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Choice in the Airline Industry

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On behalf of American Express, I would like to thank you for asking me here today, and for the opportunity to address the critical issues that Secretary Mineta has asked this commission to examine. We commend the Secretary and Congress for creating this forum, and we would like to recognize the members of the commission for the time and effort that they are devoting to these very important issues.

American Express is a fortune 100 global services company with a diverse portfolio of products and services. We operate the world's largest travel management company, and as such, are typically known for working with some of the world's largest multinational corporations. However, American Express also specializes in servicing a number of other customer segments, including over 5,000 small businesses with less than 100 employees and travelers. In addition, we have a wide-ranging global franchise network composed of hundreds of small, independently owned travel agencies and we operate an extensive network of consumer-oriented leisure travel locations. And so, we are here today to lend our perspective to the issues at hand from the vantage point of a large multinational corporation who provides travel management services to small businesses and individuals.

To begin, it may be helpful if I tell you who we are not. We are not a GDS, we are not an airline or airline website owner, we are not an association and we are not

a small business. You have heard from each one of these industry partners in previous hearings, and they have all presented their own points of view, some of which American Express agrees with, and some which it does not. Our intent is not to come here today and engage in what the media has called the “Washington food fight” to put Orbitz out of business, or to squelch the benefits of the internet to the consumer. Quite the contrary; American Express welcomes fair and equitable competition where there is clear consumer benefit.

Our intent in being here today is to convey our thoughts regarding the travel agency financial condition and the question of consumer choice. We also are here today to ask for two things: we want the ability to offer all airline inventory and fares to our business and leisure travelers in an efficient and meaningful way and we want the existing DOT GDS rules be applied to any airline owned distribution system.

The industry is abuzz with talk of distribution cost elimination. From commission cuts to airline performance incentives to the notion of airlines’ subsidizing credit card service fees, no one, certainly not American Express, disagrees that distribution cost elimination is a bad thing. By now, you have heard many points of view regarding agency compensation elimination and reductions that impact agency financials. The recently eliminated airline commissions were payments for ticket issuance, exchanges, voids and refunds as laid out in the ARC and IATA regulations. Nothing more. So, with the transferring of the commission cost

to the customer, the airlines now have a free ticket distribution system, and have been successful at getting their core product into the hands of over 70% of their customers at no cost. Let's be clear: that is not to say there is no cost associated with product distribution. There are associated marketing, promotion and sales costs, such as volume incentives to move share, similar to the distribution costs that are built into every other industry. However, as the entire industry strives to return to solvency by lowering costs, an imbalance has been created in terms of consumer choice when it comes to information and access to all inventory and fares.

Business and leisure travelers who choose to work with American Express cannot easily and efficiently get information and access to the lowest fares needed to run their businesses or to visit friends and family. Economy-conscious travelers must now book outside their preferred booking programs and locations, and book directly on an airline owned distribution system such as Orbitz if they are to be sure they have researched all avenues pertaining to lowest airfares. Because of this trend, agencies that have serviced individuals such as these in the past will see reduced or negative customer growth and their earnings will decline further. In turn, the number of agency locations will be reduced and the traveler will have fewer options when it comes to booking their travel. When the number of choices a consumer has is reduced, it is typical that the cost to the consumer rises.

In the past, American Express and other entities have made attempts to gain full inventory and airfare access for the consumer and there have been a number of different reactions from the airlines:

- ***Airline Position: Webfare access should not be an issue, as there is such limited inventory and it is very restricted.***
- Counterpoint: If that is the case, then opening full access to travel agencies and hence their customers will not erode revenues due to the low number of available seats.
- ***Airline Position: These fares are leisure fares, and do not fit the typical needs of business travelers.***
- Counterpoint: As we all know, today's financial pressures have forced business travelers to behave like leisure travelers, so access to these fares would be very helpful for small business travelers trying to lower their travel and entertainment costs.
- ***Airline Position: Certain fares cannot be offered through the GDS due to the high associated fees.***
- Counterpoint: On a recent price quote comparing the same itinerary between an airline website, Orbitz and through a GDS, the GDS fare was higher by \$98 than both the airline website and Orbitz. This difference is not solely attributable to the GDS fee.

The entire industry, including American Express, is struggling with how to help customers get access to and benefit from the lowest fares in the market.

American Express has and continues to work through a number of different proposals and options, and we will continue to do so on behalf of our customers until we have reached a meaningful resolution.

Technology solutions have been just one approach American Express has taken. It is a fallacy to believe that a technology patch is a viable long-term fare access solution. Indeed, an entire industry is being built and huge costs are being borne by agencies and customers around a problem that does not need to exist if only the airlines and airline website owners would give full airfare access. Costly technology fixes are not the solution, as the industry goal is to reduce cost, not to keep adding cost. Airlines can and do change the ability of these technology patches to access their information in the flip of a switch, and today's technology solution is obsolete tomorrow. On a second point regarding technology, there has been previous hearing testimony that the success of Orbitz is due to its superior search engine capabilities. Orbitz does have a good site, but its search engine technology is not unique and has been widely available to anyone on the market. It is also powered by an existing GDS that is familiar throughout the industry. American Express is of the opinion that it is not the search engine that makes ventures such as Orbitz successful, but rather that it has a protected position with respect to lowest fares.

