Statement of
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Before the
National Commission to Ensure Consumer Information and Choice
in the Airline Industry

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INTRODUCTION
Caldwell Associates is an independent travel management-consulting firm that works with corporations and other organizations to manage their business travel programs, both in the US and worldwide. My firm is independent of travel suppliers, including travel agencies, technology companies and GDS providers. I have actively represented business interests in the travel industry for the past 30 plus years.

I was Counsel to NBTA (then “NPTA”) during the CAB’s Competitive Marketing Investigation (“CMI”) at the time of airline deregulation. At that time, volume users supported deregulation of airlines and removal of prohibitions against volume discounting, commission sharing and travel agency licensing restraints.

I am presenting my statement before the Commission on my own initiative and the views are my own, not necessarily those of any particular client or other party in the industry. However, my perspective is based on many years of active consulting and legal practice representing the interests of purchasers of business travel.

I am conscious of and commend the important role of the Commission in examining the role of travel agencies in the new travel environment, and the related question of assuring open and fair access to airline pricing information via the Internet. Access to accurate, timely and unbiased travel information is vital for travel agencies and business purchasers, as well as individual consumers.

My practice tends to focus on larger users of business travel, with clients spending $1 million or more annually on airline purchases. These companies have a real stake in
access to all categories of pricing. This is especially important now as (1) business travel is struggling to return to a reasonable level post September 11, and (2) the line between so called “leisure” and “business” travel is increasingly blurred. Business travelers are more willing to accept the restrictions of “leisure” fares, and airlines relax some of those restrictions. The migration of business travelers to leisure fares is a direct result of substantial differences between corporate and leisure fares. For example, coach fares between Washington, DC and Dallas, TX range from a restricted fare of $386 to a full fare of $1740. Businesses no longer see the value in paying full price. The myth of inelasticity of business travel demand has largely disappeared.

In my view, airline deregulation, while not without shortcomings, has succeeded in expanding innovation, opening travel to a wider range of consumers, and allowing more choices. The free market will ultimately produce the most beneficial result for consumers. There are, however, some exceptions that may justify limited government intervention or fine tuning where concentration or potential abuses involving competing firms justifies oversight or rules to protect competition, not competitors.

Managed Business Travel

TRAVEL AGENCIES

Most corporations rely on travel agencies for reservations services. Travel agencies process airline bookings through a global distribution system (GDS), which provides access to published airfares and negotiated corporate discounts, although not to Internet-only “web fares.” Travel agency services typically consist of reservations and ticketing, seat assignment, ancillary services such as upgrades, quality control checks for low fares, reporting sales through ARC, and collecting data for use in monitoring policy compliance and performance under the terms of preferred airline agreements. Management information reports are also provided on spend, vendors, policy exceptions and related issues for managing commercial travel effectively.
Elimination of airline base commissions to travel agencies (in several phases from 1995-2002) forced the travel agencies to charge for their services. Disruptions during the transition to new pricing models resulted in cash flow problems for travel agencies as well as pressure to reduce their overhead costs. The marked drop in volume following September 11th exacerbated this, followed by the recent airline move to 0 based commissions. Combined pressures on revenues and continuing inflationary costs threaten the existence of many travel agencies, especially the smaller ones.

Traditionally, companies and individual travelers were suspicious of travel agencies because they were paid as percentage of ticket price, creating an apparent conflict with the obligation to find and promote lowest cost travel options.

Fee based pricing, which preceded elimination of standard commissions, largely removed those conflicts. Under fee-based arrangements, all supplier commissions (and sometimes a portion of GDS incentives as well, discussed later) are passed through or credited to the corporate account. This removes most of the perceived conflict. However, there are still lingering suspicions among larger buyers where large travel agencies earn airline override commissions or other incentives for market share (regardless of how described, e.g. “maintenance fees”, etc.) These are not always passed back and are difficult if not impossible to audit.

