



Statement of

**David A. Schwarte**

Executive Vice President and General Counsel  
Sabre Inc.

Before the

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

June 12, 2002

## **Introduction**

Chairman Winstead, Members of the Commission, I appreciate the opportunity to appear before you today on behalf of Sabre to address critical issues relating to travel distribution systems and travel agents.

Sabre is the leading provider of technology, distribution and marketing services for the travel industry. Headquartered in Southlake, Texas, the company has approximately 7,000 employees in 45 countries. Sabre's Travel Marketing and Distribution business distributes travel services to travel agencies – over 18,000 in the United States, most of which are small businesses. Sabre also manages the Sabre computer reservation system (CRS), the leading electronic marketplace, where multiple travel providers display information about their products, and warehouse and manage inventory. Subscribers to the Sabre system include travel agencies, corporate travel departments and individual consumers via Travelocity.com and other online agencies. As the largest electronic marketplace, the Sabre system gives subscribers a single access point to book reservations and purchase travel products and services with 405 airlines, 52 car rental companies, 229 tour operators, 9 cruise lines, 33 railroads and 244 hotel companies covering approximately 53,000 hotel properties.

In 2001, more than 900 suppliers displayed information about their products and services in the Sabre system that represented more than \$67 billion of products and services sold. The Sabre system is also referred to as a global distribution system. GDSs are a major outlet for air travel distribution in the United States and in many international regions. In addition to providing information to subscribers about airlines and other travel related vendors, the Sabre system allows travel agencies to print airline

tickets, boarding passes and itineraries. It also provides travel information on matters such as currency, medical and visa requirements, weather and sightseeing.

In addition, Sabre provides innovative technology products and services to Sabre Connected™ travel professionals worldwide to enable them to serve their traveler customers effectively.

Sabre owns Travelocity.com, one of the most popular travel sites on the Web, and GetThere, the world's leading provider of Web-based travel reservation systems for corporations and travel suppliers. Sabre is an S&P 500 company, traded on the New York Stock Exchange (NYSE: TSG).

A key component to continued growth and consumer gains in the travel market – both online and brick and mortar – is fair access to information from travel suppliers and, in particular, access to travel suppliers' lowest fares, corresponding inventory, and selling tools. It is of no benefit to distribution businesses if they have the latest technology or customer service, but no inventory to use that technology to sell customers what they want. What air travelers want are low fares and convenient travel times.

That is why we strongly believe that the denial of fair and open access to critical travel information by the five largest airlines in the U.S. – travel information all five do provide to their jointly owned “company store”, known as Orbitz -- raises substantial public policy questions that Congress, the Department of Transportation, the Department of Justice and state Attorneys General must address.

## **DOT Computer Reservation System Rules**

Sabre and the other CRSs are regulated by the U.S. Department of Transportation (and also by DOT's counterparts in Canada and the European Union) and are required, among other things, to provide unaltered, unbiased airline information to travel agencies. Currently, the CRS rules in the United States (14 CFR Part 255), unlike the rules in Canada and the European Union, do not apply to the distribution of airline information directly to consumers via the Internet. The Department of Transportation in March extended the expiration date of the U.S. CRS rules until March 31, 2003. This extension represented the fifth time the DOT has rolled over the CRS rules without substantive change.

The CRS rules were last amended in any significant way in 1992 and were scheduled to sunset in December 1997. It was over five years ago that DOT first solicited comments on how the rules should be updated to reflect the multitude of changes in the CRS landscape that had already occurred since the regulations were revised in 1992.

Ten years ago, all CRSs were owned and controlled by large airlines. Today, at least two of the four traditional CRSs, including Sabre, are free of all airline ownership. This structural change has effected substantial modifications in the fundamental incentives and business goals of those independent CRS enterprises. Further, in 1992, the Internet was in its embryonic stage as a tool for the distribution of airline products, with only a handful of airline sales made on-line. At present, roughly 15% of all airline tickets are sold through the Internet.

I understand that a draft of the rules has been completed and is under review at the Office of Management and Budget. It is critical that the revised rules sufficiently and appropriately address the most critical issues facing travel distributors today, including the impact of the airline-owned site Orbitz.