From a financial perspective, while American Express is not a small business, we too have had some significant economic challenges in the recent past. Our

business was dramatically affected by the weakened economy in 2001 and by the events of September 11th. As a result, we saw a decline in revenues and volume by some 20-25%. In the fourth quarter of 2001, we downsized our work force by over 5,000 people, and we had to make some extremely hard decisions. In the end, our costs were brought into line with our lower sales volume, we stabilized our business, and are now on solid footing. However, this was not an easy process, and we continue to see an erosion of customers who are forced to book on sites that will not provide American Express with full access. This trend continues to provide extreme challenges to the industry, especially to the small agency or franchise owners that we work with.

Prior to commission elimination, over 70% of American Express revenues were derived from airline compensation, and less than 30% from customers. In only 2 years, this model has completely reversed and today the opposite is true. Because of the dramatic changes in airline compensation, American Express has had to derisk its business and quickly transition our entire travel unit through a new economic model and change our focus entirely. Today, the bulk of our revenues are derived from our paying customers, and as an agent for our customers, that is why we are here testifying today. We are faring well under this new model. But American Express had the ability to reengineer our business model as a result of our size and our customer and product mix. Our smaller competitors and our franchise partners did and do not have that luxury. According to the Airline Reporting Corporation, the number of retail travel

locations in the United States decreased by 14% in May 2002 year over year.

This trend will no doubt continue, and over time, it is inevitable that travel agencies without the large breadth and scope of a mega-agency and without the resources or ability to provide customers the lowest airfares in the marketplace will not survive.

American Express strongly believes that both small businesses and individual consumers are the backbone that creates the economic growth that powers and stabilizes the US economy. These groups contribute heavily to the economy and should have the ability to choose to do business how they please. Without widespread fair and meaningful inventory and airfare access, small businesses and consumers are ending up the losers as the benefits gained from consolidating, tracking and managing their total costs are diluted. Smaller travel agencies and franchisees seeking to reinvest in efficiencies to help their small business customers centralize and manage their spending will be forced to close their doors, and customers will have less choice of where to fulfill their business and personal travel needs in the near future.

With respect to airline marketing practices and their impact on consumer choice, the American Express point of view is very clear: Orbitz is an airline owned distribution system, marketing their services to individuals and businesses, and should be regulated by the existing GDS rules.

GDS rules were originally created to ensure there was fairness of pricing amongst all airline owned distribution systems, and to curb the possibility of anti-consumer behavior. In its beginning stages, Orbitz was marketed as a consumer travel agency with low, restricted airfares suitable for leisure travelers. Over time, Orbitz advanced its product offering to include hotels, cars, package tours and cruises. Most recently, Orbitz and its airline owners have begun marketing the fact that businesses can now load in their negotiated corporate airfares. Orbitz has evolved into an airline owned inventory distribution system, offering multiple products and services to both consumers and businesses, and should be governed and treated in the same manner as existing GDS'. Many have likened the Orbitz model to the following scenario: if the 5 largest computer manufacturers got together, created a vertical product distribution system, offered pricing through that system that other consumer outlets would not have access to, and loaded in all their proprietary customer pricing rates, there would be reason for concern. This does not appear to be the case when the same scenario is applied to the airlines and Orbitz.

One of the main questions the commission is trying to answer is, "Is the consumer impacted by not having the meaningful, comparative fare information they need to make an educated choice?" The answer as of today is yes. Small business owners and consumers looking to make a decision on airfare purchases are typically faced with the following questions:

- ***“If I book through an online or traditional agency, will they be able to get me the lowest fare, including internet fares?”***
- ***“If I book on Orbitz or another airline owned site, will I be getting information on all airlines and be able to make the best purchasing decision?”***
- ***“How many sites will I have to visit to find the best fare?”***

While each questions poses its own unique set of problems, the truth is that as of today the questions above are still valid. No existing airline-owned website has all domestic and international carriers and fares. Factually speaking, all GDS' do not either. However, GDS' are still the largest repository of neutral inventory and fare data in the world, and still used by virtually every travel agency and airline around the world except low cost carriers. GDS' include both domestic and international fares, and are thus the best source consumers have today of comparative information for making decisions when purchasing airline travel. So it appears that for now, GDS' are in the best interest of the consumer. But we are still faced with the argument of high GDS costs when compared to the airline owned distribution channel. If the main issue at hand to solving the fare access problem is GDS cost, then cost issues can always be solved by mutual business agreements that should not be a barrier to progress. However, if the main issue surrounding inventory and fare access is not cost, but rather customer ownership, traveler loyalty and marketing aspirations, then this issue is not easily solved and will continue to exist in our industry, and the

travel consumer will end up being negatively impacted in the long run as the industry works to find a solution.

The EU commission investigating OPODO, the European owned airline distribution system and website, have recognized that it poses serious risk to consumer choice should it not be fully consumer-proofed. I am optimistic that this committee can help the DOT come to the same conclusion regarding Orbitz.

So in closing, American Express believes that what is in the best interest of the traveling consumer is for travel agencies to be given full access to all airline inventory and fares, and that GDS rules be applied consistently and fairly to any airline owned inventory and fare distribution system.

I would like to thank each of you for this opportunity to speak here today, and I would be happy to answer any questions that you may have.