

**National Commission to Ensure Consumer Information and Choice
(NCECIC)**

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Travel agencies represent an industry market place where prospective travelers have the ability to shop for air, car and hotel products for leisure or business purposes.

Travel agencies are one-stop shopping malls that have access to and can evaluate multiple suppliers as a potential solution for their clients.

Travel agencies are the primary and lowest cost channel of distribution for the airlines representing upwards of 80% of their total sales. Travel agencies also account for approximately one-third of all hotel room sales and car rentals in the U.S.

The four principal global distribution systems (GDSs) operating in the U.S. (Galileo, Sabre, Worldspan and Amadeus) provide the electronic infrastructure through which most of these transactions are processed.

The function provided by travel agencies in terms of taking reservations, providing customer service for those reservations as well as fulfilling the ticketing requirements associated with those reservations are activities that airlines have consciously decided to outsource. This outsourcing initiative precipitated the creation of the travel agency industry and has allowed airlines to focus on their core competencies associated with flying airplanes instead of processing reservations and tickets.

The travel agency community, in conjunction with the GDS community, has provided consumers and corporations a location where they can compare offerings from different suppliers inside of one environment. This has and will continue to be a valuable service that agencies provide on behalf of all participants.

Traditional travel agencies provide store-front access, telephonic access and electronic access or a combination of these as a means of interfacing with their clients. Online agencies such as Expedia, Travelocity and Trip.com provide only an electronic access similar to self-booking tools such as Highwire and GetThere (the latter of which provide the traditional agencies with the electronic access capability).

It is critical to understand that the vast majority of the transactions booked in travel today are made electronically (via the GDS) despite the fact that the interaction with the traveler can take multiple forms.

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

Historically, the airline community subsidized the cost of distributing its products through the travel agency community in the form of commissions that were paid as a percent of the ticket price. Airlines also paid for the cost of the infrastructure that provided the electronic access to their inventory in the form of commissions or segment fees to the GDS networks. Airlines refer to these expenses as part of their distribution costs. These costs are born both externally by the travel agency community as well as internally in the form of airline-owned ticket centers, call centers, airport counters, airlines websites and GDS systems support.

Recently the airline community has had a keen focus on reducing their distribution costs by way of reducing the commissions to travel agencies as well as creating solutions that would reduce the level of segment fees they pay to the GDS community. After a number of travel agency commission cuts over the past few years, the airlines finally eliminated commissions entirely at the beginning of this year. Is it simply coincidental that they all came to this conclusion within five days of each other? It is amazing that they only eliminated the commissions to a part of the distribution channel that they do not own while continuing to subsidize their internal distribution costs out of the ticket revenue they receive.

I am concerned by how airlines can rationalize that the elimination of commissions to travel agencies truly reduces distribution costs. In effect they have indirectly transferred the cost burden to the consumer and/or corporation by forcing travel agencies to institute transaction fees. In reality they have simply camouflaged a price increase. Unfortunately, this price increase only applies to a selected distribution channel – the travel agency community – the airlines' lowest cost distribution channel. A distribution channel that they do not own themselves.

In an effort to compete with low cost carriers to gain market share at an incremental cost, the major U.S. based airlines have been promoting special discounted fares or "web fares" exclusively on their wholly-owned sites. In some cases, these reservations are fulfilled through a special arrangement with a GDS. In others, they are fulfilled directly with the airline bypassing both the GDS and the travel agency.

What appears to be yet another collusive effort to dis-intermediate the travel agency community occurred approximately fifteen months ago when the most prominent U.S. based carriers representing the majority of air volume transacted, formed their own online travel agency, Orbitz offering fares that are exclusive only through their site.

This next generation of fare wars, has dramatically reduced, and in many instances, eliminated the opportunity for the travel agency community to effectively compete as they are restricted access to providing these same fares to their customers through the GDS.

As a result of these actions, the airlines have only made what is already an unlevelled playing field even more imbalanced. The net result is that the airlines have spread their internal cost of distributing roughly 20% of their volume across 100% of their sales (80% of which is sold and distributed through the travel agency community) by incorporating a portion of their distribution cost in each ticket that they sell.

In order to level the playing field across all distribution channels, airlines must first identify their true and fully allocated internal distribution costs and charge a transaction fee to the traveler that, at a minimum, covers these costs for those reservations that they fulfill through their own distribution channels. (*Appendix A illustrates the past, current and proposed transaction fee environment*)

Through their collective efforts it appears that airlines are simply trying to enact a price increase through their primary distribution channel that creates a price disadvantage for travel agencies and as a result drives disintermediation. Up to this point any actions that they have taken to turn a profit whether directly increasing ticket prices and/or capping travel agency commissions has not been successful. Any gain was quickly redistributed in the form of reduced ticket prices to the traveler. In this new environment, what could possibly allow us to believe that further alienating their lowest cost distribution channel and primary sales supporter – the travel agency community – would make airlines any more profitable?