### **Suppliers' Collective Efforts to Enter the Online Travel Channel**

In the last part of 1999, there was an apparent shift in the individual strategy and focus of airline suppliers in the U.S. in distributing their products (seat inventory and fares) via the Internet. Previously, these carriers had competed quite vigorously with each other, and with us, through improvements in the offerings of their separate web sites. In November 1999, however, four of the five largest carriers in the U.S. – Continental, Delta, Northwest and United -- announced they had formed a jointly owned, Internet-based sales/marketing agency. In April 2000, American Airlines announced that it had joined the venture as an equity owner in this Internet airline-owned joint sales and marketing agency which had been given the code name "T2" and was subsequently named "Orbitz."<sup>1</sup>

Orbitz will try to claim that one of their primary purposes is to add competition in the travel distribution business and that we oppose them because of that. Nothing could be further from the truth. If Orbitz was simply another travel agent or GDS prepared to compete on the merits of its products and services -- and on the same level playing field as other travel agencies and other GDSs – then I would not be here today challenging

---

<sup>1</sup> At least some industry analysts opined that "T2" stood for "Terminate Travelocity." See "Southwest Airline's Success With On-Line Bookings," *New York Times* (Mar. 1, 2000). Others have suggested that T2 is a reference to Arnold Schwarzenegger's movie about a killer robot. "If the commission cuts were Terminator 1 for many agents, this new airline-owned Web site will be Terminator 2 for those still barely hanging on." See "T2 Creators Dismiss Trade's Anticompetitive Fears," *Travel Weekly* (May 29, 2000).

the conduct and plans of Orbitz and its five airline owners. We are accustomed to vigorous competition in all our lines of business. However, the business purpose and effect of Orbitz, a sales outlet jointly owned by the largest carriers in the land – is to tilt the competitive playing field improperly in favor of its five owners, to the detriment of all who compete with those big airlines, and in favor of this jointly-owned travel agency, to the detriment of travel agencies. A lynchpin of their plan is to bestow on Orbitz **alone** the lowest fares these five offer, thus driving travelers who want the lowest rate to the Internet site they jointly own, and a site at which consumers will see their options through the window the five large carriers control. Thus, we believe that Orbitz not about fair and open competition. It is instead a cartel owned by big suppliers and is the antithesis of competition.

### **Orbitz: The Suppliers' Online Joint Sales/Marketing Agency**

As policy makers debate “fair access to fare and inventory information,” it is important to understand just what Orbitz *is* and what it *is not*. By focusing on certain key questions, I believe that this Commission will be in a much better position to evaluate the nature of this collective effort by suppliers to establish a powerful position in the online travel channel.

### **How/Why was Orbitz Formed?**

Airline suppliers were relatively slow to enter the Internet travel distribution channel. The first airline web sites did not add significant functionality until 1997 (which is considered relatively late in Internet terms), many months after Travelocity and other

online travel agencies had pioneered these online services to consumers.<sup>2</sup> Eventually, the suppliers began to pay much closer attention to this emerging channel of distribution and reportedly developed “fears” that absent decisive action by suppliers, “non-airline entities can use [Internet] technology to interpose themselves in [our] business.”<sup>3</sup> As one IATA official noted, airlines were “less aggressive” than other industry participants to adopt the Internet, thus increasing the airlines fear of losing control over distribution.<sup>4</sup>

The airlines’ collective response to the new Internet distribution challenges posed by independent entities was the November 1999 announcement of the formation of a jointly owned Internet sales and marketing agency – Orbitz. Public statements by the founders of Orbitz make it clear that the underlying purpose of the effort was to undermine to the increasing popularity of independent on-line agents like Travelocity.com and to counter such sites’ growing role and consumer affiliation in the distribution of air travel information.

### **What obligations are placed on participating suppliers?**

Evidence of how Orbitz operates in the online travel channel may be found in its non-equity “Airline Charter Associate Agreement.” Based on the language in this agreement, airline participants may no longer have unique sales or run special promotions with online competitors of Orbitz. Rather, participating carriers must give Orbitz access to all “published fares,” which, under the agreement, is broadly defined and includes virtually every fare in a given airline’s inventory. This includes: (1) any

---

<sup>2</sup> Jupiter Online Travel Report at 9 (June 1999).

<sup>3</sup> “IATA Legal Symposium on eCommerce,” (presentation by Michael Feldman, February 2000).

fares published in a CRS (the source of fares for independent travel agencies); (2) any fares, and corresponding inventory, published in the carrier's internal reservation system; (3) "Internet" fares, including those offered via e-mail to targeted consumers; (4) promotional fares offered to the general public; and (5) fares offered to travel consolidators.

In addition, the owners agreed among themselves to impose annual in-kind promotional support obligations on carriers, with one of the ways carriers could meet this obligation being to offer their lowest fares **exclusively** through Orbitz. Each participating carrier is obligated to provide Orbitz with substantial "In-Kind Promotions" which can run into millions of dollars<sup>5</sup> for the first 12 months of the agreement. Among other things, "In-Kind Promotion" obligations can be satisfied by offering "exclusive promotions or fares available only on" Orbitz or the participating airline's own Internet travel site.<sup>6</sup> Orbitz also has the right mutually to develop the exact terms of the In-Kind Promotional plan and to determine how such obligations will be satisfied by the smaller carriers, and can withhold certain rebates if the carrier and Orbitz fail to develop a mutually acceptable promotional plan and/or if the carrier fails to adhere to the terms of that plan.<sup>7</sup> Moreover, Orbitz's requirement that all participants immediately provide to Orbitz all promotions and fares that are offered using alternative distribution methods

---

<sup>4</sup> Id.

