study for a
2 second. In your testimony or in your charts you were talking
3 about, you pointed out that the net fare agreements that the
4 agencies and the companies have with the airlines doesn't show up
5 in that study.

6 DR. JOSELYN: No, it does. It was included. In
7 other words, one of the reasons that number was lower is because
8 almost all of TOPAZ's clients, or at least some of their
9 commercial clients, have negotiated their agreements.

10 MS. ROGGE: Okay, well, that is what I was going to
11 try to point out.

12 DR. JOSELYN: The other thing, there are some other
13 problems with it. I can tell you, I didn't go up and look
14 through exactly how everything was done. But what TOPAZ does is
15 that, when a record is booked -- and the last one they did was
16 60,000 records -- when a record is booked, they say within two
17 hours they go to the Internet to see if they can match or beat
18 that fare. Okay?

19 MS. ROGGE: So they always look at the same day?

20 DR. JOSELYN: Yes. No, it was within two hours,
21 though. As a matter of fact, I wanted to look at that again this
22 morning, looked at that once again. It was within two hours that
23 they went and looked at it, and things, as you all know, can
24 change in two hours.

25 Secondly, I am not sure from what they put down

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1 whether they made the last click and attempted to actually make
2 the purchase or not.

3 MS. ROGGE: Right. And another thing on that is I
4 think the gap is also large because they only went and checked
5 the online sites that the corporations said to go look at.
6 Whoever the companies were that they were dealing with, they
7 said, okay, go check Travelocity and Expedia and Orbitz, and
8 whatever.

9 DR. JOSELYN: No, I have a list of the sites that
10 they looked at here. It was Travelocity, Expedia, Orbitz, Cheap
11 Tickets, and, what they said, various airline sites.

12 MS. ROGGE: But on each P&R did they check each
13 one?

14 DR. JOSELYN: Don't know.

15 MS. ROGGE: Okay. Well, anyway, another item that
16 I would like to just touch on, because I want to make sure I am
17 clear on it --

18 DR. JOSELYN: They didn't mention your site.

19 MS. ROGGE: Pardon me?

20 DR. JOSELYN: I said they didn't mention your site.

21 MS. ROGGE: Oh, no, I'm off that one now.

22 (Laughter.)

23 I had noticed that they didn't also.

24 DR. JOSELYN: Yes.

25 MS. ROGGE: But I am not here just for me.

1 So we have had a lot of discussion on this whole
2 net fare or free transaction. Reading your testimony and then
3 what you have talked about today, I just want to make sure that I
4 have it correct as to what you are stating. What I heard you
5 saying was that a net fare program would either require airline
6 buy-in, which is unlikely, or government enforcement, which is
7 not warranted. And I think you also went on to say that there
8 was no other industry that had that kind of government
9 enforcement.

10 DR. JOSELYN: That I'm aware of.

11 MS. ROGGE: That you're aware of.

12 DR. JOSELYN: It is sort of like going -- and we
13 mentioned the big-box stores before, saying the big-box stores
14 should be forced, in dealing with local retailers, to identify
15 their distribution costs and make that a separate charge in the
16 purchase of a product. I don't know anyplace else where that
17 exists.

18 But I think one of my big concerns is, who is going
19 to police to make this -- I mean, it is real nice to talk about
20 that, but when you get down -- I am kind of a street guy -- and
21 when you get down to saying, okay, now tomorrow we said we do
22 this, let's make it work, then I begin having problems already
23 with enforcing it --

24 MS. ROGGE: I agree.

25 DR. JOSELYN: -- and making sure it was fair and

1 stuff.

2 MS. ROGGE: Thank you. I would agree with you.

3 CHAIRMAN WINSTEAD: Ted?

4 MR. LAWSON: Okay. Thank you very much. As
5 probably some of the other Commissioners and other witnesses were
6 indicating, I agree with practically everything you said. So
7 you've got an audience.

8 In my company we always used the adage, "Where
9 there is confusion, there's profit." At least from the airlines'
10 perspective, that seems to be true.

11 DR. JOSELYN: It is true of the consulting
12 business, too, by the way.

13 (Laughter.)

14 MR. LAWSON: And one of the other Commissioners,
15 Paul Ruden, said he always had this roundtable session where
16 travel agencies said, if you didn't think the commissions were
17 going to zero, how many here did not think that, and, to be quite
18 frank, I was surprised because it made no cost sense.

19 Because when I was with the airlines, one of our
20 cost analysis with the city ticket office was it cost 17 percent
21 for us to do a ticket out of a city ticket office. That was back
22 in 1975 or so. So I did not understand the cost until I looked
23 at the other half of the equation also.

24 Do you see perhaps from a consumerism standpoint,
25 strictly from the consumers' standpoint, if there were simplified

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1 rules for the consumer, and perhaps that they would have to
2 divulge an inventory list -- in other words, if a store only has
3 one pair of shoes at that particular price, they would have to
4 divulge it. In other words, if the airlines were only selling
5 one seat on the entire aircraft at that particular price, do you
6 see that as probably an antidote that would help the consumer?

7 Do you see any other solutions, just purely from a
8 consumer's standpoint, in the distribution system that would help
9 the consumer past this? If net fares is not the answer, perhaps
10 there is another thing.

11 I am a person that also believes that the airlines
12 have a right to use whatever distribution channels they want to
13 use. But what is the perspective from the consumer's standpoint
14 in kind of an antidote to this?

15 DR. JOSELYN: Well, first of all, I am going to
16 tell you that the fine print at the most airfare ads, which is
17 increasingly difficult for me to read without a magnifying glass,
18 indicates that, in fact, that these fares are limited, subject to
19 availability, and so on, which includes seat availability on the
20 aircraft, which maybe one seat or three or four, or so on.

21 I think the only extension you may have had in your
22 comment from that is telling me how many seats on any particular
23 ad. I think that would be sort of impractical to ask anybody to
24 do. But, yes, I mean, it would be helpful. But you don't know;
25 even if they ran an ad and said there are four seats on this

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1 aircraft, you don't know whether you were the third guy calling
2 for that or the sixth guy calling for that.

3 In terms of the other consumer information, I think
4 that having information in terms of the fact of understanding the
5 truth of the situation that, if somebody says the airfares are
6 always lower on the Internet, and in fact that may not be the
7 case, would cause those companies who want to sell in the manner
8 to develop computer algorithms that made it easier for the
9 consumer to find out all of the options that were there. All
10 right?

11 So I think that that would then be a consumer-
12 driven situation. So it goes back to the notion of customers
13 understanding that there's a lot of hype out there that ain't
14 necessarily the truth, and that it is hard to find.

15 Let me give you the example that I gave you before.

16 If you go to most Internet sites, and I am not saying that I
17 have been and booked travel on all of them, but I have done it on
18 most of them, because I wanted to see what it was like, you will
19 go in there and it will ask you departure city and arrival city.

20 If there is more than one airport in that city, it will ask you
21 which airport, but never have I been asked, "Would you consider
22 changing, if there are multiple airports in that city, would you
23 consider -- do you want us to look at options by combining
24 multiple airports?" That is how I got the fare for here.

25 So I think the computer algorithms are written in

1 such a way also that it doesn't give you all of the options that
2 might be available that a travel agent could. Could you write a
3 computer algorithm to do that? Yes, but they haven't and it may
4 not be in their interests to do that right now, is what I am
5 suggesting.

6 MR. LAWSON: Well, one followup with that then:
7 From a consumerism standpoint, you have mentioned the travel
8 agencies really have access to the, quote, "web fares."

9 DR. JOSELYN: Uh-hum.

10 MR. LAWSON: From my perspective, that is probably
11 half of the answer from the standpoint, for instance, on Orbitz
12 really what the travel agent is doing is masquerading as the
13 consumer --

14 DR. JOSELYN: Sure.

15 MR. LAWSON: -- which has legal implications within
16 itself. The consumer could very easily say, "Gee, I didn't
17 authorize that particular charge." Plus the fact the
18 serviceability of the travel agency on the other end as far as
19 schedule changes, reroutings, all of it, go away instantly if the
20 travel agent is booking on the Internet site at that particular
21 point. Plus the fact that he can really not tell from a tracking
22 standpoint where that customer is.

23 DR. JOSELYN: Well, I think I said all of those
24 things. I think that, absolutely, the serviceability is
25 diminished, but it is not unique that the travel agent would be

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1 put in that position, by the way, with Internet fares because
2 they have done it with consolidated tickets for years.

3 MR. LAWSON: Right.

4 DR. JOSELYN: Okay? The issue is that, if you are
5 going to sell the customer and you are going to say, "I found you
6 the best fare on Orbitz and I will facilitate the purchase. Give
7 me your credit card." thing, it is very important the agent
8 understand and tell that customer exactly what the transaction
9 is. It is that "I am just sitting here helping you facilitate,
10 but you're actually making the purchase directly from the
11 airline," and what the consequences are of that.

12 No, I would agree with you that there are certainly
13 legal implications to doing that, but I don't see those as any
14 different than selling a consolidated ticket and knowing that
15 there are a bunch of restrictions on that, all right, that there
16 wouldn't be if you were booking normally, a normal air
17 reservation.

18 MR. LAWSON: Okay, thank you.

19 CHAIRMAN WINSTEAD: We have a couple more.

20 MR. ROPER: One quick one. You have brought some
21 real clarity to the revenue side of this, which also really woke
22 me up on the \$6.6 billion high point of commissions, and then to
23 listen to the other chart that spoke about where the commission
24 and service charges are today at 9.5, during what I consider the
25 last two years some pretty tough economy.

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1 DR. JOSELYN: Uh-hum.

2 MR. ROPER: I mean, we are sitting here focusing on
3 the plight of travel agencies, and you have just told us at least
4 the revenue side is off the charts.

5 DR. JOSELYN: No. No, no, no, I didn't do that.

6 MR. ROPER: Okay, all right.

7 DR. JOSELYN: I said that 95 percent of the travel
8 agencies have implemented service fees, and that up until the
9 recent cut, which is the most dramatic shift, I believe that most
10 agencies have managed those troubled waters successfully. Their
11 revenue hasn't gone off the chart, but the fact that they have
12 replaced the revenue that disappeared from the declining
13 commissions, and in many cases it actually enhanced it.

14 MR. ROPER: Well, went off the chart of 6.6? It
15 went up to 9.5?

16 DR. JOSELYN: I don't understand the 9.5.

17 MR. ROPER: Well, what is the other, the combined,
18 the commissions and service charges? When I saw that chart, I
19 thought it was 9.5.

20 DR. JOSELYN: No, 95 percent of the travel agents
21 are charging fees, yes.

22 MR. ROPER: Yes, that's why I needed clarification.

23 DR. JOSELYN: Yes, sure.

24 CHAIRMAN WINSTEAD: Paul?

25 MR. RUDEN: Just two things. On this point about

1 the ability of agents to adapt during the period of declining
2 commissions, during that same period a very substantial exodus
3 took place from the industry.

4 DR. JOSELYN: Sure.

5 MR. RUDEEN: If everyone was managing the revenue
6 side so successfully, how do you account for the exit?

7 DR. JOSELYN: I actually didn't say everyone was; I
8 said our clients were, that a lot of agencies were doing --
9 certainly there was an exodus. I think when the fundamental
10 model, revenue model, changed, a lot of things happened. There
11 were a lot of things happening at the same time.

12 As the technology was coming into the marketplace,
13 there were a lot of people in this industry that said, "You know
14 what, this is just getting too hard. The technology is
15 overwhelming me. All of a sudden, now I have to go out and ask
16 the customers for money. I've never had to do that in the past.
17 I don't know how to do it. I don't want to do it. I'm going to
18 go buy a Dairy Queen."

19 And then there were other people who did it
20 unsuccessfully. They implemented service fees, and they had no
21 clue what they were doing. They implemented badly, and in fact
22 they lost a lot of business.

23 There was a tremendous difference between those who
24 knew how to do it correctly and those who blew it. All right?
25 So, yes, there was; there was a dramatic failure rate and exodus

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1 rate from the industry during that time period, but I don't think
2 it's one causal factor.

3 MR. RUDEN: Some of those people might be people
4 who looked ahead, who sat at that roundtable and saw where things
5 were going and said --

6 DR. JOSELYN: Yes.

7 MR. RUDEN: -- as you ultimately conclude, "There's
8 nothing but deep trouble, dark water ahead. So I might as well
9 get out now."

10 DR. JOSELYN: Exactly.

11 MR. RUDEN: Yes. The other thing I wanted to
12 clarify, you have said a number of times, and this deals with the
13 debt fare/transaction fee thing, whatever one wants to call it,
14 that there are no examples in industry of anyone being forced to
15 show --

16 DR. JOSELYN: I said I didn't know of one.

17 MR. RUDEN: Well, you do know of one, I suggest.

18 DR. JOSELYN: Okay.

19 MR. RUDEN: Travel agents.

20 DR. JOSELYN: Okay.

21 MR. RUDEN: Isn't that what the airlines have done
22 to travel agents? They have forced them to tell the customer,
23 "This is what it costs me to live on this business, to do this
24 business, and, hopefully, earn a return on my profit."? (sic)

25 DR. JOSELYN: Technically, I don't think that's

1 correct.

2 MR. RUDEN: Really?

3 DR. JOSELYN: If the travel agency was in the
4 business of owning the airline seats and everything else, and
5 that distribution portion of it were broken out, I would agree
6 with your statement.

7 But to go back to the model I had that said the
8 travel agency provides this bundle of services, and if the
9 agencies say, that bundle of services, including whatever I get
10 to keep in my jeans at the end of the day, is \$25 pr \$30 or \$40,
11 an equivalent comparison would be forcing the agency to say,
12 okay, break that service fee into two costs, the ones that relate
13 to the cost of performing the services and the piece that you're
14 adding on for you.

15 MR. RUDEN: Well, I guess it won't help us to
16 debate this, but the entire business of the travel agent is
17 distribution. So I would suggest that all that revenue they are
18 charging the customer in a zero-commission environment is, in
19 fact, the cost of distribution, and that they are, therefore, the
20 prime example of what you talked about.

21 The net fare regime that Mr. Wasilov was describing
22 was a suggestion that the other folks in the industry who are
23 competing with them, the producers of these products, engage in a
24 similar disclosure, I think, but that's fine. Thank you.

25 DR. JOSELYN: And let me respond one thing. I

1 don't think the entire business of the travel agency is
2 distribution. Okay? I think that what I said in my model is
3 that a travel agency has a product that augments the sale of
4 somebody else's product. So I think they are in the service
5 business as well. Okay?

6 I think that it is something that Maryles' agency
7 provides. They go out and they negotiate on behalf of their
8 suppliers. They manage information on behalf of it. They do a
9 lot of things that aren't really distribution but are services
10 that they provide. They charge for those services.

11 CHAIRMAN WINSTEAD: Pat, you had a question or a
12 comment?

13 MR. MURPHY: I did have a question. I just want to
14 make sure I understand where you come out on this.

15 First of all, I appreciate your testimony. It was
16 very helpful.

17 We have had a lot of witnesses come before us
18 through our hearings with very specific recommendations. I want
19 to make sure I understand your recommendations, which I think are
20 very general.

21 One, you would like to see a study done on
22 discretionary travel. Second, you would like rigorous
23 enforcement of the antitrust laws.

24 DR. JOSELYN: Yes.

25 MR. MURPHY: Is that as far as you would go?

1 DR. JOSELYN: Yes.

2 MR. MURPHY: You do not endorse any of these more
3 specific recommendations on --

4 DR. JOSELYN: But you need to understand the reason
5 why, and that is that there are -- I am going to say it again.
6 We consult for all sizes of agencies. We consult for people who
7 have three employees who are trying to make next week's payroll.
8 I don't want to be here today and give them any false hope on
9 something I don't think is going to work. I don't want them
10 hanging around and waiting for that.

11 So it is not that some of those things might not be
12 helpful if they work in a perfect sense. It is just that I don't
13 think they have a chance.

14 MR. MURPHY: Thank you.

15 MS. CASTO: Bob, I just have one question. On your
16 business model for the travel agency, the travel retailer that
17 you are talking about, is that mostly more like the consolidator
18 that is now in place, the consolidator businesses?

19 DR. JOSELYN: Yes, it might be, but it could be a
20 large chain such as a Uniglobe or a Carlson Wagonlit, or
21 something like that, basically saying that we are going to behave
22 more in terms of a retailer; we're going to own hotels --

23 MS. CASTO: Products and --

24 DR. JOSELYN: -- products and everything else. It
25 is a little bit what Expedia has done in the acquisition of

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1 Classic --

2 MS. CASTO: Metropolitan.

3 DR. JOSELYN: -- and also AAA of Southern
4 California, which is an agency, bricks and mortar, more of a
5 bricks-and-mortar agency, and the acquisition of Pleasant
6 Hawaiian.

7 MS. CASTO: Okay, thanks.

8 CHAIRMAN WINSTEAD: Great, Bob. Thank you very
9 much for your testimony.

10 DR. JOSELYN: Thank you.

11 CHAIRMAN WINSTEAD: We appreciate it, and we might
12 have other questions. We will get back to you with them.

13 DR. JOSELYN: I will be hanging around because I am
14 loaning my projector to the next speaker. So I will be around.

15 CHAIRMAN WINSTEAD: Oh, great.

16 We are going to take a break. The afternoon
17 witnesses, I appreciate your indulgence. Obviously, the questions
18 went a little long this morning. But if we could get back about
19 2:10, I know Lorraine's got to fly out, and then I think Ken
20 Button and then Dave Butler will be our order of witnesses.

21 (Whereupon, the foregoing matter went off the
22 record for lunch at 1:20 p.m. and went back on the record at 2:29
23 p.m.)

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1 A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N

2 (2:29 p.m.)