GDS providers pay incentives to travel agencies funded by fees paid by suppliers to participate in the GDS, based on the number of segments booked. In contrast to airline and other commissions, most travel agencies retain GDS incentive revenues to offset internal costs that would otherwise be passed on to accounts and individual consumers. Today those costs include hardware used for running the GDS. However, in some cases travel agencies share these incentives with larger corporate customers. (It is interesting to note that the travel agency practice of rebating airline commissions to corporate clients was part of carriers’ rationale for cutting commissions.) Like override commissions,
GDS incentives are driven by the volume of the travel agency, so smaller travel agencies would not qualify for a level that would enable to them to afford such rebating.

Some companies have negotiated direct contracts with GDSs, hold the contract and are responsible under its provisions, and receive incentives if they meet volume hurdles. They also assume responsibility like an agency for liquidated damages in most cases. There are three types of GDS corporate relationships:

1. The travel agency continues to operate the GDS (rare instances), but GDS decision is made by the company and it holds the contract and earns incentives. The agency operates GDS in effect on behalf of the customer with the GDS relationship. Usually this results in pass through of all GDS related costs as direct costs paid by the company.

2. Where a corporation elects to obtain ARC accreditation as a stand-alone Corporate Travel Departments (“CTD”). In such cases the company operated travel department contracts with the GDS and assumes obligations like a travel agency.

3. So called “hybrid” or customer incentive contracts can be on top of the incentives paid the agency holding the direct GDS contract. Here the agency may or may not share incentives but the customer is incentified also by the GDS to encourage or insure volume thresholds are made on a scale negotiated separate from the agency contract.

Today, there is a considerable amount of uncertainty on the part of companies dealing with agencies over the true total incentive revenue stream earned by their agency partners from GDSs, and how incentives apply for their benefit, either 100% or less, on their volume contribution to the agency total put through via the GDS used to in booking company travel. That uncertainty can produce the same type of skepticism as exists with carrier overrides paid larger agencies.
Corporate-Sponsored Self Booking

To reduce travel agency labor and process costs and also to improve savings by use of policy, corporations are implementing a variety of company-sponsored self booking tools, primarily for routine trips not requiring complex fare construction. The travel agency or a third party fulfillment service continue to provide quality control and ticketing through the GDS, with airline ticket sales reported through ARC. The company-sponsored tools base their faring on corporate discounts and all other fares resident in the GDS. While adoption has been slower than initially expected, some companies are at 80-90% of domestic travel considered eligible for self-service. Process cost savings achievable from use of self-booking for corporate travel can be dramatic: 50% or more below the process costs of traditional booking methods.

In response to customer demand, firms providing self-booking tools are also exploring direct connection options that could result in GDS bypass, an ironic result in the case where GDS providers own the online booking tools (e-Travel owned by Amadeus, GetThere owned by Sabre, and Highwire owned by Galileo). Direct connections appeal to companies with preferred airline discounts as added cost savings. Airlines and customers can share the GDS fees avoided, to mutual advantage. The efficiencies in managing multiple direct connect scenarios outside traditional GDS remains to be seen, but emerging new technologies and numerous non-GDS providers could make this a reality soon.

GDSs have to see the “handwriting on the wall” in the explosion of options for distribution, especially through the power and diversity of Internet, fast, flexible and low cost compared to traditional GDS platforms.

Travel Agency Low Fare Guarantees and Web Fares

Most contracts between corporations and travel agencies include a low fare guarantee, where the travel agency agrees to pay the difference between the ticketed fare
and any lower fare available at the time of ticketing. Initially these “guarantees,” introduced in the 80s, were relatively unqualified. In the past 5 to 8 years, agencies have restricted the commitment to a comparison to fares “available through the GDS.” The lower fare must also be for the same routing and within company policy. Rarely are those guarantees exercised, but most companies believe they have a positive impact generally. Web fares, combined with cost conscious business travelers wanting to use leisure-oriented fares, have made a mockery of low fare guarantees in travel agency contracts.