<sup>5</sup> The exact total is calculated by the carrier's "Market Share multiplied by \_\_\_ million U.S. dollars".

<sup>6</sup> The value of these exclusive fares is calculated by the difference between the exclusive fare and the next-highest fare offered elsewhere, times the number of tickets. If the fare is made available on Orbitz and not on the offering carrier's own web site, a 100% credit is applied toward the in-kind requirements; if the carrier determines to offer the fare independently, the credit is lowered to 75%. The "value" as calculated under this formula is capped up to \$1 million dollars for any 12-month time period.

<sup>7</sup> The non-equity owning carriers can also apparently satisfy these requirements by providing Orbitz with "passenger database information" and "competitive purchaser names" (e.g. e-mail addresses of passengers who booked travel through another online agency).

will undercut any incentive by Orbitz to innovate by developing and packaging special promotions from suppliers.

These unusual contract provisions were the subject of much controversy in 2000 and early 2001 as the Department of Transportation considered what safeguards might be required up front. DOT nonetheless allowed Orbitz to launch without any limitations on its ability to enforce the MFN clauses and exclusivity clauses. As I will show momentarily, an analysis of that decision, and an examination of the events of the months since Orbitz began operation, can lead only to the conclusion that if there were ever a basis for permitting Orbitz to enforce either of these provisions, it evaporated long ago.

In and of themselves, the terms of the Orbitz agreement with its Charter Associates and participating carriers have impaired the ability of Travelocity, Expedia and all independent travel agents, whether online or offline, to compete with Orbitz for airline bookings. This harm to the competitive airline process has materialized with even more severe, long-term harm inevitable. In its April 13, 2001 letter, DOT acknowledged that “Critics argue that the MFN clause undermines the ability of individual airlines to make clandestine deals with other internet travel sites – deals that they rightly contend have a pro-competitive effect on pricing... Thus, there is some potential impact on the market dynamic.”<sup>8</sup>

The “clandestine deals” by the big five on Travelocity and Expedia that were commonplace before the formation of Orbitz, and played a special role in the competitive process, have slowed substantially. The web fares offered on Orbitz are

---

<sup>8</sup> DOT Letter at 4.

hardly clandestine. Rather, like clockwork any web fare posted on Orbitz is readily detectable by all carriers -- at the same time every working day.

### **MFN Concerns**

MFN requirements have insulated Orbitz from any competitive pressure because a participating carrier cannot force Orbitz to improve its services by threatening to take its promotional offerings elsewhere. In somewhat analogous circumstances, the Department of Justice successfully urged DOT to remove such “most favored nations” provisions or “parity” provisions – clauses that require carriers to participate in all CRSs at the same level – for carriers that do not own interests in CRSs.<sup>9</sup>

In so urging, the DOJ noted that such a provision “removes an airline’s ability to obtain better service by credibly threatening to downgrade its participation level. With the most favored nations or parity provision, the downgrade threat is unrealistic because the CRS knows that the airline would also have to lower its participation level in every other CRS.”<sup>10</sup> As with the parity provisions at issue in that matter, participating carriers in Orbitz cannot simply divert their promotional efforts to other, more responsive, Internet travel sites without similarly offering those promotions to Orbitz. Orbitz’s requirement that any fares and seats offered to other outlets also be offered to Orbitz,

---

<sup>9</sup> Comments of Department of Justice, Docket OST-96-1145 (Sept. 19, 1996).

<sup>10</sup> *Id.* at 7.

will, under DOJ's and DOT's prior reasoning, render Orbitz "unresponsive to consumer preferences" and "anticompetitive."<sup>11</sup>

Frankly, we think it is wrong for major suppliers to use their collective control over inventory and pricing information (and their ability to deny such information to competitors) to tilt the playing field in favor of their joint sales agency and against sites more aligned with consumer interests.<sup>12</sup>

Orbitz explosive growth was not due to their technology or their claims about customer service – it was driven by their ability to sell product on the nation's five largest airlines in the land that all of Orbitz competitors were denied.

### **In Kind Promotions and Web Fares**

In a letter to Orbitz CEO Jeff Katz on April 13, 2001, DOT plainly expressed its rationale for allowing Orbitz to launch with contractual incentives to provide content to Orbitz exclusively. The Department expressed strong misgivings, saying:

Orbitz has assured us that charter associate airlines have sole discretion over the selection of methods to meet their in-kind promotional obligations and they are free to fulfill their in-kind contributions entirely by other methods. According to Orbitz's documentation, 'the maximum amount of credit that an airline can get through this option is set at a low, fixed number; even if revenues from the fare promotion were to exceed that limit, it would not further reduce the airline's in-kind obligation.' Furthermore, this in-kind promotion method '...cannot under any circumstances fulfill more than half of its in-kind obligation....' **Nevertheless, we have serious concerns about incentives toward exclusivity, however limited. While we are prepared to reserve judgment until we see how this provision operates in the marketplace, we will monitor these developments closely. Allowing a new entrant with no sales or market share to offer**

---

<sup>11</sup> *Id.* at 8 (citing *NCAA v. Board of Regents*, 468 U.S. 85 (1984)).