3 CHAIRMAN WINSTEAD: Lorraine, why don't you go
4 ahead?

5 MS. SILEO: Let me begin with a little background.

6 PhoCusWright is a research firm, an independent market research
7 firm that focuses on travel distribution. The company was
8 founded in 1995. I was hired in 1998 to create a research
9 practice around the expertise that PhoCusWright has in online
10 distribution.

11 My background is in looking at the impact of
12 technology on various industries and, again, travel since 1998,
13 and I am also an adjunct professor at New York University for
14 their graduate program in travel and tourism.

15 I want to start with just some general methodology.

16 All we do at PhoCusWright is study the travel industry and the
17 impact of technology on travel. Every day we talk to CEOs, CFOs,
18 e-commerce executives about the impact of technology on their
19 business.

20 We also conduct consumer research. Every fall we
21 do scientifically-valid, telephone-based research. I know there
22 is a lot of discussion today about, what does the consumer think?

23 We do go out there every year and try to gauge the consumer.

24 So really our methodology is a combination of these
25 discussions, our own research that we do with executives, as well

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1 as, sure, we use their data to help validate, and we attend
2 executive briefings, and meetings like this are also a way to
3 learn so much about the industry.

4 We were contacted by the Commission for a research
5 request: to identify whether the financial condition of travel
6 agents is declining as a result of the migration to online tools
7 and access to web fares and, if so, the effect that this will
8 have on consumers.

9 Our research is in two parts. We needed to do it
10 in two parts to get to the final conclusion. One of them is to
11 look at the market. We hear so much about share shift, and we
12 have heard so many numbers. So we looked at the market in terms
13 of the leisure/unmanaged corporate.

14 Then we looked at channel and segment, channel
15 being really four general channels: online agency, offline
16 agency -- so you will hear me say "online" and "offline" when I
17 describe agency -- online direct, which as we know is really Web,
18 the websites, and then offline direct. That could be, for a
19 hotel, it could be walk-in, is mostly the phone. It could be fax
20 for tour.

21 So the first part was to look at the mix; also, to
22 look at it by segment. We did not just look at air. We have
23 also looked at car. We have looked at hotel. We have looked at
24 tour and cruise.

25 The second part was profitability scenarios. That

1 was the interesting part. How can we look at a travel agency and
2 look at its viability, look at the impact of the distribution
3 shifts? We have created some scenarios which I will be happy to
4 share with you.

5 Before we get into that, we have heard so many
6 numbers. What is our methodology? I would like to share a
7 little bit of that with you. I know I went into it, our general
8 methodology.

9 Specifically for this project, you know, just for
10 the overall market side, of course, there is public data. We do
11 use some outside sources for car and hotel. Tour and cruise, we
12 conduct our own interviews at major tour operators and cruise
13 operators. We don't trust any other numbers that are out there.

14 They are really overblown. Again, we do consumer research.

15 A little explanation of that is online traveler
16 research, which means we research a panel -- we have done this
17 for four years -- of adult Americans who travel by air at least
18 once in the past year and use the Internet at least once in the
19 past month. So they travel by air and they use the Internet, and
20 that is our panel.

21 Travel agency figures, again, various sources for
22 the offline travel agency market with ASTA. Of course, we do our
23 own interviews with major agencies, AMEX, Carlson, World Travel,
24 the ARC data, and for average fares, rates, which we also needed
25 to compile bookings and to look at cost per booking and revenue

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1 per booking. Of course, we needed average fares and rates. We
2 again used HEDNA for hotel or TOPAZ, Respond Network for tour.

3 Online travel, again our area of expertise, a lot
4 of it is public. These are publicly-traded companies. If they
5 are not public, we know them well. They share with us their
6 information. We have a very good handle on the online travel
7 agency marketplace; we like to think that.

8 Supplier websites, interviews, you just need to go
9 and you need to call the commerce executives or the distribution
10 executives, the Carlson companies, the airlines, and hotel
11 companies. It is a grueling process, but what we do is we reach
12 the larger -- I mean, for a fragmented industry like hotel, we
13 will talk to the major chains to get a good perspective.

14 Projections, we are going to see a lot of
15 projections. Where do they come from? Again, e-commerce,
16 general e-commerce trends; of course, economic indicators, market
17 indicators, the consumer research that I discussed, the five-year
18 trends, and the online booking figures use first booking figures
19 that we have four-year trends.

20 The methodology for the scenarios, a combination of
21 ASTA data, PhoCusWright data. The two scenarios: One of them
22 was the segment, charging segment fees scenario, and the second
23 scenario was shifting product. We hear so much about
24 diversification. Is it really going to make a change or impact
25 on travel agency profitability?

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1 Consumer research all starts in, what does the
2 consumer think and what does a consumer feel? That is why we
3 take that piece of what we do very seriously.

4 Looking at the four-year trends is where we see the
5 shift. The consumer is telling us this. Every year we are going
6 about another 10 percent share taken from the traditional agency
7 marketplace to the online.

8 What I find interesting, and this is not a surprise
9 to many of us, but most of the share is coming from the travel
10 agency community and not the supplier direct. There's many
11 reasons for that.

12 One example that the Internet can actually fuel in
13 some ways -- you know, you go online and then you call the
14 supplier. So even though there is a decline in calling the
15 supplier in a direct phone and, of course, fax, hopefully, one
16 day will go away, most of the shift is coming from the
17 traditional agency community towards online.

18 Why? We could go and talk about so many different
19 reasons: ease of use, selection. Fare control, of course, is a
20 big one, but really it is price. We asked travelers, "Why do you
21 choose a certain way to buy your travel? Why did you choose this
22 particular channel?" And it comes down to price.

23 There is a perception that the best price comes
24 from online travel agencies. Basically, this has led us to
25 believe that the issue is much more perception, it is much more

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1 about marketing, it is much more about branding than it is about
2 most favored nation clauses, and whatnot.

3 Thank LowestFare and thank Priceline for this
4 perception that exists today and for the brands that Expedia and
5 Travelocity have been able to build, and never mind the brands,
6 of course, of all the airlines, which we will get into.

7 To just briefly go over what these numbers found,
8 some of the highlights, we sliced and diced it a million ways.
9 Again, this slide is the offline travel market leisure/unmanaged.

10 We did not look for this particular exercise at the corporate.
11 We do see that the agency has a very comfortable position in the
12 offline travel market at 63 percent in 2001. Where the agency
13 does not do as well is in the online travel market, where the
14 direct suppliers have a 57 percent share of the market.

15 Even though there is so much talk about Expedia and
16 Orbitz, really the momentum here is in supplier websites, mainly
17 the airline websites, but we are seeing a lot with hotels, with
18 Starwood, trying to match the best price, and Six Continents.

19 The thinking here is: Why should I allow my
20 customer to come somewhere else for the best price? I want my
21 customer to come to me directly for the best price.

22 That is what has driven in many ways suppliers, not
23 just airlines, but we are starting to see again hotels follow
24 suit with building their websites.

25 Many other reasons why the airline websites do so

1 well: Because who travels the most? You know, the frequent
2 traveler tends to be more loyal, and of course the online
3 websites are doing whatever they can to attract their frequent
4 flyer customer with services and perks.

5 Shift and share, this is for the total market,
6 agency direct. We still see that agencies, by 2004, most travel
7 will still be booked through the agency channel. This is online
8 and offline.

9 Now one thing about the offline agency channel is
10 it will decline. This looks just at online versus offline. This
11 is giving you a feeling also that the -- we are talking about a
12 small piece of the marketplace here in terms of online for the
13 agencies, still only representing about 11 percent of all agency
14 bookings are done online and will still be a minority in 2004 as
15 well.

16 So this just gives perspective. In the travel
17 agency market, more than three-quarters in 2004 will still be
18 booked in traditional travel agencies. We should remember that
19 as well.

20 But, again, this is the slide that I would like us
21 to pay attention to. This is showing the shift. This is showing
22 54 percent, more than half, of all travel booked through the
23 traditional agency, and that piece now going down to 43 percent.

24 So that is the dramatic shift. That is back to that original
25 slide showing that consumers are preferring the online channels.

1 The online is doubling both the direct and the online agency,
2 and then we have this direct business, your phone and fax, is
3 kind of remaining stable.

4 The traditional travel agency, offline travel
5 agency, in 2004 will be the second largest seller of air, the
6 second largest seller of hotel, and will remain the dominant
7 seller of cruise and tour.

8 MR. RUDEN: Lorraine, let me interrupt you.

9 MS. SILEO: Yes.

10 MR. RUDEN: For factual purposes, how do you
11 account here in the assessing these market shares for online
12 sales made through/by travel agents, if at all?

13 MS. SILEO: We do. We do. It is a small piece of
14 it. Because if you look at the top 10 online travel agencies,
15 they represent over 95 percent of the market. But there is some;
16 for example, AMEX has a site that is powered by ITN, and then we
17 have some small, independent agencies, if I am answering your
18 question, that do have online presence. That is accounted in the
19 online agency segment.

20 MR. RUDEN: I am asking a different question.

21 MS. SILEO: Okay.

22 MR. RUDEN: The Ann Mitchell, who does not have
23 hypothetically an online presence, certainly not a booking
24 engine, but goes to the Web and books her clients.

25 MS. SILEO: Right.

1 MR. RUDEN: Is there an accounting for that or is
2 that impossible to track?

3 MS. SILEO: That would fall -- and, again, I don't
4 think it is a very big piece of it, from our discussions with
5 these various suppliers, but that will be dispersed. So, for
6 example, say a travel agency wants to book an American web fare
7 through the aa.com site; that's going to fall under aa.com.

8 MR. RUDEN: Okay. So it will then appear as an
9 airline direct sale?

10 MS. SILEO: Correct.

11 MR. RUDEN: Okay, thank you.

12 MS. SILEO: Okay.

13 MR. RUDEN: But no way to measure it?

14 MS. SILEO: Only anecdotally that it is a small
15 piece of what is happening today.

16 MR. RUDEN: Okay.

17 MS. SILEO: But it probably will increase.

18 The scenarios, the two scenarios, and I am not
19 going to get into all the detail. I am willing to answer any
20 questions you have about the methodology.

21 Service fees, what we did for the service fee
22 scenario was very conservative. We applied a \$16 fee. So we had
23 this typical agency, \$3.4 million, five employees. Then we
24 applied the figures that you saw here, other figures in terms of
25 deciding, well, okay, how much does it cost to book an air

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1 booking, how much does it cost to book a car? So we applied all
2 the assumptions to create this fictional agency or what we would
3 like to think of as a typical agency. Of course, we applied
4 real data. I don't want to call it a fictional agency, but it is
5 one that we created for this scenario based on the data.

6 So the service fee, again, the \$16, really we have
7 all heard numbers up to \$50, \$60. We applied a \$16 fee on 70
8 percent of bookings, assuming no agency is going to charge a fee
9 all the time, especially relationships, overrides for customers.

10 They are not going to always charge. So we said let's just do a
11 conservative \$16 fee, and that is where we found this agency. By
12 the way, this agency was losing money, and we applied the \$16 fee
13 and were able to turn this agency around.

14 Diversification of product mix was a little
15 different. So let's say they sell 20 percent less air, and we
16 are applying that toward hotel and tour booking. While we were
17 able to fix the margin, it was a loss. The loss was less. So we
18 were able to improve that margin somewhat.

19 We still were not able to really bring this agency
20 to profitability unless you were very aggressive in terms of
21 saying, okay, I'm not only shifting to tour and to hotel, but I
22 am also getting a nice 20 percent commission from cruise or a
23 good 15 percent commission from tour, which, again, led us to
24 believe that, yes, diversification is something that would make
25 sense, but you need to have those relationships, those applied

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1 relationships, to really get those 15 to 20 percent commissions
2 that we hear about.

3 On the cost side, tour and cruise, the most
4 expensive product to book, we had them at a couple of hundred
5 dollars. So we need to really think about that, and, of course,
6 how much of that is still manual today.

7 MR. ROPER: So, Lorraine, the \$16 fee didn't get
8 them out of the hole?

9 MS. SILEO: It did. The \$16 fee got them out of
10 the hole. The product diversification did not. The \$16 fee
11 worked wonders for this agency.

12 Yes?

13 MR. LAWSON: The numbers we have always heard
14 within the industry are covering at a minimum -- in fact,
15 forgetting the travel industry, the numbers I have heard for call
16 centers that are selling Land's End is usually around \$20 to \$25.
17 Did you all take that into consideration?

18 MS. SILEO: We certainly, just to take a call -- do
19 you mean just to take a call? Absolutely. Absolutely, which is
20 again looking -- we look at minutes, is what we looked at, so
21 minutes to place that particular booking.

22 So, of course, if it is a fax-based tour, you are
23 waiting for the fax to come in. You also need to look at the
24 consultation. We did look at front-end and back-end costs, not
25 just front-end, but both front-end and back-end costs.

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1 These aren't recommendations to the Commissions,
2 but these are what we learned when it came to what does all this
3 mean. Is the travel agent in jeopardy? Of course, the market is
4 consolidating. It is contracting. So we have are in an industry
5 where the margin of error is very, very narrow.

6 Data that I have looked at, previous data from ASTA
7 showed over 50 percent of costs going into labor and postage.
8 Our scenario, we gave these travel agencies the benefit of the
9 doubt at 30 percent of costs going into -- of course, operating
10 at these 50 percent, you really need to apply some discipline to
11 your P&L.

12 First and foremost, you have to charge the fees
13 unless you really have those relationships where product
14 diversification is going to make sense for you. Secondly, we do
15 still think there is opportunity that shifting -- you need to
16 shift away from air, of course, and there is opportunity in the
17 tour and cruise market.

18 Our numbers also show that those markets are still
19 growing rapidly, and we know we all hear that we are in a
20 difficult time, but the tour and cruise industry seem to be
21 coming out of it better than, say, hotel and air.

22 Adopting the Web-based technologies, this isn't
23 just web fares, but this is all different kinds of -- getting
24 commissions on an online travel site is one of them; working on
25 referrals; using the Internet to get referrals; of course, you

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1 know, e-mail targeting, and the back end looking at automation of
2 tour and cruise bookings.

3 Accessing web fares, I don't think we need to talk
4 more about that. We know there are technologies.

5 This is an interesting one. GetThere has one where
6 you don't have to, the travel agent doesn't have to go into the
7 airline website. It used to be that you still had to go to the
8 airline website to book the web fare. Now you can do it within
9 the same screen as your published and your negotiated rates.

10 Capitalize on the merchant model, we could have a
11 whole other discussion about merchant, but, as we know, that is
12 what made Expedia profitable.

13 Value, we talked about how price is so important,
14 but you are, obviously, at this point becoming an advocate; the
15 travel agency is now the advocate for the consumer, no longer for
16 the supplier. So you get to sell that.

17 And then this hybrid marketplace, in the testimony
18 we also have the data that half of those online travelers that
19 look online will buy offline. So there is a big market there.

20 Just to wrap up, in terms of diversification and in
21 terms of these issues, it is facing all agencies, online and
22 offline. Every agency knows that air isn't going to cut it
23 anymore. Orbitz is sitting; they're also scratching its head
24 saying, "I have to sell more tour and cruise." So these are
25 issues affecting all agencies.

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1 As for small agencies, we did find from ARC that,
2 although they represent three-quarters of all agencies, they
3 represent only about 7 percent of bookings. So our findings were
4 that, if all the agencies formed a consortium, all small
5 agencies, they would still only represent less than 10 percent of
6 the industry. So that didn't seem to be a good way out for them.

7 But applying P&L discipline and other recommendations should
8 allow individual companies to at least set their own paths.

9 Thank you.

10 CHAIRMAN WINSTEAD: Lorraine, thank you very much.

11 It is very helpful data to some of the issues we are facing.

12 Just one question: On page 10 you discuss the
13 positive impact of the travel agencies shifting in their product
14 mix. That is what we are talking about, and you talked about
15 small shifts that an agency, small agency, could take over time
16 that could help.

17 But while it might be possible for some of these
18 agencies to do that, wouldn't it require more of a change in
19 consumer behavior then to recapture that? I guess the other
20 thing is the leisure passenger demand seems to be more price-
21 elastic than the business, and what impact does that have on the
22 smaller agents?

23 MS. SILEO: Right. So the first question is about?

24 CHAIRMAN WINSTEAD: How much does consumer
25 behavior --

1 MS. SILEO: Right.

2 CHAIRMAN WINSTEAD: -- impact on the ability to
3 migrate, these small agencies to migrate in a stronger product
4 mix?

5 MS. SILEO: I think that is a very good question
6 because in many cases -- I hate to use this expression, but the
7 damage is done. We felt when Sabre introduced its tools, its Web
8 Exclusives tools and its merchant model rates as well as its web
9 tools for agencies, we said, well, that is to just kind of help
10 or stop some of the gushing out.

11 But if you are a travel agent customer that has
12 migrated to an online -- and over 90 percent of people that have
13 bought online have been satisfied. Yes, we all hear horror
14 stories, but 90 percent, if you did a survey, will say, "We're
15 satisfied with our online purchase." That customer is gone.
16 That customer is gone forever.

17 How do you get that customer back? Maybe that
18 customer grows up and decides it is going to take a more pricey
19 vacation, tour or cruise, where, frankly, I think even your
20 greatest online advocate will admit, "I need help here. I need
21 someone to help me."

22 So I do think there is a progression. I think the
23 traveler is getting more sophisticated. I think the Internet
24 helps the traveler. I know cruiselines, for example, are hoping
25 that the Internet will bring about a whole new generation of

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1 cruisers, generally a different demographic, right, an older
2 demographic. Maybe a younger demographic will be attracted to
3 cruises. Maybe they will then go to a travel agent to help buy
4 that cruise.

5 So I do think there is an attempt to change
6 behavior. It won't be an easy task. Some customers are lost,
7 but not all. Some customers, as they mature, might decide they
8 want to go back to that or they are willing to pay that fee for
9 that more complex dream vacation.