Carriers are struggling to survive and fill seats regardless of yield. Web fares offer a quick fix for distressed inventory and also appeal to businesses willing to take restrictions on refunds and time and date of travel (most Saturday night stays have been eliminated at least for now). Internet fares entail lower distribution costs than standard GDS booking fees, as well as the prospect of gaining individual traveler loyalty (like that achieved through the single greatest marketing tool ever devised for travel: frequent flyer programs). Internet web sites also offer the operators and their carrier owners vast new opportunities to capture information for “data mining” on travelers either visiting the sites or booking tickets there. This is an upside for web site operators and downside for privacy, also raising concerns for corporations over data security where employee business travelers book at such sites and expect reimbursement.

Due to the fact web fares, sometimes with heavy restrictions, appear very low, individual business travelers may select such fares in defiance of company policies on use of the designated travel agency or preferred airlines with negotiated discounts and market share requirements. This “leakage” undermines corporate managed travel programs and ability to track their traveler’s business travel purchases. The multiplicity of web fares and web sites produces much confusion for companies trying to manage their travel and often results in considerable loss of productivity as travelers spend time surfing in search of savings, which may evaporate where the employee misunderstands or ignores the restrictions applicable. When travelers book on the Internet, corporations also
lose the ability to locate their travelers in the event of an emergency where there is no data on the ticket purchase.

Recently, (without any prior consultation with their corporate customers) a number of carriers have unilaterally removed low fare categories or “buckets” from eligibility for corporate discounts. This drives travelers even more aggressively to search for web fares for lowest cost options. Such excision of discounts by fare class also undercuts the ability of the company to meet share requirements that are the primary reason carriers offer volume discounts to companies.

WEB FARES CAN ALSO BE ILLUSORY

There is no doubt that web fares are producing confusion and complications for managed travel programs and travel agencies serving their corporate customers. In some cases dumping distressed inventory without restrictions will produce lower fares than obtainable through the GDS or travel agency quality control process. However, there are offsetting factors to the rhetoric about these fares:

1. Recent company audits are showing that over 90% of the time, the corporate discount booked via the GDS is actually less costly than the web fare based on identical parameters (e.g., time of travel and routing).

- TOPAZ, an independent fare audit firm used by companies, reviewed data between January and June 2002 involving 19,000 itineraries. Comparing travel agency and web fares (including Orbitz), the travel agency fares averaged $116 less than the same itineraries booked on Internet sites. The average was $478 versus $594 for web fares. However, averages do not answer the question for individual companies, prompting them to call for audits of their specific programs to try to silence outraged travelers who might leave the program for surfing on their own.
There are also new software products that search multiple web sites and report on the number of instances web fares are lower than the GDS fare including corporate discount.

2. Where companies have policies allowing use of web fares, many require a minimum savings of $100 or more to justify the loss of data, loss of credit against airline share requirements, and use of traveler search and booking time. Such a difference is rare if the comparison is for like itineraries.

3. Fare construction logic, to date, at web sites has not been as intuitive and logical as that through the GDS, often resulting in awkward and impractical routings or departure times.

4. Web fares work best for travelers willing or able to book at least 7 or more days ahead, not realistic for last minute travel. However, some travelers and companies are increasingly willing to accept restrictions to cut costs. To that extent, some of these fares work for business.

5. If GDSs revise pricing to remove the cost advantage of selling via web sites, web fares may become accessible through GDS channels. However, GDS will likely shift the costs to the travel agencies, which will in turn pass through such cost increases to their customers, including corporate accounts.

7. GDSs themselves are offering search engines for web fares, but with the same limitations as those available through travel agencies or third party technology providers. The agency contracted low fare guarantees may still apply if the GDS engine is the source of the booking, causing more pressure on travel agencies to show comparative faring for GDS and web fares.
8. Carrier strategies these days are volatile, to say the least. They could decide to eliminate use of web fares for business use or make restrictions so severe as to render such fares of even less use for business travelers.

WILL NEW FARE ENGINES WORK COST EFFECTIVELY OR BE SUITABLE FOR NON-GDS ACCESS TO WEB FARES?

