



# Chapter 5

## WHAT ACTIONS, IF ANY, SHOULD THE GOVERNMENT TAKE CONCERNING THE TRAVEL AGENCY INDUSTRY?

The Commission's authorizing statute charges us to make such recommendations as may be necessary to improve both the condition of travel agents and consumers' access to travel information. In light of this broad charge, it was striking that we received relatively few ideas for regulatory or legislative change, and those that were made did not go to the fundamental problems of the travel agency industry. The Commission believes this is primarily due to the nature of the industry's problems – agents are the victims of fundamental change in two other industries. In the airline industry, the battle for survival created by deregulation is still being fought between new low-cost carriers and older airlines with embedded higher-cost infrastructures. And the travel business is but one of innumerable industries undergoing profound change triggered by new technologies, particularly the Internet.

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Those testifying before the Commission seemed to recognize there was little the government could do to alter the inevitable trend toward consolidation within the travel agency industry. No one proposed, for example, that the government require airlines to resume paying commissions. Rather, most proposals addressed the current competition between Orbitz and the agencies, both online and traditional. The Commission does have some suggestions on Orbitz, discussed below. Even if the proposals we received were adopted, they would do little to reverse the decline in the number of agencies driven by the many factors discussed in Chapter 2. The Commission is concerned about the plight of travel agents, but believes that their problems are caused by economic forces that lie beyond the ability of regulation to control.

During our hearings, witnesses asked the Commission to recommend several actions to rectify problems agents are experiencing in the distribution marketplace. The Commission probed proponents and opponents of such proposals, and tried to determine whether such actions would produce useful results. The Commission then considered the arguments during follow-up meetings and conference calls.

Throughout this process, the Commission kept two principles in mind:

- Our ultimate concern is the welfare of both consumers and travel agencies. A proposed action that might benefit travel agents but damage consumers is not worth doing.
- The law of unintended consequences will be in full play. Many of the current complaints about booking fees, for example, result from the unintended consequences of the CAB's 1984 requirement that such fees be non-discriminatory. We are concerned that any rule we propose might make consumers or travel agents worse off than they are now.

We discuss below the major proposals for action, including those of witnesses and of the Commission. The rationale for our decisions is based in the detailed analysis contained in the report.

The proposals include:

- Mandating across-the-board access to web fares
- Restructuring of Orbitz contracts
- Revising CRS rules
- Imposing a net fare structure
- Reviewing the distribution system periodically

## Web Fare Access

The Commission heard substantial testimony from ASTA and others about the agents' lack of access to web fares that airlines make available only to Orbitz. Many travel agents proposed regulation that would require that all web fares be made available through all distribution channels. OneTravel.com, for example argued that "a group of airlines cannot withhold the fares that consumers find most attractive from other distribution channels in favor of the channel they own. . ."<sup>1</sup> AAA requested "equal access to airline inventory and pricing, regardless of channel."<sup>2</sup> And NBTA claimed that DOT must address whether consumers, corporations, and travel agents should be given full access to web fares offered outside the CRSs.<sup>3</sup> The Commission rejected this proposal because the adverse consequences for consumers could outweigh any benefit to competition in the distribution channel.

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INTERVENTION.

First, requiring individual airlines to distribute through all channels could cause substantial injury to consumers by eliminating some low web fares entirely. Those proposing this rule assume that airlines will keep offering web fares as they have been doing, even if they are required to distribute them through all channels. But this is unrealistic. Carriers could just as easily withdraw some web fares altogether as make them more widely available.

For many years, in a process they describe as market segmentation, individual airlines have made use of limited distribution channels to dispose of specific types of inventory. As Northwest's witness testified:

*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.<sup>4</sup>*

The same principle applies to web fares. If airlines are not permitted to segment the market by limiting the fares to their own web sites or to Orbitz, they may not offer all these deeply discounted fares. Passengers would pay higher fares – an injury to consumers and the economy.

Mandating access to web fares, moreover, would not solve the basic problems affecting travel agents. These problems, as detailed in the report, include fundamental changes — commissions, the growth of the Internet, and the airlines' strategy to regain control of the consumer. Even were traditional agents to gain the same access to web fares enjoyed by Orbitz, or to be equally deprived, they are unlikely to restrain the growth of Internet sales, or slow the trend toward consolidation.

The Commission also believes the proposal to regulate web fare access would require expensive and ineffective regulatory intervention. Airlines offer millions of fares, and change thousands every day. There is every opportunity for fares to get out of sync in different channels. Enforcement of a regulation under these circumstances would require

fact-based enforcement proceedings that would take years to conclude. In a time of limited resources, this would be a waste of government effort.

Requiring Orbitz charter associates to provide their web fares to all channels would reach far beyond the issue of Orbitz. The company's 42 charter associates operate in many countries and serve a wide variety of market segments. Certainly, with a web-fares-for-all approach, airlines would lose their current freedom to segment markets. Both traditional and online travel agents would also lose their ability to receive fares specific to them. Advocates of such a change must think more broadly if they want to avoid yet another example of the law of unintended consequences.