10 CHAIRMAN WINSTEAD: In a couple of the charts you
11 use the word "net." I was just wondering, for the record, if you
12 could define.

13 MS. SILEO: Yes. Actually, what it means is total.
14 It really means total.

15 CHAIRMAN WINSTEAD: Okay. Let me open it up. We
16 have some Commissioners sitting out here in the audience as well
17 as up here.

18 MR. ROPER: I just wanted to see the facial
19 expressions.

20 (Laughter.)

21 CHAIRMAN WINSTEAD: You are still with us, I hope.

22 MR. ROPER: Yes, yes.

23 CHAIRMAN WINSTEAD: Good. All right, all right.

24 MR. LAWSON: Did you find that in your cruise
25 review on your discretionaries that, if the prices increase, the

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1 desire of the consumer for accountability increased also? In
2 other words, they want someone that they can go to if things go
3 wrong, and they pay \$3,000 out for a cruise, that they want
4 someone locally that they can go to? Did that ever enter into
5 any of the consumer comments?

6 MS. SILEO: Not specifically that question, but we
7 did ask for -- of course, for air price was overwhelming, but
8 when we asked for cruise and tour, the No. 1 was service, but No.
9 2 was price. We found they were very close, and those that
10 wanted price wanted price more than those that wanted service.
11 In other words, more said, "I want -- that is the most important
12 thing to me, is price," whereas those that said service were less
13 of a -- but, again, yes, service does take priority over price
14 when it comes to those products.

15 MR. LAWSON: Showing my ignorance, for instance, in
16 California they have a travel seller's law where the companies
17 have to register. Do the online people that sell cruises, do
18 they register with California on that?

19 MS. SILEO: Well, the cruise bookers, they are
20 mostly aggregators. So do you mean as an agency, do they need to
21 do it? I don't believe they need to be accredited to sell a
22 cruise, but, again, it is really aggregating. But in half the
23 instances -- and we see this with Travelocity, where you are
24 actually booking through Travelocity, but in many instances you
25 are going direct to the cruiseline to make that booking. Cruises

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1 have been a little slower, of course, to automate.

2 MR. LAWSON: Okay, thank you.

3 CHAIRMAN WINSTEAD: Paul?

4 MR. RUDEN: Yes, I've got just a bunch of quick,
5 factual-type questions to be sure I understand exactly what this
6 thing is about.

7 The Consumer Travel Trends Survey, which is
8 apparently, reading this as a whole, one of the core documents
9 from which all this was derived, could you just briefly explain
10 how that was done?

11 MS. SILEO: Sure, sure. That is a piece of it,
12 Paul. That is the consumer research.

13 MR. RUDEN: I said it is throughout just because it
14 is cited so many times. I realize you have other sources, and I
15 am going to ask about those, too.

16 MS. SILEO: Okay. The consumer research we conduct
17 with ICR, International Communications Research of Media,
18 Pennsylvania. They are a market research firm. Again, it is
19 statistically-valid. It is a telephone-based survey of adult
20 Americans, and we do in-depth surveys. We start with a base of
21 10,000, and we say, "Have you flown commercially by air in the
22 last year, using Internet in the last month?"

23 We take a panel of 500 and we do the in-depth
24 interview then, where we discuss all these other issues and
25 questions about online travel, offline travel, out of this panel

1 of 500. This panel, this is where we found that 27 million
2 Americans have bought travel online, and that is where we extract
3 a lot of the data that we like to use to support the B-to-B data,
4 which is the sizing of the online car rental market, the online
5 hotel market.

6 That is where we do the executive interviews, and
7 we actually have to call Mark Smith at Amerikeps, and, "Mark,
8 what did you book on the Internet last year on the Web and
9 through travel agencies?" And we have to call Steve in Alaska
10 and ask him the same questions.

11 So it is a combination of this B-to-B executive
12 interview research and the B-to-C, which is this consumer panel.

13 MR. RUDEN: Okay. So in the B-to-B part of that,
14 there is no independent way to verify whether the data they are
15 telling you is accurate or not?

16 MS. SILEO: Well, this is what we do, and that is a
17 great question because the task at the end is to match it up. I
18 want to make the point that we are very confident in the online
19 travel agency numbers because many of these companies are
20 publicly-traded companies. So we have that, and we need to match
21 that up with what the airlines are saying. So we do have checks
22 and balances.

23 MR. RUDEN: The 500 people that you say they are
24 Internet users who have flown commercially by air within the past
25 year. Internet user, any Internet use or air travel purchaser?

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1 MS. SILEO: They have used the Web, not just
2 e-mail, they have used the Web once in the past month.

3 MR. RUDEN: For any purpose?

4 MS. SILEO: For any purpose.

5 MR. RUDEN: Okay. On page 7 at the bottom you are
6 talking about cruises, and you say that the cruiselines are going
7 to mature their Internet sites, and that "This will be important
8 as the number of first-time (price-sensitive) cruisers increases
9 and a large share of potential cruisers do not use travel
10 agencies."

11 MS. SILEO: It is the wording, I think --

12 MR. RUDEN: I am confused by what you mean there.

13 MS. SILEO: Yes, it's a wording. It's a wording
14 issue.

15 MR. RUDEN: Yes.

16 MS. SILEO: Obviously, 90 percent of cruisers use
17 travel agencies. So what we meant to say was there is a
18 potential market out there of individuals, to my earlier point,
19 that do not use travel agencies --

20 MR. RUDEN: For any purpose?

21 MS. SILEO: For any purpose.

22 MR. RUDEN: Ever?

23 MS. SILEO: Ever, or maybe they have through
24 corporate, through their business, because they have to, but
25 personally they say online or they call; they use the phone.

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1 What, about 10 percent of Americans have taken a cruise. So
2 maybe there is a whole new market out there, don't use an agency,
3 never took a cruise, where the Internet can be a place to market
4 and to sell to a new market of cruisers.

5 MR. RUDEN: Those people, however, would likely be
6 the least knowledgeable about cruising, and, therefore, arguably,
7 the most in need of somebody to help them do it, at least the
8 first time. Would you agree with that?

9 MS. SILEO: I would say that is correct.
10 Absolutely.

11 MR. RUDEN: Okay.

12 MS. SILEO: And if you talk to any -- Cruise 401,
13 for example, they would say that it is getting better, that
14 initially it was several calls to book a cruise. They are
15 finding that they are educating the public, but this is a long-
16 term job.

17 MR. RUDEN: On page 10 there is a Table 13 that
18 talks about how online travelers, which again are defined, as I
19 understand it, throughout this as people who didn't buy travel
20 online, but who use the Internet and travel by air within a year?

21 MS. SILEO: Right, and some of them did buy travel
22 online. Twenty -- so there would be 40 percent have bought
23 travel online. So even though --

24 MR. RUDEN: Okay, 20 percent of the --

25 MS. SILEO: Of those online travelers have bought

1 travel online. So you have a mix of -- that is what the
2 representative sample is to say. Obviously, still a minority who
3 have purchased travel online.

4 Let's try to look at a representative sample of
5 Americans, and that is what you will get this one in four
6 purchase travel online.

7 MR. RUDEN: And what is travel for this purpose?

8 MS. SILEO: Any -- we do -- one of the criterias,
9 that they've traveled by air, but when we asked them, "Have you
10 purchased travel online," we do count if they did a car or just a
11 hotel, if there is any kind of travel.

12 MEMBER OF AUDIENCE: Lorraine, is there an age
13 group --

14 MS. SILEO: There are demographic breakouts I am
15 happy to share with you.

16 MR. RUDEN: On page 11, where you begin to build
17 the scenarios, you said the average agency that you constructed
18 had \$3.4 million in gross bookings. Is that all product lines or
19 just air?

20 MS. SILEO: All product lines.

21 MR. RUDEN: All product lines. And you have data
22 for average ticket prices. You used a number of bookings. Where
23 did you get that?

24 MS. SILEO: Right. The average, we used HEDNA for
25 average hotel booking. We used TOPAZ for the average air

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1 booking. We used Respond for an average tour, we used
2 PhoCusWright data for the other segments.

3 MR. RUDEN: All right, if you used TOPAZ for the
4 average price of an air ticket, so that is a business market
5 price?

6 MS. SILEO: We applied, we did weighting. So this
7 agency, we weighted that about they do -- 70 percent is consumer
8 and 30 percent is business travel, because we do understand that
9 most agencies will sell some of both. We also did weighting, 90
10 percent domestic, 10 percent international.

11 MR. RUDEN: Okay, and the cost data came from
12 where?

13 MS. SILEO: Well, the cost data, we started with
14 the ASTA data for 2001, ASTA data, but we brought it --

15 MR. RUDEN: Excuse me. I don't think we have any
16 cost data.

17 MS. SILEO: The cost data that we used, but then we
18 applied it kind of more toward what we thought would be more of
19 an optimal cost structure for an agency. So we actually used
20 ASTA data, but we just did it --

21 MR. RUDEN: Agency cost data?

22 MS. SILEO: Right, because the ASTA had that
23 salaries and rent was over 50 percent of the cost of a typical
24 agency, and we wanted to align that more toward a lower number
25 for salaries and rent. We thought that we would not be able to

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1 reach any sort of profitability with those figures.

2 MR. RUDEN: With the figures that were in the ASTA
3 report?

4 MS. SILEO: Correct.

5 MR. RUDEN: All right. Then on page 12 -- again, I
6 am just trying to get a grip on what was done here -- you created
7 or hypothesized a service fee, an average fee of \$16 on 70
8 percent of the bookings. That is 70 percent of the air bookings,
9 70 percent of all the bookings?

10 MS. SILEO: All bookings.

11 MR. RUDEN: And this produced an operating margin
12 of .9 percent? Is that good? How would I judge whether that's a
13 good operating margin?

14 MS. SILEO: It was profitable.

15 MR. RUDEN: By the dollar?

16 (Laughter.)

17 How about return --

18 MS. SILEO: The agency was losing on a 19 percent
19 loss initially.

20 MR. RUDEN: Right, and you --

21 MS. SILEO: And we brought it up to a positive
22 margin.

23 MR. RUDEN: By increasing the fee \$3?

24 MS. SILEO: No, by just -- by applying a fee,
25 right. That's an average. That would show -- the revenue for

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1 booking goes up, not exactly by \$16 because, again, we have only
2 applied that 70 percent of the time. So it's not every booking
3 that we say -- so that's our revenue per booking, assumption is
4 the \$45.39, and then looking at all the bookings and applying the
5 \$16 fee to 70 percent of those bookings, we brought the revenue-
6 per-booking up to \$54.63.

7 MR. RUDEN: So were you comparing an agency that
8 had no service fees to --

9 MS. SILEO: That's correct.

10 MR. RUDEN: -- one that had --

11 MS. SILEO: That is correct.

12 MR. RUDEN: -- a 16 percent profit margin? Or, I'm
13 sorry, a 16 percent --

14 MS. SILEO: That is absolutely correct. The agency
15 with a 19 percent operating margin loss, operating loss, did not
16 charge fees.

17 MR. RUDEN: I see. Okay. Now I understand.

18 MS. SILEO: Which is why when we brought that same
19 agency and we did the product diversification scenario, we were
20 not able to bring them to profitability unless it were very
21 aggressive in shifting to cruise and air and a 20 percent
22 commission.

23 MR. RUDEN: And was that agency, before the \$16
24 service fee was added, earning commissions on any of these
25 transactions?

1 MS. SILEO: Oh, absolutely, yes.

2 MR. RUDEN: On the air --

3 MS. SILEO: On the cruise and tour and some hotel
4 and --

5 MR. RUDEN: But not the air?

6 MS. SILEO: No.

7 MR. RUDEN: I see. Can you give the Commission any
8 understanding about what has happened to the prices of cruises in
9 the last year, year-and-a-half? They have gone down very
10 drastically, haven't they? It is widely reported that they have.

11 MS. SILEO: From what I understand from the cruise
12 companies is that there was a faster recovery in the cruise
13 industry than air and hotel, because, you know, hotel occupancy
14 is still in that 63 percent range. You know about the airlines.
15 Cruiselines have recovered.

16 Prices, again, when I went and started to talk
17 about the perception, for what happened after the attacks in
18 terms of perception that the Internet had all these deals and all
19 these bargains, and this was not just air. This was taking a
20 five-day cruise in the Caribbean for \$500, and we have all heard
21 these stories. This is what agencies are fighting against, these
22 water-cooler conversations about who got this great cruise deal
23 off of the Internet.

24 DR. MITCHELL: When you are saying the cruiseslines
25 have recovered, they have recovered in the percentage of people

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1 who are filling in their ships or the percentage of their income
2 or their earning? And I think that refers to Paul's --

3 MR. RUDEN: Yes.

4 DR. MITCHELL: Because their discounting has been
5 tremendous, and I expect they are not very profitable.

6 MS. SILEO: And from what I understand about the
7 industry, there has been a recovery in terms of price. Even
8 those cruiselines that have added capacity are now filling their
9 ships again.

10 DR. MITCHELL: I think they're filling their ships,
11 but I really wonder about --

12 MS. SILEO: I know those great deals are not there
13 anymore --

14 DR. MITCHELL: If they're making profits, then they
15 have really been making profits before now.

16 MR. RUDEN: Thank you very much. I have completed
17 my questions. Thank you, Mr. Chairman.

18 CHAIRMAN WINSTEAD: Thank you. Go ahead, Joyce,
19 and then Pat.

20 MS. ROGGE: Lorraine, thank you. I just want to
21 focus for a second on the recommendations that you have made.

22 MS. SILEO: Uh-hum.

23 MS. ROGGE: I didn't know if in the process of
24 going through the research and the work that you have done prior
25 to this study, if you have seen any evidence of agencies starting

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1 to use some of these methods to help themselves?

2 MS. SILEO: Again, it's a great question. Yes,
3 when we read Travel Weekly and Business Travel News, we're
4 reading about those agencies who are doing things right and
5 they're turning around their business, and they're Carlson
6 agency, and they've got it all right.

7 But there are 30,000 travel agencies, from what I
8 understand, and unless you go out and actually survey all of
9 them, I don't see how we could really get a grip on what they are
10 doing. I know that Travel Weekly does have, they do an excellent
11 survey. Their issue will be coming out shortly, and that's the
12 best way to do it. You need to just go out there and talk to
13 them and say, "Are you really using these tools, and what has it
14 done for you?"

15 I highly recommend that an organization like Travel
16 Weekly to continue to do that kind of research, because with
17 30,000 agencies, you need to get out there and find out as a
18 group, where are they going; what are they thinking; what are
19 they doing? It is such a fragmented market.

20 MS. ROGGE: Would your experience as a researcher
21 lead you to believe that it is going to vary by size of agency on
22 what they can adopt?

23 MS. SILEO: My experience as a researcher is that
24 corporate agencies get it, and there are only a handful of them
25 anyway. The leisure agencies in general -- and, again, I don't

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1 want to speak for all of them -- don't quite get it, and aren't
2 quite adopting the tools and doing what they need to do.

3 Talking to Sabre, a minority of their customers
4 have yet to use their tools. They don't want to say that, but it
5 is true. They have always had where you are able to use your
6 small agency -- for example, Sabre has a technology, you could
7 build a website and use the Sabre back-end and put your label on
8 it.

9 Then when it comes down to brass tacks, okay, how
10 many agencies are actually using that? "Well, you know, it's
11 kind of a small percentage. We expect it to grow."

12 DR. MITCHELL: But that doesn't mean they don't
13 have a site just because they didn't use Sabre's.

14 MS. SILEO: That is true, but they are using the
15 Sabre GDS in this case. Sabre does offer really good, I think,
16 we think, good solutions at a reasonable cost.

17 DR. MITCHELL: There are agencies who have sites
18 that did not use GDS looking at developing --

19 MS. SILEO: But creating their own tools is so
20 expensive. That would make no sense for a small agency.

21 DR. MITCHELL: Unless you are in a group that also
22 provides a --

23 MS. SILEO: That is correct, right.

24 MR. RUDEN: We have such a deal.

25 MS. SILEO: That's right.

1 MR. MURPHY: Thank you very much for very good
2 information.

3 MS. SILEO: Thank you.

4 MR. MURPHY: I have three questions. First, one of
5 our charges is to determine whether the consumer has adequate
6 information or whether access to information is growing or
7 shrinking. Would you comment on that, how the consumer is
8 treated through all this?

9 MS. SILEO: Uh-hum. The consumer that uses the --
10 about 75 percent, by the way, of this panel of Americans use the
11 Internet. Only 33 percent have ever flown, but 75 percent use
12 the Internet. I would say if you have access to the Internet,
13 you have more information than you could ever possibly want.

14 Then there is the other percentage of the
15 population that they are not going to use the Internet for travel
16 information. So they are just not going to change their ways.

17 Again, the travel agency channel will still be in
18 2004 the largest channel for selling travel. It won't be the
19 majority anymore. It will be down to, say, 46 percent, not 53
20 anymore. But it is still the main way that Americans will buy
21 their travel.

22 Those that buy online go both ways, online
23 sometimes, offline sometimes, also very, very popular. It is not
24 an all-or-nothing scenario.

25 MR. MURPHY: Okay. Secondly, you present some

1 excellent recommendations targeted toward the agents. Do you
2 have any recommendations for this Commission?

3 (Laughter.)

4 MS. SILEO: I knew that question was coming up.

5 MR. MURPHY: Well, then I know you have a good
6 answer.

7 (Laughter.)

8 MS. SILEO: We don't take the position that there
9 should be re-regulation. Like others, we do believe, of course,
10 that DOJ needs to do its job, and DOT, and we understand that.

