

Commission Hearings

Testimony of Al Lenza

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Good morning and thank you for allowing me, as the representative of Northwest Airlines, the opportunity to express our views on the distribution environment in the airline industry. My name is Al Lenza, and I'm Vice-President, Distribution and E-Commerce for Northwest. I have worked in the travel industry, airlines and Global Distribution Systems (GDSs or CRSs) businesses for nearly 25 years, the last 8 with Northwest. I am responsible for our business relationship with GDSs, our internet and other distribution strategies, and other e-commerce initiatives such as E-Ticketing and airport self-service kiosks.

In this very difficult financial environment for our industry, Northwest has continued to place great importance in ensuring that it can sell its products from as many different distribution channels as possible and in the most efficient means available to us. Northwest has been and continues to be a full participant in all GDSs, which ensures that both traditional travel agents, internet sites, and other airlines have full access to Northwest's inventory and fares in "real-time" that is, always in synch with our yield management and pricing systems.

Our industry has always been intensely competitive. The slowdown in business travel which began in early 2001, followed by the economic recession and the events of 9/11, placed even more significant pressures on airline industry revenues.

Northwest's goals from a distribution standpoint have evolved as the internet has grown, but remain straightforward. First, to continue to grow our share of business from traditional travel agents, while bringing down the cost of distribution wherever possible.

Second, we continue to develop our web site at nwa.com to capture the growing number of customers who are choosing the internet to make their purchases, including travel.

Third, we seek to capture our fair share of the fastest growing market segment in travel distribution – third party internet sites – and do so at a competitive cost of distribution.

We have two other objectives that are at the heart of the issues being addressed by this Commission: i) Northwest is insistent that our distributors – both traditional and internet distributors -- present and sell Northwest's product fairly and in an unbiased manner; ii) We are also pulling all stops to harness the fastest growing distribution expense for Northwest – GDS booking fees, which have grown to account for nearly \$14 per ticket and continue to increase at a rate of approximately 7% per year. Northwest will spend more than \$200 million in GDS fees this year, despite reduced traffic levels.

These last two issues were the driving forces behind Northwest's backing of the creation of the industry's first neutral industry site – Orbitz. The concept of Orbitz is that it would be neutral to all airlines (and not just the owners), address the rising cost of distribution, particularly GDS fees, and place competitive pressures on the duopoly of Expedia and Travelocity to be more unbiased and more cost-effective to airlines. For consumers, Orbitz would offer the advantage of access to an unbiased site that always displays the lowest available fares on all airlines.

By every measure, Orbitz is delivering on its objectives. Northwest has saved nearly \$2 million in GDS fees in less than 1 year and is poised to save substantially more in the next few years after implementing a direct link between Orbitz and Northwest's internal reservations system. Other airlines are also working with Orbitz on similar direct links that bypass the GDS entirely. Orbitz's success, driven primarily by its industry leading pricing search engine, has attracted millions of consumers who have been looking for a truly neutral site that can quickly find and present all flight options in a clean and concise way. And in response to Orbitz's value proposition to airlines, the GDSs, who have annually dictated price increases to airlines, increased booking fees to airlines in 2002 by the lowest percentage (about 3%) in 15 years. Now, for the first time since I have been in the industry, the GDSs are actually coming to airlines offering reduced booking fees in return for extending the broad distribution of certain channel specific internet fares. And consumers are also big winners as they benefit from new technology brought to the market by Orbitz to help them find low fares. While its internet competitors attack Orbitz with meritless allegations in an attempt to preserve the status quo, Orbitz is living up to its promise of being unbiased in representing airlines and other suppliers and presenting the best fares to consumers.

While continuing to complain about the Most Favored Nation clauses in the Orbitz agreements, the 2 largest sites (the largest which is owned by the world's largest GDS) remain unwilling to commit to matching Orbitz's supplier friendly proposition with respect to costs and neutrality. Just last month, the two leading competitors of Orbitz refused to load or to feature a number of Northwest's low fares to Europe because

they conflicted with preferred agreements they each have with two of Northwest's international competitors.

There have been significant discussions about so called "web only" fares and the fact that Orbitz automatically is entitled to obtain these fares if Northwest publishes them in its own web site.

