

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

Testimony of United Airlines, Inc.  
June 26, 2002  
Chicago, Illinois

Mr. Chairman, Members of the Commission, Ladies and Gentlemen:

On behalf of United Airlines and its 84,000 employees, I want to welcome you to Chicago, our home town, and thank you for the opportunity to appear before you today to discuss our views on product distribution in the airline industry.

My name is Greg Taylor. I am United's Senior Vice President for Planning, with responsibility for pricing, inventory management, scheduling, route planning and management of United's relationships with the global distribution systems, the GDS.

Mr. Chairman, I'm not here to mince words: United had a lousy year in 2001, starting even before the September 11 attacks and the hijacking of our aircraft. This year, in the words of our company's chairman, we're "in uncharted territory," like most segments of the U.S. aviation industry. We face not only unprecedented levels of competition from established as well as low-cost airlines, but the industry remains caught in the throes of a recession in air travel, particularly business travel, that just hasn't quit.

As a result, we are examining every opportunity -- not only to increase revenues, but also to reduce costs. Like all major network airlines, we have launched across-the-

board cost reduction programs. And I don't just mean removing the sliced olive from the salad. We've slashed our capacity by 23%, grounded 86 aircraft, deferred new aircraft deliveries, renegotiated employment terms with our workers, furloughed 20,000 employees, and cut capital spending by \$3 billion through next year. Just last week, our management and administrative employees agreed to \$430 million in compensation concessions and ALPA's leadership approved a concession agreement that could potentially save United over \$520 million.

In this critical cost-cutting effort, everything is on the table -- certainly including the cost of distributing our product. Distributing our airline tickets represents our third largest cost component -- right after the cost of labor and the cost of fuel. Last year alone, we spent almost \$ 700 million on travel agent commissions, and another \$ 300 million on GDS booking fees. While we partially addressed travel agent commissions when we reduced them earlier this year, GDS fees continue to increase. These fees have gone up over 350% for United over the past twenty years. By comparison, during this same twenty-year period, United's average domestic revenue per enplaned passenger has increased less than 14%. In today's extraordinarily challenging business environment, we simply cannot afford the old way of doing business. In the cost of distribution, as in all of our functions, we need to find the most efficient, most effective, and least costly means of doing business.

We fully recognize that changing the status quo can bring forth strong feelings, and no doubt many in the travel agent community are unhappy with our cost-cutting

approaches. That is entirely understandable. At the same time, I assure you that we take no pleasure in realigning arrangements with our many suppliers or contractors -- or, most especially, our own employees -- who have also been affected by the difficult economics of today's industry. Virtually all elements of the aviation industry face unusually challenging circumstances.

That said, I'd like to take this opportunity to touch on several key points that the Commission is considering, and to offer an additional perspective on some of the claims that have been made with respect to various forms of distribution by airlines, including (but by no means exclusively) Orbitz.

Overall, I'd initially like to underscore two broad points. The first is simply that, consistent with longstanding American business and legal principles, the provider of goods or services is entitled to distribute its product as it sees fit to best achieve its business objectives, subject to competition rules. Second, in careful consideration of our business interests, we at United have chosen to distribute our different products through numerous different channels, and have done so for a long time. These include traditional travel agents, our own web site, Internet travel agents, in-house reservation agents, and corporate accounts, among others. We use these channels in order to meet the diverse needs of our customer base as well as to optimize revenues and lower costs for United.

Our largest and most important sales channel remains traditional "brick-and-mortar" travel agents, linked to us through the GDS systems. This distribution channel

remains vital to United, and accounts for the sale of more than 70% of United Airlines revenue. These agents are critical in providing the various services required by our business customers, who represent the majority of our revenue stream. Also, as the nation's largest international airline (measured by revenue passenger miles), we are especially dependent on knowledgeable travel agents who "add value" for our international customers. We are well aware that our passengers rely heavily on such agents and their expertise in planning overseas vacations and complex business trips abroad.

On the other hand, it is an indisputable fact that these same traditional travel agents, because of high GDS fees, represent our most expensive distribution channel. As I recollect, the average GDS booking fee was less than \$1 per segment in the early 1980's, prior to the regulation of the GDS fees. Once the regulations were in place, the fees immediately jumped to \$1.85. United is estimating that the fees for 2002 will be over \$4.50 per booking, an increase of more than 350% in 20 years. This is at a time when the costs associated with data processing activities in other industries have declined tremendously.

We are not alone in these concerns regarding the cost of distribution. In fact, the U.S. General Accounting Office is studying right now why these costs are rising so rapidly. Particularly, as GAO has been asked to recommend appropriate regulatory or other action to address these concerns, we respectfully urge this Commission to consult

with GAO and the Antitrust Subcommittee as it develops its own recommendations to Congress.

Given the high GDS booking fees, there is a clear need for United to realign our distribution plan. At the same time, we must also focus on optimizing a distribution system that will most effectively enhance revenues and amplify our marketing efforts, while remaining efficient and useful for our customers. In this regard, we have found that Internet and web site distribution have significant advantages for us in effectively marketing and delivering our product. For example, these channels enable us to economically offer a range of travel products -- from weekend promotional fares to last minute sales -- to different potential customer audiences. They also enhance our ability to integrate marketing efforts through such means as advertising on the site to those who are already shopping for travel, and through direct e-mail communications to potential purchasers of specific travel products. The capabilities these channels provide are more precise and considerably less expensive than promoting travel through traditional travel agents and general print media, thereby adding to the overall economic value of Internet distribution.