11 DR. MITCHELL: Would you expand on that?

12 MS. SILEO: Just when you are a consumer, the
13 question is the consumer. The consumer has more choice than
14 ever, and the consumer has really right now pretty good prices,
15 has access to just about anything they want in terms of travel,
16 whether or not I want to pick up a phone and be coddled by an
17 agency or whether I want to book Southwest in five minutes or
18 less on the Internet. So the options are there for the consumer.

19 But, obviously, yes, you need to keep an eye on the
20 five major airlines. The hotel industry, we talked about the
21 hotel industry, and I don't think even if you got Starwood and
22 Six Continents and all of them together, you get half the market
23 for hotels. But it is not an issue, but for air it is.

24 MR. MURPHY: Finally, thankfully, we haven't heard
25 a lot of the debate today that we had in some of the earlier

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1 hearings about access to web fares, but to just replot that
2 ground a little bit: My sense is that, even since we have held
3 our first hearing, access to web fares for the large Internet
4 travel agencies has grown. Are Expedia and Travelocity, are they
5 cutting their own deals, and are some of them exclusive deals?
6 Are they getting access to web fares?

7 MS. SILEO: Well, yes, absolutely. I mean, Expedia
8 and Travelocity, I know they are in the top 10. I believe they
9 are in the top five, all travel agencies. So if you are a
10 supplier -- again, this is, of course, with a small agency, this
11 has a deficit; suppliers are going to negotiate with this volume.

12 They are doing more than just negotiating for web
13 fares. I mean, they are getting placement on the search results.

14 They are getting flashing ads. I mean, this is all about -- it
15 takes us back to what we talked about, marketing and branding,
16 because this is what it is about.

17 Suppliers recognize that Expedia/Travelocity will
18 help with branding, and Orbitz, you know, help with branding, not
19 so much -- you know, Orbitz has the unbiased display -- and it
20 will help with marketing, and will help them reach as many
21 eyeballs as possible for what they believe to be a very efficient
22 price. Yet, they are being compensated for it. But Travelocity,
23 as we know, is losing market share because it is too dependent on
24 air.

25 So even if you could strike the right deals with

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1 air, that does not guarantee success. Expedia is successful
2 because of merchant model hotels. Again, the online agencies are
3 just as dependent as the offline agencies on diversification away
4 from air.

5 MR. MURPHY: Thank you.

6 MS. SILEO: And including Orbitz.

7 CHAIRMAN WINSTEAD: Paul, and who else? Paul has a
8 couple.

9 MR. RUDEN: Just a couple of follow-up questions.
10 Now that this thing has surfaced again, do you have any hard
11 information about the percentage of available web fare that
12 Sabre/Travelocity get versus the percentage of web fares that
13 Orbitz gets?

14 MS. SILEO: Just those surveys that we have all
15 seen, the Consumer Reports survey, and the deals, that Expedia
16 has deals with I guess about five different airlines, but it is
17 not for all their fares.

18 MR. RUDEN: So you don't really have any specifics
19 about who is getting what percentage of the web fares that are
20 available?

21 MS. SILEO: These are confidential agreements.

22 MR. RUDEN: Okay, I am not criticizing you.

23 MS. SILEO: I wish I did.

24 MR. RUDEN: I am not criticizing you. I just want
25 to be clear about, when a statement is made that they are

1 absolutely --

2 MS. SILEO: We don't know.

3 MR. RUDEN: -- getting the fares, I suspect that
4 the reality is somewhat different.

5 You also made reference to Orbitz's being unbiased.
6 I thought you had quotation marks around that.

7 MS. SILEO: No, no, no, no, no.

8 MR. RUDEN: But whether you did or not, are you
9 suggesting that there is a bias issue floating around out there
10 on the web that we don't know about?

11 MS. SILEO: It is about marketing and branding, and
12 the suppliers are doing what they have to do to get out there.
13 Just like you buy a TV ad on the Superbowl --

14 MR. RUDEN: That's not bias though, is it?

15 MS. SILEO: Well, I think it's --

16 MR. RUDEN: The CRS regulations define bias as
17 playing around with the algorithms to distort the display so as
18 to favor the owner or partner of the website, as distinct from
19 buying an ad on a website. Buying an ad is not bias. You would
20 agree with that, I hope?

21 MS. SILEO: Well, I do, but you could say, well,
22 the largest company with the most money gets the biggest ad.

23 MR. RUDEN: But they bought that ad. That's
24 part --

25 MS. SILEO: Right, and you are buying your

1 placement on the display.

2 MR. RUDEN: But you don't see a difference between
3 buying an ad and putting it up that says, "American Airlines --
4 we're the cheapest and best to San Juan" and putting a query into
5 a program and having it always produce American Airlines flights,
6 even if they are not either the shortest or the cheapest or the
7 most direct? I mean, that is what bias was all about in the CRS
8 rule environment.

9 The term gets thrown around a lot, and I just
10 want --

11 MS. SILEO: It does, it does.

12 MR. RUDEN: -- to be sure that we understand that
13 those are two different things.

14 MS. SILEO: It does, and I am referring to, I mean
15 there have been articles in the major newspapers about this is
16 not a secret issue --

17 MR. RUDEN: They make the same problem, the same
18 mistake.

19 MS. SILEO: I don't know if it is a problem or a
20 mistake, but it is a way , it is a business model.

21 MR. RUDEN: Okay.

22 CHAIRMAN WINSTEAD: Lorraine, thank you very much.
23 I appreciate it.

24 MS. SILEO: Oh, you're welcome. Thank you very
25 much.

1 CHAIRMAN WINSTEAD: Thank you for sticking with us.

2 MS. SILEO: Thank you for your ear.

3 CHAIRMAN WINSTEAD: Bob, thank you for your
4 equipment, letting us keep the equipment this afternoon.

5 MS. SILEO: Yes, thank you.

6 DR. JOSELYN: I do windows, and if you have cars
7 outside that need an oil change.

8 (Laughter.)

9 CHAIRMAN WINSTEAD: I think we have two remaining
10 witnesses. I think Ken Button, who's got a class at George
11 Mason, is going to start, is that not correct? We thank you for
12 sticking with us. Then David Butler will follow Ken.

13 But if you could, for the record, state your name.

14 DR. BUTTON: Thank you, Mr. Chairman. My name is
15 Kenneth Button. I'm Professor of Public Policy, School of Public
16 Policy, George Mason University.

17 My background is very much as an economist. My
18 experience, prior to coming to the states six years, I was
19 Counselor to the Secretary General Advisory Unit of the OECD in
20 Paris, where I headed up the International Initiative to
21 Deregulate International Aviation.

22 For five years prior to that, I was consecutively
23 Professor of Economics at Loughborough University, England;
24 Professor of Transport with the Free University of Amsterdam, and
25 also the Advisor to the House of Commons Transport Committee.

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1 Basically, that meant organizing the British equivalent to the
2 House Transportation Committee here.

3 I come here as a totally independent witness. I
4 fly about a quarter of a million miles a year. So I have some
5 experience. I think I have booked tickets by all forms of media,
6 although yet on the auctions no one has accepted my bid, but,
7 otherwise, I have used all forms of transport.

8 What I would like to do is not to give you any more
9 numbers. You seem to be saturated with numbers. I think you've
10 probably got every number under the sun which you could sort
11 around and define your particular permutation.

12 I would rather like to look at some of the
13 underlying economic principles and try to explain, as an
14 economist, how I see the current situation within its sort of
15 historical context, because I think it is important to realize,
16 I'm sure you all do realize, the world is very dynamic. It is no
17 good simply taking a snapshot of what the current situation is.

18 First of all, travel agents in this country
19 basically perform four functions, in my view. They provide
20 information. They are a repository of information. They are
21 like a library to the general public about travel.

22 Secondly, they consolidate, sort, and sift that
23 information to help the general public back to some sort of
24 consolidative information.

25 Thirdly, they make the contacts and bookings with

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1 the airlines.

2 Fourthly, they deal with documentation: tickets,
3 passports, so on and so forth.

4 These are, as I say, the four primary functions of
5 travel agents. Other countries actually have slightly different
6 systems. Your system is not ubiquitous.

7 If you take most of Western European countries, for
8 example, we have large amounts of inclusive tour activity.
9 Perhaps 30 percent of the aviation market feeds into inclusive
10 tours, where you actually have some form of agent which brings
11 together flights, hotels, supplementary travel, documentation,
12 and the travel agent then markets and sells that particular
13 product.

14 So their function in Europe is about a third of the
15 market is somewhat different than that in the U.S. Their
16 consolidation function is probably greater in the U.S. than it
17 is, for example, in Europe.

18 Secondly, I might just add this at the beginning:
19 The U.S. situation regarding travel agents is also not universal.

20 I was in Spain 10 days ago and talking to the President of
21 Iberia. Iberia made a significant profit, you may have noticed
22 in news released recently, off of their travel agents who are
23 going through an incredibly flourishing period. The number of
24 bookings through conventional travel agents has gone up very
25 significantly. I will come back later to why this may be the

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1 case.

2 So the U.S., in a sense, is not exactly the same as
3 everywhere else in the world. There are similarities, but there
4 are also differences. I give these as points of preamble before
5 going into my main sort of discussion.

6 But why do travel agents exist and why did they
7 come into existence? They serve the four functions I mentioned,
8 and those four functions became important, as was discussed this
9 morning in what I thought was a very articulate presentation by
10 Mr. Joselyn, because of the changes brought about in 1978
11 deregulation.

12 After deregulation, we had a large number of
13 changes in the system. The security and the conformity in the
14 system was removed, and there is a need for some form of
15 intermediary between the airlines and the flying public.

16 Coupled with that, the 1978 deregulation brought
17 about a second major reduction in airfares. The first major
18 period of reduction was with the introduction of jet airliners.
19 They brought the per-seat cost down significantly. That had
20 really been phased out by 1978. A plane today looks much like it
21 did in 1978. Take a plane before 1978, 25 years back, and it
22 looks a bit different.

23 So a technology change has taken place. The
24 deregulation in 1978 brought about managerial changes in the
25 industry, and those managerial changes reduced costs, and with it

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1 that brought in a large number of people who could now afford to
2 fly. These people had not flown before. These people were --
3 "ignorant" is not quite the right word, but not very well
4 informed about how the system operated, and the travel agents
5 performed a very important function in that particular period of
6 time.

7 What emerged to fulfill these four functions I
8 mentioned was a series of basically hardware outlets, basically,
9 brick buildings where you went and saw a travel agent. The
10 difficulty with this is it is a traditional retail problem which
11 existed at that time, is that this made excess capacity in the
12 industry because each of these small outlets in a sense has some
13 degree of monopoly power.

14 When people wish to go out and buy a ticket or make
15 some arrangements with a travel agent, they basically bore two
16 forms of cost: the cost of the transaction and the cost of
17 getting to and getting away from the travel agent. That gave
18 each travel agent a limited degree of monopoly power.

19 This is not exactly the same as having perfect
20 competition, the standard model which we talk about in antitrust
21 policy, the standard model which we hear about in economic
22 textbooks. The model of perfect competition basically assumes
23 the cost of each supplier is identical. That is not the case; in
24 all forms of retailing it is not the case. Basically, the cost
25 of going to one retailer, even if they sell exactly the same

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1 product at exactly the same price, is different to another
2 retailer because you've got the access problem to that retailer.

3 Now what has happened since then is that in many
4 forms of retailing -- and that is really what travel agents are;
5 they're just retailers -- what has happened in many forms of
6 retailing is there's been some forms of consolidation. That has
7 happened everywhere. Wal-Mart is a classic case. We talk of the
8 "Wal-Mart effect" in the United States. We talk of the "ASDA
9 effect" in the United Kingdom. We talk of the "La Clef effect"
10 in France. It is a worldwide phenomena.

11 It has taken place for a number of quite obvious
12 reasons. First of all, there's been demographic shifts, people
13 moving and living in different places, and simply visiting
14 traditional centers has not become an economic activity. It led
15 to consolidation physically of many activities, and that is why I
16 think you tend to have more larger physical travel agents and
17 fewer of the mom-and-pop outfits.

18 Secondly, there have been changes in the type of
19 product which is being offered. By that, I mean in the old days
20 travel agents basically were filling many fairly simple tasks,
21 sort of A-to-B travel. People's incomes have risen. People have
22 become wealthier. People have become more sophisticated. People
23 are enjoying different forms of lifestyle. They want more
24 complicated travel packages in many cases.

25 That involves more sophisticated hardware to be

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1 owned and operated by the travel agent on the premises, where you
2 have a fixed premise. That, again, leads to some form of
3 physical consolidation.

4 So this is a natural process. It is not something
5 which is peculiar to travel agents. We see it everywhere. We
6 see a situation of Costcos growing, the out-of-town shopping
7 centers, and so on and so forth. It is a standard retailing
8 issue. One should not be surprised, worried, or concerned about
9 it taking place in terms of being a member of society. It is a
10 natural evolution.

11 Then, of course, we came along with another change
12 in the system, and that is the movement towards the electronic
13 systems. The CRS systems obviously provided an inlet to the
14 travel agents, but at the same time, of course, ultimately,
15 people started thinking, well, how can we exploit them more
16 fully?

17 I perceive the initial use of computer reservation
18 systems within the travel agency industry as simply way of making
19 their normal interactions simpler, offering more choices to
20 consumers. It didn't really change the way in which the customer
21 felt when he went to a travel agent.

22 A customer would go to a travel agent, and instead
23 of looking through manuals and doing some complicated
24 calculations, whatever, it was done on a screen. I mean, from
25 the consumer's point of view, that was the change. The

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1 transactions did not, the business did not change from the
2 consumer's perspective. A bit faster, a bit more convenient;
3 that's good. But it fundamentally didn't change.

4 Where the fundamental changes come is when you've
5 got these developments in new information technology. These new
6 innovations in information technology do two things. First of
7 all, they facilitate the existing market, and I do want to
8 emphasize Mr. Joselyn's point this morning that there is a
9 significant existing market of direct sales in airlines. They
10 make that much easier for the airlines.

11 But, secondly, it also allows third parties to come
12 in, as it were, step over the traditional travel agent. They can
13 circumvent the physical building and go directly to customers.
14 That is the jumpover which Mr. Joselyn showed again this morning.

15 I think they are the two fundamental changes.

16 This, in a sense, is not quite as big as the
17 revolution of the jet engine in air transportation. It is not as
18 big, I don't think, as the 1978 deregulation. It is one of those
19 little blips in the system. We've got new technology and new
20 systems emerging.

21 Now what does this do for the consumer? Well,
22 clearly, from a consumer's point of view, it does give more
23 choice, as the previous witness testified. Because travel agents
24 are there; you've got choices on the Web. Consumers basically
25 vote with their pocket. They will go to the one which gives them

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1 the best deal they want. That may involve some choice in
2 quality. It may involve some choice in those options, but it
3 does basically mean they vote for the cheapest option available.

4 At the moment one sees a situation where they are
5 gradually opting for going to electronic websites. Indeed, in
6 Europe some airlines have gone further than American airlines.
7 There is one I know which takes 80 percent of its bookings from
8 its website. A no-frills carrier. We don't call them low-cost
9 carriers in Europe. All carriers consider themselves low cost in
10 Europe. These are no-frills carriers, and 80 percent the
11 bookings are by the Web. They started up; that is the way they
12 operate.

13 What effect does this have on the travel agency
14 industry to start with, and then a little bit more on the what
15 may happen in the future. But, first of all, it does seem to me
16 the travel agency has to ask, what are its main strengths in the
17 four things it does: providing information; consolidating that
18 and helping the public with that information; the interface with
19 the airline, and, finally, the booking arrangements.

20 Well, let's knock off the booking arrangements.
21 We're on to e-tickets for air travel, but that doesn't mean there
22 aren't necessary documentation activities that have to be handled
23 with the increased amount of international travel taking place in
24 the states. The big growth sector in air travel, for example, is
25 the international sector. Cruises take you overseas. There's

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1 documentation involved there.

2 Interactions with airlines? Well, travel agents
3 may wish to interact with the airlines. The commercial
4 propositions under which they do it have clearly changed and are
5 unlikely to change back, unless you force them or the government
6 forces them.

7 The way it operates is, we have transparency. The
8 travel agents, as far as they are concerned -- and perhaps in
9 comment to Mr. Ruden's question this morning, the travel agents
10 can, but do not have, to quote the passenger the commission.
11 They can basically say it will cost you so much to book this
12 flight. So in that sense, they don't have, as far as I
13 understand it, to reveal what the fee is. It is an option they
14 choose to do, and it is up to them to do that.

15 But, basically, that model has changed, and they
16 have to think how much they want to deal directly with the
17 airlines, how much they want to act in some other function.

18 The consolidation information role, that is where I
19 think the traditional travel agent does have the tremendous
20 comparative advantage. People this morning, Mr. Joselyn, I
21 referred to him several times, but he did make the point it took
22 him 25 minutes to book tickets on the Web. I always leave it to
23 my daughter. She's 14, and it never takes her more than four;
24 she gets a pretty good deal. Bang, bang, bang, and it's all
25 booked.

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1 To be honest, there's an educational process here.

2 If you invest half-an-hour learning how to do it, you note how
3 to do it, next time around it is pretty simple. It takes you
4 half-an-hour normally to drive to a travel agency and come back
5 again. So your investment in learning to use websites, in fact,
6 is relatively minimal from the time and effort it takes to go to
7 a conventional travel agent.

8 But what the conventional travel agent does is deal
9 with complicated trips. My daughter does not deal with complex
10 trips. She would not dream of trying to do it, because that does
11 involve personal interaction.

12 The reason for that is simple. Most people making
13 a complicated trip or leisure activity, whatever they are doing,
14 is not actually clear on exactly what they want most of the time.

15 They want certain things. They want to go to some sun. They
16 want to cruise. They want a various plethora of attributes.