At the same time, airlines are putting significant pressure on the GDS community to reduce their segment fees. Currently airlines pay a GDS approximately \$4.00 per segment. The average airline ticket produces 2.5 segments. The total segment fee per ticket that most airlines are charged by the GDS is approximately \$10.00.

Over the years, the GDS community has shared some of this revenue with the travel agency community in an effort to subsidize the cost of equipment required by travel agencies to interface with the GDS platform, create alliances and drive market share.

The travel agency community has traditionally applied this revenue source against their cost of operations. The airlines are putting tremendous pressure on the GDS community to eliminate this revenue to the agencies in a manner that would ultimately reduce airline segment fees. This additional loss of revenue would force agencies to increase their transaction fees even further creating an even greater disparity between a total ticket price charged by an airline versus one purchased through a travel agency.

The travel agency community represents the majority of any airline's ticket distribution. A healthy airline industry is critical to our economy. The viability of the travel agency community as a low cost distribution channel is also critically important to our economy.

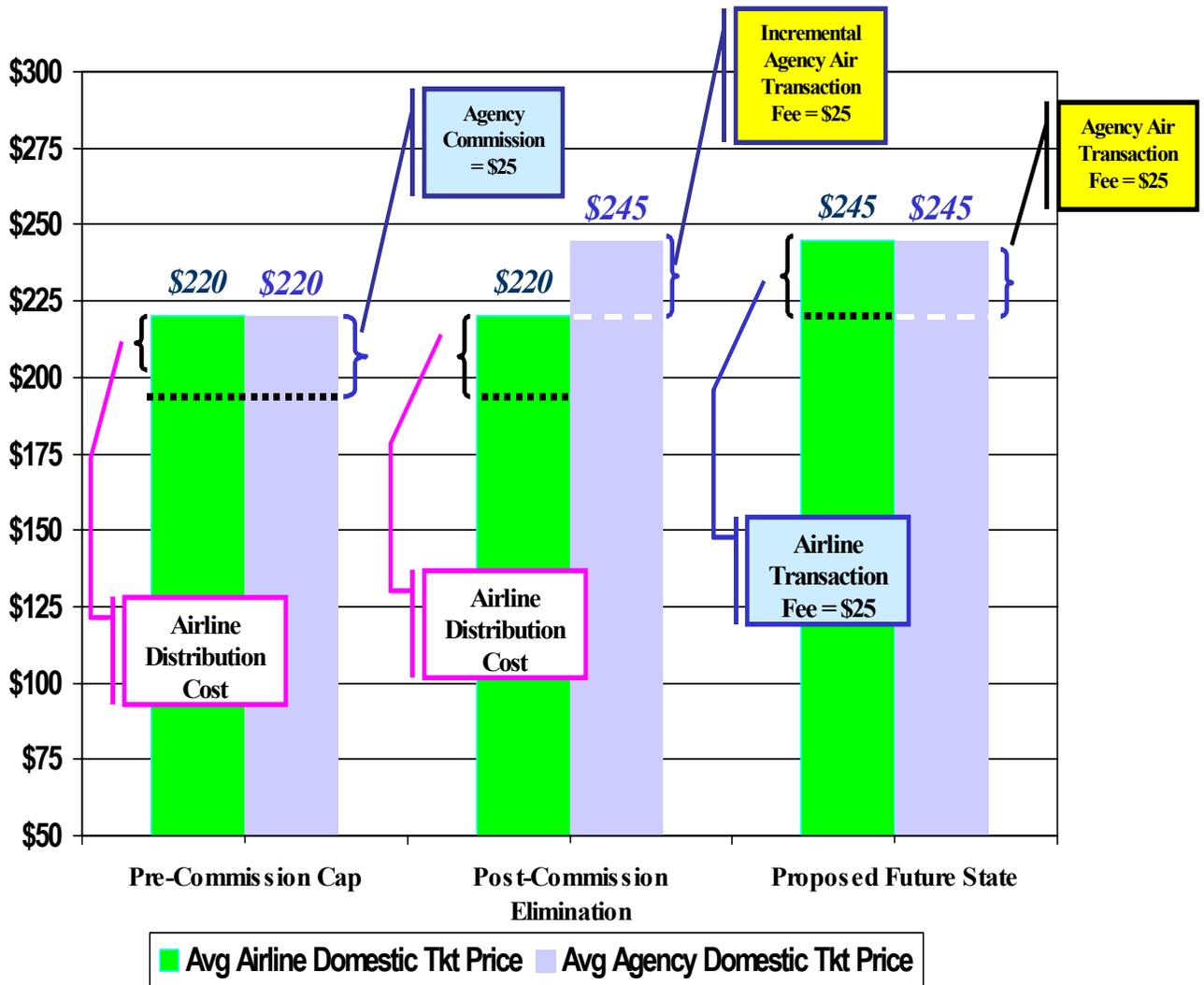
It is time to level the playing field and provide equitable ticket pricing to all channels of distribution. We need to impose transparency of costs so that consumers know what they are paying for. We should simplify pricing structures and establish fairness and equity for all participants in an industry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

This can all be accomplished very quickly and simply if the airline community would institute a transaction fee to cover their internal cost of distribution. This would set a precedence for the existence and justification of transaction fees across all channels of distribution and would allow the airlines lowest cost channel "The Travel Agency Community" to coexist and prosper.