<sup>12</sup> The founders of Orbitz have publicly stated that the formation of Orbitz is "one of the strategies that the airlines have used in response" to the "danger" of electronic travel agents "completely dominating this space, to the detriment of the travel providers themselves."

**financial incentives to get exclusive access to a very limited portion of supplier inventory may be a legitimate means of overcoming entry barriers.**

(emphasis added)

As predicted by many of its critics, the owners of Orbitz have made available to Orbitz -- and Orbitz alone -- wave after wave of web fares, often for discounts across all or much of their entire network of flights<sup>13</sup>. The representations made by Orbitz to induce DOT to allow it to commence operations unfettered by standard rules of fair play -- namely, that web fares would represent only "1/10<sup>th</sup> of one percent" of the fares on offer<sup>14</sup>-- have proven to be completely false.

To the contrary, our research has proven that exclusive web fares make up the large majority of Orbitz's top offerings. In January 2002, a search of five city-pairs in Orbitz showed that **72%** of the first ten options presented by Orbitz in those markets were web fares. Similarly, a March 12, 2002 search of three city-pairs demonstrated that **100%** of the first 30 options presented by Orbitz were web fares. Lastly, in an April 9-10, 2002 search of ten city-pairs, **85%** of Orbitz' ten top fares were web fares.

In each of these examples, a review of the results in Expedia and Travelocity confirmed that these special fares were entirely denied to Orbitz's on-line competitors. That these five airlines likewise denied these low fares to the tens of thousands of brick-and-mortar travel agents on whom most consumers and business travelers depend is further attested by the outpouring of travel agency filings in the DOT docket.

---

<sup>13</sup> Of course, we welcome low fares and the more the better. However, because the largest carriers in the U.S. have withheld comparable low fares from any of the tens of thousands of off-line and on-line travel agencies that compete with the agency they jointly own -- Orbitz -- they have distorted competition in the field of airline ticket distribution and have also injured those millions of consumers and businesses who, for all sorts of valid reasons, choose to deal with travel agencies that are independent of the big carriers.

<sup>14</sup> See DOT Letter at 7.

Importantly, these Orbitz web fares are not simply last-minute weekend travel fares on flights that have an unusually high number of empty seats; they are instead wide swaths of the airlines' fares on flights between some of the nation's most popular city pairs and are available for booking 14 or seven days or more in advance. On February 26, Karl Peterson, CEO of Hotwire, a travel web site owned by four of the five Orbitz owners succinctly described the transformation of the uses of web fares by large airlines, the fares only Orbitz got from its five owners:

“[N]o longer are web fares surgical. They are closer to a published fare sale than they've ever been....”

Because of these sweetheart deals for low web fares on the Big Five, Orbitz surpassed Expedia in November 2001 to become the number two travel web site in terms of airline bookings. What the major independent sites achieved in five years of operation, Orbitz achieved in just six months through its de facto exclusive access to web fares.<sup>15</sup>

In recent months, some of the Orbitz carriers have started to provide some web fares to a select few the independent agents. However, those carriers that do have deals to provide web fares to independent sites have evidently reserved discretion to deny to others the same fares Orbitz gets because of the continued prevalence of a large number of instances where Orbitz, and Orbitz alone, possesses web fares on all five Orbitz owners and often, on any of them. And Orbitz has now confirmed publicly that it has 10 year contracts with its owners that, among other things, guarantee Orbitz access to all these web fares.

---

<sup>15</sup> Orbitz's claim that it does not have "exclusive" fares because most of these fares are also available on the individual carriers' web sites. While Orbitz engages in such semantical games, this form of self-dealing is hardly the type of robust competition a free and fair marketplace would demand.

A key premise of the DOT's decision allowing Orbitz to proceed was that a "very limited portion of supplier inventory" would be made available to Orbitz on an exclusive basis. In other forums, Orbitz executives had asserted that these special web fares to which it alone would have access would not account for any significant portion of the lowest fares it offered. In a May 22, 2001 speech to the Aero Club, Jeff Katz said:

"We estimate that about 99% of the time that Orbitz produces a lower fare, it will be *[sic]*not be because we had access to a fare others did not, but because we found a fare that everybody had access to, but not everybody could find. Or not everyone chose to display."

As any observer of Orbitz will know, the behavior of the Orbitz owners and Orbitz has not exactly followed the story told by Orbitz. Instead, in the 11 months since Orbitz commenced operation it has offered massive "web only" discounts that the five Orbitz owners made available on Orbitz, but denied to all of Orbitz's independent competitors, on-line and off-line. On a routine basis, shoppers who booked through Orbitz got an additional five to ten percent off **every** fare sold through by one of its owners through Orbitz, but not through any independent site.