### Restructure of Orbitz Contracts

Concerns about Orbitz, which is owned and controlled by the five largest U.S. airlines, dominated the Commission hearings. Numerous large and small travel agencies, independent travel web sites, CRSs and academics voiced strong criticism of Orbitz' airline ownership, contract provisions, and the impact it has upon competing distribution channels. Their criticisms concentrated on the following key issues.

- The five largest U.S. airlines own Orbitz, creating an opportunity for them to collude on air fares. Witnesses also charged that these airlines will jointly decide how to distribute air travel, including how they will or will not deal with competitors of Orbitz, rather than leave those decisions to individual carriers. Some witnesses felt that any agreement among competitors is inherently suspect and must produce overriding benefits or efficiencies before winning government approval.
- The contracts between Orbitz and its 42 charter associates require that, in order to obtain a discount on every Orbitz booking, each airline must offer through Orbitz any fare it offers to the general public through its own web site or any other Internet or offline outlet. This most-favored-nation clause, in effect, induces the Orbitz airlines to withhold distribution of fares and inventory from other channels.

- Orbitz contracts include incentives to encourage airlines to make low fares available only on Orbitz, and, therefore, to bypass other distribution channels. This weakens the other channels and, in the long term, potentially reduces competition in travel distribution.

For their part, Orbitz, the airline witnesses and some academic witnesses said that the company has made positive contributions and offered the following counter-arguments.

- Neither the Justice nor Transportation Departments has found evidence of collusion on air fares among the Orbitz owners.
- Airlines created Orbitz to force CRSs to reduce booking fees and provide competition to the major online agents, Expedia and Travelocity. The resulting competition is why rivals are complaining, but that competition is beneficial to consumers and the economy. Airlines will experience lower distribution costs, travel agents will recapture some of the distribution payments now captured by CRSs, and consumers will benefit because Orbitz displays must be neutral.
- The most-favored-nation clause is non-exclusive and requires only that all publicly available fares from participating carriers be listed on Orbitz. Rather than displaying favoritism toward Orbitz, several charter associates have offered the same web fares to other online agencies that they have offered Orbitz. After one year in business, Orbitz accounted for less than two percent of airline sales.

The Commission recognizes the seriousness of charges related to the potential of collective action by the five largest airlines in the U.S. Such ownership, and the potential resulting incentives to disfavor independent distribution sites, including travel agents, raise major concerns that consumers could be harmed by a loss of competition among travel distribution channels. On the other hand, the new Sabre Direct Connect Availability program does provide web fare access to many independent distributors. If other carriers participate, this could increase competition among travel channels.

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The benefits claimed by Orbitz from the MFN and incentive clauses do not appear to depend on these contract requirements. If Orbitz offers lower distribution costs than competing online and traditional agencies, its participants should be willing to list web fares with Orbitz voluntarily and therefore eliminate the need to compel those listings on Orbitz. The Commission is not aware of any aspect of Orbitz' business or goals that requires the MFN or incentive clauses, or which justifies their existence. The asserted benefits of Orbitz do not appear to be dependent on the restrictive most-favored-nation clause. On the other hand, if the MFN clause is restricting airline participants from otherwise distributing their fares through competing distribution channels, then the clause artificially inhibits competition and should be removed.<sup>5</sup>

The Commission believes that the concerns raised over Orbitz are worthy of serious investigation. They could have long-term implications, not only for consumer choice and the role of travel agents but, more broadly, for travel distribution and competition. The net impact on the public could be less competition among travel web sites, fewer "special deals" outside of Orbitz, and higher air fares to consumers.

In this regard, the Commission believes that a fundamental distinction must be drawn between the independent distribution decisions of an individual airline competitor — about which the Commission heard no complaints — and the collective decisions by a group of airlines acting jointly, as is the case with Orbitz. It is this collective action, not Orbitz' stated business goals, that concerns the Commission. Unilateral action by an airline to reduce its distribution costs, for example by promoting its own Internet site, is appropriate, pro-competitive, and beneficial to consumers. The concern with Orbitz arises because five major airlines have jointly decided how they will distribute air travel, including how they will or will not deal with competitors of Orbitz, rather than leave those decisions to independent competition.

While the Commission itself does not have the resources or time to investigate these concerns further, we believe that they should be fully investigated by the governmental agencies that have continuing jurisdiction over Orbitz' activities. The Commission recommends that those agencies, the Departments of Justice and Transportation, ensure that their current investigations of Orbitz give serious consideration to eliminating the contract clauses, particularly MFN, that potentially impede full and unfettered competition among different travel

distribution channels. Due to the potential long-term impact on travel distribution, the Commission urges that these two departments move forward expeditiously.