I call on this commission to apply its influence to accomplish this goal. Let common sense and good business judgment prevail.

(Attached as Appendix B is the white paper authored by Alex Wasilov, President and C.O.O. of Rosenbluth International in which the inception of this prepared testimony was first proposed and published.)

APPENDIX A



Avg Tkt Price for Domestic 1,000 mi trip - Source: ATA Mthly Report – Jun 2002

APPENDIX B

WILL AIRLINES GROUND THEMSELVES BY GROUNDING AGENCIES?

UPDATED July 2002

- Unbalanced Airline Distribution and What Can Be Done About It -

Whether a business' distribution is wholly owned, outsourced, or a combination of both, there exists a GOLDEN RULE: Don't under price your distribution network; you will obliterate its value. Every industry in the world understands the rationale of nurturing its channels of distribution except for one: the airline industry.

While rushing to reduce their distribution costs to win the approval of the financial community, airlines have let one pertinent detail slip through the cracks. By virtually eliminating compensation paid to travel agencies, their out-sourced distribution system for reservations and ticket distribution, they may have unintentionally created a situation requiring them to return to the 1950s and re-in-source their reservations and distribution of tickets. This would come at a cost far greater than they could have ever imagined.

When this industry was in its infancy, airlines distributed tickets directly to travelers. As the demand for air travel grew exponentially, the airlines strategically chose to develop a variable cost distribution channel, the travel agency system, to work in harmony with the direct distribution channel.

In the past few years, most airlines have found themselves under tremendous pressure to enhance their business models in the face of higher costs. Given the fact that the cost of planes, fuel and labor are out of management's direct control, there was one area of improvement left to focus on: distribution costs.

For years now, airlines have been focusing their efforts around reducing their own expenses. The challenge is that instead of reducing the total cost of distribution, they focused on reducing expenses by the reduction of standard commissions to travel agencies. In essence, airline expenses would go down but the costs associated with distributing tickets would not.

By reducing commissions, and thus creating the need for agencies to charge fees directly to travelers, the airlines have created a predatory pricing environment. Airlines sell tickets directly to travelers with no incremental transaction fee. They absorb their cost of fulfillment by spreading their cost over their entire volume base. Concurrently, they pushed the travel agency community to charge fees for fulfillment, creating a significant price advantage for themselves.

The irony is that most airlines are not consciously trying to eliminate travel agencies from the picture; they simply cannot. A viable agency system is critical for the success of the airline industry. Agencies facilitate 80% of all airline bookings. In 2001, U.S. travel agencies sold \$66.5 billion in airline tickets, averaging \$182 million per day in ticket sales. A dependency on a single, wholly owned distribution system would be both a crippling expense for the airlines as well as a poor strategy in an industry with fluctuating volumes. In fact, last year the airlines were forced to furlough over 150,000 of their people and close a significant number of their reservation centers. They would be unable to manage the volume of bookings that agencies facilitate for them, nor do they want to.

If the primary driver for the airlines is to remove the agency distribution costs from their profit and loss statements, there is a very simple solution: eliminate all standard commissions and institute a fulfillment fee for every ticket distributed directly by an airline. This would level the playing field by charging fulfillment costs within direct AND indirect channels of distribution and, as a result, equalize the cost of airline tickets across all channels. An airline would then be able to lower its direct distribution costs, increase its revenue stream, and equalize its channel pricing structure.

Last winter, the airlines eliminated standard commissions. Rather than institute a fulfillment fee on tickets purchased directly through them, they choose to bury their own distribution costs in the price of a ticket. As a result of the eliminating standard commissions and no change to the ticket price, agencies have had to institute higher transaction fees to clients in order to recoup the lost revenues. Now, more than ever, we need leaders to step up the plate and make the changes that will heal an ailing industry. The industry can no longer afford a broken model. The airlines, the agencies and the public need it to be fixed. Agencies, airlines and the traveling public are all interconnected and dependent on one another. After all, we are all on the same team. We want the system to work. Sometimes the most elegant solution is also the simplest.

By charging a transaction fee, airlines would uncouple and create a transparency for their cost of distribution. Distribution fees would be determined in a fashion similar to how agencies determine them. The fee should cover all associated costs in fulfilling the reservation – whether it is telephonic or electronic. They would create a revenue stream that would offset their internal cost of distribution, and at the same time further legitimize transaction fees for the agency community. The same rationale also holds true for hotels and car rental agencies. Travel providers need to reevaluate their distribution strategies and business models. In order for this to be fair and effective, airlines should act unilaterally in instituting fees. This cannot be a voluntary measure but rather implemented throughout the industry. Let common sense prevail.

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