### **The Impact of Commission Cuts and Preferential Treatment of Orbitz**

While we are greatly concerned about the special access that Orbitz has enjoyed to the fare and other data of its five owning carriers, in the last two months another significant instance of preferential treatment of Orbitz by its five owning carriers has emerged. As of March 20, 2002, none of the five airline owners of Orbitz paid "base commissions" to U.S. travel agents, but all five continue to pay to Orbitz the "transaction fees" that Orbitz is guaranteed pursuant to the Orbitz airline participation agreement. At last report, the transaction fee the five had guaranteed to Orbitz was approximately \$6.37 per ticket. If the

CRS rules applied to the Internet, the five owners would, of course, be forbidden from engaging in this form of discrimination with respect to commissions paid.

The perverse result of this commission discrimination by Orbitz's owners is that other agencies receive commissions from the five largest airlines only if the agent delivers a "premium share" of its business to qualify under the airlines' override agreements. Orbitz meanwhile retains its privileged position and continues to enjoy a guaranteed revenue stream from all five of the carriers irrespective of its sales performance. This is the very kind of "skewing" to the distribution outlets owned by large carriers the CRS rules were designed to prevent, but represents the logical and predicted outcome of DOT's approach toward Orbitz to date.

The competitive risks from discrimination against Orbitz's travel agency competitors, in terms of sweetheart deals for special low fares to be offered to the traveling public and in terms of preferential commission compensation -- are far more pronounced than was ever so in the case of the traditional CRSs. Unlike any of the traditional CRSs, Orbitz is backed by the collective power of **all five** of America's largest airlines. Those carriers account for roughly 75-80 percent of passengers carried in this country. Thus, they can tilt competition decisively in favor of Orbitz by withholding data on their flights from the competitors of Orbitz (as well as choking off from competing travel agencies the commission income stream they bestow on Orbitz -- the company store). DOT recognized this possibility in its April 13, 2001 letter to Orbitz, which said, "...the question remains whether Orbitz substantially reduces charter associate carriers' incentives to make their lowest fares (including web fares) available through other online travel agencies, even if these agencies match the terms offered by Orbitz." In fact, many online agencies have done precisely that

since the launch of Orbitz in June 2001, yet the lowest fares are not being made available to them the way they are made available to Orbitz.

### **Negotiating with Carriers for Pricing Deals**

Just like Wal-Mart has stimulated low prices because of the negotiating leverage it has vis-à-vis suppliers, independent online agencies and large independent brick-and-mortar agencies or consortia of agencies can play airlines off against one another to get special short term rates for consumers. Most importantly, agencies that are independent of airlines have every incentive to do so because they make their money selling a multitude of tickets. The more of them, the better, and because of the earlier commission caps imposed by carriers over the last few years and the recent elimination of all base commissions, travel agencies usually have little or nothing to gain from selling high fares as opposed to low fares.

Prior to Orbitz's launch, many parties, including small airlines, consumer groups, businesses that are major buyers of air travel, and travel agencies warned that if Orbitz did have exclusive access to the lowest fares of the Big Five on a routine basis, the independent travel agencies, on-line and off-line, would suffer a distinct disadvantage in the sale of airline tickets. The data confirms those predictions were accurate.

Without more, the public should be concerned for two important reasons about this distortion of competition in the market for the distribution of airline tickets. First, as DOT acknowledged in its letter of April 13, 2001, independent sites have had a pro-competitive effect on airline pricing by promoting "clandestine deals." Second, and more generally, consumers and business should have the freedom to choose to deal with a travel agency

independent of the airlines if they prefer an agent more aligned with **their** interests, and they should not be forced de facto to deal with the airlines' "company store."

Imagine how consumers would feel if the five largest PC manufacturers decided they were tired of dealing with the Best Buy's, Circuit City's and CompUSA's of the world and would jointly start their own store chain selling PCs, and then **agreed** among each other that they would thereafter never undercut the prices they made available to those collectively-owned outlets. Of course, consumers would be up in arms – as consumers and business travelers have been with respect to Orbitz. Why? Because they would know that their freedom to shop at an independent retailer, one who would have an interest in driving down the prices manufacturers collected for their hardware, would be impaired over the near and long term. That is precisely the situation that has already occurred in the field of on-line air travel distribution because of Orbitz.

### **Smaller Carriers Have Consistently Poorer Sales In Orbitz**

There is more data that should concern consumers and business travelers, evidence that has ominous overtones for the future of airline competition. A number of concerned parties predicted in 2000 and early 2001 that Orbitz would be designed and operated in ways that would neutralize the ability of the small, discount carriers to achieve a premium share of ticket sales in the independent web sites. For example, Orbitz's refusal to allow airline advertising in the airline displays was seen by many as an attempt to deprive smaller airlines of a very useful, point-of-sale technique that touted their bargain fares. Through banner ads promoting their fare specials, smaller carriers had been able in

the independent sites to overcome their lack of name recognition and to attract needed incremental business.