A number of search engines offer Internet wide searches of all sites and booking capabilities, and in some cases claim back office reporting integration. There are, however, potential limitations to these solutions:

1. None of these engines yet have a proven track record, and productivity loss to travel agencies could be considerable. One major travel agency study showed the average time to transact a commercial booking via web site at nearly 30 minutes, compared to less than half for traditional booking by an agent and about 4 minutes for self-booking. Lower productivity results in higher costs for clients.

2. Airline monitoring of company delivery on preferred deals has traditionally been through ARC sales reporting based on tickets issued by designated travel agencies. Travel agencies issue tickets through the GDS, with appropriate coding to ensure that the corporation receives credit for tickets issued. ARC reports on tickets issued through the GDS provide the standard audit trail for a corporation’s compliance with its airline market share commitments.
   - It is not clear yet whether airlines will give a corporation credit for tickets booked on web sites and entered into the GDS as “passive” segments for reporting purposes. Web fares are not ticketed by the designated travel agency, do not include the required coding, and are not subject to standard industry auditing. Unless new reporting and acceptable verification through passive segment reports are acceptable to carriers, web fare purchases may not count toward company market share targets, inimical to the partnership for promoting share delivery for preferred airlines.
Carriers are stricter than ever on proof of market share while promoting web fares undercutting those goals.

- Corporations will need to use their leverage as major purchasers to require airlines to recognize web fare sales toward contract targets.

3. There will be added costs to be paid by the company outside the GDS. This will be another example of higher travel expense burdening the industry at the time business travel is severely depressed. No one can afford further disincentives to travel, especially if the solution costs more overall than the problem deserves.

- Multiple hits on web sites could also involve access fees (especially for “look not book” hits) where competing fare search engines all search simultaneously. This might cause web site operators to close access to such search engines.

**RECENT GDS ANNOUNCEMENT OFFERING 50% REDUCTION OF BOOKING FEES FOR DIRECT CONNECT AND WEB FARES.**

Carriers are looking for innovative ways to cut distribution costs beyond commissions. One example is direct connections into their inventory bypassing the GDS. This allows preferred carriers and their accounts to share the GDS segment fee savings. The potential is that such direct connects could be implemented with a self booking tool, thus increasing savings on process costs, (by as much as 50%) in addition to eliminating GDS fees. A number of companies are exploring this option for their preferred airline deals. Like web fares, these arrangements can present management and reporting challenges for travel agencies and companies, but incremental savings from $12- $14 more per trip paid by carriers for GDS bookings can be attractive.

Sabre recently announced a new elective option that eliminates all GDS incentives paid to travel agencies and companies in favor of lower GDS pricing, supposedly about 50% ($2 per segment) of standard pricing (about $4 per segment). This new program is available only for travel agencies and customers using Sabre and its
wholly owned booking tool, Get There (purchased at a cost of approximately $700). While details are not worked out, this supposedly opens up negotiations for direct connect and also web fare access via the GDS platform at lower distribution costs.

On its face, the announcement sounds promising for integrating GDS with direct connect and web fare access. It appeals to customers using Get There and Sabre as less awkward than using a search engine (including Sabre’s “Fare Chase” engine) and might accelerate a seamless integration of all fare options cost effectively. At a minimum, the announcement shows GDSs are more open to new solutions to the raging controversy with carriers over GDS fees.

However, there are significant negative implications:

- Sabre’s announcement states the change will have negligible impact on its revenues. Removal of all incentive revenues for travel agencies and their customers using Get There will de facto be a cost transfer back to the customer. The plan appears likely to reallocate GDS fees but with no reduction.

- Participating airlines might not share the saved GDS fees with the customer, as they did not share saved commissions or reductions in federal ticket taxes with customers.

- This change would apply only to Sabre’s self-booking product and would not benefit users of numerous competing self-booking products, even where the travel agencies use the Sabre GDS.