Our participation in Orbitz serves many of these same business objectives -- to increase ticket sales and lower our distribution costs, while enhancing our marketing effectiveness. In fact, if all the tickets United sells through the GDS channel were sold at the same cost as tickets sold through Orbitz, we (and indirectly, our passengers) would save more than \$92 million in GDS fees every year.

Mr. Chairman, I do not want to turn this into another Orbitz hearing, but with all due respect, the key arguments against Orbitz prove exceedingly thin. Let me briefly examine them.

First, there is the contention that since Orbitz is co-owned by several major airlines, it is somehow inherently a vehicle for anticompetitive conspiracy or collusion. But the fact that Orbitz is owned by a group of airlines proves nothing of the kind. Airlines interact with each other constantly -- and are required to do so by myriad federal regulations and agencies, and by the very nature of the business. They exchange and transfer literally millions of passengers each year. They sell interline tickets, and they even sell tickets on each other. Moreover, airline participation in Orbitz is entirely non-exclusive.

Should the co-owners of Orbitz engage in any improper action, the government is entirely free to act. Indeed, both DOT and DOJ currently have pending requests for information from Orbitz.

A second focus of complaints against Orbitz relates to the presumed unavailability of web fares. Here, the claim is that Orbitz was created by the airlines to allow them to monopolize all the web fares on a single Internet site. The facts are otherwise. To put the issue in perspective, revenue derived from web fares constitutes a meager 2% of United's total North American revenues. While web fares are

proliferating, new channels for their distribution seem to be opening all the time. One must understand that the value of web fares is not merely the incremental traffic they generate, they also encourage customers to become familiar with new channels that have a lower cost of distribution for United.

United is aware that broadened access to web fares was a major issue addressed at the Commission's recent hearing in Washington, D.C. United is willing to state unequivocally, and on the record, that we would be prepared to offer our web fares to any distribution outlet that offers United a cost of distribution for all traffic (not just web fares) that is equal to or better than that of Orbitz.

On the other hand, mandating that web fares be made available to all parties in the distribution system is not a solution. Like all large businesses, airlines must be free to distribute their products as efficiently as possible. For cost reasons, United, for example, has so far elected to offer some very low web-only fares only on certain Internet sites. Requiring that the airline's lowest fares be sold through its most expensive distribution outlets would tend, if anything, to foreclose the availability of low fares to consumers. What chain store would choose to sell its "clearance" items at its Michigan Avenue retail boutique?

A third issue -- and one that should merit little consideration -- is the suggestion that anachronistic Computerized Reservations System rules should be applied to Orbitz. In fact, the existence of these rules has been a key reason that airline ticket distribution

via GDS systems has become so inordinately costly. Moreover, these regulations were developed years before the concepts of web sites and web fares -- indeed, nearly a decade before the widespread proliferation of household Internet access. To apply an outmoded regulatory structure to the still-unfolding evolution of the Internet would be to shut off critically needed avenues for enhanced efficiency in product distribution.

Efficiencies derived from new technologies should not be foreclosed to the U.S. airline industry by appeals to outmoded regulatory structures and constraints. This is especially the case where Orbitz uniquely provides consumers with an important source of objective, non-biased information. In contrast, two major online competitors actively promote biased search procedures and press airlines to purchase this very bias. In fact, Orbitz provides important and needed competition to those two major online distributors, Expedia and Travelocity.

In short, the substantial differentials in both cost and marketing effectiveness between the traditional travel agency-based system and the new airline distribution options have led to major changes in the way United, and other carriers, distribute their products. Growing competition from low-cost carriers able to distribute their tickets outside the traditional, high-cost agency system, have also spurred these changes. As a result, over the last decade, major network carriers, acting independently, have reduced and ultimately ended base commissions for domestic travel. At the same time, we continue to support travel agents with other commissions -- nearly \$100 million in the first quarter of 2002 alone -- together with other forms of support.

Travel agents have adjusted to these shifts, and have moved to a customer fee system quickly and efficiently. As another airline pointed out in comments before you, this is very similar to the way in which consumers now pay for "value-added" financial services they desire, rather than a fixed fee for even simple, routine stock transactions. As a result, we understand that the percentage of travel agents charging fees has grown from 20% in 1995 to more than 90% today, with an average fee of \$13 per ticket in 2001. The success of these "value-added" travel agencies in re-shaping their businesses to meet the needs and demands of the marketplace deserves recognition.

We don't ascribe to a "one-size-fits-all" approach. Airline consumers vary considerably in their needs and preferences. Not all consumers need or desire the expertise of travel professionals in booking their flights, and many, in fact, prefer to handle travel arrangements and purchase tickets over the Internet or by other means. On the other hand, for those travelers who do prefer to work with travel agents and benefit from their expertise and assistance, it seems entirely appropriate for them to pay those agents a fair price for their services. This approach places the added cost on consumers who seek and directly benefit from the travel agents' services while providing relief to those who prefer to purchase tickets on their own or by other means.

In conclusion, United respectfully urges the Commission to recognize that the issues of consumer choice and information arise in the context of a rapidly evolving marketplace. It is a marketplace in which business and economic trends that might have

taken years to unfold in more normal circumstances have been telescoped into months by the events of September 11 and the severe economic downturn in the aviation industry. Any government action in this extraordinarily dynamic environment should be undertaken only with the greatest care, so as to ensure against unintended consequences. In preparing its report to Congress, we urge the Commission to reflect these concerns.

Mr. Chairman, that concludes my prepared remarks. I will be pleased to respond to any questions you or the Members may have.