In short, the data show that the small discount carriers **do** attract a substantially higher share of sales in the independent sites and that in Orbitz the Big Five have succeeded in nullifying that phenomenon. In effect, the Big Five airlines have replaced their individual “halo effect” in their respective airline-owned CRSs with a collective “halo effect” on the ubiquitous Orbitz.

As forecasted by many, the hard sales data for the months since Orbitz’s launch show that smaller and low fare carriers, like America West, Alaska Airlines, ATA, and AirTran, do much more poorly in Orbitz than in the two largest independent web sites. These low-fare carriers achieve a percentage of total bookings that is 15% to more than 200% larger in the independent sites than in Orbitz.

Simply put, the data concerning how smaller airlines do in Orbitz are a bad omen of what the future holds for them as more and more consumers are driven to Orbitz. Moreover, they are a stark reminder of what the world was like for smaller carriers in traditional CRSs before the Civil Aeronautics Board adopted rules in 1984 to restrain the behavior of airlines controlling CRSs.

In response to this uneven competitive playing field, Travelocity and Expedia have both publicly stated that they are shifting their focus away from the sale of scheduled air, where they have long been positive forces for airline competition, to the sale of other products, such as hotels, package vacations and cruises. Last year, 55 to 60% of Travelocity’s business was selling air transportation; this year, the number has been reduced to 45 to 50%; Expedia is likely to have experienced similar percentage

reductions. In doing so, Travelocity and Expedia may succeed in protecting their businesses. Orbitz's recently filed S-1 reveals that a remarkable 87 percent of their 2001 revenues came from the sale of air transportation. However, the foregoing data demonstrates that this forced shift in emphasis by those two is bad tidings for small, low-fare carriers, and for the consumers who look to them to serve as a competitive spur for lower fares – because more consumers will be driven to shop Orbitz for the best fares on the five largest carriers.

### **What Lessons Can Be Applied From the History of Travel Distribution To Better Evaluate This Collective Supplier Effort?**

Our best guide to determining what Orbitz *is* may be the history of travel distribution. In the 1960's and 1970's, the airline industry developed the first networked industry infrastructure for electronic commerce—the computerized reservation system or “CRS”. Interestingly, there was an initial joint supplier effort to create a single CRS from 1974 to 1976. While that effort ultimately failed, it is important to note that the airline suppliers sought the formal approval of the federal government (through a grant of antitrust immunity) *before* they engaged in those discussions and the DOJ, while granting approval, did so subject to a number of conditions.

Individual airlines or groups of airlines ultimately established carrier-affiliated CRSs -- and not unexpectedly -- the owning airlines utilized the best displays in their affiliated system to sell their inventory of airline seats. The ensuing debate and government studies that occurred in the industry in the early 1980's led to clear regulations in the distribution of airline information in the United States.

These regulatory protections include, among other things, measures that prevent carriers owning a CRS from distorting competition in the field of airline distribution by forbidding the discriminatory withholding of participation or information on their flights from CRSs competing with their own system.

When the original CRS rules were promulgated in 1984, they did not contain this safeguard. Viewing this as an open invitation, a number of airlines made their best fares and the full range of seat inventory available only to users of the systems they owned. This was a particularly effective tactic at big carrier hubs. It meant that many agencies had little choice but to take the system that the carrier demanded -- since they had to have competitive access to the fares and flights of the carrier that consumers in hub markets flew most often.

By 1992, this conduct had become so pernicious that DOT amended the regulations to prohibit CRS-owning carriers from withholding from competitors fare and other data they provided to their own system, as long as the competing system offered commercially reasonable terms. In a passage that is still fresh and relevant today, DOT said:

“We have determined to adopt the proposed rule. The rule is necessary, for some system owners do not participate in enhancements in other systems and do not provide complete information on their fares and services to competing CRSs, as we tentatively found in the NPRM. No one has argued that system owners never limit their participation in other systems as a weapon to obtain more subscribers at their hubs and no one has denied the potential usefulness of such tactics.”

57 F.R. 43780, 43800 (September 22, 1992) (emphasis added).

Essentially, DOT and others were concerned that suppliers were withholding information and desirable consumer amenities, such as pre-reserved seats, boarding passes, etc. from competing CRSs – providing those items only through their affiliated

CRS. As you might expect, it was believed that this conduct substantially undermined the utility and value of the competing CRSs.