- If carriers demanded customers drive business solely through one booking tool and one GDS for direct connect or web fare access, customers could be limited in choices and face discount contracts of adhesion that are non-competitive. Carriers have shown willingness to exercise unequal bargaining power recently in requiring corporate customers to provide sensitive back office data to a single data processor (employed by competing carriers) for monitoring contract compliance as a condition to the discount.
1. Most of the Controversy is Cost or Fee Related and Re-regulation Would Be Unwise

The current GDS controversy is mostly over pricing between the GDSs and the airlines. The access dispute is not true foreclosure of access or denial as anyone, including business travelers and travel agencies, can visit and book at any public access web site. In fact, Orbitz and some of its competitors have announced plans to compete for the commercial travel business, a pro-competitive development.

Technology products are emerging quickly to fill the gap between GDS and web fare booking, although there are unresolved issues over whether carriers will recognize web fare purchases toward volume hurdles for corporate discounts.

Orbitz is up and running and provides consumers the benefit of another booking channel, another new GDS. Competition is working on the Internet to produce more options, which can mean better service and pricing for all consumers, including corporations. There is reason to believe the products offering best cost effective solutions will prevail and adequate choices and competition should hold down prices paid by agencies and their customers for access to fares wherever offered.

Traditional GDSs do offer the benefit of a single source for unbiased information on all published fares as opposed to accessing multiple suppliers and fare databases. Orbitz has played a similar role as a clearinghouse of information on web fares, with lower distribution costs than the GDS.

If the GDSs could provide comparable distribution costs to the carriers, there should be no reason carriers and Orbitz would not want to provide the public
with expanded access to their inventory. For example, an incremental fee for booking web fares on the GDS charged to the agency, passed on to the customer, might equal the difference in cost of distribution between the web distribution cost and the GDS cost to the carrier. ($5-$8). Travelers and companies would have a choice between paying a slightly higher cost for travel agency services and booking through a web site or Orbitz. This could promote more competition between GDSs, and Orbitz and other on line agencies, and protect carriers on web cost differentials. The only basis then for foreclosing GDS participation would appear competitively motivated toward market control or domination, not in the public interest.

The most favored nation’s provisions in the Orbitz relationships should have a public interest advantage similar to that of the GDSs in providing an efficient means for the public to compare prices in one place. Carriers are still free to compete as long as they offer lowest Internet fares through one site. Fares can and will be different. GDSs also hold competing carrier fares and have for years. However, activities by Orbitz, owned and controlled by a powerful group of competing carriers, deserve continuing scrutiny in terms of risks of anti-competitive conduct. At this point nothing pernicious has been proved, other than speculation of possible adverse impact.

For web fare access, the major issues appear to relate to costs and pricing, where market forces should dictate an efficient solution. Technology solutions should emerge and are available, possibly with modification in carrier practices on discount monitoring. It would be a mistake, in my view, to recommend or have government intervention/ regulation resulting in controls over pricing or costs of distribution.
2. **Online Agencies Should Be Subject to Anti-Bias Rules**

Orbitz and its competitors represent a new distribution model adopted by and because of the Internet. While denying a role like a GDS, online agencies distribute for suppliers and offer one stop shopping for fares. Orbitz asserts they are always motivated by the best interest of customers, so presumably they would wish to avoid any appearance of favoritism toward carrier owners. Simply because the Internet is new and different does not mean reasonable DOT anti-bias and pro-competitive rules would inhibit growth or innovation. However, to require access by GDS to all web fares would necessarily involve DOT in cost and pricing issues, well beyond its purview or expertise.

3. **The Plight of Travel Agencies**

All travel agencies, large and small, will have to demonstrate that they can provide the lowest fares, including consideration of web fare searches to justify any service fees. Internet fare search engines will be available from a variety of sources. There will be pass through costs to the consumer but these are emerging anyway at web sites already.

Competition from the Internet threatens all agencies. Small and medium sized agencies competing for business travel lack of economies of scale and face high labor costs, usually over 50% of direct expenses. Customers have to be sold on the customized, responsive value adding services as opposed to doing their own travel. In effect the opportunities are greater to help companies as they face head count and internal resource limitations.

The travel agency serving business travel as now known will change or become extinct in a few years. Agencies adapting to reliance on automated processes at the same pace as customers can survive if they customize services of value for reasonable fees. Those that do not, will fail. This is an inevitable side effect of the functioning of a free market faced with radical technological change.