17 What the Web is good at is when it is selling
18 basically just one or two attributes: a cheap fare or service
19 which goes once every hour, where you've got very clear, defined,
20 single attributes. Once you get a multi-product attribute, this
21 is where the personal skills come in. So that I would perceive
22 to be the role in the future of the travel agents.

23 Where does this all fit in with the overall picture
24 of transportation? Because, clearly, one has to understand why
25 these things are happening and why the airlines are moving in the

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1 directions they are.

2 Mr. Joselyn made the point this morning it has to
3 do with revenue. Other people have made the point, having that
4 evidence, it has to do with cost. It is actually to do with
5 both. Both are involved.

6 First of all, the airlines themselves actually gave
7 away the role of their travel agency responsibilities with
8 deregulation. They could have taken on that role themselves.
9 They decided to basically outsource it. In their eyes, it was
10 not commercially viable because of the transactions cost
11 involved.

12 That world has changed. It's changed because those
13 transaction costs have come down. They can relatively easily
14 internalize many of these costs and do the operations themselves.

15 Therefore, in terms of the price ultimately charged to the
16 customer, the cost to the customer, that ultimately comes down.

17 The airlines and the other travel activities -- we
18 talk about airlines a lot, but, of course, hotels are also
19 involved -- their costs come down; they get more business. So
20 there is a logic in that. Particularly, the airlines themselves
21 need revenue, and in this particular short-term they need revenue
22 because their old management systems are not functioning as
23 efficiently as in the past. Therefore, they are strapped for
24 revenue. Therefore, this system pulls in additional revenue.

25 I would like to think of the air industry a little

1 bit like a sort of value chain, which the whole value chain makes
2 a profit. By the value chain, I mean manufacture of aircraft,
3 airports, air traffic control, airlines, travel agents. The
4 whole system and structure makes a profit as a whole; the issue
5 is how you share out that profit within the industry.

6 In recent history the airlines have not been making
7 a rate of return which covers their capital costs. Clearly,
8 their share is insignificant to sustain the system, and what they
9 are trying to do is to claw back from other parts of the system
10 which are profitable, or have been profitable, some revenues.

11 My own personal view on this is that probably it is
12 a short-term solution because I think the very rapid changes in
13 technology are going to make the margins on travel agent
14 activities or electronic versions of it so small the amount of
15 revenue is not going to be massive. But, nevertheless, that is
16 essentially my view of what is happening. It is a situation of
17 an adjustment in the system at the same time as technology is
18 changing.

19 Now what do you do in terms of recommendations in
20 these situations? Well, I have sat on a number of commissions in
21 my life. That is why I keep my evidence short. I've also
22 advised on many.

23 But I remember the words -- and I can't remember
24 the gentleman's name, a very eminent British judge who served on
25 some pretty senior commissions having to have to do with death

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1 penalties and things, so a little bit more serious in a sense
2 than this one. He made this view. He said, "If I'm making
3 recommendations, I reflect on this: Would I have made those
4 recommendations two years ago? I'm absolutely certain of the
5 right recommendations now. I'm never absolutely sure I have
6 enough information to be convinced these recommendations would be
7 the ones I would make in two years' time."

8 My view is that, quite frankly, the travel agency
9 industry, the transport sector in general, is in such a state of
10 flux, as illustrated by, I think, a relatively simplistic
11 flowchart put up by Mr. -- sorry, Dr. Joselyn; I'm underplaying
12 the guy's qualifications; I apologize.

13 Dr. Joselyn summarized the situation entirely.
14 There are so many interacting links. They are changing almost
15 hourly, weekly, and we have no idea of the outcomes. The data is
16 imperfect. The basic situation is to sit and wait and see what
17 is going to happen.

18 This judge made another comment. He said, "What
19 one ought to think about on a committee is the committee ought to
20 act bravely." By acting bravely, he meant produce a short report
21 that simply said in the short-term let's leave things alone and
22 find out exactly what's going on.

23 Thank you, Mr. Chairman.

24 CHAIRMAN WINSTEAD: Ken, thank you very much. I am
25 sure there will be a couple of questions, but one for the record

1 was the issue or your suggestion about travel agencies and their
2 monopolistic power.

3 DR. BUTTON: Yes.

4 CHAIRMAN WINSTEAD: I think that is quite different
5 than what we heard to date at the hearing. I was just wondering
6 if you could sort of define monopolistic competition --

7 DR. BUTTON: Sure.

8 CHAIRMAN WINSTEAD: -- from how you use it in your
9 statement.

10 DR. BUTTON: Monopolistic competition, it is a
11 pretty standard things in sort of 201 Economics and missed out in
12 101. Essentially, most models of competition make certain
13 assumptions. All economists basically live in a dream world of
14 assumptions.

15 Perfect competition assumes, for instance, you have
16 atomized supply, a large number of small suppliers. We have that
17 in the travel agent industry. It assumes you have perfect
18 information, which you don't, the customer does not have in the
19 travel agency industry because they go to travel agents to get
20 information.

21 Thirdly, it assumes you've got a totally -- how to
22 put it -- a totally elastic supply of travel agency services.
23 That is not the case because each physical travel agent is at a
24 particular location, and you have to visit it.

25 So, in a sense, if you wanted full information

1 about all the possibilities -- put it this way: If you wanted
2 full information about all the possibilities of travel, you would
3 actually have to visit every travel agency around to get that
4 information. That is simply not physically possible. But that
5 is one of the normal assumptions of competition.

6 Now if some of these assumptions are violated, what
7 you end up with is a situation of excess supply, where the unit
8 cost is slightly higher than it would be if you had a small
9 number of suppliers.

10 We can think of this perhaps in terms of having
11 four corner stores on a housing area, each charging \$1.50 for a
12 Coke instead of having one in the center which could charge \$1.40
13 because it would employ less labor. There would be less need to
14 carry stock. The inventory would be lower, and so on and so
15 forth. Basically, by spreading out your supply, you essentially
16 push up the unit cost. So that is what I mean by monopolistic
17 competition and excess supply.

18 If I can add something to that, it does also have
19 some advantages. It does give consumers choice. Because in my
20 example of the four corner stores compared to the one in the
21 center, the consumer can choose between those four, and they may
22 like the person owning one store rather than going to the center
23 one.

24 The same with travel agents; they may actually have
25 more confidence in some travel agents and less in others. They

1 must find for some intangible reason that some travel agents
2 provide a better service. So there is that plus to it, but,
3 equally, from a strict cost point of view you tend to get
4 overcapacity.

5 It is not something new I have dreamt up. It goes
6 back to two parallel pieces of work in the thirties. I mean, it
7 is not revolutionary.

8 CHAIRMAN WINSTEAD: Thanks, Ken. Let me ask -- I
9 know we've got some questions on the right, I know immediately.
10 Paul, go right ahead. I didn't see another hand fly up.

11 (Laughter.)

12 MR. RUDEN: Well, I have learned from hard
13 experience over many, many years not to tangle with economists
14 too much.

15 (Laughter.)

16 But in the scenario you just described of the four
17 corner stores, when you talked about the one store, was the
18 assumption there that it was the fifth store or the only store?

19 DR. BUTTON: The only store.

20 MR. RUDEN: And your scenario is the only store
21 would end up charging lower prices than the scenario of four who
22 were on corners opposite each other and competing with each
23 other?

24 DR. BUTTON: No --

25 MR. RUDEN: If I heard you correctly, you said

1 \$1.50 versus \$1.40.

2 DR. BUTTON: I did say that it would happen.
3 Technically speaking, you could have -- in terms of economic
4 efficiency and excess capacity, it has to do with the unit cost
5 of providing it. So in this case, if you have a monopoly single
6 supplier in the middle, then that is a problem. I did that
7 simply as illustration for the cost side of things, in fact. My
8 argument would be that in that case you would have the potential
9 for monopoly.

10 Alternatively, in the travel agency case, when you
11 come back to it, you are actually finding there's more suppliers
12 coming on the market, not having a single monopoly in the middle.

13 I was going back to the case of before the electronic system
14 came in, when you simply had your standalone travel agents.

15 MR. RUDEN: Well, that was the scenario where you
16 said not much fundamental change, when that level of automation
17 first came in?

18 DR. BUTTON: Not when the first electronics -- the
19 websites --

20 MR. RUDEN: The beginning of the first electronic
21 revolution in which agents automated with CRS produced a result
22 in which virtually every agency had essentially the same
23 inventory as every other agency across the United States

24 DR. BUTTON: Certainly.

25 MR. RUDEN: Okay.

1 DR. BUTTON: But then you get the halo effect on
2 top of that. You have to interpret what is on the CRS system.

3 MR. RUDEN: Right, and that is one of the jobs, one
4 of the functions agents do --

5 DR. BUTTON: Exactly.

6 MR. RUDEN: -- that you mentioned before, if I
7 heard you right?

8 DR. BUTTON: That's right.

9 MR. RUDEN: So there's actually five?

10 DR. BUTTON: No, that would be my second one, the
11 consolidation of information and bringing the information
12 together for consumers.

13 MR. RUDEN: All right, I'm sorry, I misunderstood
14 you. That would include the evaluation --

15 DR. BUTTON: Yes.

16 MR. RUDEN: -- the giving of advice?

17 DR. BUTTON: Yes.

18 MR. RUDEN: Would that also include post-event
19 service for issues and problems that seem to crop up from time to
20 time in the air travel business?

21 DR. BUTTON: Probably yes. I mean, they basically
22 would advise the customer what to do if they had some difficulty.

23 MR. RUDEN: And negotiate on their behalf
24 afterwards to get them help? That's part of that same second
25 thing --

1 DR. BUTTON: I put it under that second. It may
2 come under documentation, if there is a necessity for
3 documentation for claiming money back. I mean that would fit in
4 some way.

5 MR. RUDEN: I've got a bunch of other questions
6 that I want to walk through quickly in your written testimony,
7 but I do want to address and clear up one thing about this
8 observation you made about agents having to disclose their
9 service fees. The fact is that it is not optional because the
10 travel agent is not permitted to include the service fee in the
11 price on the documents, whether it is an e-ticket or any other
12 type of document. They have to report that separately and
13 collect it separately on a credit card form, which appears as a
14 separate charge on the client's statement. So it really is the
15 case that the airlines have done that to the agents uniquely, I
16 think.

17 When you talk about efficiency in your testimony,
18 Professor, you say efficiency is the provision of a service that
19 meets the demands at the lowest price. Is that the same thing as
20 saying that it meets the demands at the best ratio of inputs to
21 outputs?

22 DR. BUTTON: Assuming everything is priced
23 correctly, yes.

24 MR. RUDEN: Okay. Have you done any studies of how
25 travel agents and their clients communicated with each other

1 during the period of the eighties?

2 DR. BUTTON: No, I've read something on it. I've
3 done none myself -- in the British context as well, not the
4 American.

5 MR. RUDEN: The use of telephones, for example, to
6 communicate would, if I accept for the moment, hypothetically,
7 though -- I do not accept this notion that there is monopoly
8 power arising out of location. The use of telephones would
9 pretty much wipe that power off the map, wouldn't it?

10 DR. BUTTON: It is. I mean, if I recall from
11 Britain, which I assume is much the same -- I mean relatively
12 developed --

13 MR. RUDEN: You have worse traffic than we do, I
14 think.

15 (Laughter.)

16 DR. BUTTON: What you tended to find in the travel
17 agents, I remember some surveys done in the -- it would be around
18 1987-88, around that time -- that certainly telephones were used
19 widely for what you might call singular trips, you know, if you
20 are going from simply Washington to Detroit and back. But
21 personal visits were pretty common in terms of making bookings
22 for more complex travel activities, not just travel but hotels,
23 and so on.

24 Then I think there was a survey done by the British
25 Travel Association or something. The survey was done in the

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1 context of labor utilization.

2 MR. RUDEN: This monopoly power that you described
3 travel agencies having is actually an attribute of every business
4 that has a physical presence, no matter what it is --

5 DR. BUTTON: Exactly.

6 MR. RUDEN: -- including my child's lemonade stand.

7 DR. BUTTON: Exactly.

8 MR. RUDEN: Okay. On page 6 of your testimony you
9 said that most of the other actors in the value chain make a
10 reasonable return over the business cycle.

11 DR. BUTTON: Uh-hum.

12 MR. RUDEN: Which sectors are you referring to?

13 DR. BUTTON: There was a study done by McKinsey --
14 I can provide you, if you like, subsequently with a photocopy of
15 -- of the returns earned by each of the sectors involved:
16 aircraft manufacturing, CRS systems, airports, and so on. If you
17 would like that, I can submit that.

18 MR. RUDEN: You're not saying that airlines and
19 travel agents necessarily make --

20 DR. BUTTON: Airlines are making a profit with --

21 MR. RUDEN: -- reasonable returns?

22 DR. BUTTON: Well, reasonable return is taken
23 somewhere between 9 and 7 percent. You've got the airlines with
24 below that. Travel agents are slightly above it, I believe.
25 Aircraft manufacturers are way above it. These were long-term.

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1 MR. RUDEN: If you could supply that --

2 DR. BUTTON: Yes, it is a McKinsey study.

3 MR. RUDEN: -- I would appreciate that.

4 DR. BUTTON: Certainly, I shall send that to you.

5 MR. RUDEN: You say that Orbitz can be viewed, on
6 page 7 of your testimony, as a revenue generation measure. Could
7 you explain what you mean by that?

8 DR. BUTTON: Well, simply I think the airlines want
9 to have control over their revenue flows, and by setting up a
10 subsidiary in a sense, they are closer to that flow than going
11 through a disparate number of channels. You know, it gives them
12 a closer view of the picture.

13 They, basically, also want revenue --

14 MR. RUDEN: A closer view of what each is doing?

15 DR. BUTTON: Well, no, no. A closer view of the
16 overall market. But there's two aspects. There's that. The
17 second one is -- and, therefore, they have more information --
18 the second one is, of course, involvement. That someone presumes
19 that that would generate revenue, hopefully. They may hope so
20 anyway.

21 CHAIRMAN WINSTEAD: Gerry is going to jump in.

22 MR. RUDEN: Well, go ahead, and maybe you can come
23 back.

24 CHAIRMAN WINSTEAD: Gerry and then Ted and then --

25 MR. RUDEN: I always get this pressure; I don't

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1 understand it.

2 (Laughter.)

3 CHAIRMAN WINSTEAD: Gerry, go ahead.

4 MR. ROPER: I love to harass lawyers.

5 (Laughter.)

6 Many witnesses today and in the past -- and I could
7 ask this of David, but, you know, you're here -- I think have
8 made some recommendations. I would just like to try to sum them
9 up and see what your thoughts are on the following:

10 Probably what I have heard today is worry less
11 about Orbitz? You know, I mean sort of get the focus of that and
12 look at market shifts, so you don't place all of your revenue
13 dreams on just the airlines. Technology enhancements are
14 critical to the future of not only the travel agents, but
15 probably other people in the travel industry. Charge service
16 fees, and we saw that that seemed to be a good recommendation,
17 and find new clients; i.e., those people who have not traveled,
18 have not been on a cruise. Reduce your expenses because that is
19 what everyone is attempting to do or you are going to go out of
20 business.

21 I mean, does that sort of sum some things up for --

22 DR. BUTTON: We come back to the question which the
23 Chairman asked the previous witness. It seems to me, are you
24 making recommendations to the travel agency or are you making
25 recommendations for policy?

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1 The travel agency industry is an industry. If it
2 has got flaws within itself -- for example, there's the
3 perception that online web fares are lower than those of travel
4 agents -- then there is something wrong with the industry. They
5 are not marketing themselves well. I am not altogether sure. I
6 mean, public agencies, you can't tell them that; they should know
7 it. Their shareholders should tell them, and something should be
8 done about that.

9 Introducing the appropriate technology, that's the
10 travel agent's job. It is not the job of a recommendation of any
11 committee, public committee. It is a job of the industry, and
12 the shareholders should tell them this.

13 Talking about fees, I happen to think fees are the
14 way forward. They are simply there, and they are the way most
15 things are charged for. I must confess I was slightly incorrect,
16 and I didn't know that, about showing up these fees. It does
17 seem to me that if someone is selling a product, that person
18 should have the right to actually just sell that product and
19 charge it as the product they are selling. So it is the ticket
20 plus the service they are adding in.

21 If we go to a retail store, I don't buy a shirt of
22 a certain price and then have a certain amount added on because
23 the salesperson has dealt with me, hung it up, marketed it. I
24 mean, I find that wrong.

25 I think that I would make a recommendation that

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1 that should be removed. There should be the ability of travel
2 agencies to sell the product as a comprehensive product.

3 In terms of new markets for travel agents, again,
4 that is their job. That is their job to go and find it. I mean,
5 that is what the customer pays them for. If the customer doesn't
6 want to pay them for it, then the customer is clearly
7 dissatisfied with them.

8 That is why I come out with a very limited range of
9 recommendations. I didn't realize the one about the fees. If
10 that is the law, then I think that one is something that should
11 be looked at.

12 I think the antitrust policy is in place.
13 Implementation, to go and tell the Department of Justice what
14 their job is, well, committees do that. I suspect, though, that
15 the Department of Justice would probably sit back and wait a
16 little longer.

17 I mean, this Commission, as I understand it, was
18 initially envisaged two years ago. Would you be discussing
19 Orbitz two years ago? Would you be spending all the time one
20 that?

21 The world is in a state of flux. When you've got
22 flux, the best thing to do is to settle down and then find out
23 what the real underlying problems are. It seems to me in this
24 case the market is actually working pretty well on many scales.

25 There are more efficient technologies coming

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1 online. We've got a vast range of choices for consumers. It is
2 relatively easy to access. I mean really, I mean the cost of
3 learning to use these websites is trivial.

4 I really don't see in the short-term what the
5 problem is. Of course, there may be problems down the road, but
6 given technology is changing, given the structure of the industry
7 is changing -- I was a professional forecaster for many years. I
8 tell you, I look back on my forecasts, and I figured I was pretty
9 good, and they were disastrous.