### Revision of CRS Rules

The commission was also urged to propose modifications to the CRS rules. Several witnesses urged that part or all of the CRS Regulations (14 CFR Part 255) should be applied to the Internet, or to online agencies owned by multiple airlines.<sup>6</sup> Sabre and others focused on the provision of Section 255.7 that requires that any airline owning a CRS must participate in, or provide its data to, all systems. If this were applied to the Internet, this would compel all owners of Orbitz to provide their fares to all CRSs and online agencies. American and other



carriers want the CRS rules amended to eliminate the non-discrimination provision (Section 255.6) so that they can use their market power to negotiate booking fees with the CRSs.<sup>7</sup> Currently, CRSs do not enter such negotiations because they are required to charge non-discriminatory fees to all carriers in the world. Others suggested that all CRS rules be applied to Internet sites, in the same manner as the European and Canadian rules.<sup>8</sup> This would require non-discriminatory schedule and fare displays.

For several years, the Department of Transportation has been studying revisions to the CRS rules, first issued in 1984 and revised in 1992. Based on the testimony before us, the Commission urges DOT to complete its rulemaking without further delay.

### Net Fare Structure

Although the airlines' reduction of commissions has damaged the financial position of many smaller agents, the Commission did not hear proposals that the government should regulate commissions. However, some travel agents did suggest that airlines should be required to offer fares to its distributors on a net, or wholesale, basis,

no matter what the distribution channel. Then, in theory, each channel, including those of the airlines, would assess a service charge covering its own costs of providing distribution.<sup>9</sup>

The Commission rejected this proposal because it would impose costs on the airlines with little likelihood of any meaningful difference in the current arrangement. If the government were simply to require that airlines establish a distinct fee for distribution, the airlines presumably would be free to establish a nominal fee of 25 cents or a dollar as the cost of distribution. Some airlines might even choose to establish a zero distribution fee. If a carrier established such a nominal distribution fee, there would be no difference between the way fares would be offered to consumers under the proposed system and how they are offered now.

Thus, to be meaningful, any requirement that carriers offer net fares must involve something more than the government forcing carriers to separate a distribution cost from their other costs. To achieve the desired goal, the government would have to define distribution cost, and assure that each carrier report and calculate its costs in accordance with that definition. This would be an enormously complex procedure, and might even be illegal under the Airline Deregulation Act of 1978. That Act eliminated government regulation over fares and ultimately led to the abolition of tariffs. A meaningful net fare proposal would seem to require that at least part of a carrier's fare – the distribution charge – be set at levels that are no less than its costs. This would constitute a return to price regulation.

### **Periodic Review of Distribution**

Airline distribution is important, has changed rapidly in the last few years and will continue to change. While the Commission believes that the current regulatory proposals should not be adopted because they would not solve the problems of travel agents, we recognize that their condition should be of vital concern to both Congress and the Department of Transportation. Even though there are no good present solutions to their problems, we believe the Government should be concerned, as the industry consolidates, whether travel agent service will remain available to consumers. The Government must also beware that future changes in distribution do not deprive consumers of some of the benefits that have already achieved through the Internet.

Therefore, the Commission believes that DOT should be required to review distribution issues more frequently than has occurred in the past. DOT's current CRS review began in 1997 and, during the intervening period, has been extended five times. To make the Department more responsive, Congress should require that DOT report to it every two years on the state of the travel agency and online distribution systems.

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## Other Suggestions

The Commission heard some further useful suggestions that it feels worthy of mention, and of potential action by the industry. These include debit memo arbitration and a separate ticket box for service fees.

There clearly must be a neutral party to resolve disputes about debit memos. The Commission agrees with agents about the arbitrary nature of many debit memos, and the airlines' refusal to negotiate in good faith over debit memo claims. We think it is appropriate to amend the Travel Agent Arbiter program, which already exists under ARC, to make its handling of debit memos more useful.<sup>10</sup> The current program requires the consent of both parties before submitting disputes between airlines and agents to arbitration. It is also expensive, particularly when compared to the size of most debit memos. The Arbiter could hear individual disputes in a paper proceeding, without a costly hearing, and hold hearings on disputes about an airline's policies when they affect an entire category of debit memos. Such a remedy could make both parties less recalcitrant and more reasonable in debit memo disputes. To be effective, this change would have to preclude airlines from retaliating against agents who seek or defend arbitration.

The Commission has discussed the problems created for agents by ARC's refusal to place a service fee box on the standard form of airline ticket. (See p.35) We agree with agents that adding such a box would benefit both consumers and agencies that desire to use it. Carriers insist that such an addition is impractical because it would require a unanimous vote by members of the International Air Transport Association. Some airlines object that they do not want agent service fees included in the price of their services. The Commission believes that addition of a service fee box would be more efficient for agents, and could also provide consumers with better information on the elements contributing to their total cost. We urge the industry to start now on the process of making the change. It should prepare

specifications for the change and work out procedures for ensuring that agents absorb the credit card fees for the service charges.

To ensure action on both proposals, Congress should direct DOT to convene airline and agency representatives to resolve these issues. DOT should report back to Congress within six months, and periodically thereafter, on the status of its efforts to achieve both goals.