The facts are that:

- Nothing in our Orbitz agreement prevents Northwest from filing any fare in any channel, and in most cases we do exactly that. Unlike Southwest Airlines, which doesn't publish any price or inventory to any internet site nor to the majority of travel agents, the vast majority of Northwest's prices are published in all channels, and to all distributors. Northwest continues to obtain nearly 70% of its revenue from traditional travel agents, and nearly 10% from third party travel agents like Travelocity, Expedia, and Orbitz.
- Northwest is expanding its web site dedicated to travel agents by soon offering a booking site exclusively for travel agents. This will provide us with a platform to reach travel agents without the need to sell via a GDS. Until this functionality is in place, there is nothing to prevent travel agents or any distributor from purchasing any fare published in the Northwest site or any other site on behalf of their customer and many are doing just that. In fact, there are several third-party companies that are assisting distributors in shop-comparing among many airline and third-party sites.
- Northwest's decision to publish targeted offers in certain channels or distributors is no different than how business has been done over the 25 years I've been in the

industry. Before the internet, and even now, airlines have used specialized agents to sell inventory to target market segments which are not available in public retail channels. Northwest also offers certain corporate discounts to specific corporations and makes those prices available only to the travel agent designated by that corporate account. The internet has become an efficient way and one more option for airlines to sell certain targeted inventory but it is just that – one more tactical option and consumers are taking advantage of the competition that has been stimulated. There is a view among some that all prices should be available in all channels at all times. It is our view that if such a regulation or process were to become a requirement, airlines would lose their incentive to offer low fares in cost-friendly distribution sites or channels and lose any leverage over GDS fees. The net result is that consumers could lose the opportunity to purchase some low fares.

When Northwest evaluates where to publish targeted offers that are channel or distributor specific, we look at a number of factors (how many seats do we need to sell, what is our cost of distribution by channel offered, etc).

In many cases, what starts out as a limited tactical filing, may, for competitive reasons, end up being published in all channels.

It is important to note that some of Northwest's pricing and other incentives such as frequent flyer mile bonuses for online purchases are designed to encourage customers to visit our web site for other services unrelated to the sale of flights. These include important services that if accessed directly by the consumer, Northwest saves money. For example, the ability to do refunds and exchanges online, check flight

arrival/departure information, frequent flyer account balances and the ability to purchase award travel online are services that have considerable benefits for consumers and for Northwest. Other services, such as signing up to be paged when a flight is delayed are rapidly growing. Bonus miles and other marketing tools attract first time customers to the site, and many subsequently become more loyal customers of Northwest.

The travel distribution landscape is undergoing significant structural change as the internet allows individual customers direct access to all of the content previously available only through intermediaries. Unlike access to a GDS, which is essentially “closed” to those particular users, the internet is available to anyone with a computer (or a cell phone or palm pilot) now. And a customer, intermediary, or any other party who doesn't like what they see in one internet site, can quickly click to a competing site. In fact, there is software in the marketplace that eliminates the need for customers to even have to do the shop-compare. Many of these robots in fact, often search through multiple sites to produce the best flights and prices for the internet consumer. Direct access to all of this information provides significant consumer benefits because it allows airlines for the first time to more tailor promotions to individual customer segments. For example, Internet sites like Hotwire and Priceline allow airlines to distribute inventory in a way previously not feasible but with fences that make segmentation possible, while allowing customers who are flexible to obtain very low prices.

As for Orbitz, there has never been a more scrutinized entity in the travel business. The fact that Northwest is an aggressive competitor with the other owners of Orbitz alone ensures that Orbitz will be operated neutrally and fairly. Nevertheless, we continue to look forward to the DOT, DOJ and other reviews of its operations as we

believe they will confirm what we've been saying all along – that Orbitz has been pro-competitive for airlines and consumers. Rather than interfere with the competitive landscape through special rules or regulations, Northwest encourages the committee to allow market forces to continue to drive the direction of travel distribution and not recommend measures that artificially protect or promote certain interests whose ultimate goals are to protect their businesses from competition. In this very difficult financial environment, Northwest must have flexibility to maximize its revenues at the lowest costs possible. I'll be happy to answer any questions you may have.