10 This is a market economy. It is not a planned
11 economy. You don't know what is going to happen. Basically, you
12 solve problems when they crop up. You don't try to anticipate
13 them.

14 CHAIRMAN WINSTEAD: Ted, I think you had a
15 question?

16 MR. LAWSON: Just two quick ones. I was very
17 interested from another position on another task force that you
18 were talking about the hubs of the airlines versus the low-cost
19 carriers and how they compete, the hub airlines compete against
20 the low-cost carriers. I believe your testimony indicated that
21 in the hubs the consumer does suffer from the standpoint that
22 there's less competition in the hub cities, is that correct?

23 DR. BUTTON: Well, I actually looked at hub
24 airports and did an analytical study. It is quite interesting if
25 you look at the hub airports in the U.S. Whatever complaints

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1 there are, they do tend to attract, other things being equal, a
2 large number of high-tech jobs. In fact, in the U.S. their
3 attraction average about four years ago was around 12,000 extra
4 high-tech jobs, you know, just holding everything else constant
5 and holding the size of the airport constant.

6 So hubs have got a lot of attractions. The point
7 is there may be higher fares. Certainly, a GAO study suggested
8 somewhat higher fares at hubs. But, on the other hand, there are
9 certain attributes that go with a hub. You use one airline to
10 get frequent flyer miles for just one thing, but, equally, you
11 get a whole range of direct services if you live in a hub city.
12 You have lounges.

13 There's a whole portfolio of things which can make
14 them attractive for certain travelers. Other types of travelers
15 need/seek other attributes. Therefore, in a sense, it is more
16 expensive, a hub, in probably money terms on average, but, on the
17 other hand, you are getting a different package of goods and
18 services.

19 MR. LAWSON: I guess my point being, coming from a
20 smaller city that, for instance, Southwest would not be
21 interested in, the hubs are a vital concern to cities like
22 ourselves because we connect to them.

23 DR. BUTTON: Right.

24 MR. LAWSON: Yet, these airlines at the hub cities
25 seem to be suffering the most. From an economist's standpoint,

1 do you have a remedy for that?

2 DR. BUTTON: Let me tell you, one thing I am doing
3 at the moment is a very large study for the Association of
4 European Airlines, who have asked me exactly that question. I
5 suppose the answer is, it depends on if your fare is larger than
6 theirs or not.

7 (Laughter.)

8 It is a problem. The difficulty is right. I mean,
9 Southwest provides a superb type of service for a large number of
10 people, but it does provide a comprehensive range of services.

11 What you are finding in some parts of Europe is you
12 are gradually getting in some very low-cost, no-frill carriers
13 which makes Southwest look positively luxurious. They are
14 serving some quite small cities.

15 You are also finding in this country, I notice,
16 that some cities are actually getting together -- well,
17 businesses in some cities in the states, the businessmen are
18 actually getting together to guarantee a certain amount of
19 revenue for carriers to continue to operate, irrespective of
20 whether the number of flights make up to that revenue or not,
21 simply because they feel the benefit of having the availability
22 of this service exceeds the amount they use it. It is a sort of
23 standby capacity concept. So there's a number of ways in which I
24 think these things can be helped out.

25 But one thing I would say, people have seen the

1 market for aviation as static. The crucial thing, of course, is,
2 with the exception of the last year or so, it grows pretty
3 steadily over time. A growing market does actually increase the
4 potential for new entrants, increases the potential for existing
5 carriers to carry more passengers. People's incomes are rising.
6 Therefore, people have more disposable income. It is a dynamic
7 market.

8 It is difficult to say what you do about the
9 leaning forks on a hub-and-spoke system. It is troublesome.

10 CHAIRMAN WINSTEAD: Ken, let me just ask one. Ken,
11 do you have a class at 4:30?

12 DR. BUTTON: I can make it okay there. It is only
13 on transport safety and security; it's nothing important.

14 (Laughter.)

15 MR. LAWSON: I just wanted to follow up. Your
16 definition of the Tom Sawyer effect is, I presume, you do
17 yourself.

18 DR. BUTTON: That's the other guy.

19 MR. LAWSON: Oh, okay, I see, okay. That's fine.
20 That's all.

21 CHAIRMAN WINSTEAD: Do we have any others here?

22 MR. MURPHY: I just have one question. I must say,
23 as you summed up your written testimony, it reminded me of my
24 career in the federal government when I would find myself
25 sometimes over in the Old Executive Office Building dealing with

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1 some other President's economic advisors, and they would
2 constantly tell us, as we would come over from the Executive
3 Branch, that government failure may be worse than market failure.

4 So think very carefully before you try to move.

5 In that light, you suggested, based on what exists,
6 you think perhaps periodic reviews might be the most important
7 thing you think we could do. Could you elaborate just a little
8 bit on that?

9 DR. BUTTON: I think that when you've got a state
10 of flux in the market, you obviously don't know what the
11 immediate outcome is going to be. But the difficulty is you can
12 have problems that creep up on you which you may be able to
13 anticipate in advance, not necessarily act on them, but look at
14 them.

15 You talk about the Council of Economic Advisors;
16 they are the leading indicators in a sense. You try to highlight
17 things you may want to look at in a little bit more detail.

18 I was simply hypothesizing that one may, something
19 like the European Union does, maybe even broader than just travel
20 agents, which I think is a little narrow perhaps, but the
21 European Union has periodic reviews of its packages of
22 deregulation for aviation.

23 In Canada they have periodic reviews of transport
24 regulation, every five years, I believe. I advised them on the
25 last one.

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1 So those sorts of things concentrate the mind on
2 what the current problems are and what may be coming up. The
3 recommendations on them are usually fairly general indicators of
4 where things may be looked at in more detail. I think that is
5 helpful.

6 The difficulty, of course, becomes it can be very
7 cumbersome with large committees. The Canadian one is quite
8 small, and you basically focus on certain things which appear
9 important.

10 MR. MURPHY: And in this country would you see that
11 done by the Executive Branch, these periodic reviews?

12 DR. BUTTON: I think you need it -- it has to be
13 independent of transport or Justice and environment as well, EPA,
14 because environment comes under transport. I would think you may
15 well want it done by something like the Executive. I am not
16 sufficiently familiar with the legal structure, but I have
17 thought it probably would have to be outside.

18 MR. MURPHY: Thank you. I appreciate it.

19 CHAIRMAN WINSTEAD: Paul?

20 MR. RUDEN: Yes.

21 CHAIRMAN WINSTEAD: Okay.

22 MR. RUDEN: We have, of course, some of the kind of
23 review you are talking about. The living example that interests
24 everybody in the room is the CRS regulations. They were supposed
25 to be reviewed in five years, and it has now been ten years.

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1 DR. BUTTON: Yes.

2 MR. RUDEN: So I guess we have a "times two" rule
3 here.

4 (Laughter.)

5 I understand this thought about government failure
6 versus market failure, but isn't it also true that one of the
7 functions of government, especially in the antitrust area, is
8 precisely to investigate and act on market failures to be sure
9 that they don't persist? Would you agree with that?

10 DR. BUTTON: Yes, indeed.

11 MR. RUDEN: One area where, if you want to call it
12 "regulation," you could --

13 DR. BUTTON: Oh, I do. I do.

14 MR. RUDEN: I do, too. That is an appropriate
15 thing for the government to do?

16 DR. BUTTON: Yes.

17 MR. RUDEN: Okay. I also respect, though I don't
18 perhaps agree with it in the finer level of detail, the
19 proposition that you want to be careful where you intervene.
20 Things are changing. This industry is in constant change. If
21 people look for equilibrium, however you wish to define that
22 term, I would suggest that if you go back looking for equilibrium
23 as far as 1945, when jets started coming in, you will not find
24 equilibrium anytime during that period.

25 So if you adopt a philosophy that we are simply

1 never going to intervene, no matter what happens, because the
2 thing is fluid, then intervention simply is out of the question.

3 But it is not out of the question because you agree that
4 antitrust is an appropriate area to intervene.

5 With that predicate there, does it not concern you
6 at all that the five largest airlines on the plant have gotten
7 together to intervene in the retail portion of the marketplace?

8 DR. BUTTON: Well, first of all, two questions,
9 let's take the general question first. I think intervention is
10 important. Everything is in flux all the time. There's never an
11 equilibrium, but there are certain times when the flux is so
12 considerable that it is best to let the thing settle a little bit
13 to really see where the wood is and where the trees are in the
14 system. I think that is the case maybe with the travel agents.

15 Regarding the five getting together, that is an
16 interesting question in itself. It is also happening, of course,
17 in Europe to some extent with Opodo, which you are probably
18 familiar with. It is a slightly different structure, of course.

19 MR. RUDEN: The government actually caused that
20 structure to change over, didn't they? Didn't they do something
21 about the MFN in Opodo?

22 DR. BUTTON: I don't know, to be honest.

23 MR. RUDEN: Okay.

24 DR. BUTTON: I don't know.

25 But regarding the five getting together, the gist

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1 of the Sherman Act is not that a monopoly is a bad thing; it's
2 the actions of the monopoly which is the damaging feature. It is
3 basically a structure/conduct/performance-type test.

4 My point at the moment is, they may be setting up
5 -- it is not a monopoly. let's be honest; it is no way near a
6 monopoly. They haven't got a very large market share. There is
7 a fear of a monopoly.

8 This may be where you do have periodic reviews
9 because a few years' time, whatever the period is, there may be
10 more public concern about that monopoly. Therefore, it should be
11 looked at.

12 So, in that sense, there is this tradeoff between
13 government and market failure. What you want -- I think I talked
14 about it in the report, my notes; I can't remember -- we're
15 basically looking for something called workable competition,
16 where the competition works as best as it can and better than if
17 you try to interfere too much with it. Sometimes it goes one way
18 or the other, but periodic reviews would certainly allow it to be
19 looked at.

20 But why I suggest it being larger than just travel
21 agents is because of the point you just made. If it is very
22 small and something like CRS systems or travel agents, there is a
23 tendency just to move on, drift on. If it is larger, you can get
24 the bigger picture.

25 But I do like the notion of the value chain, where

1 travel agents, airlines, and other parts of the system sort of
2 fit into that picture, and the whole picture needs to be looked
3 at periodically.

4 MR. RUDEN: Okay. Our assignment, of course, is
5 not really just to look at travel agents, but to look at
6 consumers and their relationship to the information sources and
7 supply in the entire air transportation system, which is a pretty
8 big picture.

9 Thank you, Mr. Chairman. Thank you, Professor.

10 CHAIRMAN WINSTEAD: Thank you. I really appreciate
11 it, Ken.

12 DR. BUTTON: Yes.

13 CHAIRMAN WINSTEAD: I hope you make that class.

14 DR. BUTTON: Well, they have to do their
15 presentations today for grading.

16 CHAIRMAN WINSTEAD: Oh-oh.

17 (Laughter.)

18 Thank you very much.

19 Our last witness is David Butler. Again, David, we
20 appreciate your sticking with us to the end of the day.

21 Also, Ann, you had some familiarization with
22 David's work, right?

23 DR. MITCHELL: I became aware of David's research
24 when he called me, when he saw that I had been appointed to the
25 Commission. It is rather recent research, and I think he has

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1 some information that can be helpful in our overall
2 understanding.

3 CHAIRMAN WINSTEAD: That's great. Well, thanks
4 again for joining us.

5 DR. BUTLER: Well, thank you all for sticking
6 around yourselves. The perspective out there is a lot easier
7 than, I'm sure, the perspective is up there after the fourth
8 hearing.

9 (Laughter.)

10 Let me give you a little bit of background. Once
11 again, my name is David Butler. I'm an Assistant Professor in
12 the International Development Program, the Department of Economic
13 Development, at the University of Southern Mississippi. I am
14 also President of Butler and Associates, a consulting firm.

15 The research that I am going to talk to you about
16 was undertaken roughly, was completed about a year ago, and it
17 was ongoing for about two-and-a-half years. It was funded by the
18 Department of Transportation which I was an Eisenhower Fellow
19 from 1999 to 2001 under Dr. Eileen Paine. I want to mention her
20 and the program for appreciation.

21 Let me tell you about bias. I don't consider any
22 one -- and, you know, I will get to it -- any technology to be
23 unbiased. You can only get as neutral as possible. Some of my
24 biases are, No. 1, I own some Southwest Airlines stock, a
25 whopping 50.22 shares. As you can imagine, during the annual

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1 meeting they're just waiting for my proxy statement to show up to
2 swing a vote.

3 (Laughter.)

4 I'm also a Northwest Airlines frequent flyer.

5 (Laughter.)

6 Other than that, I have no interests directly in
7 any travel agent, any other airline, any CRS, or any balloon with
8 any of these.

9 I am going to talk about each segment that has been
10 under the review: consumer, CRSs, the travel agents, and the
11 airlines.

12 My fascination with airlines goes back to when I
13 was a kid looking up and seeing airplanes, reading Aviation Week
14 -- I was in middle school -- and following the industry overall.

15 It is something I'm fascinated by. The leaders in the industry
16 that brought it about, I was fascinated by.

17 The CRSs, GDSs, Orbitz, et cetera, they are
18 information hub collecting mechanisms, not dissimilar to what I
19 do as an academic, which is trying to figure out what in the
20 world is going on in the mind of the consumer, what they like,
21 what they dislike, and how to leverage that. I leverage it for
22 academic publications and dissemination, GDS owners, airlines. I
23 leverage it for profits. We are in a very similar business.

24 Travel agents, I read the testimony -- I assume
25 most of you all have -- for the last three sessions. Travel

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1 agents have gone everywhere from wearing the black hat, being the
2 worse thing on Earth, to wearing the white hat and saving
3 everyone. In reality, travel agents are simply entrepreneurs,
4 just like everyone else who is a small business owner, a large
5 business owner.

6 They start their business in the United States, try
7 to make a profit, and most of them that I have researched over
8 time are trying to bring their love of travel to people. Are
9 some of them more biased than others? Sure, they are, but,
10 basically, they are entrepreneurs, in a nutshell.

11 The consumer, I don't believe consumers are dupes.
12 I think they are efficiency mechanisms, especially collectively.
13 Whether it is on the Web or any other means of collecting
14 information, they go out, they seek it out; they say, "I'm tired
15 of seeking information." They make a decision on the information
16 they have collected at that time.

17 So whenever you are discussing or whenever we are
18 talking about the consumer, I want to keep that in mind. They
19 are not perfect information collection sources, but neither are
20 they a vast vacuum of information. There is some moderation
21 somewhere in between all of those.

22 When you talk about the airline industry and put it
23 into some historical context, most of this testimony that I will
24 talk to you about is from the larger perspective. I am looking
25 at the forest, not at the individual trees, and I am looking at

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1 trends over time and the logic embedded within it.

2 Airlines are, by default, one, a government-
3 subsidized entity historically with airmail contracts. If it
4 were not for the federal government, airlines would not exist in
5 their current incarnation.

6 No. 2, airlines are, through the CRAF regulations,
7 by default, military air transport. If people thought that was
8 gone, Desert Storm reinstated that clearly.

9 No. 3, airlines are also a reserve of military
10 airline pilots. Whether they are reserve pilots or not, they are
11 still there. They know how to fly the aircraft.

12 No. 4, airlines are a show of the flag domestically
13 and overseas. Airlines are the United States, be it in the air,
14 whether they are bombed over a country, whether landing in
15 another country. It is this symbol that is the reason why a lot
16 of countries that should not, or probably could not, afford an
17 airline actually do have an airline.

18 Airlines are also an economic development tool.
19 Whether it is through government subsidies to help airlines serve
20 small communities, building airports, infrastructure, they are an
21 economic development engine. Businesses, travelers, consumers,
22 all use airlines, and it is a money-flow system.

23 Last, U.S. airlines are a restricted industry in
24 the United States. Control over the shares of the airline are
25 restricted in terms of nationality. Likewise, so is access to

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1 the United States in terms of foreign carriers.

2 All right, let's get to the meat of it, after all
3 that is done. There are two basic philosophies in the U.S.
4 airline industry. You have premium pricing and you have discount
5 pricing. Premium pricing, in a nutshell, is airlines, and most
6 of these are the large hub airlines, are going to try to get as
7 much money as possible per seat available.

8 That means that if they can charge \$1,000 a seat,
9 they will do so, if the market will bear it. And if the market
10 doesn't bear it, they will constantly bid down that price to fill
11 up the maximum number of seats possible. That is the standard
12 measurement, standard technique that most hub airlines have used.

13 That is what yield management is used in airlines to maximize.

14 A second philosophy underpinning airlines is use of
15 the discount, using Southwest as the main example, is the "Wal-
16 Mart strategy," what I described it as. Basically, you go into a
17 market and you don't ask, "How much can I charge per seat to fill
18 up the seats?" It is, "What's the lowest I can charge per seat
19 so that I can fly as many routes out of here as possible to get
20 as many people on it?"

21 Now they may seem like a gray area, but I think
22 these are two fundamentally different processes at work. Because
23 of the two different philosophies at work, they implement and
24 they use information technologies differently because it makes a
25 difference on what they are trying to absorb out of each

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1 consumer, information they are gathering, and how they are using
2 it.

3 Airlines, just outside of the financial sector, are
4 the No. 1 user, developer, independent organization on
5 information technologies. If information technologies were not
6 in existence, airlines could not do most of what they do. Though
7 I know there's a lot of criticisms of what they do and how they
8 do it, if IT was not there, it would be much worse.

9 What's not in the testimony, just to give you an
10 example, Robert Crandall, former CEO of American, actually, I
11 believe during the CRS regulation committee hearings, actually
12 made a statement, and some took it as tongue-in-cheek; some
13 didn't know how to take it, whenever he said he would rather get
14 rid of every aircraft in his fleet before he gave up control of
15 the CRS.