DOT noted that many industry participants were alleging that carrier-owners had “reduced the level of their participation in other [CRS] systems in order to handicap the ability of other systems to compete for subscribers.”<sup>16</sup> In requiring that owner-carriers participate in CRSs on equal terms, DOT noted that “[t]his requirement appears justified on competitive grounds, since it would prevent a CRS owner from using its dominance of a regional airline market as a tool for obtaining dominance in the area’s CRS market.”<sup>17</sup>

However, because the current CRS rules were adopted at a time when the use of the Internet to make airline reservations was barely in its infancy, they contain a huge – and inviting – loophole that Orbitz has exploited. The many protections of the regulations are fully applicable to CRSs distributed to travel agencies, but are completely inapplicable to ticket distribution systems targeted at consumers. It is noteworthy that the Canadian and European rules, adopted more recently than the U.S. rules, have eliminated this loophole.

### **DOT Inaction**

Unfortunately, DOT has not addressed the “sea changes” in the industry that have occurred over the past ten years. Because the regulations fail to address the industry as it

---

<sup>16</sup> DOT Notice of Proposed Rulemaking, 56 *Federal Register* 12586 (Mar. 26, 1991).

<sup>17</sup> *Id.*

exists today, they risk becoming an anachronism -- the equivalent of a quill pen in a world of electronic commerce.

We have urged DOT to address in a substantive way the critical issue raised by a host of commenters to the DOT Docket, including Members of Congress, the Attorneys General for twenty-three states, low-fare airlines, including Southwest, the National Business Travel Association (NBTA), a multitude of travel agents, and dozens of consumer groups. That issue is the now well-advanced campaign by Orbitz to seize control of, and dominate, the on-line distribution of airline tickets.

The current threat to competition posed by Orbitz was well put by the National Business Travel Association (NBTA) where that association, which represents corporate travel managers, said:

Currently, many of the web fares found on the airlines' sites and on websites like Orbitz are not found in the CRS, the traditional method of reservation acceptable for corporations and travel agents. Over the near and long term, as the independent, neutral distribution channels, such as the CRSs and online and off-line agencies are weakened, the largest carriers will gain ever more control over the window through which travelers are allowed to see their options.<sup>18</sup>

We believe DOT should act now to ban the use by Orbitz of contract provisions that require carriers to provide "most-favored nations" ("MFN") treatment to Orbitz with respect to fares and other. The Department should also void the provisions of the Orbitz Agreement that give carriers financial incentives to confer fares and other content on Orbitz on an exclusive basis. If DOT fails to tackle these problems posed by Orbitz, it may be necessary for Congress to step in and do the job DOT has failed thus far to do.

---

<sup>18</sup> National Business Travel Association filing to DOT CRS Docket, February 24, 2002, p.1.

### **Should Orbitz Be Permitted to Operate?**

Sabre, unlike many other critics of Orbitz, has never asked that Orbitz be blocked from operating. Instead, we have expressed concern over the consumer harm and competitive implications of DOT not taking action while Orbitz implements a business plan predicated on exclusive access to the lowest fares of the five largest carriers in the U.S. We have urged the Department to address this risk head-on, allowing Orbitz to exist, but with appropriate protections for competition learned from the hard lessons of the past. Our concerns have been founded on solid logic and hard facts from the start. On its face, is it not extremely odd that this “new entrant” was able to extract MFN clauses and exclusivity provisions from the world’s largest airlines at a time when it had no sales and no market share?<sup>19</sup>

### **Orbitz: A Tool to Shift Directly To Consumers Airline Distribution Costs**

Many predicted also that once this airline-owned web site achieved market strength that it would be used to disadvantage consumers in other ways. That prediction too has become a reality. In December 2001, shortly after gaining the number two spot among on-line agencies for airline bookings, Orbitz made its first overt move to effect such a goal when it imposed a five dollar service fee on **all** tickets purchased on that site.

This move by Orbitz becomes even more worrisome when one considers the industry reports that the standard participating carrier contract Orbitz has had since its

---

<sup>19</sup> In the days when CRSs were primarily carrier-owned, the DOT had to force nondiscrimination conditions and mandatory participation on system owners. The DOT’s failure to update its CRS rules to apply to the Internet have created an environment in which a *carrier-owned* travel distributor can avoid these conditions even though the competitive concerns remain the same.

launch specifies a substantially **declining** commission rate schedule for airlines between 2001 and 2006. That understanding, coupled with this newly-announced service fee for consumers, illuminates the road map Orbitz has agreed to follow. Each year, Orbitz will shift to consumers an ever-increasing portion of the cost of distributing the tickets of its owners.

If Orbitz should counter broadly that these substantial decreases in charges to airlines merely reflect some anticipated decreases in the projected costs of Orbitz's operations, we believe the U.S Government should put such assertions to the test by reviewing its historical and future business plans.

**DOT Should Amend Its Rules to Apply To  
Orbitz Owners Obligations of Non-Discrimination**

We have argued that once the Department of Transportation has addressed the most pressing problems presented by the MFN and exclusivity provisions of the Orbitz contract, it should then move to impose on the airline owners of Orbitz the same duties of non-discrimination applicable to airline owners of traditional CRSs.