16 Now there's a lesson there, and the lesson is, the
17 aircraft can come and go. You can lease them, et cetera. But
18 the CRS is the controlling mechanism. It is the information
19 technology mechanism that moves passengers, revenue, capacity. I
20 don't think that needs to be lost, the airlines and the linkage
21 between airlines and information technology.

22 Back to the biased and unbiased. Technology is
23 nothing but a physical item. It cannot have a bias. But people
24 that create the technology, that program technology, that try to
25 gain maximum yield from the technology, do bias them.

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1 Anytime you write code, you are writing something
2 in there. Something is going to show up on top, whether randomly
3 generated or not. Someone's ad is going to be shown during prime
4 time. There's no such thing as unbiased technology. If you want
5 to debate this, I will be more than happy to do it, but I think
6 this is a really critical point. Anytime someone says this is
7 unbiased, immediately a red flag goes up in my mind because they
8 are trying to make a point that cannot be made.

9 When you talk about airline cost, and most of this
10 you have heard and read in previous testimony, high fixed costs.

11 Fuel, not much you can do about that. For airlines, you can
12 hedge it. Labor costs, you know, I pray for anyone who has to
13 deal with labor union organization and contract negotiations for
14 these companies. Fixed cost of aircraft, aircraft leases, direct
15 purchases.

16 The only other top four costs that airlines have an
17 ability to play with, thanks to the technology, is their
18 distribution. Because of that, that is where you see the
19 shifting change and movement from the traditional sense, a little
20 bit before deregulation, travel agent outlet to the Web.

21 Now let me talk a little bit about this switch to
22 web-based ticket distribution, and let me mention or highlight
23 something that other people mentioned with the call centers. I
24 have done some extensive call center research. I have been in
25 them. I have visited with them. I have talked to the

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1 reservation agents. I have talked to the reservation directors.

2 I have talked to the executives of many of these airlines who
3 run their centers.

4 Reservation centers and travel agents cost
5 approximately the same amount to distribute a ticket, the average
6 being between \$8 and \$10. Now the reason why the reservation
7 centers exist, besides the historical precedent of moving them
8 through there, is because travel agents are mostly 8:00 to 5:00.

9 Whenever a consumer, a customer on the airline, is
10 in trouble after 5:00 p.m., most of the time they cannot call
11 their travel agent at home. The CRS is probably not at home. So
12 the consumer needs access. It is this access that is the reason
13 why a lot of the res. centers are in existence, and most of the
14 airlines did not see them as competing forces.

15 Now when it came to the Web, this is a competing
16 force to travel agents because of the savings. The number that I
17 have heard repeatedly is between \$1 and \$2. If you compare that
18 to the \$8 to \$10, you are looking at 80 percent savings in
19 distribution cost. I don't care if you put it on the cost side
20 or the revenue side, it's the bottom line for the airline.
21 They're saving a big chunk of money.

22 Now the question is, why have they moved to web
23 ticketing? I would argue that, No. 1, it is the cheapest cost of
24 doing it. I have heard people say it's not, back and forth. It
25 is the lowest cost, because you have one fixed cost, developing

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1 the technology, and then you spread that existing technology over
2 all the bookings. As the bookings increase on the Web, there is
3 a decrease in cost per the technology implemented. That is the
4 main way they have gone and will continue to go.

5 I know briefly the "Tom Sawyer effect" was
6 mentioned, and let me mention that in brief. The reason why the
7 Web is cheap, besides spreading the cost of the technology, is
8 labor is the No. 1 cost of moving tickets.

9 Travel agencies, I know the number 50 percent was
10 reduced to 30. I believe 50 percent is probably right. People
11 cost money. Reservation agents cost money.

12 It is easy to run IT lines. It is easy to get
13 terminals in there. With the deregulation of the phone industry,
14 it is easy to afford long distance. It is the recurring cost of
15 labor that drives up ticket distribution costs in res. centers
16 and in the travel agency.

17 What the Web has allowed is that now the consumer
18 -- I'll actually play the consumer, not for arrogance purposes,
19 but just to give a demonstration. I'm at home. I go to Dell and
20 I pay \$1,000 or \$2,000 for my computer. I pay a recurring fee of
21 \$20 for my ISP to connect at home.

22 I come home from work. I want to book a ticket.
23 I've already paid the \$2,000. I've already paid the \$20 a month.

24 Now I sit down on my own time, log on, and spend whether it is
25 four minutes because you are fast or thirty minutes of my own

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1 time doing what a travel agent or a reservation agent used to do
2 in the past.

3 This is what I call the "Tom Sawyer effect" because
4 Tom Sawyer in the book by Mark Twain was sophisticated enough in
5 marketing to say, "This is fun. This is exciting. This is new.
6 Go paint the fence for me. Surely you have the skills." And
7 effective companies have used this very efficiently to move a
8 large segment of the population.

9 Is this a bad thing? No, as long as it is one of
10 many other distribution channels in existence. That is the "Tom
11 Sawyer effect" in a nutshell.

12 Let me talk about Orbitz. I know a lot of people
13 wanted to stay away from it, but considering information
14 technology and airlines cannot be delinked, I think it is
15 critical to keep Orbitz in the picture, for the primary reason
16 that you have five major hub airlines coming together to join in
17 a distribution channel.

18 The statement alone sends off a red flag to me.
19 Why? They have travel agents. They have second-party
20 Travelocity and Expedia. They have their own web distribution
21 channel. Why would five major airlines spend money on a losing
22 company to date to distribute tickets in a manner that other
23 people have done already? They have multiple channels.

24 It seems to me that it is a strange spending of
25 capital to duplicate activities that currently exist. That is

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1 why I think Orbitz should raise some red flags.

2 Let me tell you some things that Orbitz is. One,
3 it is a late attempt to get into the IPO market. Clearly, when
4 it came online, the IPO market was just declining. They were
5 late. They could have gone early. They could have grown
6 capital. Most of that has fizzled out. Less expensive means to
7 move tickets on the Web, once again the "Tom Sawyer effect"
8 coming into play.

9 Let me skip over here. No. 3, Orbitz is also a
10 means of consumer data collection. Let me explain to you what I
11 mean by that.

12 If I am a customer and I go to a website, I enter
13 my name, my address, credit card number, destination -- very few
14 fields to be entered. Airlines collect that data and say, all
15 right, we know that John Doe over here, David Butler flies from
16 point A to point B through this route and pays this much money.
17 That data is not shared with any other airline. It belongs just
18 to that one airline, Northwest, whoever, through their own
19 website.

20 Going through a GDS, every member of that GDS has
21 equal access to share that same data. That is where yield
22 management comes in. That is where you can say, all right, I
23 know Airline X is charging this for this segment; I know how I
24 should price to keep competitive in that market.

25 Orbitz does the same thing for the Big Five. They

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1 already have it with GDS. Orbitz allows them to do it more
2 efficiently with newer technologies.

3 I would also argue that Orbitz allows the premium
4 pricing philosophy to kick in at a higher rate because, once
5 again, the data collected of the Big Five are shared with each
6 other. With that in mind, you can premium price up as high as
7 possible.

8 It is clearly competition for Travelocity and
9 Expedia, one more venue to distribute tickets and access more
10 people as more people are moving online and traveling. And I
11 would also argue it is a means of airline owners to take control
12 of the distribution channel. It is something that they own.
13 Airlines own the product, which happens to be a ticket or a seat
14 in an aircraft, and this is their means of reclaiming control of
15 part of that channel.

16 Let me briefly, once again, talk about or briefly
17 highlight a quote from this book, "Blown to Bits," to give you
18 the concept of information technologies in the airlines. It
19 says, "The greater their penetration, the greater their
20 competitive advantage. In many contexts this has resulted in
21 room for only one standard worldwide. Whoever owns that
22 standard, even if only in the most indirect ways, has the
23 opportunity to extract enormous value."

24 It is this philosophy by the Boston Consulting
25 Group, the same group that was hired by these major five

1 airlines. Even though they have their own technical capacity
2 internally, even though they have their own GDS representation,
3 they hired this group to set up Orbitz.

4 So my question is, how does this philosophy of this
5 group interact with Orbitz? I think it is direct. It creates a
6 strong incentive to invest in creating such a standard which I
7 believe Orbitz is on the way to setting and to ally with others
8 to increase the chance of acceptance, and to give away 99 percent
9 of a priority content to capitalize on the advantage. In a
10 sense, this is the philosophy underpinning Orbitz.

11 We can also reflect on the recent DOT report. I
12 guess it was out a week or two ago. In a sense, it is a great
13 review, but it comes to zero conclusions except we're going to
14 wait. We're going to wait on DOJ. Politically, that may be a
15 very wise move, to stop and say, "We don't want to make a
16 decision when DOJ may question our findings or overturn what we
17 have to say."

18 However, I would also argue there's something else
19 in there, and that is, DOT, based on my interviews with many of
20 the people over there, are spread thin. The capacity of them to
21 investigate many of these leading-edge technologies is very
22 difficult because they don't have the person power, the
23 knowledge, or the expertise to fully investigate many of these
24 new technologies that are emerging.

25 To get information on Orbitz or Travelocity or

1 Expedia, they have to go to the source. They have to go to each
2 one of these and ask the engineers, scientists, managers, policy
3 people, "How does this work?" Of course these people say, "It
4 works great. It's unbiased. There are no problems with it."

5 Unless there is a way that DOT or the DOJ can bring
6 in their own people that have the level of expertise as the
7 people creating this, it is very difficult to have an oversight
8 or an excellent insight into the investigative process of what
9 these technologies actually are and what they are intended to do.

10 In the ideal world, all airlines would be a
11 monopoly because that is the ideal world for any given company.
12 I would want monopoly control if I was a CEO of a major
13 corporation, because you extract as much money value out of the
14 economy as possible.

15 The ideal world for the consumer, and I understand
16 the consumer is the focus here, is as many parties competing head
17 to head for their dollar. The problem is these are antithetical
18 to one another. One is, let's come together and have one or
19 multiple people; the other one is, we want as many as possible.

20 The question is, what is the reality, given these
21 two hypotheticals? The reality is the airlines are still
22 undergoing a consolidation process from deregulation. We have
23 five majors and a few smaller, and it looks, after September
24 11th, we are going to have further consolidations. Most of the
25 consolidation is probably going to come from bankruptcies and

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1 purchasing for pennies on the dollar, and you don't have to worry
2 about labor union contracts.

3 Most of the ones that will survive this
4 consolidation process also happen to be the ones that are
5 invested in Orbitz. Is this competitive? Well, with the market
6 shrinking, with the number of players, the number of airlines,
7 this is not the best scenario for consumers.

8 Once again, the best scenario for consumers would
9 be to have 10, 20 airlines competing. You don't want just a Wal-
10 Mart; you want a Wal-Mart and a K-Mart and a grocery store and
11 whatever other establishment you have out there. You want
12 multiple suppliers, and suppliers right now are shrinking.

13 Likewise, airlines have realized, since roughly
14 about 1985 a little bit on, with the price wars, if you remember
15 those, where each one was bidding up or bidding down the prices
16 of certain routes. Airlines learned quickly that this was not an
17 ideal world for them.

18 If one airline would say, "We have a fare for
19 \$200," the other one comes in at \$190, and if someone else drops
20 it to \$170, pretty soon they all have high load factors and they
21 are all losing money.

22 The reality there is, let's don't do this or we are
23 going to go bankrupt. So a lot of them have entrenched back to
24 their hubs, and this level of competition has been much slower
25 since then.

1 So where are people positioning themselves now?
2 For the foreseeable future, once again, we are going towards a
3 level of consolidation. I'm guessing, based on most of other
4 industry sectors, we will probably end up with three major
5 airlines, plus Southwest, a few of the other startups; jetBlue
6 we're still unclear of to this point.

7 I believe airlines will continue to consolidate
8 their sales and ticket distribution system, mostly through the
9 Web, but also through other avenues as much as possible. I
10 believe there is a strategic plan to move away from the GDSs.

11 Let me tell you why I think that. Before airlines
12 cut revenue, before airlines cut commissions to travel agents,
13 they broadcast this for several years. You have a level of
14 complaints that came out.

15 Interestingly, reading the testimony of the
16 airlines, there were a lot of complaints about GDS fees. "GDS is
17 too high. It can't make us have a profit." Very funny that they
18 actually owned them just a few years ago in a large capacity.

19 But they are doing the same broadcasting. I think
20 there is going to be a fundamental shift away from GDS ownership,
21 of what's left of it, and a shift, I think it is going to shift
22 towards an Orbitz-like GDS system that exists.

23 Let me go ahead and skip over here to the travel
24 agent, and then I will conclude. The travel agent industry
25 collectively has made some very poor decisions in the past, and I

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1 mean historically meaning since the 1940s onward.

2 There was an attempt to do a joint consolidated
3 equivalent of a computer reservation system early on when the
4 technology was maturing throughout the fifties. Interestingly,
5 some of the initial studies and starts were by travel agents
6 themselves. Most of these were talked out of by airlines,
7 interestingly enough, to abandon these technologies and go to
8 other means or to let the airlines do it, since they had better
9 capacity; they had better people and more understanding of the
10 technology.

11 Likewise, when the CRSs did come online, travel
12 agents were given the option to buy into the system. They opted
13 not to. There was a chance they could have been getting some
14 revenue stream from that.

15 Likewise, finally, with the Web coming online, many
16 of these companies that were just routing tickets directly to
17 consumers have been undercut or bypassed. Because they don't own
18 the product, being the airline seat, this puts them at a horrible
19 disadvantage because, as soon as you move from, as a distribution
20 channel, basically, a conduit to that conduit being rerouted, you
21 are left with nothing. Once again, they strategically positioned
22 themselves in a bad way.

23 It is a "Brave New World" for these airline
24 companies. As different people model, we are going to have
25 increase, decrease, whatever consolidation. I think it is going

1 to consolidate much faster than a lot of people expect.

2 I think there are opportunities for the travel
3 agency industry to make some decisions, mostly in terms of
4 collecting the information themselves. With the new security
5 requirements that are going to be coming down, there's also
6 opportunities there to position themselves as a value-added
7 strategic leverage point between the consumer and the airline.
8 But that is a decision that the agencies will have to make
9 collectively to put themselves into that value chain.

10 The ideal world for the consumer, once again, is
11 multiple options. Right now the best option being offered is
12 Southwest coming into a market. If Southwest enters a market
13 that a hub airline has, prices fall because there's competition.

14 Most airlines cannot run Southwest Airlines out of
15 the market because Southwest has grown so big and such deep
16 pockets, that is not a strategy they can employ successfully
17 long-term and continue their revenue. So right now the Southwest
18 model is the ideal model for consumers in the marketplace. If
19 there is a strategic disadvantage built into an Orbitz system or
20 similar system to disadvantage Southwest, I think the consumers
21 would be hurt significantly.

22 Recommendations: Please do not delink information
23 technologies, telecommunications, information collection from the
24 airlines and their practices. These are seamless entities. They
25 are one. The airlines cannot exist without these technologies.

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1 As much as you would sit there and delink the information
2 technologies from any financial sector.

3 Two, airlines, because they are in the business of
4 making money, as they should be, will use these technologies to
5 the maximum advantage they can. Whether it is CRSs, their own
6 websites, Orbitz, they will leverage as much out of these as
7 possible, and they should. That is what they are in the business
8 to do. However, it brings up some interesting problems when you
9 have many of them coming together trying to leverage it for the
10 same purpose.

11 Last, an analogy, imperfect I know, but one that
12 has to be considered: People ask, "Are there any parallel
13 industries, any parallel examples going on?" The closest example
14 I can find is Microsoft. Microsoft is the technology leader. It
15 owns a large percentage of the market, as do the five major
16 airlines that are interacting with Orbitz.

17 When Microsoft introduces a new product, it doesn't
18 go before all of the other software writers. It doesn't go
19 before the distribution channels and say, "By the way, do you
20 have any ideas? We're about to do something." They say, "Here's
21 the new product. We're launching it. If you want to stay in
22 business, you write to this code. If not, you're out of the
23 market."

24 Likewise, whenever airlines make changes, they go
25 to the travel agents and say, "By the way, this is your

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1 commission level." It happens to be zero now. "This is your
2 override amount. You must sign an ARC contract." And if anyone
3 has ever read an ARC contract, by the way, I find that to be one
4 of the most prohibitive contracts I have ever read. Then they
5 say, "You have to sign a lease with this CRS, and this is the way
6 you'll channel it, and if not, you're out of luck."

7 If the remedy for Microsoft is some form of
8 oversight, breaking up, separating its functions, components, the
9 question becomes, is the similar remedy for airlines coming
10 together, using and leveraging the information technologies to
11 their advantage, to break up the potential of these entities
12 coming together in a similar format? I would argue, if it is
13 shown that they are, then, clearly, that is what would be in the
14 best interest of the consumer.

15 Thank you very much. I am happy to take any
16 questions.

17 CHAIRMAN WINSTEAD: David, thanks again for coming
18 all the way up here and sharing with us your dissertation,
19 research, and testimony.

20 I just had one question, and know there are a
21 couple of others. On page 11, you comment on exactly how do you
22 think the airlines share data on pricing and maximizing yields
23 through Orbitz. If you could just comment a little bit more on
24 that?

25 DR. BUTLER: The ideal world for any company is to

1 know their consumer inside and out. They want to know their
2 likes, their dislikes, what they are willing to pay for
3 something. They want to know everything. Their information
4 collection tool, that is yield management. They want to know
5 everything about someone, so they can price the ticket as high as
6 possible to make the best profit possible. That is what every
7 company should do.

8 Right now GDSs allow that to a certain extent to
9 GDS owners, but you must be a GDS owner. The ATPC code allows if
10 you are a certain level. Orbitz I believe allows the same
11 capacity.

12 One of the problems is, once again, with the DOT
13 issue is technical capacity of the people who are investigating
14 it. Second of all, we don't know exactly what is in Orbitz
15 because there has been an oversight function going on.

16 The analogy I use in there is, you know, you are
17 driving down the road and there's a cop there. You're not going
18 to speed. The cop pulls off. The people start accelerating.

19 Is there an oversight needed to make sure Orbitz is
20 not turned into a vast colluding virtual mega-airline where this
21 information is shared amongst a group of airlines that have 80
22 percent market capacity.

23 Does that answer your question?

24 CHAIRMAN WINSTEAD: Yes.

25 DR. BUTLER: Okay.

1 CHAIRMAN WINSTEAD: I think, Paul, you've got a
2 question for him?

3 MR. RUDEN: Yes, now that you mention colluding.

4 CHAIRMAN WINSTEAD: Or, Maryles, do you have one?
5 I saw Maryles' hand.

6 MS. CASTO: I just wanted to clarify something.
7 You had quoted, I think on page 18, what you call a scenario
8 emerging as an attempt at the legal consolidation of these large
9 top carriers. Are you alluding that the airlines are colluding,
10 that they are actively acting in an anticompetitive manner? Is
11 that what you are trying to say?

12 DR. BUTLER: What I am saying is, No. 1, if I was a
13 CEO of a company -- and understand I have had discussions with
14 colleagues, and some of them say airlines can't see past two
15 weeks. I'm giving them the benefit --

16 MS. CASTO: What do you mean?

17 DR. BUTLER: Meaning that their vision, their
18 strategic vision, is not beyond the following quarter. I give
19 them the benefit of the doubt. If I was a CEO of a company, of
20 an airline, I would maximize the use of the technologies
21 available.

22 It is very difficult to make money in the airline
23 industry. The model, because of the hub-and-spoke network, you
24 must move massive amounts of people at the highest level
25 possible, and then sometimes you make great profits, and then you

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1 go through years that it is really rough.

2 To try to maximize the revenue, to maximize your
3 profits, you want to leverage the technology the best possible.
4 Now one way of doing that is collecting as much information on
5 people as possible, building that into the algorithm for the
6 pricing plan.

7 Would airlines comes together to make sure that
8 their pricing is in line with each other? I think history has
9 shown, yes, they have done that. They will leverage that
10 technology. Are they doing it now? Probably not because people
11 are watching them. Does that mean there is a space or an
12 opportunity for someone to go in and look at, investigate, have
13 some oversight on the potential of this occurring? I think so.

14 Am I now saying this is an oligopoly and they're
15 acting in that manner? No, but there is the potential, and the
16 history does show it. The strategic vision of a CEO would be to
17 leverage as much from each airline -- each airline would leverage
18 this as much as possible.

19 So I think the logic holds. I think that would be
20 a path a lot of them would seek, not illegally, but they would
21 push it to the limit as much as possible. Sometimes they do step
22 over it.

23 Does that answer your question?

24 MS. CASTO: Yes. Thank you.

25 DR. BUTLER: Okay.

1 CHAIRMAN WINSTEAD: Anybody on the left here?

2 (No response.)

3 All right, Paul?

4 MR. RUDEN: I guess it falls to the center.

5 CHAIRMAN WINSTEAD: Well, to the right of center.

6 MR. RUDEN: Yes, yes,

7 (Laughter.)

8 You said, as I understood it, that Orbitz was about
9 premium pricing. Could you explain what you mean by that?
10 Because Orbitz says they're about low prices, that the airlines
11 really want to drive prices to the lowest possible levels.

12 DR. BUTLER: The first question I would ask is, why
13 -- the only rationale to drive prices to the lowest level is to
14 do a Wal-Mart pricing discount strategy, which is you lower the
15 prices so much, the demand soars so much, that you end up earning
16 money with economies of scale.

17 MR. RUDEN: Now they're not earning any money?

18 DR. BUTLER: Orbitz is not earning any money.
19 Likewise, the hub-and-spoke network is not designed with the
20 premium pricing philosophy in place to have that. It is yield
21 management, which means you get as much as possible from each
22 seat. But you can put a discount label on anything and try to
23 sell it.

24 MR. RUDEN: I understand yield management. I am
25 trying to understand your statement that Orbitz was about premium

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1 pricing. I just want to understand it. How is that so? Because
2 they say the opposite, "they" being the five owners and the other
3 folks who participate.

4 DR. BUTLER: Any information collection technology,
5 be it GDS or an Orbitz/GDS, whatever new incarnation comes about,
6 will be an information collection tool for the airlines to
7 premium price. They can call it whatever they want. They can
8 call it best pricing, discount pricing, lowest pricing. That's a
9 marketing opportunity for them.

10 Maybe right now they are holding the prices down.
11 Right now there are multiple suppliers out there, but the
12 technology enables them to premium price on their routes.

13 MR. RUDEN: Are you saying that -- they invested
14 \$200 million, according to their SEC statement, the five owners,
15 \$200 million in this thing, of which \$153 million has so far been
16 lost; the statement, the SEC statement, says they have no
17 expectation of profits in the foreseeable future -- that they are
18 doing that for the purpose of collecting customer data about who
19 uses the Internet?

20 DR. BUTLER: I think they will do it as one means
21 of collecting customer data. I think the value of Orbitz is more
22 than just as a ticket distribution mechanism. If they wanted a
23 ticket distribution mechanism, they could have taken the
24 Travelocity/Expedia model and created a system far more
25 inexpensively than they are. And I am assuming the airlines are

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1 wise enough not to throw money down the trash, considering how
2 hard it is to generate a profit in the arena they are in right
3 now.

4 MR. RUDEN: An interesting assumption.

5 One other line of questions and I am done,
6 shockingly, I know. On page 6 of your testimony you talk about
7 this bias idea that you opened with today. You say that some
8 airline is going to be listed at the top of the screen. I guess
9 we would all agree that is true, but are you saying that the CRS
10 displays, as they operate today, are biased?

11 DR. BUTLER: Yes.

12 MR. RUDEN: Could you explain that?

13 DR. BUTLER: Decisions have to be made anytime
14 information is displayed. Whether it is font size, whether it is
15 the number, whether it is a type of random number generator you
16 assign to each flight listing, whether it is each segment,
17 whether you list by price, by alphabet, by color, a decision has
18 to be made. There is a bias built in. The best you can do is
19 minimize that bias on any technology.

20 MR. RUDEN: Well, I don't want to debate it, but
21 the government has said, and I think at this point history,
22 everybody I know has accepted, that the CRS displays are not
23 biased in the sense that they prefer the carrier owners or
24 investors or partners or marketing pals, whatever the term is.
25 They don't favor them. They are in that sense neutral, and that

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1 is what the goal of the regulations was.

2 Are you disputing that that has been achieved?

3 DR. BUTLER: I would argue that, prior to the
4 rules, there was clearly screen bias display.

5 MR. RUDEN: No question.

6 DR. BUTLER: There was prioritized display, whether
7 it is time slot allocation -- all those things were definitely
8 being leveraged effectively by airlines until the regulation.

9 However, since then, it is more neutral in the
10 sense that the probability of any one airline coming up may be
11 equal. So the bias or the potential bias that is in there is
12 spread evenly across to where everyone is happy.

13 Now so in terms of the definition of bias you were
14 using previously -- I understand that is what we are talking
15 about here -- is it legally biased, meaning one is getting a
16 larger value? Probably not. Is there a bias in the system
17 inherently? Yes, and that is the opening that anyone can do or
18 leverage at any time if there is not an oversight function,
19 because it is inherently built in, or can be with code taken out
20 and new code put in, an algorithm put on top or in back of
21 something else.

22 MR. RUDEN: All right, and then just to close this
23 up, because this is a subject of debate in the industry of some
24 importance, you say someone's banner will be run as an ad. Of
25 course, that is, I guess, a truth also. Someone buys an ad; they

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1 get a banner, and it appears. People look at it and say,
2 "There's an advertisement."

3 You would agree most people would figure somebody
4 paid for that thing in one way or another? Is that bias or is
5 that not just an effort of a commercial party in an open
6 marketplace who purchased exposure?

7 DR. BUTLER: Okay, if we are running a banner --
8 say I'm on Travelocity. I type in point destination, and all of
9 a sudden American Airlines comes up with the first listed fare,
10 and all of a sudden there's an American banner right above it.
11 Right below it there is a Delta flight, the same price. Is that
12 going to bias me toward American? Maybe so. Is that an accident
13 that that occurred? It depends on how it is programmed in.

14 Should we build in an anti-bias to where anytime
15 the top listed fare cannot run a banner with it? Well, that is
16 also biasing it as well because the probability is you are going
17 to have a banner with a given airline show up a certain number of
18 times.

19 Once again, back to my argument: There is bias
20 built into it. Someone is going to be listed first. You're
21 going to have an ad running. You're going to have overlap there.

22 MR. RUDEN: That kind of bias that says, if you
23 want to call it -- I don't think that is bias. But someone buys
24 an ad that is supposed to pop up whenever their flights appear
25 first. Let's suppose that the flights appearing first is not

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1 biased. That is a function of the request you made and a neutral
2 algorithm.

3 DR. BUTLER: Okay.

4 MR. RUDEN: Is that somehow antithetical to an
5 open, competitive market environment or is that just, you know,
6 what happens when people compete? They are always seeking brand
7 identification, reinforcement of the purchase. They want people
8 to buy them. So there is a device they use that they paid for,
9 and it is open. Everybody can see it. There is no mystery about
10 it. It is not buried in some algorithm. It goes up in front of
11 their face. Is that what you call bias?

12 DR. BUTLER: No, I consider that advertising.

13 MR. RUDEN: Okay.

14 DR. BUTLER: However, if they do mask it as a fare
15 and if they do treat it as something other than advertisement to
16 potentially sway a consumer a different direction -- so if there
17 is a pop-up ad that says, you know, "You've got an error. Click
18 here," I think there is an inherent problem with that.

19 MR. RUDEN: Well, my last question, I promise.

20 (Laughter.)

21 The day's long.

22 When I go on The Washington Post, which I do every
23 day -- I save the nation paper by reading The Post online -- and
24 these very annoying pop-up ads appear on behalf of my cell phone
25 company and various other purveyors -- one is from the diamond

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1 company which actually sends this thing floating over the stuff
2 you want to look at, and then it moves off the screen, so you
3 have to sit and wait until it gets out of your way before you can
4 read. Somebody thinks that's a good idea.

5 Does The Washington Post cite bias as a result of
6 that, in the terminology you are using, or is this not --

7 DR. BUTLER: No.

8 MR. RUDEN: -- just a bad judgment about how to
9 sell ads?

10 DR. BUTLER: No, actually, it is a good judgment
11 because they are making revenue off that. Your judgment as a
12 consumer is to go out and buy the software that filters this out.

13 MR. RUDEN: Yes, okay. Thank you very much.

14 CHAIRMAN WINSTEAD: Tom, you had something?

15 MR. DUNNE: I've got a couple of questions here.
16 If you will look at page 11, item 3, at the bottom, it says, "a
17 tool that allows each of the five airline owners to share data on
18 pricing to maximize yield management?" Would you give me an
19 example of that?

20 DR. BUTLER: That is if Northwest prices a flight
21 on any given segment at \$300 and Delta has access to that same
22 information, as does American and the other owners, they can look
23 at that information and, I would assume, have built into it some
24 form of trigger mechanism that alerts them to price changes and
25 allows them to adjust their prices accordingly.

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1 MR. DUNNE: Well, if that is the case, then how
2 does Southwest get their information?

3 DR. BUTLER: They go out, I assume, and do market
4 analysis of a given area and say, what can be sustained in this
5 market at this price, and choose to run the right number of
6 aircraft that would be filled at whatever their capacity would be
7 to make a profit.

8 MR. DUNNE: So they're not being leaked any
9 information? They are just doing market analysis? So if the
10 other five did market analysis, they could be doing the same
11 thing, right?

12 DR. BUTLER: Right, but market analysis that way is
13 more expensive and more difficult to do than is having your
14 competitive release a fare and your information being triggered
15 immediately to respond in kind. It is a very easy and efficient
16 way of gathering information.

17 MR. DUNNE: But my point is, it doesn't seem like
18 Southwest worries about that. They just go ahead and make their
19 prices and go on with it.

20 DR. BUTLER: That's right. It is a different
21 philosophy altogether.

22 MR. DUNNE: So I guess they're really not
23 maximizing their management yield then, are they, the airlines,
24 by doing what they are doing? Because somebody is beating them
25 continually.

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1 DR. BUTLER: They are making their money by flying
2 more people, more planes, more efficiently than any other
3 competitor on a given route could.

4 MR. DUNNE: But I guess my point is, what I am
5 saying is, the airlines, by getting together with Orbitz and
6 making this monster that they have made, are not really gaining
7 anything?

8 DR. BUTLER: Yes, they are, because right now they
9 don't have to guess what the competition is going to put out
10 there.

11 MR. DUNNE: But, then again, they are still getting
12 beat by somebody else in competition, correct?

13 DR. BUTLER: On a given route, potentially, yes.

14 MR. DUNNE: Okay, that's my question. Okay.

15 The second part, "Airlines have used a GDS
16 technology for this type of price signaling in the past (See
17 DOJ)" -- I am assuming that is the Department of Justice.

18 DR. BUTLER: Right.

19 MR. DUNNE: Has there been something filed against
20 Orbitz?

21 DR. BUTLER: No, this is the past price colluding
22 that the Justice filed; I believe the airlines settled out. That
23 is what I was referencing to, that the airlines in the past have
24 shown that they do price signaling to each other through some of
25 the GDSs.

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1 MR. DUNNE: Through the GDSs?

2 DR. BUTLER: Correct.

3 MR. DUNNE: So now we've got the GDSs involved with
4 Orbitz, too?

5 DR. BUTLER: No.

6 MR. DUNNE: They're not involved with Orbitz?

7 DR. BUTLER: There is a GDS behind the Orbitz
8 architecture at present.

9 MR. DUNNE: But this DOJ was part of another
10 particular case at the time when the airlines were getting
11 together, is that correct?

12 DR. BUTLER: This is the time when airlines were
13 accused of price signaling.

14 MR. DUNNE: Okay. So what you're saying, that they
15 pricing signaling today? What is the signal today? Just putting
16 it on there and the other one reads it?

17 DR. BUTLER: What I am saying is the technologies
18 that are evolving are sophisticated that enable price signaling
19 to occur more seamlessly, and potentially in a way that is harder
20 to detect than has been the case with current GDSs. I am not
21 saying they are doing it now. There is the potential to do that.

22 MR. DUNNE: I agree with that. There is the
23 potential to do a lot of things, but, I mean, I am saying that
24 you used pretty strong statements here about maximizing their
25 yield on management and doing such things, and, yet, in fact,

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1 they are getting beaten in competition. That is all I am getting
2 at. It doesn't make --

3 DR. BUTLER: On certain routes they are being
4 beaten, but --

5 MR. DUNNE: But they are still getting beaten?

6 DR. BUTLER: On certain routes by one airline.
7 Then the question is, how come one hub airline is not competing
8 directly with the other hub airline? Why is it Southwest that
9 has to be the competition that is coming in on a given route?

10 MR. DUNNE: Thank you.

11 CHAIRMAN WINSTEAD: Are there any other questions?

12 DR. MITCHELL: I expect that David would like for
13 me to clarify that, though we both live in Mississippi, I did not
14 meet him until today. He is a newcomer to the University of
15 Southern Mississippi, which is five hours south of the University
16 where I live.

17 MR. ROPER: You can tell by your two different
18 accents.

19 (Laughter.)

20 CHAIRMAN WINSTEAD: David, thank you very much. I
21 appreciate you coming all the way, and I thank you for both the
22 written testimony and the Q&A, and if we have any other
23 questions, we will get back to you.

24 DR. BUTLER: Great.

25 CHAIRMAN WINSTEAD: Thank you very much for

1 traveling up.

2 I don't believe, unless there are any issues or
3 statements by the Commissioners -- we have a little work ahead of
4 us, but, Ted, go ahead.

5 MR. LAWSON: The only thing is Worldspan is the
6 power or search engine behind Orbitz.

7 DR. BUTLER: That's correct.

8 MR. LAWSON: Orbitz really is not a new GDS system.

9 DR. BUTLER: No, but there is -- reading the Orbitz
10 testimony, there is indication that they are moving in that
11 direction.

12 MR. LAWSON: They've moved off of that. I've got a
13 letter -- I think the other Commissioners may have received that
14 letter -- that Orbitz, as I suspected, moved off of that
15 position. They do not visualize themselves as a GDS system now.
16 In fact, they will stay with --

17 DR. BUTLER: If I may say, I think that reinforces
18 the point of why oversight, when you start investigating, digging
19 beneath the layers, people start backing off a given position
20 that was clearly thought through before it was given to the test.

21 MR. RUDEN: There is some disagreement here about
22 what that letter says.

23 CHAIRMAN WINSTEAD: Well, we have a copy of the
24 letter, and we will make sure that it gets in the record. We
25 will provide you a copy of it as well.

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1 Any other comments? I can see Gerry is finished.

2 Before we conclude, I will say that, you know, we
3 have had four now, I think, very informative hearings. We thank
4 you all for participating.

5 There are a couple of people. I mentioned,
6 obviously, Dick and Tillie and Bill and Dorothea, but also Joan
7 Feldman, who is with us and is doing a lot of work with us, and
8 will continue to over the next three or four months.

9 Please, the offices are going to be open. We've
10 got fax, e-mail. We are going to have a website up, Dick tells
11 me. We will be there tomorrow. So if there is any additional
12 input, please let us know.

13 We thank you again for all your input. We will be
14 doing a lot of work over the next three months. Thank you very
15 much.

16 (Whereupon, the foregoing matter went off the
17 record at 4:55 p.m.)