The limited scope of the U.S. rules, causing them to apply only to computer reservations systems **to the extent these systems are used by travel agents**, may have made sense in 1992. However, at a time when tickets sold online directly to consumers are approaching 15% of all sales, it is nonsensical to say that stringent rules banning bias, discriminatory booking fees, and the discriminatory withholding by airline owners of key flight data are essential elements of public policy in the case of the four traditional CRSs (some of which are no longer airline owned), but that a ticket

distribution system like Orbitz that is backed by the combined strength of the five biggest airlines, gets a regulatory free pass.

In fashioning the appropriate regulatory response to the meteoric rise and competitive harm of Orbitz, the Department should be mindful of the philosophical and policy underpinnings of the regulations. In 1984, the CAB found that regulation of airline owned or marketed CRSs was necessary because, it concluded, airlines that owned the electronic distribution outlets for airline tickets had both the means and the incentive to use that control to advance their fortunes as airlines. The Department found a documented halo effect that favored major carriers that owned distribution outlets at the expense of smaller carriers.

In 1992, the Department affirmed that view and also found that airlines had an inherent incentive and power to favor the distribution outlets they owned over all others. No good reason exists today to believe that these fundamental dynamics in the airline industry have been repealed. Indeed, all signs point toward a halo effect *déjà vu* for its owners, which the Department ought to stop dead in its tracks before Orbitz steers even more traffic away from low-fare carriers. In the face of those facts, it is difficult to see how anyone could make a principled argument that the rules designed to prevent abuses by even a single carrier owning a traditional CRSs offered to travel agencies are unnecessary when the five biggest carriers get together to design and operate a web site targeted at consumers.

The Department of Transportation should promptly take the steps needed to apply in the case of Orbitz and its owners the same regulatory safeguards that it found

long ago were necessary to protect competition in the case of traditional airline-owned CRSs.

Equally important, given the sharp rise of the Internet as a major medium of airline travel distribution, and the unquestioned success of individual airline sites prior to the launch of Orbitz, the Department ought not to continue to countenance inherently suspect arrangements among horizontal competitors like MFN and exclusivity provisions.

In its filing of February 24, 2002, NBTA framed the issue DOT now confronts with great clarity:

Without DOT oversight, the major airlines will use their control over the windows through which travelers are allowed to make their choices and cloud the transparent consumer choices that existed prior to the birth of the non-CRS linked Internet sites. Why are consumers, corporations, and online and off-line travel agencies that serve corporate and consumer needs any less deserving of protection against abuses that the DOT has many times determined airlines owning the distribution channels for airline tickets have both the incentive and means to commit?

Id., at 2.

### **Conclusion**

Based on its MFN and exclusivity provisions and exclusive access to waves of web fares on the nation's five largest airlines -- fares that predominate its listings despite its earlier representations to the contrary to the Department -- Orbitz has gone from nowhere to become the second largest Internet travel agency, in record time. This attempt by Orbitz to seize control of the Internet window through which consumers view their options, and the exact unfair tactics it would use, were foreseen by many in the industry well over a year ago.

The present empty propaganda by Orbitz to the contrary notwithstanding, competitors of Orbitz have vigorously and publicly pursued access to these same fares. Until recently they were rebuffed entirely. Even now, only **some** of the Orbitz carriers make **some** of the same fares available to the independent web sites that compete with Orbitz. And while we now know that Orbitz has a 10 year lock on these fares (coupled with a long-term guarantee of transaction fees from its five owners), even this limited access to web fares for the independent sites can apparently be revoked on short notice.

The data also show that Orbitz is hardly a friendly site for low fare smaller airlines. The actual booking data demonstrate that smaller airlines attain a consistently lower percentage of sales in Orbitz than in the two independent sites, a growing threat to their ability to compete. This phenomenon too was predicted by many.

Action is needed now to prevent Orbitz from continuing to use these features of its agreement to harm consumers, competing travel agencies, and competition and to promptly thereafter modernize its CRS rules to apply fully to Orbitz and its owning airlines.

The rise of Internet commerce has initiated a true revolution in the travel distribution industry, and holds the promise of greater efficiency and enhanced competition at all levels. As a policy matter, and as a legal matter, we do not believe suppliers should be able to engage in collective action to withhold information from independent distributors.

Given Orbitz's unusually fast seizure of a substantial market share, if the MFN clause were ever justifiable in April 2001 because Orbitz had "few sales and no market share" and if the exclusivity incentives might have been defended as a legitimate means to "overcome entry barriers," those reasons for DOT to stay its regulatory hand have

disappeared completely. In its report to Secretary Mineta, this commission should recommend that DOT act forthwith to void these provisions of the Orbitz contract.

Mr. Chairman, thank you for the opportunity to testify. We look forward to working with the Commission as it continues to evaluate the dangerous impact of Orbitz.